

Managing General Underwriter

Background

The Managing General Underwriter (MGU) is an important party to self-funders and other vendors and as such deserves discussion. The MGU is particularly well suited to the placement and management of stop-loss. It has historically been a significant figure therewith and is positioned to play an even larger role in the future. The MGU has a special place in the state insurance laws.

The topic is discussed under these headings:

- Model NAIC MGU Act
- Why the MGU fits into the Insurance Model
- Challenges in using an MGU
- How insurers control the MGU.

Model NAIC MGU Act

Introduction

This model act was published by the NAIC in 1993 and is in six parts:

- Definitions
- Licensing
- Required contract provisions
- Duties of insurer
- Examination authority
- Penalties and liabilities.

The act has been adopted in the same (or modified form), by law, in all of the states.

Definitions

Actuary – A member in good standing with the American Academy of Actuaries.

Insurer – A duly licensed insurance company.

MGU – A firm that does the following:

- Manages the business of an insurer in some detailed manner (separate division, department or underwriting office)

- In an agency capacity, produces and underwrites gross direct premiums in excess of 5% of the insurer's surplus and also handles claims and negotiates reinsurance

A firm, or person, is not an MGU that:

- Is an employee.
- Is a manager of a U.S. branch of an alien insurer.
- Is an underwriting manager, by contract, under the direct control of the insurer.
- Acts under the power of attorney of a reciprocal or interinsurance exchange.

Underwrite – Authority to accept or deny acceptance of risk.

Licensing

The MGU must be licensed by the appropriate Insurance Commission. The license may be a nonresident license. An MGU-provided bond may be required.

Required Contract Provisions

To operate as an MGU, there must be a contract between such MGU and the insurer providing, as a minimum, the following responsibilities:

- The insurer may terminate such contract by written notice, for cause; the insurer may suspend underwriting authority during any dispute investigation.
- The MGU must account for the money transactions by periodic reports at least monthly.
- MGU shall handle all monies as a fiduciary, with a trust, using an FDIC-regulated bank. The MGU may not retain more than three months of estimated claims payments (and allocated loss adjustment expenses).
- Details on all business written must be maintained by the MGU with full access to such records by the insurer. Such records shall meet NAIC standards of reporting and disclosure.
- Such contract is not assignable or transferable.
- The MGU must adhere to the agreed-upon underwriting rules.
- Where the MGU has claims-processing authority, such MGU must (a) properly and promptly report, (b) notify the insurer at once of a potentially troublesome claim that exceeds (or has the potential to exceed) the MGU's authority limit or (c) is open for more than six months. Claims are the joint property of the MGU and the insurer; insurer has access thereto.
- Where EDI is involved, the contract must address with specificity this procedure.
- The insurer and MGU may share profits (or losses). The claim reserves must be matured and also actuarially determined.
- Detailed rules must be followed where the MGU arranges reinsurance on behalf of the insurer.

Duties of Insurer

There are the duties of insurer:

- Do an independent financial audit of the MGU.
- Conduct at least twice per year on-site underwriting and claims audits.
- Have the MGU-prepared users actuarially audited.
- Binding authority for the reinsurance must be with the insurer and not the MGU; the MGU may arrange such reinsurance, however.
- An MGU appointment must be reported to the Insurance Commission.
- The insurer shall monitor the data of the MGU to be sure it does not become an MGU by reasons of having the premiums of the MGU exceed 5% of the insurer's surplus.
- The insurer and the MGU must maintain corporate independence that relates to ownership, board of directors, governance, e.g.

Examination Authority

Acts of the MGU are deemed to be acts of the insurer; the MGU may be examined as though it were an insurer.

Penalties and Liabilities

Dollar penalties for noncompliance may be invoked; also revocation or suspension of license. Further, the commission may pursue civil actions. All insurance laws may be brought to bear on any miscreants. Nothing in the act shall protect the MGU or the Insurer from rights of creditors, claimants or insureds

Why the MGU Fits into the Insurance Model

From the insurer's position, the MGU is useful for these reasons:

- No large initial capital investments
- MGU brings special skills where most needed (claims, underwriting and marketing)
- Immediate beneficial influence on insurer
- Small cost by the insurer to ingress or egress the market.

Challenges in Using an MGU

The four primary challenges are these:

- Attaching the risk
- Premium handling
- Claims processing

- Reinsurance placement.

Attaching the Risk

The Model NAIC MGU Act was written in 1993 and was a direct result of the failure of the insurer and MGU to recognize the long-tailed nature of the typical MGU-managed risk. In statistical terms, this is the lognormal distributed claim function into which medical claims fit nicely. The MGUs brought more than a few carriers to financial failure by misuse of their broad powers to attach the risk and place the reinsurance. While primarily limited to workers' compensation, the insurers cost of giving the MGU the pen was disastrously high. Insurers who have suffered from MGU excesses include Legion, Mission, Transit, Integrity and Reliance.

