Howden Tiger

Travelling light

How asset-light business models are fostering a more responsive insurance market

HOWDEN | CONNING®

Introduction

Across the global property-casualty (P&C) market, insurers are discovering the benefits of travelling light.

Asset-light vehicles such as managing general agents (MGAs), fronting companies and reciprocal exchanges are burgeoning in the US, the world's largest P&C market, and increasingly taking root elsewhere. The solutions they are offering, often buttressed by innovative data models, are changing the face of insurance, creating a more responsive market for insurance buyers at a time of increasing risk volatility.

Reciprocal exchanges

Fronting companies

MGAs

This report is the product of close collaboration between Conning and Howden over a period of several months. It reflects Howden's market-leading position in the asset-light space, serving the needs of MGAs, fronting companies, reciprocals and consortia.

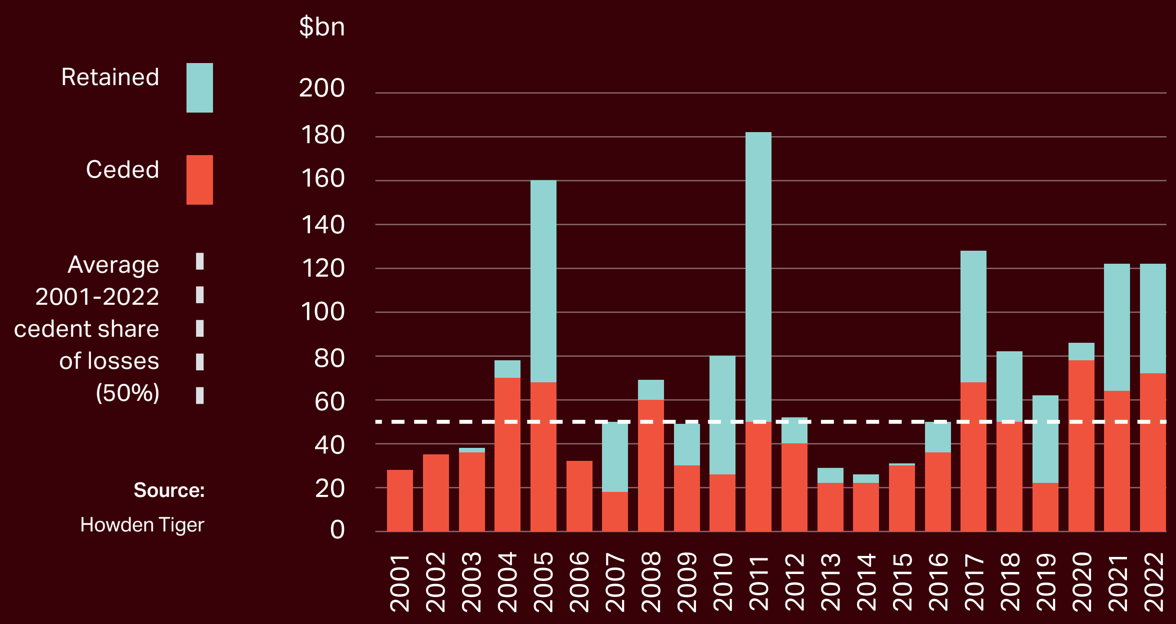
It also reflects Conning's deep knowledge of the MGA market, developed over more than a decade of research, and the wide array of capacity providers, including the fronting companies described in this report, that have fuelled the market's recent rapid growth.

The assumption of risk, especially catastrophe-exposed risk, remains a heavy lift, necessitating a strong balance sheet. For every new asset-light entity, there will typically be a range of capacity providers committed to assuming most or all of the risk underwritten. It is through the partnership of asset-light and traditional balance sheet vehicles that an increasing volume of risk is originated, priced and insured in today's market.

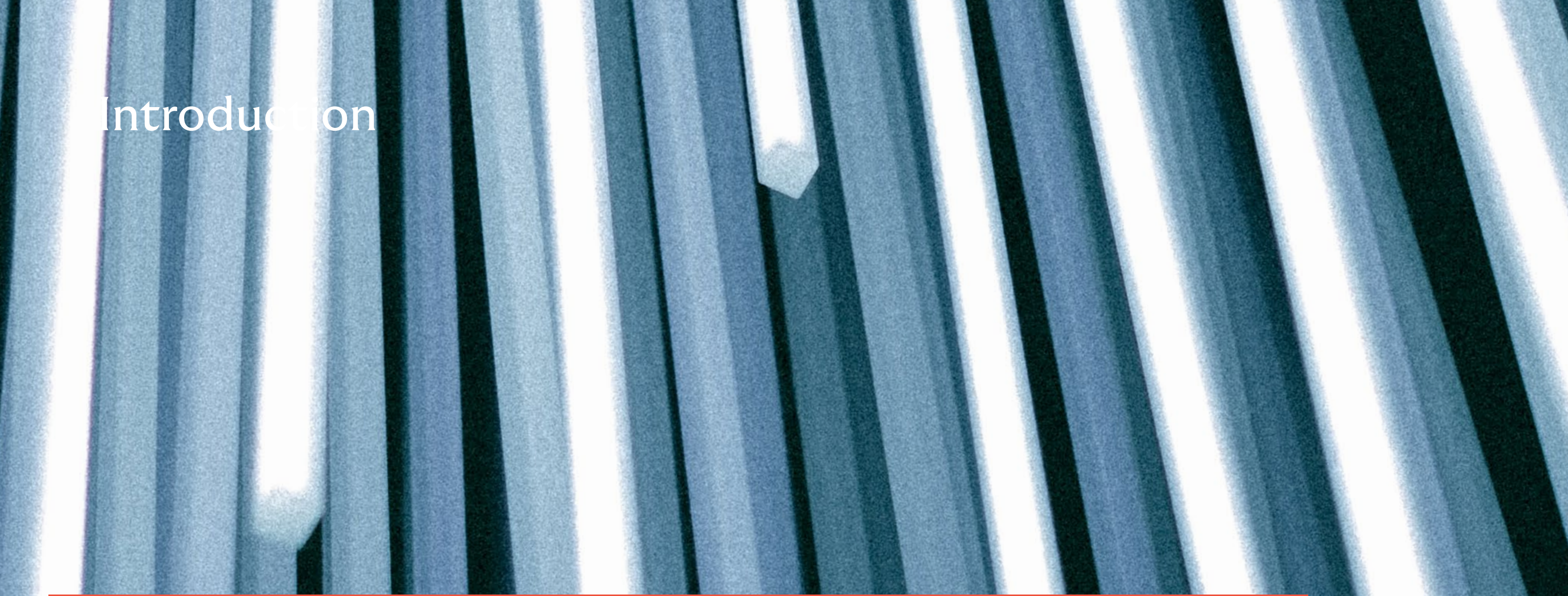
In fact, the space between asset-light and asset-heavy can be seen as a spectrum with businesses constantly adjusting their models to assume more or less risk. For primary property insurers, the recent trend has been towards the assumption of more risk, not always enthusiastically, as reinsurance capacity has diminished and prices have soared, particularly for lower layers. Between 2001 and 2022, cedents assumed, on average, around 54% of nat cat losses. At 2023 retention levels, Howden Tiger calculates cedents would have absorbed 64% of these losses.

