GUY CARPENTER

GC BRIEFING

An update from Program Managers Solutions

July 2015

POISED FOR GROWTH

GUY CARPENTER'S NINTH SPECIALTY INSURANCE PROGRAM ISSUING CARRIER SURVEY, 2014

As a result of, or in some cases in spite of continued fluctuations in the standard insurance marketplace, the Program Administrator and Managing General Agency (PA/MGA) market continues to be an important part of the overall insurance arena. When Guy Carpenter & Company (Guy Carpenter) conducted its first survey in 2005, little had been published about this vital segment. Agencies, underwriters, reinsurance intermediaries and third party service providers such as claim administration firms, all were asking the same questions:

- *How big is the program market?*
- *What do program carriers look for in programs?*
- *What types of PAs/MGAs are carriers looking for?*
- *Which lines of business are most attractive to program carriers?*

The above list is not exhaustive.

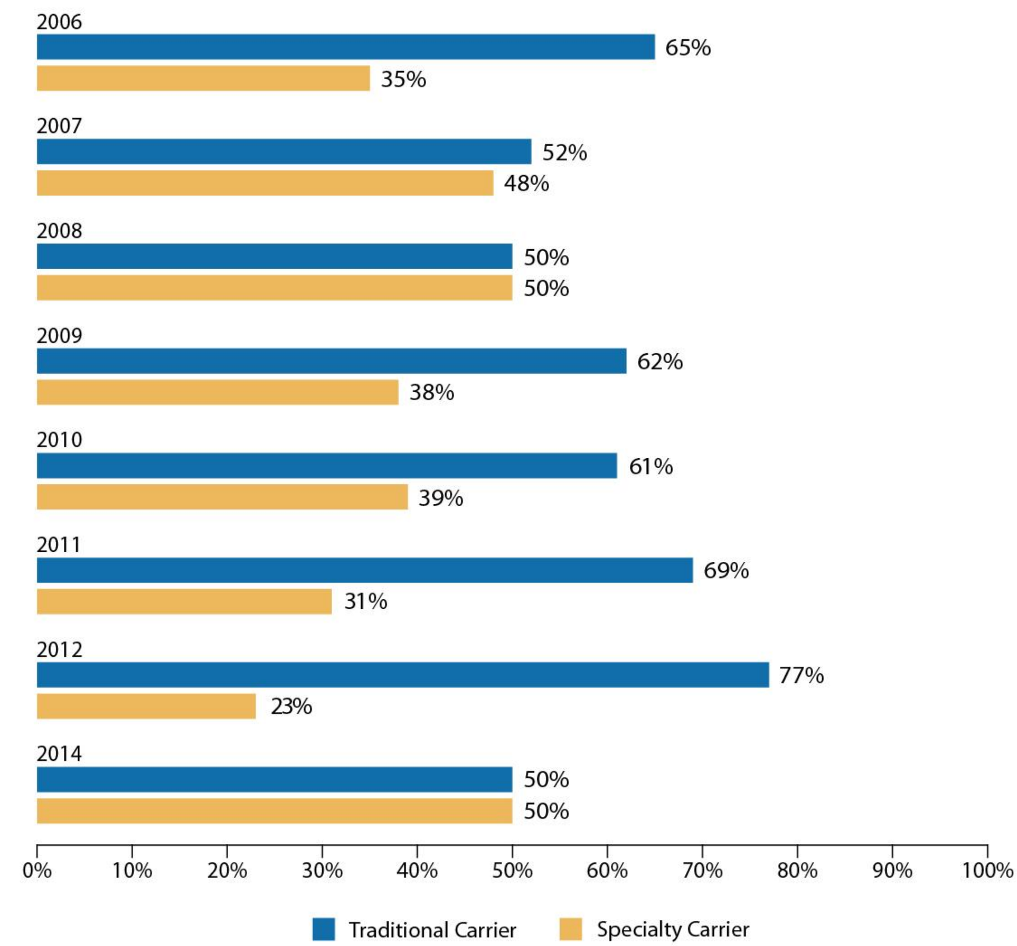
Now, 10 years later, the same questions are being asked, and Guy Carpenter continues to provide the industry with our survey analysis of the current program marketplace from the program issuing carriers' perspective.

While Guy Carpenter attempts to maintain survey consistency from one year to the next, we have to balance this goal against the emerging needs of the PA/MGA marketplace. Further, respondents change each year. We provide this service as a means of benchmarking key industry issues rather than as an effort to capture granular detail. Our goal is to shed light on the direction of the PA/MGA market and stimulate appetites for program business. Once again, we thank all who replied for investing their valuable time in assisting us with this effort.

About This Year's Respondents

The respondents were an even mix of traditional insurance companies that have specialty program operations (50 percent) and true, specialty insurance carriers (50 percent). As carriers continue to search for new areas of premium growth and market share, the traditional insurance companies see programs as one way of achieving these goals.

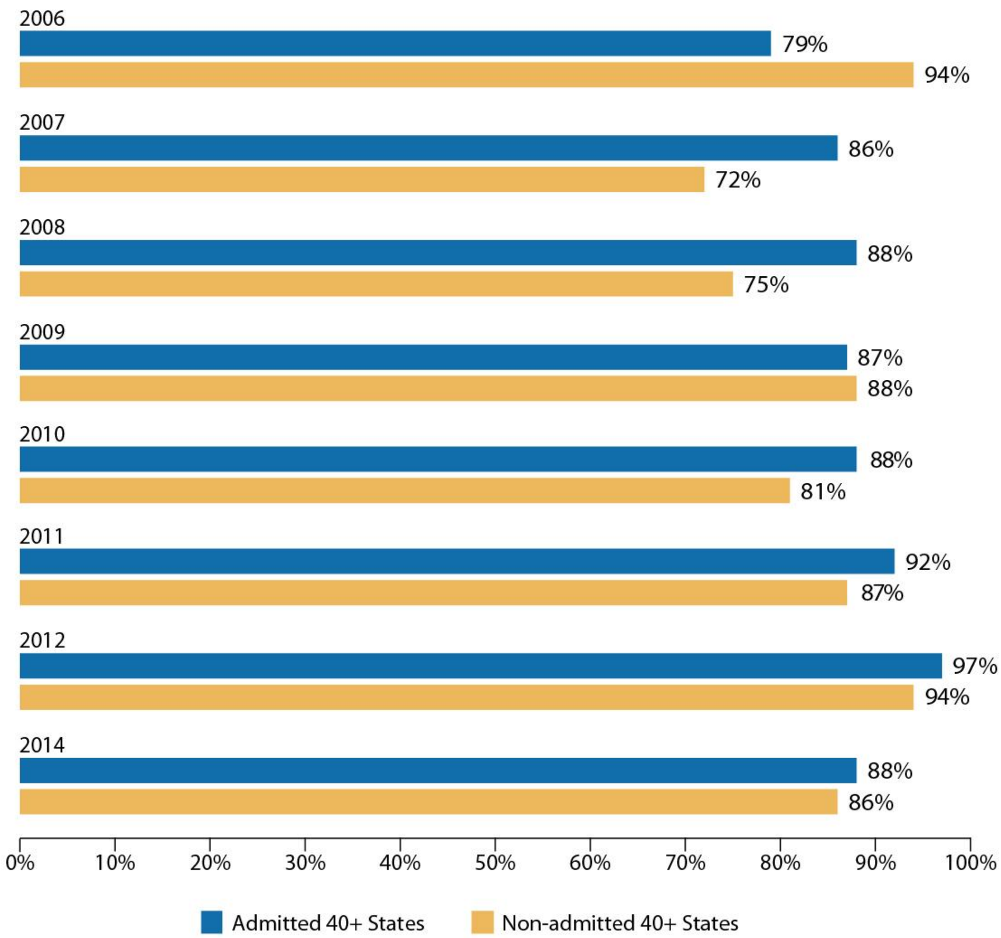
PROGRAM OPERATIONS



Source: Guy Carpenter

Those responding this year are widely licensed in more than 40 states with both admitted (88 percent) and non-admitted (86 percent) paper. While 2012's results represented the highest percentages over the course of the survey's history, there was a slight decline in percentages in the latest survey.

