Give MGA owners skin in the game

MGA owners perform better if their interests are aligned with those of their carriers. Citadel Risk Services has developed a unique way of achieving this, as Mike Palmer of Citadel explains to *Baden-Baden Today*.

Owners of managing general agents (MGAs) perform better if they have 'skin in the game'—the potential to benefit, as well as lose, based on the performance of their underwriting. An innovative structure conceived by Citadel Risk Services has the potential to achieve this in a completely new way.

The company has developed a structure whereby the carrier holding the risk sourced by the MGA completes a quota share agreement with a protected cell in a Bermuda captive owned by the owners of the MGA. This means they have the ability directly to profit—or lose out—based on the performance of their portfolio.

Mike Palmer, director of Citadel Risk Services, explained that the way most MGAs work at present, they stand to lose very little if the portfolio is not profitable. While risking the carrier's refusal to back them going forward, because the majority of their income is made from commission paid at source, there is no real risk to their business. Most receive a profit commission if the business performs well, but if it does not there is no other downside.

"In good years, the salaries, the infrastructure, the ongoing costs and the profit commission all get paid. In addition, the re/insurer gets his premium with a sub 100 percent loss ratio," Palmer said.

"In a bad year, the salaries, the infrastructure and the ongoing costs get paid—only the profit commission is not paid. The re/insurers lose out, but the MGA really is unaffected."

Under the terms of Citadel's structure, an agreed percentage of the portfolio would be transferred via quota share to a protected cell. There are two challenges involved.

"The first is the cost of setting up the cell, but cells can be set up relatively cheaply and quickly and they offer a very real opportunity to MGA owners to start to take an element of downside, and more importantly offer a comfort to reinsurers that delivers a more lasting relationship," Palmer said.

> "It focuses the MGA towards fully considering the downside and perhaps turning away some business."

The second issue is that, in Bermuda in particular, the risk in the cell would have to be funded dollar for dollar. This could be done with premium, cash normally in the form of letters of credit, or by using reinsurance in the form of a stop loss protection.

"This means the MGA owners need to come up with some real money in the first year but after years two and three, assuming the portfolio performs well, this will reduce. By year four, it may be possible to draw down a dividend from the cell."

Focusing the minds

Palmer said a combination of the upfront commitment and the potential downside serves to concentrate the minds of underwriters. "It focuses the MGA towards fully considering the downside and perhaps turning away some business," he said. "They also get a share in the upside, of course, which they will take pride in.

"This model means the MGA takes some real skin. Instead of all the risk being assumed by the insurer or reinsurer, Citadel has passed some of the risk back to the MGA itself—that changes the whole dynamic of the chain for the better."

Citadel Risk has already formed two cells for this purpose: one for an MGA in the UK writing solicitors professional indemnity business, and one for an Italian surety liability book. Both were formed this year and Palmer said there is already strong interest from other MGAs keen to explore establishing a similar structure."

He said he is unaware of any structure of this nature having been done before, but it could revolutionise the relationship between MGAs and carriers for the better. He also stressed that, while Citadel favours Bermuda's robust regulatory regime, there is no reason the same concept could not work using cell structures in other jurisdictions such as Malta.

Citadel is unusual in that it services MGAs, runs a reinsurer and a rated carrier and owns captives on Bermuda—allowing it to deliver the complete solution. But, Palmer said, the concept can work for any MGA.

"This can work for everyone. A lot of MGAs are interested in what we have done but also reinsurers and insurers and brokers.

"We expect to be completing more deals soon and others to follow suit in examining whether this is also possible for them," he concluded.

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