Presale:

PFS Financing Corp. (Series 2023-B)

May 15, 2023

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Preliminary ratings

Class	Preliminary rating	Interest rate	Preliminary amount (mil. $)	Expected final maturity	Legal final maturity
A	AAA (sf)	Fixed	376	May 15, 2026	May 15, 2028
B	A (sf)	Fixed	24	May 15, 2026	May 15, 2028

Note: This presale report is based on information as of May 15, 2023. The ratings shown are preliminary. This report does not constitute a recommendation to buy, hold, or sell securities. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings.

Profile

Expected closing date	May 24, 2023.
Collateral	Insurance premium finance loans.
Issuer	PFS Financing Corp., a Missouri corporation.
Servicer	IPFS Corp.
Trustee and backup servicer	UMB Bank N.A.

Rationale

The preliminary ratings assigned to PFS Financing Corp.'s premium finance asset-backed fixed-rate notes series 2023-B reflect:

- The credit enhancement in the form of overcollateralization and the available excess spread related to the company's historical portfolio loss performance;
- The credit quality of the pool's insurance carriers; and
- The servicer's ability to service the portfolio, which we believe is in line with its historical performance.

The net proceeds from the new issuance will be used to reduce borrowings under the existing variable funding notes series.

Environmental, Social, And Governance (ESG) Factors

Our rating analysis considers a transaction's potential exposure to ESG credit factors. We view the transaction's exposure to environmental credit factors as average, to social credit factors as average, and to governance credit factors as average.

Since insurance is a service industry, companies' direct exposure to environmental risks is fairly limited, relative to other, more resource-intensive industries. Insurers tend to have smaller carbon footprints and limited water use, and are not significant greenhouse gas emitters. The industry's exposure to environmental risk largely stems from indirect sources of risk through its underwriting and investment activities. Given the geographical diversity of the collateral pool, we do not believe customer payments would be significantly affected by weather-related events.

Regulators are focused on ensuring that insurers are treating customers fairly and are providing value in the financial advice that they are giving. In addition, the COVID-19 pandemic has resulted in regulatory limitations on the cancellation of insurance policies, which restricts the servicer's ability to cancel the insurance policy upon a nonpayment of a loan. Such regulatory actions have all since expired or been lifted; however, they could be reimplemented if there is a change in the COVID-19 pandemic. Historical cancellation rates have been low, and, therefore, we don't believe the social credit factors will have a huge impact on this sector.

Given the nature of structured finance transactions, most have relatively strong governance frameworks through, for example, the generally very tight restrictions on what activities the special-purpose entity can undertake compared to other entities. Originators' strategy, execution, timely monitoring, internal controls, and overall management will affect the performance of the obligors, speed of submitting cancellations, and efficient tracking and recovery of the unearned premiums.

Transaction Overview

IPFS Corp. (IPFS) plans to issue a new series of premium finance asset-backed notes (series 2023-B) through PFS Financing Corp., a bankruptcy remote, special-purpose entity. Series 2023-B will be offered as fixed-rate notes and will have a weighted average life of approximately three years. The transaction is backed by a revolving pool of insurance premium finance loans, which are secured by the right to receive the unearned premium amounts from the insurance companies if the borrowers fail to pay the amounts due on the premium finance loans.

The series 2023-B outstanding principal amount, along with all accrued and unpaid interest, will be paid on May 15, 2026, the scheduled payout commencement date, if the issuer is able to refinance that series. If the issuer is not able to refinance the series 2023-B notes on the scheduled payment date, the first distribution of class A principal will be made on June 15, 2026, and the first distribution of class B principal will not occur until the class A notes are paid in full.

PFS Financing Corp. (the issuer) is a bankruptcy-remote, special-purpose Missouri corporation organized in 1993, and a wholly owned subsidiary of IPFS. The issuer has outstanding term notes and revolving short-term debt that are rated by S&P Global Ratings, and its premium finance loan portfolio is the collateral asset pool backing the series 2023-B notes.

IPFS, the servicer, originates property and casualty (P&C) insurance premium finance loans throughout the U.S., Puerto Rico, Guam, and the Virgin Islands. The company has acquired about 24 companies since 1996.

On March 2, 2020, IPFS Financing Canada ULC, an indirect, wholly owned subsidiary of IPFS, acquired all the capital stock of SNAP Premium Finance Corp., a corporation organized under the laws of British Columbia. Following the acquisition, IPFS Financing Canada ULC and SNAP Premium Finance Corp. amalgamated, with the resulting entity known as Imperial PFS Canada Payments ULC. Up to 5% of the eligible receivables may consist of Canadian dollar-denominated assets. The Canadian dollar exposure is unhedged. The unhedged risk is mitigated by the minimum 3% level of excess spread and the maximum Canadian concentration limit of 5%.