ADMITTED VS. NON-ADMITTED

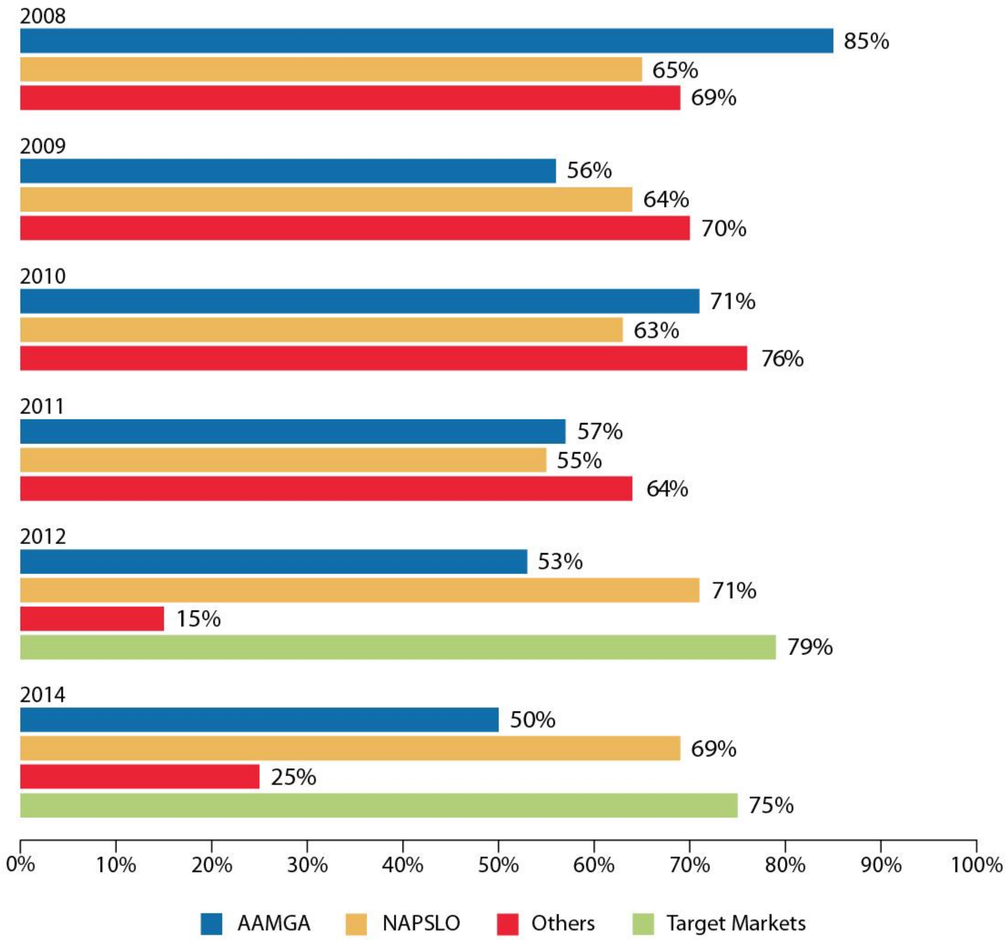


Source: Guy Carpenter

The size of programs targeted by the respondents this year shows a continuing trend towards smaller programs, with a majority of the carriers (63 percent) targeting programs with premium volumes between USD5 million and USD15 million.

All respondents attend one or more annual industry conferences that involve the program space. The American Association of Managing General Agents (AAMGA) and the National Association of Professional Surplus Lines Offices (NAPSLO) continue to be seen as valuable conferences for the carriers. However, respondents continue to rank the Target Markets Program Administrators Association (TMPAA) conference as the number one conference in terms of value provided.

ATTENDING WHICH ANNUAL MEETINGS/CONVENTIONS BRINGS YOU BENEFITS?

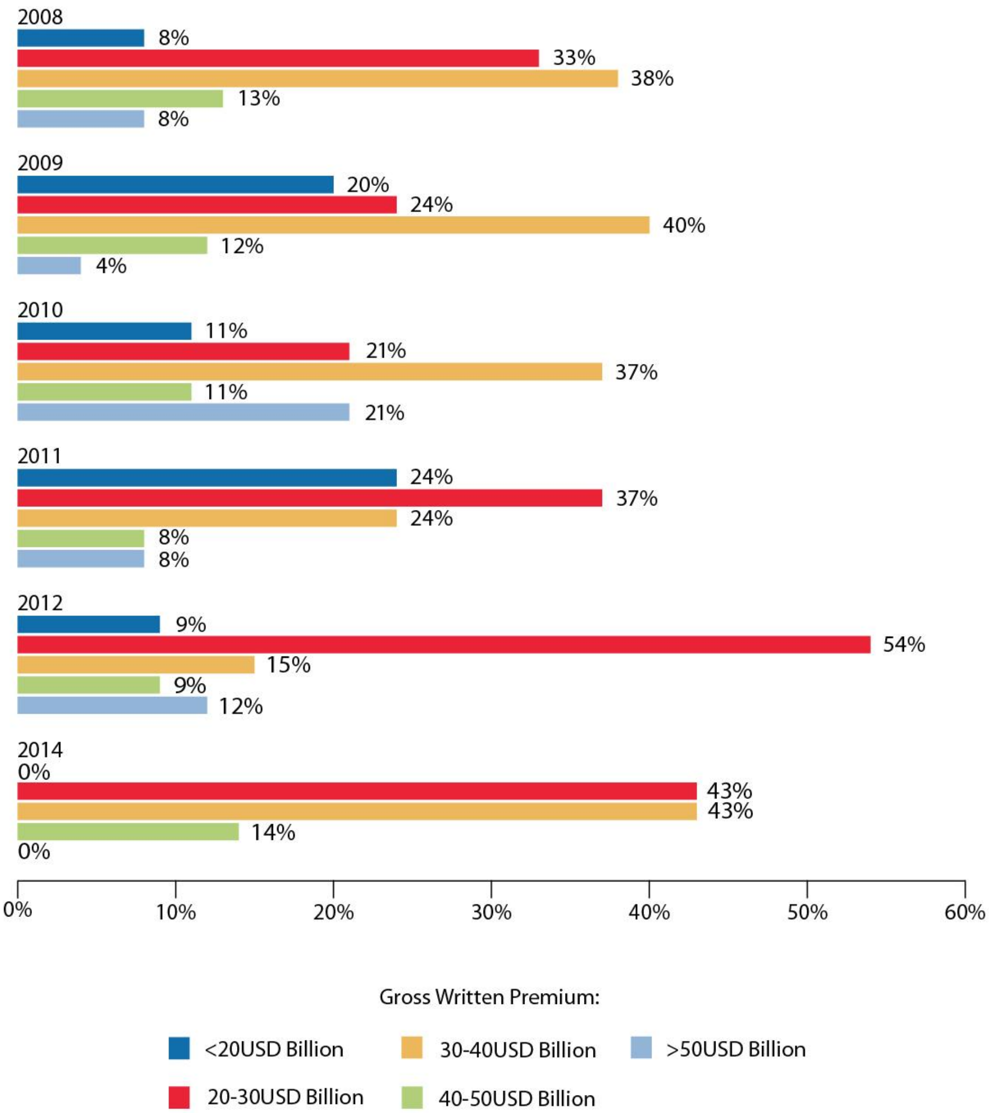


Source: Guy Carpenter

Market Size and Dynamics

Even though responses to the questions on the perceived size of the PA/MGA market continue to reflect it as large, the respondents this year returned to the views of the earliest years of the survey. The largest percentage of respondents (43 percent) believed the market to be sized at USD30 billion to USD40 billion. This range tied with the percentage of respondents (43 percent) believing that the market is sized at USD20 billion to USD30 billion. Interestingly, no respondents believed the market was smaller than USD20 billion or larger than USD50 billion, a first. Fourteen percent of respondents felt the market stood between USD40 to USD 50 billion, the highest that number has been since 2008 when it came in at 13 percent.

HOW LARGE DO YOU BELIEVE THE CURRENT MGA/PA MARKET IS?



