2008 CAS Ratemaking Seminar
COM-2: Non-Standard Distribution Channels: Managing General Agents and Programs

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Agenda

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Overview

New Business Opportunities

Risk Sharing

Managing a Program

Exit Strategy

Summary

Overview

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Overview

Program Administrator (PA)

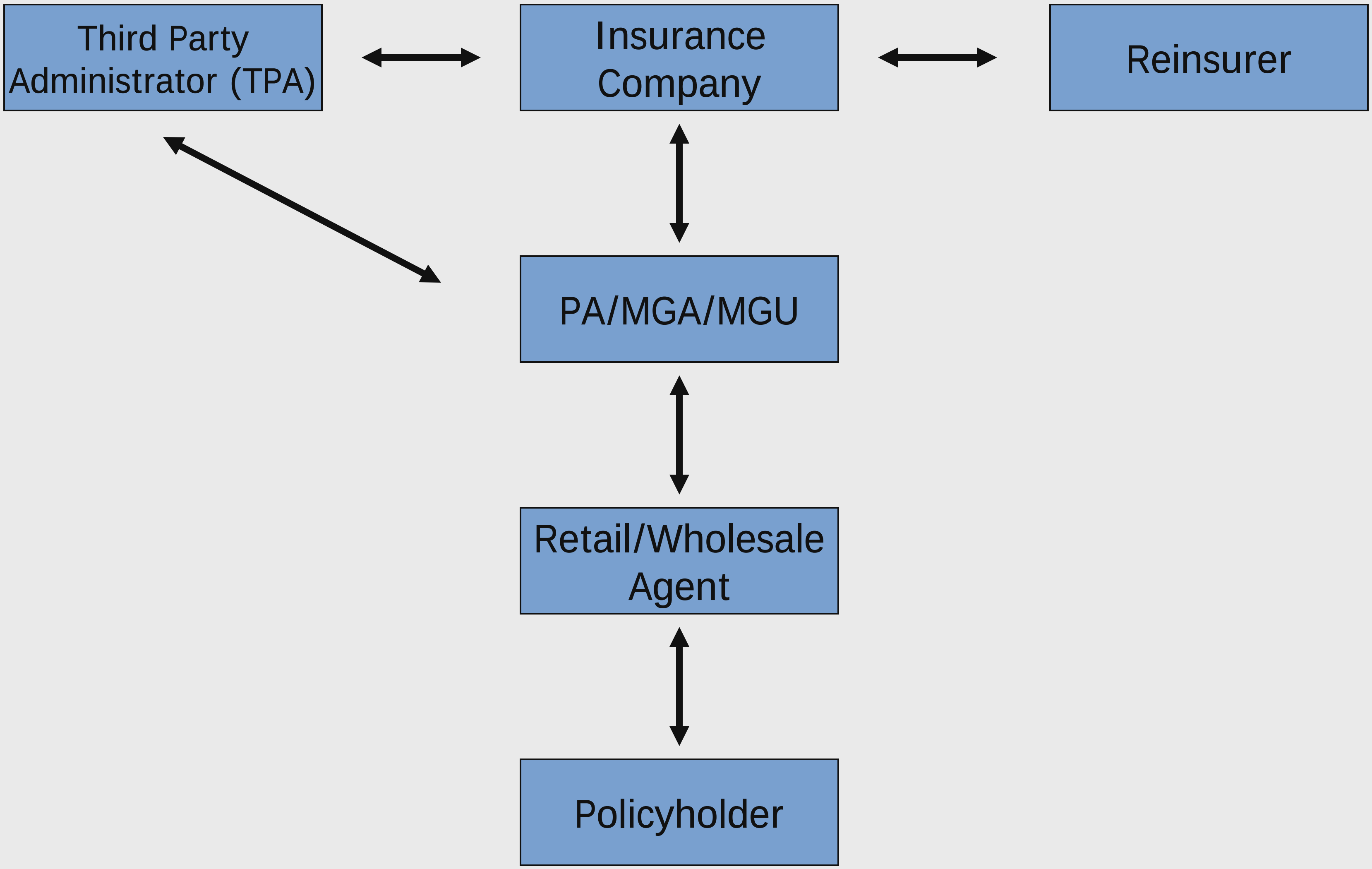
- An agency that provides some or all of the following services:
  - Marketing
  - Underwriting
  - Binding
  - Policy Issuance
  - Premium Collection
  - Data Processing
  - Loss Control
  - Claims Management

Overview

Program Administrator (PA)

- Independent contractor, not a branch of the company
- Could be called managing general agent (MGA), managing general underwriter (MGU) or simply general agent (GA)
- Aggregator of retail agents and insureds that meet business model for program
- Some larger PAs employ an actuary

