CHARTA LEARNING · INTERVIEW PREPARATION

MGAs and Delegated Authority

Interview preparation summary · IN track

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INT.NV.1.a · The MGA model

Explain the MGA model: what delegated authority is, why capacity providers use MGAs, and how an MGA differs from a broker and from a conventional insurer.

A managing general agent (MGA) is a specialist underwriting agency. It finds, underwrites and administers a defined class of business, such as a niche property or liability book, but does not carry the risk on its own balance sheet. The risk is carried by a capacity provider: an insurer or a Lloyd's syndicate, and sometimes a reinsurer behind a fronting insurer. The capacity provider gives the MGA delegated authority, meaning the right to quote, bind and often handle claims within limits written in a contract. Capacity providers use MGAs for expertise they lack, access to distribution, speed into a new class, and a cost that moves with premium rather than a fixed team. The price is a loss of direct control, which is why oversight matters. An MGA differs from a broker because it acts for the insurer and binds cover, where a broker acts for the client and places it. It differs from a conventional insurer because it has no capital of its own at stake, so its pay can reward volume before the claims arrive. Terms vary by market and by contract, so check current practice. The usual mistake is to describe an MGA as a broker with a nicer name.

WORKED EXAMPLE: BUILD IN-HOUSE OR USE AN MGA?

Hartlow Insurance, an invented mid-sized carrier, wants to enter niche e-bike insurance and expects 12.0m of premium a year. Building its own team costs 1.8m a year fixed plus 25% of premium in variable cost (operations and brokerage). An MGA would charge 28% of premium all-in, and Hartlow would still spend 0.4m a year on oversight. Compare the two costs at 12.0m and find the premium at which they are equal. Conventions: annual figures, ignore tax and the MGA's claims results, amounts in millions.

Answer: At 12.0m of premium the in-house team costs 4.8m (40.0%) and the MGA route 3.76m (31.3%); the costs are equal at about 46.7m of premium, so the MGA is the cheaper route at this scale.

> **Interview tip:** Say: at 12m of premium the MGA route is about 31% against 40% in-house, and break-even is near 47m, but I would also weigh expertise, speed and the control we give up, and I would budget for oversight.

INT.NV.1.b · The MGA model

Explain how binding authorities, coverholders at Lloyd's, line slips and programmes work, and what limits and terms a binding authority sets.

A binding authority agreement is the contract that gives an agent the power to bind insurers to risks without asking each time. At Lloyd's the agent is a coverholder: a firm approved by Lloyd's that binds on behalf of one or more syndicates under a binding authority, usually arranged through the syndicate's managing agent. The agreement sets the class of business, the territory, the largest sum insured or limit per risk, the total premium allowed in the period, the wording and the rating or pricing parameters, when a risk must be referred, any claims authority, reporting duties, and the rules for ending it. A line slip is a facility in which a lead insurer, with followers on agreed shares, accepts risks declared under set terms so each risk does not need fresh negotiation. A programme is an arrangement for a defined portfolio of similar risks, often an affinity scheme or niche class, written on agreed terms and guidelines with regular reporting. Names and structures differ between markets and contracts, so check the wording before relying on a label. The usual mistake is to treat authority as general permission: anything outside the written limits is unauthorised and may leave the agent exposed.

WORKED EXAMPLE: CHECKING AUTHORITY USE AND SHARING A LOSS

Brackenfield Cover, an invented coverholder, writes under a binding authority with an annual premium limit of 6.0m. After 8 months it has written 4.4m. The capacity is shared by a line slip: a lead syndicate at 50%, and two followers at 30% and 20%. A loss of 480,000 is agreed. Work out the projected annual premium at the current pace, the headroom and the shares of the loss. Conventions: straight-line pace, premium written as the measure of use.

Answer: The pace projects 6.6m against a 6.0m limit, so writing must slow to 0.40m a month or the limit must be raised in advance; the 480,000 loss splits 240,000, 144,000 and 96,000.

> **Interview tip:** Say: a binding authority is a limit, so I track use against it every month and ask for more before I need it, and a line slip shares each loss in the agreed proportions.

INT.NV.1.c · The MGA model

Explain how an MGA is paid through commission, profit commission and fees, work out its income, and say how each form of pay aligns or misaligns its interests with the capacity provider.

