Commercial Lines Insurance Premium Finance

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Introduction

Insurance premium finance is a well established, high margin, high growth commercial lending activity associated with low credit quality costs. We estimate the commercial segment has grown to roughly $45 billion of annual originations.

The insurance premium finance industry is well positioned to continue its expansion despite rising interest rates and an anticipated recession. Historically, property and casualty insurance premiums have exhibited steady growth, registering a 5.3% CAGR from 2011 to 2021. Recently, high inflation and a selloff in the equity markets have pressured insurance carriers into raising premiums to maintain reasonable risk adjusted returns, sustaining a hard insurance market. In 2021, commercial P&C premiums exhibited the largest year over year increase since 2012. Although a recession may reduce overall exposures in the U.S., the increased need of small businesses to borrow in a downturn coupled with rising insurance premiums will continue to expand the premium finance market.

Insurance premium finance is a pillar of commercial lending, financing mission critical insurance products for small businesses. Premium finance lenders generate short duration, collateralized, low loss assets. The insurance premium finance asset class represents a defensive opportunity for lenders and borrowers alike. From the borrower's perspective, insurance premium financing presents a cash flow management tool, which is especially valuable in the current environment of tightening monetary policy. As a highly collateralized, short duration (9-10 months average maturity) fixed rate loan, generally priced at a spread over Prime, insurance premium finance represents a safe avenue for lenders to deploy capital at attractive risk adjusted returns.

Over the past two decades, continued industry consolidation has created a bifurcated competitive landscape in which a limited group of large players have amassed significant market share compared to the fragmented universe of smaller players. AFCO's recent acquisition of BankDirect (#4 participant) further concentrated the Big Four into the Big Three, comprised of IPFS, AFCO and FIRST. Although AFCO gains significant volume in the acquisition, the next tier of bank owned lenders will likely benefit disproportionately, as larger insurance agencies previously serviced by AFCO and BankDirect may choose to diversify. The top three players now command an estimated 80% market share.

M&A activity in the premium finance industry is likely to remain strong despite anticipated macroeconomic headwinds. Deposit-rich banks seeking an avenue for the safe deployment of capital are drawn to premium finance due to the conservative nature of the underlying asset. Conversely, banks with lower levels of deposits that are already in the industry may consider divesting their portfolios to preserve liquidity and improve capital ratios in a tightening monetary policy environment.

Current Market Trends

1. *Large, growing market*. Commercial insurance premiums grew rapidly in 2021, presenting significant growth in premium financing volume. We estimate the market has grown over 28% to $45 billion from $35 billion in annual originations since our November 2019 report

2. *Excellent asset class for banks*. Low cost of funds and large balance sheets provide bank owned premium finance companies a strategic advantage. Nonetheless, the market is led by privately held Imperial PFS, a serial acquirer and issuer in the capital markets

3. *Bifurcated competitive landscape creates opportunities for smaller players*. The Big Three command an estimated 80% market share and are largely focused on the upper end of the credit spectrum, still leaving an estimated $9 billion of annual volume for smaller players. AFCO's recent acquisition of BankDirect creates an opportunity for smaller players to gain market share as large agencies may diversify to smaller, more nimble lenders

4. *Q4 Market Update*. On an aggregate basis, our index reported a 4.3% quarterly increase in outstandings and a 23.3% year-over-year uptick for the industry

