



One Minute Memo®

Basics of Insurance Certificates for Lending Transactions

Lenders commonly take a security interest in all real and personal property of a borrower. Upon the occurrence of an event of default, secured lenders generally have the right to exercise remedies with respect to the collateral, such as foreclosing on the property. What happens if (1) the collateral is damaged, destroyed or another form of loss occurs while the loan is outstanding, or (2) damages arise out of an incident occurring with or on any property serving as collateral for the loan? In these situations, the secured lender is susceptible to unintended consequences. In the case of property damage affecting the collateral, the secured lender may find its collateral base reduced, and in the case of a liability claim, the secured lender may find itself included as a defendant. These possibilities highlight the need for secured lenders to confirm that appropriate insurance exists and that such insurance provides the lender with certain protections. As a closing condition to most loan transactions, the borrower is required to deliver insurance certificates showing the borrower's satisfaction with the insurance requirements agreed to by the parties in the loan documents. As a result, having a basic understanding of the rights, benefits and risks of insurance certificates is important.

Insurance certificates are issued in lending transactions (and many other transactions, such as arrangements with suppliers, contractors and tenants) for a variety of reasons, including difficulty with receiving full and complete copies of the actual insurance policies on a timely basis. In addition, in the event underlying insurance policies are available, the reader in most instances lacks the necessary knowledge and experience to understand the policy terms and conditions.

While not all issuers of insurance certificates use the same forms, ACORD certificates (Association for Cooperative Operations Research and Development) serve as the standard in most transactions. A lender with a blanket security interest in a borrower's real and personal property should receive an ACORD 25 (Certificate of Liability Insurance) insurance certificate and such certificate should show the lender as a "Certificate Holder" and liability coverage should be extended to the lender as an "Additional Insured" in the certificate. In addition, such a lender should receive an ACORD 28 (Evidence of Property Insurance) insurance certificate and rights in the property coverage should be extended to such lender as a "Mortgagee" and "Lender's Loss Payee" in the certificate. In the event the lender does not have a security interest in the real property of the borrower, the appropriate insurance certificate for property coverage is ACORD 27 (Evidence of Property Insurance) and the lender should be shown as the "Certificate Holder" and listed as a "Lender's Loss Payee."

The benefits of "Additional Insured," "Mortgagee" and "Lender's Loss Payee" rights are set forth below:

- (1) "Additional Insured"—Extends liability coverage to the certificate holder on the same terms provided to the named insured. Coverage is limited to the activities of the named insured approved by the insurer.
- (2) "Mortgagee" and "Lender's Loss Payee"—Extends rights in property coverage to the certificate holder. The certificate holder will have the contractual right to receive payment of any insurance proceeds. In addition, and most importantly, the certifi-

cate holder will be protected against any defense that may be used by the insurer to void coverage as a result of the actions or inactions of the named insured (note that such protection is not provided when the lender is listed simply as a "Loss Payee"). For instance, the named insured's failure to timely file a proof of loss or the named insured's intentional destruction of personal or real property, will not be enforceable defenses against the certificate holder.

It is extremely important to note that most insurance certificates are merely provided for informational purposes. In order to gain the benefits of the foregoing rights and coverage extensions, the lender must ensure that proper endorsements are subsequently issued and attached to the underlying policy.

With respect to both property and liability insurance certificates, lenders should confirm/consider the following:

- if a broker is issuing an insurance certificate on behalf of insurers, the broker should be required to evidence its authority to do so;
- the certificate holder and all other interested parties should be properly listed (i.e. an administrative agent for all lenders should be referred to as such);
- all insurance companies should be shown with current policy numbers and all coverage limitations should be referenced;
- the lender should be given 30 days advance written notice before cancellation, non-renewal or a material adverse change to the specified insurance coverage, and any "endeavor to mail" language should be removed;
- in liability insurance certificates, a waiver of subrogation rights in favor of the additional insured should be included (note that such waiver may require an endorsement to the policy);
- the insurance certificate should state that no act, error or omission of the named insured will adversely affect the lender's rights under the policy; and
- all rights set forth in any insurance certificate should be documented in an endorsement attached to the underlying policy, and if the certificate contains "information only" language, consider requiring the insurer to provide a copy of the actual endorsement that will be recorded with the policy.

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