

Program Administrator Contracts



Part I

Joint Presentation: THOMCO and Munich Re

Presenters: Greg Thompson and Chris Daley

INSURANCE



what my friends think I do



what my mom thinks I do



what society thinks I do



what customers think I do



what I think I do



what I really do

PA-Carrier Contract

- Assume the worst Re: Carrier CEO of the future
- Carrier staff may be transitory but contract is permanent
- Most contracts have terms that could put you out of business
- Definition of the best possible contract:

Maximizing your leverage to address your highest priorities while conceding the carrier priorities required to reach agreement.

PA - Carrier Contract

- Each carrier has their own contracts and positions on these topics.
- Contract needs to assume PA can no longer continue normal duties.

Records and Expirations

- Defining Records
 - Correspondence
 - Policy Files
 - Sub-producers
- Defining Expirations
 - Renewal Dates
 - Account names and addresses
- *Importance??*
 - Primary Valuation Basis of an Agency!

Typical Contract Conditions

- PA retains exclusive ownership of R&E at termination if no outstanding account balances.
- **NEVER ACCEPT ANY OTHER RESTRICTIONS**
- Example: If carrier owns Records:
 - Carrier forces PA to give them all records upon termination of contract
 - Carrier uses information to Solicit PA Producers and Accounts
- Example: If carrier owns Expirations:
 - Can use expiration dates to quote PA renewals

EXPIRATIONS

- PAA owns expirations unless
 - Termination caused by one of four reasons (misappropriation of funds, bankruptcy, breach of agreement (after cure period), fraud or...)
 - PA is in default of remitting premiums.

Ownership of Claims Data

- Importance: Claims data critical if program ever has to be moved
- Carrier Preference: Data owned exclusively by carrier
- PA Preference: no restriction on use of data
- Options:
 - Data owned by both (ideal and typical)
 - PA provide notice of use of data to approach another market
 - PA Solution: Pay for actuarial report using data. Clause becomes more difficult to enforce

RECORDS - Carrier Minimum Requirements

- PA must keep accurate records
- PA must permit carrier access to records
- PA must allow carrier to copy records (at carrier expense)

Claims Records

- If PA is also the TPA, claims files may be handled differently
- Carrier owns claims file.

Claims Records

- If independent TPA used:
 - We ask TPA to give access to PA for claims data.
 - We allow PA to contract separately with the TPA to obtain claims data.

For Cause Termination: “Boiler Plate” Language

- Fraud
- Misappropriation of funds
 - Example: Out of Trust
- Bankruptcy
- Financial insolvency, i.e. liabilities greater than assets

Not for Cause Termination:

- Carriers prefer short notice: 30 to 90 days
- PAs should request 180 days: takes a while to replace program
- BUT: Notice protection weakened if Carrier can change authority or guidelines on short notice.

Termination for Cause (PA Preferences)

- At least 10 days notice
- Provide cure period for errors/guideline breach/ license cancellation(latter : localize)
- Very high loss ratio or combined ratio for termination
- Reinsurance Termination
 - Advance notice
 - Major Changes Only
 - Terminate lines impacted only
 - Good faith effort to replace
- Limit changes in laws/regulations to those having major impact on exposure
- Limits on change of control or key staff leaving:
 - Minimum % Ownership change
 - Days notice for key staff change
- Finite(usually one year) contracts: Minimum notice of 90 days to non-renew.
- PA cancel “for cause” if A.M Best Rating below A-

Suspension of Authority

- "Below the Radar" way of putting PA out of business
- Less terrifying than "T" word
- "Suspension" sounds like temporary measure
- Usually no requirement to reinstate authority
- Usually with little or no notice
- PA Perspective: Reasonable Triggers
- Carrier Perspective: sole discretion

Other PA Preferences

- _____ # days notice to suspend underwriting authority
- _____ # days notice to change underwriting guidelines
- _____ # days notice to change premium rates or coverage
- Carrier changes not used to effectively terminate program

My Favorite Words

- “Material”
 - Example: Termination due to a "material" violation of Underwriting Guidelines
- “Significant”
 - Example: Suspension due to “significant” errors in reporting premiums to Company
- PA breaches: “willful and numerous”

Termination / Suspension

- Carrier needs to protect Underwriting Risk
- Carrier needs to protect Regulatory Risk
- Carrier doesn't want to put PA out of business

Run-Off Provisions

- Who will run off business?
- Carriers: require prior approval to change coverage
- PA: Absence of endorsement authority a nightmare
- Middle Ground: PA authority to run off subject to adequate performance of duties
- Middle Ground: PA retains endorsement authority subject to suspension due to significant errors/authority violations/delays

Run Off

- PA received commission on the business.
- PA has records.
- PA has relationship with agent/insured.
- Carrier will take it over if they don't feel PA can do it properly.

Q & A

- Questions???

