Lowenstein Sandler's Insurance Recovery Podcast:
Don't Take No For An Answer

Episode 57

Knowing Your R&W Insurer: MGUs & MGAs v. Insurance Companies: Part II

By Lynda Bennett, Eric Jesse, Michael Wakefield

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Lynda Bennett: Welcome back to Don't Take No For an Answer. I'm your host, Lynda Bennett, chair of Lowenstein Sandler's Insurance Recovery Practice. Today we're going to be continuing a conversation that we started on a prior episode that addresses MGU and MGA agreements in the context of rep and warranty insurance coverage. And I'm honored to have welcome back Michael Wakefield from CAC Specialty and my partner Eric Jesse from Lowenstein Sandler's Insurance Recovery Group to continue the conversation.

As I mentioned on the first episode, Michael is an insurance broker that leads the transactional practice at CAC and he has extensive experience with placing rep and warranty policies and other types of insurance solutions in M&A deals. And my partner Eric Jesse, is a policyholder advocate and zealot in the rep and warranty space, lives and breathes this every day. So Michael and Eric, welcome back. Thanks for joining us again.

Eric Jesse: Glad to be back. Thanks.

Michael Wakefield: Yeah. Thank you, Lynda.

Lynda Bennet: So last time we educated our listeners on what MGU and MGAs are and the underwriting process. And we concluded that episode with the burning question of, okay, I've now got a claim that I'm presenting under a policy that was placed through an MGU or an MGA. And the burning question is who's going to pay that claim? How's it going to work?

Eric Jesse: Yeah, so at the highest level, it is ultimately the insurance company that are backstopping the policy that's issued through the MGA or MGU, that's going to be responsible for the claim payments. So the MGU, MGA, they're not coming out-of-pocket to pay the claim. That is the insurance company. And we talked about, on the last episode, how it's possible that an MGU could be working with multiple insurance companies. Where they each share a percentage of the risk. And so if there are multiple insurers, they will only be responsible to pay their percentage share of the policy limit. And those insurers are going to be severally not jointly liable.

Lynda Bennet: So I want to back you up though there, Eric. So what you're saying is when the claim gets presented, the expectation is, and the policy requires the insurance companies that signed onto that risk, pay the claim. But are you telling us that the MGU or the MGA is not liable at all? What is their role in the claim process? Do I not have a claim that I can assert against an MGU or an MGA if there's a refusal by the insurance companies to pay?

Eric Jesse: So I mean if there is a refusal, you're ultimately going to have to sue the insurance company to recover. But the MGU or MGA, they are going to have a role in the claim process. And that role is really going to be to adjust the claim. When you present your claim, you are presenting it to the MGU, instead of having to present it to one or two or three or four different insurance companies. And so it's ultimately the MGU that's going to be adjusting the claim and either making a decision on the claim or making a recommendation.

And one of the things when we're negotiating the R&W policy is to make sure that there's language in there that says, when the MGU or MGA speaks or communicates with us with respect to a claim, we all agree. The insurers agree that their communication will be binding on the insurers, so that we can count on the MGU's word that's being communicated to us.

Lynda Bennet: So what if the MGU or the MGA adjusts that claim in bad faith? We provide all of the information, and they make a determination that we think is in bad faith. Who can we assert that bad faith claim against?

Eric Jesse: Yeah, so in that context, and so I mean if you're dealing with a claim denial, as I mentioned, you're suing the insurance companies for sure. And I think just for good practice and to make sure all necessary parties are in that lawsuit, you're going to be suing the MGU or MGA as a practical matter. And if the claim has been adjusted in bad faith, you absolutely want to assert that claim against the MGU and MGA as well. Because they are ultimately on the frontline with respect to that conduct that occurred.

Lynda Bennet: So Michael, on the front end when we're placing the policy, and we touched on this during the last episode. You do educate your clients about the difference of a traditional insurer versus an MGU and MGA. Is there any discussion at that point that the clients understand their ultimate remedies barring a bad faith claims handling? Their ultimate remedies are going to be limited to the insurers, and not having a direct line to the MGU or the MGA?

