Module K Unit 22

MANAGING GENERAL AGENTS AND DELEGATED AUTHORITY UNDERWRITING

Purpose

At the end of this unit the participant should understand what is a Managing General Agent (“MGA”), its purpose and how it operates.

Assumed knowledge

An understanding of the regulation of an insurance manager see Unit 7

Summary of learning outcomes
1. Explain the purpose of an MGA.
2. Describe the key roles undertaken by an MGA.
3. Describe the responsibilities of an MGA under a Delegated Authority Agreement.

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22.0 INTRODUCTION

An insurer's purpose is to underwrite better risks at a better price to be more financially successful than their peers. Insurers recognise that there may be situations where a particular underwriter may have:

- better knowledge of risk in a specific market or location,
- command a better reputation with the brokers and/or
- have better systems relevant to the particular risk.

That is where the insurer may delegate to another underwriter, not employed by them, to underwrite the particular class or geographic area of risk more advantageously.
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The purpose of this section is to explain the nature of delegated authority and how it typically operates. The phrase Delegated Authority is usually used in the Lloyd's and UK space but the US phrase of Managing General Agent (MGA) has become common parlance to signify an underwriter operating under a delegated authority.

22.1 WHAT IS AN MGA?

MGAs come in many forms but the general principle is that an MGA is a regulated intermediary which is able to price and put conditions on risks and bind its insurer or insurers to those risks. The MGA is appointed by the insurer or insurers and acts with their authority in pricing, risk acceptance, imposing conditions and agreeing wordings for a risk.

In the UK the MGA will usually be licensed as an Insurance Intermediary. It will act as the agent of the insurer and is not operating for the benefit of its ultimate clients whose business will be received from an insurance broker who takes on the duties and responsibilities to its customers. Funds accepted by the MGA are effectively assets of the delegating insurer. As such the MGA operates an insurer account and is therefore not subject to the rules around the operation of client money accounts.

The degree of delegation and the conditions placed on the contract will be defined in a Delegated Authority Agreement. Failure to observe the conditions of the Agreement could open the MGA up to a liability claim if such non-observance creates loss to the insurer. The MGA needs to ensure that its own policies and procedures match the conditions of the delegation. Such checks and conditions may well be built into the underwriting systems which the MGA utilizes.

22.2 DELEGATED AUTHORITY AGREEMENT

The scope of the delegated authority will be encapsulated in an agreement between the insurer (s) and the MGA. There are standard wordings in use in the Lloyd's market and the London company market as well as used by major insurers and the structure of a typical agreement is attached at the end of this unit. The agreement will address such issues as:

- <u>Definition of the Underwriting Agent</u> – Covering the Name, Company number, registered office regulated status of the entities who are contracting together.

- <u>Underwriting Agent Authority</u> – This will define how the authority is granted and evidenced, the period of the agreement and the conditions for renewal. This section will define those persons

- with the ability to bind, issue documents, exercise claims authority. It will define how the organization goes about changes of those persons named in the agreement.

- Scope of Authority – this will define the bounds of the delegation covering the classes of business and cover which are authorised and those excluded. It will cover territorial limits of operation, financial limits on liability or values insured. It may define required deductibles and excesses on policies and limits on the period of insurance.

- Underwriting Agent Commissions and Expenses – Will define how the MGA is to be remunerated by commissions, fees, the basis of refund of same and profit commissions and their calculation. The purpose of the profit commission is to ensure the Insurer's and the MGA's interests are aligned otherwise the MGA's actions could be driven by business volume only.

- Documentation for Insurances Bound – will define the insurer's expectations in terms of documentation to be received in respect of a risk, approval of proposal forms and the definitions of documents which are expected to be signed or issued by the MGA.

- Claims and Complaints – this will cover the procedure for the handling and settlement of claims and pursuit of potential recoveries. Authority may be delegated to the MGA to receive claim notifications through to full authority to adjust and agree claims. The section will also cover redress of the client and the conduct of any complaints or proceedings which might arise.

- Reporting, Records and Aggregate Exposures – This will cover the reporting of the business written in a bordereau report which will typically include all the necessary information for the Insurer to identify that the risk fits the agreed profile, such as exposure, risk class, territory etc. The reporting of the paid position will also be covered so as to detail the amounts received, the appropriate deductions etc. This will also specify any quarterly or annual reporting requirements on the overall performance of the account.

- Advertising – This will cover the insurer's requirements in controlling or approving any advertising and promotional material connected to the delegation or scheme. The insurer will have an interest in how the MGA represents its relationship to intermediaries and clients.

- Bank Accounts – This will set rules around the operation of Bank Accounts for the facility. Whether the Insurer requires separate bank accounts be set up for their business or allows co-mingling of funds with those of other insurers for who the MGA acts perhaps under a different facility. Possibly requiring separation of insurance and claims funds accounts.

