Insurance Premium Finance

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Commercial Lines Insurance Premium Finance

A Growth Asset Class for Commercial Banks

Strong U.S. commercial banks – flush with deposits, pursuing loan growth, and in good standing with regulators – are actively seeking to acquire specialty commercial finance platforms. Banks are attracted to specialty commercial finance businesses that offer high yields, diversification of assets and earnings, and returns that are superior to their core banking business. Asset-generating platforms such as insurance premium finance are in high demand.

Colonnade estimates that the U.S. commercial lines insurance premium finance industry totals approximately $30 billion of volume annually and has grown at a compound annual rate of 4% over the past 12 years. Growth of the premium finance market is tied to the property and casualty insurance industry. In times of market dislocation, however, growth in the premium finance industry can exceed the overall P&C market.

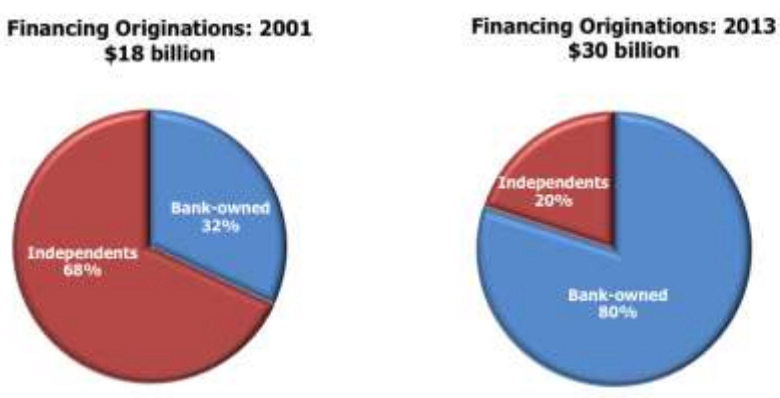
The insurance premium finance industry has consolidated massively over the past twenty years, transforming a cottage industry to one dominated by large financial institutions. The top six market participants control 75% of the commercial lines premium finance industry; all but one are owned by banks.

Industry consolidation has left few opportunities for banks to enter the industry through acquisition. Few independent national platforms remain, but several regional players are rapidly gaining market share by hiring qualified salespeople that are available due to the fallout of recent large acquisitions. As these smaller firms approach $100 million of assets, many will become acquisition targets for financial institutions.

The scarcity of platform acquisition targets available to the broad range of interested buyers – which also includes private equity firms – creates a favorable environment for sellers of established commercial lines insurance premium finance companies. We expect the next generation of emerging platform companies to generate considerable attention among buyers as they approach critical mass.

Rationale for bank ownership

Insurance premium finance is a well-established, high margin, high growth commercial lending activity that generates low credit quality costs. A dozen U.S. commercial banks have entered the industry since 2000, with commercial banks now controlling more than 80% of all commercial lines insurance premium finance volume, up from only 32% in the year 2001.



Regulatory filings and Colonnade estimates

Positive fundamentals for banks

Short duration assets	• Loans typically have a nine-month term and 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 10-30bps
Attractive loan spreads	• Loans are generally priced as a spread over Prime
Increased fee income	• Fee income derived from premium finance activities typically can reach 15%-20% of gross revenue or 1%-2% of earning assets
Growth in unit volume	• An indirect origination strategy leverages a finance company's direct sales force
Diversification of assets and earnings	• Premium finance loans diversify banks' commercial loan categories
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
Efficiently deploy capital in a high margin lending business	• Commercial lines insurance premium finance companies generally contribute 2% to 4% pretax return on average assets, well above traditional commercial lending activities
Build franchise value independent of the bank	• Specialty finance units can generate superior returns and incremental equity value with and apart from the bank franchise

