Errors & Omissions Insurance and Claims Issues For Today's Appraiser

The significant increase in insurance claims and disciplinary complaints against appraisers over the last few years is directly related to the foreclosure phenomenon and subsequent pattern of appraisal reviews performed during the last decade. The validity of both the process and results of these forensic reviews may have little relationship to the subsequent actions by those seeking the deep pockets of the appraiser and their insurance carriers to recover monies lost in bad loans. This trend shows no sign of diminishing. It remains incumbent upon appraisers to understand their errors and omissions insurance policies, any available risk management services available through the insurer and the common occurrences that result in claims or complaints.

Understanding Your Errors And Omissions Policy

Errors and Omissions insurance policies have language and conditions that dictate the appropriateness of the policy for one's appraisal practice and how coverage may be applied in the event of a claim. Here is a brief look at important policy features.

The policy definition of "Who is an Insured" is the first stop in a review. Insurers may offer policies for both individual appraisers and appraisal firms. Policies for individual appraisers typically name only one appraiser as a covered insured. If an appraiser utilizes trainees, independent contractors or employees to perform professional appraisal services, then an individual plan may not be adequate and the insured may require a plan that also names independent contractors or employees under the definition of who is an insured. The policy should also properly reflect the correct business entity (sole proprietor, LLC, corporation) and that name should be present on the policy declarations page or in an "Additional Insured" endorsement. An appraisal business can take many forms and evolve over time, so a regular review of coverage is critical.

Next, the "Definition of Professional Services" should fully reflect all areas of an appraiser's practice. Policies for solo appraisers may define professional services as the active performance of a real property appraisal by the named insured. This typically includes a desk review but may or may not include the supervision of a trainee or other appraisers. A solo appraiser who expands his or her business to now include additional appraisers needs to review this portion of their coverage to determine if coverage is adequate or a policy with broader definitions is needed. Many policies provide coverage for both residential and commercial appraisals. Some will state this specifically while others may make no distinction in policy language. When completing an application for insurance, the appraiser should disclose their exact duties to ensure that proper coverage is provided and there are no surprises in the event of a claim.

The policy "Exclusions" section states what is clearly not covered. Common exclusions include dishonest or intentionally wrongful acts or fraud, fee disputes, appraisal of property owned by an insured or where there is a financial interest, or any guarantee or assessment of future value. Other exclusions exist and should be reviewed by the insured.

A most important feature of E&O insurance is the Retroactive or Prior Acts date of coverage. This date indicates the point from which an appraiser is covered under the policy. For example, if the retroactive date is 11/7/2007, then all professional services covered in the policy are protected back to that date. Maintaining continuous coverage is important as a gap in coverage can mean the loss of that date and appraisals done in the past may not be protected. Some less than honest insurance agents may dissuade an appraiser from switching insurers, stating that another company will not honor the retroactive date. Most insurance companies will honor the retroactive date as long as there is no gap in coverage or serious claims history.

Some policies provide "Supplemental Payments" or other coverage extensions for disciplinary hearings, subpoena expenses, security or data breaches, discrimination and other events or actions against an appraiser that might result in a claim or complaint.

Two other policy sections are worth noting. One is the duty of the insured in the event of a claim or potential claim. The policy will clearly state what the insured must do, and within what time frame, should they become aware of a possible claim. Confusion may arise if the insured is notified of a disciplinary complaint as they may or may not develop into a formal claim and thus create uncertainty as to whether the insurer should be notified. One reason to engage the insurer in these circumstances is to take advantage of any protection or assistance available in the policy. Some insurers offer free and confidential risk management or pre-claims services allowing a policy holder to speak with an attorney who can provide direction on how to proceed in the event of a complaint or potential claim.

Another important policy feature is called the "Extended Reporting Period", or "tail" coverage. This describes the provisions on how the policy holder can protect their retroactive date of coverage should they close their practice or retire.

Preventing And Responding To Claims

The value of selecting and maintaining an errors and omissions insurance policy is most apparent after a claim is asserted. Nearly anyone can assert a claim and, irrespective of whether the claim has merit, a response is necessary. The typical errors and omissions insurance policy requires the insurer to provide a defense to the appraiser, meaning the insurer will retain and pay for a qualified attorney to defend the appraiser. The attorney will work with the appraiser to assess the merits of the claims being asserted and to prepare a defense. The initial information gathering and first response stage is critical to the ultimate resolution of the claim.