While the MGU will typically abide by an insurer-provided underwriting-rating manual, the ability of the MGU to vary therefrom is extensive and the practices are noted for their lack of discipline. These variations are noticeable as the market hardens and softens.

Practices of the MGU which will bring the insurer to its knees are these:

- Gravitating to poor risks
- Taking advantages of rating discounts
- Using producers with a compromised sense of ethics.

Existing court decisions make clear that knowledge of the producer becomes that of the MGU which becomes that of the insurer. Also that the powers provided by the insurer to the MGU go beyond these written word and extend into implied contractual arrangements.

Premium Handling

This function places the MGU in the position of being a fiduciary with the premium trust account as the trust property. The trust agreement sets forth with specificity how the money is to be handled. It is the duty of the insurer to audit or otherwise monitor the trust's activity with regularity. The insurer may prosecute any breaches in the MGU even if the insureds were not harmed.

Claims Paying

The MGU may be provided the authority to pay claims up to a set limit of authority. With self-funded plans, where the stop-loss has the employer as applicant-owner-payer-beneficiary, any glitches in claims processing are subject to the state's Unfair Claims Settlement Practices Act which may expose the MGU to expensive punitive damage awards. On the other side of the coin, MGU claims-handling favorable to the employer will rapidly make a product line noncompetitive.

Reinsurance Placement

Such is a privilege granted to the MGU and is commonly found with property and liability as well as workers' compensation coverages. It is rarely found with stop-loss, however. The stop-loss carrier to which the MGU is contracted will provide for its own retrocessions.

How Insurers Control the MGU

By long experience, insurers have learned (or are quickly learning) that you can give the pen to the MGU but only with these disciplines:

- Careful selection of MGU
- Due diligence by insurer
- Tight contracts
- Well-crafted underwriting-rating manuals
- Trust agreement written in great detail
- Profit/loss performance standards
- Acceptable service standards
- Ongoing monitoring and surveillance.

Careful Selection of MGU

The insurer should demonstrate a strong business reason for contracting with the MGU. The candidate MGU should be able to show financial capability and a good loss ratio track record. Adherence to discrete selection criteria and evaluation by established benchmarks are critical to the MGU appointment decision.

Due Diligence by Insurer

These items, at a minimum, must be on the insurer's checklist when considering the appointment of an MGU:

- Background check on key players
- Details contained in proposal contracts
- Ability of candidate MGU to adhere to the proposal service standards
- Review of performance on existing contracts
- Details of proposed trust agreement.

Tight Contracts

While contracting with agents/brokers may be a standardized procedure, such is not the case with MGU Contracting. Two particularly troublesome provisions are highlighted:

- Termination
- Risk-sharing.

Termination. The problem may be that the insurer wishes to withdraw for business reasons but wishes to avoid an insurer-inspired termination that will leave it exposed to the charge of failing to provide a market. Many other termination problems could be cited. The best language appears to be the right to terminate with six months notice and without cause. This is realistic trade-off of each party's interests.

Risk-Sharing. Typically, the MGU is paid a fixed commission with a profit/loss contingent commission. The prevailing wisdom is that both profit and loss be recognized and not one alone; i.e., the sliding scale is essential. The preferred accounting practice is that assets or liabilities from such profit-sharing arrangements be formally recognized on the books of both the insurer and the MGU.

Well-Crafted Underwriting and Rating Manuals

The underwriting and rating manual should deal in great detail with both topics. The manual should be followed in both a consistent and disciplined manner. Waffling will weaken the relationship.

Trust Agreement Written in Great Detail

Several prominent errors with the trust agreement are these:

- Prohibition against commingling is not made clear.
- Ability to withdraw funds only for carefully enumerated reasons is not made clear.
- Insurers fails to regularly and aggressively audit such trust accounts.

Profit/Loss Performance Standards

The insurer has multiple reasons for wanting the MGU to be financially successful; being so helps the insurer's bottom line as well as enhances its reputation.

Acceptable Service Standards

Notwithstanding its ability to turn a profit; the MGU must meet acceptable business disciplines and standards as regards service items such as:

- Control TPAs with which it deals
- Control agents/brokers with what it deals
- Properly and promptly process claims
- Correctly handle premiums and the trust account
- Issue and attach the risk as required by insurer
- Provide requisite internal auditing
- Deliver requisite premium, claims, etc., data.

Ongoing Monitoring and Surveillance

The insurer has not only the right but the obligation to do monitoring and surveillance. This includes on-site inspections, claim audits by outside firms (if so elected by insurer), and CPA-performed audits.