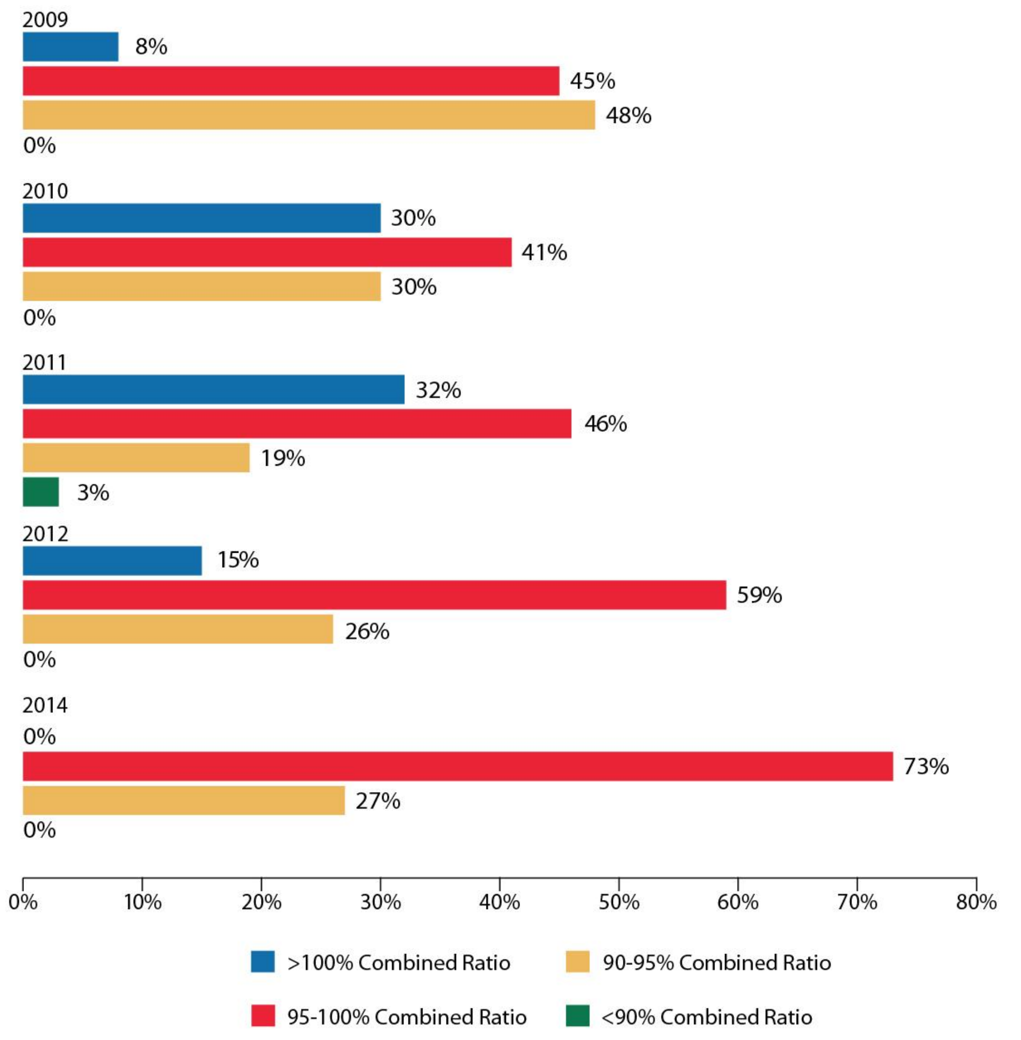
Source: Guy Carpenter

The results indicate that respondents believe the PA/MGA marketplace has shifted dramatically since 2012 and will continue to grow. Sixty-three percent of respondents believe this segment will grow, while none see it shrinking.

The majority, 53 percent, say their production pipeline will remain the same while 27 percent perceive the pipeline production will be larger this year than last.

Program marketplace profitability was addressed again this year with 73 percent of the respondents believing the combined ratio for the PA/MGA market is greater than 95 percent and 27 percent believing it is less than 95 percent. This represents a significant swing in opinion from 2012 when 15 percent of respondents felt the combined ratio was over 100 percent. In the current survey none of the respondents believed it was over 100 percent, the same result as in 2012. While the program marketplace is expected to remain profitable, the perception of the extent of the profitability has changed significantly.

HOW PROFITABLE IS PROGRAM MARKET?

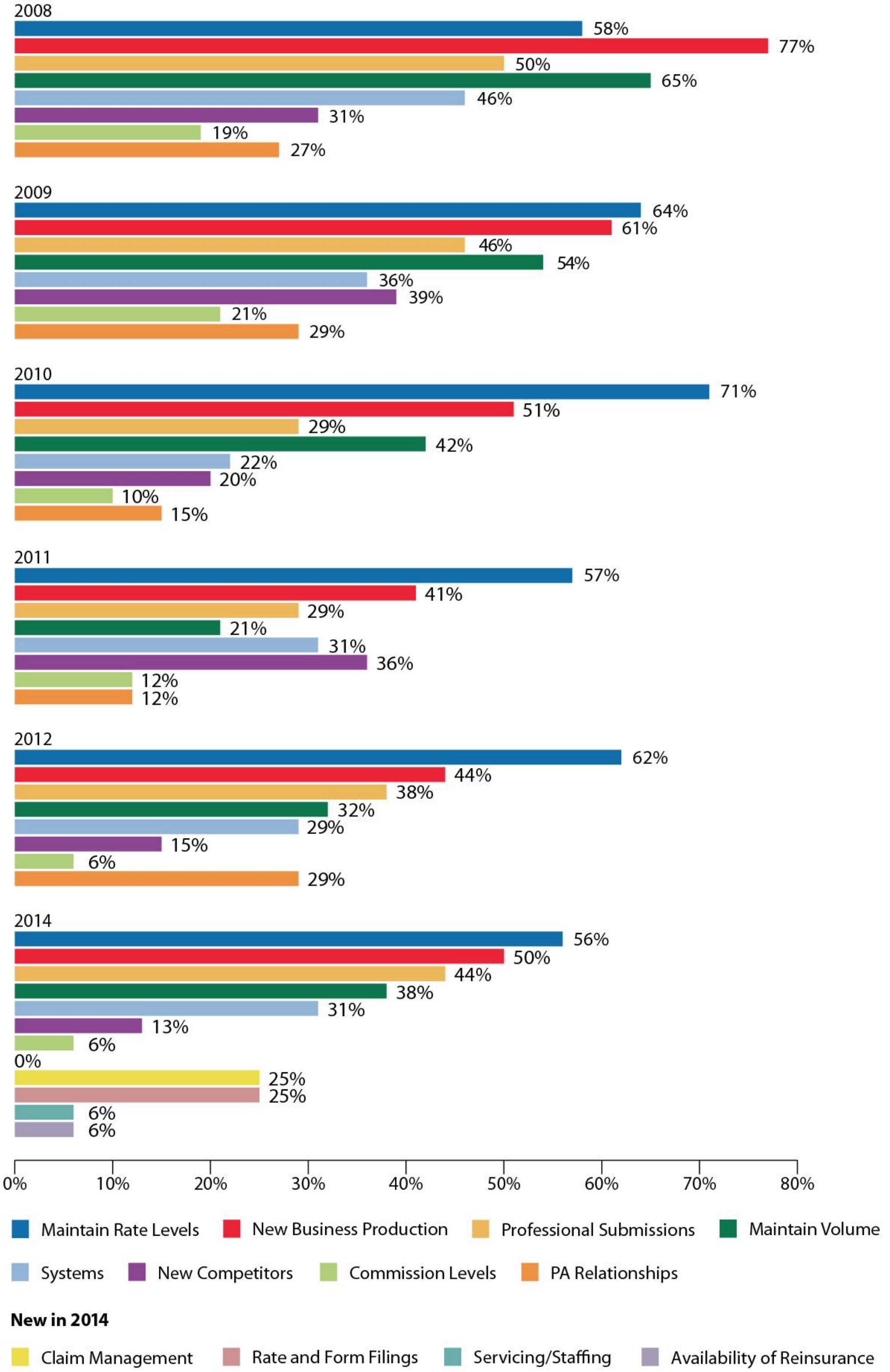


Source: Guy Carpenter

Five Greatest Market Challenges

The challenge of balancing profitability with market share continues for carriers writing PA/MGA program business. This market dynamic was reflected in the level of responses for maintaining rate level (56 percent) and new business production (50 percent) as the largest challenges. (See chart on following page)

OF THE FOLLOWING PROGRAM COMPONENTS, WHICH THREE PRESENT THE BIGGEST CHALLENGES FOR YOU AS AN INSURANCE COMPANY WRITING PROGRAMS OVER THE COURSE OF THE NEXT 12 MONTHS? PLEASE SELECT THREE.



