Is a Certificate of Commercial Property Insurance a Worthless Document?

By W. Rodney Clement Jr.

A court once described a certificate of insurance as a "worthless document." *Bradley Real Estate Trust v. Plummer & Rowe Ins. Agency, Inc.*, 609 A.2d 1233 (N.H. 1992). Given recent developments, this description arguably remains accurate for the current version of the ACORD 28 "Evidence of Commercial Property Insurance."

Certificates and Evidences of Insurance Generally

When lenders make loans secured by real estate, they usually require the borrower to provide proof that the borrower has property insurance in an amount sufficient to pay off the loan in case the improvements are destroyed by casualty. Loan servicers also have a strong interest in having meaningful certificates of insurance exist because their contracts usually require them to confirm the existence of property insurance and timely renewals, but the volume of loans that they service makes it impractical for them to read every policy.

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The traditional proof of the existence of property insurance has been a certificate of insurance issued by an insurance agent or broker. The difference between an insurance agent and an insurance broker can be important in evaluating the certificate. An insurance agent usually represents one insurer and has authority to bind the company, subject to limitations in the contract between the insurer and the agent. An insurance broker, on the other hand, usually represents the insured in obtaining insurance from among insurers. Although an insurance agent usually has broad authority to act on behalf of the insurer whom it represents, an insurance broker has authority only to the extent that an insurer contractually grants such authority to the broker. Agents and brokers sometimes are collectively referred to in the industry as "producers."

Courts often quote the definition of a certificate of insurance from *Black's Law Dictionary*: "A document acknowledging that an insurance policy has been written, and setting forth in general terms what the policy covers." Black's Law Dictionary 256 (9th ed. 2009). Although certificates of insurance have been used for many years, the first standardized forms were promulgated by the Association for Cooperative Operations Research and Development (ACORD) in 1976. ACORD forms are not considered insurance policies that have to be approved by state insurance commissioners. In contrast to ACORD, Insurance Services Office, Inc. (ISO), prepares standard insurance policy forms that are approved by the states and that insurers can purchase.

ACORD promulgates many forms. The form that addresses property insurance for commercial properties is the ACORD 28, entitled "Evidence of Commercial Property Insurance." The significance of naming this form an "evidence" rather than a "certificate" is that an evidence is provided to someone with a direct interest in the property being insured, such as a mortgagee.

When a borrower purchases a new property insurance policy contemporaneously with a closing, an insurer can provide a binder, which is a temporary insurance contract providing proof of insurance until the official policy is issued. See ACORD 75 (insurance binder). From the standpoint of the lender, a binder is a poor substitute for a policy because a binder does not contain all of the terms of the policy. Moreover, a binder typically expires after six or fewer months, depending on state law. Thus it is possible that the binder could expire before a policy is issued because the insurance industry is notoriously slow in providing the policy after the premium has been paid. Policies for commercial properties and large multi-family properties usually take longer than policies for residential and small multi-family properties because the insurer inspects the property before the policy is issued.

Evolution of the Current ACORD 28 Form

Before 2003, if an insured asked its agent for proof of property insurance, the agent usually would provide an ACORD 24, "Certificate of Property Insurance." The ACORD 24 provided, among other things, "[t]his certificate is issued as a matter of information only and confers no rights upon the certificate

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holder. This certificate does not amend, extend or alter the coverage afforded by the policies below." The ACORD 24 also provided that if the policy was cancelled, the insurer would endeavor to mail notice to the certificate holder, but the failure to give the notice would not impose liability on the company. Savvy lenders insisted on using the ACORD 27, "Evidence of Property Insurance," which provided that it was "evidence that insurance as identified below has been issued, is in force, and conveys all the rights and privileges afforded under the policy." The ACORD 27 also provided that the issuer would give notice to the lender before cancellation of the policy. For further discussion of the differences between the ACORD 27 and a predecessor of the ACORD 24 (the ACORD 25-S), and problems with the latter in the context of commercial real estate loans, see Alfred S. Joseph III & Arthur E. Pape, *Certificates of Insurance: The Illusion of Protection*, Prob. & Prop. 54, Jan./Feb. 1995.

When the World Trade Center was destroyed on September 11, 2001, property insurance coverage for the property had been bound following completion of a lease in July 2001, but the insurance policies had not been issued. Among the many issues in the subsequent litigation was the basic question of which policy form defined the coverage. This litigation brought attention to the problem of confirming the existence of property insurance. In 2003, in collaboration with the Mortgage Bankers Association, ACORD issued a new ACORD 28, "Evidence of Commercial Property Insurance." The 2003 ACORD 28 contained the same language from the old ACORD 27 that the form "conveys all the rights and privileges afforded under the policy" and that the issuer would give the written notice before cancellation of the policy. The ACORD 27 was revised for use in residential and personal property transactions.

