Executive Insights

Independent MGAs: The Future of Underwriting or a Flash in the Pan?

The managing general agent (MGA) model in insurance, in which specialised insurance agents or brokers underwrite on behalf of insurers or other capital providers with delegated authority, is not a new idea, having existed at scale since at least the 1990s. However, the industry has grown rapidly over the past decade, now representing up to 15% of global specialty insurance risks placed in the London and U.S. markets. Independent MGAs specifically have been highly sought-after acquisition targets for brokers, carriers and private equity alike, attracting sometimes eye-watering multiples.

Many MGA start-ups have proved to have lifespans of just three to five years. Often these supposedly pioneering new businesses either have been subsumed into insurers by acquisition or have been disintermediated and then failed as the insurers have learned to underwrite the relevant risks themselves. On the other hand, others have evolved into insurers, using the MGA model as a bootstrap mechanism in the start-up phase.

Some industry participants view MGAs as an unnecessary and costly additional link in the insurance chain, adding to end-customer premiums. For example, *The Insurance Insider*'s survey in mid-2019 indicated that 55% of London market respondents thought the strong growth in delegated authority business was either unjustifiable or difficult to justify, and more than 60% thought the expansion of MGA business would be hard to sustain[1].

The industry is nervous and talk of the bubble bursting is getting louder, as both market participants and investors question the sustainability of the MGA model. But the MGA model can mean many different things, and there are significant differences between broker-owned, insurer-owned and independent MGAs — with multiple approaches even within these categories. In this *Executive Insights*, L.E.K. Consulting explains these models, focusing primarily on independents, and seeks to identify the most sustainable independent MGA strategies.

MGA business models

The simplicity of the underlying definition of MGA belies the myriad sub-categories that fit within it. For example, Figure 1 illustrates the competitive landscape for MGAs in the U.K., categorised according to three key dimensions.

The first key dimension is size and complexity of the risks being underwritten. Many MGAs focus on less complex, often SME risks; insurers agree to provide capacity to these MGAs as an additional channel to expand distribution opportunities outside of the most specialist risk types. Other MGAs with particular underwriting expertise focus on more complex and larger risk types.

The second dimension is breadth of product offering. Some MGAs are deep specialists in a specific area of business (e.g., aerospace), whereas others operate across multiple lines.

The third dimension is ownership. MGAs may be owned by insurance carriers or by brokers, or they may be independent of both, with the MGA's function, objectives and reasons for being established varying in each case.

[1] *The Insurance Insider*

Independent MGAs: The Future of Underwriting or a Flash in the Pan? was written by **Peter Ward**, and **Ashish Khanna**, Partners at L.E.K. Consulting. Peter and Ashish are based in London.

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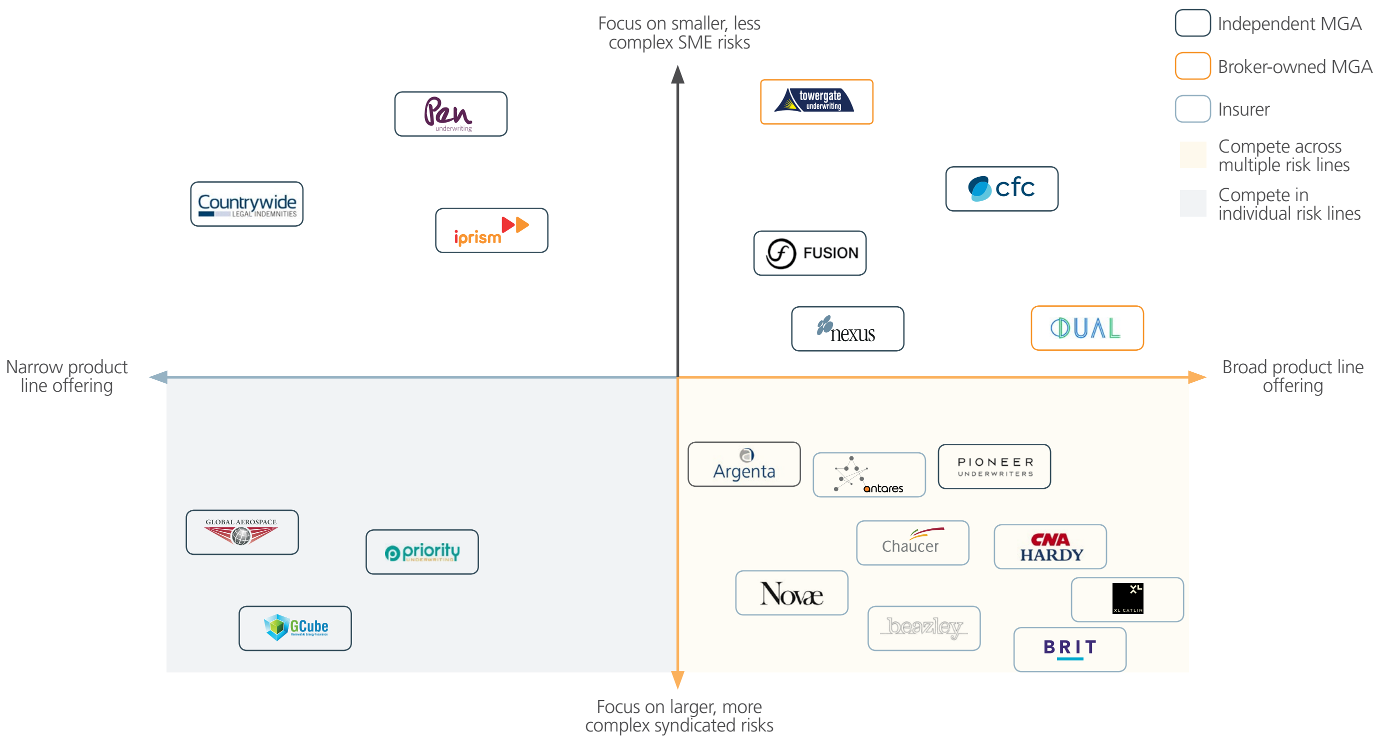
Figure 1
The U.K. MGA competitive landscape