Asset-heavier ... Cedents' share of nat cat losses has been rising

Total insured loss ($bn, 2023 prices)



Source: Howden Tiger

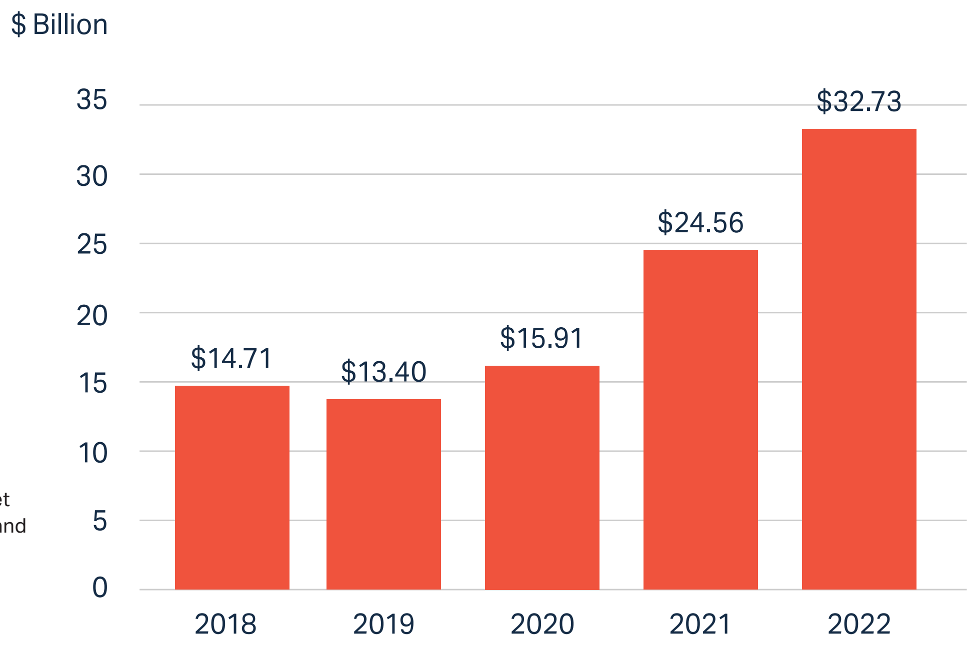


As the burden of risk has grown across many lines of business, balance sheet insurers have sought ways to lighten their own asset bases. One approach, which will be explored in this report, is to form consortia – specialised coinsurance arrangements which are increasingly popular in the Lloyd’s market. Consortia can reduce the amount of capital the lead insurer is required to hold, while generating fee income from the following market.

More broadly, the growth of asset-light businesses reflects increasing dependence of large sections of the market on technology skills that have not historically played a large role in insurance. Traditional carriers have often found it hard to recruit talented individuals in fields such as software development and data science, whereas these individuals are often attracted to the entrepreneurial opportunities presented by MGAs.

Where the talent has led, significant investment has followed, with an influx of non-insurance investors into the insurance market to support tech-enabled asset-light businesses, particularly MGAs and, in the US, reciprocal exchanges. These investors are often willing to make large up-front investments, but are seeking far less volatile returns over time than those associated with balance sheet insurance businesses.

Asset-lighter ... Premium underwritten by US MGAs not affiliated with insurance companies, 2018 – 2022



Prepared by Conning, Inc.

Sources:

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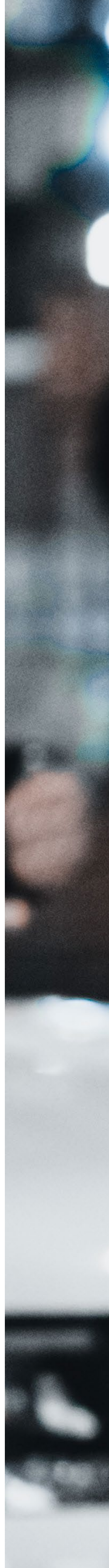
Responding to a more volatile risk landscape



A more volatile risk landscape for many classes of insurance is helping to drive the popularity of asset-light vehicles among investors. Recent, elevated catastrophe loss experience in the property market– sometimes too readily ascribed to climate change – is contributing to this. But it is not the only market affected.

In May, State Farm, by far California's largest homeowners' insurer, announced it would cease writing new homeowners and business insurance policies in the state, blaming in part "rapidly growing catastrophe exposure".[1] Other major insurers, reeling from wildfire losses for which they say they cannot adequately price, have followed suit.

The admitted homeowners' market in California is currently uncongenial for both carriers and MGAs due to its inflexible pricing environment, but in the E&S market a number of MGAs have developed wildfire models to price wildfire risk at a far more localised level than was previously possible.[2]

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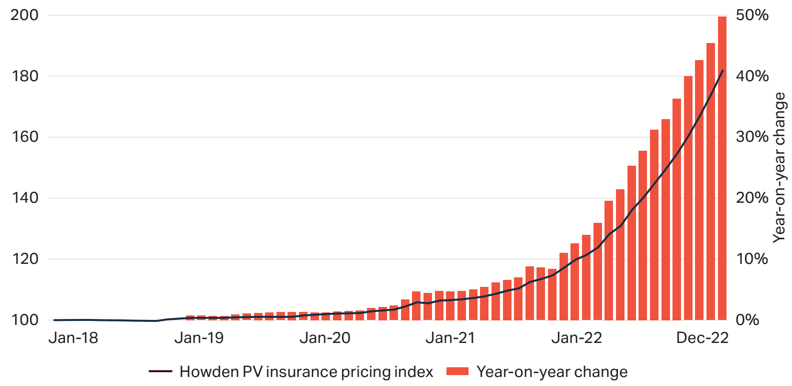
[1] https://newsroom.statefarm.com/state-farm-general-insurance-company-california-new-business-update
[2] Wildfire: Meeting the Modelling Challenge, from The World's Most Innovative Insurance Market, a Conning report on the E&S market sponsored by Amwins, October 2022, page 37.

Political violence coverage moved into hard market territory in 2022



Source: Howden Tiger

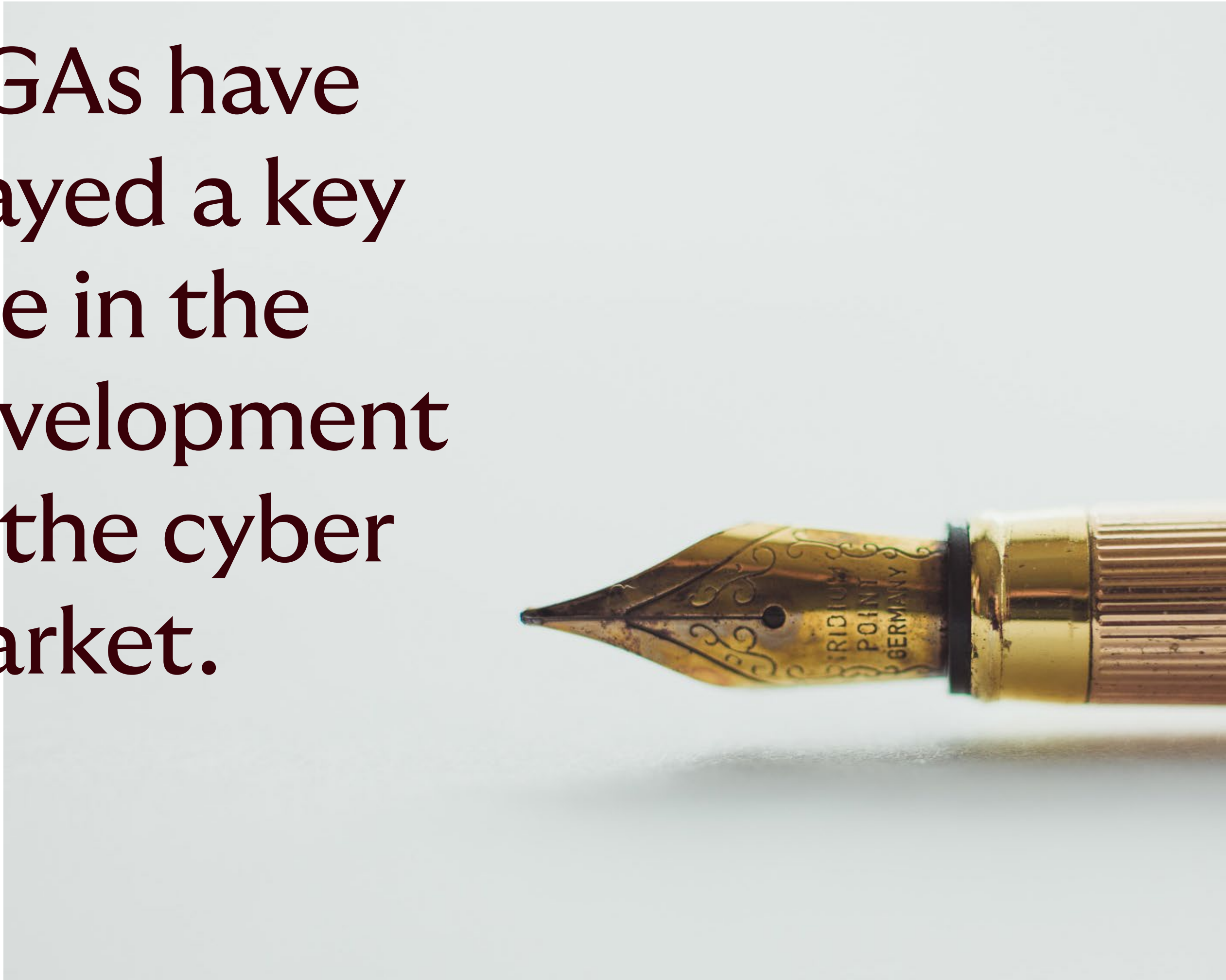
Prepared by Howden

Other lines of business have seen deteriorating loss experience and rising uncertainty on a global scale. In April, Howden noted that increased frequency of severity for insurance losses deriving from strikes, riots and civil commotion (SRCC) was rivalling or even surpassing natural catastrophe losses in certain territories.[3] An elevated and interconnected risk landscape has reset loss expectations for this business. Pricing today is up more than 80% from its nadir in 2018.

