TARGET MARKETS

Program Administrators Association

The TMPAA State of Program Business 2012

Sponsored by:

SCOTTSDALE INSURANCE COMPANY®

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ADVISEN Insurance Intelligence

Introduction and Executive Summary

What does it take for a program to succeed?

In 2011, the Target Markets Program Administrators Association (TMPAA) launched "**The TMPAA State of Program Business Study**," to look into the views of program administrators and carriers about program success criteria. Through the ground-breaking research on the program insurance market, the TMPAA sought to present a snapshot of the program business in the United States and document the characteristics, growth, dynamics and other information about the industry.

TMPAA describes program administrators as firms that offer insurance products targeted toward a particular niche market or class, generally representing a book of similar risks placed with one carrier. These specialty firms' activities include marketing, underwriting selection, binding, issuing, billing, premium collections, data gathering, claims management, loss control and, possibly, risk sharing. They distribute these programs on a retail or wholesale basis.

The inaugural survey yielded valuable insights from program administrators and carriers about the size and scope of the program administration business, as well as the trends that affect the industry. The 2011 survey looked into 2010 business results. Its most important finding is that the program business seems to be growing and defying the overall soft market for property and casualty insurance.

To assist its more than 300 members in conducting their businesses more efficiently with greater proficiency and profitability, the TMPAA conducted the second leg of the survey in 2012. This year's study presents 2011 business results.

The 2012 survey goes beyond documenting the size of the market and tracking the growth of the program business. It offers a look into the views and practices of program administrators in terms of commissions paid, merger and acquisition activity, and use of information technology in their business. Program administrators also assessed carriers on their excellence as program partners, ranking the quality of their services on a scale of one to five with one as poor and five as excellent.

Also presented in the survey is a carrier perspective on coverages, program consideration, and outsourcing. In this survey, insurers also share their views on new program selection – the information they need to see, the financial factors they want to examine, and the threshold premium amount they look for in a new program.

What makes this year's survey even more valuable is the comparative analysis of the results with the baseline data gathered in 2011.

In addition to presenting the responses gathered from program administrators and carriers, the TMPAA also conducted an analysis of the market. The market analysis is composed of two parts: a survey response analysis and a U.S. market analysis.

As with last year, the research was conducted in tandem with Advisen Ltd., a global provider of information and analytical tools for risk managers and the commercial insurance industry. The production and publication of the benchmarking report was sponsored by Scottsdale Insurance Company and Western Heritage Insurance Company – members of the TMPAA.

The question topics for the 2012 survey were designed and reviewed by a committee of TMPAA member Program Administrators and Carriers, the TMPAA Board, Advisen and the New Street Group (TMPAA Special Consultant for the Program Business Study).

Advisen conducted an online survey of TMPAA members between 16 July and 31 August 2012. "The TMPAA State of Program Business Study 2012" survey looked at both program administrators and program insurance carriers. Respondents to the survey include 190 program administrators and 43 insurers who completed parts, if not all, of the sections in the questionnaire.

KEY FINDINGS

Overall

- Pegged at $ 24.7 billion in premiums in 2011, program administration is a huge business. The estimated size of the market rose 9 percent from $22.6 billion in 2010.
- Carriers and program administrators reported an estimated 2,000 individual programs – an increase of 5 percent from the 1,900 individual programs estimated last year.
- The industry continues to grow as a greater number of program administrators reported an increase in premium volume over the past year. The average increase reported for 2011 was 9 percent compared to 4 percent in 2010.
- Amid a declining market place, many administrators continued to report high renewal rates. At 84 percent, the average renewal rate for the 2012 poll was the same as what was reported for the 2011 survey.
- Many program administrators and carriers are optimistic about prospects for future growth as they see increasing value in placing specialized risk. This is evident in the comments they provided in the survey about the future of the program business.
- There seems to be a mismatch in the M&A picture as there are more buyers than sellers. While 43 percent of respondents expressed their intention to purchase other administrators, only 9 percent said they plan to sell. Since demand is greater than supply, it appears that there exists a sellers' market and multiples for program agencies may increase. Combined with higher revenue and profitability, the dynamics of the merger and acquisition marketplace may change.