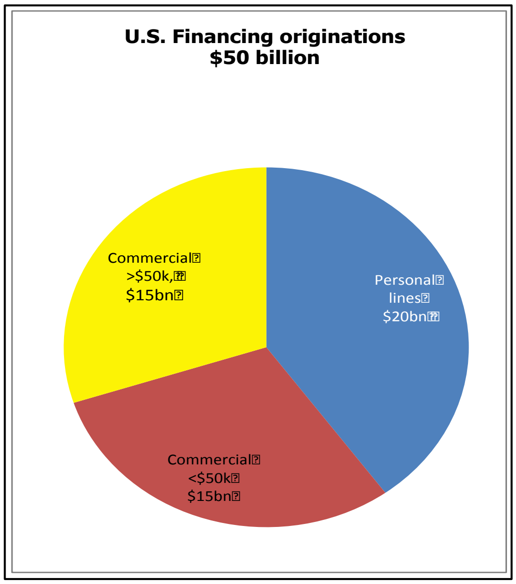
Premium finance industry

Insurance premium finance companies provide short-term, collateralized financing to facilitate the purchase of insurance for commercial property, casualty and liability risk. Insurance brokers/agents typically quote P&C insurance in terms of an annual premium for a level of coverage at a certain deductible. The entire premium usually is due within 30 to 60 days of the effective date of coverage. To manage cash flow and credit lines, some businesses choose to finance the purchase of insurance coverage with premium finance companies. Premium finance companies assume no risk of loss on policy claims; all claims are borne by the insurance carriers.

Premium finance companies utilize an indirect origination strategy, relying on relationships with insurance brokers and agents to drive financing opportunities. Brokers and agents are often compensated for referrals through commissions, as regulated by individual states. Long term relationships with brokers and agents result in recurring interest and fee income for premium finance companies.

Market size

Colonnade estimates that nearly 15% of the $235 billion of U.S. commercial P&C insurance premiums were financed in 2013, generating approximately $30 billion of financing originations. The commercial lines premium finance industry can be further segmented between large commercial loans (above $50k) and small commercial loans (below $50k). The combined personal and commercial lines premium finance industry is estimated to exceed $50 billion in annual originations.



Industry highlights

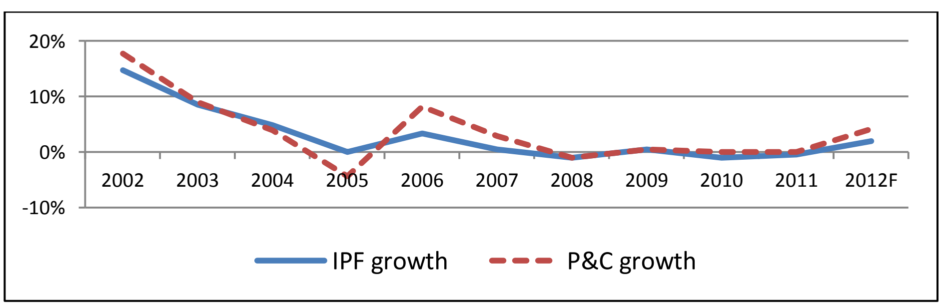
- U.S. commercial lines P&C industry: $235 billion of premiums
- U.S. commercial lines premium finance originations estimated at $30 billion; total industry estimated at $50 billion
- Over 1,000 premium finance companies compete in the U.S.
- Top six U.S. players account for more than 40% of total originations and 75% of commercial lines volume
- International markets are considerably smaller and highly concentrated

Fitch Ratings and Colonnade estimates.
Assumes 15% of all premiums financed, 15% down payment

The United States P&C industry totaled an estimated $235 billion of net commercial lines premiums written in 2013, an increase of 1.6%, according to Fitch Ratings, a global credit rating agency. Although cyclical, the P&C market has increased at a compound annual rate of 5% over the past 30 years and a 3% rate over the past ten years.

Growth of the premium finance industry is tied to the P&C industry. In times of market dislocation, however, growth in the premium finance industry can exceed the overall P&C market. Double-digit premium hikes and a tight credit market can drive significant unit volume growth in the premium finance industry as more companies seek to finance the increased premiums. In addition, when credit markets are tight, hundreds of small premium finance companies, typically affiliates of insurance agencies, have difficulty finding capital for growth and forfeit market share to better-capitalized companies.

Growth rates of commercial lines P&C and insurance premium finance markets



Fitch Ratings and Colonnade estimates

Improved pricing in the commercial lines P&C market is expected to strengthen industry profitability. Anticipated interest rate increases are likely to benefit industry players. We expect market leaders to generate superior returns over the next several years. Owners of smaller firms may seek to capitalize on improved operating conditions by evaluating exit opportunities.