An MGA is usually paid in three ways. Commission is a percentage of premium written, often out of which the MGA pays broker brokerage and meets its own costs. Profit commission is a share of the underwriting profit that the capacity provider makes on the business, usually calculated after claims, commission and the carrier's costs, and sometimes with a hurdle or a deficit carried forward. Fees are charged for specific work, for instance policy fees, claims handling or administration fees, and are often paid by the customer or the broker rather than the insurer. The design matters because it sets incentives. Commission alone rewards volume: the MGA is paid when it writes, not when claims are settled years later. Profit commission pulls the MGA towards the carrier's goal, but it has no downside for the MGA if the business loses money, and it can reward the MGA for under-reserving early. Capacity providers therefore use sliding scales, deficit carry-forwards, deferral until claims have developed, and limits on growth. Rates and structures vary, so check current practice. The usual mistake is to read commission as profit: most of it is spent on brokerage and the MGA's own costs.

WORKED EXAMPLE: WHAT DOES AN MGA ACTUALLY EARN?

Larkfield Underwriting, an invented MGA, writes 20.0m of premium. Claims are 11.0m. Total commission is 30% of premium, of which 15% of premium is paid out as brokerage. The carrier's own costs are 3% of premium. A profit commission of 20% is paid on the carrier's underwriting profit after claims, commission and its costs. Fees are 0.5m and the MGA's operating costs are 3.4m. Work out the MGA's income and profit. Conventions: millions, earned equals written, no hurdle or deficit.

Answer: The MGA earns 3.0m of net commission, 0.48m of profit commission and 0.5m of fees, 3.98m in all, and makes 0.58m after its costs.

> **Interview tip:** Say: commission is not profit, because brokerage and costs come out of it; profit commission aligns the MGA with the carrier's result, but I would want deferral or a deficit carry-forward so it is not paid before claims develop.

INT.NV.2.a · Oversight, economics and risk

Describe how a capacity provider oversees delegated authority through audits, bordereaux, referral and authority limits and performance monitoring, and read a bordereau for warning signs.

Delegating authority does not delegate responsibility. The capacity provider stays answerable to its regulator, its policyholders and its own reinsurers for what the MGA does, so it needs a control framework. Before it signs, it does due diligence on people, systems, data, financial standing and controls. During the contract it uses authority and referral limits, so that large or unusual risks come back to it. It receives bordereaux, which are regular schedules of the risks bound, premiums, claims paid and reserved, usually monthly, and tests them for completeness and for breaches. It audits samples of files on site or remotely, to check that risks were written within authority, priced to the agreed rates, with the right documents and claims handled well. And it monitors performance against agreed measures such as loss ratio, rate change, mix of business and complaints, with escalation triggers. At Lloyd's, managing agents and the Corporation of Lloyd's also audit coverholders. Warning signs on a bordereau include premium above the authority limit, late or incomplete data, a drift in the mix of business, falling average rate, and loss ratios that worsen as years mature. Check current expectations: UK regulators expect firms to oversee delegated authority and to remain responsible for it.

WORKED EXAMPLE: READING A QUARTERLY BORDEREAU

Northmere Insurance, an invented carrier, receives a quarterly bordereau from an MGA. Earned premium by quarter is 1.0m, 1.4m, 1.8m, 2.2m, and incurred claims (paid plus case reserves, no allowance for late claims) are 0.45m, 0.78m, 1.19m, 1.54m. Northmere's trigger is review above 60% for a quarter. An audit of 50 files found 7 outside authority; the tolerance is 5%. Work out the quarterly and cumulative loss ratios and the audit breach rate, and say what to do. Conventions: no IBNR, millions.

Answer: Quarterly loss ratios are 45.0%, 55.7%, 66.1%, 70.0%, with the last two over the 60% trigger, and the audit breach rate is 14% against 5%, so Northmere should escalate and require a plan.

> **Interview tip:** Say: I look at the quarterly trend as well as the cumulative figure, I remember the recent quarters are immature, and I pair the loss numbers with the audit results before deciding to tighten authority.

INT.NV.2.b · Oversight, economics and risk

Judge the economics of an MGA book from both sides, using loss ratio, combined ratio, profit commission and the effect of growth and immature years, and say what good underwriting and data discipline look like.

