September 19, 2022

Technology and Talent Drive MGA Growth

MGAs can play a vital role in matching risks and insurers and have attracted participants throughout the insurance industry

Principal Takeaways

- Premium growth attributable to MGAs has increased significantly in the last decade.
- DUAEs are playing a more prominent role, partnering with insurers to address the need for increasingly specialized coverage to cover evolving and emerging risks.
- The capital backing the risks MGAs are underwriting is not naïve and new MGAs can underwrite with clean balance sheets and without considering legacy liabilities.
- Experience and specialty expertise have helped DUAEs widen the scope of responsibilities they handle for their insurer/partners.
- Technological advancements have allowed DUAEs to add accretive value to both new and established relationships.

In the current global insurance market, some of the biggest growth areas include construction, energy, healthcare, environmental, professional, and cyber liability. Inflation, changes in climate-related risks, and exposure to cyber attacks have combined to necessitate specialized coverage to address inherent risks. The factors involved with these risks has fueled a demand-side need for more specialized coverage approaches and created a multitude of premium growth opportunities for the managing general agent (MGA) segment. MGAs play a vital role in matching these risks and insurers. In addition, MGAs entering new markets such as cyber have helped attract new capital and talent.

The prominence of the MGA market has greatly increased over the past decade. The market has been a hotbed for consolidation, with mergers and acquisitions of insurance distributors leading to a decline in the overall number of brokers in the market. At the same time, the number of MGAs has risen. Some specialized brokers have shifted to MGA operations, providing insurers with a more cost-effective conduit to new markets. Some MGAs used established relationships with affinity groups and their ability to bundle risks, to provide insurers access to niche business opportunities.

AM Best includes MGAs in the category of delegated underwriting authority enterprises (DUAEs), which groups together managing general underwriters, coverholders, program administrators, program underwriters, underwriting agencies, direct authorizations and appointed representatives. In its *Best's Performance Assessment for Delegated Underwriting Authority Enterprises* methodology, AM Best defines a DUAE as a third party appointed by a (re)insurer, through contractual agreements, to perform underwriting, claims handling, and other administrative functions on behalf of its partners.

DUAEs – The Basics

Unlike traditional insurance agents and brokers, DUAEs may be granted underwriting authority by an insurer and can administer programs and negotiate contracts acting as the insurance agent or broker for the insurer. Insurers grant underwriting authority selectively since underwriting capability differs from one DUAE to another. DUAEs can also serve as the

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Exhibit 1
Delegated Underwriting Authority Enterprise Descriptions

Managing General Agent	MGAs are specialized insurance agents/brokers that represent (re)insurance companies, acting as intermediaries among (re)insurers, retail agents, and wholesale brokers or agents. MGAs take on functions ordinarily handled only by insurers, such as binding coverage, underwriting and pricing, appointing retail agents within a particular area, and settling claims. Unlike MGUs, MGAs can be involved in the claims process (paying and/or adjusting claims) or the loss control process. MGUs have been less involved with claims or loss control than MGAs. MGAs are usually involved with risk classes or lines of coverage that require specialized expertise.
Managing General Underwriter	MGUs have many of the same characteristics as MGAs but are typically granted broader underwriting responsibilities than MGAs because of their expertise with the risk class, program, or line of business. (Re)insurance companies will contractually allow MGUs to underwrite and bind coverage on risks that fall within specific guidelines or parameters established by the (re)insurer. The MGUs' responsibilities can extend to pricing, crafting policy wording, appointing retail agents, and occasionally handling and adjusting claims and claims payments.
Program Administrator	A program administrator is often synonymous with an MGA and the terms are used interchangeably. Program administrators will handle similar functions as MGAs for specific programs of homogeneous risks, generally providing services such as underwriting, binding, policy issuance, and premium collection. They also provide back office support to insurers, helping them better manage the program from their end. Given the depth of program administrators' expertise, (re)insurers may extend them certain loss control and claims management duties, as well.
Underwriting Agency	Agencies given underwriting and policy writing authority by an insurer. The authority given allows the agency to underwrite, price, and issue the physical policy to the insured. For the scope of services rendered, the agency receives increased commissions.

Source: AM Best data and research

intermediary between insurers/agents and insureds. Additionally, insurance carriers use DUAEs because of talent and infrastructure constraints. Insurance companies give these insurance partners the authority to bind business, along with responsibility for other functions. MGAs, the most common form of DUAE in the US market, will be the primary focus of this report.

