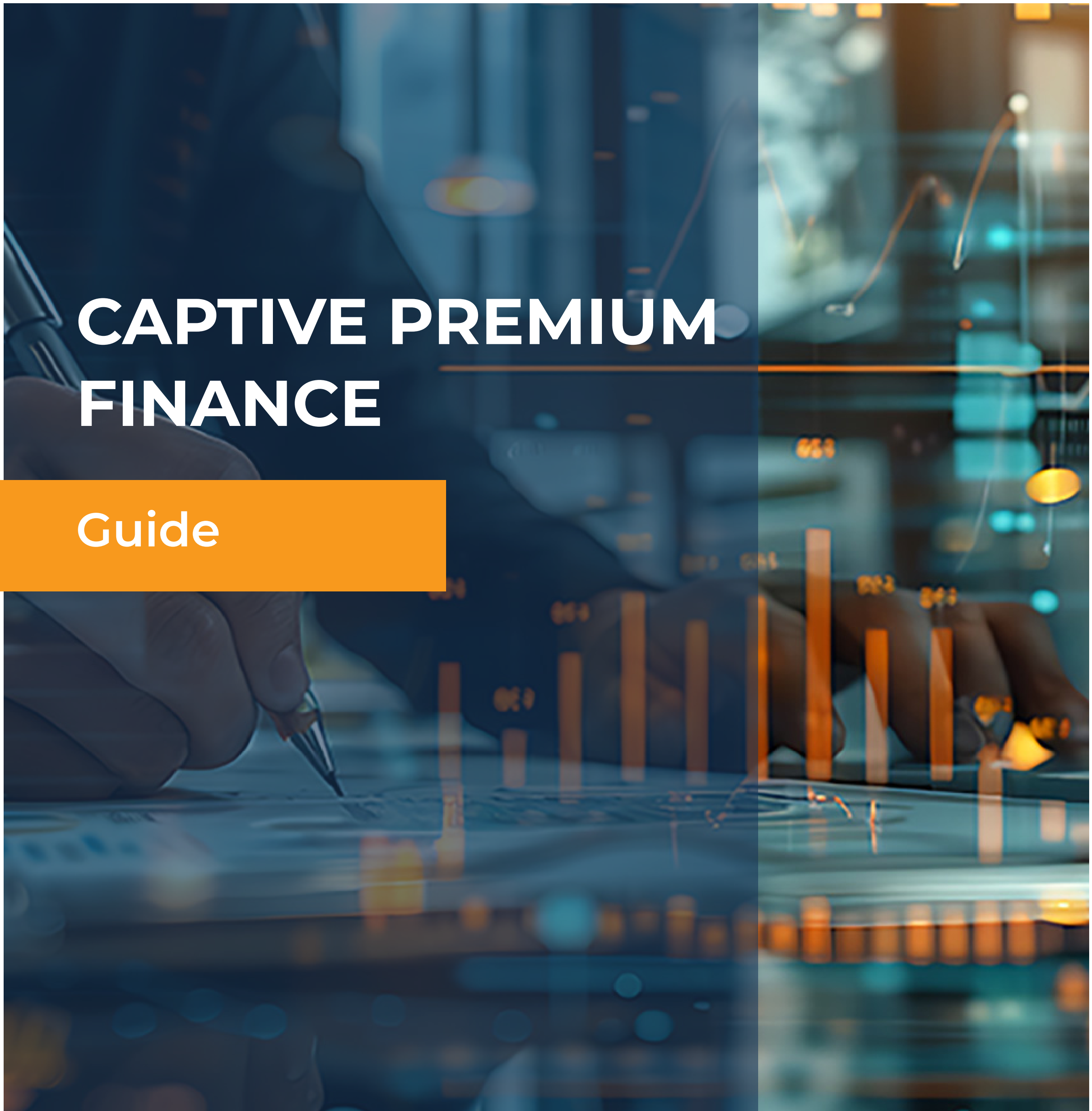
Input 1

CAPTIVE PREMIUM FINANCE

Guide



The benefits of forming your own premium finance company

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*By offering insureds **in-house premium financing**, agents can enhance their customers' experience and strengthen their relationships while also capturing needed revenue that would have otherwise gone elsewhere."*

Introduction

Like many industries, the property and casualty insurance sector is experiences market cycles that shift with economic conditions. In a hard market, placing risks becomes more difficult as prices rise rapidly. In a soft market, heightened competition drives premiums down, and carriers are more willing to underwrite risks. Establishing a premium financing solution provides strategic advantages in both environments, helping agencies navigate challenges and maximize opportunities.

The Benefits of Forming Your Own Premium Finance Company

In a hard market, rising premiums can boost commission for agents and managing general agents (MGAS), but they also create greater challenges. Retaining clients becomes more difficult as many face steep double- or even triple-digit premium increases. These clients demand more attention and innovative solutions to ease their burden—without which, they may look elsewhere, even if only out of perception.