The recent loss experience of the cyber market has been more benign, but its potential to deteriorate rapidly has been appreciated since a massive upsurge of high value ransomware claims blindsided the market in 2019. Ransomware losses to date in 2023 have not risen at anything like their earlier pace, but the number of attacks has increased materially this year.[4]

[3] A World of Trouble, Howden report on political violence market, 11 April 2023.
[4] Cyber Insurance: Coming of Age, Howden report on cyber market, 5 July 2023

“MGAs have played a key role in the development of the cyber market.



MGAs have likewise played a key role in the development of the cyber market, particularly in the small and medium enterprise (SME) space. These MGAs are helping to grow this market by offering valuable cyber hygiene advice as part of a streamlined service and customer experience to SMEs around the world. However, tail risk capacity remains – for now – a significant constraint on the market's future growth potential.

Concerns persist over the potential for massive catastrophe losses deriving from a zero day exploit – a successful attack on a widely used piece of software that could spread rapidly among users before patches become available.[5] The growth of the cyber market – which Howden has estimated could hit $50 billion in premium by 2030[6] – will depend in large measure on how much confidence the capital markets have in MGAs' risk modelling.

[5] Cyber Risk: On the Edge of Insurability, Conning focus series report, July 2023, page 13
[6] Cyber Insurance: Coming of Age, Howden report on cyber market, 5 July 2023

Finally, in the US since the pandemic, increased volatility can also be seen in many casualty lines that are affected by soaring jury verdicts, a trend fuelled by social and political tensions that is commonly known as social inflation. The current extent of these tensions in the United States may not be unprecedented, but it is certainly extreme. Political polarisation is a much larger factor than in the 1980s, when massive jury awards against supposedly deep-pocketed defendants were the main drivers of liability insurance pricing.[7] Social inflation is one of the trends that is driving more business into the US E&S market, a further development that is positive for asset-light vehicles. In the admitted market, an MGA that is able to price risks dynamically using large data sets may offer modest value because the prices it charges are subject to regulatory scrutiny and cannot be adjusted swiftly. The E&S market is the natural home for many MGAs.

Uncertainty on the scale described above means underwriters must adapt and be nimble. In volatile conditions fed by discontinuous change –large -scale, abrupt change requiring a shift in assumptions – an insurance market dominated by large and relatively inflexible insurance companies is in danger of underperforming, both for insurance buyers and for investors. Today's environment instead requires a diverse range of risk management and risk transfer options, enabling buyers to secure appropriate insurance coverage and investors to find opportunities tailored to their risk appetite.

Asset-light insurance businesses are rising to this challenge. Assuming little or no underwriting risk, these businesses have proved more attractive to many investors than balance sheet carriers. Supported by data and technology, they have partnered effectively with traditional insurers to identify profitable opportunities in a challenging market.

[7] See Time Magazine cover story, Sorry America, Your Insurance has been Cancelled, 24 March 1986

The MGA revolution

At the forefront of the asset-light revolution in insurance are managing general agencies, arguably the most versatile insurance structure ever invented. MGAs, intermediaries that act in law as the agents of insurers, are ubiquitous in today's market, particularly in the United States, but also increasingly in other markets. They can be found:

Offering coverage for some of the most challenging and volatile risks insurers confront, including wildfire, flood and cyber.

Pioneering enhancements in the **customer experience of insurance**, particularly in the small business and personal lines markets.

Introducing **technology-enabled operational efficiencies** into the market that increase the pace at which risks can be underwritten and insured.

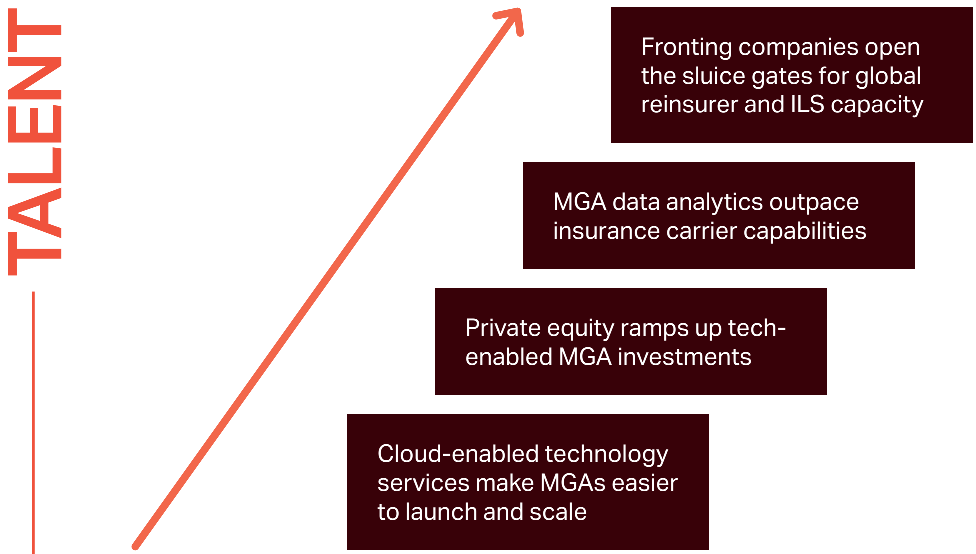
Three resources have powered the MGA revolution:

Talent, technology and capital.

Of these, talent has been the most important, but the rising appeal of MGAs to some of the most talented insurance professionals cannot easily be disentangled from developments in the technology and capital fields.

MGAs have seen a striking evolution over the past decade in the eyes of talented underwriters. Specialist programme managers have existed for decades but they have primarily operated as distribution channels for products developed by carriers, and their role in product development was limited. That has been changing as experienced underwriters have been jumping ship to join – or to form – MGAs.

The growth of MGAs has recently been strongest in the US, where by Conning's estimation they underwrote in excess of $85 billion in premium in 2022. But they play an important role in other markets as well, notably the UK, Australia, Canada and the Netherlands. The Managing General Agents Association (MGAA), which represents more than 200 UK based MGAs, estimates that its members write more than £6 billion in premium annually worldwide.



Advances in technology and growing investor interest encourage talented insurance professionals to "make the leap" to MGAs.

The three MGAs profiled below reflect the talent now to be found at the helm of the best MGAs. Their stories reflect the huge opportunities that MGAs in the US market have tapped into, but also the complexities and challenges of running these businesses:

Capital management: SageSure

SageSure is remarkable for being one of the fastest growing property-focused managing general underwriters (MGUs) in recent years – now insuring more than 400,000 homes and businesses in 14 coastal states – as well as for a multifaceted capital management strategy that has supported its growth through a particularly challenging period in the property insurance market.

Founded in 2009, SageSure now has more than $1.2 billion in inforce premium, backed by a combination of AM Best A- rated insurance companies and two reciprocal exchanges (rated A by Demotech). The exchanges' catastrophe exposures are protected by a mix of traditional reinsurance, SageSure's affiliated reinsurance captive, and $780 million worth of protection from ILS investors raised through five cat bond issuances.

Terry McLean, SageSure's CEO and co-founder, and his team have built a unique model for SageSure while keeping a close eye on what has worked, and what has not, elsewhere in the market. He quotes Jim Stanard, the former CEO of Renaissance Re (where McLean worked for a spell), on the dangers of "diworseification" – diversification into geographies with deceptively attractive risk profiles. SageSure has no near-term plans to broaden its geographic footprint, he says.

The MGU's journey has not always been smooth. For much of its history, it was backed by a small number of carriers, including FedNat, one of several Florida-based property insurers that have recently gone insolvent under the pressure of losses incurred in that state's turbulent property insurance market. "We knew [in 2020] that we needed to diversify our carrier panel and we should have done it a bit earlier, frankly", McLean says, "[although] this was a time at which FedNat was doing okay".