Each DUAE has unique characteristics, and agreements can include distinct functions and features. Insurers typically enter relationships with DUAEs to generate growth, provide specialized market expertise, and handle administrative functions related to the business produced. **Exhibit 1** describes some of the common types of specialty insurance distributors. (The terms "managing general agent" and "program administrator" are largely interchangeable.) Insurers use these distributors to access specific risk classes because they may not have the expertise to underwrite them. Some DUAEs handle a number of their partner insurers' functions, such as administrative services and claims management

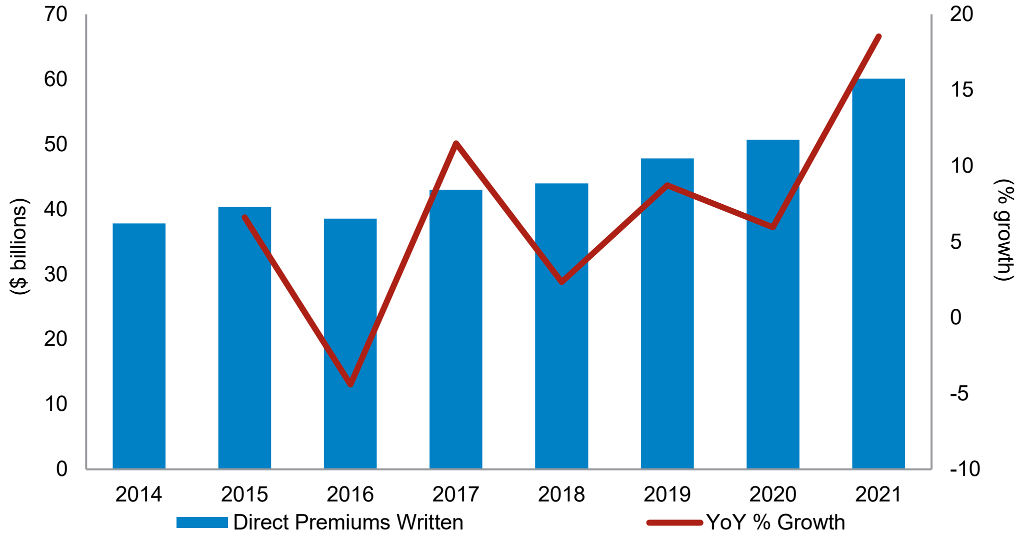
Expanding Relationships Drives Growing Market Prominence

The COVID-19 pandemic and the economic fallout due to lockdowns led to a severe contraction in the economy. Real GDP in 2020 contracted by 3.4%, versus growth of 2.3% in 2019. However, the story of 2021 was one of growth, with the economy rebounding as the lockdowns were lifted; easy monetary policies contributed to real GDP growth of 5.7%. As businesses reopened, commerce resumed, the insurance industry enjoyed premium growth of 9.5%, attributable to exposure growth as GDP grew, along with marketing hardening that affected several lines of coverage owing to inflationary concerns resulting from supply chain disruptions, and to extended monetary easing.

Insurers are required to record details of the premiums generated by MGAs when these premiums are greater than 5% of the insurer's policyholders' surplus. According to raw totals in Note 19 of statutory filings, MGA premiums stood at a record $60 billion, or 19%, in 2021, up from $51 billion,

Exhibit 2

US P/C Industry - MGA Direct Premiums Written, 2014-2021



Source: BESTLINK

up 6%, in 2020. However, the actual premium produced by MGAs is more than $60 billion since insurers report only MGAs that generate premiums greater than the 5% surplus; there may be a number of MGAs whose premiums have not been captured because of the 5% threshold (**Exhibit 2**).