IPFS offers premium financing services through relationships with a network of approximately 17,000 insurance agencies. During the 12 months ended March 31, 2023, IPFS originated about 634,700 loans totaling about $15.7 billion, with an average premium of approximately $24,700.

Parameters considered by IPFS's underwriting standards include:

- The loan structure;
- The obligor's creditworthiness;
- The insurance company's creditworthiness;
- The capabilities and standards maintained by the insurance brokers and agents;
- The down payment made on the loan (typically expected to be about 20% of the total premium); and
- The repayment period.

Due to the loans' short life, which is typically less than one year, IPFS monitors the aging on payments daily. Generally, a notice of intent to cancel is sent to the obligor when the payments are about five to 10 days overdue, and a notice of cancellation is sent when the payment is about 24-30 days past due. IPFS' policy is to issue a notice of cancellation on all accounts in default no later than the 30th day after the defaulted installment due date, subject to any relevant state law requirements. Barring few exceptions, IPFS writes off all accounts 45 days after receipt of all unearned premiums.

Strengths

The transaction's strengths include the following:

- IPFS has a strong history of originating, underwriting, and servicing collateral.
- The recoveries for defaults on insurance premium loans remain relatively high.
- Excess spread (which may vary) is available as additional credit enhancement.
- The required reserve percentage, initially set at 10.00% for class A and 4.25% for class B, is dynamic and may increase based on various trigger events.
- Shared excess principal collections may be available to cover any interest or principal shortfalls because all outstanding series share the same collateral portfolio.

Weaknesses

The transaction's weaknesses include the following:

- The amount of shared excess principal available for covering any shortfalls is pro-rated among the various issuances and may not be sufficient to cover the shortfall amount for any one series.

- The issuer must (if able) redeem the notes in full on the scheduled payout commencement date through a refinancing.
- Additional future issuances may affect the notes' subordination and change the pool's concentration limits, which would affect the pool's credit quality.

Mitigating factors

The factors mitigating the transaction's weaknesses include the following:

- The transaction has approximately 5.30% excess spread and high recovery on defaults.
- Our credit analysis showed that the required reserve amount can cover the estimated net losses at the 'AAA' and 'A' levels.
- A failure to refinance would lead to a rapid amortization event (i.e., the note principal would begin to be repaid).
- Any additional issuance is subject to S&P Global Ratings' review.

Sector Outlook

We expect that the U.S. P&C sector's premium growth will slow down to an average of 5% in 2023, from about 10% in 2022, as the same macro-economic headwinds P&C insurers faced in 2022 will persist in 2023. Inflation continues to run well-above the U.S. Federal Reserve's target, with the consumer price index estimated to have risen 6.30% year-over-year in 2022.

Reduced bond valuations as interest rates rise are having a negative impact on capital in portfolios with high bond allocations, and the region's overall underwriting profitability (as measured by the net combined ratio) is still hindered by unanticipated spikes in claims severity, as well as natural catastrophes.

For 2023, we expect personal auto insurers to continue pursuing rate increases in the mid-to-upper single digits as they attempt to catch up with elevated claims costs. For commercial lines, we anticipate that rate increases, which have slowed gradually over the past two years, will stabilize at 5%-7% for standard commercial lines (varying by line of business) and remain at or above loss cost trends. These expectations should lead to a modest improvement in the industry's statutory ratio to 99%-101%, assuming catastrophe losses contribute about eight percentage points to the loss ratio. We are also assuming that the U.S. economic outlook does not deteriorate materially beyond what S&P Global Ratings' economics teams currently projects, which is a modest deterioration of GDP of 0.10% in 2023.

We expect to downgrade those insurers whose capitalization has fallen materially below our expectations and show projected earnings and capital management options, in our view, that will be insufficient to rebuild capitalization to a level consistent with our current ratings over the next 24-36 months.

Many personal lines insurers have struggled to increase rates to keep pace with the inflationary pressures. We predict that inflation likely peaked in the third quarter of 2022 but will remain high until late 2024. The inherent lag in achieving rate adequacy due to the time it takes for rate increases to be filed, approved, and earned, will likely continue to pressure personal lines insurers' underwriting income until mid- to late 2023.

In the Canadian P&C sector, underwriting performance should remain profitable at 95%-98%, as price increases will help insurers deal with claims, inflation, and more frequent weather-related losses. Real premium growth should remain slightly positive in 2022-2023 thanks to price increases on key lines of business, offsetting inflation.