A general understanding of how and why claims arise is helpful in preventing claims from arising in the first place and in working with counsel to efficiently resolve them once they do. While every claim involves unique factual circumstances, most have overlapping themes and theories of liability. Negligence, negligent misrepresentation, breach of contract, and fraud are common theories of liability all of which require the party asserting them to establish certain basic elements.

Most claims derive from a complaint about the appraised value. Although complaints that the value is overstated are predominant, a claim could certainly be based on a complaint that the property value is understated. The issue is not whether the value arrived at is right or wrong but rather whether the appraiser exercised the appropriate level of care and skill in formulating the opinion.

The Uniform Standards of Professional Appraisal Practice ("USPAP") are the usual starting point for assessing the merits of a claim. Rule 1-1 provides that in developing a real estate appraisal, an appraiser *must*:

> (a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal; . . . (b) not commit a substantial error of omission or commission that significantly affects an appraisal; and . . . (c) not render appraisal services in a careless or negligent manner, such as by making a series of errors that, although individually might not significantly affect the results of an appraisal, in the aggregate affects the credibility of those results. . . .

In other words, appraisers must exercise appropriate care and skill in making an opinion of value by adhering to the standards set out in USPAP and/or any other applicable state regulations. A deviation from the standards, if it affects the credibility of the appraisal, could give rise to a claim.

The precipitous decline of real estate values over the last several years caused huge financial losses and generated many claims against appraisers. While the declining real estate market – rather than problematic appraisals – is the source of many losses, appraisers have been and continue to be frequent targets in lawsuits alleging they overstated property values. A typical claim arises after a lender forecloses on the property and the property is sold for less than was owed. The lender then asserts the appraiser is responsible for the difference and perhaps other consequential damages.

Although lawsuits arising from the real estate market crash persist, a new more conservative lending climate has also generated claims against appraisers. Lenders now frequently utilize review appraisals and, when the reviewing appraiser reaches a different conclusion than the original appraiser, there can be financial consequences to both the lender and, consequently, the original appraiser. For example, if a review appraisal is conducted and results in a repurchase demand, the lender may contend the appraiser is liable for any losses associated with the repurchase. If a review appraisal is conducted and a repurchase demand is not made, but the lender is required to purchase additional private mortgage insurance ("PMI") due to a different loan to value ratio, the lender may demand the appraiser pay the cost of the additional insurance.

As noted above, the simple fact that two appraisers reach different opinions of value is not in and of itself, evidence of a negligent appraisal. What matters most is how the appraiser arrived at the conclusion and whether, in doing so, he adhered to the appropriate professional standards. Thus, in practice, the party asserting a claim against an appraiser will need to establish that the appraiser did or failed to do something which act or omission fell below the professional standard of care and resulted in harm.

The types of acts and omissions that are complained about vary from claim to claim. The use of inappropriate comparable sales is a common complaint. For example, the comparable sales could be in the wrong neighborhood, have dissimilar characteristics or be outdated. Alternatively, there could be a comparable sale that was missed. Failure to identify relevant known characteristics of the property is another complaint. The property could be affected by an easement, encumbrance, or other similar restriction, which, if not accounted for, could affect the appraised value. Making adjustments that are not fully supported is another common complaint.

The relationship of the individual or entity asserting the claim and the appraiser can also vary from claim to claim in that parties are pressing the boundaries of who is an "intended user" of the appraisal. Typically, it is the client identified in the appraisal report who can assert a claim. However, with varying degrees of success, which depends largely on the jurisdiction in which the claim is asserted, borrowers, unknown investors, and others assert claims for negligent misrepresentation. In those cases, the plaintiff must show that the appraiser knew the plaintiff intended to rely on the appraisal, the appraisal contained a false statement of material fact (*e.g.*, that the appraisal report and statement of value complied with USPAP when one or both did not), and the plaintiff reasonably relied upon the appraisal to his detriment. Whether liability will be extended to third-parties other than the client will primarily turn on any limiting language contained within the appraisal report and the law of the jurisdiction in which the appraisal was performed.

Instituting and maintaining reliable, consistent day-to-day practices and procedures can help minimize the risk of claims. A few tips to consider: 1) keep a comprehensive working file in good order which supports the findings in the report; 2) avoid use of boilerplate language in the report; 3) provide clear explanation and commentary where necessary; 4) clearly state in the report who may and may not rely upon it; and 5) promptly report to your insurance carrier any claims that an appraisal was deficient in some regard and avoid any further communications with the client about the appraisal until after you have consulted with counsel.

In sum, performing appraisals in today's real estate climate may seem like walking through a minefield. A judicious understanding of one's insurance needs and adherence to sound practices which minimize the risk of a claim will significantly contribute to a successful appraisal practice.

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