Source: Guy Carpenter

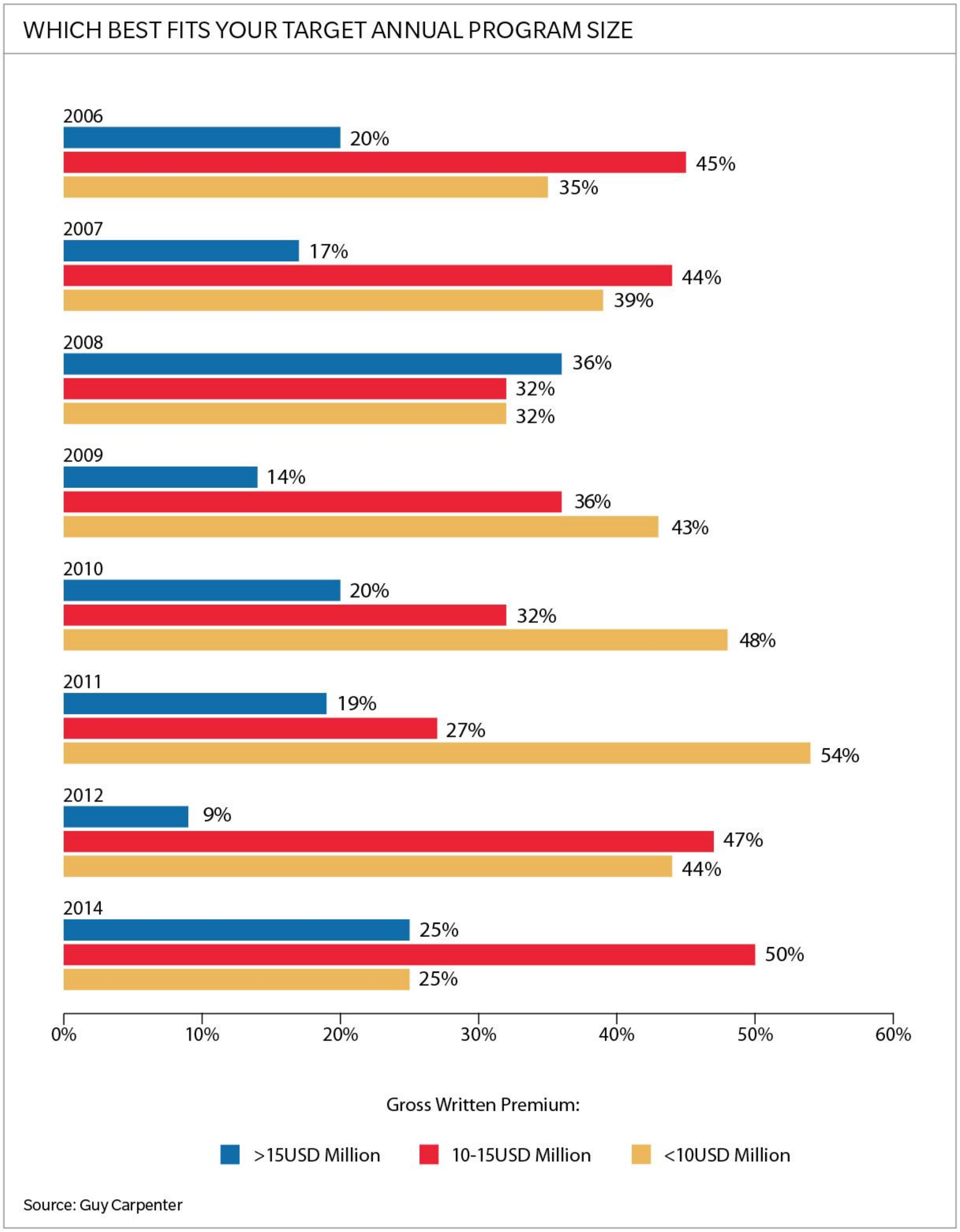
Because of the dynamics of the insurance industry as a whole and the program market segment in particular, the challenges rated as important should be considered collectively rather than individually. A company's rate filings will affect the rate level it is able to charge. This, in turn, will determine how competitive its product is in comparison to new competitors and, ultimately, if it will be able to maintain or increase current premium levels. This year's respondents are obviously working through this set of interrelated challenges.

Program Size

The average size of programs targeted by carriers has changed to reflect economic, rate adequacy and expense factors. Carriers remain more flexible with their program minimum premium requirements, their willingness to consider startup programs, their willingness to front and the territorial scope in which they are willing to write business.

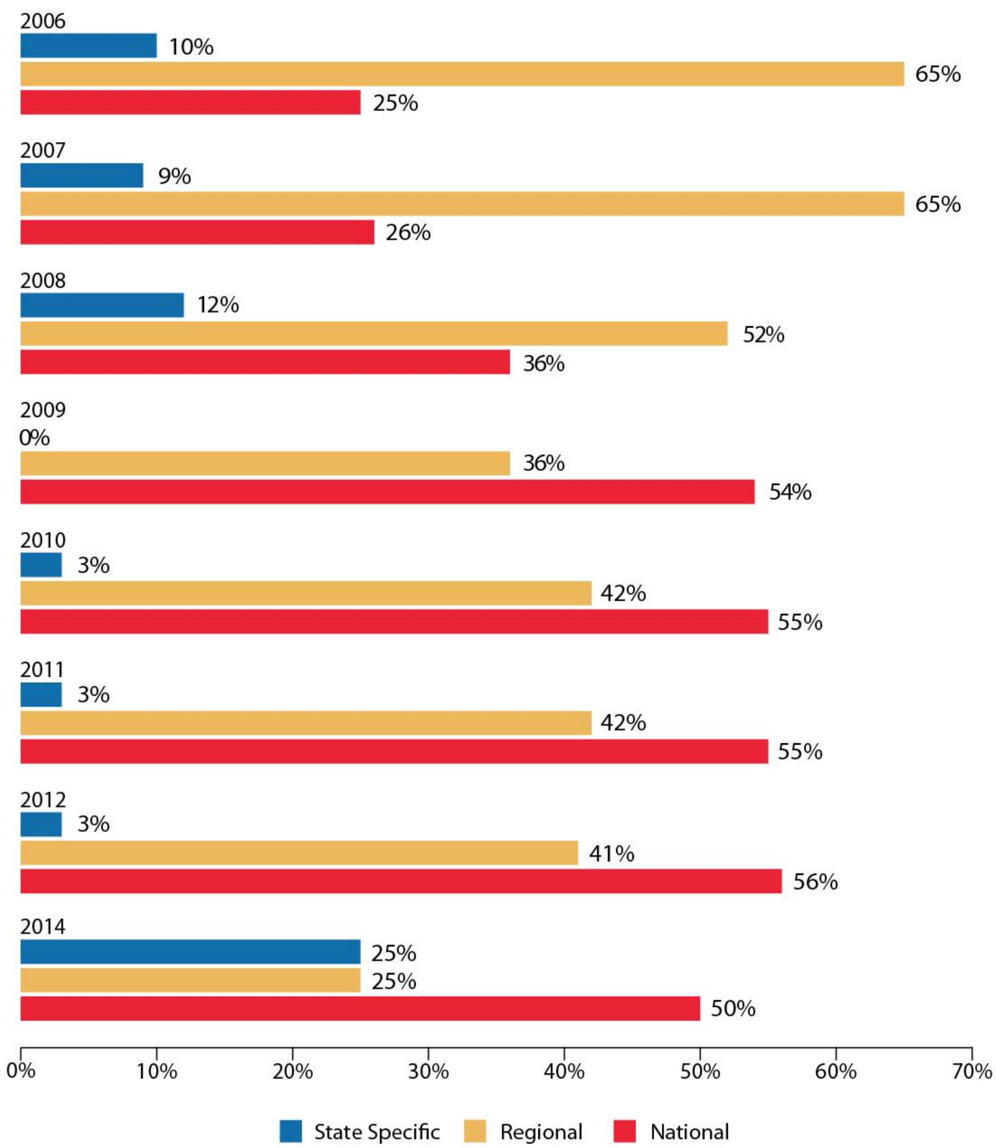
Targeted Program Gross Written Premium (GWP) and Geographical Preference

This year the overwhelming majority of respondents are targeting programs in the GWP USD10 million to USD15 million range (50 percent this year compared with 47 percent in 2012). The percent of respondents targeting programs larger than USD15 million (25 percent) rose dramatically by more than half (9 percent in the previous survey).



In 2006, 65 percent of program carriers responding to our survey wanted regional-specific programs while this year the percentage wanting regional-specific programs declined significantly to 25 percent. Those looking for state-specific programs increased notably to 25 percent from 3 percent over the prior three surveys. National programs represented 25 percent of respondents in 2006 – but since 2009 they have dominated territory preference coming in at 50 percent this year.

WHAT IS YOUR PREFERRED SCOPE OF PROGRAM TERRITORY?