Overview


Third Party Administrator (TPA)
Insurance Company
Reinsurer
PA/MGA/MGU
Retail/Wholesale Agent
Policyholder

Overview

Program Business

- A well-defined and narrow segment of insurance marketplace
- Company interfaces with PA only
- PA “controls” business
- PA may assume some underwriting risk
- Specialized coverage
- Proprietary rates and rating factors

Overview

Other Attributes of Program Business

- Life span of program varies
- Premium rolls on and off in large, identifiable blocks
- Meaningful expenses at both end points
  - Due diligence process at the start
  - Run-off expense without premium income at end
- Expired programs can pile up and strain current resources
- The universe of established PAs is limited and known
- More parameter risk than a book of business produced directly through retail agents

Overview

Why discuss MGA/Program Business?

- Significant Market Segment

- Past Failures

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Overview
Using PA's: Pros and Cons

PROS:

- Allows a company to enter a new market segment without significant fixed overhead expense.
- Ease of entry and withdrawal
- Special line/class expertise
- Geographic targeting
- Portfolio diversification

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Overview
Using PA's: Pros and Cons

CONS:

- Incentive divergence
- Systems mismatch
- Expensive way to do business
- Flight risk

New Business Opportunities

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New Business Opportunities

General Considerations:

- The Best Predictor of Future Behavior is…
  - Know the PA’s history
  - Know the history of the particular book of business
  - How have they performed in the hard and soft markets?
- Strong Financials
- Market Reputation

New Business Opportunities

General Considerations (Continued):

- New, New Business – How do they expect to PROFITABLY gain market share?
- Existing Book – Why are they leaving their current carrier?
  - How many times have they switched carriers in the last 10, 15, 20 years?
- What do they bring to the table other than premium volume?
- Potential Conflicts
  - What other programs do they administer?
  - What other business do you write that may compete?

New Business Opportunities

Actuarial Considerations:

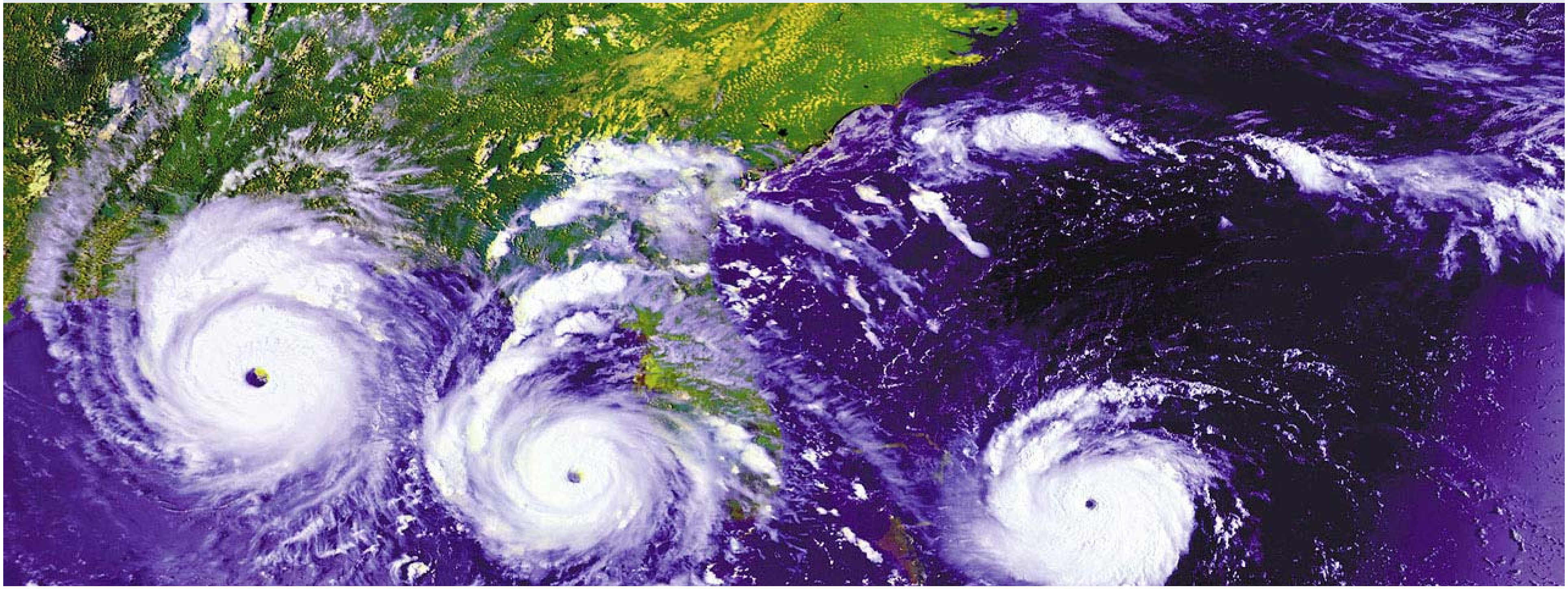
- Program experience is often not “fully credible”
- A complete premium and loss history
  - Current Evaluation
  - Include any “re-underwritten” classes
  - Identify CATs separately
- Large Losses
  - Use to calculate a limited loss ratio

