

May 2008

## New Opportunities and Old Challenges Converge

### Fourth Annual Specialty Insurance Program Issuing Carrier Survey

*The program market is evolving. While most Program Administrators and Managing General Agents (PAs/MGAs) wrestle with many of the challenges from years past, this year's survey has uncovered several new opportunities as well. Respondents expect continued growth through 2008 for a market that most perceive to be greater than USD20 billion in gross written premium (GWP). Pricing, premium and new business production remain top concerns for PAs/MGAs, but they are joined by appetites for mergers and acquisitions (M&A) and the use of outside capital to fuel new endeavors.*

*While Guy Carpenter & Company, LLC ("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. Thus, we provide this service as a benchmark for 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. We thank all who replied for investing time in this effort.*

#### Survey Highlights

The program market continues to grow and more is expected. Carriers participating in this space believe that recent results have been favorable and that combined ratios have and (will run consistently) below 100 percent.

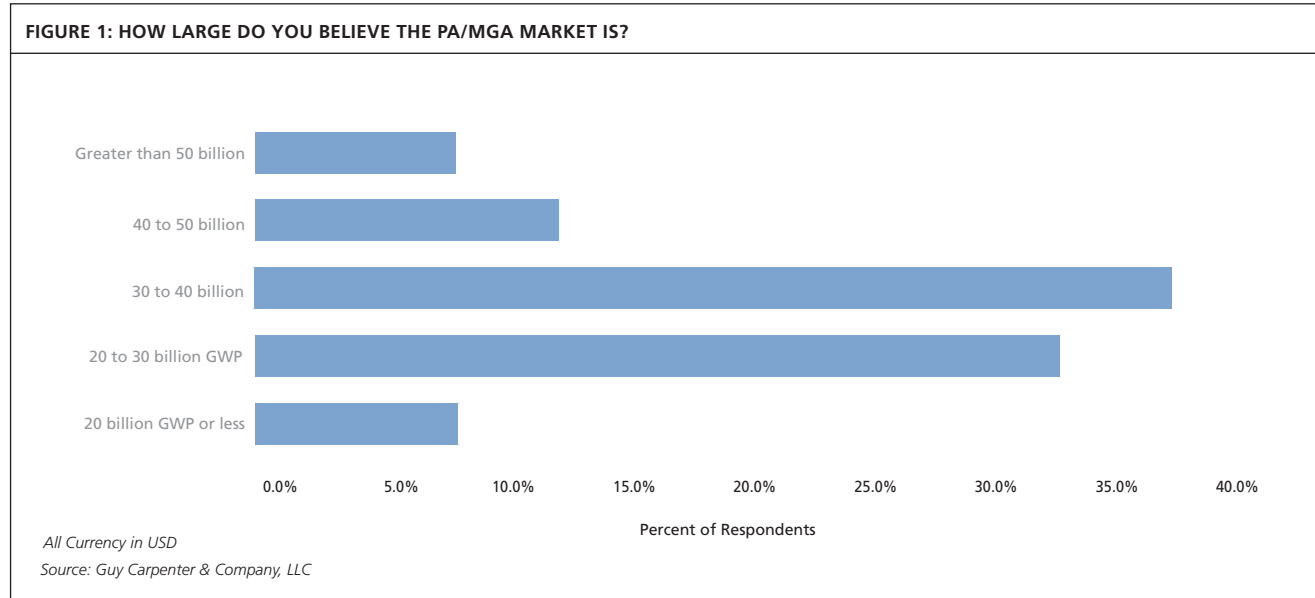
New business production and premium growth, while maintaining current pricing levels, continue to be the biggest challenges facing program writers as they approach mid year 2008.

Programs of almost any size are being considered. With carrier growth objectives, increases in capital and new markets entering the space, there appears to be market interest across the PA/MGA market.

There is more on the carrier's agenda than organic revenue growth. Most PAs/MGAs, according to our annual survey, are eager to make acquisitions and capitalize on a soft market to capture market share and position themselves for future opportunities.

### Market Size and Dynamics

Almost uniformly, respondents perceive the PA/MGA market to be large. Ninety-two percent estimate the total PA/MGA market to be at least USD20 billion in GWP. Thirty-three percent specified a range of USD20 billion to USD30 billion, with 38 percent putting the market at USD30 billion to USD40 billion. More than 20 percent believe that the PA/MGA market generates GWP in excess of USD40 billion.

