

TRIALS AND TRAPS IN PREMIUM FINANCE AGREEMENTS

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Several recent Hotline inquiries have brought to the fore some misunderstandings of premium finance arrangements and how the wholesale broker may be at risk if care and awareness are not exercised. The most frequent issue arises in the context of the premium finance company (PFC) exercising its right to cancel a financed policy in the event the insured defaults in making an installment payment.

To take a step back, when an insured is faced with a sizeable premium, he will often times opt to finance the amount by entering into a premium finance agreement (PFA). The PFC pays the premium at inception and the insured repays the PFC in periodic payments which include a finance charge. The agreement itself sets forth the name and address of the insured and the retail broker but doesn't necessarily include the name and address of any intermediate or wholesale broker.

The Banking Law requires the retail broker to notify the PFC of the name and address of any wholesale broker involved in the transaction and, in turn, the finance company is required to advise the wholesale broker and the insurance company of the amount of the gross premium, the borrower's (insured's) name and address and the policy number. This information should not be relegated to the file and forget bin.

To secure the PFC, the insured signs a premium finance agreement which contains a power of attorney from the insured to the lender, giving the PFC the right to cancel the policy and receive any return premium from the insurer if the insured doesn't make a payment. The cancellation process under a PFA is governed in most part by the NY Banking Law and the NY Insurance Law. What

gets problematic is how and when a cancellation is effective. The statute requires the PFC to give the insured ten days notice of its intent to cancel the policy (plus three days for mailing, and the day of mailing is not counted) and if the default is not cured within that period, the finance company can issue a Notice of Cancellation to the insurer stating when the policy shall be cancelled. What if the PFC requests the insurer to cancel the policy as of the 10th of the month but the insurer doesn't receive the notice until the 15th of the month? Is the cancellation effective on the 10th or the 15th? And, what if there is an occurrence between the 10th and the 15th? Does coverage attach?

The New York Court of Appeals was faced these issues in the case of *Crump v. Unigard Ins. Co.*, decided in 2003. The finance company, AFCO, sent a notice of cancellation on November 19th which was to be effective as of November 25th. However, Unigard didn't receive the notice until December 6th. As you might guess, there was an accident on November 29th resulting in a fatality. Unigard, of course, claimed the policy was cancelled as of November 25th while the insured alleged coverage was still in effect until Unigard actually received the cancellation notice on December 6th. The court sided with the insured and held that the accident was covered. Sometimes, it may work the other way. For instance, if there is a sizeable return premium resulting from the cancellation, an insured may want an earlier date while the carrier would argue for the later date. But the Unigard case still governs; the cancellation doesn't become effective until the Notice of Cancellation is actually received by the insurer (or its agent).

What if the insurer receives the NOC at 10:00am and an occurrence takes place sometime later on that same day. Case law holds that in the event of a policy cancellation, coverage remains in effect for the entire day on which the cancellation is to be effective. Thus even if the insurer receives a NOC on a

particular day and there is an occurrence later (or earlier) on the same day, the policy would be in effect until midnight of that day and coverage would attach.

Many wholesalers, upon receiving a cancellation notice from the finance company will wait a few days before taking steps to effect the cancellation to see if the insured will make the necessary payment. The insurer, or the wholesaler acting on behalf of the insurer, has 60 days after cancellation within which to return the gross unearned premium to the PFC so keeping track of the effective date of cancellation becomes important in order to avoid a statutory violation. Further, the law requires the insurer to return the unearned premium to the PFC even if the premium is in the possession of the agent who placed the coverage. And, gross unearned premium means exactly what it says, commissions paid to or retained by a broker or agent cannot be deducted from the amount remitted to the PFC. But where the insured has made a down payment on the premium and financed the balance, upon default and cancellation, the insurer must remit to the PFC the gross unearned premium of the amount financed, not the unearned portion of the total premium.

In many instances where a policy is effectively cancelled for non-payment of an installment, the insured will make payment and request reinstatement of the policy. It is good practice to request a “no known losses” affidavit from the insured and the retail broker before reinstating or asking the insurer to reinstate the policy without a lapse to avoid “buying” a loss after cancellation.

If you are acting on behalf of an insurer with respect to a policy where the premium is financed, you should be sure that you are on record with the PFC and the lender knows that you are the person who is to receive the cancellation notice. Especially if the insurer is described in the agreement as “Lloyds of London.” Further, once you receive such a Notice of Cancellation, you may not be able to cancel immediately if there are statutory, regulatory or contractual restrictions on

the right to cancel, i.e. an additional insured endorsement which requires more notice than the statute demands or an auto liability policy. This is another situation where careful record keeping and keeping data moving up and down the line are essential if you are to avoid risk.

Over the years PIWA has acted in the best interests of the wholesale brokerage industry in proposing and supporting legislation to assist the wholesale broker in the premium finance situation. One of the proposals being discussed is the electronic transmission of notices, etc. among the insured, the retail broker, the wholesaler and the insurer. This would appear to facilitate keeping track of requests for cancellation, returning unearned premium and dealing with requests for reinstatement. For the moment, however, it important to

- Take note of premium-financed policies, keeping track of the name of the premium finance company and relevant data about the insured, the retail broker and the insurer;
- Remember that the effective date of the cancellation may not be the date stated in the Notice of Cancellation but will be the date the insurer (or you if you are issuing agent) receive the Notice and that coverage will remain in effect until midnight on the day on which the NOC is actually received.
- Be aware of restrictions on the ability to cancel the policy and provide adequate notice to third parties who by statute, regulation or contract are entitled to Notice of Cancellation of the policy;
- Diary the file for return of the unearned premium which must be sent to the premium finance company within 60 days of the effective cancellation date;
- When remitting the unearned premium to the Premium Finance Company, be sure you return only the unearned premium on the portion of the premium that was financed, not on the total premium;

- Exercise caution when asked to reinstate a lapsed policy requesting “no known losses” affirmations from the insured and the retail broker;
- PIWA will keep you advised of any proposed legislative changes affecting premium finance practice and procedures so stay aware of any amendments that may affect you;
- When in doubt – GIVE US A SHOUT- CALL THE PIWA HOTLINE 844 FOR PIWA (844)367-7492 or piwahotline@piwa.org