New Business Opportunities

Actuarial Considerations (Continued):

- Rate History
  - Including LCMs and discretionary mods
- Loss Development
  - How often have they changed TPAs? Is there evidence that the change(s) have impact the development patterns?
  - Industry benchmarks may not be appropriate
- Underwriting Guidelines
  - Impact of a change in underwriting guidelines on the ELR

Risk Sharing



Risk Sharing

Types:

- Captives / Rent-a-captives
- Profit-sharing commission
- Sliding-scale commissions

How much is appropriate?

- Review PA's financials
- What would 1 or 2 years of bad results do to the PA?

Risk Sharing

Pros:

- Alignment of interests ("Skin in the game")

Cons:

- Collateral requirement
- Shrinks the universe of potential business partners

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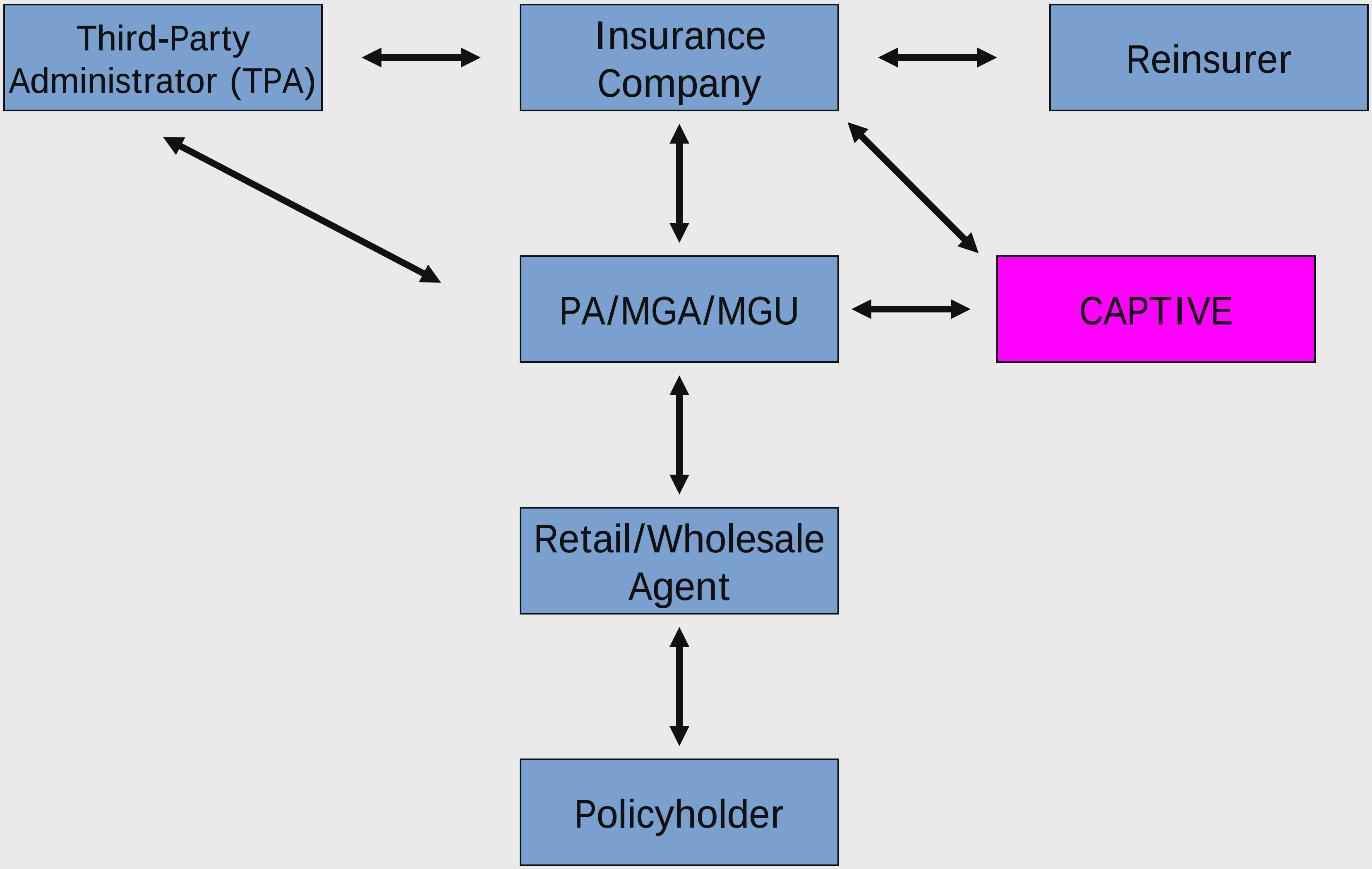
Risk Sharing
Captive



