Simply Speaking

Obscure legal concepts or terms in a loan document explained in plain English

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Insurance Assignments

Example

As security for the Obligations, the Assignor hereby grants, sells, transfers, assigns and sets over unto the Assignee, for the benefit of the Lender, a continuing, first priority security interest in and to all of the Assignor's right, title and interest in, to and under the following property, whether now owned or existing or hereafter from time to time acquired or coming into existence:

i. all insurances (including, without limitation, all certificates of entry in protection and indemnity and war risks associations or clubs) in respect of the vessel, whether heretofore, now or hereafter effected, and all renewals of or replacements for the same;

ii. all claims, returns of premium and other moneys and claims for moneys due and to become due under or in respect of said insurances;

iii. all other rights of the Assignor under or in respect of said insurances; and

iv. any proceeds of any of the foregoing.

What is it and what does it do?

A standard ship finance loan agreement requires that the borrower maintain certain insurances with respect to the vessel and grant the lender (or security agent/trustee on behalf of the lender) a security interest in such insurances. Typically, this is accomplished through an insurance assignment executed by the borrower/owner that grants a security interest in the insurances to the lender, as assignee, and sets out specific undertakings and perfection requirements relating to the insurances.

Why is it there and how is it relevant to shipping?

An insurance assignment is required in ship finance transactions because it helps protect the lender's interest if there is a casualty affecting the vessel. Maritime casualties are an inherent risk in shipping, and there is always the possibility that the vessel may cause damage or be damaged or lost. The vessel is the primary collateral for a loan, and the lender will insist that it is protected in the unlikely event that the vessel causes damage or is damaged or lost.

More practically, an insurance assignment specifies what insurances are being assigned and set out how the security interest is perfected. The insurance assignment also sets out what terms the loss payable clauses endorsed onto the insurance policies include. The loss payable clauses, discussed further below, specify in what circumstances a loss payable by an insurer under a policy may be paid to the borrower/owner and in what circumstances such loss must be paid to the lender.

Why is it important (or not so important) to the lender?

Unlike many other types of collateral, security interests in insurance policies are carved out of Article 9 of the Uniform Commercial Code which governs perfection of security interests. Therefore, a so-called "UCC financing statement" does not perfect the lender's security interest, and the lender must take other actions to protect its interests in respect of the assigned insurance policies.

The perfection of a lender's security interest in insurances is governed by state law, and generally requires that, together with the execution of an insurance assignment, notice be provided to the insurers. Therefore, an insurance assignment will include a form notice of assignment that the borrower must execute and deliver to the insurers as part of the borrower's obligations under the insurance assignment. As additional protection, the lender also commonly requires the insurance underwriters to execute a letter of undertaking in favor of the lender and that the lender be named as an additional insured or loss payee on the policy, as further discussed below.

How does it affect the borrower in practical terms?

The insurance assignment affects the borrower primarily by (a) restricting under what circumstances a loss payable by an insurer may be paid to the borrower/owner, and (b) by placing certain initial and ongoing obligations on the borrower/owner. Initially, among other requirements, the borrower must provide notice of the assignment to the insurers to perfect the lender's security interest. The insurance assignment also contains (if they are not set out in the loan agreement itself) restrictions on amending the insurances and include certain ongoing lender notification requirements. The borrower must be careful not to technically default under a loan agreement by failing to comply with the ongoing insurance notification requirements and undertakings.

How is it negotiated?

Insurance assignments are a standard element of any ship finance transaction. However, specific insurance coverage requirements are frequently negotiated between the borrower and the lender. While lender insurance coverage requirements often reflect insurance coverage the borrower already maintains, in some cases the lender may require more insurance cover or different types of cover (such as protection against loss of hire) than the borrower deems necessary, and the coverage requirements are then negotiated.

Unlike loan agreements and some of the other security documents in a ship finance transaction, an insurance assignment also commonly includes obligations on third parties. Under a typical insurance assignment, the insurance underwriters must (a) execute letters of undertaking in favor of the assignee, and/or (b) endorse loss payable clauses onto their policies. The insurance underwriters are not party to the insurance assignment itself, but must agree to provide these letters of undertaking and endorse the loss payable clauses. As such, when negotiating an insurance assignment, it is typical for the letters of undertaking and the loss payable clauses to be negotiated and agreed with the insurance underwriters during the documentation stage. Many insurers have preferred form letters of undertaking and will not agree to a letter of undertaking that does not follow such insurer's preferred form.

With respect to the loss payable clauses, the borrower and lender often negotiate the thresholds and circumstances under which a loss payable may be paid to the borrower/owner. The borrower typically seeks to increase the threshold under which the insurer is permitted to make a payment directly to the borrower/owner without the consent of the lender. Conversely, the lender seeks a lower threshold to help protect its interest in the collateral. The lender typically requires losses payable in connection with a major casualty to be paid directly to the lender or requires that the lender first consent to any such payment to the borrower/owner, but allows payment of certain amounts directly to the borrower/owner, for example to affect repairs in the case of a smaller casualty. The threshold varies based on the value of the vessel, the anticipated size of any potential casualties, the size of the facility and the value of the other collateral securing the loan, and the financial strength of the borrower.

Questions?

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