From MGA to full-stack insurer: Everything you need to know

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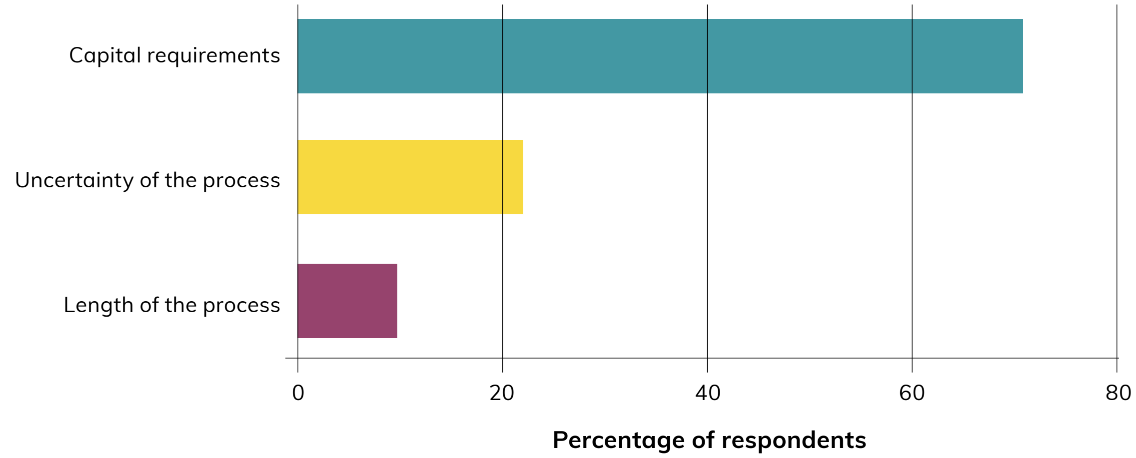
Introduction

It is a good time to be an MGA. There has been significant growth amongst both new and traditional agencies. Inevitably, many MGAs are looking at the potential next stage of their evolution - becoming a full-stack insurer.

According to an Insurtech UK survey, 57% of its MGA members would transition to a full-stack insurer if possible. In the UK the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) both have to agree to authorise this change in status. However, there are very few companies which have made this transition. No insurtechs have become full-stack insurers via the UK's financial services regulatory body, the Prudential Regulation Authority (PRA) - its New Insurer Startup Unit, set up in 2018, has yet to approve an application.

During this process, companies must overcome a range of challenges, including capital-related issues, the long waiting time for determination, and the uncertainty around the process. When the wider InsTech community was asked in April 2022 what they believed the most significant barrier to be, capital requirements came out on top with 70% of the vote.

What is the biggest challenge MGAs face when trying to become a full-stacker insurer?



Source: InsTech

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In March 2022, PKF sponsored an InsTech event deep-diving into what deters those who want to transition, investigating the implications of an MGA becoming a full-stack insurer. This included a discussion of the regulatory and compliance implications, how much capital is needed and where to go for the relevant expert guidance and some alternative approaches.

Robin and Matthew were joined on stage by:

- Martin Watson, Partner, PKF
- Rachel Hillier, Partner, Capital Law
- Matthew Jones, Partner, Anthemis
- Christen Smith, Chief Revenue Officer, Flock
- Kenneth Underhill, Director, ICSR
- Richard Leftley, Executive Vice President Global Sales, MIC Global
- Rory Tanner, Government & External Affairs Manager, Insurtech UK
- Michael Ashton, Senior Executive, Gibraltar Finance

The panellists gave a range of differing perspectives about operating as an insurer versus an MGA. Advisors present, including PKF, Capital Law and ICSR, talked about their experiences of helping firms through the process of becoming an insurer. Flock, MIC Global and Anthemis were able to give their view from the frontline.