We believe interest rate increases should partly offset inflationary concerns and result in better reinvestment opportunities. Conversely, the sector's exposure to winter storms, earthquakes, hurricanes, and adverse reserve developments from claims inflation above provisions for adverse deviations could dent underwriting performance.

For more information regarding on our view of the P&C insurance sector, see "Global Insurance Markets: Inflation Bites," published Nov. 30, 2022, and "U.S. Property/Casualty Insurers Face Declining Investment Values And Personal Lines Loss Cost Inflation," published Jan. 25, 2023.

Structural Analysis

The issuer's loan pool has collateralized all outstanding series of notes. Interest and principal payments to each series are allocated from the pool's collections based on the proportionate size of the series' note balance, unreimbursed charge-offs, and overcollateralization (each series' investor interest in the pool). The issuer interest excess, which is the pool's balance over the sum of all series' investor interests, is not allocated to any specific series.

The issuances from the pool include a revolving period ending May 15, 2026, (the scheduled payout commencement date) for the series 2023-B notes, during which, the issuer will not use principal collections to reduce the notes' principal balance. Rapid amortization events may occur, based on various events. A failure to pay the notes in full on the legal final payment date is an event of default.

The class B note interest will not be paid on any payment date until the class A monthly interest for that date has been paid in full. The class B note principal will not be paid until the monthly interest and principal payable to the class A noteholders have been paid in full.

The servicer may choose to purchase the notes on any payment date on or after the payment date when the investor interest is reduced to an amount less than or equal to 10% of the initial note principal amount. The issuer is also required (if able) to redeem the notes in full on the scheduled payout commencement date through a refinancing. In both instances, the purchase price would be the principal and the accrued and unpaid interest on the notes through the day preceding the redemption date, plus any other amounts payable to the noteholders.

Transaction Collateral

The notes are backed by insurance premium loans, which are typically installment loans with a duration of less than one year and that usually cover a high percentage of the premiums financed. The security for the loans is the unearned premium balance that the insurance carrier owes if the underlying policies are canceled. We believe the insurance carrier is the main source of repayment because there generally should be no loss if the servicer cancels and the insurer remits the unearned premium payment on time. As a result, we do not analyze the borrowers but instead focus on the credit quality of the insurers providing the underlying policies.

Although the borrower remains liable to repay the loans, the insurance carrier must refund unearned premiums if the borrower defaults on the loan (because the default would lead to the underlying policy's cancellation). This means that for the loans to experience a loss, both the borrower and the insurance carrier would have to default. Although the insurance carriers owe certain payments that are backed by state insurance guarantee funds in the event of the carriers' insolvency, we believe receiving those funds could be delayed. Therefore, when analyzing the credit quality of the insurance carriers in the portfolio, we assign a recovery rate to the defaulted carriers' obligations that we discount to reflect the recovery timing.

Another issue relating to losses on premium finance loans is broker or agent fraud in origination. S&P Global Ratings reviewed the underwriting and collection process and believes that competent loan servicing is critical in mitigating this risk. The servicer hasn't experienced any fraud case exceeding $360,000 since 2010, and we expect it to service the portfolio in line with its historical performance.

Eligibility Parameters And Pool Characteristics

Based on the preliminary offering memorandum, the portfolio contains about $5.24 billion in premium finance loans as of March 31, 2023 (see table 1).

Table 1

Portfolio characteristics(i)

Portfolio size ($)	5,244,369,437
Overdue receivables (%)	
1-29 days	1.10
30-89 days	0.86
90-179 days	0.48
180 days and over	0.12
Total	2.56
Current receivables balance (% of total balance)	
$0-$4,999	8.05
$5,000-$9,999	6.08
$10,000-$24,999	11.89
$25,000-$49,999	10.29
$50,000-$99,999	11.41
$100,000-$499,999	27.90
$500,000 or more	24.38
Total	100.00
Remaining installments (% of total balance)	
Nine payments or less	81.32
10-11 payments	17.93
12-24 payments	0.67
More than 24 payments	0.08
Agent concentration (% of total balance)	
Top three agents	15.49
Top five agents	22.91
Top seven agents	29.37

Table 1

Portfolio characteristics(i) (cont.)

Top five geographic concentrations (% of total balance)

Florida	17.00
Texas	14.91
California	12.85
New York	8.19
New Jersey	3.49

(i)As of March 31, 2023.

The loans are used to finance a wide variety of policies that cover general liability, commercial property, professional liability, and automobile insurance. Loans that are transferred to the issuer's pool must satisfy eligibility criteria that address loan maturity and other requirements, according to the transaction documents (see table 2). In addition, eligibility is further constrained by certain concentration limits that generally address the insurance carriers' diversity and credit quality.

