Insurance for Leasing Companies

By Murray Derraugh, Swandel and Associates

When people in the leasing industry think of insurance, they automatically think of equipment or vehicle insurance—in other words, coverage to protect the assets under the lease. Although protecting our assets on lease is critical, there are many other ways insurance can protect the lessor. The purpose of this article is to give the reader a broad understanding of insurance, with specific advice on the key insurance needs of the lessor. We will look at insurance from the perspective of a general business and then will drill down more specifically to the additional insurance requirements that a lessor needs to consider.

TYPES OF INSURANCE

Regardless of the type of business, there are certain types of insurance that should be considered. Some would be mandatory, such as a Business Owner Policy, whereas other types would depend on the structure of the company, such as Key Man Insurance. Following are the main types of insurance to contemplate.

1.Business Owner Policy (BOP)

This is a package policy designed for small- and medium-sized businesses and includes both property and liability coverage. *Property Insurance* includes coverage for a building and its contents for *named* perils such as fire, lightning, explosion, windstorm, etc. *Liability Insurance* covers defense and damages resulting from the actions or failure to take action by a business, that caused injury or property damage to another party. There are four categories of business liability: bodily injury (slip & fall), property damage, personal injury (slander), and advertising injury.

2.Directors and Officers Liability Insurance

This coverage provides personal protection for directors and officers of companies against liabilities that may be imposed upon them while performing their duties. The insurance protects individual directors and officers when they are sued individually or jointly. When the operation of an "indemnity clause" in the corporate bylaws causes the corporation to indemnify the directors, the policy will cover the corporation for this instance. Coverage includes damages, judgments, settlements, costs, and defense costs.

It should be emphasized here that the corporation is not usually insured by a D&O policy (except for the corporate reimbursement coverage indemnifying the directors). The insurer will not defend the corporation if it is named in the lawsuit.

There are three general exclusions in most D&O policies: matters too precarious to underwrite, such as prior or pending litigation; matters covered by other policy types, such as bodily injury and property damage; and matters uninsurable under the law, such as dishonesty. (An example would be insider trading.)

3.Key Man Insurance

This is a subtype of life insurance that is aimed at the business world, where one person's skills and abilities can make an enormous financial difference. Key Man insurance is meant to cover a company's losses in the event of the death of a key employee. That employee may be a particularly capable salesperson, a manager, or the company owner. The underlying assumption is that the company will suffer greatly should that person pass away.

Key Man insurance is generally a term life policy, with the length of the term being the time until the employee retires. The company pays the premiums on the policy and receives the death benefits if the employee dies unexpectedly.

4.Business Interruption Insurance

This insurance can be just as critical to a company's survival as fire insurance. Many business owners fail to think about how they would manage if a fire or other disaster damaged their business premises so that they were temporarily unusable. A business that has to close down completely while the premises are being repaired may lose out to competitors. A quick resumption of business after a disaster is essential.

Business interruption insurance compensates the business for lost income if the company has to vacate the premises due to disaster-related damage that is covered under their property insurance policy, such as a fire. Business interruption insurance covers the profits the company would have earned, based on their financial records, had the disaster not occurred. The policy also covers operating expenses such as electricity that continue even though business activities have come to a temporary halt.

INSURANCE SPECIFIC TO LEASING

Drilling down from a general business to a leasing company that funds leases, there are many other types of insurance that are required or should be contemplated. Following are the main types of coverage that need to be investigated and discussed with an insurance agent or broker.

1.Contingent & Excess Liability Insurance

This insurance covers the lessor's interest only. Contingent and Excess Liability applies when the lessee's coverage does not come through, due to either the lessee's policy being denied or the lessee being underinsured. There are strict requirements that must be met in order for the claim to be paid out to the lessor. For example, the lessor must ensure that the lessee provides their own insurance and must continue to track coverage of the lessees's insurance.

Specific Contingent Liability insurance protects the lessor in the event they are named a defendant in a legal action resulting from a lessee's involvement in an accident while not maintaining adequate insurance required by the lease agreement.

Specific Excess Liability insurance protects the lessor above the lessee's primary liability policy or above the lessor's contingent liability policy, such as with a catastrophic accident.

2.Interim Car Coverage

This insurance protects the lessor against damage to a vehicle not assigned to a lessee, owned by the lessor, while it is held for sale or reassignment under a new lease agreement.

3.Garage Liability Insurance

This insurance protects businesses from claims involving customers' automobiles while on business premises. This would extend to automobile dealers, repair garages, parking lots, and delivery and towing operations. The insurance applies to liabilities involving garage buildings, contents, stock and equipment, and automobile liability. Note that Garage Liability insurance will not cover liabilities unless directly related to the garage or to the vehicles themselves.

4.Conversion and False Pretense Insurance

This type of insurance is excluded under Garage Liability but can be brought back under as an inclusion. The basic premise is that if the lessor is deceived after performing reasonable due diligence, False Pretense inclusion would protect the lessor from losses relating to the fraud. Conversion is when the lessee or some other party that had possession of a vehicle owned by the lessor fraudulently sells the vehicle. This inclusion would protect the lessor from this loss.

5.Vicarious Liability Insurance

A vicarious liability claim can occur when people or organizations are held liable for the negligent actions of another, even though they are not directly responsible for the actions. There have been a few key rulings in the United States whereby the lessor of a licensed vehicle has been held liable for damages resulting from auto accidents involving their leased vehicles.

On August 10, 2005, the United States passed the *Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users*, the effect of which was to eliminate, on a U.S. national level, all vicarious liability statutes imposing liability on motor vehicle leasing companies. The U.S. law permits states to pass mandatory minimum insurance requirements, which can expose vehicle lessors to liability if they do not ensure such minimums are met.