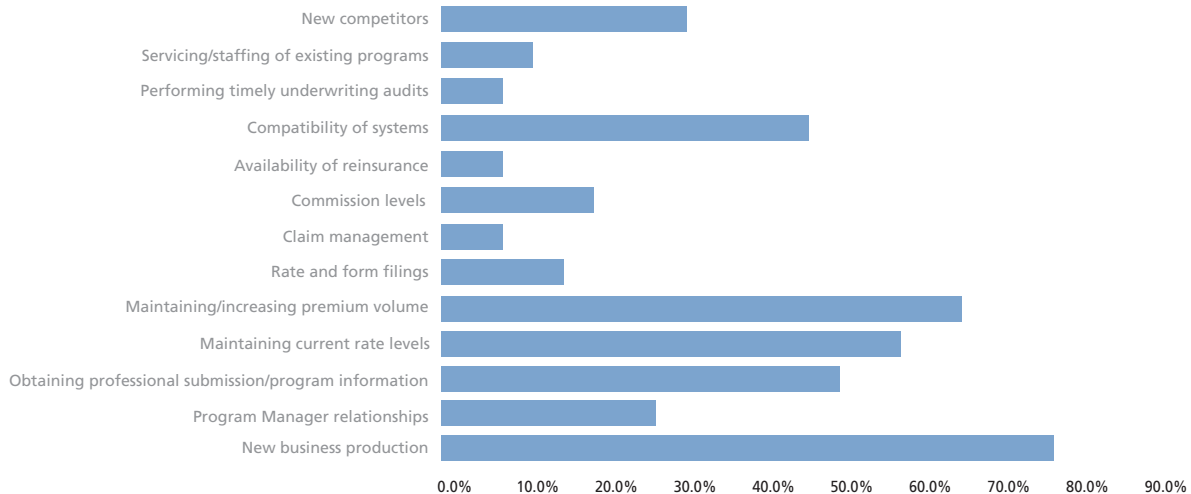


The PA/MGA market is not only large; it is growing. Fifty-six percent of respondents expect the market to grow in 2008, while 32 percent indicated that it will remain flat. Only 12 percent think the PA/MGA market will shrink this year.

Profitability perceptions are fairly consistent. Ninety-two percent of respondents estimate a combined ratio for the market of 90 percent to 100 percent, with 68 percent putting the market at 90 percent to 95 percent. The market may tighten, however, because the pressure to increase GWP could come at the expense of bottom-line results.

Respondent attitudes toward PA/MGA challenges were focused on new business production (77 percent), premium growth (66 percent) and maintaining rate levels (58 percent). As one might expect in a softening market, obtaining professional submissions is a growing challenge for program carriers, as well. The fact that the compatibility of systems is becoming a greater challenge is unsurprising, particularly given carriers' increasing flexibility in the use of front end rate/quote/bind/issue systems.