Taking its experience during the 2020 hurricane season to heart, SageSure has significantly diversified its sources of capacity at all levels, including the formation in 2021 and 2022 of two reciprocal exchanges. The company's carrier partners have also been very active sponsors of catastrophe bonds over the past two years, raising $780 million of coverage through five issuances. McLean is an enthusiast for reinsurance capacity raised in the capital markets for three reasons:

- It offers three-year protection that has not recently been available in traditional reinsurance markets. "The ability to lock down a [three year] commitment at a known price is incredibly valuable for a business like ours that's growing."
- It can be tapped at any time.
- It's a more transparent market that avoids the difficulties of reconciling non-concurrent terms from different reinsurers.

Set against this, he recognises the value of strong reinsurance company relationships that cannot easily be emulated in the capital markets. And reinsurers have a greater appetite for lower, high frequency layers than ILS investors.

McLean acknowledges that SageSure's business model is complex. But building the largest residential property insurance MGU in the US at a time of extreme market turbulence requires a lot of optionality.

> “ SageSure's carrier partners have been very active sponsors of catastrophe bonds

Technology: Starfish Specialty

For any insurance business, decisions over whether to outsource or insource key capabilities can be difficult. For a new MGA, they can be life or death decisions.

Jeremy Hitzig knew he had two big challenges in setting up Starfish Specialty, an MGA that launched its first programme – FLIProtect, providing builders' risk coverage for owners and contractors renovating buildings for sale – in 2021.

Finding capacity was, naturally, one.

Prior to forming Starfish, Hitzig had been the long time CEO of Distinguished Programs, one of the most successful MGAs in the US. Distinguished relied heavily on large, well-established insurance companies for capacity. "But that's not how programs are getting done these days", Hitzig says. "Almost nothing new is written with the big stock legacy companies. Billions are being written by the fronting companies."

Starfish's second challenge was technology.

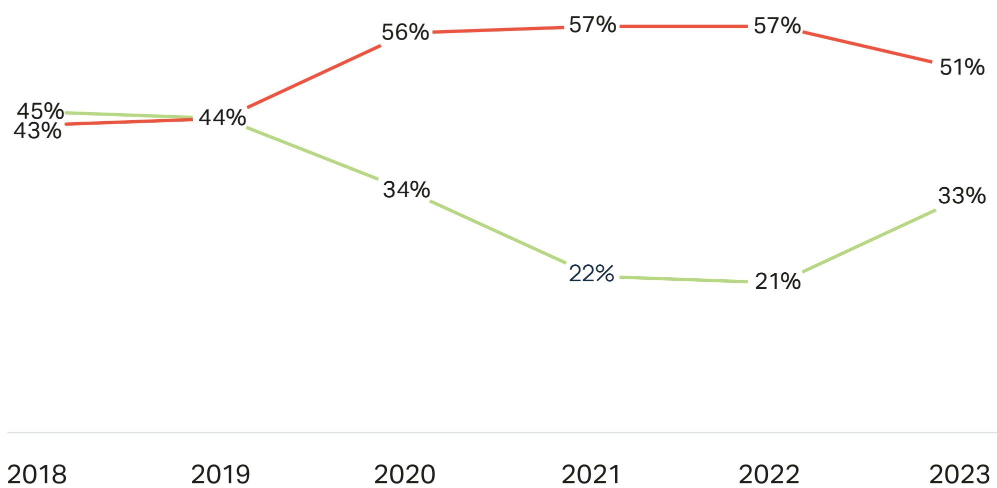
"We were worried we'd select a tech provider – we'd be really thoughtful about it – and a year or two later we'd find it didn't work."

In addressing both of these challenges, Starfish ended up swimming against the tide. Although Hitzig personally supports the fronting model and has invested in a leading fronting company, Starfish ultimately signed up with three traditional insurance companies. And on the technology front, rather than hiring a chief information officer and designing or redesigning its own systems, Starfish outsourced the challenge to Azur, a technology provider allied with Salesforce that had intimate knowledge of the MGA market, having started out as a tech-enabled MGA itself.

The technology supporting MGAs' business has evolved rapidly in recent years to the point where it is no longer a liability for MGAs but, often, a major asset, particularly in writing large volumes of small business risks. Confidence among MGA managers in their technology investments has correspondingly grown, but decisions on whether to build or buy can still be challenging.

MGAs are gaining confidence in their technology investments

Survey statement: **"I'm worried our firm is not investing enough in technology":**



Source:
Conning, Inc. MGA surveys, 2018 - 2023

Hitzig is confident that Starfish has made the correct decision for its business. "We had an underwriter who was working for an insurance company who had developed a product that was targeted well down market – an affordable product that no one else was doing," he recounts. "He found us and we showcased our technology and said you can write thousands of these policies super efficiently here. There was no equivalent platform at the company he was working at."

It's a story that would resonate with numerous MGAs and, to their chagrin, with insurance companies. MGAs have been attracting star underwriters from carriers in part because they can often offer underwriters far more effective and user-friendly technology with which to process business.

Uncovering overlooked opportunities for carriers: Arden Insurance Services

Brian Cohen, founder and chief executive of Arden Insurance Services, experienced an epiphany a few years ago when he realised his pitch to insurers and reinsurers misconstrued the value proposition that an MGA brings to a capacity provider.

> “ When I started out, I emphasised our underwriting expertise. You know what? It failed to grab a carrier’s attention.

Cohen took a step back and put himself in the shoes of a capacity provider.

> “ It dawned on me that an insurer or reinsurer is a capital allocator. They have capital to deploy, and they want to deploy it in the area that’s going to give them the greatest return. So, I switched my whole narrative.

He chose to de-emphasise Arden’s underwriting and operational capabilities and focus instead on the unique attributes of the line of business.

> “ Successful MGAs discover niche markets that provide better underwriting profit or, as I now describe it, outsize returns on capital. We found the condominium association market and, within that, we just focus on garden style residential condos. It’s a subset of a subset of risk that typically doesn’t get distinguished from the regular habitational market.

He now tailors his presentation to describe the attributes that combine to provide “a portfolio of risk that outperforms traditional property risk”. For example, he highlights the alignment of interest between condo owners and the insurer. Condo owners have more incentives to treat their property better than a renter. Condo association owners tend to live in a unit longer than a renter. Maintaining stable condo association fees incentivises an association to stay up to date on maintenance.

Cohen can back up his arguments with an inception to date loss ratio in the low forties that has proven very stable

After nearly a decade in business, Cohen can back up his arguments with an inception to date loss ratio in the low forties that has proven very stable – apart from 2021, when people were confined to their homes during the pandemic and losses from what he calls "stupid fires" leaped up.

Of course, the quality of the risks Arden insures is only part of the reason for its strong underwriting performance. The competitive dynamics of the market also matter. Here Arden, in common with other MGAs, benefits from its narrow and disciplined approach.

"When it comes to underwriting condo associations, I will put Arden's underwriters up against anyone because it's all they do eight hours a day five days a week. Conversely a typical commercial underwriter working at a carrier jumps from one commercial risk to the next."

Cohen adds, "the challenge for carriers is that condo associations typically form only a part of their habitational or commercial property book [where] loss ratios have been increasing by double digits. We're cherry-picking accounts [now] that are seeing 20% to 25% increases from their incumbent carrier. That's how we can generate great returns in a tough property market."