DUAE Roles and Responsibilities

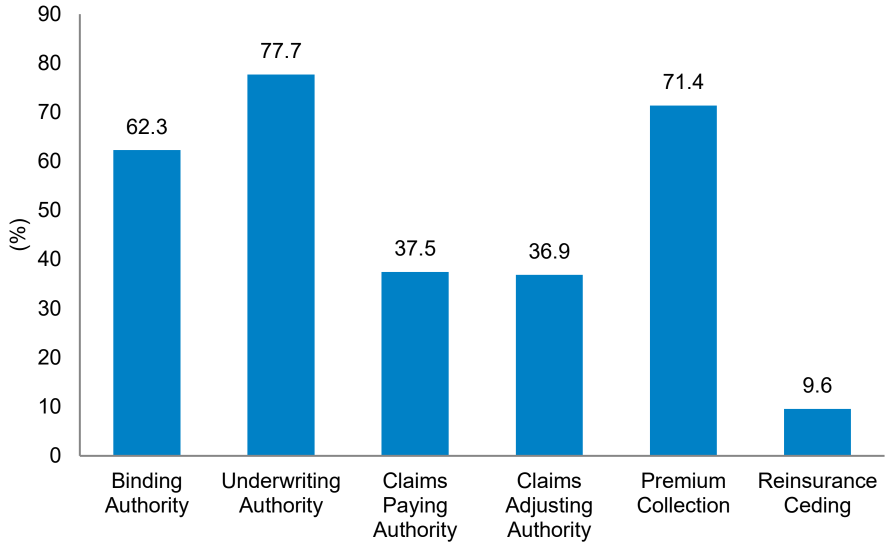
MGAs play a variety of roles in their partnerships with insurance carriers, depending on their contractual agreements. These benefits include expanding capacity, diversifying portfolios geographically or by line of business, and enhancing a carrier's market agility, since MGAs can handle time-consuming roles such as policy processing and servicing functions. MGAs provide carriers with risk management and governance infrastructure, along with underwriting and pricing acumen. Because building such services and capabilities from scratch requires significant investment, MGAs provide a cost-effective way for (re)insurers to cover niche or emerging risks, as they can supply carriers with access to business for a fraction of the investment required to establish the necessary expertise in-house.

Aligning with MGAs allows carriers to withdraw their capital investments relatively quickly if performance does not meet expectations. Successful MGAs tend to have strong, long-standing customer relationships, robust frameworks for both managing account information and monitoring performance, and specialized expertise. As companies' risk appetites and strategies change due to market conditions, MGAs can offer a flexible alternative to adapt to insurance cycles. An MGA's functions depend on the authority granted by the insurer, such as administering programs and negotiating contracts (**Exhibit 3**), and include the following:

- Binding/underwriting/ policy issuance: The MGA selects the risks to be underwritten, quotes on the risks, and binds the insurer on them, and issues policies, endorsements, binders, and other related documents.
- Claims payments: The MGA services and settles submitted claims, based on contractual guidelines.
- Reinsurance ceding: The MGA manages binding reinsurance or retrocessions on behalf of the insurer.
- Premium collections: The MGA collects premiums due on the insurer's behalf.
- Appointing agents: The MGA enters into agreements with properly licensed and qualified professional insurance agents and brokers to accept policies on the insurer's behalf.

Exhibit 3

Types of Authority Granted to US P/C Managing General Agents



Source: AM Best data and research

Typically, MGAs granted underwriting authority are also granted the authority to bind their insurance company partners on underwritten business. In the rare instances when DUAEs are given only binding authority, the insurer bears responsibility for account underwriting. In these cases, the insurer can also cancel a policy when it reviews the risk subsequent to binding.

Shifts in Market Strategies, Technology, Talent Bolster MGA Market Growth

By our estimates, the premium generated through the MGA market has doubled over the past decade. Acquisitions and consolidations of insurance distributors have led to a decline in the number of brokers, while the number of MGAs has grown. Specialized brokers have shifted to MGA operations, providing insurers with a more cost-effective conduit to new markets. Some MGAs have used established relationships with affinity groups and their ability to bundle risks, to provide insurers access to niche business opportunities.

Demand-side conditions make the market ripe for MGAs. The awareness of risks such as pandemic risk, cyber, inflation, and climate risk have increased quite dramatically. The challenges of cyber security are elevated because of increasingly sophisticated ransomware criminals. Climate risk has worsened in line with the increase in both frequency and severity of both primary and secondary perils. In addition, states such as Florida have issues related to litigation on the rise. Inflation has caused an increase in asset values—corporations, consumers, and their agents are increasingly facing an insurance market with very cautious risk appetites.

Technology has played a vital role in the MGA market as well. As the larger insurance companies struggle with legacy systems and databases, the smaller MGAs have proven to be agile in implementation of these systems that incorporate sophisticated algorithms that can perform risk selection, pricing, and underwriting that are accretive to the profitability of the insurers.

Another key area where MGAs add value is talent. The considerable underwriting talent that has been absorbed in the MGA market has resulted from senior underwriters and actuaries looking for entrepreneurial opportunities or senior insurance professionals looking for opportunities due to the ongoing and rapid consolidation in the broker and insurance markets. Either way, these professionals bring superior underwriting skills and a network of relationships that considerably enhance the value-add of MGAs.