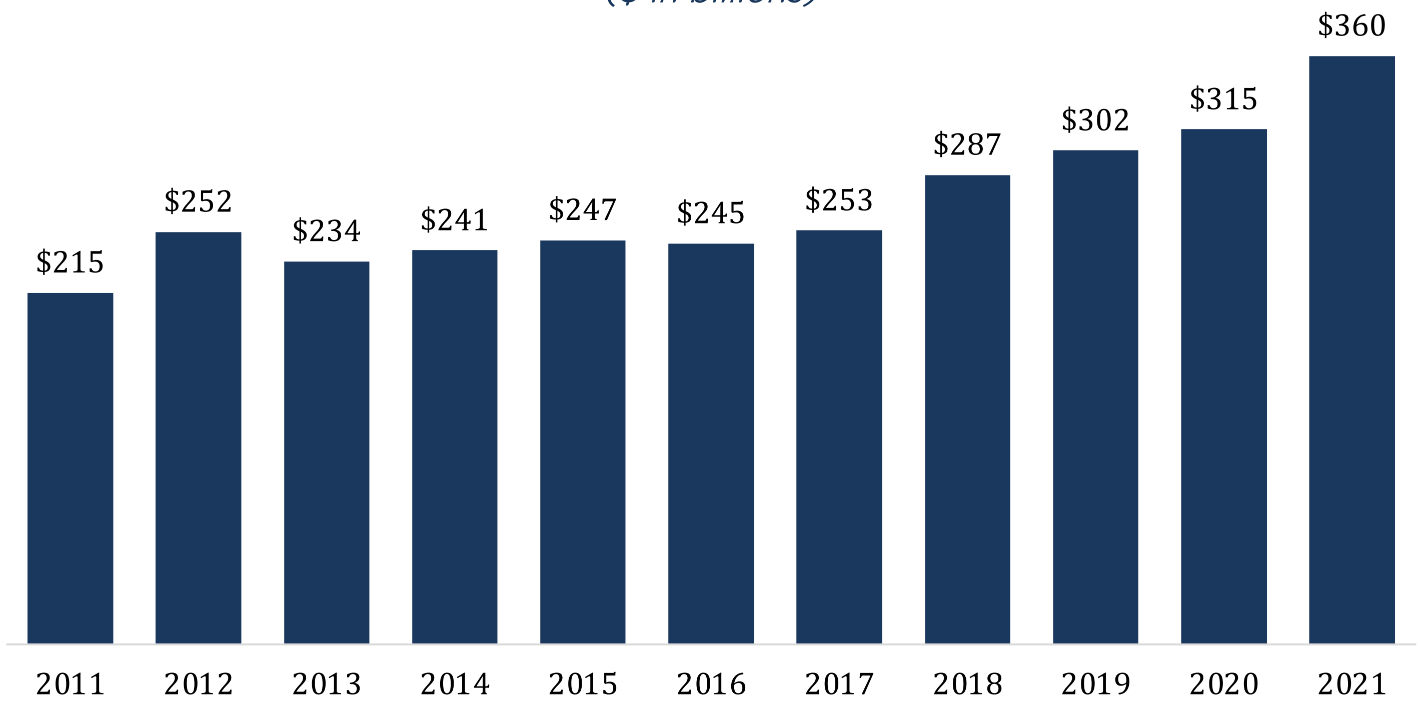
1 Large, growing market. Inflation is accelerating premium growth, increasing borrowing needs.

Commercial property and casualty insurance premiums have grown at a 5.3% CAGR over the last decade to $360 billion in 2021 from $215 billion in 2011. Higher insurance premiums create greater lending opportunities with the same marginal origination cost.

Growth in the P&C industry is accelerating, spurred by inflationary pressures. Commercial P&C insurance premiums increased 14.2% in 2021 to $360 billion, the largest increase since 2012. The hard insurance market has caused the P&C premium finance industry to expand to roughly $45 billion of annual originations. P&C premiums are likely to continue to grow at an above average rate into the near future as higher levels of inflation persist, strengthening the premium finance industry.