- As expected, the bigger players have a greater tendency to buy other program administrators, while the smaller firms have a greater propensity to sell in the next few years.
- Program administrators expect technology to play a bigger role in their business in the coming years. To date, three-fourths of survey participants, many of which are large companies, have internal IT departments. The majority of those polled plan to invest in quoting systems and underwriting systems.
- As would be expected, program administrators and insurers are one in their view that underwriting profitability is what matters most when establishing a successful program. When asked to rate a number of factors crucial to program success on a scale of 1 to 4, with 4 as the most important, program administrators registered an average rating of 3.8 for underwriting profitability, while insurers recorded an average rating of 4 for this factor.

Program Administrator

The program business in the United States is composed of relatively small firms in terms of the number of employees, gross written premiums, and number of distinct programs administered. A comparative analysis of these small firms and their larger counterparts showed distinct differences between small and large administrators across various areas of their operations, including the size of programs they administer, their appetite for M&A, their IT investment focus, and the services they provide.

- "The TMPAA State of Program Business Study 2012" found that there are approximately 800 confirmed organizations in the United States that meet the definition of program administrator laid out by the TMPAA and that another 150 firms are likely program administrators. The estimated total number of program administrators in the United States is therefore pegged at around 950.
- The market reflects the 70/30 rule: about 70 percent of agencies have less than 60 employees while firms with more than 60 employees account for about 30 percent of the market. This trend is probably more pronounced is the distribution of gross premium income between larger and smaller agencies.
- The majority of program administrators polled reported increases in premiums administered between 2010 and 2011. One-third of the survey participants saw premiums administered rise by 10 to 25 percent – a significant improvement over 2010 when only a fifth recorded such level of growth. The average increase reported for 2011 was 9 percent compared to 4 percent in 2010.
- Across industries, program administrators recorded the largest volume of premiums in government, non-profit and education; construction; and transportation. The lowest volume, on the other hand, was seen in retail, financial services, and leisure.
- The program administrators surveyed reported having a program with 55 carriers in the past five years. On top of their list when it comes to being an excellent program partner are: Meadowbrook Insurance Group, Western World Programs, Great American Insurance, Liberty International Underwriters, and Markel Programs.

- The average commission paid by program administrators to their individual producers is 12 percent. The majority of program administrators who responded to the survey pay producer/brokers a commission rate of 5 to 15 percent.
- Underwriting profitability and the carrier remain the most valuable factors for program administrators in terms of building a successful program. On a scale of 1 to 4 with the latter as the most important, underwriting profitability recorded an average score of 3.8, while carrier had an average rating of 3.3.
- Amid a declining market place, many administrators continued to report high renewal rates. As with the 2011 survey, the average renewal rate for the 2012 poll was 84 percent. Interestingly, the smaller firms reported higher renewal rates.
- The survey revealed significant differences between the larger and smaller program administrators, one of which is that the larger firms also administer the larger programs, while smaller firms also handle the smaller programs.
- The larger firms also tend to perform more services in-house as opposed to smaller firms which have a greater propensity to have some services handled by either a carrier or a third party.
- As would be expected, the larger firms also exhibited a greater tendency to purchase other program administrators.
- There are also significant differences when it comes to IT-related practices. The larger firms tend to have internal IT operations. In terms of IT investments, the smaller firms have a greater propensity to invest in quoting systems. The larger firms, on the other hand, plan to invest in underwriting and billing systems.

Insurer

Building a new program and giving it time to succeed require a great deal of investment. Selecting the program administrator is likewise a crucial step. This is why carriers are very selective about the program administrators they work with.