Fronting companies

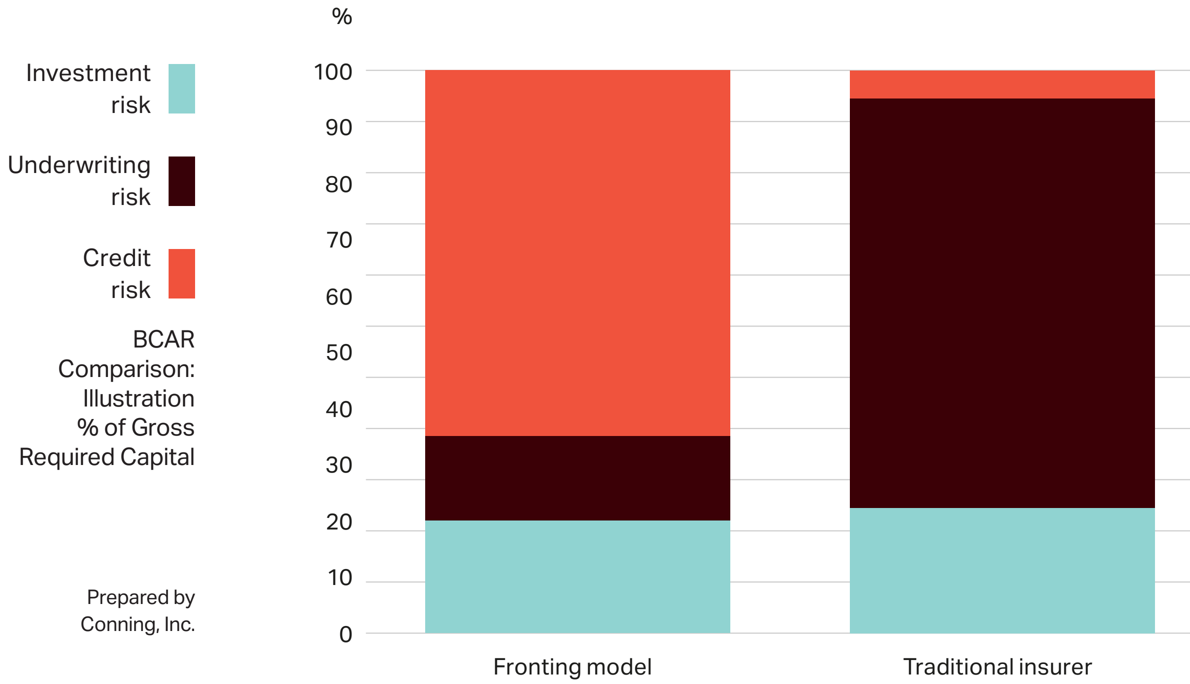
Fronting companies are playing a critical and expanding role in the broader eco-system of asset-light insurance vehicles. Over the past three five years, a rapidly growing cohort of fronts has channelled billions of dollars of capacity from global reinsurance markets into the MGA sector.

This has been particularly valuable in fuelling the growth of US MGAs at a time when Lloyd's, historically and still today their largest single provider of capacity, has been moderating the business it writes through this channel. As a result, in 2021, fronted premium sourced through MGAs outstripped Lloyd's premium sourced through coverholders (as MGAs are known in the Lloyd's market) by a significant margin. It raced further ahead in 2022.

Fronts take two forms. So-called pure fronts retain little or no underwriting risk. This is the model long adopted by State National, the oldest and still by far the largest fronting business in the US, owned since 2017 by Markel.[8] In 2022, Markel's fronting businesses wrote $3.4 billion in premium, almost all of which was ceded out to reinsurers.[9]

The alternative model, which has been more popular in the US market in recent years, is known as hybrid fronting, under which fronting companies retain a larger proportion of the business they write. Retentions have typically been in the range of 5% to 10% but at some fronting carriers – and for some lines of business – they can be materially higher. The hybrid fronting model is more flexible in times when reinsurance capacity is tight, but it adds insurance risk to the credit risk that is the principal risk run by a pure front.

Fronting companies assume greater credit risk than traditional insurers, but less underwriting risk



BCAR Comparison: Illustration % of Gross Required Capital

Prepared by Conning, Inc.

[8] https://www.markel.com/about-us/news-and-press/markel-to-acquire-state-national-7776
[9] Jeremy Noble, President, Insurance, Markel Corporation: FQ4 2022 Earnings Call, 2 February 2023

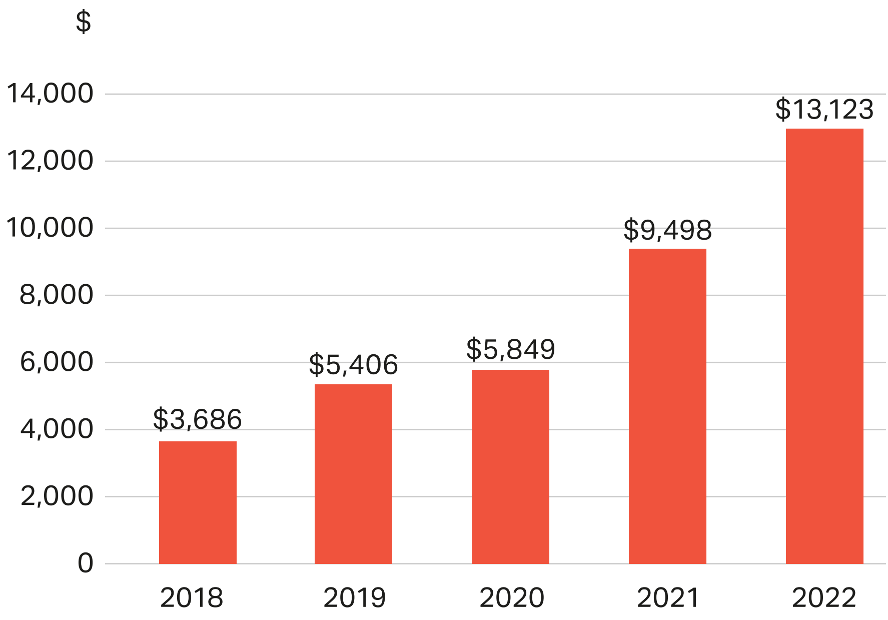
Fronting companies

Just as Tokio Marine's acquisition in 2020 of the attorney-in-fact that ran the PURE reciprocal exchange drew attention to the value that an AIF can generate[10], so Markel's acquisition of State National for $919 million (or nearly three times book value per share) in 2017[11] sparked widespread interest in the largely fee-based fronting model. In the years since that acquisition, more than 20 new fronting companies have emerged.

Fronting companies tracked by Conning wrote more than $13 billion in premium in 2022, well over twice the business written just two years previously. Strong premium growth is expected to continue, although competition for the business of the best performing MGAs is now intense.

More recent evidence of the value that can be built in a short space of time by fronting companies came last year when Transverse, a fronting company incorporated in 2018, was acquired by the Japanese insurer Mitsui Sumitomo Insurance (MSI) for $400 million, or a price to earnings multiple of around 12 times forecast 2023 earnings, according to MSI.

Fronted market premium development
($ in millions)



Prepared by Conning, Inc.

Source:
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[10] Tokio Marine Agrees To Acquire PURE, PURE press release, 2 October 2019.
[11] Markel to Acquire State National, Markel Corporation press release, 27 July 2017.
[12] MS&AD Insurance Group Holdings, Inc., Acquisition agreement on Transverse Insurance Group, LLC, investor presentation, 10 August 2022

MSI identified a number of attractions to Transverse's business model.[12] Transverse receives fronting fees (typically between 4% and 6% of gross premiums) from the reinsurance panels that line up to support it behind each MGA. It also receives fronting fees from reinsurance captives established by these same MGAs – an increasingly popular way for MGAs to enhance their earnings potential that reduces their dependence on third party reinsurance capital while showing strong alignment of interest with those reinsurers. Finally, Transverse has the potential to earn a return on the premiums it retains for its own account.

Looking ahead, the fronting model clearly has further scope for growth, although perhaps not at the same torrid pace as over the past two years in the US. Outside the US, the market is far less crowded, with only three fronting-type businesses active in Europe: Accredited, Accelerant, and the recently authorised London-based front, Bridgehaven. (Of these three Accelerant is not technically a fronting company as it does not charge fronting fees, but it has a similar asset-light model with modest premium retentions.

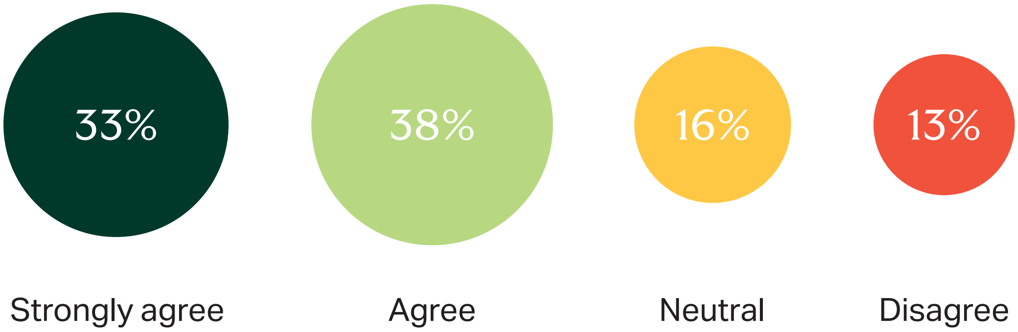
→ Case study: Accelerant

MGAs are asset-light vehicles fuelled by capacity loaned principally by balance sheet insurers and reinsurers, so it is unsurprising that the greatest fear of MGA executives is that the capacity they depend on may, at any moment, be withdrawn. Conning's 2023 MGA survey revealed this fear to be growing.