In contrast, a soft market brings slower premium growth, benefiting customers with lower insurance costs but posing financial challenges for agencies. With reduced premiums come lower commissions, yet the costs of securing a sale remain unchanged. This puts pressure on profitability and makes it harder to sustain the high service levels that initially earned their clients' trust.

By managing billing terms through an in-house premium finance company, agents can strengthen client retention by offering flexible payment solutions during periods of rising premiums while also capturing additional revenue that would otherwise go to third-party lenders. This revenue can be reinvested to maintain high service standards and support business growth.

Captive premium financing integrates seamlessly into an agent's existing business model. Agents understand their clients' financial needs better than any outside lender, allowing them to tailor competitive payment terms that can be the deciding factor in winning or retaining a deal.

When considering the volume of financed policies an agency processes each week, month, or year, the potential for revenue growth is substantial. This new venture becomes an additional profit center but also increases the agency's overall value.

Despite these clear benefits, most agents and MGAs still rely on outside finance companies, ultimately forfeiting valuable income and reducing their wallet share.

Additional Earnings on the Same Business

The revenue generated from premium financing typically adds the equivalent of two to three commission points to an agency's bottom line.

Rather than earning a standard 10% commission—$1,000.00 on a $10,000 premium—agents can increase their earnings to $1,200.00 - $1,300.00 or more per transaction.

How is Premium Financing Used to Pay for Insurance?

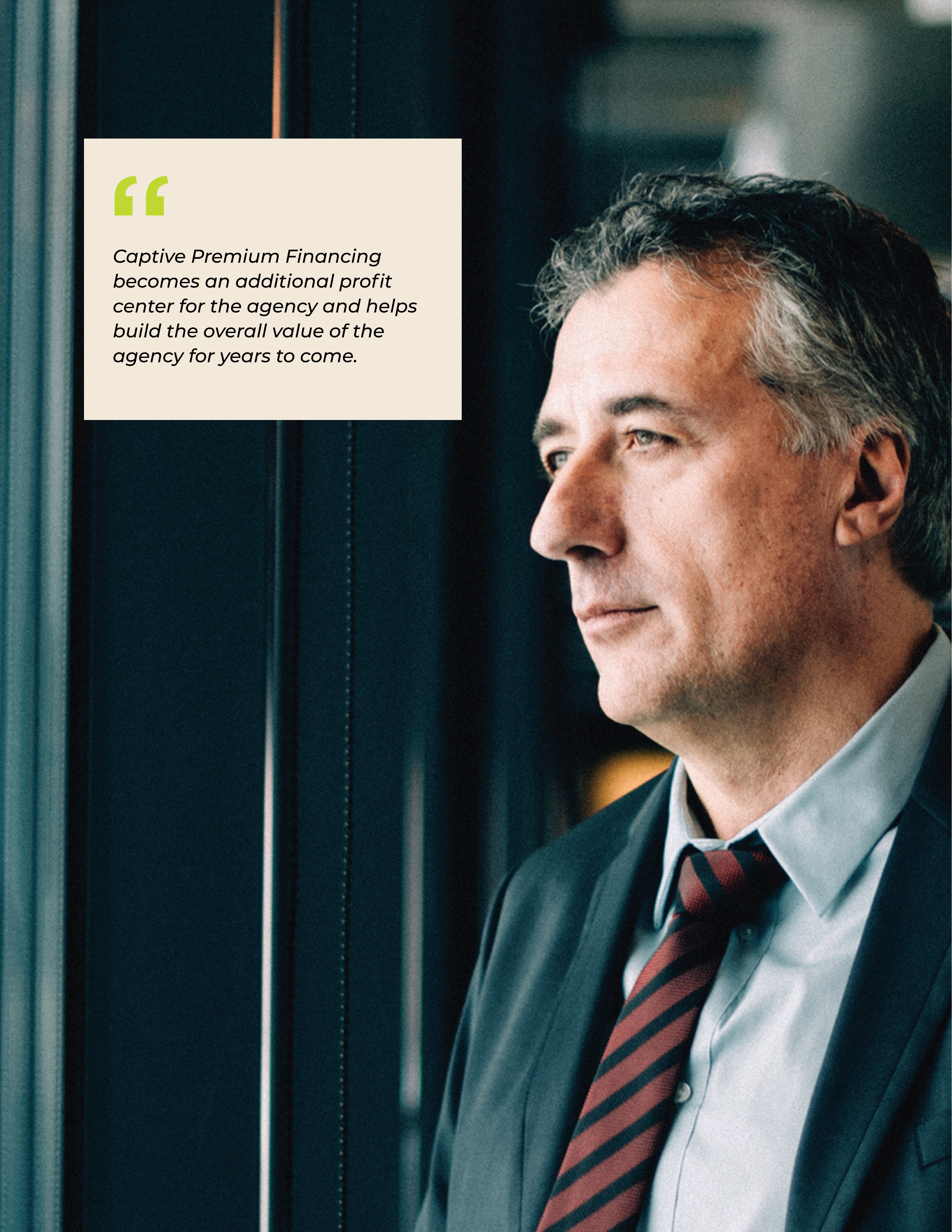
Premium financing provides an alternative to rigid carrier installment plans or full upfront payments, the latter being especially common in the excess & surplus market. By signing a finance agreement, the insured authorizes the premium finance company to advance the annual premium to the insurance carrier on their behalf.