In July 2006, however, ACORD issued a revised form of the ACORD 28. One reason for the 2006 change to the form was the insurance industry's concern that the 2003 form arguably expanded the insurer's obligations beyond the terms of the policy. The new form, however, substantially limits the document's usefulness because it states that the form "is issued as a matter of information only and confers no rights upon the additional interest named below. This evidence of commercial property insurance does not amend, extend or alter the coverage afforded by the policies below." The form also provides:

> Should any of the above described policies be cancelled before the expiration date thereof, the issuing insurer will endeavor to mail __ days written notice to the additional interest named below, but failure to mail such notice shall impose no obligation or liability of any kind upon the insurer, its agents or representatives.

In addition, the 2006 form states that it is subject to all of the terms of the policy. In other words, for practical purposes the form was changed back to old ACORD 24.

Lenders, who did not have any input about or notice of the 2006 changes to the ACORD 28, criticized the changes, primarily because of the deletion of the obligation to give notice of cancellation and the "information only" language. Freddie Mac refused to accept the 2006 ACORD 28 because the language of the form conflicts with the standard mortgagee loss payment endorsement requiring notice to the lender in case of policy cancellation. The changes to the form are particularly troublesome for lenders making nonrecourse loans, because the property, or, if the property is damaged, the devalued property and the insurance proceeds, is the only source of repayment of their loans. The 2006 changes to the ACORD 28 also are problematic for the commercial mortgage-backed securities industry. Rating agencies began excluding loans that relied solely on the 2006 ACORD 28 for proof of property insurance from pools of loans being securitized.

The ACORD Working Group

ACORD, recognizing the conflict between the mortgage lending and insurance industries over the 2006 changes to the ACORD 28, formed a working group of representatives of mortgage lenders, insurers, and producers to see if they could reach a consensus on changes to the form to address the concerns of lenders. This working group began holding weekly telephone calls in February 2007. During the course of the working group's meetings, representatives of producers, insurers, and lenders each explained their positions on the "information only" language.

Producers opposed removing the "information only" language on the ground that they were not being compensated for providing the form or for any risk of liability to the lender from providing the certificate. Insurers argued that a policy could be changed only by endorsement, that a certificate of insurance could not amend the policy or impose any obligations on the insurer, and thus the statement added to the ACORD 28 that it was for "information only and confers no rights" was accurate and should not be removed. Moreover, insurers argued, certificates are often issued by producers who do not have authority from the insurer to issue the certificates, and producers often do not send the certificates to the insurer. In fact, some insurers reportedly have discouraged producers from sending copies of certificates to the insurers. Insurers asserted that lenders could protect themselves by getting binders for new policies or endorsements for existing policies. Lenders argued that binders and endorsements would be costly to borrowers, who are also customers of the insurers and producers, and would delay closings if lenders have to review and obtain endorsements for individual policies. The administrative burdens do not end when the existence of insurance is confirmed at closing, because lenders and servicers need to confirm that the policies listed in the certificate get timely renewed or replaced. Lenders argued that it was in the best interest of the customers of the insurers and the producers to have a form of certificate of insurance on which lenders could rely.

Although the representatives discussed draft forms of changes to the ACORD 28 and reached tentative agreement regarding alternative notice provisions, the working group was not able to reach any consensus on changes to the "information only" language. The National Association of Insurance Commissioners expressed interest in mediating the issues, but the parties could not agree on the terms of the mediation.

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The ACORD working group went into hiatus in May 2009. No more meetings of the working group are scheduled.

A change to the ACORD 28 that is under consideration now is the deletion of the notice requirement altogether. The reason for this change is that state laws usually provide a notice requirement.

Legislative and Administrative Actions

Meanwhile, state legislatures and insurance departments have taken actions that have supported the position of insurers and producers. California was one of the first states to act. A California statute enacted in 1978 provides that a certificate of insurance must state that it does not amend the policy and is subject to all terms of the policy. Cal. Ins. Code § 384. In other states, commissioners of insurance have used their administrative rulemaking authority to issue bulletins promulgating regulations limiting the use of certificates of insurance. For example, in 1997 the New York Insurance Department issued an administrative bulletin cautioning government agencies and corporations that a certificate of insurance could not amend, extend, or otherwise alter coverage. This bulletin further advised that: "[A] certificate of insurance, even one completed by a licensed producer, is not the best evidence of the terms of an insurance policy and may not accurately reflect the actual terms of the policy." Ins. Dep't Circular No. 15 (1997), www.ins.state.ny.us/circltr/1997/cl1997_15.pdf.