Commercial P&C Premiums

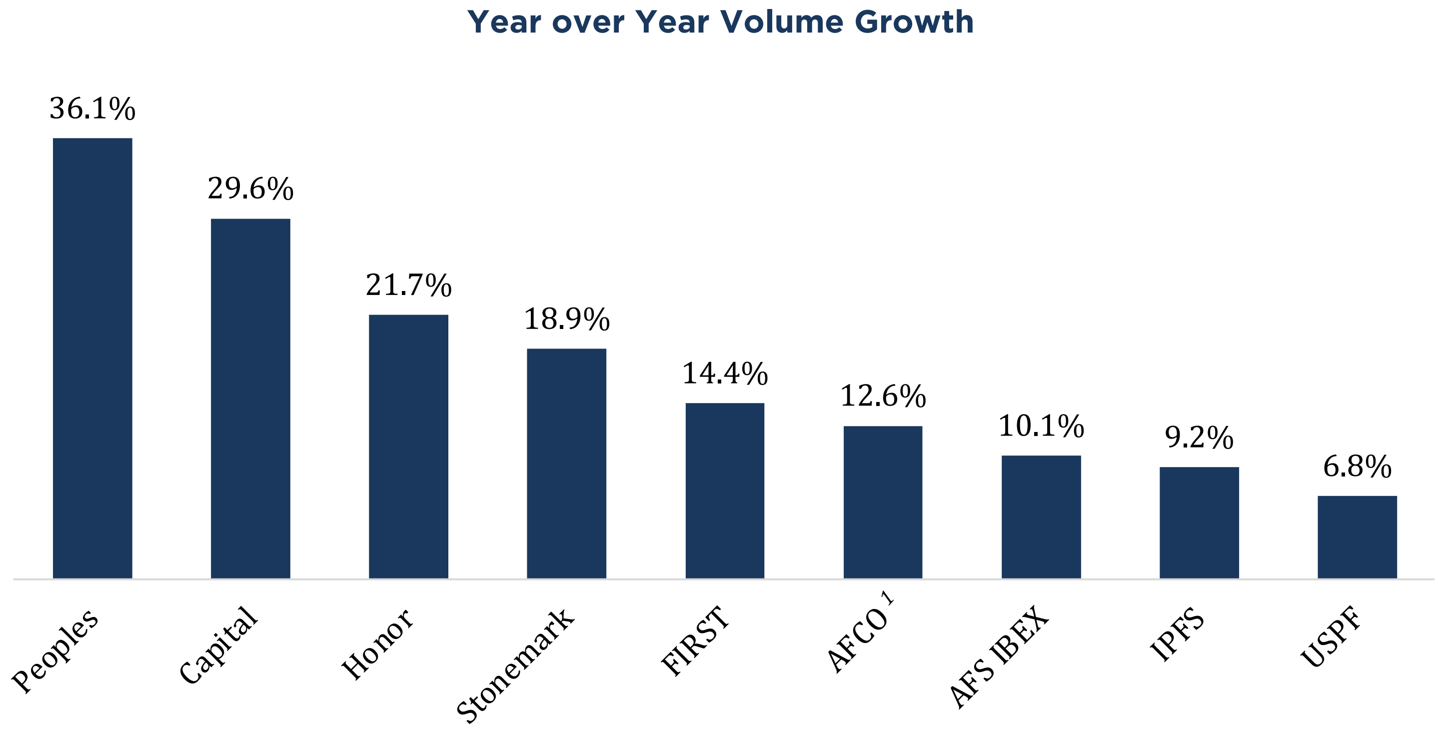
($ in billions)



Source: Insurance Information Institute (https://www.iii.org/graph-archive/all); SNL Financial

Not surprisingly, smaller players are growing faster than larger ones. We are particularly impressed with the growth rates of Peoples, Capital, Honor, and Stonemark, each of which is growing faster than the overall market. Disciplined execution and select key sales hires are enhancing equity valuations for these firms. Acquirers generally pay higher multiples for faster growing firms. We find that premium finance companies below $750 million of portfolio generate the highest transaction multiples, owing to the law of large numbers.

Also impressive, of course, is the 10%-15% growth of each of IPFS, AFCO, and FIRST on multi-billion dollar portfolios. These significant gains are accelerating the bifurcation of the market.



[1]AFCO volume growth excludes incremental originations associated with the acquisition of BankDirect
Source: SEC Filings, Regulatory filings, company presentations, Colonnade estimates

2 Excellent asset class for banks

Two macroeconomic pressures, inflationary and recessionary headwinds, generally provide opportunity for the premium finance industry. As highly collateralized and short duration loans, P&C insurance premium finance loans are largely insulated from interest rate and credit risk. Low credit losses on short duration assets generate a safe and lucrative opportunity for banks to deploy deposits.

Economic slowdowns generally prompt insureds to seek premium financing, as cash flow management becomes a greater priority in a tight economic environment, further increasing demand for premium financing among insureds.

Banks remain enamored with the asset class, creating a deep market of interested bank buyers. Few platforms exist for new entrants, however, creating scarcity value for sellers.