Table 2

Portfolio constraints

Item	Parameter	For values	Constraint
1	Policy term	Original policy term: 60 months or less	N/A.
2	Insurance obligor concentration maximums(i)	S&P Global Ratings' credit rating on insurance obligor: at least 'A+'/at least 'BBB+'/at least 'BBB-'/less than 'BBB-'	Maximum percentage of outstanding obligations: 9.0%/7.0%/4.0%/2.0%.
3	Carve-out for largest insurance obligor	N/A	Maximum 15.0%.
4	Minimum rating bucket	'BBB+' by S&P Global Ratings or 'Baa1' by another rating agency	At least 60.0% of the portfolio has an insurance obligor with these ratings.
5	A single direct obligor	N/A	If 85.0% of the obligors' policies have insurance obligors that are rated 'BBB' or higher (or 'Baa2' or higher by another rating agency) 2.0% of the portfolio; otherwise, 1.0% of the portfolio.
6	Single producer	N/A	Maximum 5.0%, except for designated producers that are specifically named in the transaction documents.
7	Carve-out for designated producers	Two named producers (agents) are allowed to have larger percentages	Specified at 6.0%/9.0%.
8	Canadian direct obligors	N/A	Maximum 5.0% of the portfolio.
9	Government agency direct obligors	N/A	Maximum 2.0% of the portfolio.
10	No. of installments	N/A	Maximum 4.0% of the portfolio allowed for more than 11 installments.
11	Personal lines of insurance	N/A	Maximum 3.0% of the portfolio.

Table 2

Portfolio constraints (cont.)

Item	Parameter	For values	Constraint
12	Receivables with a down payment less than 5.0%	N/A	Maximum 6.0% of the portfolio.
13	Four largest insurance obligors	N/A	Maximum 24.0% of the portfolio.
14	Financed receivables rate	Over any three-month period	The ratio of new loans to total premiums must remain below 85.0% (at least an average of 15.0% down payment on the premium loans).

(i)Unless indicated, these rating levels allow for credit ratings from other rating agencies. N/A--Not applicable.

Credit Analysis

Credit support for the notes will be provided by overcollateralization via the required reserve amount. The transaction includes certain performance triggers that, if breached, will increase the required reserve percentage or add reserves and, as a result, increase the credit support available to the notes.

The performance triggers for the class A required reserve percentage (which is initially 10.00%) are:

- If the three-month rolling average defaulted receivable rate exceeds 1.00%, or if the sum of all receivables in the pool related to insurance companies that are in liquidation or that have been placed in conservatorship or rehabilitation for more than 180 days exceeds 3.50%, the required reserve percentage will step up to 12.00%.
- If the clause above is not applicable and the percentage of insurance companies in the pool that are rated 'AA-' or higher by S&P Global Ratings is less than 12.00%, the required reserve percentage will step up to 11.00% until the percentage of insurance companies rated 'AA-' or higher increases to at least 12.00% for three consecutive months.
- If the net portfolio yield averaged in three consecutive months is less than 3.00%, an additional 1.5x the difference between 3.00% and the average net portfolio yield in those three months will be reserved until the net portfolio yield is at least 3.00% for six consecutive months.

The performance triggers for the class B required reserve percentage (which is initially 4.25%) are:

- If the three-month rolling average defaulted receivable rate exceeds 1.00%, or if the sum of all receivables in the pool related to insurance companies, which are in liquidation and that have been placed in conservatorship or rehabilitation for more than 180 days, exceeds 3.50%, the required reserve percentage will step up to 6.25%.
- If the clause above is not applicable and the percentage of insurance companies in the pool that are rated 'AA-' or higher by S&P Global Ratings is less than 12.00%, the required reserve percentage will step up to 5.25%.
- If the net portfolio yield averaged in three consecutive months is less than 3.00%, an additional 1.5x the difference between 3.00% and the average net portfolio yield in those three months will be reserved until the net portfolio yield is at least 3.00% for six consecutive months.

Increased credit support is available from the issuer interest (the portion of the pool that isn't allocated to any series of notes). If the loans and funds available in the issuer interest are insufficient to maintain the investor interest, within a defined timeframe, the transaction will enter into a rapid amortization mode in which the issuer will allocate all available funds to pay down the note principal.