Source: Company websites; L.E.K. analysis

Broker-owned MGAs are often established by brokers who wish to expand their participation in the value chain and hence generate higher revenues by taking a larger share of the end-to-end revenue from servicing a particular end customer. Alternatively, brokers may acquire MGAs that have underwriting expertise in areas in which they are struggling to find traditional sources of capital with capacity to meet their clients' needs.

Insurer-owned MGAs are set up by carriers for a range of purposes. One such purpose is to add flexibility and breadth to their product offerings: a carrier may wish to offer brokers a wider range of products than those in which it has the in-house underwriting expertise, or which satisfy its internal return requirements — in both cases, owning a vehicle that can find alternative sources of capital satisfies the need. A second purpose is to gain more specific and detailed expertise in particular niches that carriers may themselves wish to participate in, but where they do not currently have the expertise — owning an MGA can be a significant, lower-risk step towards this participation. A third purpose is simply to earn commissions from the MGA's core activity of managing third-party capacity.

Independent MGAs are set up to address available market opportunities directly where an organisation with underwriting expertise wishes to deploy this skill without having to provide its own capital or bear the associated risks. New opportunities to do this have arisen as technology and access to distribution have allowed specific niches to be underwritten at smaller scale.

Insurance carriers have been willing to place capacity with MGAs, especially in the recent environment of excess capacity, as a means of accessing these niches more efficiently and at lower cost than building the capability and business in-house. Insurers also enjoy more flexibility because they are able to review exposure annually and easily adjust as risk appetite changes. Further, some sources of capital, such as reinsurers and non-traditional alternative capital, have also become more interested in participating in primary insurance risk but lack the underwriting skills to do so. MGAs provide a route for them to do this.

Winning independent MGA models

Within the independent MGAs category, the following are the most commonly observable models, each with its own specific challenges:

- **Specialist underwriting capability** offering insurers a new risk category or improving their existing underwriting efficiency. For example, CFC Underwriting pioneered cyber insurance for SMEs. One challenge to the sustainability of this version of the MGA model is the likelihood that they may be acquired by an insurance company. The second challenge is that, over time, insurers observe the underwriting methods used by the MGA, and can replicate or supersede the relevant IP, leaving the MGA with no seat at the table. MGAs pursuing this strategy will require a second line of defence to grow sustainably, i.e. to pursue simultaneously one of the other models below.

• **Proprietary access to end-customer risks** enabling insurers to build their books of business where they have no other viable route to do so. For example, a global specialty MGA may have strong relationships with retail brokers (or local MGAs), and thus may control the supply of end risks to be underwritten. Alternatively, an MGA may have relationships with a large number of small brokers, in which the end capacity provider has little interest, relevant skills or bandwidth to address this customer directly. Again, CFC has this in its SME cyber business. Broker and/or local MGA consolidation is the biggest threat to this category of MGAs as it puts existing proprietary relationships at risk.

• **Alternative capital access to primary insurance risks**. Traditional capital provided by primary insurers still represents the bulk of capacity provided to MGAs. However, alternative sources of capital, where investors have little appetite or lack the necessary in-house expertise to develop the relevant underwriting skills or customer relationships, are now an increasingly significant component. This capital is provided by either reinsurers or, albeit at relatively lower volumes at this stage, ILS funds, both of which have been looking to get closer to the primary risk, in part driven by the search for yield resulting from 'lower for longer' interest rates[2]. The biggest concern for this category of MGA is the potential flight of capital when interest rates rise or returns decline in line with weakening loss ratios. There is also the risk of these alternative sources of capital gaining interest in direct participation in underwriting.

A mixed picture in aggregate, but substantial specific opportunities

There is increasing speculation throughout the industry about a bursting of the MGA bubble. In our view, however, it is too simplistic to view the MGA space, or even the independent MGA sub-space within it, as a single industry. The business models explained above illustrate the range of approaches and the challenges to sustainability in each case. Opportunities to invest and expand need to be assessed in detail on a case-by-case basis to ensure that there is a sound foundation for future success, with prior performance serving as no guide to the future.

[2] Lower for Longer: Have Low Base Rates Permanently Changed Financial Services?

About the Authors

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