Don't Sign on the Dotted Line:

Letters of Guarantee (LOG) & Legal Jeopardy

How does the routine and common practice of signing a Letter of Guarantee with your borrower's physical damage insurance company become a legal nightmare for you? Simple. You signed up for it.

As is standard procedure, when a borrower totals his or her car, the insurance company sends the lien holder a summary letter and a document called a Letter of Guarantee (LOG). The Letter of Guarantee details what they will pay in return for releasing the title of the totaled auto. This letter is written by the insurance company and is, naturally, designed to protect their interests; however, it has the potential to jeopardize the interests, legal and financial, of you and your borrower—if you sign it!

Signing Away Your Borrower's Rights

While signing these letters has become fairly standard practice, it is costing lenders and their borrowers millions of dollars annually and potentially puts the lender in legal jeopardy by signing away your borrowers' rights.

For more than 89 years, Weltman, Weinberg & Reis Co., LPA has been providing comprehensive creditor representation and legal services to financial institutions. Matthew M. Young, a Shareholder at Weltman, Weinberg & Reis Co., L.P.A., explains, "When there is a lien on the lost vehicle, the borrower is the insured, and the lender is a third-party beneficiary. There is potential for conflict if the borrower has a dispute with the insurance company on the vehicle valuation but the lender has agreed to the insurance company's terms by signing the Letter of Guarantee. If that happens, there is the potential for the borrower to claim tortious interference of contract against the lender, i.e., that the lender interfered with the borrower's right to negotiate the vehicle's value."

Notice to Invoke the Appraisal Clause: Third-Party Appraisals

As the lien holder, lenders require that borrowers carry physical damage coverage to protect the collateral. As part of this coverage, most insurance policies have a little-known provision that is designed to help protect consumers and lien holders from unfair insurance settlements. This provision, called a Notice to Invoke the Appraisal Clause, gives the insured (your borrower) the right to get an independent third-party appraisal of the damage to the vehicle or an independent actual cash value if the vehicle is deemed to be a total loss. This is the borrower's primary recourse for disputing the insurance company's valuation of the vehicle.

The problem is, in the case of a total loss, insurance companies commonly utilize a valuation process that results in a value that is below the vehicle's actual fair market value. Once the lender signs the agreement and accepts the check, it is difficult to dispute the valuation. By signing the insurance company LOG, lenders are unknowingly agreeing to settlements that are typically less than what the true insured settlement should be.

"To avoid conflict in these situations, generally speaking, a lender should strive to make sure that its borrower is in agreement with the terms of the offer from the insurance company. And both parties - the borrower and lender - should consider being signatories," states Young. "Legally, the lender does not have the right to waive the borrower's or the named insured's contractual right to invoke the appraisal clause."

Factors that determine a vehicle's true market value are numerous: year, make, model, color, options, mileage, condition and more. Seasoned appraisers, who are neutral in the matter and not loyal to the insurance company's interests, will properly determine a vehicle's fair market value.

"Lenders don't realize that they are potentially agreeing to a valuation process that could cost them and/or their borrowers thousands of dollars," said Phil Markwell, a partner at Frost Financial Services. "This could leave the lender liable if the borrower decides that he or she would have preferred to contest the vehicle valuation."

Why does all this matter? If the borrower has GAP, GAP helps cover the difference between what the vehicle is WORTH and what the borrower owes. If the insurance company does not provide what the vehicle is worth, the GAP provider would pay more in the GAP claim than they should. The GAP market has experienced sky-rocketing claims over the last several years, and this practice by primary insurance companies is a major reason that most lenders have seen the cost for their GAP program increase!

Even worse, if the borrower does not have GAP, then the borrower could be stuck with a much larger loan balance, and the lender may get stuck with a problem loan or potentially a lawsuit.

In summary, do not sign the Letter of Guarantee from the insurance company. Rather, when you receive communications regarding a loss from an insurance company, follow these steps to protect you and your borrower:

1. **Contact the borrower and let them know what the insurance company has offered.**
2. **Have the borrower sign the lender's version of the Letter of Guarantee that retains their right to dispute the valuation.**
3. **Submit the executed version of the lender's LOG back to the insurance company.**

Avoiding this common situation is very simple and can help protect the lender and your borrowers from accepting settlements that could cost you hundreds and possibly thousands of dollars. To download a free Letter of Guarantee sample that includes language about the appraisal clause, please go to www.FrostInsure.com/Letter-of-Guarantee-Sample

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Frost Financial Services has been serving the lender industry since 1972 and is best known for its proprietary VisualGAP solution. Frost is the largest "independent" GAP program administrator in the lender market and currently serves over 1,000 financial institution clients nationwide. For more information about their services, visit www.frostinsure.com or contact Phil Markwell at (888) 753-7678.

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