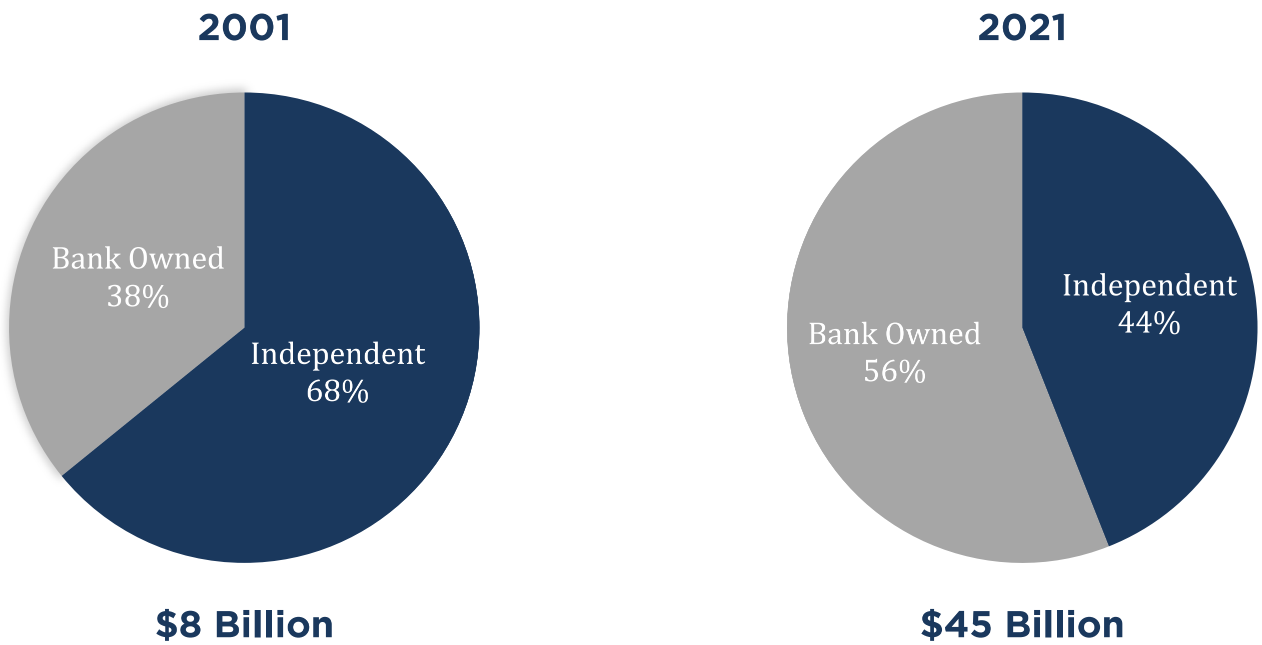
Short duration assets	• Loans typically have a nine- to ten-month term, and portfolios have an average life of five months with principal amortizing throughout the loan
Minimal credit losses	• Premium finance companies rely on the strength of the insurance carrier backing the underlying insurance policy as collateral. Commercial lines premium finance companies typically average annual net losses on the order of 10bps-30bps
Attractive loan spreads	• Loans are generally prices as a spread over Prime • Short-term, fixed rate loans re-priced every nine or ten months
Increased fee income	• Fee income derived from premium finance activities typically can reach 15% to 20% of gross revenue or 1% to 2% of earning assets
Growth in unit volume	• An indirect origination strategy leverages a finance company's direct sales force. High efficiency and number of loans per employee
Diversification of assets and earnings	• Premium finance loans diversify banks' commercial loan categories • Loans to insured borrowers with $1 million or less in revenue could count towards CRA requirements
High ROA and ROE	• High yields and low losses coupled with a strong efficiency ratio and operating leverage generate superior returns on assets and equity, well above other bank products
Competitive advantage via banks' access to capital and low cost of funds	• Bank-owned premium finance companies maintain a competitive funding advantage relative to independent operators

Banks dominate market share

When Colonnade started tracking the industry in 2001, the market was largely controlled by independents. In 2001, only four of the largest players were bank owned; most others were funded in the commercial paper conduit market. Of the dozen largest players at the time, all but three have since been consolidated. Between 2001 and 2013, a dozen banks entered the industry, and several properties traded hands during the financial crisis. By the end of 2013, the tables had turned, and banks controlled an estimated 60% of the commercial segment.

In late 2017, IPFS acquired Premium Assignment Corp (PAC), a top five player, from SunTrust, shifting nearly $3 billion of originations from bank owned to independent. That deal cemented IPFS' position as the largest player in the industry, having completed roughly 30 acquisitions since inception in the 1990s. IPFS' acquisition of PAC was significant, as was its acquisition of AICCO's $1.5 billion portfolio from AIG during the financial crisis.