Source: Guy Carpenter

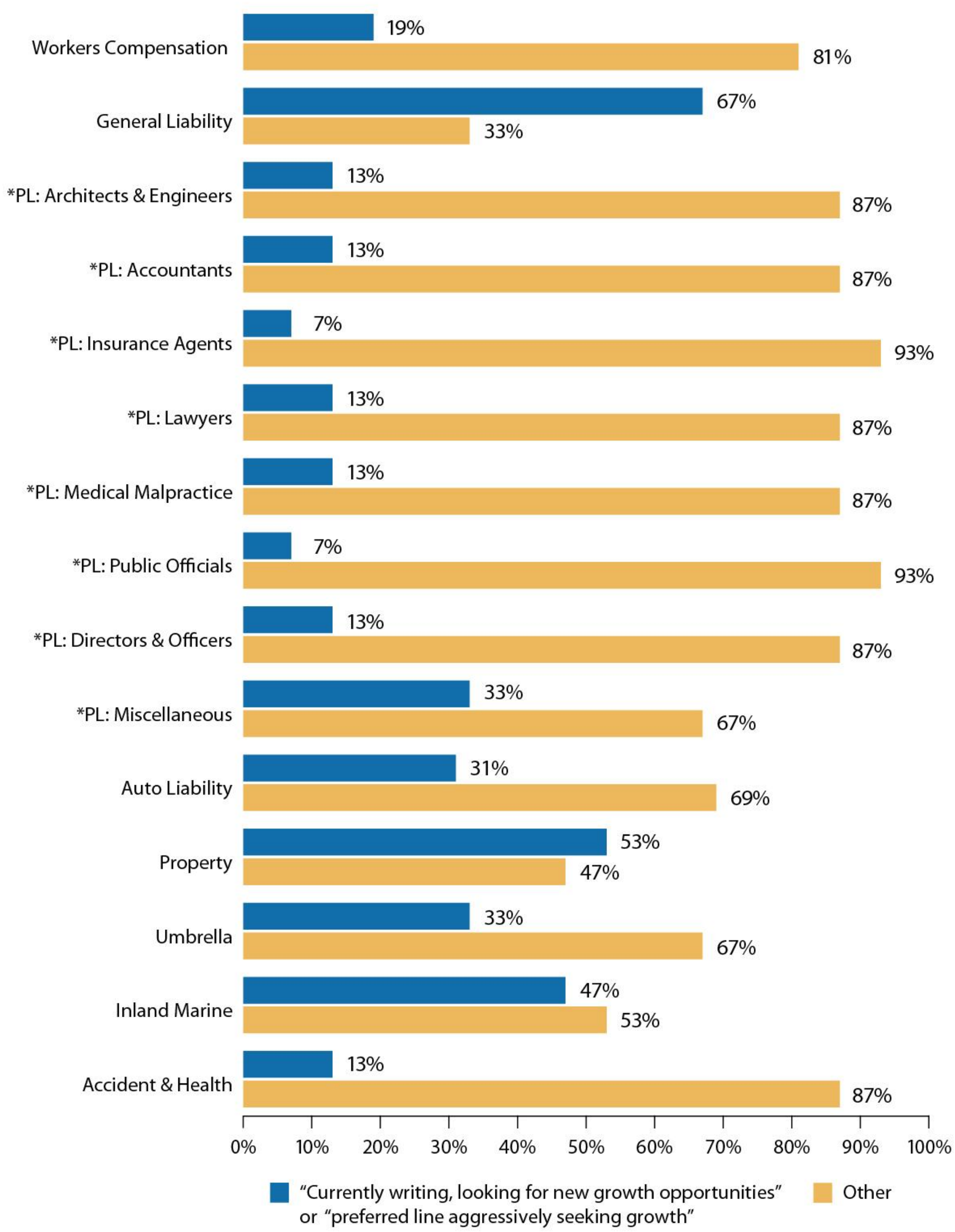
Beginning in 2011 we queried carriers about their interest in programs or fronting opportunities to see what, if any, interest there was in these two potential revenue-generating areas. In 2014 a majority of the respondents (81 percent) said they would be willing to consider start-up programs, while 25 percent would consider fronting opportunities. Understanding that all start-ups can be different and not all fronting structures are the same, it was somewhat surprising to find this level of continued interest in these two program areas.

As account premiums and program sizes have shrunk, program carriers realize they need to be more flexible in their approach to generating program related revenues. This year's survey indicates that they are now considering smaller programs, larger territorial scopes, start-up programs and fronting opportunities in order to grow, or to at least maintain, a reasonable market share.

Commercial Lines Appetite

A line by line comparison of respondents' appetites in the prior year's survey with those of this year reveals some changes in emphasis. Workers compensation and medical malpractice experienced large growth in percent of respondents who were currently writing, looking for new growth or aggressively seeking growth. The property line grew by 6 percentage points to become only the second line, outside of general liability, where the majority of respondents say they are pursuing business. Inland marine, accident & health and professional liability for insurance agents showed significant declines in business pursuit. Overall, many of the lines saw drops in appetite or remained unchanged. It appears that current economic conditions and elevating loss ratios are keeping carriers' growth expectations in commercial lines business relatively flat. (See next page)

COMMERCIAL LINES APPETITE



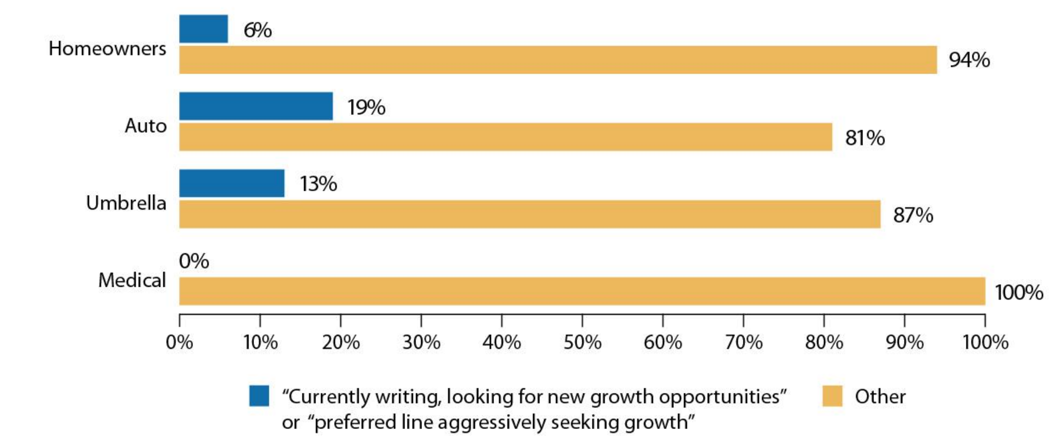
Source: Guy Carpenter

*PL: Professional Liability

Personal Lines Appetite

On the personal lines appetite side, auto grew by 13 percentage points and umbrella grew by 6 percentage points over the previous survey in terms of pursuing growth. Both homeowners and medical were unchanged.

PERSONAL LINES APPETITE

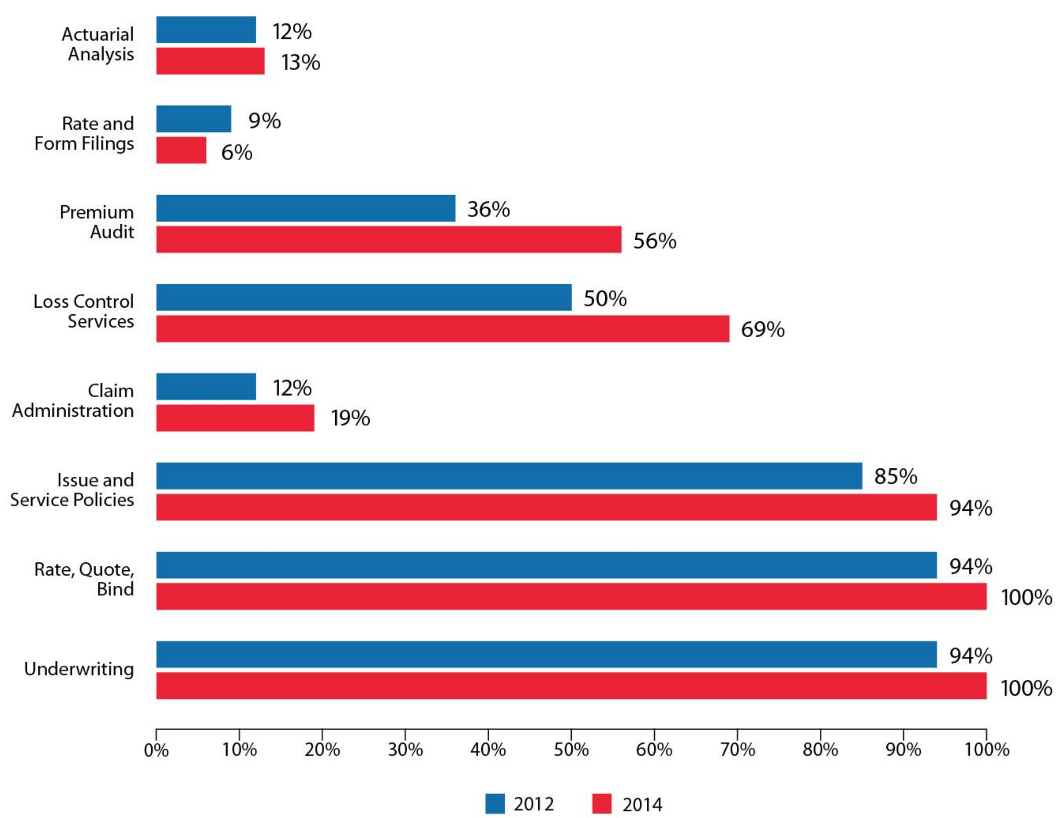


Source: Guy Carpenter

Operating Platform

Carriers continue to maintain flexibility regarding their requirements for the services they expect their PA/MGA partners to perform and what they feel they need to control. As in the 2012 survey, respondent carriers expect their PAs/MGAs to underwrite (100 percent of respondents), rate, quote, bind business (100 percent) and issue and service policies (94 percent). The survey indicates carriers expect their PAs/MGAs to perform premium audits (56 percent) and loss control services (69 percent). Most of the other services, even though not required or expected of PAs/MGAs, are often performed by them, a third party, or in many cases, the carriers' themselves.

