

Flat Canceled Loans



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What does it mean to “Flat Cancel” a loan? Why is this done in some circumstances and not in others?

The definition of “flatting” a premium finance loan is to cancel the loan on the policy effective date. This means that there is no earned premium and no financing takes place. The effect of flat/canceling a loan is that the financing transaction is either completely reversed, or completely negated.

A loan is typically flat canceled for one of the following reasons:

1. The borrower chooses not to finance the policy.

In most states, after a borrower signs a premium finance agreement, he/she is given the option of disaffirming (“undoing”) the finance transaction. If the borrower chooses to disaffirm their request for financing, the premium finance company will flat/cancel the loan and notify all parties involved that they are no longer a party to the transaction.

2. The policy terms upon which the premium finance company based its decision to approve the premium finance agreement have changed and the new terms are unacceptable to the premium finance company.

It is important to understand that a premium finance agreement is not a loan agreement as many people think it is. Actually, it is an application for a loan which becomes a loan agreement if the premium finance company accepts it and the borrower does not disaffirm it.

When a premium finance agreement is received by a finance company, certain underwriting procedures will be performed. These include verification of the down payment, APR, number of installments, the names of the carriers (to determine what the ratings are) checking for signatures, and a myriad of other items. Once this is complete, the premium finance company may elect to accept or reject the application.

If the finance company chooses to accept the loan, a Notice of Acceptance will be mailed to the borrower

and the agent and a Notice of Financed Premium will be mailed to the carrier.

When would this happen? Here is an example using a type of loan other than premium finance:

Assume that John went into his bank for an automobile loan. John was looking to borrow money to purchase a used car which cost \$25,000.00. Assume further that the bank agreed to make the loan. All the paperwork is prepared and signed, but, before the bank gives John the money, John must show the bank the car. What do you think would happen if John brought the car to the bank and the car had a huge dent in the side that was estimated to cost \$5,000.00 to repair? You guessed it, the bank would reverse its promise to make the loan (or possibly make a smaller loan). Why? Because the car was the bank’s collateral and the actual value of the collateral was not what John reported it to be when the bank agreed to make the loan.

Now, let’s apply this to premium financing. We know that the unearned premium is a finance company’s collateral in a premium finance loan. So, if the value of the unearned premium was not what the finance company thought it was when it accepted the loan, it might choose to flat/cancel the loan. Here are some things that might cause the unearned premium to have a different value than was first thought:

- The policy had a minimum earned premium of 30% which was not disclosed on the premium finance agreement (meaning that the available unearned premium upon cancellation might be lower than expected.)
- The policy premium listed on the premium finance agreement was incorrect (if the premium is higher, the required down payment would be higher.)
- The insurance carrier listed on the PFA was not correct (although this does not change the dollar amount of the unearned premium, if the carrier had a lower rating, there is more risk to the finance company.)



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3. The insurance carrier will not honor the finance company's request to cancel the policy.

Why is this important? Well, we know that premium is earned every day and that when a borrower does not make his/her payment, a cancellation notice is mailed which stops the premium from being earned (and consequently stops insurance coverage). If a finance company could not stop the premium from being earned thereby locking in the amount of the unearned premium, there is no certainty regarding the value of the collateral (this is like a bank making a car loan but not having the right to repossess the car if the borrower doesn't pay). If a carrier will not honor a finance company's request for cancellation, the premium cannot be financed.

Some insurance carriers like to finance their own policies and try to discourage outside financing. This would be the same as General Motors making it easy to finance through GMAC but difficult to finance through Bank of America.

Obviously, this is not ethical and in most cases, it isn't tolerable. However, the insurance premium loan industry is very small in comparison to other industries and sometimes insurance carriers simply get away with this discriminatory practice.

There are a few other reasons why a loan is flat/canceled but the above three reasons are the most common.

A loan can be flat canceled anytime during its life provided all the funds advanced by the finance company are returned to the finance company and all of the monies paid by the borrower are returned to the borrower.

Remember that a flat cancellation requires the policy to be canceled as of the policy effective date. Only the insurance carrier can do this. Often times, however, an insurance carrier will not want to cancel the policy as of the effective date because that means that insurance coverage which was once in place is now retroactively taken away. This opens up the possibility of a lawsuit if the borrower files a claim and the carrier has retroactively retracted coverage.

The rule more often than not is that flat/cancellations will most likely occur before the financing takes place as opposed to after. However, as described above, this can

occur after the loan has been funded and sometimes even after the borrower has begun to make payments.



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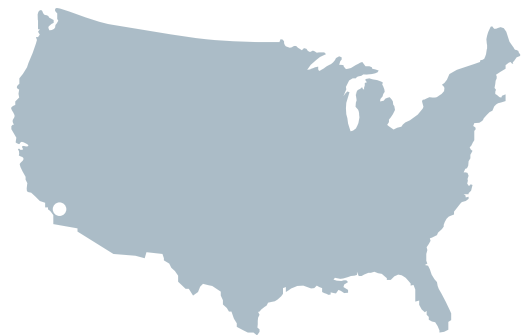
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