The capacity provider's test is the combined ratio on the MGA's book: the loss ratio plus the commission and its own costs. Anything under 100% earns an underwriting profit, before the cost of capital and any reinsurance. The MGA's test is different: its income is commission net of brokerage, plus any profit commission and fees, set against its running costs. The two diverge when the book grows. New business is usually less well understood and develops worse than renewals, so a fast-growing book can show a good early loss ratio simply because most of its premium is too recent to have claims. Capacity providers therefore ask for ultimate loss ratio estimates, not just reported ones, and look at rate change, the mix between new and renewal business, and how the loss ratio develops as each year matures. Good underwriting discipline means written guidelines, rating that is tested against claims data, referral rules that are followed, and clear authority records. Good data discipline means timely, complete and consistent bordereaux that reconcile to premium and claims, so that both parties see the same numbers. Figures here are illustrative, and real terms vary by class and contract. The usual mistake is to quote the reported loss ratio of a young, growing book as though it were final.

WORKED EXAMPLE: DOES FAST GROWTH CHANGE THE PICTURE?

Larkfield's renewal book is 8.0m of premium at an expected ultimate loss ratio of 58%; new business is 4.0m at 68%. The carrier's commission is 30% and its own costs 4%. The MGA pays 15% of premium in brokerage, has costs of 1.5m and gets 20% of the carrier's underwriting profit as profit commission. Work out the blended loss ratio, the carrier's combined ratio and margin, the profit commission and the MGA's profit, and the new business loss ratio at which the carrier breaks even. Conventions: millions, ultimate figures, earned equals written.

Answer: The blended loss ratio is 61.3%, the carrier's combined ratio 95.3% (a margin of 4.7%), the profit commission 0.11m and the MGA's profit 0.41m; the carrier breaks even if new business reaches 82%.

> **Interview tip:** Say: the carrier looks at the combined ratio on ultimate figures, the MGA looks at net income less costs, and growth in new business moves the carrier's margin first, so I would ask for ultimate estimates and a split by new and renewal business.

INT.NV.2.c · Oversight, economics and risk

Name the main risks of the MGA model, including conflicts, adverse selection, concentration on one capacity provider, loss of capacity and regulatory scrutiny, and explain how brokers and reinsurers fit in and how the risks are managed.

The MGA model's risks come from the gap between who decides and who pays. A conflict of interest arises when the MGA is paid on volume or has an owner, broker or reinsurer relationship that pulls against the carrier's interest. Adverse selection arises when the MGA's risks are worse than the carrier's own would be, because they were refused elsewhere or because the best are placed with other capacity. Concentration risk runs both ways: an MGA that relies on one capacity provider can fail if capacity is withdrawn, and a carrier with a large share of its premium in a few MGAs has an accumulation of its own. Capacity can be lost through poor results, a change in the carrier's strategy, a rating agency downgrade or regulatory pressure, and the MGA's income stops while its costs continue. Rating agencies and regulators look at delegated authority closely. In the UK, firms are expected to control and take responsibility for delegated underwriting and claims, and to assess how customers are treated across the chain; check current rules. Brokers bring the business and the MGA competes for broker

loyalty, and a broker that owns or is owned by an MGA brings a dual-role conflict. Reinsurers often stand behind the carrier and set their own audit and reporting rights. The usual mistake is to treat the MGA's risks as the carrier's only. See also the topics on reinsurance, underwriting and capital and regulation.

WORKED EXAMPLE: WHAT IF THE MAIN CAPACITY PROVIDER LEAVES?

Fernlow Cover, an invented MGA, writes 30.0m of premium and 80% of it is with one carrier, Alder Insurance. Its net retained income is 15% of premium and its costs are 3.2m. Alder gives notice that it will not renew. Work out the MGA's profit before, the position after if costs do not change, and the cost cut needed to break even. Conventions: annual figures, millions, no run-off income, no replacement capacity yet.

Answer: The MGA earns 1.3m today but would lose 2.3m a year after losing Alder; a cost cut of 72% would be needed to break even, so concentration on one provider is the key risk.

> **Interview tip:** Say: loss of the main capacity provider takes away most of the income but none of the costs, so I would look for diversification, longer notice periods and results good enough to keep capacity.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.