**FIGURE 2: OF THE FOLLOWING PROGRAM COMPONENTS, WHICH FIVE PRESENT THE GREATEST CHALLENGE FOR YOU?**

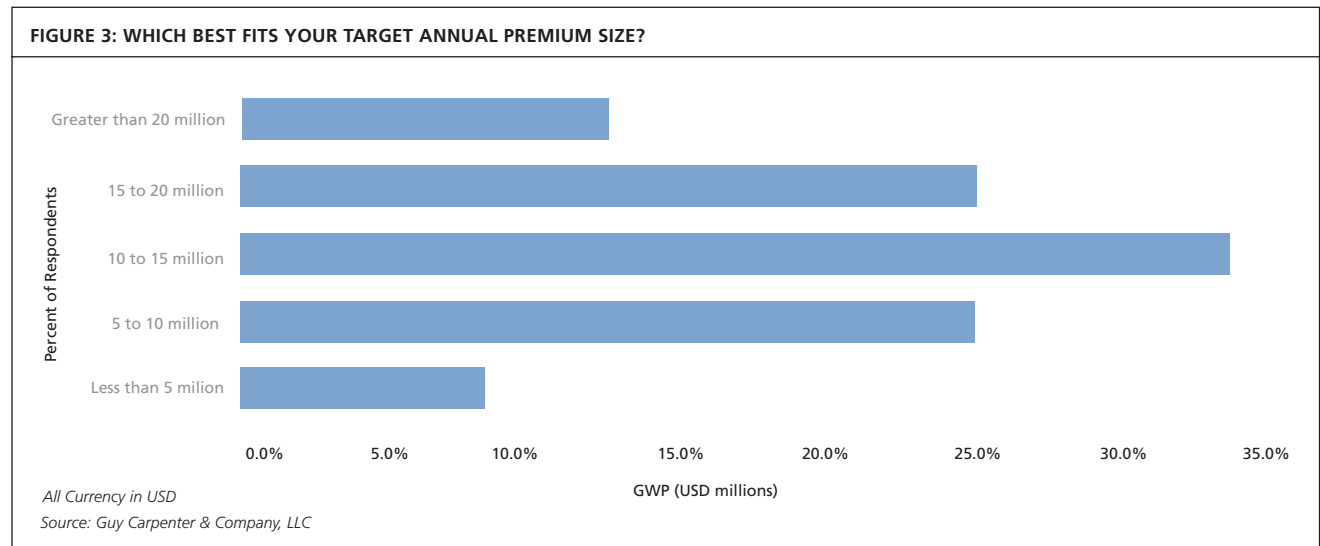


Source: Guy Carpenter & Company, LLC

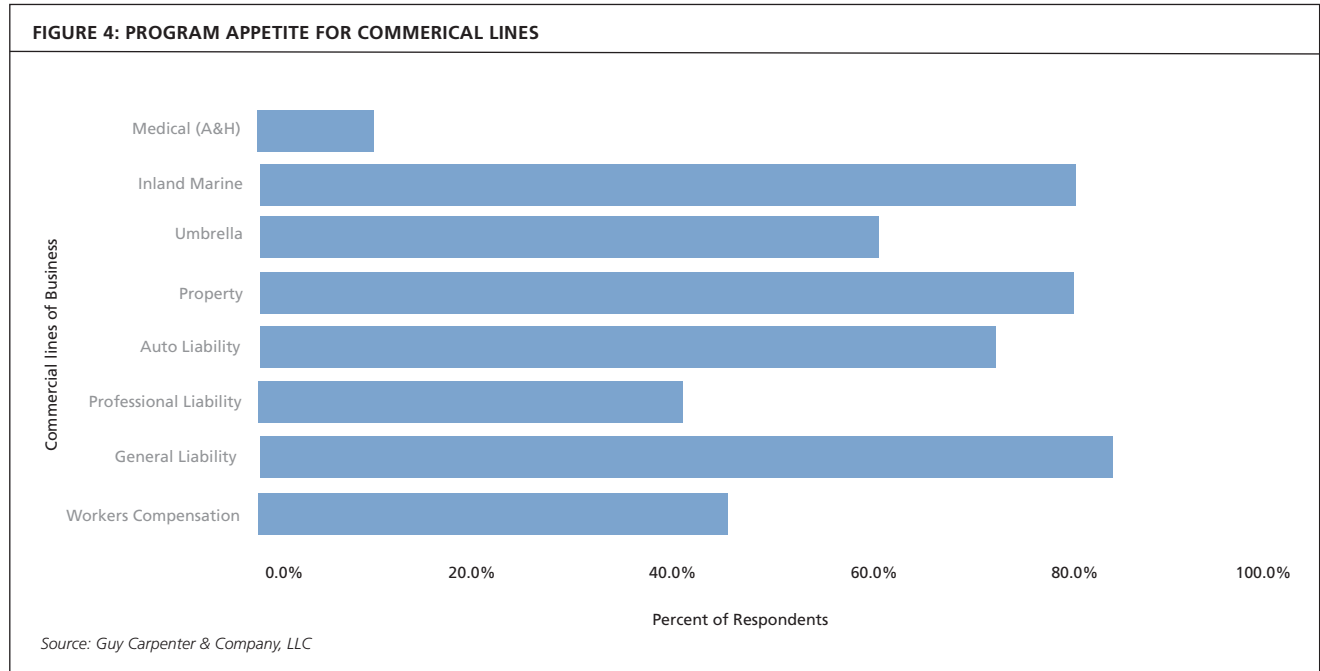
Because of the dynamics of the insurance industry as a whole and the program market segment in particular, the challenges viewed as most important should be considered collectively rather than individually. A company's rate filings are going to affect the rate level it is able to charge. This, in turn, 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 Appetite