One company has come up with a distinctive solution. "Our aim", says Jeff Radke, chief executive officer and co-founder of Accelerant, "is that Accelerant members never have to worry about capacity again".[13]

[13] Accelerant press release, 22 June 2023

"Finding an insurer partner replacement after an incumbent insurer exits a programme is increasingly difficult."



Source: Conning, Inc.'s MGA survey 2023

The model that Radke and his colleagues have developed differs from that of fronting carriers in important respects:

- For those MGAs that Accelerant approves (which it calls members), capacity is guaranteed for five years.
- MGAs do not negotiate capacity for their programmes in two stages as they would typically do with a fronting company – first with the front and then with its reinsurers. Reinsurance support is automatic.
- Accelerant does not charge MGA fronting fees.

Accelerant is also unusual among asset-light capacity providers in providing paper to MGAs in the UK and continental Europe, as well as in the US. Founded in 2018, the company now supports over 100 MGAs. Accelerant's members tend to be established programme managers that can show the underwriting track record the company looks for, with low catastrophe exposure.

In June, Accelerant launched the next iteration of its business model, a risk exchange designed to match MGAs to capacity providers – both institutional investors and (via its reinsurance sidecar vehicles) and other third-party insurance carriers. Matches are still backed by a five year capacity guarantee.

To date, Accelerant members have grown their revenue at "high double digit percentage", says Matt Sternberg, chief operating officer for the Accelerant Risk Exchange. "The long-term capacity guarantee as well as our technology and service model enables MGAs to focus exclusively on what they do best – selecting risk and growth."

Fronting companies

Three broader market developments can be expected to present challenges to the fronting model, varying in intensity according to the business they are writing.[14] These are:

1. The reset in reinsurance markets that emerged with this year's January renewals.

This is affecting the MGAs that source capacity through fronts in two main ways. It is making the terms on which they can buy reinsurance coverage less attractive, with ceding commissions being squeezed and it is lengthening the time it takes to negotiate coverage.

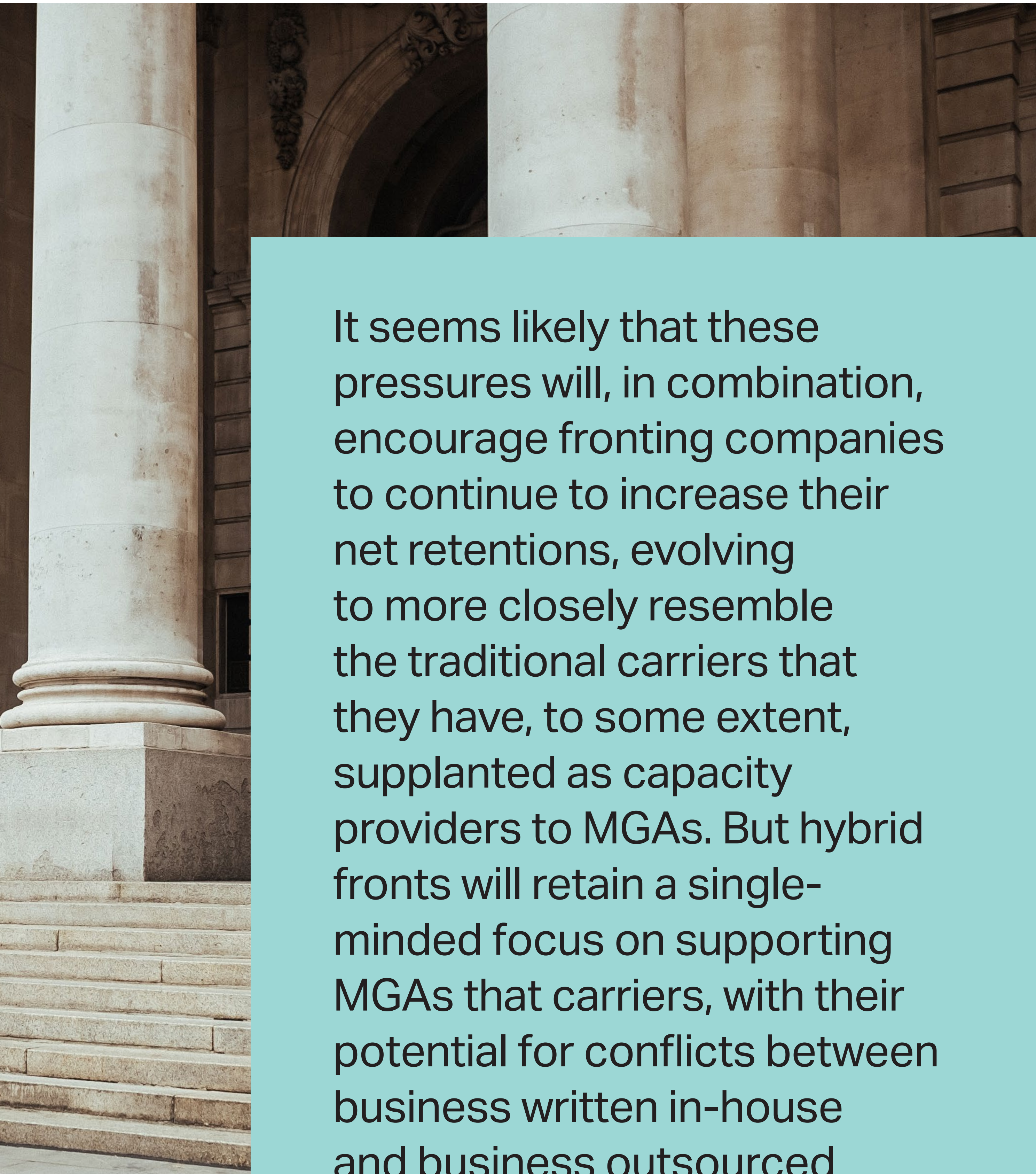
2. For fronting companies themselves, the cost of capital is rising.

Not every front will have access to capital, particularly if they seek to increase their premium retentions, and this may lead to more sale transactions.

3. Finally, there will likely be increasing scrutiny of reinsurance security

by rating agencies and regulators in the light of recent issues and fraud allegations surrounding letters of credit posted to collateralise certain reinsurance obligations by a major tech-enabled platform that had been channeling significant ILS capacity into the MGA market. MGAs are strongly supported by collateralised reinsurance – far more than the carrier market – often supplied by their own reinsurance captives. Such arrangements are valued by third party reinsurers as evidencing alignment of interest – as long at the collateral is impeccable.

[14] The Fronting Insurance Market: At an Inflection Point,' Conning focus series report, June 2023



It seems likely that these pressures will, in combination, encourage fronting companies to continue to increase their net retentions, evolving to more closely resemble the traditional carriers that they have, to some extent, supplanted as capacity providers to MGAs. But hybrid fronts will retain a single-minded focus on supporting MGAs that carriers, with their potential for conflicts between business written in-house and business outsourced to MGAs, cannot match.

Reciprocal exchanges: new wine in old bottles

Reciprocal exchanges are the most venerable of the structures that form part of the asset-light revolution, with origins that stretch back to the 1880s when dry goods merchants in New York pioneered a new mutualised insurance model that they believed would reduce their premiums. They have enjoyed a renaissance in recent years, particularly in providing capacity for catastrophe-exposed property risks. Thirteen have been established since the beginning of 2019 in states including Florida, Texas, Colorado, Arizona and Delaware, and five more are expected to come on stream this year.

Reciprocal exchanges are not in their entirety asset-light structures – indeed they account for an estimated 7% of the total surplus of the US P&C market[15], with major insurance groups such as Farmers, USAA and Erie Insurance having operated this model for decades. But a key component of the structure – the attorney-in-fact (AIF) that runs the day-to-day operations of the exchange – is asset-light. And recent experience has shown that these entities can generate significant value for founders and other investors.

Reciprocal renaissance

Reciprocal exchanges comprise two parts: an unincorporated association of subscribers, who are also policyholders insured by the exchange (this component is formally known as a reciprocal inter-insurance exchange) and the AIF. The balance sheet component of the structure will typically by capitalised by contributions from policyholders, reinsurers, and surplus notes investors (normally specialist private equity funds or ILS funds.)