WHAT SERVICES DO YOU EXPECT YOUR PA TO PERFORM?

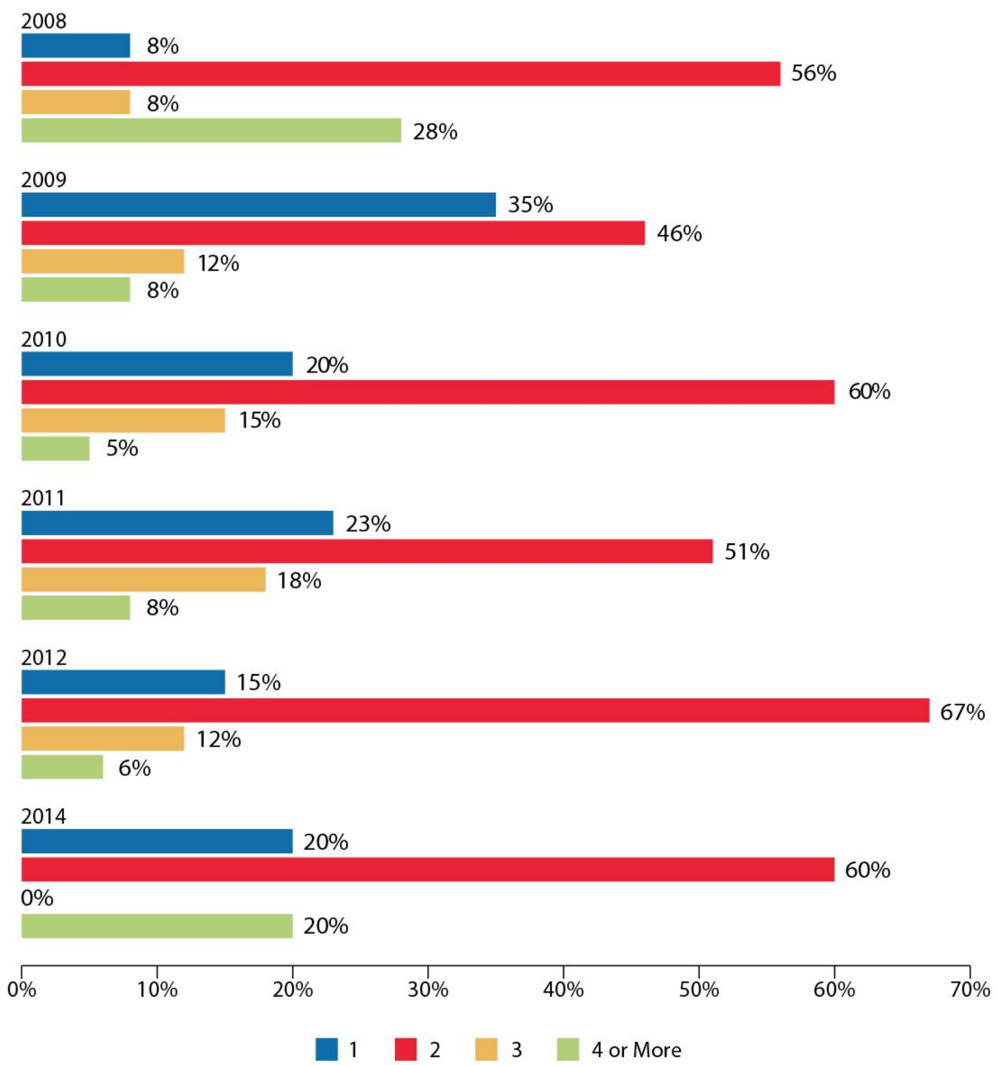


Source: Guy Carpenter

Performance Management

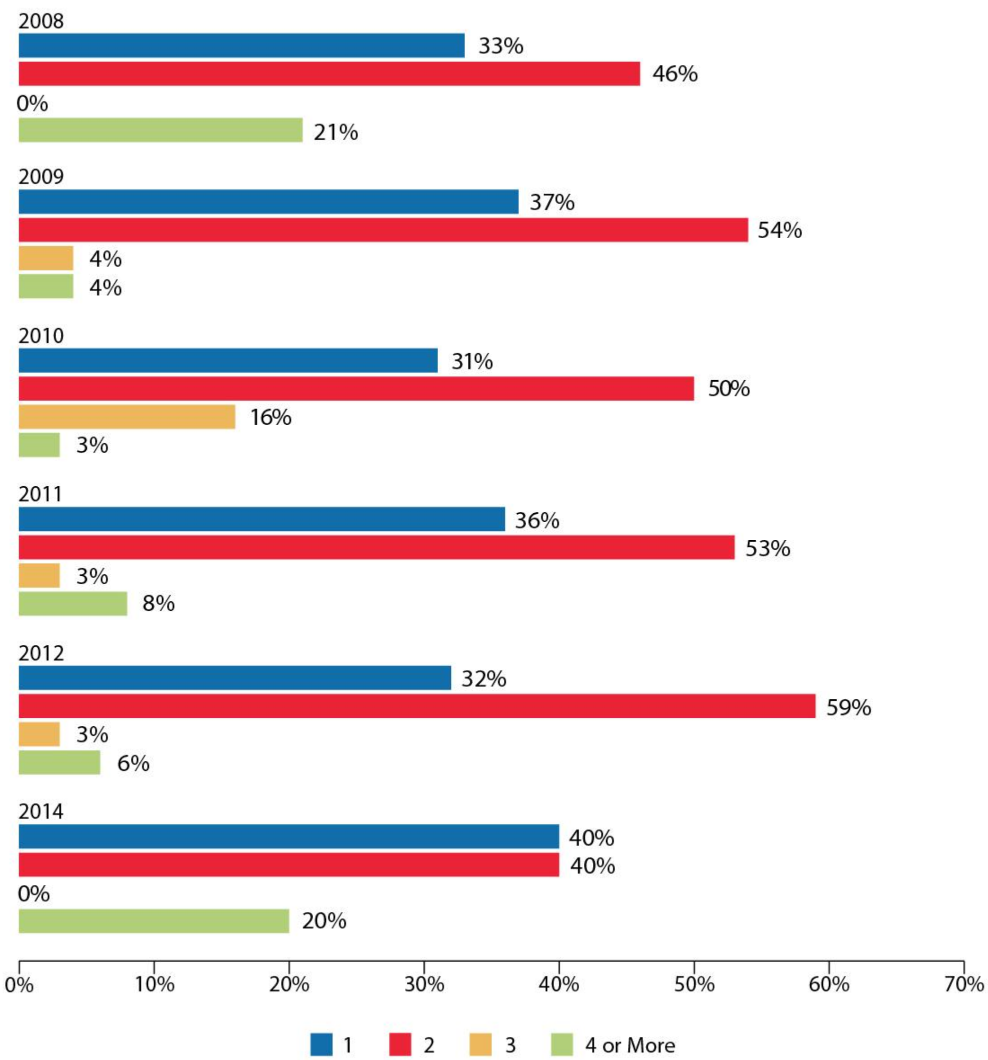
A carrier's need for growth and profitability has to be closely monitored and controlled in the PA/MGA space. Every respondent in this year's survey indicated that they had audit procedures in place to assure adherence to established risk selection and underwriting guidelines, financial billing, collection, remittance and banking guidelines, claim reporting, adjusting and settlement guidelines. Even though some changes have taken place in the number of audits conducted each year, including a notable increase in the percent of respondents doing four or more audits, rising to its highest level since 2008, this year's results reflect the current and historical importance of the carriers' PA/MGA management process.