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Part II

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Exclusivity

- PA wants exclusive program
- Makes sense: prevents carrier from competing through other sources
- Downside?
 - Carrier will want mutual exclusive
- What does that mean?
 - PA must give all eligible business to carrier
- Before moving business, PA has to give 90 to 180 days notice depending on contract terms

Exclusivity continued...

- Problem?
 - What if carrier loses rating
 - What if carrier implements new guidelines, reduced coverage or pricing making program uncompetitive
- Bottom Line: PA stuck with carrier during termination notice period
- If PA's only business: Could put out of business
- At best: Negative impact on production and profits
- Conclusion: One-way exclusive? Great! Otherwise, evaluate benefits and downside carefully

Exclusivity

- Also...PA's need may depend on the carrier's product line and agency force

Negotiating Terms: Commissions, Payments, etc.

- Compensation
- Arab Rug Market vs. What you need for what you will do
- Services to be provided important:
 - Inspections
 - Audits
 - MVR Expense
 - Credit Reports
 - ISO Specific Rates

Terms Continued...

- Policy Fees that can be charged:
 - Carrier Restrictions
 - State Restrictions
- Payment Terms
 - Standard 45 days
 - Range 30-60 days
 - Agent vs. Company Statement

Terms

- **Fees**
 - Admitted vs. Non-Admitted paper
 - Fees may need to be filed (admitted).
- **Payment terms**
 - Direct bill may be an option

Profit Sharing Agreements

- Contingency (No downside)
- Sliding Scale
- Agency Captive

Contingency Agreements (Common Terms)

- Minimum Earned or Written Premium to Qualify
- Carry forward of Negative Balances
- Terminates immediately if “For cause” termination
- Formula: Gives agent a payout based on loss ratio performance

Contingency Agreements - Vesting

- Some pay quickly i.e. one time payment of amount due 75 days after end of accident year.
- Some stretch way out, i.e. 30 months after end of accident year, 25% of amount due, 50% of amount 42 months, 75% 54 months and 100% 60 months.
- Which is better?
 - Depends:
 - Delay could be worth it if formula shares more profit
 - Later valuation dates reduce IBNR issue

Contingency Formulas

- Percentage of premium based on reported loss ratio (Capped – 5%?)
- Percentage of profit (25%) based on expense factors:
 - Commission (20%?)
 - Company Expenses (6-12%)
 - Cost of Capital, ROE (5%)
 - Taxes, assessments (4%?)
 - Loss of Adj. Expense (4%?)
 - IBNR (varied by LOB)
 - Incurred losses
 - Incentives: Business mix, growth, etc.
- Not all factors provided: check with actuary to verify reasonableness
- Sometimes: Have to pay back cash received if loss ratio deteriorates

Sliding Scale Commissions

- Company pays bonus commission or PA returns commission based on results.
- Slide usually in range of 2 – 3% up and down.
- PA must maintain escrow account or put up Letter of Credit to cover downside
- Close out of Escrow and payment slide:
 - When all claims are paid OR
 - At end of set time frame (5 years?)

Risk Sharing

- Risk sharing vs. profit sharing
- Keeps priorities in line (bottom line vs. (just) top line)
- Risk needs to be appropriate (no starving partners)

Risk Sharing

- Things to consider...
 - Look at advantages and disadvantages of taking minimum commission vs. posting collateral (sliding scale)
 - Look for credit carry forward when deficit carry forward exists
 - Consider three year block vs. carry forward.

Trust Funds

- Separate operating funds and trust funds
- Requirement to segregate account by carrier is now common
- Problem: Segregating accounts is hassle for multi-carrier PA
- Compromise: Agree upon date to move carrier funds to segregated, joint account
- Terms of joint account

Financial Guarantees to Carrier

- Personal Guaranty
 - Unlimited liability
 - Account payment vs. all other
- Escrow or Letter of Credit to back up ability to pay balances
- Escrow or Letter of Credit to back up ability to pay return commission on a sliding scale

Audits

- Carrier: PA guarantees audits
- Typical terms: PA can return audits to carrier within 45 days after billing
- PA not liable for AP but loses commission on transaction
- Audit Liability can be big \$

Need for NDA (Non-Disclosure Agreement)

- Proposing a program to an Insurance Company
- Proposing to sell your Company
- Any situation where you are sharing proprietary information of value
- Example

What an NDA should exclude

- Information already in possession of receiver
- Information generally available to public
- Information readily available to receiving party on non-confidential basis

What NDA should do

- Require all proprietary information to be shared only with appropriate internal staff of receiver
- Prohibit Receiver from using information for any other purpose than to evaluate proposed relationship.

NDA Term

- Preferred for Provider of Information
 - NDA valid up to three years after signing or one year after termination of resulting Agreement, whichever is later.
- NOTE: Unlimited term for “Trade Secrets” is standard.

Q & A

- QUESTIONS???