# *Premium Financing*

***Can Be a Great Management Tool***

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**Homeowner** and private automobile insurance companies offer a variety of low cost premium payment choices when they invoice you for your home and auto insurance. You receive a renewal premium notice and select the payment choice that best suits your budget. Usually, the company makes a minor installment charge of $2.00 to $3.00. If you are a business owner, many of the commercial property and casualty insurance companies offer direct bill payment plans, again for a seemingly paltry sum. Large commercial and large specialty insurance consumers may be able to negotiate more sophisticated arrangements including deposit premiums with monthly, quarterly, or annual audits.

Where does that leave the specialty insurance buyer when there is no insurance company payment plan available? What about the general aviation consumer?

Specialty insurance companies such as aviation or marine carriers do not offer premium payment plans. During the past 5 or 10 years, insurance products have become commodities. GEICO, State Farm, Allstate, and others offer direct bill premium installments leading the public to believe that is the way all insurance should be.

As insurance agents, we are frequently asked to extend the same payment terms offered by our clients' personal insurance carriers. Unfortunately, the rules on the aviation side of the industry are quite different.

## AGENTS ARE RESPONSIBLE TO THE COMPANIES FOR PAYMENT

Aviation insurance agencies enter into brokerage contracts with insurance underwriting facilities requiring them to pay the underwriter within a set number of days whether the client has paid them or not. Usually, this "account current" payment is due to the company within thirty days after the policy inception date. If the underwriter does not receive the premium payment on time, notice of cancellation will be processed on all past due policies. The company will then pursue collection from the agent putting the agent's contract in jeopardy.

If the client has paid the agent and the agent has not paid the insurance company within the prescribed time, the company can cancel the delinquent policy. Because of the stringent fiduciary laws and penalties in most states, most agents are very careful to fulfill their responsibilities to remit their client's premium payments to the underwriting company as agreed in their brokerage contracts.

## SLOW PAY CLIENTS ARE NOT WORTH THE RISK

Many agents allow their clients to delay paying their premiums. Some agents, trying to be accommodating, will allow the client to stretch well beyond the time allowed by the insurance company for payment. This can become a hardship on the agent's cash-flow and can lead to eventual difficulty in their ability to pay the underwriter.

## THE PREMIUM FINANCE PLAN

Frequently, the client needs the latitude of stretching out premium payments. Cash flow issues, matching premium payments to charter or rental income, coordination between owner/partners, and numerous other cash flow needs make premium financing a popular tool. And, a tool it is. Most aviation insurance agencies offer premium finance contracts as an accommodation to their clients. Although the interest paid to the finance companies is a "pass through", the agents are not strictly benevolent in their efforts. This service is a method of collecting premiums on time while accommodating the client's cash flow needs.

## WHAT DID YOU AGREE TO?

For this discussion, I have chosen the finance contract used by AI Credit (AICCO). Although there are numerous premium finance companies AI Credit is one of the largest and most respected. Most premium finance contracts have similar wording.

## SECURING THE LOAN

"To secure payment of all amounts due under this Agreement, insured assigns LENDER a security interest in all right, title and interest to the Policy, including (but only to the extent permitted by applicable law): (a) all money that is or may be due to the insured because of a loss under the Policy that reduces the unearned premiums (subject to the interest of any applicable mortgagee or loss payee), (b) any return of the premium for the Policy, and (c) dividends which may become due to one insured in connection with the Policy."

In short, the Lender's only security is the down payment and any unearned premiums. The amount of the down payment must be carefully calculated to allow the insurance company and the Lender time to comply with any legal notification requirements imposed by applicable state insurance or lending laws. In addition, the insurance company must have time to advise any certificate holders that coverage will be interrupted.

These notification requirements may take more than two months for the process to be completed. It is easy to see how the finance company arrived at the 20% to 25% down payment. The balance can then typically be financed over the remaining eight to ten months allowing for total premium payment prior to expiration of the policy period.

## THE AGENT MUST SIGN THE FINANCING CONTRACT

The agent or broker becomes a party to the finance contract. The finance company requires the insurance agent to warrant that all policies financed are subject to normal cancellation terms. The agent agrees to hold in trust for the Lender any payment by the insured or premiums credited to the insured's account by the insurance company. The agent must advise the Lender of any information that could effect cancellation of the policies and interrupt the return of unearned financed premium. The agent must agree to return any unearned commissions to the finance company in the event of default.