All series of notes will begin rapid amortization if any of the following issuer payout events occurs:

- Any seller or the servicer becomes bankrupt.
- The sellers are unable to transfer the receivables to the issuer according to the purchase agreement, and this continues for three business days after the issuer or any seller is notified.
- The issuer or any seller becomes an "investment company" under the Investment Company Act of 1940, as amended.
- The aggregate deposit in the trust accounts exceeds 66.67% of the aggregate principal receivables at any time.

Each of the following events will lead to a series payout event, which may trigger rapid amortization:

- The issuer fails to pay any monthly interest (including deficiency and additional interest), the proportion of trustee fees and expenses, servicing fees, and any deferred fees and expenses, and this failure is not remedied within the grace period.
- The issuer provides an incorrect representation or warranty, and it is not remedied within the grace period (except for a representation or warranty breach in the transaction documents related to a receivable--if the servicer has received a deemed collection of the balance of that receivable and all accrued and unpaid interest).
- The issuer, any seller, or IPFS becomes subject to any bankruptcy or voluntary payment suspension.
- The issuer, any seller, or IPFS becomes an "investment company" under the Investment Company Act of 1940, as amended.
- A servicer defaults, and the default is not remedied within the applicable grace period.
- The three-month rolling average of the net portfolio yield falls below 0.75%.
- The monthly defaulted receivables rate exceeds 1.50% in any one month.
- The three-month rolling average monthly payment rate falls below 15.00%.
- In any one month, the aggregate adverse determination receivables and those for which a deemed collection has been received equals or exceeds 10.00% of the sum of all receivables and adverse determination receivables for which a deemed collection has been received.
- The trustee fails to have a valid and perfected first-priority security interest in the receivables and related security.
- The coverage test is not satisfied, the required reserve amount cannot increase for specified periods, or the risk retention requirements are not met and remained uncured for a specified period.
- The issuer or any seller faces certain impositions of tax liens.
- There is a change in control of IPFS.
- A purchase termination event under the purchase agreement occurs.

- An event of default under the indenture occurs.
- The issuer fails to pay out the notes in full on the legal final payment date.
- A payout event occurs under any other series.
- An involuntary filing of a decree or order for relief by a court having jurisdiction in the premises regarding the issuer or any substantial part of the trust estate in an involuntary bankruptcy.
- The servicer cannot transfer the receivables' collections or proceeds to the issuer.

Our analysis for premium finance transactions produces expected loss levels at different ratings through a combination of three inputs that are weighted differently. The three inputs are:

- Historical annual net defaults. These defaults, which have averaged about 0.28% over the past 20 years, are stressed by a multiple, depending on the rating scenario. Given the evolving economic conditions related to the COVID-19 pandemic, we also ran a sensitivity scenario using the annual net default of 0.47% from 2009 as a loss proxy, as it represented losses during the last recessionary period. We considered a 5x multiple appropriate in the 'AAA' base-case scenario and a 3x multiple appropriate in the 'A' base-case scenario.
- A loss caused by a default of the largest insurance carrier (as assessed by S&P Global Ratings) and affiliates that are rated within one notch of the parent (which has a financial strength rating that is four or more notches below the rating scenario). In this scenario, we assume a high recovery level because the issuer, which holds the right to collect the unearned premiums, would receive a high ranking among the creditors of an insurance company under receivership.
- A loss caused by a default of all insurance carriers with a financial strength rating four or more notches below the rating scenario. Again, we assume a high recovery level.

Given its revolving nature, the portfolio may become more concentrated or more diversified or maintain its current insurance carrier concentration level. As such, a worst-case portfolio, based on the concentration limitations, shows that the deal would be susceptible to volatility in its concentrations.

Based on the transaction's documents and credit support levels, we believe the enhancements available are sufficient to support the assigned rating levels, and the notes will be paid timely interest and ultimate principal in full by the legal final maturity date.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities , Dec. 22, 2020
- Criteria | Structured Finance | Legal: U.S. Structured Finance Asset Isolation And Special-Purpose Entity Criteria , May 15, 2019
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions , March 8, 2019
- Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions , Jan. 30, 2019
- Criteria | Structured Finance | General: Global Framework For Assessing Operational Risk In

Structured Finance Transactions , Oct. 9, 2014

- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts , May 31, 2012
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011
- Criteria | Structured Finance | General: Methodology For Servicer Risk Assessment , May 28, 2009
- Criteria | Structured Finance | ABS: U.S. Insurance Premium Loan Securitizations: Methodology And Assumptions , April 28, 2005

Related Research

- U.S. Property/Casualty Insurers Face Declining Investment Values And Personal Lines Loss Cost Inflation, Jan. 25, 2023
- Global Insurance Markets: Inflation Bites, Nov. 30, 2022