Shifting market share of commercial lines insurance premium finance originations



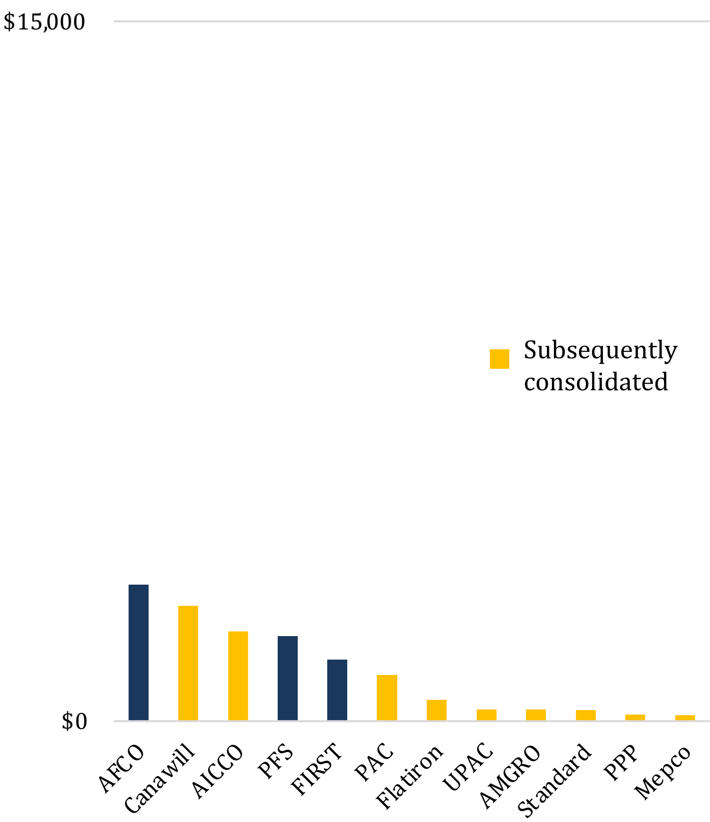
Source: SEC Filings, Regulatory filings, company presentations, Colonnade estimates

As of 2021, bank owned operators once again generate the majority of originations in the commercial lines P&C premium finance space. Large balance sheets and lower cost of funds generally enable banks to originate more aggressively than independents.

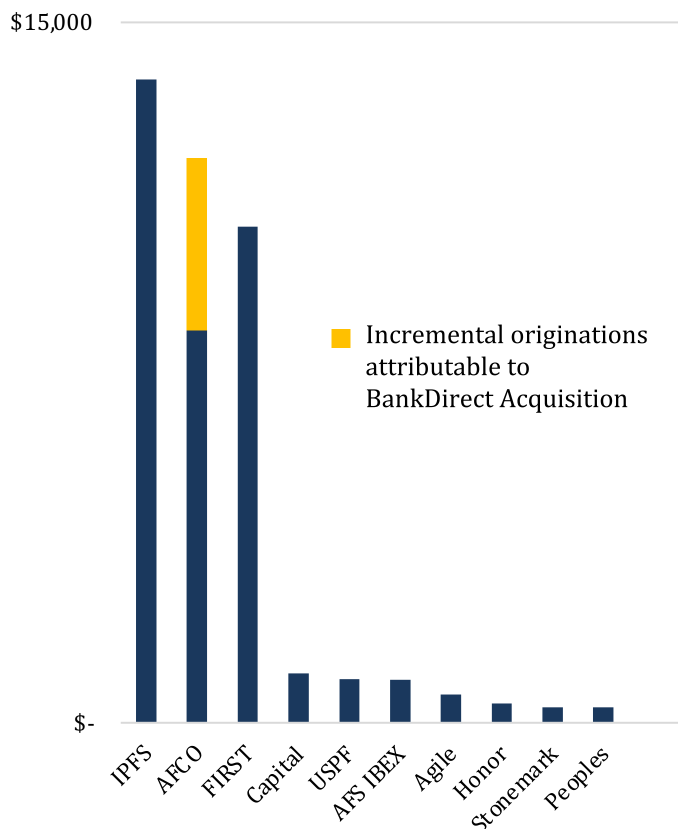
3 Massive industry consolidation creates a bifurcated market

There has been considerable industry consolidation over the past two decades, with nearly $10 billion of portfolios trading hands in the U.S. premium finance industry. Industry leaders IPFS, AFCO and FIRST have led the consolidation charge.