- Three-fourths of carriers polled insure fewer than 30 programs.
- In terms of distribution of insurance coverages included within programs, the most frequent areas are All Lines Package, Professional Liability, and Casualty. All lines is generally considered to include the full suite of insurances needed by a business, while Casualty generally includes general and automobile liability, as well as umbrella and excess liability coverages. Professional liability includes the errors and omissions coverages tailored to the specific professional exposures of an organization. Management Liability encompasses such lines of business as Directors & Officers Liability, Employment Practices Liability, Fiduciary Liability, as well as ancillary Lines of Business such as Crime. Workers' compensation refers to insurance paid by companies to provide benefits to employees who become ill or get injured on the job. Packages would include a variety of Lines of Business (e.g. property, general liability, umbrella, etc.) offered within a single policy.
- As would be expected, rate adequacy and premium potential remain on top of insurers' priorities when considering whether or not to write a new program or accept a rollover program. On a scale of 1 to 4 with 4 as the most important, rate adequacy registered an average of 3.93, while premium potential had an average of 3.04.

- A program administrator's track record with other programs and longevity in the business are the two most important factors that carriers consider when deciding whether or not to partner with them. In the 2012 survey, track record had a score of 3.5 compared to 3.39 in the 2011 survey. The average rating for time in business rose from 3.06 in the 2011 survey to 3.29 in the 2012 poll.
- Three-fourths of insurers polled say the threshold premium amount that they look for in a new program is greater than $1 million.
- Carriers surveyed say on average it takes about a month for initial program definition, and two months for internal approval. Three months are needed to complete the development of rules, application and policy forms, while it takes nearly four months for the filing and approval of rates, rules and form. Time to receipt of first submission is about five months, then time to first binding is six months.
- Sixty-one percent of the insurers surveyed say it takes one to two years to evaluate the success or failure of a program. The remaining 39 percent say the evaluation period takes two to five years. No insurers reported taking less than a year or more than five years for evaluation.

About TMPAA

The Target Markets Program Administrators Association is an organization dedicated to the unique challenges of insurance program administration. The TMPAA's mission is to help Program Administrators conduct their business more efficiently, with greater proficiency and profitability. The organization provides its membership with an array of business and educational services including access to program carrier decision makers, best practice information and recognition, Target University, Program Marketing and Distribution, Target Programs (online portal), Industry Studies and two annual Member Meetings. www.targetmarkets.com

About Advisen

Advisen Ltd. manages business information and market data for the commercial insurance industry and maintains critical risk analytics and time-saving workflow tools for more than 530 industry leading firms. Through its work for the broadest customer base among information service providers, Advisen delivers actionable information and risk models at a fraction of the cost to have them built internally. Designed and evolved by risk and insurance experts, and used daily by more than 100,000 professionals, Advisen combines the industry's deepest data sets with proprietary analytics and offers insight into risk and insurance that is not available on any other system. Advisen is headquartered in New York. For more information, visit http://www.advisen.com or call +1.212.897.4800 in New York or +44(0)20.7929.5929 in London.

About Scottsdale Insurance Company

Celebrating 30 remarkable years of stability and leadership, Scottsdale Insurance Company operates on both an admitted and non-admitted basis, doing business in all 50 states. We offer comprehensive solutions for Commercial Property & Casualty, Commercial Transportation, Excess & Umbrella, Personal Lines, Professional Lines, Programs, and Brokerage. With over $400 million in business placed through our Program Managers, Scottsdale Insurance Company is a leader in the specialty market. As a wholly owned subsidiary of Nationwide , our consistently profitable results, our A.M. Best rating of A+XV, and our financial stability for the last 30 years give us the strength to succeed in all market conditions. Add to that strong relationships and inspired leadership and you have a unique Scottsdale experience.

www.scottsdaleins.com

About Western Heritage Insurance

Western Heritage Insurance Company is part of the Scottsdale group of companies, a wholly owned subsidiary of Nationwide and benefits from the backing of one of the largest insurance and financial service providers in the United States, an A.M. Best rating of A+XV (superior) and a Standard & Poor's "A" rating. As part of an industry leader with impeccable financial strength and stability, Western Heritage Insurance Company provides Property and Casualty, Garage products and expertise, and full support for Program Managers. We provide diverse solutions to meet our Program Managers' needs by offering both a non-admitted and admitted platform, either stand-alone lines or as a complete Package program, and with a countrywide, regional or state-specific focus. Western Heritage has been offering opportunity through partnerships for 26 years, so business partners can expect more with Western Heritage.