Risk Sharing
Captive

Characteristics:

- Can (somewhat) “mimic” the insurance company’s results
- Insurance company cedes a share of the business to the captive
- Insurance company (or an affiliate) provides stop loss protection to limit the PA’s risk
- Collateral
  - Statutory requirement – Up to the expected losses
  - Additional credit risk – From expected losses to stop loss attachment
- Captive manager (another expense)

Risk Sharing
Sliding-Scale

Characteristics:

- Profit commission that also slides downward
- "Provisional" (up -front) commission usually set in the middle of the slide
- Adjustments:
  - Annually
  - Include IBNR (Contractually defined)
- Can be multi-year blocks with profit/loss carryforwards.
- Difference between the provisional commission and the minimum commission is credit risk to the company.

Risk Sharing
Sliding-Scale

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Example:

Provisional Commission = 20%

Loss Ratio	Commission
40%	22% (max)
50%	20%
60%	18% (min)

“Initial” Credit Risk = 2% of Premium (20% - 18%)

Risk Sharing
Sliding-Scale

Collateral example:

- $10M program
- 2% downward slide
- Required collateral = $200,000 (2% of $10M)

Issues:

- When is it “safe” to release collateral?
- Collateral accumulates - How much collateral is needed after year 2, year 3, etc.?

Managing a Program

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Managing a Program

During the due diligence process, an “underwriting box” for the program is created:

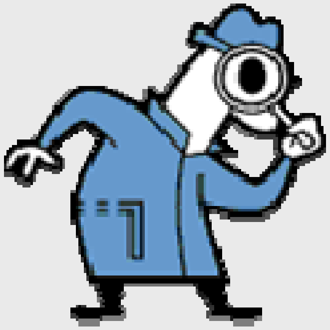
- Lines of business
- Classes
- States
- Limits
- Coverages
- Etc.

So now what?…

Managing a Program
Monitor, Monitor, Monitor

“Trust, but verify”

- Ronald Reagan



Managing a Program
Monitor, Monitor, Monitor

Is the PA adhering to the underwriting guidelines?

Is the PA selecting the right risks?

- U/W Guideline should include a section describing the characteristics of a target risk.

Is the program achieving the desired results?

- Target loss and combined ratios
- Mix of business (e.g. state, class and limits distributions)

Managing a Program
Monitor, Monitor, Monitor

Monitoring methods:

1. Individual account referrals
2. Reports
   - Underwriting results
   - Rate and price monitoring
   - State and limits distributions
3. Audits

Managing a Program
Monitor, Monitor, Monitor

Individual account referrals

- Accounts where the PA does not have binding authority
- Criteria defined in the underwriting guidelines
- Typical criteria:
  - Premium/exposure threshold
  - Higher limits
  - Hazardous class
  - Location (e.g. CAT zone)
  - Poor loss history

Managing a Program
Monitor, Monitor, Monitor

Reports

- Underwriting results
- Rate and price monitoring
- Renewal ratios, new vs. renewal split
- Profiles
  - State/territory
  - Limits
  - Classes
- Submit/quote/bind ratios

Managing a Program
Monitor, Monitor, Monitor

Audits

- Underwriting
  - In-depth file review of a “representative sample”
- Claims
- Financial/systems

Exit Strategy

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Exit Strategy

“You can put wings on a pig, but you don’t make it an eagle.”

- William Jefferson Clinton

Exit Strategy

"Fish or cut bait?"

Considerations:

- Poor results
- Underwriting guideline violations
- Key person defections
- Softening market
- Run-off expenses with no premium income

Summary

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Summary

KEY TAKE-AWAYS

1. Know your business partner – Start with a thorough due diligence
2. Align your interests – Provide the PA with a financial incentive to produce good results
3. “Trust, but verify” – Monitor, Monitor, Monitor
4. “Fish or cut bait?” – Have an exit strategy

Thank you very much for your attention.

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