2001 Financing Originations
($ in millions)



2021 Financing Originations
($ in millions)



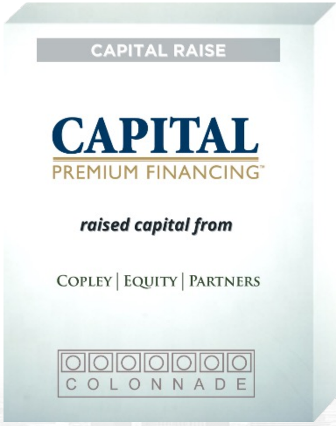
Source: SEC Filings, Regulatory filings, company presentations, Colonnade estimates

Over the past two decades, more than a dozen banks have entered the industry through acquisition or by inheriting a platform through a bank merger, only to subsequently divest their premium finance businesses to reallocate capital to other strategic, core business lines. We expect several smaller bank owned participants may change hands during this economic downturn.

The table below summarizes M&A activity within the insurance premium finance space in the last five years. Colonnade has been involved in nearly all of these deals, deepening our proprietary transaction database to guide our current and future clients.

Date	Buyer	Seller
Nov 2022	AFCO / Truist	BankDirect Capital Finance
Aug 2022	National Partners PFco (WebBank)	**Security Premium Finance Company**
Mar 2022	Copley Equity Partners (minority investment)	**Capital Premium Financing Inc.**
Jan 2022	Gracie Point Holdings (recap)	Honor Capital
July 2020	Peoples Bancorp	**Triumph Premium Finance (Triumph Bank)**
Mar 2020	Imperial PFS	SNAP Finance (Canada)
Apr 2019	WebBank (Steel Partners Holdings: SPLP)	**National Partners (MLF Financial Group)**
Apr 2018	HW Kaufman Group	**Stonemark Inc.**
Dec 2017	Imperial PFS	**Premium Assignment Corp (SunTrust)**
Jan 2017	Ameris Bank	**US Premium Finance (Brand Bank)**

Bold indicates Colonnade client



AFCO's acquisition of BankDirect creates opportunities for smaller players

AFCO's recent acquisition of BankDirect, which combines two of the four largest lenders in the industry, significantly accelerates industry consolidation. AFCO vaults from the number three to number two position. Yet smaller players may benefit disproportionately, as larger agencies may seek to diversify.

With the acquisition of BankDirect, the three largest lenders in the industry account for approximately 80% of originations. However, AFCO is unlikely to capture the full origination volume of BankDirect. Larger agents typically maintain relationships with several insurance premium finance companies to ensure a competitive bidding process for larger deals. Most large agencies have two to four approved providers of premium financing. The acquisition of BankDirect may encourage larger agents to seek new financing partners, giving smaller bank owned lenders the opportunity to gain share.

Truist discussed the motivation for the BankDirect transaction in its Q3 2022 earnings call:

> *"Strategically, BankDirect effectively doubles our premium finance business, broadens our capabilities to include life insurance and expands our West Coast presence. Pro forma, we estimate Truist Insurance Holdings will be the number two premium finance player after this deal closes later this quarter. BankDirect brings with it a $3.2 billion loan portfolio [including life] with strong projected growth, attractive profitability, limited credit risk and short duration."*
>
> -Mike Macguire, CFO of Truist Financial Corporation

Competitor Wintrust addressed the impact of the acquisition on the premium finance industry in its Q3 2022 earnings call. When asked if the BankDirect transaction represents an opportunity for market share growth, Wintrust executive David Dykstra responded:

> *"...If you lose a competitor in the space, that's good for us... So if Texas Capital sells to Truist, you now have one less competitor in that group of four. So generally, that's a positive for us. Number of our agents and brokers want multiple premium finance providers. And so if, for instance, they were using Texas Capital and Truist, then they're going to have to find another provider, and we would be a likely candidate for that...it's a competitive industry. You got to fight for every client, but we think it should be a positive just because of one less competitor in the marketplace.*
>
> -David Dykstra, Vice Chairman and COO of WinTrust