Activity by the states has increased dramatically in the last few years, encouraged by producers. The Independent Insurance Agents & Brokers, for example, has posted a Model Bulletin on Issuance of Certificates of Insurance on its web site. See www.iiaba.net/eprise/main/VU/NonMember/WilsonCertLawsRegs.htm (listing at least 32 states that have enacted statutes or issued bulletins that limit even further the usefulness of certificates of insurance). The Nebraska Department of Insurance substantially adopted this model bulletin in 2008. Dep't of Ins. Bulletin CB-118 (June 20, 2008), available at www.doi.ne.gov/bulletin/cb118.pdf. Typically these bulletins prohibit a producer from issuing a certificate or evidence of insurance other than a standard ACORD form without first filing the certificate for approval by the state insurance department and require that any certificate state that it does not amend, extend, or alter the coverage provided by the policy. Most of the administrative bulletins also specifically prohibit producers from altering the ACORD form.

One reason for these legislative and administrative initiatives by producers is that producers increasingly have been the targets of claims arising out of the issuance of certificates of insurance. One theory for these claims is that by issuing certificates that list coverage but do not identify endorsements that limit the policies, the producer is misrepresenting the coverage represented by the certificate. See Donald S. Malecki, *Certificates: A New Wave of Problems*, Rough Notes (Oct. 2009), available at www.roughnotes.com/rnmagazine/2009/october09/09_10p142.htm; Bill Wilson, *Certificates of Insurance, Insurance Agents and Rolling Stone Syndrome*, CPCU eJournal (Nov. 2009), www.cpcusociety.org/file_depot/0-10000000/0-10000/3267/conman/CPCUeJournalNovember09article.pdf.

The only good news for lenders has come from New York, which ironically was one of the first states to limit the use of certificates. As noted above, one reason that certificates of insurance are used is because the insurance industry is notoriously slow in preparing the policies. In a bulletin entitled "Contract Certainty," the New York State Insurance Department directed insurers and producers to adopt practices that would enable them to issue policies within 30 days. Ins. Dep't Circular No. 20 (Oct. 16, 2008), available at www.ins.state.ny.us/circltr/2008/cl08_20.htm. This concept of "contract certainty" as applied to insurance contracts originated in the London reinsurance markets and requires that terms be agreed to on the date of inception of the reinsurance policy. So far there have been no published reports of any action by the New York State Insurance Department to enforce this policy.

Courts and Certificates of Insurance

In general courts have found that the disclaimers in certificates of insurance are enforceable. For example, the Supreme Court of New Hampshire upheld the validity of an "information only" disclaimer in a certificate and stated: "In effect, the certificate is a worthless document; it does no more than certify that insurance existed on the day the certificate was issued. We leave it to the legislature or to the future bargaining of parties to rectify inequities in the notification process." *Bradley Real Estate Trust v. Plummer & Rowe Ins. Agency, Inc.*, 609 A.2d 1233, 1235 (N.H. 1992). The disclaimer of any liability from failing to give notice also has been held to be enforceable. See *Nazami v. Patrons Mut. Ins. Co.*, 910 A.2d 209, 216 (Conn. 2006).

Although there have been cases in which courts have held that an insurer was bound by a certificate of insurance because the producer had apparent authority or because the producer had made some additional representations on the certificate, these cases tend to be exceptions to the general rule that the disclaimers are enforceable. The web site of the Independent Insurance Agents & Brokers of America has a collection of court cases addressing certificates of insurance at www.iiaba.net/eprise/main/VU/NonMember/WilsonCertCourtCases.htm.

The Value (or Lack Thereof) of the Certificate of Insurance

To summarize, the ACORD 28 states on its face that it confers no rights, and courts generally have held that this disclaimer is enforceable. A majority of states have enacted statutes or issued administrative bulletins to the effect that the ACORD certificates cannot be modified. Most property insurance policies, including those promulgated by the Insurance Services Office, state that the policy can be amended or waived only by an endorsement issued by the lender. Considering these negatives taken together, is there any value at all to a lender using the ACORD 28?

A certificate of insurance has some minimal value to the lender because it gives a snapshot of the coverage that the borrower has at the time the producer issues the certificate as a result. If the producer issuing the certificate misstates the coverage and the lender suffers a loss, the lender may have a cause of action against the producer. Most producers carry errors and omissions (E&O) insurance that can provide a

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source of recovery for the lender, at least up to the amount of the insurance, but the producer's E&O policy is at best an uncertain source of recovery.