In return, the insured receives a structured payment plan from the finance company, which includes both premium and interest payments. If the insured fails to make timely payments, the premium finance company retains the right to request policy cancellation from the insurance carrier.

Income Scenario

Experience shows that a captive commercial premium finance operation, with average premiums of $3,000.00 can generate approximately $20,000.00 - $30,000.00 in annual income for every $1 million financed.

The actual earnings will depend on several factors, including the interest rate spread (the difference between borrowing and lending rates), late fee revenue, and the efficiency of business administration.



Captive Premium Financing becomes an additional profit center for the agency and helps build the overall value of the agency for years to come.

How Does a Finance Company Generate Income?

A finance company generates income by borrowing funds at a set interest rate from a financial institution (e.g., banks, private investors) and lending those funds at a higher rate to policyholders. Additional income streams include late fees and other incidental charges.

The costs associated with forming and operating a premium finance company include interest expenses (the cost of borrowing), administrative overhead, licensing, and accounting fees.

With effective financial modeling and a strategic approach to promoting premium financing, these loans can yield a substantial return on investment.

Why Consider Captive Financing?

The most compelling reason for establishing a captive finance company is to maximize profitability. As an agent, you bear the full cost of acquiring new business but often fail to capture the total revenue potential of each transaction—leaving valuable income on the table.

Additionally, in an environment of rising insurance premiums, insureds may struggle to pay in full. Without flexible financing options, they may reduce coverage or forgo purchasing a policy altogether—outcomes that are detrimental to both the insured and the agent.

By managing your own finance company, instead of relying on external lenders, your agency gains control over financing terms, improves client retention, and maximizes profitability.

How Do You Get Started?

Establishing a premium finance company requires careful planning, particularly when assessing financial feasibility. Like any business, premium financing has minimum requirements that must be met to justify startup and ongoing operational costs. The total amount of premiums to be financed, along with the expected number of loans per year, plays a key role in determining financial viability. Additionally, setting appropriate interest rates for different premium ranges is essential in creating a clear financial forecast and understanding the potential return on investment.

Companies such as Input 1 can assist in this process by providing a pro forma financial statement at no cost, helping to evaluate the financial outlook before making a commitment. Once a decision is made to move forward, securing capital should be the first priority. Agents may explore financing options through their local bank or lending institutions, or they can leverage industry-specific relationships provided by premium finance software vendors like Input 1, which can introduce them to lenders specializing in this niche market.

While arranging financing, it is also essential to begin the licensing process. Licenses must be obtained in all states where business will be conducted. Although many states share common licensing requirements, others have more complex regulations that must be addressed. Engaging legal counsel or a consultant can help streamline the process, ensuring compliance while allowing you to focus on your core business operations.

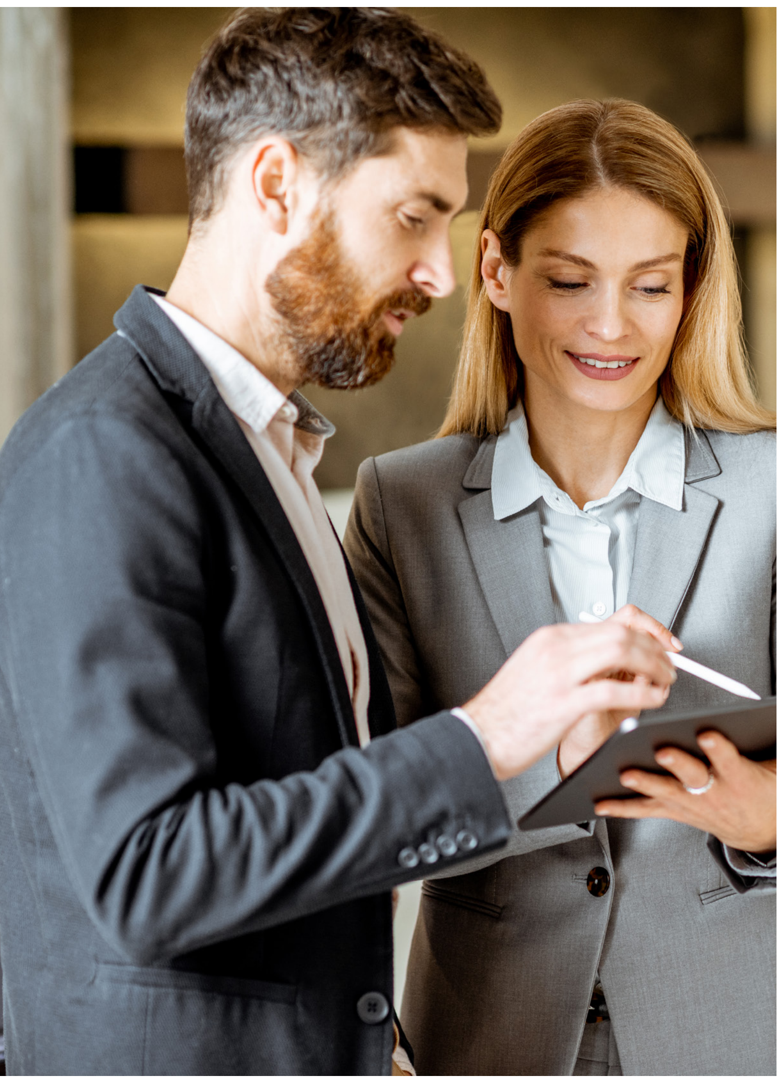
Third-party premium finance administrators and software providers often offer licensing assistance as part of their services, making it easier to navigate the regulatory landscape efficiently.

