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The Practical Lender

A bulletin devoted to highlighting the practical effects of law on the finance business. The  denotes practical lender tips for the lender.

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ILLINOIS' COLLATERAL PROTECTION ACT MANDATES NEW PROCEDURES FOR LENDERS

The State of Illinois recently implemented the Collateral Protection Act (the "Act") requiring that certain procedures be followed by a secured creditor (*i.e.*, lender or lessor) when purchasing insurance on a debtor's behalf and charging it to a debtor. Most secured credit agreements and leases provide that if a debtor fails to maintain insurance on collateral, the creditor can purchase the insurance and charge the debtor for its cost. As a result, the Act is relevant to almost all secured lenders/lessors in Illinois.

Pursuant to the Act, a creditor may only purchase insurance and charge it to the debtor if the following requirements are satisfied: (a) the credit transaction is evidenced by a written credit agreement; (b) such agreement requires the debtor to maintain insurance on the collateral; (c) such agreement contains a notice regarding the procedures by which a creditor can purchase insurance on behalf of a debtor, in substantially similar form to the notice set forth below; and (d) each separate agreement or document with each person liable for the obligations (such as a guarantor) must contain a similar notice to that described below.

Suggested Notice in Agreements and Leases

Suggested agreement and lease language to comply with the notice requirement under the Act is as follows:

Unless you provide us with evidence of the insurance coverage required by your agreement with us, we may purchase insurance at your expense to protect our interests in your collateral. This insurance may, but need not, protect your interests.

The coverage that we purchase may not pay any claim that you make or any claim that is made against you in connection with the collateral. You may later cancel any insurance purchased by us, but only after providing us with evidence that you have obtained insurance as required by our agreement. If we purchase insurance for the collateral, you will be responsible for the costs of that insurance, including interest and any other charges we may impose in connection with the placement of the insurance, until the effective date of the cancellation or expiration of the insurance. The costs of the insurance may be added to your total outstanding balance or obligation. The costs of the insurance may be more than the cost of insurance you may be able to obtain on your own.



Lenders desiring the right to purchase collateral insurance if a borrower defaults should remember to include the required notice in the loan agreement and related contingent obligor agreements such as guaranties.

Post-Closing Notice of Placement of Insurance

In addition to the notice requirement set forth above, the Act requires that written notice be given of the purchase of insurance to each debtor and contingent obligor (such as a pledgor or guarantor) within thirty (30) days of such purchase entitled "Notice of Placement of Insurance," which should read substantially as follows:

Your credit agreement with us requires that you maintain adequate insurance on your collateral until you pay off your loan. You have not given us proof that you have adequate insurance on your collateral. Under the terms of your credit agreement, we have purchased insurance at your expense to protect our interests in your collateral. The insurance we purchased will pay claims made by us as the creditor. The insurance we purchased may not pay any claims made by you or against you in connection with your collateral. You are responsible for the costs of this insurance, including interest and

any other charges we may impose in connection with the purchase of this insurance. The costs of this insurance may be more than insurance you can buy on your own. You still may obtain insurance of your own choosing on the collateral. If you provide us with proof that you have obtained adequate insurance on your collateral, we will cancel the insurance that we purchased and refund or credit any unearned premiums to you. If, within thirty (30) days after the date this notice was sent to you, you provide us with proof that you had adequate insurance on your collateral as of the date we also purchased insurance and that you continue to have the insurance that you purchased yourself, we will cancel the insurance that we purchased without charging you any costs, interest, or other charges in connection with the insurance that we purchased.

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Loan operations procedures should require the statutory notice be sent to the borrower and all contingent obligors whenever a lender purchases insurance on behalf of a borrower.

Repayment Terms

The Act mandates certain terms for repayment of the cost of the insurance, together with interest thereon. Such repayment terms must include one or more of the following options:

- a. full payment within thirty (30) days after the date of the "Notice of Placement of Insurance";
- b. a final balloon payment within thirty (30) days after the last scheduled payment required by the credit agreement; or
- c. full amortization over the term of the credit transaction, the term of the collateral protection insurance policy, or the term for which amortization is used by the creditor.

The Act permits a debtor, at any time, to cause the

cancellation of collateral protection insurance by providing proper evidence to the creditor that the debtor has obtained the insurance required by the credit agreement. Further, the Act provides that if within thirty (30) days after the "Notice of Placement of Insurance" is sent, the debtor provides the creditor with proper evidence that the debtor (i) had insurance as required by the credit agreement on the date the creditor purchased insurance and (ii) continues to have the necessary insurance in place, the creditor is obligated to cancel the insurance that it purchased. Moreover, the creditor may not charge the debtor any costs, interest, or other charges in connection with the insurance.

The Act is applicable to all credit transactions (*i.e.*, loan or lease transactions) entered into on or after July 1, 1997. If the Act is not satisfied, a creditor may be unable to charge a debtor for the cost of insurance on the collateral purchased by the creditor.

If you would like more information on the above article or any finance topic, please call your Vedder Price contact attorney. Our main number is (312) 609-7500.

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