

Compatibility is Critical to Getting a Program Off the Ground in Today's Marketplace

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By Gill & Roeser's Program Business Group*



Gill and Roeser, Inc.

Financial Advisor and
Reinsurance Intermediary

Program business can be a source of revenue and profits for agents, insurers and reinsurers. But, as in other partnerships, a profitable relationship will never develop if the partners are not compatible. That's why professional reinsurance intermediaries who work with program managers do more than simply search for insurers and reinsurers in a marketplace that has thinned out in recent year. Like matchmakers, reinsurance brokers essentially work to join program managers with the right insurer and reinsurance partners, so that partnerships can survive over the long term.

Program Business Then and Now

Program business by definition can describe varying aspects of the insurance industry. The term as used here denotes that business which is produced and underwritten by a program manager on behalf of an insurance company. This business is usually homogeneous in nature and has a proven track-record that differentiates one managing general agent (MGA) from another; The MGA in question would also have policy issuance capabilities, and in some instances, claims handling authority as well.

Historically, many insurers have viewed this business favorably because programs are developed by a program manager with strong underwriting expertise in a particular class of business. In many cases, program managers can underwrite the business more cost effectively and efficiently than the carrier itself.

When an insurer or reinsurer commits to a program, they are generally doing so based on the underwriting acumen of a particular program manager.

Although program managers may suggest rates and draft underwriting guidelines, the final decisions are generally made by the insurer. In the past, most program managers did not bear any of the financial risk for their program business. Today, however, more and more program managers may bear financial risk through a sliding scale commission or through a rent-a-captive facility or their own captive insurance company.

Typically, in a sliding-scale commission arrangement, the program manager is rewarded or penalized for underwriting results through a formula that varies the commission rate inversely with the loss ratio, subject to a minimum and maximum. The scales are not always one to one. For example, as the loss ratio decreases by 1 percent, the ceding commission might increase by only 0.5 percent.

Placing program business in today's marketplace can be a real challenge. While insurance pricing, terms and conditions have changed dramatically over the past few years, changes in the program business environment have been even more pronounced and have evolved more quickly than pricing and conditions in the traditional areas of underwriting and business production.

All of these changes plus reinsurance problems, reserve increases and the losses resulting from the September 11, 2001 attacks caused many insurers to reallocate financial assets back to their core businesses, thus abandoning the program business marketplace. Other insurers cut back on the programs they would write, while some were downgraded by the rating agencies and therefore rendered ineffective.

The result is a contracted marketplace for program business. Those markets that remain are quite sophisticated in the implementation of a program, which is a far more complex process today than it was five years ago. Turn-around time on program business has slowed considerably, with more and more empirical data being required before a commitment can be made. Actuarial reviews have become an important part of the analysis for all programs and the cost of these reviews can be substantial.

Gill and Roeser, Inc. Program Business Group consists of Charles T. Black, Andrew P. Burger, Michael J. Meek and James B. Wynn who can be reached at 212.972.4880 or www.gillroeser.com

Insurers generally require a track record of at least five years of historical underwriting and need to know estimated loss costs as well as projected underwriting profits. Without this statistical analysis, many viable opportunities go to the bottom of the pile of submissions and never get considered. Those programs that do pass initial muster by an insurer then endure a lengthy review of all aspects of the opportunity, including a due-diligence review of the underwriting files, financials, systems, primary rate structures, management, underwriting and investment strategies. In this environment, start-ups are nearly non-existent due to the time and expense of the process. When a rent-a-captive or captive is involved, a feasibility study, with actuarial and financial projections, is mandatory.

The Role of Reinsurance

Reinsurance plays an important role in the placement of program business, and more importantly, in the longevity of a program. In many instances, it can be the determining factor in the ultimate success of the program opportunity.

Many program carriers do not have corporate treaties in place so program specific reinsurance is essential on the front-end of the process. Once the program is bound, the reinsurance underwriter becomes another set of eyes and ears, bringing added value to the process based on underwriting expertise for the class of business being underwritten. The carrier, reinsurer and MGA working towards a common goal represents the best formula for the long-term success of any program opportunity.

Further complicating program business, reinsurance prices began rising in mid-2001 with the arrival of the hard market. Security issues surrounding reinsurance companies became more and more important, and reinsurers began requiring insurers to retain more of the risk.

Prior to 2001, insurers generally bought pro rata reinsurance on their program business risks and some covered 100% of the risk with reinsurance.

Today, it's nearly impossible to find a reinsurer willing to assume 100% pro rata reinsurance. Generally, reinsurers now favor excess of loss reinsurance, rather than the pro rata approach.

Making a Match

Programs need to be structured in such a way as to work financially for the program manager as well as the insurer and reinsurer. The reinsurance broker is an asset to the program manager in finding the right partners for the program and structuring a deal that works for all parties involved. This is because brokers have extensive market relationships and can identify a number of potential insurers and reinsurers for a given class of business. Once the insurer has been identified, the broker then places the program-specific reinsurance.

The intermediary's matchmaker role is crucial. If the insurer and the program manager are not compatible, the program will more than likely need to be re-marketed sooner than expected, and this is the last thing a program manager wants to see happen. A professional reinsurance broker can greatly reduce the risk of this type of upheaval.

In sum, then, a reinsurance broker places the insurance and reinsurance and can be essential to the long-term success of a program. Further, working with a professional reinsurance broker should provide the program manager with more input and more control over the program in the long-term.

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