

Tightening Credit, Hardening Market Drive Demand For Premium Financing

by National-Underwriter

The struggling economy presents unique challenges as well as growth opportunities for premium finance companies, which will have to manage a delicate balancing act to meet increasing demand for their services in this tight credit market while remaining aware that the deepening recession could lead to a greater number of delinquencies and defaults among commercial insurance clients, experts in the field warn.

Last year, premium finance players said the soft insurance cycle hurt business to a degree, because with prices dropping, fewer customers needed to finance their payments.

Indeed, Luther Grafe, executive vice president and chief operating officer of BankDirect Capital Finance—a premium finance company based in Lake Forest, Ill.—said last year that “we’ve seen premiums down as much as 30 percent from two years ago, so there are some clients who have historically financed their policies who now can pay cash.”

This year is a very different story, as the same Mr. Grafe cited an increased desire to finance premium payments—most likely due to the poor economy. “It’s absolutely true that with lower premiums, fewer clients will finance their policies,” he said. “However, with the current economic conditions, there appears to be an increased desire by the insureds to finance.”

Throw in the fact that banks are pulling back on credit, and the result is a growing demand for the services provided by premium finance companies, according to Gregory Ludwig, director of financial services for Royal Premium, based in Southfield, Mich.

Eric Sepci, vice president and chief operating officer of Premium Payment Plan, based in New York, explained via e-mail that insureds want and need to keep their cash available as credit availability shrinks.

“We certainly believe that the restricted availability of credit has made the premium finance service much more desirable, as it is for the most part off-balance-sheet borrowing, which allows the insured to keep cash in hand and credit lines untouched. When you couple this with the cost of funds, we would hope a natural demand will balloon for our product and services.”

In another positive development for premium finance firms over the past year, with the soft market petering out, there has been less competition from standard carriers that offer direct-billing programs. Experts last year noted that as the market continued to soften, standard carriers entered insurance markets they generally avoid in harder markets. These standard carriers typically offer their own billing programs.

Carrier direct-billing is still an issue, but less so than a year ago, according to Mr. Grafe. He noted that many agents and brokers have told him they do not like using the carrier direct-bill plans because they are not as well managed as programs offered by premium financing companies.

“My experience from talking to our clients is that insurance companies have become experts, as they need to be, at underwriting insurance policies and assessing insurance risk, and not necessarily at trying to figure out a way to send out bills once a month to their insureds, and to do it effectively, efficiently and accurately,” he said. This is especially true, Mr. Grafe added, when there is a significant amount of endorsements, such as an auto policy that has a number of additions and deletions.

How agents and brokers receive commissions also comes into play, according to Mr. Grafe. With the direct-bill plans, he explained, agents and brokers may receive part of their commissions up front, but “their commission flow schedule is then contingent upon the insurance company billing and then collecting premium from the insured.”

With premium finance companies, he said, “basically everything is paid up front. Within 30 or 45 days of the effective date, all of the premiums have been collected and remitted to the insurance company, and the commission paid to the intermediary.”

Mr. Sepci stressed that while the faltering economy may give premium finance companies some advantages, the impact of tough times is “not always for the better.” He warned that premium financiers need to navigate the current market “with both eyes open and aware how different businesses are being impacted by the recession we are in.”

“Certain lines of business that have historically provided excellent volume with reasonable cancellation experience are not performing nearly as well, forcing companies to reconsider terms to ensure a more secure loan,” he explained. “To this respect, we’ve all been forced into a quasi-economist role.”

Royal Premiumâ€™s Mr. Ludwig noted that, because of the recession, there is an increase in delinquencies, bankruptcies and first-payment defaultsâ€™for all lenders in generalâ€™resulting in higher charge-offs as more clients are unable to make good on their loans. In such an atmosphere, Mr. Ludwig said the challenge for Royal Premium is striking a balance of pricing against the higher risks in a worsening economy.

To that end, Mr. Grafe of BankDirect said an additional effect of the economic downturn has been a sharp reduction in some of the favorable terms that were offered to insureds during last yearâ€™s softening insurance market.

For example, while typical markets see terms of 20-to-25 percent down, and about nine months of equal payments, last year some premium finance companies were offering up to 12 months of equal installments.

Mr. Grafe said 12 months of equal payments is â€œnow a thing of the past.â€• Premium finance company appetites for enhanced terms, he added, is less today, but he noted agents understand that, and they are letting insureds know they should not expect such sweet repayment deals in this tight credit market.

Premium Paymentâ€™s Mr. Sepci added, â€œYou want to offer aggressive and reasonable terms, but what may have been reasonable last year would be considered too aggressive this year due to the rate of failure in certain lines of business. Some of our competitors are staying aggressive in these markets, resulting in some hypercompetitive situations where we need to, and will remain disciplined.â€•

Additionally, just as the economy has affected consumersâ€™ ability to borrow, it has had the same impact on premium finance companies.

Mr. Sepci said some premium financiers will struggle in this environment because of â€œthe way the economy has impacted their ability to borrow or securitize their portfolios. This tumult has certainly created an unlevel playing field between premium finance companies, which will undoubtedly result in scaled-back operations, company sales or mergersâ€™not uncommon to what many banks are going through.â€•

BankDirectâ€™s Mr. Grafe said he sees opportunity in the prospect of consolidation among premium finance companies. He said consolidation has historically created chances to expand relationships with agents, and even create new partnerships.

Aside from managing their own affairs, premium finance companies will also need to keep an eye on carriers, Mr. Sepci cautioned. He explained that as insurers feel the repercussions of the worsening economy, â€œwe as finance companies will need to be vigilant and disciplined in review of carrier performance and ratings to ensure our collateral is being held by financially sound insurance entities.â€•

Ultimately, success in premium financing comes down to maintaining and strengthening relationships, according to Mr. Ludwig, who said partnerships with agents is the foundation of his business.

Mr. Grafe said BankDirect Capitalâ€™s approach in this market will be focusing on what the company can do for its agency clients to build long-term relationships, and also to â€œbe smart about how we conduct our business.â€•

Mr. Sepci echoed that sentiment. â€œWe'll undoubtedly have to hold off on nonessential projects, or cut back in areas to ensure our operation is lean and focused on providing superior return on investment,â€• he said. â€œAs many changes occur within our industry, much uncertainty will surely follow. This uncertainty will breed opportunity for us and we will seize it each time the opportunity presents itself.â€•

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