Competition

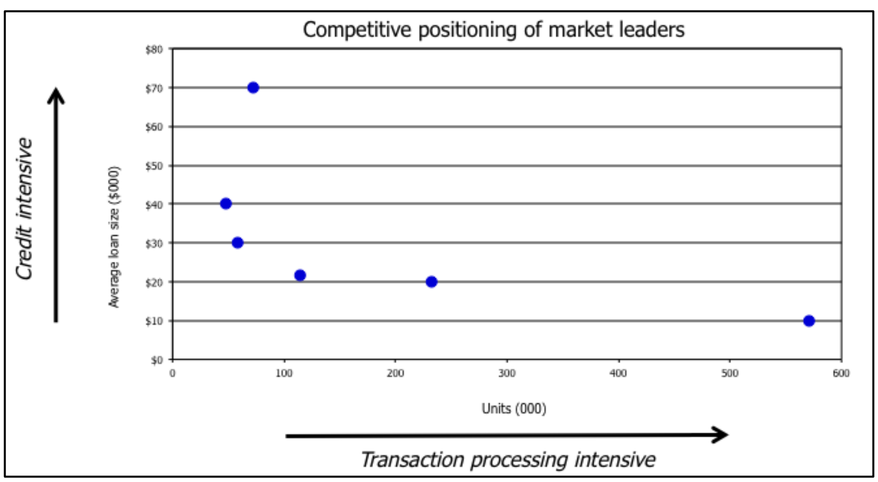
Over 1,000 companies are licensed to operate in the premium finance industry in the U.S., few of which have the capacity to serve national and large regional insurance brokerage firms. Most premium finance companies will extend credit on a wide range of transaction sizes, for both personal and commercial policies.

The U.S. market for premium finance companies is three-tiered. The first tier is composed of national premium finance companies, primarily owned by large financial institutions. Seven of the top ten premium finance companies are owned by commercial banks. The second tier is comprised of regional premium finance companies owned by entrepreneurs, smaller financial institutions or managing general agencies. These firms typically have strong penetration and loyalty within a certain geographic region and gradually seek to expand nationally, provided sufficient access to low cost capital. The third tier includes hundreds of small, local premium finance companies, particularly affiliates of insurance agencies.

The table below illustrates the largest providers of premium financing in the United States. Each originates well in excess of $1 billion annually.

	Company (headquarters)	Ownership
1	Imperial PFS (KS)	Private
2	AFCO Credit Corp. (NY) and Prime Rate (SC)	BB&T Corp. (NYSE: BBT)
3	FIRST Insurance Funding (IL)	Wintrust Financial (NASDAQ: WTFC)
4	Premium Assignment Corp. "PAC" (FL)	SunTrust (NYSE: STI)
5	Flatiron Capital (CO)	Wells Fargo & Co. (NYSE: WFC)
6	BankDirect Capital (IL)	Texas Capital Bancshares (NYSE: TCBI)

Premium finance companies differentiate themselves in terms of the markets they serve. Larger premium finance companies often target larger insurance agencies, which typically represent more sophisticated borrowers with higher financing needs. This market can be characterized as price-sensitive and generally involves some level of credit underwriting expertise to mitigate exposure. Premium finance companies that serve this market are expert at credit evaluation and offer flexibility on terms and a high level of service. At the other end of the spectrum, commercial lines premium finance companies focused on the middle market generally achieve higher yields and offer more standard terms with fewer opportunities for credit risk. Most premium finance companies maintain a portfolio of large and small ticket business to achieve a balanced risk / reward profile.



Mergers & acquisitions activity

The U.S. insurance premium finance industry has consolidated massively in the past two decades, with nearly $10 billion of assets having changed hands. Several larger players have acquired scores of mid-sized premium finance companies; and a dozen U.S. financial institutions have entered the industry through acquisitions.