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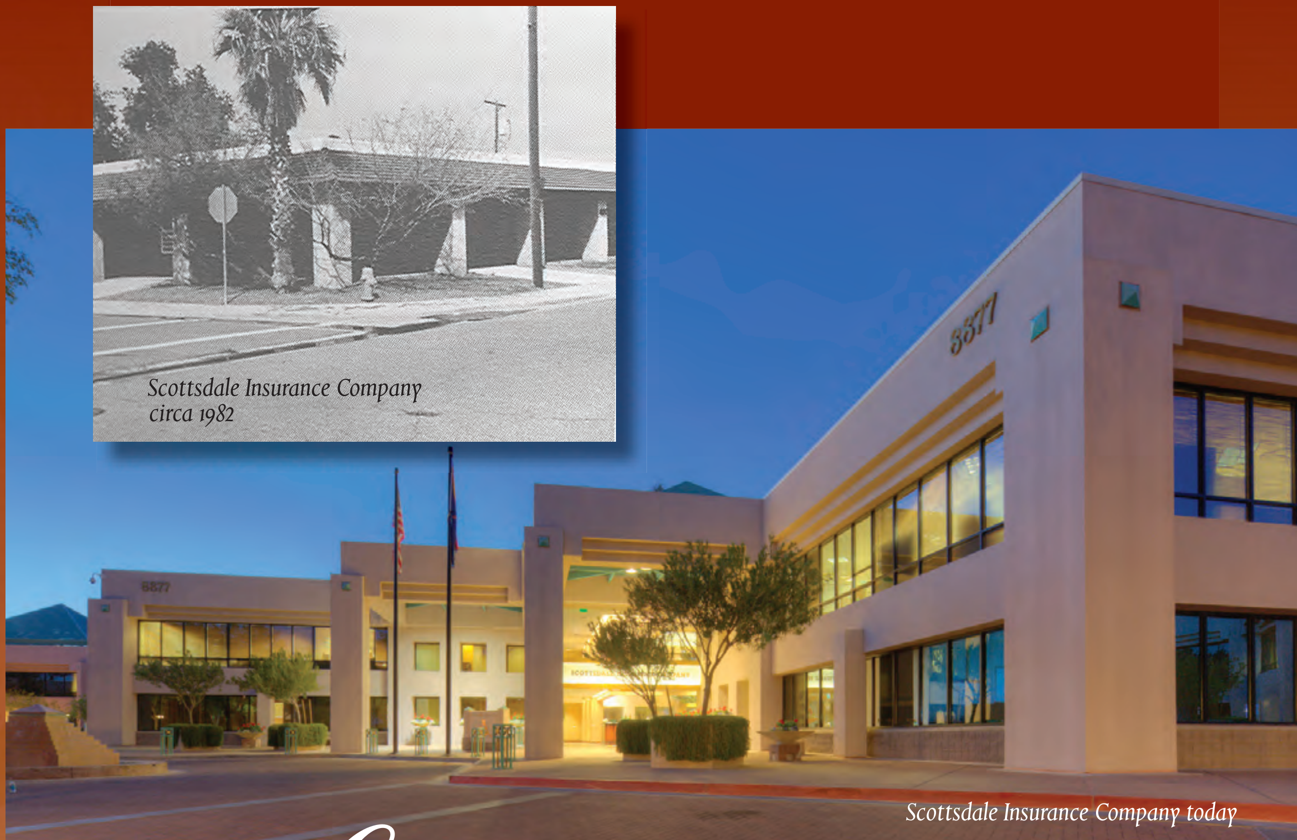

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Our consistently profitable results, our A.M. Best rating of A+XV, and our financial stability for the last 30 years give us the strength to succeed in all market conditions. Add to that strong relationships, inspired leadership, and a unique Scottsdale experience.

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