Program appetite suggests growth potential. Most PAs/MGAs want to know the program sizes in which carriers are interested relative to annual minimum GWP thresholds. Survey results indicate that there is interest in programs of almost all sizes. Eight percent of the respondents are targeting programs with GWP below USD5 million GWP, and 12 percent are seeking programs greater than USD20 million in GWP. The remaining 80 percent are looking for program sizes between the two extremes.



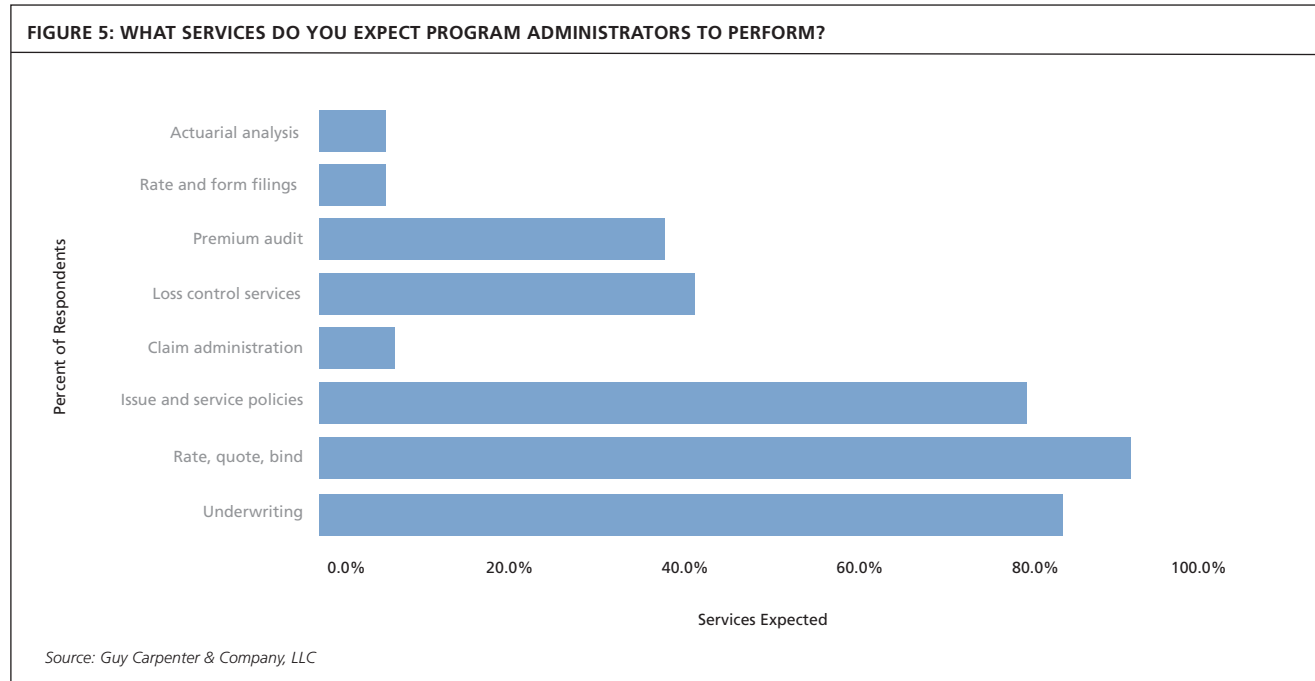
Commercial lines did not change substantially year-over-year. PAs/MGAs generally are focused on growing the same lines of business, particularly inland marine, property and auto liability. Umbrella liability was the lone surprise, at 62 percent in 2008 (from 26 percent in 2007).



For personal lines, on the other hand, PAs/MGAs are shifting. This year, 31 percent of respondents expressed an interested in growing business in the homeowners segment, a noticeable increase from 21 percent in 2007. Thirty percent of survey participants last year indicated that they wanted to grow their auto books. In 2008, auto dropped to 15 percent. Personal umbrella appears to be a growth area, with 15 percent of this year respondents looking to increase their writings, versus 9 percent last year.