Strategic entry into the life insurance premium finance market

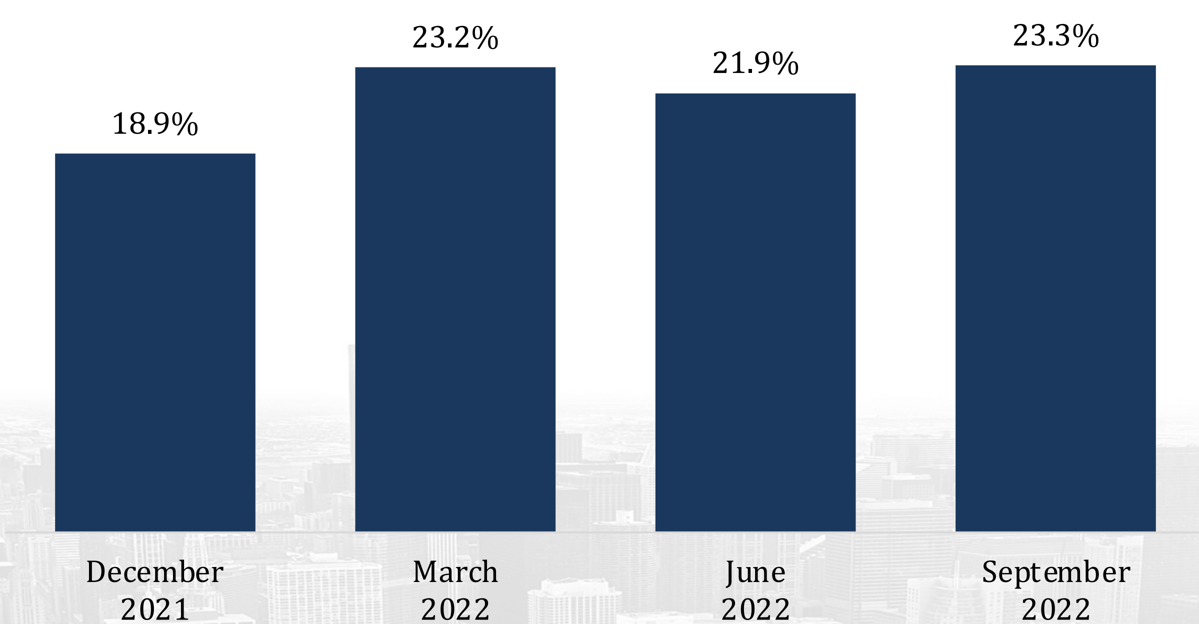
Truist's acquisition of BankDirect also cements a leadership position for AFCO in the life insurance premium finance market, a complementary asset class. An estimated one half of the BankDirect portfolio involved life insurance premium finance loans, which are generally longer duration (5-7 years), variable rate (reset annually based on a floating rate index and fixed for the following 12 months), and generate nearly zero losses, as the loans are collateralized by the cash surrender value of financed life insurance policies plus additional liquid collateral. BankDirect is a leading player in the life insurance premium finance market, dominated by Wintrust (FIRST), which reports more than $7 billion of loans in that segment. Truist's entry into life insurance premium finance lending is consistent with its insurance focus, particularly through its ownership of life wholesaler Crump.

4 Q4 P&C Premium Finance Update

Of the top ten firms, only four are owned by public banks that report segment data for their premium finance groups. On an aggregate basis, this group reported a 4.3% quarterly increase in outstandings and a 23.3% year-over-year uptick.

	Outstandings ($mm)	Q / Q Change	Y / Y Change
First Insurance Funding	$5,713	3.1%	23.7%
US Premium Finance (A Division of Ameris Bank)	1,063	12.8%	26.4%
AFS IBEX (A division of MetaBank)	480	(0.3%)	11.9%
Peoples Premium Finance	168	10.1%	24.4%
Aggregated Report	$7,424	4.3%	23.3%

Aggregate YoY Outstandings Growth



Despite macroeconomic headwinds, the insurance premium finance industry reported a healthy 23.3% annual growth in outstandings, underscoring the attractiveness of the premium finance asset class to both lenders and borrowers alike.

Wintrust recently communicated an optimistic outlook for its premium finance segment in its Q3 2022 earnings call:

> *"Premium finance will continue to do very well through next year."*
>
> -Richard Murphy Vice Chairman & Chief Lending Officer of WinTrust

> *"...Life loans are -- historically, if you look at it, at zero losses. And the P&C portfolio has relatively low losses."*
>
> -David Dykstra, Vice Chairman & COO of WinTrust

Ameris Bancorp echoed the conservative nature of the asset class, speaking to its insulation from interest rate risk in its Q3 2022 earnings call,

> *"Our premium finance book is about a 10-month duration. So, even though it's technically a fixed rate loan, it's going to reprice. So we're a little more asset-sensitive on the loan side from a variable rate perspective"*
>
> -Nicole Stokes, CFO of Ameris Bancorp

Outlook

The commercial lines insurance premium finance industry offers an attractive investment opportunity for commercial banks, in particular. The asset class has a track record of consistently delivering strong risk-adjusted returns with low credit losses. In a challenging macroeconomic environment, borrowers are likely to leverage premium financing to better manage cash flow and liquidity, accelerating growth for premium finance lenders.

