Lowenstein Sandler's Insurance Recovery Podcast:
Don't Take No For An Answer

Episode 56

Knowing Your R&W Insurer: MGUs & MGAs v. Insurance Companies

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Lynda Bennett: Welcome back to Don't Take No For an Answer, and happy new year everybody. Glad to have you back. I'm your host, Lynda Bennett, chair of Lowenstein Sandler's Insurance Recovery Group. Today we're going to be talking about an issue that's often overlooked by buyers who are evaluating reps and warranties insurance proposals as part of their M&A deal. And the issue is who exactly is providing the insurance, negotiating the terms, and most importantly paying the claim if and when there's a breach and a loss?

The answer is not always clear, but it can make a difference. Yes, there are plenty of traditional insurers that sell rep and warranty policies and other types of transactional risk policies and pay claims, after we twist their arms of course. But there are also many MGUs and MGAs, which for those of you who are not familiar, stands for managing general underwriter or agent, and they are players in the rep and warranty market as well.

So today we're going to be talking about MGUs and MGAs and how they differ from traditional insurers and how and why it matters. And we're pleased to welcome back Michael Wakefield from CAC Specialty. Michael's an insurance broker and leads the transactional practice at CAC with extensive experience placing reps and warranties insurance and other types of insurance solutions for M&A deals. So welcome back, Mike. Good to see you.

Michael Wakefield: Thanks, Linda. Glad to be here.

Lynda Bennett: I'm also joined again by my partner, Eric Jesse, from Lowenstein Sandler's Insurance Recovery Group. Eric works on behalf of our buyer clients in M&A deals to guide them through the rep and warranty process from selecting the insurer to negotiating the rep and warranty policy and, of course, to inevitably helping to handle those claims that do come out of some of those busted deals. Welcome, Eric.

Eric Jesse: Thank you. Good to be back.

Lynda Bennett: So with that, let's jump right in, and we'll start by setting the table. So what is that MGU MGA and how are they different from a traditional insurer?

Eric Jesse: So an MGU or MGA, they are not an insurance company, but they do specialize in placing particular types of insurance. And so they focus on those types of insurance like reps and warranty insurance. So when an MGU or MGA is involved, the insurance company, what they've done has essentially outsourced a lot of their key or traditional functions like underwriting, evaluating and accepting the risk, negotiating the policy, and possibly administering or adjusting a claim if there is one.

Michael Wakefield: And Eric, I would add, it helps me understand how MGAs and MGUs fit into our space to think about it from both the insurer's perspective and the MGA principles, the individuals who run MGA or MGUs, their perspective. From the insurer's perspective, it can be... And this isn't the only rationale for exposure to the rep and warranty insurance market through an MGA or MGU as opposed to through your own in-house underwriting team. But for some insurance companies, they might say, "This looks like an interesting business line. It's a new business line. Kicking off our own new business line is a big effort. We have to hire people, take on their overhead, their salaries, we have a longer-term commitment to them, we have employee benefits, or we can enter into a contract with essentially a service provider partner in the form of the MGA or MGU, and we can give that MGA or MGU capacity of ours to bind coverage in a rep and warranty policy, and that's a shorter-term commitment. There's not as much fixed cost and we renew our binder every year." And so it's a way to start, a little bit dip a toe in the river, of a new line. And that applies beyond just rep and warranty insurance.

Eric Jesse: Yeah, and that's a good point, Mike, because I think a lot of the R&W insurance market seems to be growing every year and a lot of the new entrance into the market, to your point, we're not seeing the traditional insurance company. It is that MGU or MGA that's emerging on the market.

Lynda Bennett: Mike, I want to kick a question over to you, which is, so you're the insurance broker, you're working with a client. Are you disclosing to them or talking to them about the different offerings and are you telling them, "Hey, this proposal is coming through an MGU MGA, this is coming through a traditional insurer." Is that something that your clients are asking about or that you feel I'm going to affirmatively put that out on the table as we're going through the different options?