### Operating Platform

Carriers are still flexible with regard to the services that PAs/MGAs provide, including system use and claim handling. More than 80 percent of respondents expect the PA/MGA to underwrite, rate, quote and bind the business, as well as issue and service policies. Loss control and premium audit services remain important to some carriers, securing 39 percent and 42 percent, respectively. This is consistent with our 2007 findings.



With the softening market and the need to produce new business and grow premium volume, this year’s respondents continue to have robust procedures in place to monitor results and control the processes involved in working with PAs/MGAs. Ninety two percent of all respondents conduct two or more underwriting and operational audits of the PA/MGA each year. This is up slightly from last year’s 86 percent. Consistency was noted in the number of claim audits conducted with 21 percent of respondents this year conducting 4 or more audits, compared to 22 percent in 2007.

### **Mergers and Acquisitions**

M&A was clearly on respondents' minds this year, with 72 percent indicating interest in making acquisitions. Fifty-four percent are interested in acquiring other PAs/MGAs, and 39 percent are interested in carriers. Twenty-three percent would like to acquire wholesalers, and none indicated an interest in acquiring third-party administrators (TPAs).

The majority of respondents plan to use company funds to make acquisitions (54 percent), though company stock is another popular way to self-finance acquisitions. Private equity garnered 27 percent, and venture capital and bank financing lagged with only 8 percent of respondents each.

### **Reinsurance Purchasing**

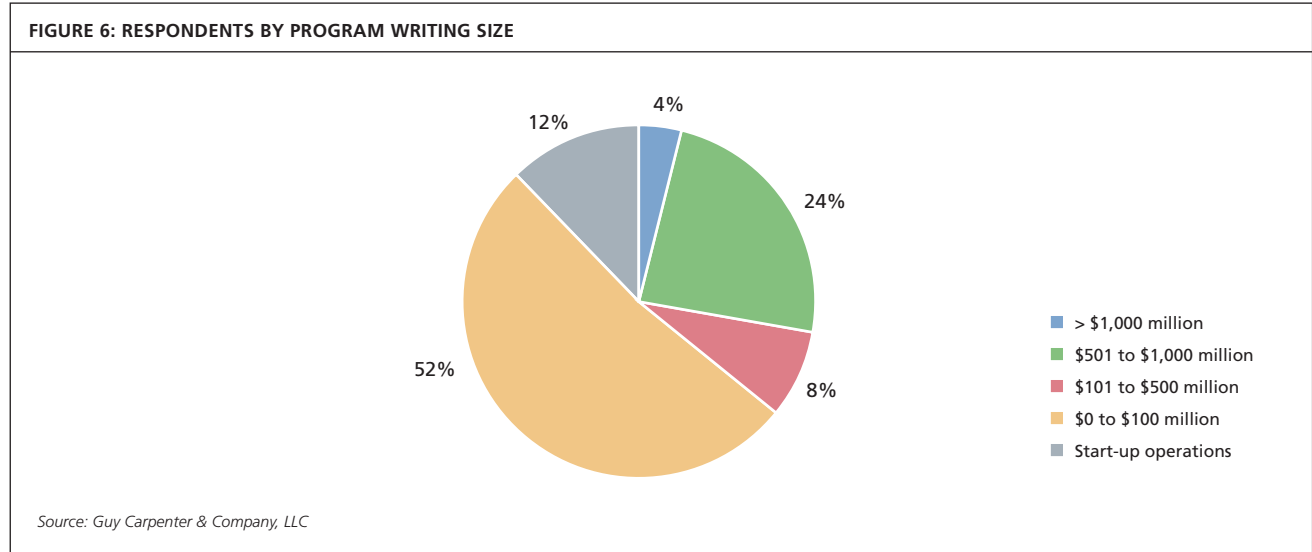
Reinsurance continues to play an important role for program issuing carriers. They continue to buy from both reinsurance intermediaries and directly from reinsurers, with 83 percent of respondents using a combination of both approaches. But, the preferred structure has shifted slightly. Respondents preferring quota share increased 67 percent – from 30 percent last year to 50 percent this year. Carriers preferring excess of loss structures dropped from 61 percent in 2007 to 50 percent in 2008, a change of 18 percent.