Two decades of industry consolidation has resulted in a limited inventory of insurance premium finance operations available for acquisition. AFCO's recent acquisition of BankDirect has further consolidated the industry but has also given smaller players a significant opportunity to capture additional market share.

Despite liquidity challenges and macro factors, banks remain highly interested in the asset class. While we anticipate several smaller bank owned properties may be sold in this economic downturn, banks overall are buyers of this asset class.

Colonnade is the leading advisor to the insurance premium finance industry

SELLSIDE
SECURITY PREMIUM FINANCE, INC
has been acquired by
NATIONAL PARTNERS
a subsidiary of
WebBank
COLONNADE

CAPITAL RAISE
CAPITAL PREMIUM FINANCING
raised capital from
COPLEY | EQUITY | PARTNERS
COLONNADE

SELLSIDE
MEPCO insurance premium financing
was sold to
INDEPENDENT BANK
COLONNADE

SELLSIDE
MEPCO
a subsidiary of
INDEPENDENT BANK
was sold to
SEABURY CAPITAL GROUP
COLONNADE

BUYSIDE
IMPERIAL PFS
acquired
MEPCO
the Premium Finance subsidiary of
INDEPENDENT BANK
COLONNADE

SELLSIDE
STONEMARK Premium Finance Group
was sold to
Kaufman
COLONNADE

CAPITAL RAISE
CAPITAL PREMIUM FINANCING
raised capital from
Ameris Bancorp
COLONNADE

SELLSIDE
CAPITOL PAYMENT PLAN
was sold to
IMPERIAL PFS
COLONNADE

SELLSIDE
Premium Payment Plan
a division of
FIRST NIAGARA
was sold to
WELLS FARGO
COLONNADE

SELLSIDE
upac
a subsidiary of
FIRST BANK
was sold to
IMPERIAL PFS
COLONNADE

SELLSIDE
NATIONAL PARTNERS
was sold to
WebBank
COLONNADE

SELLSIDE
BIC Budget Installment Corp
a subsidiary of
Webster Financial Corporation
was sold to
TEXAS CAPITAL BANK
COLONNADE

SELLSIDE
FLATIRON CAPITAL CORP
a division of
TD
was sold to
WELLS FARGO
COLONNADE

SELLSIDE
PREMIUM ASSIGNMENT CORPORATION
a subsidiary of
SUNTRUST
was sold to
IMPERIAL PFS
COLONNADE

SELLSIDE
TRIUMPH PREMIUM FINANCE
a division of
TRIUMPH
was sold to
Peoples BANK Working Together, Building Success
COLONNADE

SELLSIDE
AMGRO PREMIUM FINANCING
a subsidiary of
The Hanover Insurance Group
was sold to
IMPERIAL PFS
COLONNADE

SELLSIDE
AFS IBEX
was sold to
MetaBank
COLONNADE

SELLSIDE
CANANWILL PREMIUM FUNDING
a subsidiary of
AON
was sold to
MACQUARIE
COLONNADE

SELLSIDE
CANANWILL PREMIUM FUNDING
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SELLSIDE
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Allianz
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SELLSIDE
CANANWILL PREMIUM FUNDING
a subsidiary of
AON
was sold to
BB&T
COLONNADE

SELLSIDE
BROADWAY PREMIUM FUNDING CORP
a portfolio company of
Sumitomo Corporation of America
was sold to
WINTRUST
COLONNADE

SELLSIDE
upac
was sold to
FIRST BANK
COLONNADE

CAPITAL RAISE
CAPITAL PREMIUM FINANCING
raised capital from
TEXAS CAPITAL BANK
COLONNADE

SELLSIDE
US PREMIUM FINANCE
A DIVISION OF AMERIS BANK
was sold to
Ameris Bancorp
COLONNADE

CAPITAL RAISE
gotoPremiumFinance
a subsidiary of
INPUT 1
raised capital from
BMO Harris Bank
COLONNADE

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This advertisement was prepared December 2022. It is not investment advice, and Colonnade undertakes no obligation to update the information contained herein.

Sources:

1. Regulatory Filings
2. SEC Filings
3. Company Presentations
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8. Truist Q3 2022 Earnings Call (https://seekingalpha.com/article/4547234-truist-financial-corporation-tfc-q3-2022-earnings-call-transcript)