



# Insurance Coverage **ALERT**

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## Hurricane Sandy Reveals “Silent” Insured to Homeowners; Guidelines Issued to Help Victims

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In October 2012, Hurricane Sandy rolled into the Northeast United States, causing property damage in the billions of dollars. Although the waters have subsided, power has been restored, and the process of rebuilding has begun, it remains uncertain who will ultimately foot the bill for this catastrophic loss.

Thousands of homeowners in the affected areas will have another surprise coming when they discover that there is an additional, usually silent, insured party under their homeowner’s policy, i.e., their mortgagee. This complicates processes such as those involving insurance proceeds checks. The mortgagee may even have first claim on part of all of the insurance proceeds pursuant to their policy’s mortgagee clause.

As far back as 1879, the U.S. Supreme Court held that when a mortgagor insures property for the mortgagee’s benefit, the mortgagee holds a lien on any insurance proceeds up to the amount of the outstanding mortgage. *Wheeler v. Factors’ & Traders’ Ins. Co.*, 101 US 439, 442 (US 1879). In 1902, the Florida Supreme Court recognized that these equitable rights achieve contractual status when the policy has a formal mortgagee clause. *Glenn Falls Ins. Co. v. Porter*, 33 So. 473, 478 (Fla. 1902). In 1905, the Connecticut Supreme Court of Errors determined that a mortgagee “is entitled to receive so much of any sum that might become due under the policy as did not exceed its interest as mortgagee, and nothing more. Such is the accepted rule in this state, and, with few possible exceptions, elsewhere.” *Collinsville Savings Society v. Boston Ins. Co.*, 77 Conn. 676, 60 A. 647, 69 L.R.A. 924. Virtually all policies now have a mortgagee clause, granting the mortgagee status as a loss payee with a superior claim to the insurance proceeds, even superseding the mortgagor’s claim until the mortgage is eliminated.

In the aftermath of Hurricane Sandy, the mortgagee clause creates challenges, which unfortunately are necessary. Because the home is the asset backing up the loan, the mortgage company wants to ensure that the homeowner uses proceeds to make the repairs necessary, thus bringing up the value of the home.

## Fannie Mae and Freddie Mac Guidelines for Emergency Condition Insurance Proceeds

Realizing the potential roadblock to recovery, both Fannie Mae and Freddie Mac, the largest backers of insured mortgages in the U.S., issued more flexible disaster policies in an effort to facilitate recovery



efforts. Fannie Mae advised lenders that for mortgage loans other than certain refinancings, and where the damage does not affect the safety, soundness, or structural integrity of the property, the lending bank must ensure that professional estimates of the repair costs are obtained and that sufficient insurance proceeds are held for the borrower's benefit to guarantee the completion of the repairs. Homeowners should be aware that their mortgagee cannot avoid these guidelines and should proceed accordingly.

For properties that suffered a total or near-total loss as a result of Hurricane Sandy that are the borrower's principal residence and current, or delinquent 30 days or fewer, servicers may release insurance proceeds up to the greater of \$40,000 or 10 percent of the unpaid principal balance. Proceeds of less than \$20,000 may be released directly to the borrower, while proceeds greater than \$20,000 must be released payable to the borrower and the homeowner's contractor when the insured has retained a contractor.

Other highlights of the guidelines include:

- When a servicer receives insurance proceeds to cover the loss of the borrower's contents or personal property or off-residence living expenses, it must immediately release these funds to the borrower.
- When insurance loss proceeds are deposited into an interest-bearing account, the account must be for the borrower's benefit.
- Foreclosures and evictions were put on hold for 90 days until the Federal Emergency Management Agency (FEMA) issues a report on further needed recovery efforts.

## Practice Note

Insurers issuing damage checks in the hard hit Northeastern states should review and be familiar with these Fannie Mae and Freddie Mac regulatory guidelines for mortgagees so that they can offer guidance and information to affected homeowners. View the Fannie Mae Disaster Guidelines at <https://www.fanniemae.com/content/announcement/111209.pdf>

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