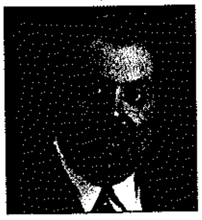

CORPORATE EXPOSURE: Premium Financing Options

Harry P. Mirijanian

Reviewing coverages, evaluating costs, and—most important—determining what services the carrier provides are the essential factors considered by most individuals in their insurance selection decisions. Although a number of carriers offer a variety of payment options, some clients are still unable to consider these options because of their unique cash flow situations. To meet this need, premium financing is available.

Some carriers have their own in-house finance company. There are two other sources, however. The first is the independent premium finance organization, and the second is the captive premium finance company owned by participating insurance agents. Banks are rarely used to finance insurance premiums because they may have recourse beyond the scope of the premiums should the lender fail to pay. Insurance agents and brokers are typically solicited by premium finance companies to promote their product to insureds. Usually, these companies do not provide the agent with any commission or monetary incentive to select one organization over another. There can, however, be distinct differences between companies, such as lower interest rates and down payments.

To gain access to the finance company, the organization must complete an application, include the necessary down payment, and provide necessary financial reports for a complete review of the company's financial position. The contracts used by premium finance firms vary in their provisions but must reflect governing state laws. Fairly common among the contracts are the inclusion of detailed cancellation provisions, although these can vary dramatically from company to company.

We urge our readers to carefully review the definition of "default" and what action the law in your state permits with respect to cancellation for nonpayment. The financial data on the contract should include information on the amount of the down payment, the amount financed, the number of payments, and the exact payment amount, as well as the period of time available for satisfaction. Another clause that requires careful review is the power of attorney provision. Some power of attorney provisions give the finance company "permission to cancel the policy in the event of default" and to "act in my place...." Be certain that you understand these clauses before you execute any agreement.

Also note the cancellation section of the agreement—which may also stipulate conditions under which the finance company can cancel your policy. Some that we have noted indicate that if either the insured or the insurance company becomes involved in any insolvency proceedings, they may cancel the policy. Obviously, this provision is too broad and could jeopardize your coverage significantly. Another notable provision states that the finance company will cancel the contracts if you become involved in any bankruptcy proceedings. Also, most cancellations for default are irrevocable. Finance agreements cannot be reinstated and late payments are applied to offset existing indebtedness only. Finance companies usually insist on the right to attach dividends, loss payments, or any monies due the insured from the carrier.

In simple terms, the finance company usually advances the full premium funds to the agent for delivery to the carrier. The agent or broker deducts the insurance commission and remits the balance to the carrier. The finance company uses the unearned premium (funds not yet due the carrier for coverage) as collateral. Down payments and monthly installments are scheduled to accrue sufficient unearned premiums to protect the finance company against loss in the event of default. This is one reason why certain policies usually cannot be financed. For example, any policy that requires the insured to "report" values or exposures periodically (say, monthly) throughout the policy year cannot be financed because the finance company cannot protect itself by accruing unearned premiums.

Organizations should rely on their agent or broker to provide the best alternatives. Further, most states require finance companies to file with state finance authorities—something you should certainly review. If a finance company fails, your coverage may lapse and credit for previous payments will not be recoverable. In addition to reviewing the finance company's financial integrity, be certain you are familiar with the cancellation provisions and the power of attorney clauses we referred to earlier.

With the availability of premium financing arrangements, insurance programs that were thought to be unaffordable for your organization may in fact be a viable option. ■

Harry P. Mirijanian is president of Applied Risk, an independent risk management services firm established to assist the business community in reducing exposure to loss and insurance costs. He is a frequent speaker at AMA seminars.

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