The Association of British Insurers (ABI) has given notice to the British Bankers’ Association (BBA) that on 30 June 2012 it will end the longstanding protocol designed to protect banks’ interests as mortgagees of property. This article explains what the agreement has covered and what it has not. It also suggests alternative ways for lenders to protect their interests. If you rely on insurance as part of your credit support package, this practical guide is a must read.

The ABI/BBA Agreement

In 1992, some of the major UK insurance companies, represented by the ABI, made an agreement with a number of UK banks (represented by the BBA). Before the agreement, when an insurance company received notice that a bank had an “interest” in mortgaged property, it would endorse the insurance policy with a record of that interest. The effect of the agreement was that, instead of endorsing the insurance policy in those circumstances, the insurers instead agreed they would:

- advise the bank if the policyholder did not renew the policy;
- advise the bank if the policyholder reduced the insurance cover, or any risk previously covered was restricted or cancelled; and
- keep the bank’s interest in the policy in force, provided the bank agreed to pay the premium.

The agreement aimed to reduce the administration for insurers (who would otherwise have to produce a separate endorsement). It also aimed to provide a safety net for the banks if they failed to make specific arrangements to ensure they could rely on the insurance cover.

The ABI and BBA do not intend to replace the agreement with any similar arrangement.

What does “noting of interest” mean in practice?

Some lenders wrongly believed that a “noting of interest” gave them a security interest in the insurance policy. Others thought it put them in the same position as a loss payee. The benefits of having an interest “noted” are, in reality, very limited. Having your interest “noted” does not by itself:

- protect you if the acts/omissions of the borrower enable the insurer to avoid the policy or refuse to pay out;
- make you a party to the insurance or give you a right of enforcement;
- entitle you to payment of the proceeds of any insurance claim;
- protect you from facing subrogation proceedings brought by the insurer; or
- give you priority over other creditors if the borrower becomes insolvent.

If lenders want to achieve any of these objectives, they need to provide for this in the transaction documents and often...
Getting the security right

There are different ways for lenders to try to ensure they will get access to insurance proceeds if there is a claim. Not all are available, or suitable, for every transaction. To protect their interests, lenders need to understand the legal framework within which insurance policies operate. They must also remember that many insurance policies only last for a year. So whatever safeguards a lender puts in place at the beginning of a transaction, it needs to ensure they are also in place for any replacement policies. Having an efficient monitoring system in place is crucial.

The safeguards available

A lender may have the following options to protect its interest in its borrower’s insurance policy:

- being named as a co-assured on the policy;
- taking a security assignment of its borrower’s right to be indemnified under the insurance policy;
- being named as loss payee in the policy;
- relying on the rights available under the Contracts (Rights of Third Parties) Act 1999; and
- establishing a trust over the insurance proceeds.

A lender can use some of these in tandem, but not all are available for every transaction or every policy. And not all methods of “sharing” the benefits of insurance provide equal protection. In each instance, the lender needs to consider:

- Do I want to be able to enforce the right to the insurance proceeds in my own name?
- Do I want to ensure the insurer cannot refuse to pay out because of the insured’s non-disclosure, misrepresentation or breach of policy?
- Do I want to avoid having to share any insurance proceeds with other creditors if the borrower becomes insolvent?

Once a lender has developed a strategy it needs to engage with the insurer as soon as possible. The insurer may not always agree to the preferred approach.

Conclusion

The end of the ABI/BBA agreement may provide a useful prompt for some lenders to reconsider their attitude to insurance. If they overlook the insurance undertakings in the finance documents until late in the day, it can be difficult to negotiate significant improvements. Getting those undertakings right, checking that the insurance contracts properly reflect the agreed position and understanding the special rules that apply to insurance contracts are all key. Leaving these issues to chance can leave a lender without recourse to insurance proceeds.

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