Michael Wakefield: Yeah, we do. In every memo that we prepare for a client... And I'll take one step back. So we as the broker talk to our client about securing quotes for a rep and warranty policy. We then go to market, collect quotes, and put those into a memo with a summary and analysis of the quotes that we've obtained and then our views on the quotes. In that memo, we always say, "Out of your top four options, these two are insurance companies and these two are

MGAs," and I'll just use the terms interchangeably for now, "underwriting on behalf of insurance companies."

Depending on the situation and the client and the companies at issue, we might say more. We might say, "We think that's important for ABC reasons." Or, "We think that you should focus on an insurer or an MGA for these reasons." But it's very complex and as we're going to see in the rest of this discussion, there are a lot of reasons you might prefer one or the other and it's rarely a single answer or a factor determining who you want to work with between an MGA and an MGU or an insurer. So we do talk about it and then typically we get on the phone and talk through any issues particular to that deal.

Lynda Bennett: Great. And Eric, we deal with a lot of alphabet soup in the insurance space and we are talking about MGA MGU, and Mike mentioned he'll use it interchangeably, but what is the difference between the two, if any?

Eric Jesse: Yeah, so I think the main difference is that MGA, as the name describes, it's essentially going to be an agent of the insurer and it's going to perform many of the functions or traditional functions of the insurance company. So that might be administrative tasks along with the adjustment of the claim in addition to the underwriting. An MGU, as the name suggests, is really just I think generally going to underwrite that risk, negotiate the policy without much more involvement beyond that. I think in under each arrangement there's ultimately going to be contractual parameters between the insurance company and the MGA as to what it will do and the insurance company and the MGU in what they're authorized to do and what the risk parameters are going to be.

Lynda Bennett: All right. So let's dig a little bit deeper into this now and talk about how it works. So when you have an MGA or an MGU, are they writing policies on behalf of one insurance company, multiple insurance companies at the same time? Let's get into the weeds. How does it work?

Eric Jesse: Yeah, so I think the answer is it depends. When you have a reps and warranty policy or another M&A insurance policy, there's going to be the declarations page and it's going to identify who the insurers are that are backstopping the policy. And so sometimes it can be just one insurance company, but in other cases there can be a number of different or unaffiliated insurers and they're each going to share a percentage of the risk and a percentage of any claim payment.

Lynda Bennett: So Mike, when we're dealing with an MGA or an MGU who's issuing the policy on behalf of multiple insurers, what are some of the specific considerations that you as the broker look at in assessing that opportunity?

Michael Wakefield: Well, it's always important to understand who the insurers standing behind the MGA are. And as you indicated a minute ago, the number of those per MGA spans from one, and there are only a handful of MGAs in the rep and warranty space who only underwrite on behalf of one market. But actually some of the MGAs started out with one insurer and now have expanded their capacity to more than that. All the way up to we see what we call line slips.

The line slip would be the breakdown of percentage responsibility each insurer has for the risk, and so you see these long decimal place numbers, 11.3687% of the risk is with insurer A on down the list. You might have more than 10 in some cases. So this can take many, many forms.

We see brand name insurers that you would recognize as large insurance companies in the US, we see European insurers, we see insurers you've never heard of because they're a subsidiary of another company or insurer. There's a whole separate category almost, which you might have a separate podcast on one day of Lloyd's of London MGAs and their syndicates. Back to my practicing law days, I ran into a lot of Lloyd's of London issues, and they are unique in a lot of ways from how you would think about an MGU underwriting on behalf of three US insurers.

So understanding that's important. I would say perhaps the most important piece from a practical standpoint, and this is cutting through a lot on the placement side, and I know this is close to your heart, Lynda and Eric, the most important thing is to have some understanding of the claims relationship between the MGA and the insurers. And that can span... We never have access to those contracts really, and we don't always have full transparency, but we as the broker, part of our job is to understand how the claims relationship works. And the spectrum there goes from claims control and authority where if the MGA says, "This is a claim, and we believe it's a legitimate claim that should be paid." Then the check shows up in the mail all the way to the MGA says, "We have built credibility with our insurer partners and while they will ultimately adjust the claim, we will advise them and hopefully for our clients, and this is what we want, advocate on your client's behalf to get our legitimate claims paid."

