

PROPERTY INSURANCE PROTECTION FOR A SECURED LENDER: HOW NOT TO GET BURNED

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When taking a security interest in equipment, inventory or such other goods, every prudent lender understands the value of making certain that its collateral is adequately insured. Call it a statistical certainty, or *Murphy's Law*, some borrower in some transaction is going to suffer an accidental loss or damage to its property –*the collateral for the loan*- and repayment of the loan will depend upon the lender's obtaining the insurance proceeds.

As typical in most closings, lender's counsel will have provided borrower's counsel with a detailed closing list, setting forth the items needed for closing and the responsibilities of the parties involved, weeks in advance of the closing date. When the time eventually comes to consummate the transaction, however, one of the last pieces of due diligence to arrive will be the evidence of insurance, which usually arrives on the closing table in the form of a certificate, rather than a copy of the actual policy. (Note that lender's counsel should insist on reviewing the evidence of insurance on the insurance industry's ACORD Form 27, which sets forth, along with the name of the insured and the types and limits of the coverage, the name and interest of the person to whom the form is issued and an undertaking by the insurance carrier to provide notice before cancellation or nonrenewal.) Designation of the lender's interest is crucial to obtaining the highest and best protection for a lender. The chart below sets forth the three options of designation: certificate holder, loss payee, and lender loss payee, and the effects of each.

Designation	What the Designation Provides	What the Designation Doesn't Provide
Certificate Holder	<p>Lender's name and address should always appear here!</p> <ul style="list-style-type: none"> ●As a certificate holder, Lender is entitled to notice from the insurance carrier prior to cancellation or nonrenewal of the policy. 	<p><i>As a "certificate holder" alone:</i></p> <ul style="list-style-type: none"> ●Lender does not have any contractual rights against the insurance carrier. ●Lender is not afforded the right to obtain insurance proceeds in the event of loss or damage to the property of the borrower.
Loss Payee	<p>Designation provides the person to whom insurance proceeds are payable.</p> <ul style="list-style-type: none"> ●Under an "open loss payable endorsement," Lender has the right to receive insurance proceeds in the event of loss or damage to the property of the insured (borrower). ●Lender steps into the shoes of the insured. 	<p><i>Under an "open loss payable endorsement":</i></p> <ul style="list-style-type: none"> ●Lender is subject to any breach of contract defense like fraud or arson, which the insurance carrier may raise against the insured; therefore, lender may be unable to recover from the insurance carrier.
Lender Loss	Designation provides a separate and	

Payee	<p>independent contract between the insurer and the Lender.</p> <ul style="list-style-type: none"> ●Under a "lender loss payable endorsement," also known as standard loss payable clause or a "New York" clause, a separate contract is created between the lender and the insurance company, and the policy cannot be invalidated the insured's own inaction. Lender has the right to receive insurance proceeds in the event of loss or damage to the property of the insured (borrower). ●Lender is entitled to notice of cancellation of the policy. ●The insurance carrier will be subrogated to lender's right of repayment under the loan documents, to the extent of payments made to lender under the policy. 	
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Thus, because the designation of "lender loss payee" creates a separate contract between the insurer and the lender that the insured (borrower) cannot invalidate based upon its own actions/inactions, **a lender loss payee endorsement will prevent a lender from not being burned when its collateral goes up in smoke.** However, it must be noted that under such an endorsement:

- Lender must pay the premiums on the policy if the insured fails to do so; and
- Lender has a duty to notify the insurance company of a change of ownership, occupancy, or increase of hazard that is known to it.

Typically, insurance carriers will provide the certificate holder/loss payee with ten (10) to thirty (30) days' notice before cancellation/nonrenewal of the policy for nonpayment. Therefore, lenders should always try to obtain as much notice as possible. In addition, a lender should negotiate to remove the provision in the lender loss payable endorsement that requires the lender to notify the insurance company of a change of ownership, occupancy, or increase of hazard that is known to the lender. Lenders may become aware of these facts during the course of loan, and the protection of the endorsement should not be jeopardized on account of the same.

The lender loss payable endorsement is available to lenders on equipment, inventory and other such goods for no (or little) additional cost to the borrower and should be demanded as a matter of course. Like coverage on a different form is available when the collateral consists of vehicles. Moreover, a breach of warranty rider provides similar coverage for marine or aircraft equipment. However, the cost for the rider may be more to obtain than a lender loss payable endorsement.