Michael Wakefield: Yes, there is, and that is something we talk about. Let me give a little bit of a broader answer to that and I think it'll help our discussion. So when I think about MGAs and MGUs and insurers and how that should impact where we place coverage for our clients, I think a lot about the incentives that are in play. And I think you have, for MGAs, you have a slightly different set of incentives than insurers, although they probably boil down to a similar place.

So if I'm the MGA, I have a strong incentive to preserve a good reputation in the market in the insured facing the client facing direction. If I'm the MGA that either drives a bad process, which is not really what we're talking about. Or doesn't get claims paid or places policies where claims aren't paid. And back to the insurer distinction, my business is not going to last very long. So I'm not going to have clients come to me anymore because the brokers are going to know, the law firms are going to know that I'm not a trustworthy MGA and my business is going to go away.

So strong incentive there. On the flip side, and this is where the distinction between insurer and MGA is really interesting. My other incentive, it's not so much to manage profitability of a book of business. Although depending on what the contractual arrangements between the MGAs and the insurers are, it might be. It is more to make sure I maintain my binding authority for the next year. So how the MGA gets paid by the insurer for the underwriting service it's providing, which is not always a noble thing, but might impact the incentive. And because the incentive of the MGA is not always directly driven by profit and loss paid on this claim. Sometimes you have MGAs who really are good advocates for your claim. It's almost having a co-advocate in the room because their reputational tilt is so far towards that first client facing direction. That they really just want to get your claim paid so you'll come back to them and their insurers are going to pay that claim. Now that only goes so far.

If you have an MGA that is unprofitably underwriting, they're not going to get a renewed binder the next year and their business is going to go away. So you have a macro business risk that you can't get that far. But in the middle if you're not at the margins, if you're in the middle, that distinction in incentives can actually result in an MGA being a good place to have a claim. But again, there's no one-size-fits-all answer. Different MGAs have different arrangements and different MGAs are in different stages of the profitable book of business game. So we always want to make this simple. This is just not a simple conversation, but one, the more you understand, the better you are, I think.

Lynda Bennet: Yeah, no, and I think that's a great point that there... And we see this all the time with claims, there's always the consideration of the merits of the claim. And then there's the consideration of the broader business implications for every stakeholder involved in the claim process. So that was really, really great perspective there. I appreciate that. But Eric, let's get into the actual dynamics of a claim. Again, let's assume that we have four insurers that have signed on to this risk. Is the buyer in a good position when they're having to chase four different carriers? Or who's hurting those cats to get the claim paid?

Eric Jesse: Yeah, so this is, like I've said before, certainly in the R&W context. If you have a claim on a policy that was issued through an MGU, you're going to be dealing with that MGU, not the four different insurance companies. It's really going to be the MGU's responsibility to herd those cats. So that diminishes the potential for an unwieldy process. And this also just reinforces the importance of really having this discussion at the outset of the process of the R&W placement process. Because you want to make sure you're working with that MGU who is reputable and who has credibility with the insurance company. So that after the MGU has done their job, they've evaluated the claim and they're hopefully prepared to make a recommendation for payment.

You want the confidence that the recommendation will be followed by those insurance companies. And this is ultimately a reputation-based business. It is a small knit community. So you can have that comfort by working with your advisors, whether it's counsel, whether it's brokers like Michael, to really get the comfort that the MGU you're selecting has that credibility.

Lynda Bennet: So Michael, in your practical experience, when you have multiple insurers on one policy, do you generally see that they take a one for all and all for one approach? Or have you had experience where two out of the four carriers are ready to pay the claim and the other two are saying no? What happens in that circumstance?

Michael Wakefield: I will say generally claims have been smooth and more in the former, the offer one category. Just to be candid, we're early in the market. We've had a lot more entrance into the rep and warranty market than we have had exits. Although there have been some exits that I don't think they've generally been for my book of business is on fire and I have to exit before I lose money reasons. I think they've been for other business reasons so far. But this market at some point, somebody's going to have a bad run and exit the space. And when that bad run starts to happen, I think is when you see insurers maybe hold out. We are very keyed into that. I go back to practicing law and I was actually policyholder counsel myself before coming in, so I understand a lot of what you're saying.