NUMBER OF U/W – OPERATIONAL AUDITS EACH YEAR



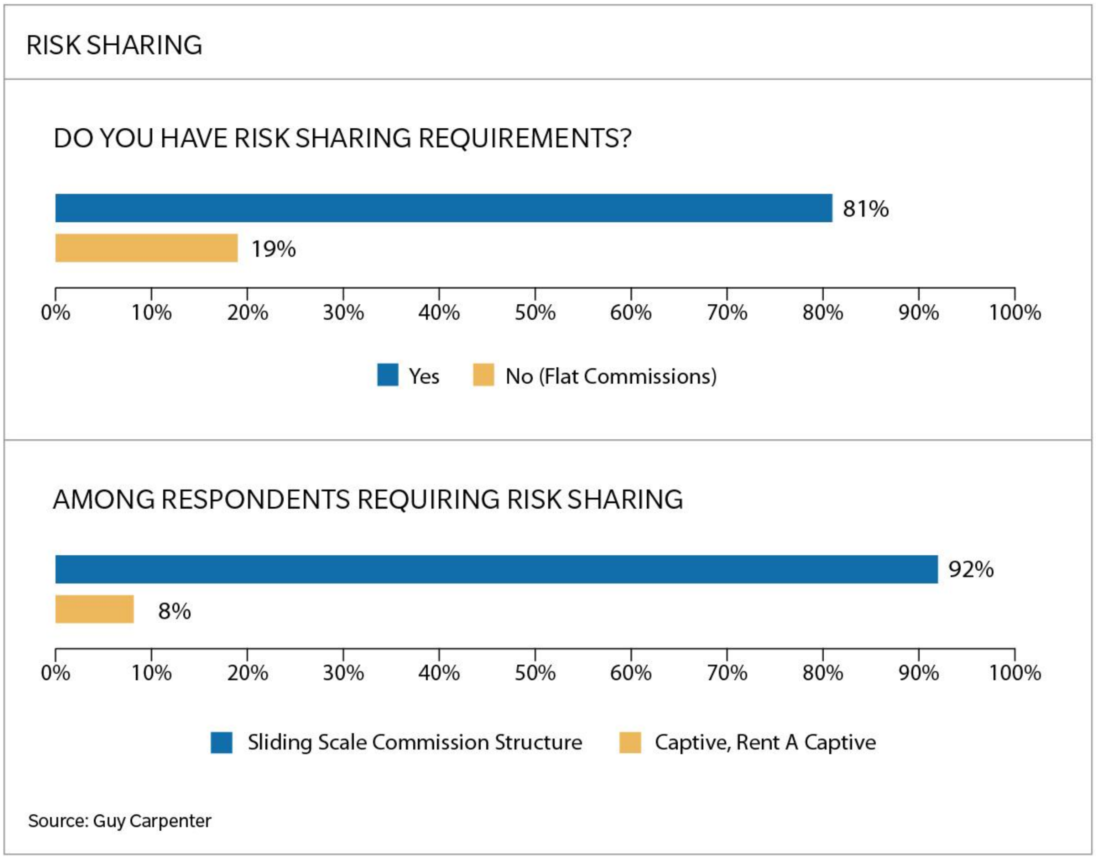
Source: Guy Carpenter

NUMBER OF CLAIM AUDITS EACH YEAR



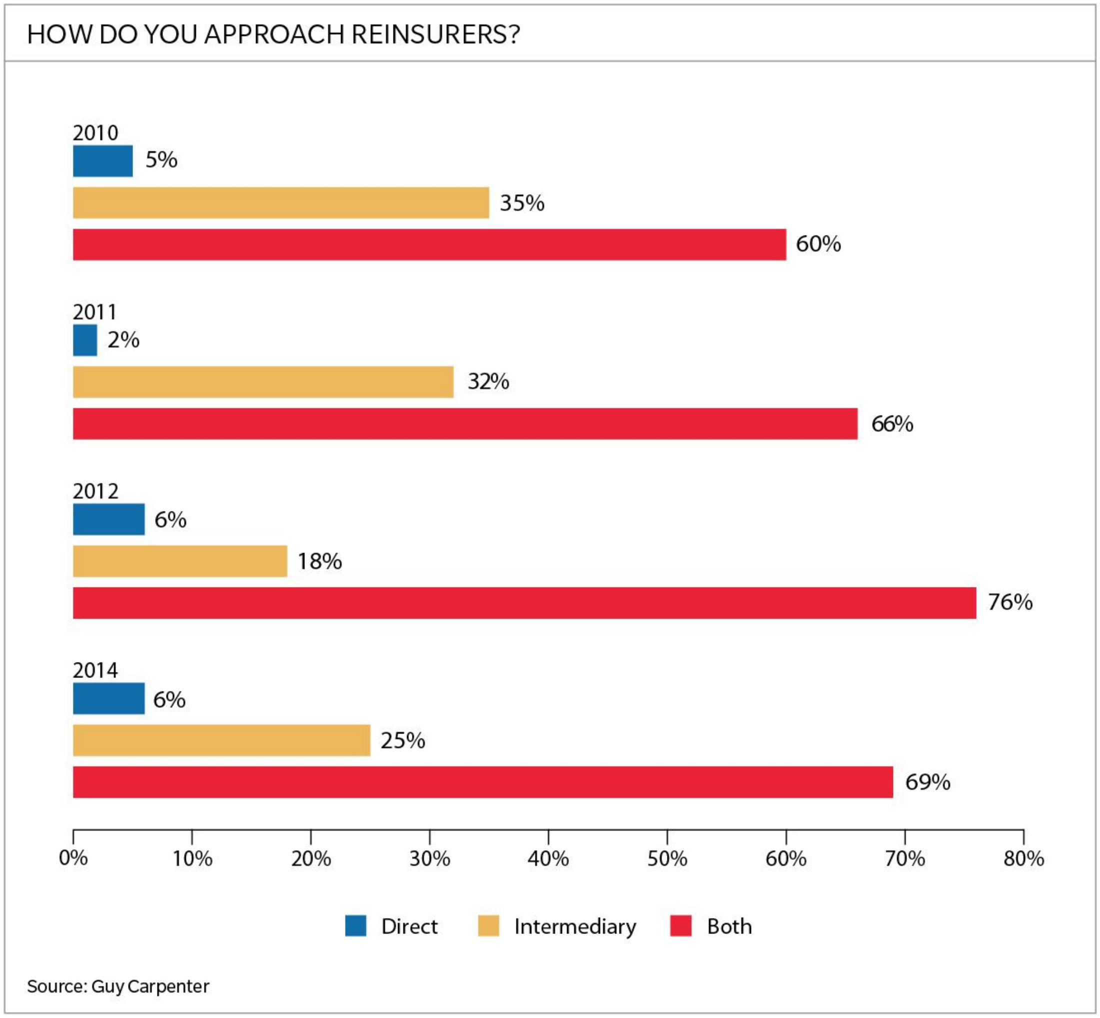
Source: Guy Carpenter

Program managers may also manage the performance of their programs through the pursuit of risk sharing on behalf of their PA/MGA partners. As we saw in past surveys, not all respondents require risk sharing. This year, a significant number of respondents said they utilize a sliding scale commission structure (92 percent versus 76 percent for the prior survey year). The percent of respondents utilizing some type of captive structure fell this year to 8 percent from 24 percent in the prior year. Alternately, 19 percent of the respondents will still pay flat commissions, a sizeable drop from 36 percent in 2012.



Reinsurance Purchasing

Reinsurance continues to play an important role for program issuing carriers. Sixty-nine percent of respondents to the survey this year indicated the use of both direct reinsurers and intermediaries, down slightly from 76 percent in 2012. Those managing their purchase through intermediaries exclusively increased to 25 percent of respondents from 18 percent in the prior year. (See chart on next page)



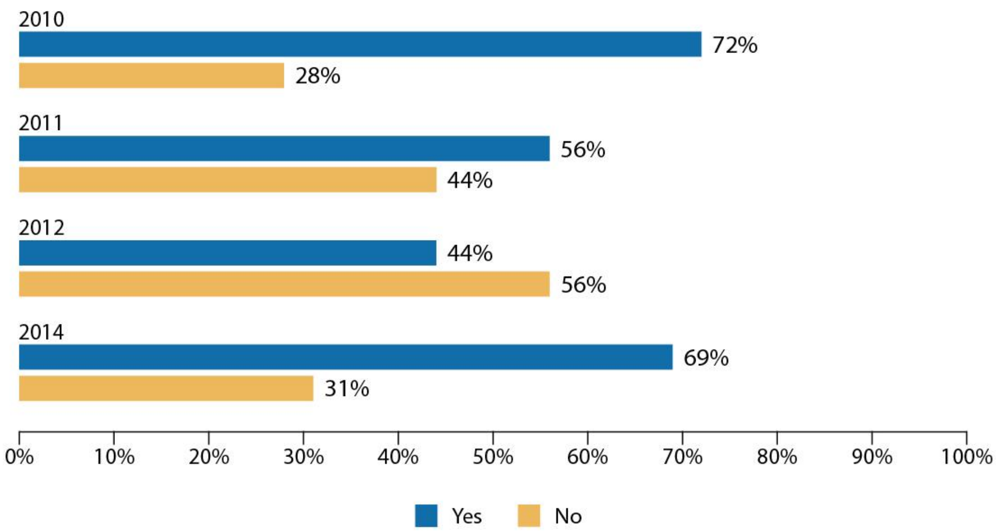
Structural preferences regarding reinsurance shifted to some degree. This year, 57 percent of respondents preferred excess of loss reinsurance structures versus 63 percent in 2012 and 43 percent preferred quota share versus 37 percent in the previous survey.

There appears to be more willingness on the part of carriers to compensate reinsurance intermediaries when program-specific reinsurance is not purchased. In 2012, 82 percent of the respondents indicated they would compensate intermediaries either directly, via a finder's fee or by increasing the PA/MGA's compensation, allowing them to pay the intermediary. This year, 94 percent of the respondents indicated they take this approach.

