

PUBLICATION

Insurance Premium Financing and the Effect of Bankruptcy and Restructuring Stays

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Insurance Premium Financing Insurance premium financing is a type of short term financing where a third party lender or insurance broker can finance the upfront cost of an insurance policy and use the insurance premiums that have yet to be earned by the insurance company to secure the loan. The authority for this system of lending is derived from the various pieces of provincial insurance legislation, which in Alberta, is found in the Insurance Act RSA 2000, c I-3 (the "Insurance Act"). Specifically, section 535 of the Insurance Act provides that an insured may assign its right to a refund of unearned premiums from its insurance policy to a third party. It is these unearned premiums that act as security for the lender. In the event of default in payment by the borrower at any point during the term of the policy, the lender may send notice to the insurance company terminating the policy and requiring that the unearned premiums from the remaining term of the policy are paid directly to the lender.

Insurance Act

Assignment of premium refund 535(1) If an insured assigns the right to a refund of premium that may accrue by reason of the cancellation or termination of a contract under the terms of the contract and notice of the assignment is given by the assignee to the insurer, the insurer must pay any refund to the assignee despite any provision in this Act or condition in the contract, whether established under this Act or not, requiring the refund to be paid to the insured or to accompany any notice of cancellation or termination to the insured.

Status of Assignment of Interest

Something that may become more frequent given the current economic environment, realization on this security may not be as straight forward from a troubled borrower. In the event the borrower seeks the protection of Bankruptcy and Insolvency Act RSC 1985 c B-3 (the "BIA") or Companies' Creditors Arrangement Act RSC 1985 c. c-36 (the "CCAA"), there is the added difficulty of accessing the security as a result of the stay of proceedings over the borrower. These stays can act to prevent creditors from seizing assets or taking steps to recover debts owed by the borrower until a collective action of the creditors can be arranged. The effect of a stay is a particularly important issue for a lender secured by unearned insurance premiums, as any delay in recovery reduces the amount of the security. Effectively, less unearned premiums are available to the lender as time passes. Given this time sensitivity, it is important to ensure that a stay will not impact a lender's security.

In insolvency proceedings, particular creditors, those with a secured interest in the insolvent individual's assets may be able to avoid the stay and realize on their security. This then raises the question: Is a lender secured by unearned premiums considered to be a secured creditor?

Most secured priorities in Alberta are determined by the Personal Property Security Act RSA 2000, c P-7 (the "PPSA"). In order to ensure priority and a secured interest in a particular asset of a debtor, secured parties are required to take steps to perfect their security interest. A common method of perfection is through registration of the interest at the Personal Property Registry. This can be particularly cumbersome for a shorter term insurance lender.

Fortunately, subsection 4(c) of the PPSA, subsequently confirmed in *Stelco, Re.1*, exempts an insurance lender from this registration requirement. In that case, the Ontario Court of Appeal clarified that the assignment of an interest in unearned insurance premiums under the Ontario Insurance Act did qualify for the exemption from the Ontario PPSA, and as such, did not require the lender to register. As the Alberta legislation is similar to the Ontario legislation in all material respects, this case confirms that the insurance lender does not need to register its interest in order to be secured by the unearned insurance premiums. Note, that as this interest is created through the Insurance Act, it is important that the lender conform with all requirements contained in the act.

Personal Property Security Act

Non-application of Act

4 Except as otherwise provided under this Act, this Act does not apply to the following:

(c) the creation or transfer of an interest or claim in or under any policy of insurance, except the transfer of a right to money or other value payable under a policy of insurance as indemnity or compensation for loss of or damage to collateral;

Bankruptcy

While the *Stelco, Re* decision makes it clear that insurance lenders are secured creditors, it did not determine priority between the perfected security interest in the PPSA and the non-PPSA insurance premium security interest. Unfortunately, by the time the Ontario Court of Appeal heard the appeal, the insurance policy that was the subject of the decision had expired and there was no reason for the court to rule on the priority between secured creditors. While this leaves the law somewhat unclear, our position on the matter is that the priority of the interest in unearned premiums should be treated similarly to a purchase money security interest ("PMSI") under the PPSA. Given that an insurance lender cannot register under the PPSA and avail itself of the PMSI; and further, that similar to a PMSI registration, without the funds from the lender, the borrower would not be able to purchase insurance, it is our position that the insurance lender should have priority to the unearned premiums over any prior perfected PPSA security interest. Further, extraneous discussion in the case law, leads us to believe that if this matter is ever considered by a court our position would be confirmed. Thus, in a bankruptcy, an insurance lender should be entitled to apply to court to obtain an order partially lifting the stay of proceedings to allow for the termination of the insurance policy.

Restructuring

As an alternative to bankruptcy, a debtor may initiate a proposal for restructuring under the BIA or, if the proposal is more complicated or the debtor is larger, then the CCAA. These restructurings pose a slightly different problem than the bankruptcy proceedings, as the goal of the restructuring process is to allow the debtor time to deal with their debts so that they may continue to operate. The difference in goals is important as insurance is often a vital element in an operating business. If the court were to allow the insurance policy to

be terminated, then the borrower would be unable to operate and almost certainly be pushed into bankruptcy.

Not unexpectedly, courts are reluctant to allow the termination of insurance policies in these situations despite the detrimental impact it would have on the insurance lender. In order to deal with this prejudice to the lender, the court in *Arclin Canada Ltd., Re2* granted an interim order to require the borrower to continue paying the lender's monthly loan payments during the stay. This allowed the borrower to continue operations, thereby preserving the borrower's assets while the creditor proposal was being prepared, while also avoiding serious damage to the lender's position. To obtain such an interim order, a lender must show that it is particularly prejudiced by the stay. Owing to the diminishing value of its security, this requirement is often met. Given the beneficial nature of this trade off, our position is that *Arclin Canada Ltd., Re* will continue to be followed and rather than allowing the stay to be lifted to terminate the policy, a court will look favourably on an application which would require the borrower make its loan payments to the insurance lender until such time as a proposal can be put in place and the stay can be lifted.

Summary

While the law surrounding insurance premium financing has not been entirely mapped out, given the decisions over the past decade, it appears to be relatively settled. As a secured creditor, an insurance premium lender should be entitled to an order partially lifting a stay in bankruptcy to allow for the termination of an insurance policy and payment of the secured, unearned premiums. As well, in the event of a stay of proceedings in a restructuring, given the value of the insurance policy to the borrower, and the substantial prejudice that could result to the lender, courts have looked favourably on, ensuring continued payment to the insurance premium lender in order to support the continued insurance coverage. Based on this, we expect that an insurance lender should be protected even in these tumultuous times.

For further information please contact the author, Garrett Hamilton or any member of our Corporate | Commercial Group.