



Changing Partners Can Be A Risky Proposition For Program Administrators

Commission structure is only one consideration for PAs considering moves

By JAMES L. GUERIN AND GEORGE P. LAGOS

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Despite the best of intentions and efforts of risk capital providers and program administrators, the reality is that change is inevitable.

It may be a case where the risk capital provider initiates the change due to a corporate shift in strategic direction or a decision to exit the class or program business altogether.

Alternatively, the program administrator may seek to end the relationship anticipating a shift in market conditions, underwriting or marketing restraints, or materially better terms of trade offered by a new risk capital provider.

Changing risk capital partners is not something taken lightly by program administrators. Considerations include the risk to continuity on a program and disruption caused by the transition, exposure to implementation delay or failure, and potentially increased administrative demand and expense.

Whenever a change must be made, it is critical to assure the fit is a good one and the new relationship will last.

Based on our experience in developing, implementing and managing programs, we will examine the key criteria to be considered by a program administrator in situations where it must move its business from an existing relationship to a new source of risk capital, whether that is an insurer, re-insurer or Lloyd's managing agent.



• Capital Position

It is critical that the risk capital partner have sufficient financial strength to support the program. A.M. Best provides financial strength ratings for carriers and Lloyd's. A carrier is considered secure under Best's criteria if it achieves a financial strength rating of at least "B-plus."

Some programs have specific size or rating requirements associated with the insured client base. Even if that is not the case, the financial strength and security of the risk capital will be relevant in terms of comparing the program to those offered by competing programs in the same market space.

• Underwriting Authority and Flexibility

Underwriting authority and flexibility are of fundamental importance to delegated authority relationships.

Underwriting guidelines should be mutually agreed and properly documented to avoid the possibility of future misunderstanding. The underwriting criteria—the "box"—needs to be broad enough to ensure that the majority of the business can be bound without "re-underwriting" by the risk capital provider.

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For those risks falling outside the defined parameters, an efficient process to effectively handle "exception" accounts is a fundamental customer service requirement.

- Exclusivity and Channel Conflict

It is essential to assure that the risk capital provider does not support a substantially similar program.

When the underwriting vehicle is part of a larger holding company where there are a number of entities writing various accounts and classes of business, it is prudent to fully explore these potential conflicts at the outset. Program conflicts will inevitably result in cross competition for accounts and distribution outlets.

There should be a documented commitment that no such similar program will be sponsored or supported either directly or indirectly by the risk capital partner in the future.

- Commitment and Continuity

What is the risk capital provider's program business history? Has the entity demonstrated a long-term commitment to writing program business?

Does program business represent a significant part of the carrier's overall premium income or merely a nominal contribution?

Although time in the business is no guarantee going forward, a proven commitment through market cycles provides some confidence that the capital is less likely to vanish abruptly when the going gets tough.

- Terms of Trade

It is important that the program administration agreement reflects balance and mutuality.

One-way agreements that heavily favor the drafting party require close scrutiny.

The time to address these issues is up front, not at a future point in time when there is a problem and little room to deal with it.

The commission structure must adequately support the business and provide for a reasonable profit margin to the program administrator. It is equally axiomatic that the risk capital provider must realize an underwriting profit on the business produced.

Typically, alignment of interests is greatly enhanced when some portion of the program administrator's profit opportunity is allocable to profit sharing, underwriting risk participation, or other performance-based calculation.

In those cases, the methodology for determining profitability should be unambiguous, and a contractual right to premium, loss and expense data is critical.

Reasonable termination provisions are essential. Program transitions are difficult and create some risk under any circumstances. Unreasonably short notice provisions (for reasons other than cause) or those which create issues with respect to ownership of expiration and renewal rights can substantially impair the ability to successfully move the program to a new risk capital provider.

- Administrative Capability

While some programs are highly autonomous compared to others, the program administrator needs to evaluate how much administrative support it requires from the risk capital provider to successfully run its program, and then establish how much of that support it can expect to receive.

Dealing with an experienced point of contact is a critical success factor. The account manager representing the risk capital provider in its day-to-day relationships with the program administrator will largely be responsible for how the business runs.

An unresponsive or inexperienced account manager is a strong negative indicator. Program administrators who have had multiple relationships know full well that the business can run either very well or not at all, depending on the product knowledge,

expertise, support and cooperation at ground level.

- Systems Compatibility

Systems compatibility is a significant factor. There are few things as painful as a bad systems implementation during a program transition. While manual workarounds are often seen as acceptable at the outset in order to get up and running, inevitably, data capture and transfer falls behind and the systems issues will spill over to other aspects of the relationship.

If utilization of the risk capital provider's system is required, the program administrator must be certain that it has a good understanding of the system's capabilities and how the integration process will work. If the systems issues that need to be addressed are substantial, assure that there is a mutual understanding of what needs to be done, who will be responsible for doing the work (cost/resource sharing) and the timeframes for completion.

"It's not rocket science" are famous last words.

- Claim Handling

Claim authority and administration is critical to all specialty programs, and most risk capital providers have strong philosophical views on claim handling.

Some refuse to let any third-party participate in the claim process in any way, while others believe that TPAs can be effective or even necessary in handling program business claims.

The program administrator must be satisfied that the approach that will be taken can and will maximize the performance of the program and meet the needs of program policyholders.

In a prior article we pointed out the importance of undertaking due diligence on a prospective program administrator from a risk capital provider's perspective. (See NU, Feb. 23, page 12.)

As we have described above, it is every bit as important for a program administrator to undertake the same exercise prior to entering into a new risk capital relationship. The future success and perpetuation of the program will depend upon it.

James Guerin and **George Lagos** are principals of GL Insurance Partners LLC (www.glinsurancepartners.com), an insurance consulting and services firm focusing on specialty commercial program business issues. They may be reached at james.guerin@glinsurancepartners.com and george.lagos@glinsurancepartners.com.