The practical outcomes of that aren't as clean as that spectrum suggests. It's not necessarily the case that one is bad, and one is good, but it's good to understand that and to know what you're getting into when you have a claim.

Lynda Bennett: Yeah, Mike, you're hitting on one of the core values of our podcast, don't take no for an answer, which is the importance of understanding the players at the front end before the policy's placed, understanding how those relationships are supposed to work, and again, through the broker's lens, understanding and seeing claims on the other side who's selling you a bill of goods versus who's going to actually deliver on what the expectations are for how the policy's supposed to work. Seems to me though that one of the biggest benefits to a policyholder in going the MGA route is that it could potentially streamline the underwriting process, as you said, if we've got six or seven different carriers each signing on for a percentage piece of this risk, not having to go through the underwriting process answering questions from each of those six carriers individually seems to be a benefit to policyholders.

So Eric, before we wrap up the front end of this discussion because there's so much to cover, we'll continue into another episode here, when you're placing a rep and warranty policy in particular with an MGU or an MGA, have you seen that the underwriting process is different than when placing with a traditional insurer?

Eric Jesse: It varies, but one thing I do like about working with some MGUs as opposed to traditional insurance companies is, because as we talked about the outset, the MGUs are really focused on specializing in this product and in many cases focused on specializing in even a particular industry. And so, they have expertise and frankly, the confidence to really take the lead in the underwriting process and take the lead on the underwriting call as opposed to having outside counsel, which a lot of rep and warranty insurers do use. So if you're on an underwriting call, many times it's outside counsel that's asking the call, but when you're working with an MGU, there's a good chance that you might just be working with one underwriter. And that just helps to, I think, streamline the process, and just make the response time quicker as you are answering follow-up questions after the call, you're able to get the underwriter to sign off as opposed to the underwriter having to check with their outside counsel.

Michael Wakefield: Yeah, Eric, that's a great point and I'll add to that. We started out the call talking about insurer's reasons for maybe dipping their toe in the rep and warranty river, for example, through an MGA. If you think about it from the other side, from the viewpoint of the principles at the MGA, say I have expertise in underwriting rep and warranty risk, which is a tough concept to pin down, but let's say I do. I have an edge in that space. I can't very well hang out a shingle and say I'm an insurance company. There are all kinds of capital requirements, licensing requirements. There are 1,000 reasons I can't do that. What I can do is go to an insurance company and say, "Hey, I have this expertise. It can make you money. You should enter a contract with me where I do underwriting for you."

And there is some non-absolute, but general shift, or general leaning, of people who have that entrepreneurial spirit toward people who align with a lot of our clients and your clients, Eric and Lynda, for example, private equity firms who are nimble and fast moving and always work on deal time. I think that entrepreneurial spirit might align with people who have the same view of deals and scrappy nature to get deals done that some of our clients do. And sometimes you end up with very hands-on underwriting and get the deal done no matter what sort of attitudes. And that can help the underwriting process. But again, that's not absolute. We have great insurance company partners who work around the clock as well. I just think it's something to think about. To put it more broadly, the personality of the underwriter, whether it's an insurer or an MGA, can be something to think about as you match them up with the client.

Lynda Bennett: Mike and Eric, thank you very much. I think we've set the table well. I'm sure that we've educated some listeners that didn't know that there are MGAs or MGUs that are standing behind some of the policies that they've already purchased. And we've touched on the underwriting process and the benefits in going this route with an MGU or an MGA. But Mike touched on it and the most important issue, of course, the burning question on the mind of our clients all the time is, "How's this going to work when I present a claim?" And so I'd love to have you both back on a future episode so that we can pick up the ball with that and answer that burning question. So if you're willing to come back, it'd be great to continue the discussion another time.

Eric Jesse: Absolutely. Thank you.

Michael Wakefield: I would welcome the opportunity.

Lynda Bennett: All right, terrific. Thanks so much and we'll see you next time.

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