- Compliance, Regulatory and General Requirements – The agreement will need to specify the actions required in respect of licences to underwrite of the insurer and how it is able to access business. The operation of premium taxes will also need to be covered whether the MGA pays certain taxes for certain jurisdictions or whether the MGA passes such taxes on to the insurer. The operation of the facility will need to ensure the insurer is in funds to meet its tax requirements. Similarly the agreement will need to define how certain fees and charges which may arise are handled and administered. Are such fees or charges deducted prior to the calculation of the MGA's Commission has to be clarified.

The MGA will need to maintain indemnity insurance and minimum requirements may be specified within the agreement.

The agreement may also lay down certain minimum requirements for the MGA's business continuity plans and ability to recover form an incident howsoever rising.

The agreement will cover the confidentiality requirements placed on the MGA in respect of the business.

The agreement will need to address conflicts of interest howsoever they may arise and how they will be identified and dealt with and if necessary, how agreement to a particular situation needs to be addressed and recorded.

The agreement will also need to address how the MGA will maintain compliance with the law and financial crime legislation particularly. The MGA and the Insurer may be formed in different jurisdictions and operating under different regulatory regimes and that needs to be addressed and the outcome recorded in the agreement. Similarly, Data Protection will generate requirements in both the MGA and the insurer's jurisdiction which will need to be addressed in the agreement. Both Financial Crime and Data Protection requirements are becoming almost a common standard across jurisdictions so this is unlikely to cause any conflict of requirements but may require the MGA to be cognisant of the requirement in the insurer's jurisdiction.

<u>Termination and Non-Renewal</u> - this will cover the basis for termination including early termination, the required notice for such termination and then the effects of such termination. Termination may require the MGA to run-off the business or to hand over all the information relating to the business to the insurer or its agent.

<u>Miscellaneous</u> - There will be fairly standard legal wording around the general interpretation of the agreement, enforceability clause, legal wording around the rights of Third Parties which could arise otherwise, the application of several liability and a jurisdiction and governing law clause for the agreement.

1. Risk Transfer

The MGA will typically be granted risk transfer by the insurer such that receipt of funds by the MGA as agent of the insurer is considered as receipt by the insurer. As such any terms and conditions on the payment of premium by the insurance intermediary are satisfied when the funds are received by the MGA.

It is important for an intermediary to know that when funds are passed to the MGA which benefits from Risk Transfer it has satisfied its duties to act in the interests of its clients in handing their funds only to an entity where receipt satisfies the terms of purchase of the insurance policy. Otherwise the intermediary still has duties to track the funds where they would remain client monies.

2. Claims handling

Insurers may also pass claims handling to the MGA if it has the particular capability to handle that. Or the insurer may retain all of the claims responsibility and there are all the points in between in terms of delegation. The MGA may be able to adjust claims itself or have the ability to appoint adjusters. The delegation of claims may depend on value with the insurer reserving to itself only the adjustment of the larger claims.

The MGA will typically have some form of Profit Commission in its remuneration arrangements which can create conflicts of interest in the handling of claims. As such the duties placed on insurers to Treat Customers Fairly (TCF) will require it to monitor the operation of the MGA's claims handling to ensure claims are handled properly.

3. Insurer's relationship with the MGA

The insurer and the MGA are usually completely separate in their ownership but there could be some investment by the insurer if they want to lock the MGA into the relationship. For a lot of MGA businesses purchase by the insurer can be an advantageous exit route for the MGA investors. An MGA will typically want to have a group of insurers for whom it underwrites. Being exposed to a single insurer whose attitude to underwriting could change for reasons completely unrelated to the performance of the MGA is a real risk. Having a group of underwriters allows for the ability to bring in new capacity and having insurers who could always increase their capacity to provide cover for an unplanned leaver.

4. Product Governance and Treating Customers Fairly

The UK is the most likely source of capacity for an MGA which we are considering here. That will bring the MGA into requirements which may not exist in its own jurisdiction but which are placed on the insurer whatever the jurisdiction of the source of business. The FCA requires its licensed insurers to follow a Treating Customers fairly regime. Other jurisdiction of insurers may well have similar requirements. This will place a regulatory burden on the insurer, who have a role in Product Governance, to ensure the insurance they are selling meets the rules and follows the processes and responsibilities required. It is vital that the MGA and the Insurer are clear about the role of each in the chain of responsibility in bringing a product to market and that it meets the TCF and other regulatory requirements.

5. Audit

The Insurer(s) will typically require a periodic audit of the MGA. This could be an in-house auditor or organisations such as Lloyd's use independent auditors who have been approved for use by the Corporation of Lloyd's and thus represent all the capacity providers.

6. Reporting

An MGA will typically report on a monthly basis to its insurer(s) on the risks written in the month and on a paid basis for the monies received. Such reports which list the risks are known as Bordereaux and would be prepared on a written basis and a paid basis. The Bordereaux will typically have the fields which allow the insurer to verify that risks are being accepted within the terms of the Delegated Authority. Organisations such as Lloyd's will have particular requirements for fields and information to be included in the Bordereaux. The Bordereaux may be delineated by currency, risk location, risk type/code etc.

