CLEAR
INSURANCE MANAGEMENT

Lenders Interest

Co-insured or composite insured

As lenders become more risk averse we are seeing an increasing appetite from banks, building societies and finance houses to protect their investment in properties. One of their methods relates to insurance policies through what is called the Co-insured or Composite insured clause. In essence the clause means that the policy benefits, in terms of settlement of claims, are payable to a lender as an insured party.

The lender already has first charge on your property regardless of the size of loan to value (LTV), a co-insured clause gives them first charge over your insurance policy as well.

What are the implications of this for landlords and property owners?

In our view, the rapidly growing use of co-insured clauses (sometimes they are referred to as a lender's or mortgagee protection clauses) is threatening to take insurers and their clients into unplumbed legal waters and could present a serious threat to property-owners' scope to plan and budget ahead for their business.

Security

Lenders obviously have a clear interest in wanting to see that insurance is in place for a secured property. Evidence of insurance is normally a condition of the loan agreement. They will also want to know that the property remains covered during the life of the loan and this is usually achieved through a covenant to maintain satisfactory insurance and notify claims.

Basically there are two ways of giving lenders the protection they need. Standard property-owners' insurance is the most common, supported by the sort of agreements and notifications mentioned above i.e. notification of interest: And finally there is the co-insured clause.

Lenders like to take the co-insured route (and are using it more and more frequently) because it allows them to tighten their terms of lending. It means that the lender does not just have a right to be notified of a claim but is in effect the insured party. And, no matter what the borrower does in relation to the policy – breaching the terms and conditions, for instance, or even non-disclosure or providing inaccurate statements – the policy continues for the benefit of the lender. This is achieved through a 'subrogation waiver' in favour of the lender in the co-insured clause. It also provides for the lender to be made first payee and given sole discharge in the settlement of a claim.

For the property owner they should fully realise the implications of what they are signing. For example, claim settlement to re-instate or take a cash settlement, providing insurers agree to this? Importantly, if the insurer opted to settle in cash and the bank accepted this, the landlord would be left with no option to reinstate the asset unless the bank put money towards this (please see later point regarding potential impact on the lease). And as the banks get tougher, many landlords are losing sight of the fact that they no longer have the benefit of their own insurance policy even though they have paid the premium.

For smaller claims there is usually no problem because the 'first loss payee clause' will normally have a limit written in. This typically ranges from £50,000 to £250,000 depending on the size of the property. It means that a claim below the limit can be dealt with by the policyholder directly with

About CLEAR

CLEAR is a Chartered Broker and proud to be a Top 10 Independent Insurance Broker in the UK.

Our considerable experience in the property sector gives us the capacity to design bespoke and exclusive insurance solutions for the whole property market.

normal notification to the lender. But for larger losses the property owner has signed away all powers of decision making.

Protection

It's clearly the broker's responsibility to clarify for clients the risks inherent in co-insured. We usually suggest that they try their best to persuade the lender to go down another route. But if this doesn't work the insurance policy contains, at the very least, a right to reinstate agreement. We also push for the highest possible limits (£100,000 to £250,000) in relation to the first loss payee clause. And it's also very important to keep a light touch in relation to compliance with the policy terms by simplifying the wording, particularly in relation to requirements to notify the lender of policy adjustments.

Some insurers understandably increase their rates to provide the extension of cover inherent in the non-vitiation clause – the extra cost being effectively a further charge on the loan to the property owner. And many insurers also sign legal agreements tying them to service promises they make to the lenders, which means that if clients want to change insurers they will have to obtain the lender's permission. The scenario below illustrates some of the problems inherent in switching these contracts.

Example

'A bank insists that insurer X includes a co-insured clause in covering a group of mortgaged properties owned by landlords, ABC Group.

On renewal insurer X increases the rate on the policy but the broker discovers that a saving of £3,000 can be made by switching to insurer Y. On further investigation, however, it becomes apparent that the legal fees required to draw up another agreement would exceed £5,000. It is also suggested by the lender that by switching insurers they might prejudice the original agreement. So ABC Group is left with no freedom to switch and consequently higher costs.'

It seems clear to us that no co-insured policy should be entered into without the clients legal advisors confirming the insurance arrangements does not contravene the conditions of the Fully Insuring and Repairing Lease, particularly in the area of reinstatement of the property. For example the signing of a lease can significantly expose the landlord; the two contracts are separate, so just because the benefit is paid to the lender, does not absolve the landlord of his responsibility to reinstate the premises under the terms of a lease. Another implication where co-insured does not sit comfortably with a lease is that the landlord is obliged to arrange insurance on behalf of the tenant at a fair market price. If say 3 quotes are obtained and the holding insurer is well above the other two, it could be considered that the landlord is stuck with a more expensive insurer, therefore in contravention of lease obligations.

It is important to note that insurers will not pay indemnity twice, a payment to one insured party i.e. the lender is held to be a payment to all insured parties. This is another important consideration going back to the lease, if a leaseholder incurs cost in the event of a loss because they are responsible under the lease and subsequently attempt to recover these costs under the policy, they may not be paid if indemnity has already instead been provided to the lender: an important consideration for a large asset owner.

Is there an impact on your brokers? the answer is yes. It is not uncommon for lenders to require a freeholders intermediary to agree to a non-standard process or notification. This has an operational impact of having to notify lenders in the event of a claim, cancellation or even change of cover.

In conclusion, we fear the rapid growth in co-insured arrangements will cause increased friction between lenders and borrowers, and detriment to many borrowers' businesses. In the long term, the onus is on the insurance industry to come up with a standard form of policy which protects the rights of both parties. Until then clients will have to rely on the vigilance of their brokers and their legal team.

How Can We Help

At Clear Insurance Management Ltd we are specialists in the property market. If you'd like further information contact us today or visit www.thecleargroup.com/property.

Contact Us

For further property insurance advice and guidance please contact:

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