The Benefits of Forming a Captive Premium Finance Company

Area of Interest	Captive Premium Finance
Commissions	Earned upfront as soon as the down payment is collected from the insured, rather than being distributed over the policy term, as is common with direct billing.
Increased Profits	Agencies can achieve a 2-3% increase in commission per loan by operating a captive premium finance company, generating additional revenue.
Cash Flow for Insureds	Billing terms can be customized on a case-by-case basis based on risk assessment. This flexibility provides insureds with tailored payment options, enhancing affordability.
Control	Greater oversight of accounts reduces costly cancellations and policy rewrites by allowing for adjustments to payment schedules, terms, and holds when necessary.
Client Retention	Offering in-house premium financing strengthens client relationships by providing a seamless, integrated payment experience, increasing customer satisfaction and loyalty.
Competitive Advantage	A captive finance company differentiates your agency from competitors by providing value-added service that enhances both customer convenience and operational efficiency.

The Pros and Cons: Outsourcing vs. Licensing

Agents and MGAs exploring the formation of a captive premium finance company must make a fundamental decision: outsourcing servicing to a third-party provider or licensing the necessary software to manage operations in-house. The agency's business philosophy and long-term goals will have a great influence on this decision, requiring careful evaluation of both options.



The Choice to Outsource

Outsourcing is a well-established practice in the insurance industry, particularly for functions outside an organization's core expertise. For example, insurance carriers frequently outsource policy administration and billing to focus on risk assessment and premium investment - their core competencies.

Since premium financing is not typically an agent's core function, outsourcing is often a practical solution. A well-structured outsourcing arrangement allows a wholly owned third-party finance company to manage servicing needs while ensuring the agency retains control over underwriting and operational guidelines. Your team will work closely with a dedicated outsourcing partner who follows your predefined standards, effectively serving as a "virtual service center" for your finance company.

To ensure a smooth operation, a detailed workflow must be established in collaboration with your outsourcing partner. While the framework should be customized to your agency's objectives, leveraging the partner's industry expertise can help refine processes. Effective workflows take time to build and require continuous adjustments. A common mistake among new finance company owners is rushing into the business without fully understanding the complexities, which can lead to operational challenges.

Regular management-level discussions with your outsourcing partner are essential, particularly in the first 6-12 months.

These meetings should occur at least monthly to review and refine established processes, ensuring they align with your agency's goals.

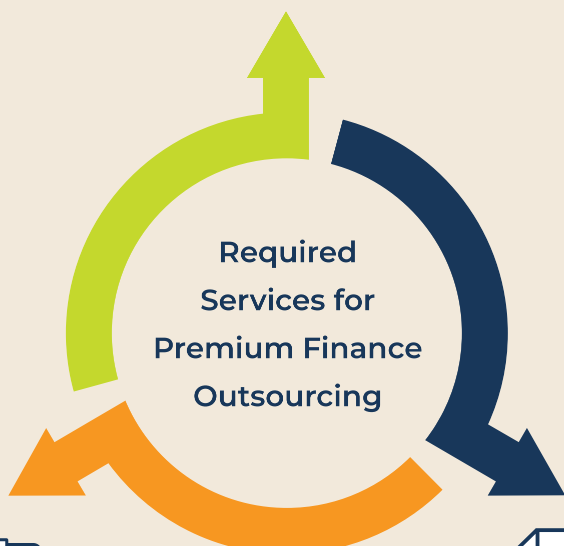
Additionally, comprehensive management-level reporting is crucial for evaluating the financial performance of your finance company.

If a line of credit is secured with a lender, specific reporting requirements will apply. It is essential to understand these obligations upfront and confirm that your outsourcing provider can meet them.

