Program Administrator Contracts:

"I look at life from both sides now."

Greg Thompson CPCU, ARM, CPL

Senior Managing Executive-Programs

Markel Specialty

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Background/Experience

- Founder/Owner of P.A. 30+ years
- Sold to Markel 2012
- 3+ years with Markel
- Most of that: President, Markel Specialty
- Reviewed dozens of P.A. contracts over the years
- Negotiated approximately 20 contracts as owner of THOMCO
- Been in litigation or arbitration of several agreements

What’s the big deal about PA Contracts? Aren’t they all very similar?

- There is no “boiler plate” language when it comes to the wording that counts
- In truth, when the relationship works well, the contract may seem irrelevant
- BUT ... when there is friction, usually when the relationship is coming to an end, the wording can significantly impact the financial success of the carrier and the survival of the P.A.
- When negotiating a contract, think about what the other party could do to you if the wrong person was making the decisions
- For PAs: courts and arbitrators view contract as B to B. Don’t expect a lot of consideration for being a smaller business than the carrier

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Focus for Today

- Teach Target University Contracts course leading to CPL designation
- Includes P.A. Contract with Carrier, Non-Disclosure Agreements (NDAs), Producer Agreements and Profit Sharing Agreements
- Today: PA Agreements – Four Key provisions:
  - Termination
  - Suspension
  - Exclusivity
  - Ownership of Records and Expirations
- These four: Provide leverage to protect the carrier financially and can put the P.A. out of business

Termination Not for Cause

- 30 days to 180 days
- Admitted vs Non-Admitted
- Notice Protection weakened if Carrier can change: Underwriting Guidelines, Pricing, Coverages or P.A .Authority on short notice
- Compromise Solution: “Cannot be used to effectively terminate the program”

Termination for Cause (Boiler Plate Language)

- Effective Immediately
- Fraud
- Misappropriation of Funds
- Bankruptcy
- Financial insolvency, i.e. liabilities greater than assets

Termination for Cause (Carrier Preferences: Typical Conditions)

- Any violation of Underwriting Guidelines or other P.A. Obligations
- Any change in P.A. ownership or staff handling program
- Any change in reinsurance
- Cancellation, suspension or declination of any license in any state
- Any changes of laws or regulations affecting carrier exposures

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Termination for Cause (Carrier Preferences less Common Conditions)

- Loss Ratio exceeds a certain level
- Premium volume drops below a certain level
- Company pulls out of the class of business involved
- Financial Ratio Triggers

Termination for Cause (P.A. Preferences I)

- Provide Cure Period for errors, guideline breaches, license cancellations, etc.
- Minimum 10 days notice for termination for cause to hopefully allow P.A. time to address issue
- Reinsurance Termination or Change
  - As much notice as possible
  - Material changes only
  - Good faith effort to replace

Termination for Cause (P.A. Preferences II)

- Reasonable limits on change of control or key staff leaving
- Changes in laws/regulations: Material impact on exposure
- Financial Ratios/Loss Ratio/Premium Volume: Negotiate numbers
- P.A. cancel “for cause”: Carrier AM Best Rating drops below A-

Suspension of Authority

- ”Below the Radar” Provision
- Less Terrifying than “T” Word
- Suspension sounds temporary
- Usually no requirement to reinstate authority
- Usually with no notice or very little
- Common Triggers for Suspension:
  – At Company’s “sole discretion”
  – During the pendency of any dispute
  – Failure of PA to meet any obligations to carrier
  – Upon receipt of notice of termination (vs effective date)

A P.A.'s Favorite Words:

- "Material" as in a "material" violation of underwriting guidelines
- "Significant" as in a suspension due to "significant" errors in reporting premiums to the company
- "Willful and Numerous" as in "willful and numerous" violations of authority
- "Shall not be reasonably Withheld" as in a change of control is subject to approval by carrier which "shall not be reasonably withheld"
- "Cure Period" as in the P.A. will be given a "cure period" of 30 days in the event of termination or non-renewal of a license

Exclusivity (Conditions)

- In most cases: P.A. wants exclusive but carrier prefers not to give
- BUT ... It's complicated!
- Typically, carrier will insist on mutual exclusive.
- What if later P.A. wants to move business to another carrier or sell Company?
- Then ... P.A. will have to provide notice of termination on contract, which averages 120 days

Exclusivity (Consequences)

- Problem:
  - What if carrier makes drastic changes in interim: underwriting guidelines, authority, pricing, etc.?
  - What if carrier has just lost their AM Best Rating?
- Result: P.A. struck with carrier in interim
- Conclusion: Unless one way exclusive, evaluate benefits and downside carefully

Ownership of Records and Expirations (Definitions)

- Defining Records:
  - Correspondence
  - Rating worksheets/analysis
  - Policy files
  - Sub-Producers
- Defining Expirations
  - Renewal Dates
  - Account names and addresses
- Primary Basis of ownership value of any insurance agency!
  (Car and title analogy)

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Ownership of Records and Expirations (Trends)

- The Standard Provision historically: P.A. retains ownership of records and expirations upon payment of all outstanding account balances to carrier
- HOWEVER … Times are changing!
- Carriers are taking steps to protect their books of business, especially from other Carrier M&A
- Most contracts still give ownership of expirations to PA, but wording on records is increasingly favorable to carrier
- Carrier Favorable Terms on Records:
  - Carrier exclusively owns records but P.A. has access
  - Joint ownership P.A. and Carrier
  - P.A. will retain records on behalf of Company
- Compromise: P.A. exclusively owns all records related to distribution of product

Records and Expirations: It can get ugly!

- Case Study: Recent Carrier Contract
- If Carrier terminates not-for-cause, P.A. owns records and expirations
- If Carrier terminates for cause, and even if P.A. pays all outstanding premiums, Carrier owns records and expirations. (vs Standard Provision)
- If P.A. terminates not-for-cause, Carrier owns records and expirations!!
- Plus: P.A. has signed mutual exclusive with carrier
- SO … Imagine this!:
  – P.A. unhappy with carrier relationship and wants to move business or sell
  – P.A. has to terminate contract due to exclusive to make a move
  – P.A. learns that they have to give their business to existing carrier … they no longer own it!

Ownership of Claims Information

- P.A. Perspective: Access to claims data is essential or will never be able to move the business
- Carrier Perspective: Prefers that claims data not be used to allow P.A. to move the business
- Most contracts: Allow P.A. ability to use claims data either explicitly by granting joint ownership or implicitly by not mentioning at all.
- Some Contracts restrict P.A. access to data:
  - By allowing P.A. to only use data if carrier terminates the contract not-for-cause or is otherwise unable to write the business
  - Only if Carrier AM Best Rating drips to A-
  - Only if P.A. provides carrier advance notice of sharing of data with third party
- P.A. Protection: Actuarial Study funded by P.A.

How to Manage Your attorney or in-house counsel:

- Carrier or P.A.: Choose the right hills to die on
- Hill #1 for P.A.: Ownership of Records and Expirations
- Hill #1 Carrier: Ability to move quickly if P.A. represents significant credit or underwriting exposure for carrier
- Make sure your attorney or counsel knows your priorities
- For P.A. only:
  - Make sure attorney has expertise on agency contracts-Examples
  - Don't let attorney re-write the contract
  - Beware of the "R" word

Conclusion

- Contracts may seem like a waste of time when things are going well
- But when it hits the fan …
- They can make you or break you

Q & A