7. Reinsurance

Usually the insurer will retain the duties to manage a reinsurance programme which may protect the MGA business line. This would be the case if the MGA is one of a number of sources of business within a particular class of business operating under a common reinsurance programme. Where the MGA is the sole source of a particular class of business there may be a reinsurance programme bought specifically for that line of business. Depending on their knowledge and experience the MGA may have the responsibility to purchase a reinsurance programme dedicated to the facility business. Similarly there may be requirements to buy facultative reinsurance to protect the facility for a particular a piece of business. Again this may be the responsibility of the insurer or of the MGA but those responsibilities and the policies and procedures applying will need to be clearly defined.

8. Finances and Remuneration

The MGA will operate insurer accounts which may or may not be set up under a trust structure. Trust structures for an intermediary must be used where the intermediary has a duty of care to its clients to protect those assets from financial failure of the intermediary. For an MGA there is no direct duty to the insured but there is effectively a duty to protect the funds it receives for its client the insurers. With the granting of Risk Transfer, payments into the MGA's insurer account will be equivalent to a payment to the insurer. The monies in the MGAs insurer accounts would still need to be protected from the bank or other parties enforcing debts of the MGA against those funds.

The MGA's staff will need to reconcile the accounts between itself and the insurance intermediaries who produce the business to receive its due funds. The accumulation of premium payments received within the reporting period (weekly, monthly or quarterly) will be paid up to the insurer in the following period.

The MGA will be remunerated for its role in insurance distribution. Typically this will be by a % of the premium which flows through its accounts. The MGA's remuneration may be a set % of the premium flowing to the insurer or it may be as part of a cap on the maximum amount of commissions taken by both the insurance intermediaries and the MGA. This allows the MGA greater flexibility to pass more commission to the intermediary if it is warranted most likely for achieving certain volume targets. It also may suit the insurer to set a cap on commissions to at least protect its residual income from being eaten into by both the intermediary and the MGA.

9. Regulation

In Guernsey MGAs are licenced and regulated by the GFSC on the same basis as an Insurance Manager and must comply with the requirements of the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) law 2002. The regulator regards the MGA business model as being more akin to that of an Insurance Manager rather than an insurer. Please refer to the unit discussing Insurance Manager. But in essence the MGA is required to adopt robust operational, financial and governance platforms, It will report to the regulator on a regular basis advising its business plan (and any material changes thereto), file annual financial statements and returns and confirm adherence to corporate governance standards.

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Typical Delegated Authority Contract

Definition of the Underwriting Agent (Name, Company number, registered office regulate status)

Underwriting Agent Authority
- Completion of and evidencing of agreement
- Period of agreement and conditions on renewal
- Persons responsible for operation and control (ability to bind, issuance of documents, exercise of claims authority, changes of persons)
- Grant of Authority
- Delegation of Authority
- Other conditions on the operation of the Agreement

Scope of Authority
- Authorised Classes of Business and Coverage
- Excluded Classes of Business and Coverage
- Territorial Limitations
- Maximum Limits of Liability or Sum Insured
- Premiums, Deductibles and Excesses for Insurances Bound
- Gross Premium Income Limit
- Period of Insurances Bound
- Automatic or tacit renewal of Insurances Bound
- Premium Finance Contracts

Underwriting Agent Commissions and Expenses
- Commissions
- Refund of Commissions
- Expenses

Documentation for Insurances Bound
- Application or Proposal Forms
- Contract Documentation

Claims and Complaints
- Procedure for the handling and settlement of Claims and pursuit of Recoveries
- Complaints or Proceedings

Reporting, Records and Aggregate Exposures
- Risks Written Bordereau(X)/Reporting and Aggregate Exposures
- Accounting Bordereau(X)/Reporting and Settlements
- Records, Statistical Information and Audit/Inspection

Advertising
- Advertising and Promotional Material

Bank Accounts
- Separate Bank Accounts

Compliance, Regulatory and General Requirements
- Licences and Taxes
- Fees and Charges

- Indemnity Insurance
- Business Continuity
- Confidentiality
- Conflicts Of Interest
- Compliance with The Law and Financial Crime
- Data Protection

Termination and Non-Renewal
- Termination

Miscellaneous
- General Interpretation
- Enforceability Clause
- Rights of Third Parties
- Several Liability
- Jurisdiction and Governing Law

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Self-test questions
Answering these questions will remind the participant as to what has been learnt. Once completed, please check your answers against the relevant text. 1. Why would an insurer appoint a MGA? 2. Name three key roles of a MGA? 3. How is a MGA remunerated and by whom? 4. How is a MGA regulated in Guernsey? 5. Which other regulator might have an influence on the operations of the MGA? 6. How does a MGA handle claims? 7. Why would a MGA purchase reinsurance?

Summary of learning outcomes
1. Explain the purpose of an MGA.
2. Describe the key roles undertaken by an MGA.
3. Describe the responsibilities of an MGA under a Delegated Authority Agreement.