At a minimum, here are some specific areas that should be provided by your outsourcing partner:

Customer Service

- Quoting
- Data Processing
- Underwriting
- Management Review



Accounting Services

- Payment Processing
- Billing
- Collections

Business Services

- Correspondence
- Reporting
- Notice Generation & Mailing

The Outsourcing Advantage

1

Industry Expertise

Partnering with an experienced outsourcing provider gives you access to years of knowledge and best practices. They can help you establish operations quickly while offering strategic guidance on running your premium finance business effectively.

2

Eliminates Staffing Concerns

When you outsource, there's no need to hire and train additional staff. Your outsourcing provider assums the responsibility of maintaining a skilled team to manage day-to-day operations.

3

Cost Efficiency

Instead of incurring fixed costs, outsourcing allows you to pay a per-loan administration fee, aligning expenses with business volume. This structure keeps costs predictable and scalable.

4

No Equipment Investment

With outsourcing, there's no need to purchase additional computers, services, or office equipment. Your partner should supply the necessary technology, minimizing upfront capital expenditures.

5

Advanced Technology & Customer Experience

The right outsourcing partner offers a suite of technology-driven services, such as online quoting, real-time account management, and flexible payment options. These features enhance customer experience while streamlining your finance company's operations.

The Choice to Run it Yourself

For a number of agency owners, the thought of outsourcing all or a piece of their organization is simply not an option.

If your business philosophy prioritizes managing all operations in-house with your own team, maintaining full control over processes, you may be pleased to know that transitioning this function internally is more straightforward than it may seem.

An executive-level commitment is required by the agency principal to hire and maintain a staff to run your finance company. Depending on the volume of loans generated by your finance company, this can be a part-time, one-person shop or a 5-10 person staff dedicated to just your finance company.

For example, an agency financing 100 contracts a month would on average process five loans per day. One staff member using a software package from Input 1 should be able to quote, enter, and process the entire loan in as little as 10 minutes – this comes to less than one hour a day. You must also consider the time needed to handle the customer service, payment processing, mailing, collections, accounting, banking, and other day-to-day tasks. For the example above, this should not add up to more than 2-3 additional hours per day.

With the right clientele and pricing strategy—particularly the interest charged on premium finance loans—it is entirely possible to generate enough revenue in just 6-9 months to cover the cost of the software investment.

One critical but often overlooked factor in purchasing premium finance software is the quality of the technical support.

Your vendor should have a well-trained support team available to assist you when needed. Does the vendor offer 24-hour emergency support? Having access to experienced trainers and technicians is invaluable in ensuring a smooth implementation. Nothing is more frustrating than attempting to adopt a complex software solution without proper guidance.