Several key factors to consider when moving from an MGA to an insurer were discussed during the event. In particular, PKF noted the following are vital when considering the move to become an insurer:

- **Have a clear reason for becoming an insurer.** Reasons to consider this move include:
  - Having more security and control of capacity
  - Enabling product innovation, which may currently be limited by existing capacity providers
  - Maximising longer term exit value, in particular if an IPO is a possible exit route
- **Consider how the move would change your operational agility.** As an insurer, there are significantly more administrative burdens and regulatory requirements. This includes increased costs associated with people, systems and processes.
- **Understand the advantages and disadvantages of your insurer location.** Whichever location chosen will be a trade-off between time, certainty of outcome and cost of set up.

The move to becoming an insurer comes with an increased discipline and understanding of underwriting. However, you haven't got the capital to reload your balance sheet if things go south, so understanding the risks and obligations associated with your underwriting is absolutely key to future success.

PKF

PKF is one of the UK's largest accountancy brands. With over 150 years of experience in the insurance market, PKF's insurance team acts for major carriers and syndicates, brokers and MGAs. PKF is ranked as the 7th largest auditor of general insurers and the largest auditor of insurance intermediaries in the UK. PKF is able to provide a full range of audit, accountancy, tax and advisory services.

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MGA to full-stack insurer: the challenges

Rory Tanner
Insurtech UK
Government & External Affairs Manager

Insurtech UK is a trade association for the community of insurtech start-ups in the UK. It started as a small group of people who felt that those working in insurtech needed a voice, particularly in relation to government policy. Now Insurtech UK is a lobbying group for insurtech companies, working on issues such as the PRA's lengthy insurer application process.

As the first speaker at the event, Rory Tanner set the scene for the evening. He discussed the process of becoming a licensed UK insurer and the main barriers holding MGAs back based on Insurtech UK's research.

Capital-related issues

Insurers are required to provide capital upfront based on their projected three-year business plan. This can be seen as a disproportionate amount of capital for a fast-growing MGA to provide. Insurtech UK has suggested that the PRA could introduce year by year forecasting and a lockstep process where the ratio of capital requirements is increased each year.

Another capital-related issue is around EIS (Enterprise Investment Scheme) eligibility. When an early-stage business is EIS-qualifying, an investor can claim a number of tax reliefs, including upfront income tax relief, tax-free capital gains and loss relief on each investment that returns less than what was put in. When a company becomes an authorised insurer, it loses its EIS eligibility for three years retrospectively. Many investors are not willing to give up EIS status on their shares. Insurtech UK suggests that raising the issue with investors early could be beneficial.

Uncertainty around the process

Whilst companies are waiting to hear back from the PRA, there is no way of telling if it is likely that their application will be successful. When a company does hear that it has been successful, it is expected to be able to operate as an insurer straight away. If the company started as an MGA, it would have to change its operating model and resources, both on the financial and operations side. This includes promptly recruiting the talent needed to execute the functions of an authorised insurer before they hear back about their application.

The length of the process

To become an insurer in the UK, a company has to go through a pre-application and an application process with the PRA. The pre-application stage involves meetings where plans can be discussed, and the PRA can provide feedback and next steps. The application process following this can be lengthy. The statutory deadline for the PRA and the FCA to decide on an application is six months if it is complete when submitted and 12 months if it is missing any required information. For many fast-moving start-ups, this is too long a time to wait. In other jurisdictions such as Gibraltar, the timeline from initial interaction with the regulator to insurance licence approval can be half as long. Insurtech UK has suggested that the PRA should aim to respond to an application within three months from receipt of a completed application, making the total process six months to allow for the necessary pre-application phase. Doing this would make the process more appealing to start-ups and make the UK more competitive internationally.

MGA to insurer - additional regulatory and operational requirements

Martin Watson
PKF
Partner

PKF provides a range of auditing, tax and advisory services to insurers. Based on his extensive experience, Martin Watson highlighted the differing regulatory requirements that MGAs and insurers face in the UK.

One of the main differences between an MGA and an insurer is the extent of the regulatory requirements faced. MGAs deal with the FCA, but Solvency II authorised insurers have to also deal with the PRA and have oversight from the Financial Reporting Council (FRC). This increases the regulatory burden for insurers, who will face additional requests for information to meet both PRA and FRC requirements. Insurers also face additional corporate governance and process and control requirements.