Given that a number of this year's respondents were small carriers, divisions, units or start-up markets, we noted an increase in those looking to buy program specific reinsurance versus rolling new programs into existing treaty structures.

As program carriers continue to look for new ways to generate new opportunities, the reinsurance intermediary continues to be a valuable resource. Where program specific reinsurance is not purchased, all respondents this year have indicated a willingness to compensate the producing intermediary for bringing them opportunities. They will either pay a finders fee directly to the intermediary (69 percent of the respondents) or increase the MGA commission so they can pay the intermediary (31 percent).

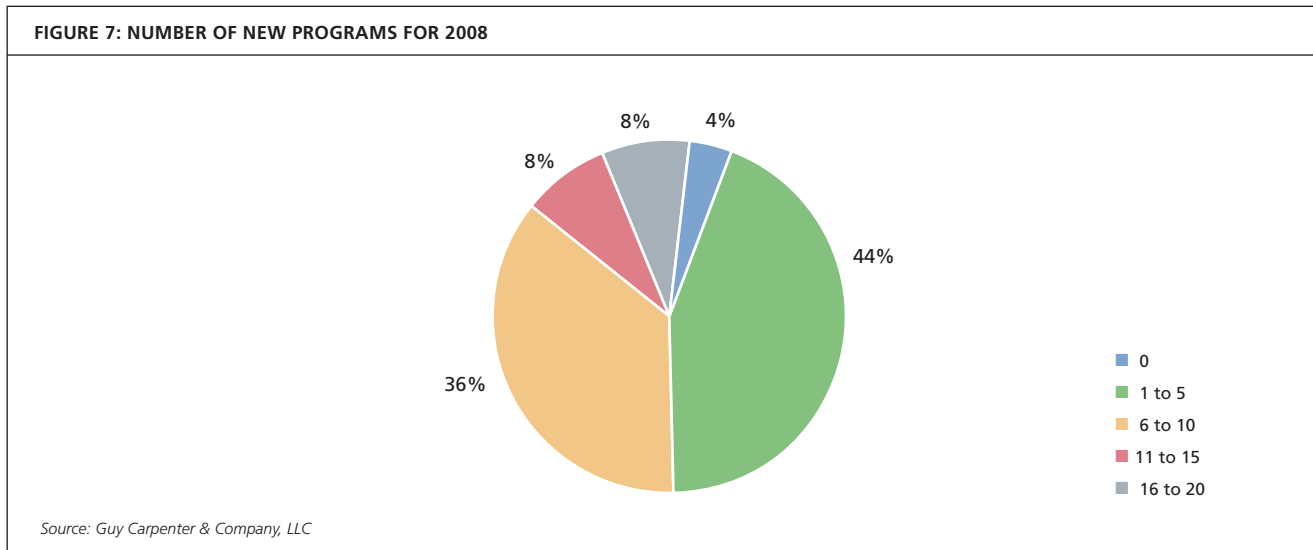
### About the Respondents

This year's respondents were split evenly. Fifty percent were traditional multi-line insurance carriers, and 50 percent were specialty carriers. This represents a slight change from 2007, in which 52 percent were traditional carriers. More than half of all respondents had 2007 GWP of less than USD100 million, and 24 percent were between USD101 million and USD500 million. Among this year's respondents, there are three new MGA operations.