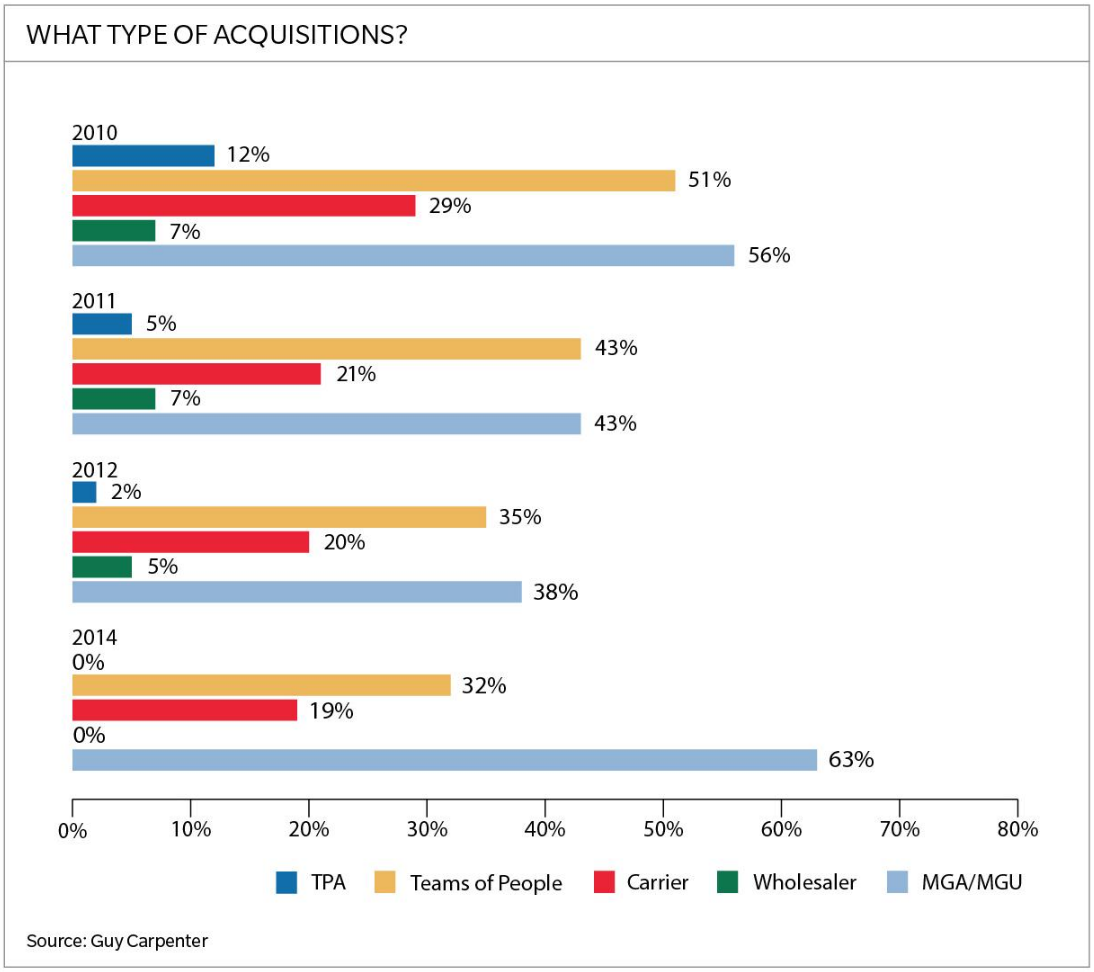
Growth Through Acquisitions

The survey indicates a dramatic shift in the percent of program carriers interested in making acquisitions, following a couple of years of steady decline. This year, 69 percent of respondents indicated an interest in growing through acquisitions (up from 44 percent in 2012). When queried on the types of acquisitions they are seeking, most respondents' interests appear to be acquiring either MGA/PA firms (63 percent) or teams of people (32 percent). This year none of the respondents was interested in acquiring third party administrators or wholesalers. Interest in carriers buying other insurance carriers remained relatively unchanged at 19 percent.

ARE YOU INTERESTED IN MAKING ACQUISITIONS?

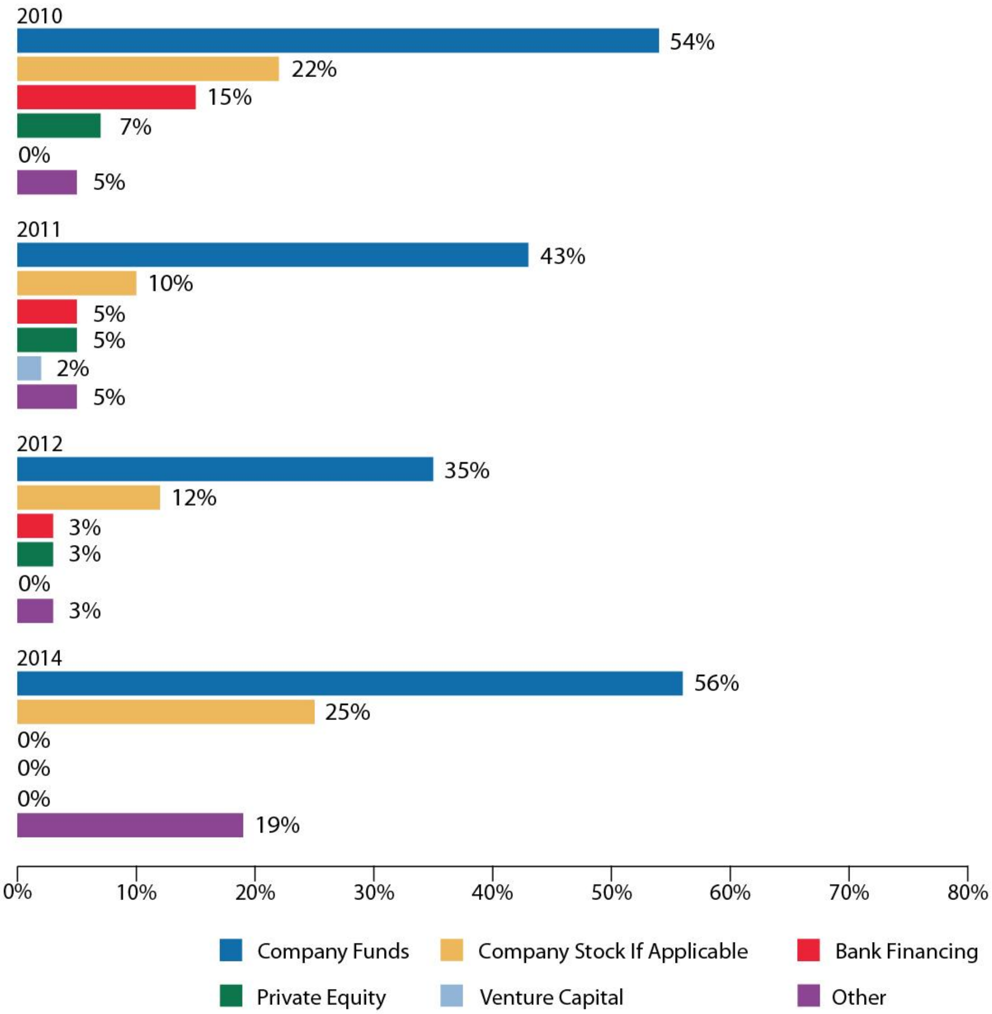


Source: Guy Carpenter



The vast majority of the respondents intend to use company funds or company stock (if applicable) to make acquisitions (81 percent this year versus 47 percent in 2012). Despite access to bank financing, private equity and venture capital options, respondents showed no interest in employing those financial vehicles. It appears insurance companies continue to have ample capital and would use their own resources rather than go to outside sources.

WHAT TYPE OF FINANCING?



Source: Guy Carpenter

As excess capital continues to absorb business and stifle organic growth, carriers will likely have to consider acquisitions in order to attain any meaningful growth.

Conclusion

The PA/MGA market continues to thrive. Over the course of the last ten years through our survey, Guy Carpenter has tracked the market from the carriers' perspective. The 2014 results reflect change, flexibility, growth opportunities and an exciting outlook for 2015. As the entrepreneurial spirit of the PAs and MGAs pushes them to look for ways to profitably expand and grow their business, their carrier partners appear poised to work with them in order to find solutions to assist in that growth. The PA/MGA space remains an underwriting arena and as such it will be driven by underwriting profit. Hopefully, the results of this year's survey have provided some insight into what program carriers are looking to do in order to achieve mutual growth and profitability with their partners in this vibrant insurance market segment.

Should you have any questions, please contact any member of the GCFac/GC Special Risk – Program Managers Solutions team listed below.

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