"Companies that keep on top of these requirements are those that have clear and well-controlled processes set out from the beginning."

- Martin Watson, Partner at PKF

As part of this regulatory compliance, insurers are required to have an audit committee. Martin noted how reporting deadlines are stricter and the ramifications are more severe if missed. Insurers must produce several key regulatory reports, some of which have to be publicly disclosed, including:

- Solvency and Financial Condition Report (SFCR)
- Regular Supervisory Report (RSR)
- Quantitative Reporting Templates (QRTs) and National Specific Templates (NSTs)
- Own Risk and Solvency Assessment (ORSA)

Issues to consider when transitioning from an MGA to an insurer

Rachel Hillier
Capital Law
Partner

Kenneth Underhill
ICRS
Director

Capital Law's Rachel Hillier and ICSR's Kenneth Underhill highlighted some key issues to think about when considering the move from MGA to insurer.

For more information on the issues and a broader view of the necessary considerations, ICSR covers them in an in-depth report they released in March 2022.

Choice of jurisdiction

Rachel highlighted the importance of considering which jurisdiction to set up your holding company or insurer in, based on the location of the risks you are insuring. Once an insurance company has been set up in the UK, it is difficult to branch out into Europe. If you are planning only to insure risk in the UK, the options are to go through the PRA or Gibraltar. Insurers can passport into the UK from Gibraltar. If the risk is in the EU, there are many more options. If the risk is a mix of both, the organisation needs to understand that creating a third country branch from the UK is difficult, especially since Brexit.

Distribution route

When setting up an insurer, it is important to consider whether you want the company to just insure or to also distribute. If a distribution model is already in place, Rachel advised that it may be best for the insurance company you set up not to distribute and keep the two separate.

Holding companies

Rachel noted that setting up a holding company could be beneficial, consequently the MGA does not own the insurer or vice versa. A holding company can also help with protecting your intellectual property (IP) separately from your insurance model. The IP built up through your MGA can be put into a holding company and then licensed to both your insurer and MGA.

Increased underwriting and regulatory controls

When a company is an MGA, its capacity providers undertake underwriting audits. When you become an insurance company, you are responsible for doing these yourself. As well as these increased underwriting controls, you will have to deal with changing IT, reserving and claims handling controls. Kenneth explained how having access to the right expert advice is key to ensuring full compliance.

Is it the right path?

Kenneth and Rachel both highlighted that if you have a successful MGA model, becoming a full-stack insurer might not be the right path. If you have a good relationship with your capacity provider and can do everything you want to, it might be best to continue operating as an MGA. However, if you are experiencing resistance against new products and new market expansions and/or consistently making good underwriting profits every year then becoming an insurer may be a better option.

Gibraltar: an alternative route to becoming a full-stack insurer

Michael Ashton
Gibraltar Finance
Senior Executive

In 2001, the UK government introduced legislation that allowed any insurer set up in Gibraltar to market and passport its products in the same way as any other European insurer. Today, over 50 insurance companies are based in Gibraltar, including Admiral and Hastings.

During the event, Michael Ashton from Gibraltar Finance highlighted some of the benefits of basing your insurance company in Gibraltar.

Speed to market

In 2021, the law in Gibraltar around regulatory outcomes of insurance-related applications was clarified. The regulator has to determine the outcome of an insurance application within six or twelve months depending on the completeness of the application. For becoming a licensed MGA, an outcome has to be reached within three or twelve months.

Access to the regulator

If a company urgently needs to see a regulator, it can within 48 hours. Michael noted that insurtech businesses often want to remain nimble and opportunistic, so having easy dialogue and relationships with the regulator can be important.

Employment flexibility

If a company is established in Gibraltar, it is relatively easy to obtain work permits to bring employees over. For this to happen, the company's core management must be based in Gibraltar.