In situations where the transaction will be a true lease, the lessor needs to be vigilant that the lessee continues to maintain appropriate insurance. In order for lessors to mitigate their risk in these situations, there is vicarious liability insurance.

6.Residual Value Insurance

This insurance protects the lessor for the difference between the projected residual values and the actual market values at contract termination. Residual value insurance is generally required for securitization purposes.

7.Asset Insurance

This insurance provides primary coverage to the lessor on leased equipment not covered by the lessee's insurance. This insurance can also provide single-interest liability protection to the lessor against vicarious liability claims for bodily injury or property damage caused by the use or existence of leased equipment.

Some of the key benefits of a lessor offering asset insurance are:

- The lessor is able to pass the cost of insurance to the lessee and potentially earn fee income
- Expedites the lessor's funding process by providing immediate asset protection
- Offers a convenient option for the lessee to meet the insurance requirements of the lease
- Offers broader coverage than a typical commercial property policy

Asset insurance, provided either by the lessee or by the lessor on behalf of the lessee, is made mandatory by most funders, such as banks and securitizers.

8.Title Insurance

This insurance protects the lessor's financial interest in real property against loss due to title defects, liens, or other matters. It will defend against a lawsuit attacking the title as it is insured, or reimburse the policyholder for the actual monetary loss incurred, up to the dollar amount of insurance provided by the policy. Title insurance differs in several respects from other types of insurance. Where most insurance is a contract where the insurer indemnifies or guarantees another party against a possible specific type of loss, such as an accident or death at a future date, title insurance generally insures against losses caused by title problems that have their source in past events.

HOW INSURANCE IS DISTRIBUTED

Insurers use different methods to sell their products, namely the direct writing system and the independent agency/brokerage system. Under the direct writing system, producers are employees of the insurer and are limited to selling only those products provided by the insurer.

Insurance Agents are contractors who are the authorized representative of one or many insurers. Agents can be independent agents, representing multiple insurers, or exclusive agents, representing a single insurer.

Insurance Brokers are authorized representatives of the policyholder for the purpose of negotiating and obtaining insurance coverages. The broker is an advocate for the policyholder's interests, and although they represent several insurance products, their main role is to work on the client's behalf.

DETERMINING COVERAGE

Coverage is generally based on the likely significance of identified possible losses. Insurance and risk management professionals use a wide variety of methods to identify specific loss exposures. For businesses, this includes reviewing years in business, location(s), organizational policies, financial statements, risk appetite, etc. Additionally, for leasing companies in particular, the discussion with the insurance agent or broker includes reviewing the leasing operation and goals, along with the types of leases written, asset values, location of lessees, credit types (A, B, or C), types of assets, claim history, credit losses (bankruptcies and repossessions), and lease agreement language. Based on the information gathered, the insurance professional will recommend coverage and obtain pricing for the agreed-upon risk management solutions.

Insurance premiums are not really negotiable; however, the individual or organization can affect their rates by changing their coverage parameters. For instance, increasing deductibles or giving up coverage for a particular type of loss, such as theft or earthquake, will generally decrease premiums.

The key to appropriate risk management is to make sure that the insurance agent or broker fully understands your company's business model, what the company is about, and your tolerance for risk and financial variability. Being honest and up front initially and as changes happen in your business, will provide the insurer with the information needed to advise on the proper levels and types of coverage.

RATING AGENCIES

Rating agencies play an integral role in determining which insurance companies should be considered by a lessor. All insurers receive a rating from at least one rating agency. A rating agency is an independent third-party evaluator that subjects all insurers to the same rigorous criteria, providing a valuable benchmark for comparing the financial health of insurers. Examples of rating agencies are Fitch and A.M. Best.

Ratings are time sensitive and can change over time. The Insurance Broker has an obligation to place business with a sound insurer, and must keep their clients informed if there are any changes to the insurer's ratings. Ratings range from AAA, indicating an exceptionally strong insurer, to a low of C, signifying an exceptionally weak insurer.

The rating is important to the lessor because it provides a strong indication of the insurer's ability to pay claims. Ratings of A- and lower would be cause for concern, as there is a greater chance that the insurance company may not be able to cover losses in the case of a claim. However, a rating alone is not sufficient to determine whether the insurance company is the right one to form a relationship with; knowledge of the leasing industry and capacity to pay out in tough times are other critical factors.

RECOMMENDATIONS TO CONSIDER

Insurance is necessary both personally and in business. For lessors, there are many different aspects of insurance that must be considered in order to protect the assets of the company and the employees and shareholders, in addition to the equipment or vehicles leased to their clients. Here are a few final points to ponder when analyzing your insurance provider and portfolio:

- Claims or potential claims should be reported to the insurance agent/broker or insurer immediately; otherwise, the claim can be denied due to the insurer's position being prejudiced.
- The key to reading and understanding insurance policies is to read the exclusions and miscellaneous provisions first. It is just as important to understand what a policy does *not* cover, as what it *does* cover.
- Annual meetings with insurance agents or brokers to review coverages and to discuss any changes in risk or requirements are recommended. However, any changes in business plans or portfolios that might affect insurance coverages require that the agent or broker be contacted immediately; a policyholder should not wait until the annual review. If the broker or agent does not initiate an annual review process, it is probably time for the policyholder to find a new broker or agent.
- And finally, when selecting an agent or broker, it is critical to form a relationship with one that specializes in and understands leasing. Leasing has unique characteristics, so choosing an insurance partner that understands the business reduces the time spent educating them. And, most important, they will know how to best protect the investment in your company.

Murray Derraugh is a principal with Swandel and Associates who has expertise in sales, risk management, and operations efficiency in the financial services industry. Mr. Derraugh is also the editor in chief of the Canadian Lease Education On-line series, based on the Certified Lease Professional program. This article was

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