**CANCELLATION**

In short, a premium finance contract is nothing more than a loan to the policy holder requiring a down payment and monthly installments. The security for this loan is the down payment and any unearned premium remaining at the time of cancellation. You might say the only security the finance company has is the policy itself.

The "LENDER may request cancellation of the insurance policies listed in the (policy) schedule upon expiration of 10 days written notice of intent to cancel (13 days in New York, 15 days in Pennsylvania), provided said default is not cured within such period and the Lender may proceed to collect the entire unpaid balance due hereunder or any part thereof by appropriate legal proceedings."

**HOW DOES THE INSURANCE COMPANY RECOGNIZE A FINANCE CONTRACT?**

Once the premium finance agreement is executed, a copy of this document will be sent to the insurance company. This contract gives the company the authority to issue an endorsement to the insurance policy agreeing to the requirements of the finance document.

The best example we have found of such wording is taken from the W. Brown & Associates (XL Specialty) policy:

"It is hereby understood and agreed that:

The premium for this Policy has been financed in whole or in part through: <u>name of the premium finance company (the LENDER)</u> under an agreement assigning certain rights of the Insured to the Lender, therefore:

(a) All return premiums under this Policy shall be payable to the said Lender and Insured, as their respective interests may appear; and
(b) The said Lender shall have the exclusive right to cancel or cause to be cancelled in the Insured's name and stead this Policy; and
(c) Loss, if any, under this Policy shall be adjusted with the Insured and payable to the Insured and the said Lender, as their respective interest may appear.

(d) The Company reserves the right to cancel the Policy at any time as provided by its terms but in such case notification shall be given the Lender, when, not less than 10 days thereafter, such cancellation shall be effective."

Not all premium financing endorsements read the same but, the intended meaning is similar.

**AGENT OF RECORD**

What if you decide to change insurance agents mid-term? Most (not all) insurance companies will accept a mid-term reassignment of insurance agents. This can be accomplished by making your request in writing to your insurance company.

The existence of the premium finance contract does cause complications, however. It is customary in the industry that the initial agent earns the commission on the policy for its entire term. The new agent being assigned mid-term will service the policy for the remainder of the policy period for free.

If the policy holder defaults on a premium payment to the LENDER, the insurance company will return any unearned premiums net of commission as agreed in the premium finance endorsement. The new agent, having never received the commission, is unable to return it to the LENDER. But, the new agent was never party to the finance contract. It was the initial agent who agreed as a party to the finance contract to the following commitment:

"Upon cancellation of any of the scheduled Policies, the undersigned Agent or Broker agrees upon demand to pay to LENDER or its assigns their commission on any unearned premiums applicable to the cancelled Policies."

So, it works for the LENDER. The insurance company returns the unearned premium and the original insurance agent must return the unearned commission even though he is no longer the "agent of record" on the account.

**PAY ON TIME**

A premium finance contract is no different than any other loan. Distinct and specific payment terms and conditions are laid out in the contract and agreed to by the insurance company. If premium payments are not made on time, there is nothing your insurance agent can do to interrupt the cancellation process. If your payment is late, you will receive a late payment notification. If payment is not paid, the finance company will request cancellation from the insurance company who will have no alternative but to cancel.

**THE AGENCY HAS LITTLE CONTROL**

As agents, we have had clients become very upset with us because their finance and insurance companies have canceled coverage. Somehow, the client blames the agent.

There is nothing that the agent can do. The only person responsible for such action is the client himself. The lesson is, "if you finance your premium, make your payments on time."

**A GREAT MANAGEMENT TOOL**

A good relationship with a premium finance company can be a very important tool for any business or individual. There are times when cash flow is tight. It always seems to happen precisely when those large fixed expenses become due.

Premium financing is an easy credit resource that seldom requires a financial statement or credit history. After all, the policy is the security for the loan. It is inexpensive. The larger the premium, the lower the interest rate charged. We have seen rates range from below prime to the high teens. The reality is that the actual rate charged translates into a very small amount of interest paid. Keep in mind, the interest is paid only on the unpaid portion of the premium.

The next time you renew your insurance, ask your agent for a premium finance quotation. You may be pleasantly surprised at this new tool. ✈