Alternatives to the ACORD 28

Lenders need detailed but brief summary information about coverage terms and conditions that confirms the lender's status and rights under the policy, that is issued at the time coverage is bound, and that is on a standardized form that the insurer incorporates into the policy. The form should combine the binding force of the ACORD 75 with the detail about coverage in the ACORD 28. Perhaps a form promulgated by ISO could accomplish this goal. Until such a form exists, however, lenders have to work with the existing certificates and endorsements.

Some lenders are requiring the use of the 2003 ACORD form or changes to the 2006 form, such as striking out the "information only" language and the disclaimer of liability for failure to give notice. But these changes to the current form of the ACORD 28 probably will be of no effect in a state that had adopted a statute or issued an administrative bulletin prohibiting these changes. Even in states that have not taken these legislative or administrative actions, the producer probably does not have the authority from the insurer to issue an altered certificate purporting to bind the insurer. Use of the 2003 form or changes to the 2006 form also may violate ACORD's copyright on the form.

The only way that a lender can be sure that it is protected by the borrower's property insurance is to have an endorsement issued by the insurer that recognizes the lender's interest. ISO forms of property insurance policies contain a mortgagee clause, also known as a lender's loss payable clause, that provides special protections for mortgagees. The mortgage clause typically includes provisions to the effect that payment of a covered loss will be made to the lender rather than to the borrower, that the lender is entitled to be paid even if the insurer would have a defense to a claim by the borrower because of the borrower's acts, and that the lender will receive written notice of cancellation by the insurer, usually 10-days notice for nonpayment of premium and 30-days notice for any other reason. ISO forms also provide that the insurer will give the lender notice if the insurer elects not to renew the policy. Most policies, however, also provide that a lender does not have these contractual rights unless the lender is named in the policy, which requires an endorsement to the policy. The lender should review the wording of the endorsement because some forms of endorsements will limit the lender's rights. If the lender relies on a binder, it can usually require that a copy of a mortgage clause be attached to this binder.

Non-ISO forms of property insurance policies may not have the standard mortgagee language. To address this situation, and to avoid having to review each policy, lenders sometimes specify a particular endorsement, sometimes in conjunction with the ACORD 28. The ISO CP 12 18 series of endorsements all contain the ISO standard mortgage clause.

It is important to distinguish the mortgage clause from a general loss payee endorsement or additional insured endorsement. The mortgage clause typically provides coverage to the mortgagee despite the acts of the insured, but the loss payee and additional insured endorsements do not. A good resource for learning more about the distinctions among endorsements is Donald S. Malecki, Pete Ligeros & Jack P. Gibson, *The Additional Insured Book* (5th ed. 2004).

Although by requiring the insurer to give notice the mortgage clause protects the mortgagee if the insurer cancels the policy, a mortgage clause does not protect against the risk that the borrower will cancel the policy. Most states have laws that permit an insured to cancel the policy at any time.

One way that lenders and servicers protect themselves is with mortgage impairment insurance. Mortgage impairment insurance, also known as mortgage-holders errors and omissions coverage, provides property insurance coverage if the mortgaged property is uninsured or underinsured as well as liability insurance protecting from loss due to errors and omissions in the insured's procedures for obtaining and maintaining property insurance. An example of this coverage is ISO Form CP 00 70 06 07.

Some lenders who make nonrecourse loans exclude from the nonrecourse loan provisions losses caused by the cancellation or amendment of the insurance coverage before delivery of the original policy. Borrowers tend to push back on this point because the borrower is usually not the reason for the delay in getting the insurance policy.

One idea that has been discussed as a compromise among lenders, insurers, and agents is to have binders continue until the policies are issued. But this approach is complicated by the plethora of state laws governing certificates of insurance that provide different time periods after which binders expire. Binders also apply only to new policies, not to renewals of existing policies.

One problem that certificates of insurance are intended to address is that the insurance policy usually is not available at the time that the premium is paid. One would think that more timely issuance of policies could be accomplished with modern technology. In the alternative, perhaps a product akin to gap coverage for title insurance, to protect the mortgagee during the period between the time that the premium is paid and the policy is issued, would work. There should be a market among lenders for such products. Perhaps innovation is difficult in the current economic environment because the market has little demand for commercial mortgage-backed securities and the difficulty of obtaining financing for new ventures. When (and if) the commercial mortgage-backed securities market returns, more financial incentives and opportunities will exist to meet the demand.

Conclusion

The current version of the ACORD 28 is of little value to mortgagees. The only way that a mortgagee can be sure of being protected is to get the benefit of the standard mortgagee clause, by endorsement for existing policies or a binder with a copy of the endorsement or the standard mortgage clause attached for new policies. ■

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