In light of these factors, AM Best believes that the capital backing the risks MGAs are underwriting is not naïve and that it has the advantage of underwriting without considering legacy liabilities. A slight counter to our positive view stems from the experience of the early 2000s, when a number of casualty insurers became insolvent or experienced severe adverse reserve development. Due diligence in underwriting and pricing is critical for insurers, which will have to demonstrate a thorough understanding of the risks they assume even if they give their pen away.

Consistency Counts

Insurers that partner with MGAs have been consistent about their relationships, sourcing of premiums, and these insurers have tested strategies that allows them to be nimble in their use of MGA premiums.

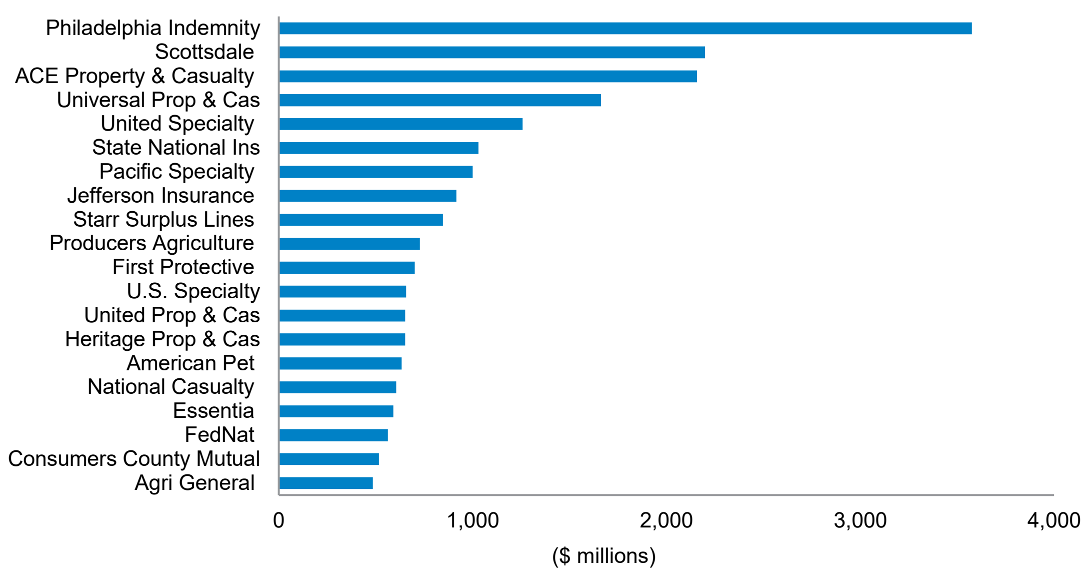
Exhibit 4 shows the 20 insurance companies that have generated the most premiums through MGAs. In 2021, Tokio Marine's Philadelphia Indemnity Insurance Company, a commercial carrier that has long focused on specialty niches, again generated the highest DPW for any company using MGAs. The company wrote its almost $3.6 billion in direct premiums through an affiliated underwriting manager, Maguire Insurance Agency, which is owned by the same parent company.

Both Affiliated and Unaffiliated MGAs Augment Insurer Operations

Because an unaffiliated MGA operates independently of insurers, it may do business with any number of insurers and move its business from one carrier to another. The percentage of MGA premium generated by unaffiliated entities has risen over the last several years, as insurers have sought to achieve organic growth via expanded distribution channels. According to our research, in 2021, 20 unaffiliated MGAs generated over 60% of the total direct premium produced by unaffiliated US MGAs.

Exhibit 4

US P/C Industry: MGAs' Direct Premiums Written by Insurer, 2021



Source: BESTLINK

Best's Performance Assessment for DUAEs

Our *Performance Assessment for Delegated Underwriting Authority Enterprises* is a forward-looking, independent, and objective non-credit opinion indicative of a DUAE's ability to perform services on behalf of its insurance partners. The PA is a comprehensive analysis consisting of a quantitative and qualitative assessment of underwriting capabilities, governance and internal controls, financial condition, organizational talent, and depth and breadth of relationships.

The DUAE role is an essential part of the insurance distribution model.. In this methodology, DUAE is used as a blanket term to capture MGAs, MGUs, coverholders, program administrators, program underwriters, underwriting agencies, direct authorizations, and appointed representatives. AM Best recognizes that each DUAE has unique characteristics but believes that the application of this methodology is sufficiently comprehensive in capturing the key factors necessary to assign a PA to any of these entities. Best's PA for DUAEs provides insight to market participants, such as carriers and agents, that are contemplating a partnership with a DUAE.

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