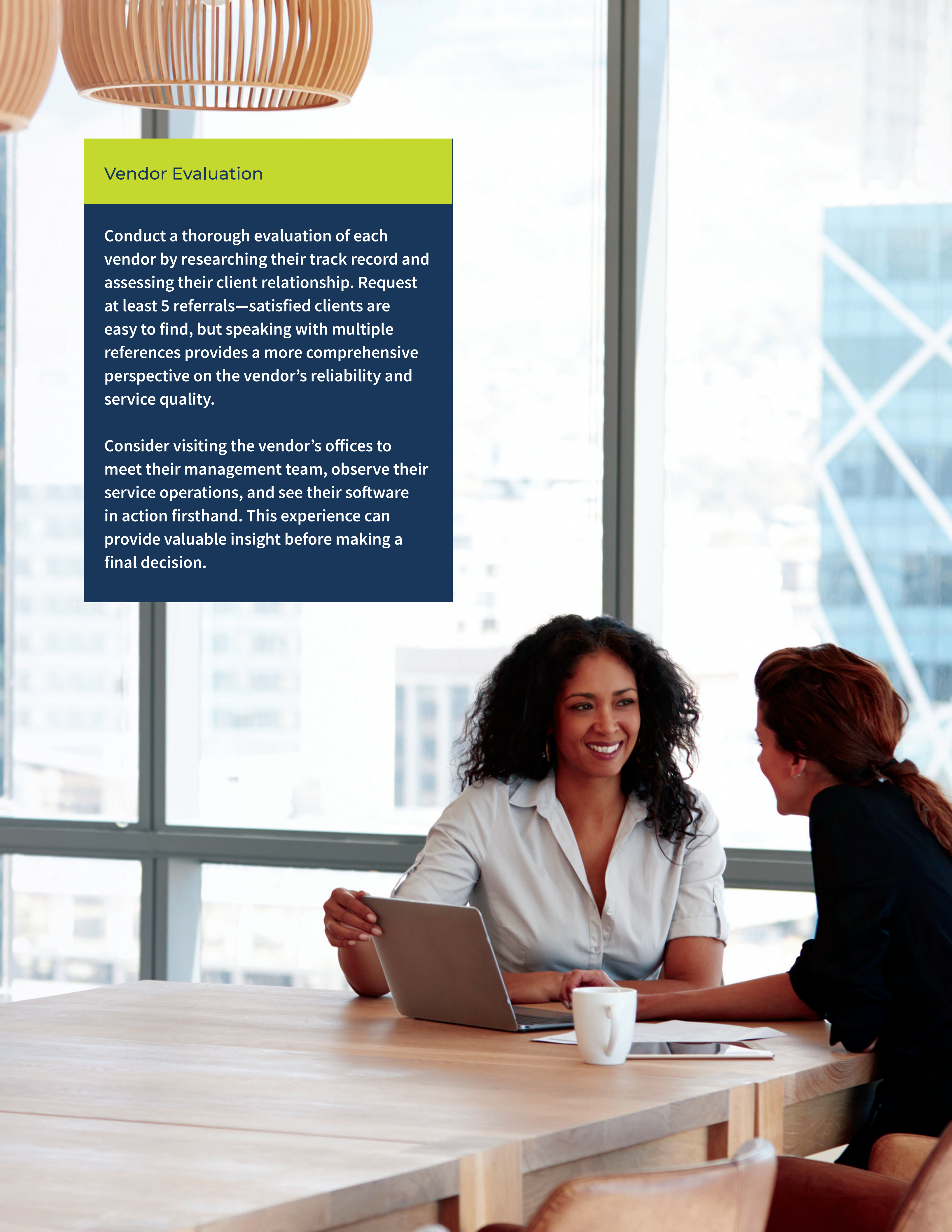
The Software License Advantage

Depending on the type and volume of business, you may be able to adsorb the staffing requirements of the finance company into your existing overhead. If you already have available resources to deploy toward this process, then additional expenses could be minor.

Vendor Evaluation

Conduct a thorough evaluation of each vendor by researching their track record and assessing their client relationship. Request at least 5 referrals—satisfied clients are easy to find, but speaking with multiple references provides a more comprehensive perspective on the vendor's reliability and service quality.

Consider visiting the vendor's offices to meet their management team, observe their service operations, and see their software in action firsthand. This experience can provide valuable insight before making a final decision.



The Pitfalls One Can Avoid with Running a Captive Premium Finance Company

You have made the decision to establish a captive premium finance company and determined the operational model—whether outsourcing to a third-party vendor or managing the process in-house with specialized software. Your lending arrangements and state licensing are likely already in place, positioning you to begin operations and book your first loan.

However, before officially launching your business, it is essential to take a step back and carefully evaluate key considerations in this new venture of insurance premium financing.

Price and Terms

Developing a solid strategic plan and understanding the key components of your business are essential to long-term success. An important factor in determining overall profitability is setting the right interest rate. It is crucial to establish an APR that not only covers borrowing costs, administrative expenses, and overheard but also ensures a healthy return on your investment.

Additionally, the down payment and installment terms you offer will directly impact your overall returns. A conservative approach—such as requiring a 25% down payment and 9 installments—can provide financial stability in most situations. However, depending on specific coverage types or geographic regions, there may be opportunities to offer a lower down payment.

In other cases, a higher down payment may be necessary to mitigate risk. Similarly, while 9 or even 10 installments may be appropriate in some instances, 7 or 8 may be more prudent approach in others.

Your outsourced service provider and/or lender should be able to provide a pro forma income statement to help you analyze various financing structures and determine the optimal terms for maximizing returns.