It is the attorney-in-fact that has tended to hold stronger appeal to investors from outside the insurance industry, particularly technology investors (assuming the reciprocal's business is supported by innovative technology). As Sean Harper, the founder of Kin, one such tech-enabled reciprocal exchange, describes it: "The economics of an AIF are close to those of a software company or very high-margin services business".[16]

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[15] S&P Global Market Intelligence, LLC
[16] Reciprocal Exchanges are Best for Insurtech Investors – 5 Reasons, Sean Harper, March 12, 2021 (www.linkedin.com/pulse/reciprocal-exchanges-best-insurtech-investors-5-reasons-sean-harper)

34 new insurance company formations in florida since january 2017, 5 of which were reciprocals.

Reciprocal licensed in the U.S.

	2016 A	2017 A	2018 A	2019 A	2020 A	2021 A	2022 A	2023 A	2024 E	2025 E	2026 E	2027 E	2028 E
Beginning of year count	53	54	55	55	57	59	63	68	73	77	81	85	89
New formations	1	1	0	2	2	4	5	4	4	4	4	4	4
End of year count	54	55	55	57	59	63	68	73	77	81	85	89	93

Florida specialists

Florida newco formations since 2017	
Reciprocal exchange	5
Total	34
Reciprocal exchange %	14.7%

($ in millions)	2012 A	2017 A	2019 A	2022 A
FL specialists premium				
FL specialist reciprocal DPW	$0	$0	$36	$747
FL specialist total DPW	13,482	15,614	17,309	27,291
FL specialist reciprocal %	0.0	0.0	0.54	2.7
Surplus				
FL specialist reciprocal surplus	$0	$2	$34	$335
FL specialist total surplus	4,745	6,729	7,446	8,175
FL specialist reciprocal surplus %	0.0	0.0	0.5	4.1
FL specialist reciprocal exchange count	0	1	2	5
Total count of FL specialists	104	115	105	106
FL specialist reciprocal %	0.0	0.9	1.9	4.7

There have been 34 new insurance company formations in Florida since January 2017, 5 of which were reciprocals

Capital & Surplus of reciprocals and statutory entities writing >50% of business in Florida

Number reciprocals and statutory >50% of business in Florida

Source: Copyright 2023 S&P Global Market Intelligence, LLC.

Paid by fees from the exchange subscribers, the attorney-in-fact is cushioned from insurance risk and will typically have far smoother earnings than the risk-bearing part of the business. They tend to be valued at similar earnings multiples to MGAs.

For example, Erie Indemnity, the publicly quoted attorney-in-fact for the Erie Insurance Exchange, saw its net income rise marginally in 2022 (to $299 million from $298 million the previous year) while the combined ratio recorded by the Erie Insurance Exchange worsened materially, rising from 103.9% in 2021 to 116.1% in 2022.[17] Erie Indemnity was trading on the NASDAQ at a price-to-earnings ratio of 41.26 in late August.[18]

For exchange subscribers (i.e. policyholders), low and volatile returns are not in themselves a drawback of the model because the main benefit sought by these stakeholders is dependable insurance coverage at a reasonable price. Their contributions to the exchange's capital (which take the form of an annual surplus contribution) can therefore come with a lower cost of capital than investors in a stock company would demand.

Evidence of the value that can be built by AIFs operating within a reciprocal exchange structure emerged in 2019 when Tokio Marine agreed to buy Privilege Underwriters Inc., the AIF for Privilege Underwriters Reciprocal Exchange (PURE), for $3.1 billion – a price to earnings multiple of 33 times the company's expected post tax profits in 2020. PURE was founded in 2006 and specializes in high net worth personal lines business; its AIF had generated fee income of $229 million in 2018 on just under $1 billion of managed premium.[19]

Since then, a number of the fastest growing and most successful property insurers in the US market have either adopted a reciprocal exchange model themselves or have obtained capacity from one or more of these entities (see case studies on Kin on page 30 and SageSure on page 12). For MGAs they present an additional attraction: an MGA backed by a reciprocal exchange that it controls will be assured of durable capacity that cannot be withdrawn.

The flexibility of the reciprocal exchange model can be further enhanced by their being capitalised in part through the issue of surplus notes, deeply subordinated unsecured debt that is treated by insurance regulators as issued surplus. Surplus note issuance hit a ten year record of $2.97 billion in 2022, including funds raised by reciprocal exchanges operated by Kin, Loggerhead, and one of the country's largest commercial and residential property MGAs, ICAT, owned by Marsh McLennan subsidiary,[20] Victor.

[17] Erie Indemnity Company Annual Report, 2022.
[18] As at 29 August 2023.
[19] All information regarding this transaction comes from Tokio Marine Holdings' investor presentation: https://www.tokiomarinehd.com/en/ir/event/presentation/2019/h10q7e000000r1i6-att/191003_e_presentation_final.pdf
[20] https://www.spglobal.com/marketintelligence/en/news-insights/research/pc-insurers-issued-surplus-notes-at-highest-pace-in-years-despite-rising-cost

→ Case study: Kin

Asset-light models can present strong customer appeal, as Kin, a successful direct-to-consumer homeowners' insurer has demonstrated. Founded in 2016, the company expects to write almost $400 million in premium in seven states this year.

In its eight years in business, Kin has adopted two of the asset-light models described in this report. It began life as an MGA and in 2019, and converted itself into the manager of a reciprocal exchange. It now manages two reciprocals (more may be to come) and bills each of the reciprocals as "a member-owned insurance company that's customer-focused by design".

Kin's story illustrates many of the attractions of asset-light models to entrepreneurial teams who are enlisting technology and untapped data sources to improve the policyholder experience.

"We see ourselves as being really good at the tech, really good at customer acquisition, really good at the customer service", says Sean Harper, CEO and a founder of Kin. "We're not primarily trying to make money on the balance sheet."

Kin seeks to differentiate itself in the homeowners' market in two ways. It offers what Harper describes as a seamless multichannel service, more in line with what a bank would offer than is typically found in insurance, where the agency model means "the distribution part of the value chain has been decoupled from the manufacturing part of the value chain". And secondly it employs technology, rather than agents, to gather and interpret the large volumes of unstructured risk-related data that are available.

“We found there’s lots of unstructured data floating around the world, in real estate records, government records, images, etc. We send the user around the house with a phone to take more images. We can ingest those to come up with our own point of view.”

Harper stresses that reciprocal exchanges are far from being a “free lunch” from a regulatory perspective. “They are regulated just like an insurance company. Our first reciprocal exchange was Florida domiciled. It took us a year to jump through all the regulatory hoops. It wasn’t easy.”

Regulatory complications also threatened to slow the company’s growth in other states, due to a convention known as “retaliatory seasoning”. Seasoning is the length of time an insurer licensed in one state must have transacted a particular line of business in that state before it can transact the same business in another state. Retaliatory seasoning occurs when states mirror the seasoning requirements of other states, meaning that the three-year seasoning requirement imposed by Kin’s initial home state regulator of Florida could slow its expansion into other states by three years, if no waivers were granted.

Kin overcame this by acquiring a shell company that already held the licenses it needed and converting this into a second reciprocal exchange – a process that was rare although not unprecedented. “It was a little bit of a short cut”, says Harper. “It had been done before twice, but not for a long time, and not in Arizona”, where the company’s second reciprocal is now domiciled.

Navigating the US insurance regulatory landscape was not what motivated Harper and his colleagues to set up Kin: he is much happier talking about the customer experience. (Kin’s net promoter score – how likely customers are to recommend the company – is around twice the insurance industry average.) But for asset-light insurers in the US, as for balance sheet insurers, regulatory complexity goes with the territory.

Consortia: asset-lighter

There is also evidence that traditional balance sheet insurers are seeking to lighten their own asset bases through the formation of Consortia.

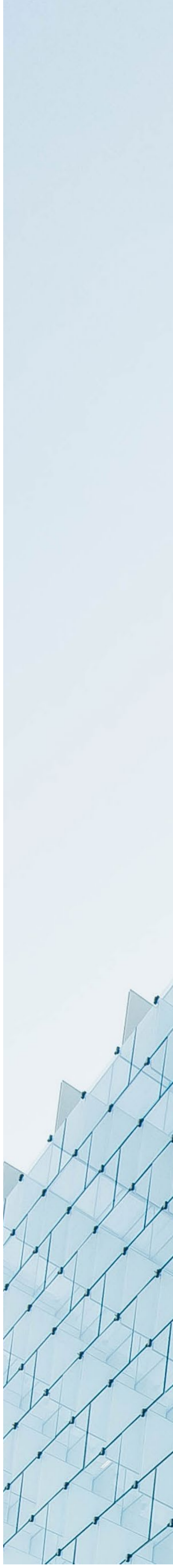
These operate in a similar way to proportional reinsurance, but premium and exposure are effectively written 'off balance sheet' through a formalised co-insurance with other traditional insurers. This arrangement serves to reduce the amount of capital the lead insurer is required to hold, and / or allows them to reallocate premium and reserve risk more efficiently within their capital model. Much like proportional reinsurance, the lead insurer derives non-risk related fee income from the arrangement, which serves to further enhance shareholder value.