Views from the frontline

Flock

Flock is an MGA with capacity provided by SOMPO and Aioi Nissay Dowa.

Christen Smith
Flock
Chief Revenue Officer

What does Flock do?

Flock is aiming to make the world a quantifiably safer place. We originally provided pay-as-you-fly drone insurance and now work with thousands of connected vehicles and fleets. We work across couriers, self-drive hire fleets and trades.

Flock currently operates as an MGA. What are the benefits of this?

Financial ratings are important to a lot of our broker partners and motor fleet customers. If Flock were to launch as an insurer right away, it would be difficult to get an official rating as we are a new company. We can provide more certainty and security to our customers by working with rated insurers. Operating as an MGA also gives us more security in terms of our balance sheet. If a shock loss happens in the first few years, it does not affect our balance sheets but that of our capacity providers'. Being an MGA also gives us more flexibility and allows us to innovate more quickly, as funding does not have to go towards capitalising an insurance company.

What are the disadvantages of being an MGA?

Many successful companies remain as MGAs, but there are benefits to being an insurer. A full-stack insurer makes its own decisions, avoiding any potential resistance from capacity providers. Along with greater autonomy, there is also potential for greater rewards if you are underwriting profitably.

Views from the frontline

Anthemis

Anthemis focuses on investment for insurtech business, investing in MGAs including Flock.

Matthew Jones
Anthemis
Partner

What does Anthemis do?

Anthemis was initially an early-stage investment firm focused on companies at the pre-seed, seed and series A stages. Over the last 10 years, we invested between $250,000 USD and $5 million USD at any one time. We still make investments from $250,000 USD, but now we go up to $20 million USD, and all companies we invest in are related to the insurance industry.

What does Anthemis look for when investing in MGAs?

At the earliest stages of the business, there has to be both technology and insurance knowledge in the team. Anthemis has also never invested in an MGA that does not plan at some stage to become a full-stack insurer. Inevitably, not all of them will, but that pathway has to be there for us to invest in the company.

Why are there currently no insurtechs becoming UK insurers?

The PRA has work to do in becoming more approachable and making the process not as daunting. Additionally, the venture capital community has generally not invested enough to support companies looking to make this transition. Although there are challenges, if as an MGA you have a genuine underwriting advantage and strong margins, it is worth trying to become a full-stack insurer.

Views from the frontline

MIC Global

MIC Global began as a broker and now has a reinsurance licence in Anguilla, an insurance licence in Guernsey and South Africa, a micro insurance licence in Kenya, a brokerage licence in Ghana and Pakistan and has also recently set up a Lloyd's syndicate.

Richard Leftley
MIC Group
Executive VP
Global Sales

What is the history of MIC Global?

Twenty years ago, I set up a business called MicroEnsure. It was active in Africa and Asia focused on selling insurance that cost 3 cents to a dollar a month to the low-income markets. In 2009 we started working with mobile phone companies and later with ride-hailing and food delivery companies. To MIC Global, micro insurance is increasingly about short distance and duration. We are now active in Europe, the UK and the US. For example, MIC Global provides an embedded insurance product that covers packages on doorsteps in the US by making use of video doorbells.

What has MIC Global's insurance journey been like?

We realised that it was challenging being a broker and doing micro insurance. MIC Global couldn't get the products we wanted from traditional insurers and weren't getting paid a lot despite bearing much of the workload. We were designing the products, selling them, collecting premiums, educating customers and getting claims paid, but were only getting 10-20% commission. At first, we thought being bought by a big global insurer was a good move, but decided against it. Instead, we merged with a reinsurance company in Anguilla in 2020 to form MIC Global. We are also now a "syndicate in a box" at Lloyd's.

What is a "syndicate in a box"?

It is a route for business that Lloyd's would not usually underwrite. The participation and entry criteria is adjusted to make it more capital-efficient for smaller entrepreneurial companies to enter and trade at Lloyd's for their first three years. Lloyd's typically chooses innovative or tech-led businesses to become syndicates in a box.

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