And by the way, my goal is to never have a bad faith claim on any policy that we place. Those are bad words now that I'm in the middle instead of on the policyholder council side. But we're still in a place in the market where processes run smoothly and insurers are anxious to pay claims to preserve their reputation and to build good client books of business. I have some experience and not as great as yours, but understand what you're talking about when you have holdouts in a tower and we as the broker work to avoid those situations. Clearly they could come. Right now, we trust our underwriter partners and we'll continue to do so until proven otherwise.

Lynda Bennet: So Eric, what's one of the biggest risks though when you're doing one of these quota share multiple carrier policies? It's not risk-free.

Eric Jesse: No, it's not. I mean that's why you want to go in eyes wide open. But one risk is, as we talked about, that you do have that one insurer that is a holdout. So that's an issue. But ultimately if the other three are lined up and you have the MGU that has made a claim recommendation or a payment recommendation, your coverage case will be that much stronger.

The other risk you have to be aware of, and this is because as I mentioned earlier, these carriers are just covering their own percentage. So if a insurance company goes into liquidation or becomes bankrupt, you have that credit risk. So that's why, again, when you're placing the policy at the outset, you want to make sure that the credit rating of those insurance companies is top-notch. Especially when you're seeing the names you're not too familiar with. You want to make sure that there's the right credit rating there.

Lynda Bennet: Now that's a great point and Michael referenced it during the first episode. In this way, these policies are similar to any of our listeners that have placed coverage through the London Market. It's several liability, it's not joint and several liability. So as you say, Eric, if a carrier goes down, goes into runoff, has the inability to pay, the other carriers are not going to step in and fill that gap. That's an orphan share that becomes the policyholder's responsibility.

All right, so we're just about ready to wrap up on this very interesting and informative topic. So I'm going to ask you each this question. Bottom line, what are you advising your clients with respect to the selection of a rep and warranty insurer? You're steering them towards the traditional insurer route in most instances, or do you have a preference toward the MGU, MGA?

Michael Wakefield: I don't have a clean one sentence answer on that. It depends on the deal. I would advise clients to understand the partners they're partnering with. Whether that's an MGA or an insurer, and to understand the dynamics that come along with that. And like I mentioned in our prior conversation, there really are personalities to these underwriters. And those personalities align with our clients in various ways, whether that's an underwriting or a claim. And as the broker, understanding those dynamics is a very important part of the service we're offering. So it's in sometimes either is the short answer and I'm sorry that's not as clean as you'd like if it were a deposition question, but that's my honest answer.

Lynda Bennet: I'm not going to move to strike it. I'll tell you. I'll accept the answer. I won't move to strike. Eric, how about you?

Eric Jesse: Same. It really will depend. I am looking for number one, the strongest quote on paper and then I'm asking the question. “All right, now that we have a good quote, who is standing behind this?” If it's an MGU, do they have credibility to get the carriers to step-up and pay when there is a claim made? And if it's a quote from a traditional carrier, what is their reputation? Are they difficult on claims? Because you can certainly have an insurance company that's going to be difficult on claims, and so it's really going to come down to that intangible consideration.

Lynda Bennet: Yeah, well, I'm really struck by what Michael said during our first episode too. Which is use of MGUs and MGAs is really growing out of entrepreneurship and specialization and knowledge in the space. So definitely this is a topic that we will be coming back around to. As Michael mentioned, it's seems to be a trend in the rep and warranty space. We all know that we're in for a long bumpy ride in 2023 on rep and warranty policies generally. But we will certainly keep an eye on this, and I would love to have you both come back.

But really appreciate you sharing your knowledge and experience today. So thanks for joining us.

Michael Wakefield: Thank you, Linda.

Eric Jesse: Thanks.

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