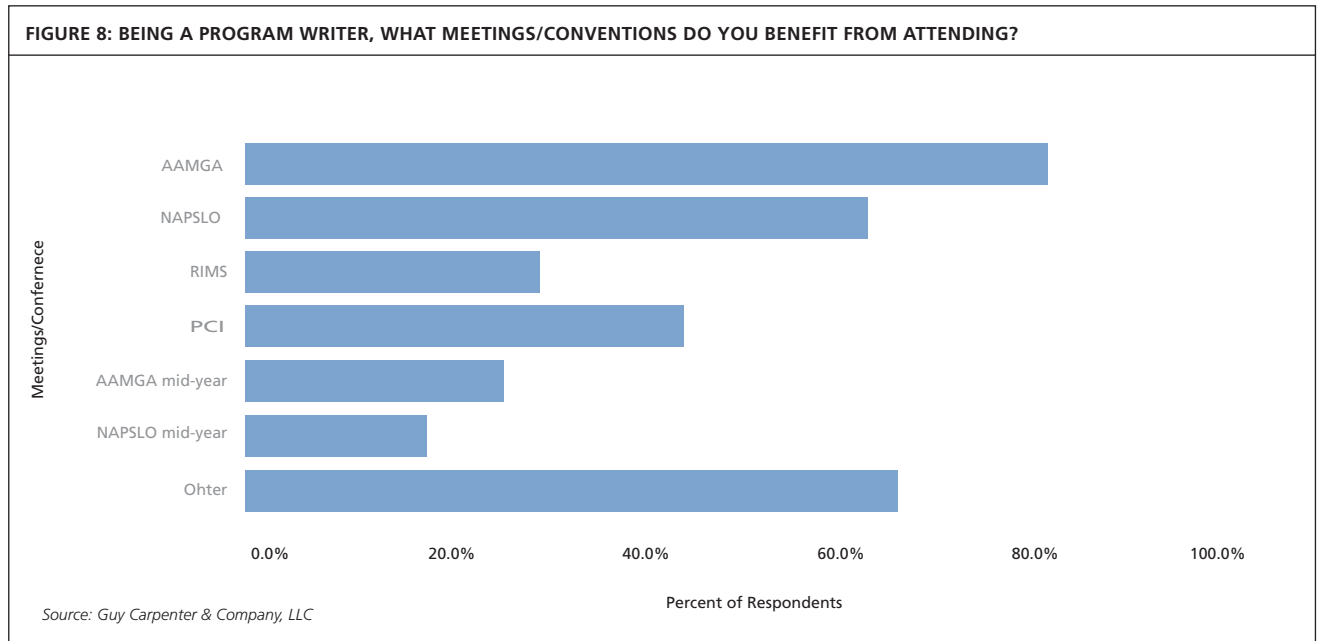
Few changes are expected for the coming year, as most respondents did not indicate that their sizes will increase or decrease substantially. Thirty-three percent of respondents indicated that they are likely to exceed USD100 million in GWP compared to 24 percent in 2007. Most respondents plan to write between one and five new programs in 2008, with 36 percent anticipating six to 10 new programs.

Obviously new business production and premium growth are major objectives for program issuing carriers. Regardless of the carriers' current size or longevity in the program marketplace, production and premium growth are critical to success. In today's marketplace it comes as no surprise that they are also considered major challenges.



Eighty-eight percent of respondents have access to admitted paper in 41 or more states. Only 4 percent are admitted in 25 or fewer states, while 8 percent are admitted in 26 to 40 states. Seventy-five percent of respondents have access to non-admitted paper in 41 or more states, with the remaining 25 percent admitted in 25 or fewer states. This is consistent with responses for 2007, in which 86 percent had access to admitted paper in at least 41 states and 72 percent had non-admitted paper in at least 41 states.

Carrier interest in industry meetings and conferences continued to increase in 2008. This year, the AAMGA annual meeting is the most popular with our respondents, as 85 percent claim they benefit from attending (up from 52 percent in 2007). The popularity of NAPSLO’s annual meeting grew slightly, from 61 percent to 65 percent this year. Sixty-nine percent replied that they benefited from other conferences such as Peak Performance, PLUS, VCIA, to name a few. Mid-year meetings are less popular, with only 27 percent of respondents saying they benefit from the AAMGA mid-year meeting and 19 percent for the NAPSLO mid-year event.



The program market is as active as ever and continues to attract new capital. Regardless of program size, organizational structure, technology platform or servicing capabilities, there appear to be parties interested in doing business with PAs/MGAs. Whether it is to provide the insurance for programs, partnering in expanding operations to grow revenues or to be the potential buyer of a PA/MGA operation, the results of our survey indicate all the ingredients are present for an exciting year in the program marketplace.



## **Contacts**

### **Carl Bach**

**Managing Director, Practice Leader**

Hartford, Connecticut

860.550.8244

carl.a.bach@guycarp.com

### **John Barrows**

**Vice President**

Hartford, Connecticut

860.550.8279

john.h.barrows@guycarp.com

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