Date	Buyer	Seller
Jan 2015	Cinven (UK)	Premium Credit Ltd (UK) from GTCR
Dec 2014	Meta Bank Financial Group (CASH)	**AFS/IBEX Financial Services**
Oct 2012	GTCR	Premium Credit Ltd (UK) from Bank of America
Feb 2012	Wintrust Financial / FIRST	Macquarie Premium Finance (Canada) from Macquarie Group
Jun 2011	BankDirect Capital (TCBI)	Standard Funding Corp from New York Community Bank (NYCB)
Jun 2010	Flatiron Capital (WFB)	**Premium Payment Plan from First Niagara (FNFG)**
Feb 2010	Premium Financing Specialists (PFS)	AICCO from AIG
Dec 2009	Premium Financing Specialists (PFS)	**UPAC from First Banks**
Nov 2009	BankDirect Capital (TCBI)	**Budget Installment Corp (BIC) from Webster Financial (WBS)**
Sep 2009	Macquarie Premium Funding	**Cananwill's Canadian business from Aon**
Sep 2009	Macquarie Premium Funding	**Cananwill's UK and Ireland businesses from Aon**
Jul 2009	Allianz	**Cananwill's Australian business from Aon**
Feb 2009	BB&T Corp. (BBT)	**Cananwill (U.S.) from Aon Corporation (AOC)**
May 2008	Wells Fargo & Company (WFC)	**Flatiron from Toronto-Dominion (TD)**
Feb 2008	Premium Financing Specialists (PFS)	Payments Inc. from DCAP
Nov 2007	Wintrust Financial / FIRST	**Broadway from Sumitomo Corp. of America**
Aug 2007	Premium Financing Specialists (PFS)	SCR Premium Budget
Mar 2007	Macquarie Group	Insurance Pay Canada
Jan 2007	**Premium Financing Specialists (PFS)**	Mepco (premium finance) from Independent Bank Corp (IBCP)
Jan 2007	BB&T Corp. (BBT)	AFCO Credit Corp / CAFO from Mellon (MEL)
Nov 2006	Premium Financing Specialists (PFS)	**Capitol Payment Plan**
May 2006	First Banks	**UPAC**

-- Colonnade's clients in bold --

Entering the business

As financial institutions evaluate the buy versus build decision, it is critical to balance the risks and opportunities of a de novo enterprise versus acquiring an existing platform. The current scarcity of attractive platforms, however, is driving several financial institutions to strongly consider hiring teams and/or committing internal resources to build insurance premium finance platforms from scratch, particularly those banks that have an insurance agency and/or opportunities to direct captive flow.

	Risks/Challenges	Benefits
De novo	• Finding talent • Time to achieve critical mass • Acquisition and implementation of new systems and controls • Fraud prevention • State licensing	• No inherited liabilities / frauds • Avoid legacy systems
Acquire mid-size platform company	• Typically regional in scope • Scalability of systems and controls • Skill set of management team to handle growth • Integration of bolt-on acquisitions • Inherited liabilities / frauds • Valuation • Management retention	• Management and salesforce have strong local / regional market knowledge • Systems / controls in place • Nearing critical mass • Track record • Typically not bank-compliant
Acquire large platform	• National players often focus on larger loan sizes • Greater management infrastructure required • Inherited liabilities / frauds • Valuation • Management retention	• Strong management teams • Typically national in scope, often with several strong regions • Scalable systems / controls • Critical mass • Acquisition and operating track record • Typically bank-compliant

Outlook

The commercial lines insurance premium finance industry presents a compelling investment opportunity for commercial banks. Several large financial institutions have a long, successful history with the asset class, enjoying the high yields, short duration and low loss rates.

Although recent consolidation has significantly reduced the inventory of properties available for acquisition, several privately held firms are approaching critical mass and may soon be acquisition targets of commercial banks.

Recent transaction:
Colonnade advised AFS/IBEX Financial Services on its sale to MetaBank

MetaBank, the banking division of Meta Financial Group (NASDAQ: CASH) acquired the assets and operations of AFS/IBEX Financial Services in December 2014.

Founded in 1986, AFS/IBEX is one of the top ten insurance premium finance companies in the U.S., originating commercial loans through a network of over 1,300 independent insurance agencies. In 2013, AFS originated over $200 million of insurance premium finance loans.

Founded in 1954, MetaBank is a federally chartered savings bank. Headquartered in Sioux Falls, South Dakota, MetaBank's primary banking businesses are deposits, loans and other financial products and services to meet the needs of its commercial, agricultural and retail customers.

"We believe that insurance premium finance is a perfect complement to our national deposit franchise to diversify our business and build our loan portfolio," said MetaBank CEO J. Tyler Haahr. "The experienced team at AFS will lead this business for MetaBank and anchor our platform for future growth."

For more information on the Insurance Premium Finance Industry, please contact:

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