Types of Coverage and Policy Provisions

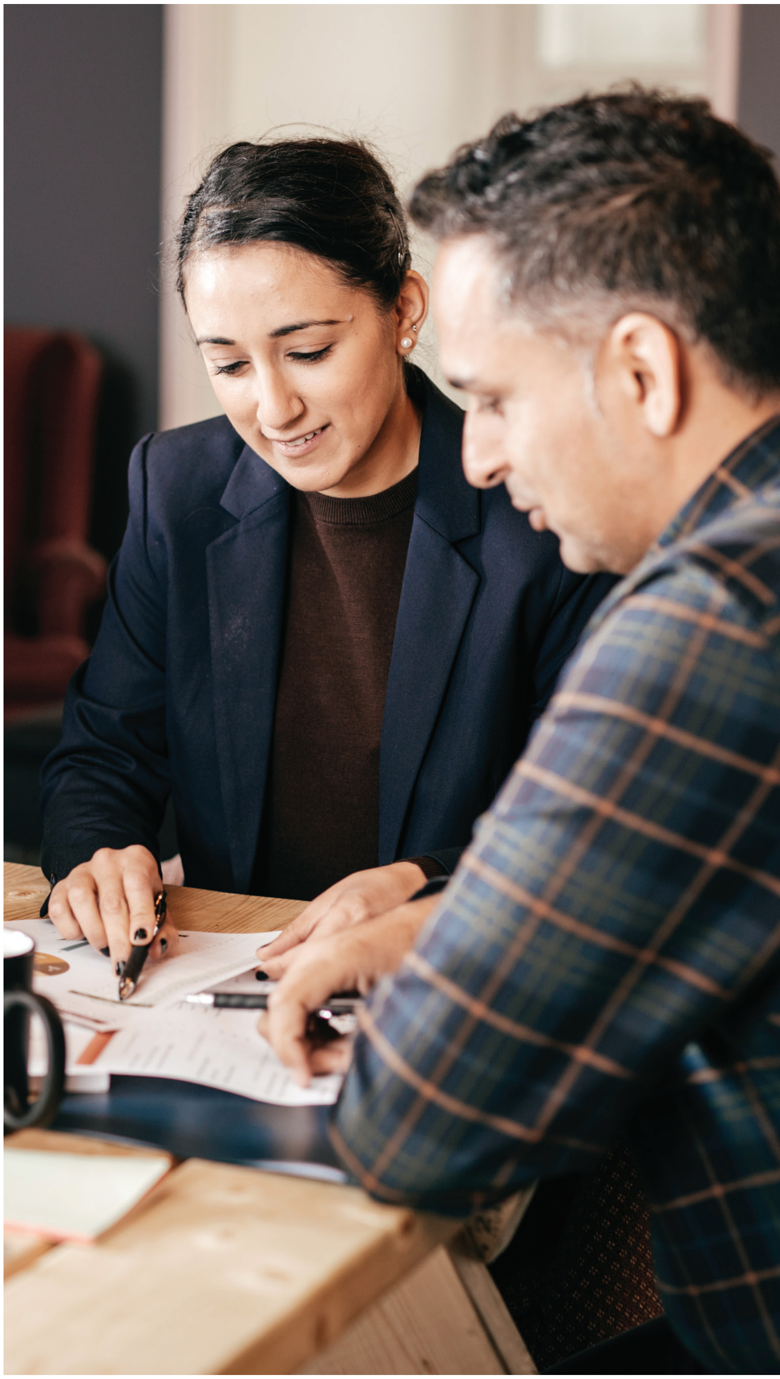
Surprisingly, one of the most critical factors in determining the appropriate down payment and installment structure for a loan is a clear understanding of the specific provisions within a policy. Ideally, every policy would include a 10-day cancellation period, no minimum earned premium, no audit provisions, and pro-rata earning structure. However, as you likely know, this is rarely the case. What may be less apparent is how these provisions can impact premium financing.

For instance, a policy with a short-rate cancellation provision instead of pro-rata will result in approximately 5% less unearned premium being returned in the event of a cancellation. If you finance a $10,000 policy, this could leave your finance company short by as much as $500 on the loan balance. Unless you can collect the difference from the insured, this shortfall becomes a direct financial loss.

State regulations also play a role. In California, for example, policies written by admitted carriers and financed by a California-licensed finance company must provide a pro-rata return of unearned premium. However, this is not the case in all states. Certain policy types—such as Liquor Liability and Directors & Officers (D&O) insurance—may have provisions that render the policy fully earned or subject to accelerated earnings, significantly reducing any expected return of premium.

A reduction in earned premium directly affects profitability, making it crucial to understand policy structures before finalizing financing terms.

To mitigate risk, it is essential to familiarize yourself with various policy coverages and work closely with a knowledgeable vendor. A reputable vendor should provide valuable insights and guidance to help you navigate these complexities effectively.



Carrier Insolvency

While the likelihood of an insurance carrier becoming insolvent is low, it remains a risk that must be carefully considered. To safeguard your premium finance business, it is advisable to finance policies only from carriers with strong financial ratings and substantial reserves. This can be verified through rating agencies such as A.M. Best and Standard & Poor's, the most widely recognized authorities on carrier financial stability. Most commercial premium finance companies require carriers to have an A.M. Best rating of at least B+ (Very Good) and a financial size category of V (indicating capital, surplus, and reserve funds between $10 and $25 million).

The specific standards you establish for your business should align with your risk tolerance.

Know Your State Laws

Once your financing operation is running smoothly, regulatory oversight becomes a critical factor. State governing bodies that regulate premium financing may conduct periodic audits to ensure compliance with applicable laws. If you outsource servicing, your provider typically handles these audits. However, it is ultimately your responsibility to ensure compliance with key regulations, including:

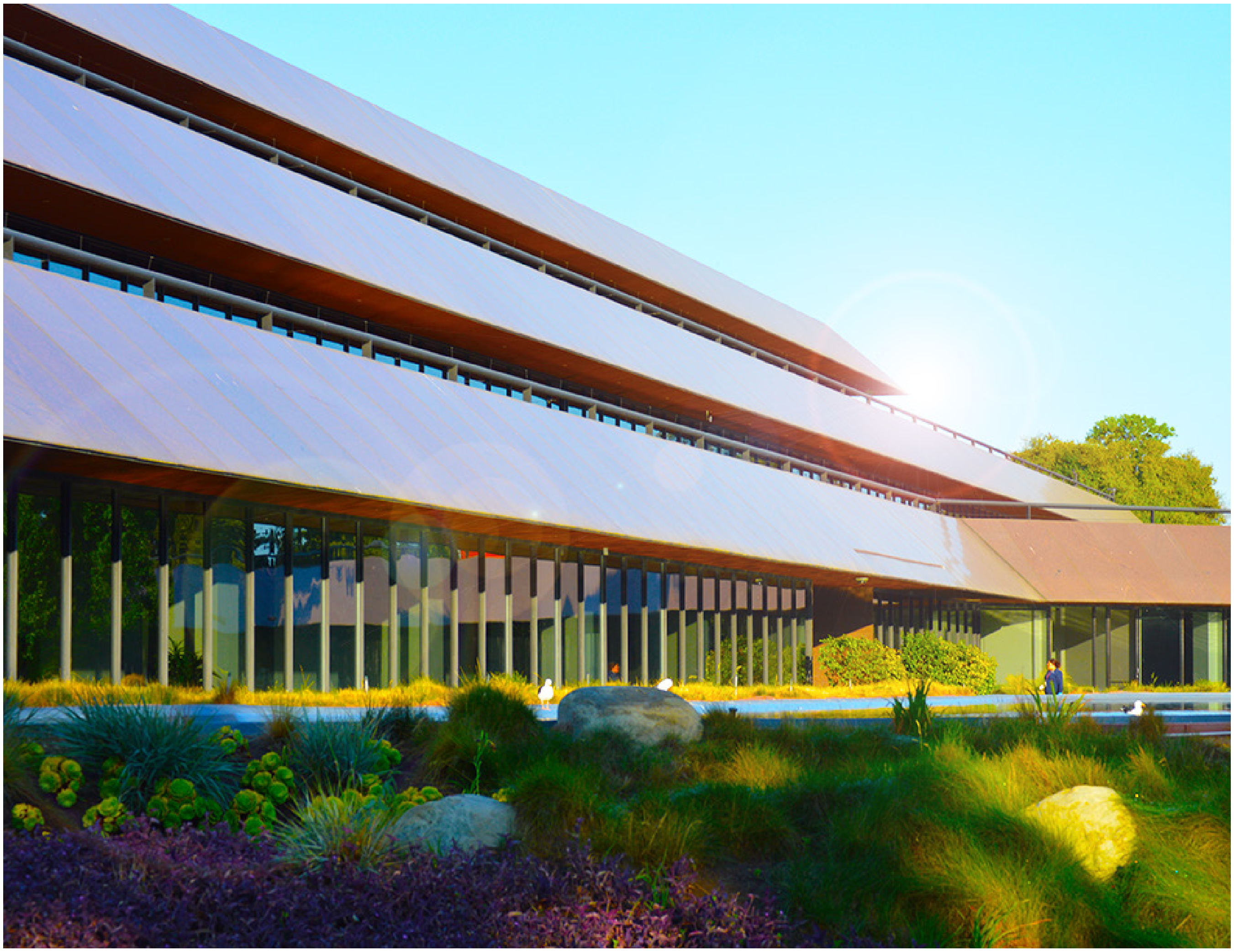
- Charging permissible interest rates
- Assessing late fees in accordance with state statutes
- Properly issuing refunds to borrowers
- Following state-mandated timelines for sending cancellation notices

Selecting a vendor with a strong understanding of state laws is crucial. Whether you use in-house software or an outsourced solution, the system must be designed to comply with regulations governing interest rate caps, allowable fees, and procedural requirements. Despite the support of vendors and software, it is essential to familiarize yourself with the specific legal framework in the states where you operate, as compliance directly impacts your financial and operational stability.

Maximizing Profitability While Managing Risk

Any business venture with significant profit potential inherently involves risk. Captive premium financing is no exception. However, thorough due diligence on your vendors, a deep understanding of regulatory requirements, and careful selection of the business you finance can significantly mitigate these risks.

For those who approach captive premium finance strategically, the rewards can be substantial. Many industry leaders have leveraged captive premium financing to generate impressive returns on their initial investment. The question is: are you ready to take the next step and maximize the profitability of the business you have worked so hard to build?



About Input 1

Since 1984, Input 1 has been a leading provider of digital billing and payment solutions for the insurance industry, dedicated to simplifying the insurance process for both insurers and policyholders.

Our easy-to-use platform streamlines billing, payments, and premium finance, making premium collections more efficient and offering flexible solutions to fit the needs of our clients.

Managing $16 billion in premiums across all platforms for over 2 million users annually, Input 1 delivers exceptional operation efficiency, cost reduction, and increased profitability. With 99.99% uptime availability, our cloud-based system ensures reliable service, offering unparalleled capability, security, and stability.

We’re proud to help insurance providers modernize their operations, stay competitive, and improve their bottom line, all while maintaining a high level of service for policyholders.

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