



Loss Payee Versus Lender's Loss Payee: One Word Can Make All The Difference

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June 2016

When a lender makes a loan secured by personal property, it will perfect its interest in the collateral under applicable law. To further protect the value of the collateral supporting its loan, the lender will also require proof of insurance and obtain an endorsement on the borrower's insurance policy. Whether the lender obtains an endorsement as a "loss payee" as compared to a "lender's loss payee" can make all the difference if the insured borrower's policy is for some reason deemed to be invalid or voided. Because the borrower purchases the insurance and becomes the named insured, secured lenders and lenders' counsel should ensure the lender is adequately covered under the policy.

There is a very important distinction between "loss payee" and "lender loss payee" endorsements. Despite the similarity of the two terms, the distinction between the practical effect of each makes a critical difference in determining whether a secured party can recover insurance proceeds under the borrower's insurance policy after a loss to machinery, equipment or other personal property. (It is important to note that the term "loss payee" is not interchangeable with "mortgagee," but rather pertains to personal property collateral rather than real property).

Loss Payee Status: A lender can arrange to be named as a loss payee under a property insurance policy. This status typically does not entitle the lender to any rights under the policy except the right to be paid jointly with the named insured any proceeds after a loss.

A loss payee provision is not a separate agreement between the insurance company and the loss payee. Another way to think of it is that being named as loss payee under a standard loss payable provision does not create privity of contract between the insurer and the lender. Therefore, a loss payee generally has no right to payment of proceeds where the named insured has no right to recover. In other words, a loss payee can only recover to the extent the named insured can recover.

If an insured does something that voids the policy or otherwise precludes its ability to recover for a loss, such as making a material misrepresentation, failing to timely file a claim, intentionally destroying the covered property, or commits any other act which is deemed a breach of the policy thereby causing the policy to be void, then the insurer may deny coverage. In these and other circumstances where the insured's acts void the insurance policy, the insurer will also deny coverage to the loss payee under a bare loss payable clause.

The important thing to remember is that under a typical loss payable clause, the insurer is under no obligation to make payment to the loss payee if payment for a loss can be denied to the insured. A loss payee's rights are only as good as the insured's rights.

Lender's Loss Payee Status: There is a significant difference between a loss payable and a lender's loss payable provision, as the lender's loss payable clause affords the loss payee considerably more protection than the standard loss payable clause described above. As discussed, when a loss payable provision is issued by an insurer as proof of security for a loan or a lease on personal property, insurance on the lender's or owner's insurable interests can be invalidated by any act of the borrower or lessee of the property. In contrast, a lender's loss payable provision creates privity of contract between the lender and the insurer, and therefore insurance on the lender's interests is not invalidated by the acts of the borrower. Stated differently, a lender's loss payable endorsement allows the loss payee to recover even when the named insured's acts invalidate coverage or the policy.

Additionally, a lender's loss payable endorsement ensures that: (i) payment for a covered loss is made to the lender, not to the borrower; (ii) the lender's coverage is not jeopardized by acts of the borrower; and (iii) notice of cancellation is required to be provided to the lender.

In summary, while the terms sound similar, the lender's loss payable provision is the only way to truly protect the secured lender, because insurance on the lender's interests is not invalidated by the acts of the borrower. Lenders and lenders' counsel should be mindful of the difference between the two endorsements and always insist on obtaining a lender's loss payable endorsement because a secured party receives far greater protection when its rights are endorsed as lender's loss payee.

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