Whilst the concept of consortia is not a new one, it is becoming increasingly popular in traditional subscription markets such as Lloyd's, as managing agents seek not only to lighten their asset bases whilst generating fee-based revenue, but also to enhance their proprietary products with the assistance of third party balance sheets, reinvest in their underwriting and claims capabilities to further cement their lead positions, and gain market share.

The development of consortia in the Lloyd's market has also been facilitated in recent years by the advent of the 'follow only' underwriting model, whereby Lloyd's syndicates, whether separately capitalised or via a ring-fenced P&L, seek to actively select portfolios of business to co-insure that are written by recognised market leaders in their field who have historically outperformed the market. These 'follow only' business models typically operate at a lower expense ratio than the lead Syndicates with whom they partner, while providing them with non-conflicted peer group capacity within the subscription market, with which they can lighten their asset base.

The alignment of interest between lead and 'follow only' business models that this dynamic creates, and the clarity it gives to their respective roles, are creating new efficiencies in the traditional subscription model and are thereby becoming a central feature of the effort to modernize the Lloyd's market itself.

Conclusion: a lighter future



Asset-light vehicles, represented primarily by MGAs, were until recently a largely cyclical phenomenon, growing when carriers were hungry for premium in soft markets and shrinking when capacity withdrew in hard markets.

No longer. Since the global commercial insurance market began to harden in 2018,[21] all of the asset-light strategies described in this report have surged in popularity, with growth accelerating dramatically since 2020:

- The US **MGA market,** which Conning has tracked closely for the past decade, grew in premium terms by 51.5% in just two years between 2020 and 2022, to $71.2 billion.[22]
- MGA premium underwritten with the support of **fronting companies** more than doubled over the same period to $13.1 billion.[23]
- **Reciprocal exchanges**, which numbered 57 in 2020, now stand at 73 (both authorised and awaiting authorisation).
- **Consortia** (not, as we have seen, asset-light but rather asset-lighter vehicles) are rapidly increasing in market relevance, with c. 110 traditional consortia registered in Lloyd's during 2023.

Looking ahead, it seems likely that the trends that have driven the recent growth of asset-light vehicles have further to run. MGAs and the ecosystem that has evolved around them – including fronting companies and some reciprocal exchanges – are well suited to providing tailored solutions for niche markets that larger balance sheet insurers are ill equipped to offer. MGAs are adaptable and nimble at a time when the increasing volatility of many exposures supports such a 'narrow gauge' approach to risk.

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[21] Howden, The Great Realignment, January 2023, Page 6.
[22] This is premium generated by the larger MGAs that is recorded in Note 19 of insurance companies' regulatory filings. The total US market, including business backed by Lloyd's syndicates and smaller MGAs that are not recorded in Note 19, is estimated by Conning, Inc. at $85.5 billion. See Managing General Agents: Proving their Mettle, Conning, Inc.'s Strategic Study, July 2023, page 26
[23] See Managing General Agents: Proving their Mettle, Conning, Inc.'s Strategic Study, July 2023, page 78

The biggest challenge for MGAs will continue to be securing durable capacity. A sudden and well-publicised shortfall in collateralised reinsurance capacity supplied to the fronting market by one major ILS platform has understandably sparked concerns about the availability of fronted capacity, which has provided support for the MGA market's growth in recent years. It looks likely that the fronting model will weather this challenge and continue to grow its share of total MGA business. There is plenty of room along the spectrum from asset-light to true balance sheet businesses; fronts will perhaps need to move to the right a little, increasing retentions, but they can still add value as relatively asset-light businesses because they are 100% committed to finding capacity solutions for the MGA/MGU market in a way that traditional carriers are not.

The valuation of hybrid fronting carriers will doubtless be the subject of some debate if they assume materially larger underwriting risk while reducing their credit risk exposures to reinsurers. Should they then be valued like intermediaries, as has hitherto been the case, at multiples of EBITDA, or more like traditional insurance companies, in relation to the book value of their assets? A 'bi-focal' approach to valuation, giving due weight to both dimensions of the business model, would seem appropriate.

These are important issues because they feed into the incentives that have helped drive the recent growth of asset-light business models in the P&C market. But they are eclipsed by a much more important issue for insurers and the role they play in addressing the risks of the twenty-first century.

The insurance industry has not always succeeded in attracting outsiders with skills that it could use to the benefit of its clients. As we have seen in this report, the rise of asset-light vehicles – particularly MGAs – has created a bridge for talented technology professionals, strongly supported by technology investors,
to participate in the insurance market. Their contribution is likely to grow even more important in the years ahead.

A market leading position in the asset-light space

SabRE

MGA and programme broking is part of Howden Tiger's DNA. SabRE, an industry first, comprises specialists from Bowood, Howden's specialist delegated binding authority division, as well as Howden Tiger's coverholder teams. As the only 'full stack' reinsurance broker in the marketplace, SabRE is built for the modern client, with a leading position in our chosen markets.

SabRE will place a combined ca. $6bn of gross written premium (GWP) in FY23, making it the largest MGA/programme broking group globally.

The SabRE team are supported by Howden Tiger's treaty and facultative capabilities, bespoke analytics, market leading investment bank, industry leading data and analytics team and strategic advisory group.

SabRE's combined talent and expertise is a true differentiator in the market and will provide clients as well as London market and global capacity providers with further opportunities to grow.

At a time of continuing market disruption, SabRE is a core part of Howden Tiger's strategy to enhance the scale and depth of its reinsurance offering, providing a holistic risk, capital and strategic advisory capability that delivers more choice for today's clients and creates a fresh alternative of real scale and relevance.

Consortia

Howden Tiger is the only broker with a fully dedicated Consortium advisory, placement and operational resource, combining insurance and reinsurance capabilities with expertise covering a broad range of classes.

Working in close collaboration with Howden Tiger Treaty, Fac, SabRE, Capital Advisory and Analytics, Howden Tiger Consortia will place ca. $1.5bn of multi-class gross premium through consortium placements in FY23.

Due to the holistic (re)insurance placement and portfolio management service offered to clients, Howden Tiger manages high-profile consortium placements for some of the largest managing agents in the market, providing them with bespoke consortium product and capacity innovation to suit their individual requirements.

Consortia are rapidly gaining popularity as a commercial means to modernise syndication towards a purer lead / follow model; the consortium market is still a greenfield site offering immense opportunity to early movers who strategically adopt consortia into their business models as a mechanism to drive capital and balance sheet efficiencies.

DUAL

Howden have been passionate about MGAs for years, founding DUAL in 1998, which is now a $2.5bn MGA in its own right.

DUAL is one of the world's largest international underwriting agencies and also one of Lloyd's largest international coverholders. Some of the world's largest and best-rated insurance and reinsurance companies back DUAL.

DUAL is driven to create and deliver the right products for the right people across the globe; with underwriting offices around the world by connecting capacity providers with new markets, intermediaries with capacity providers and brokers with their clients to meet the needs of the end customer.

"Expert underwriting. It's what we do."

Specialist underwriting is at the core of DUAL's business. The goal to be the world's best underwriting business means its core focus is always on delivering exceptional underwriting and high standards of service.

DUAL is part of Howden Group Holdings, an international insurance group with employee ownership at its heart. Howden Group Holdings was founded in 1994 and operates in 50 territories and employs over 14,500 people.

A market leading position in the asset-light space

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The Conning Insurance Research group is the insurance research arm of Conning, a leading investment management firm with a long history of serving the insurance industry.

For over 50 years, Conning's Insurance Research group has been providing solutions that help management teams understand and navigate a rapidly changing insurance landscape. Conning's well-respected research and consulting solutions result from deep industry knowledge; ongoing surveys of industry executives; proprietary Conning data, forecasts, and models; and our in-depth reviews of insurer performance.

Recent Conning publications include our in-depth study into the fronting market, The Fronting Market: At an Inflection Point, and our tenth annual strategic study on the US MGA market, Managing General Agents: Proving Their Mettle.

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