Birketts
Clear Legal Advice

Establishing an MGA in the UK

MGAs, once regarded as the 'new kid on the block', are clearly now the third UK insurance market, and a genuine, cost effective way for insurers to access distribution and transact SME business efficiently. MGAs are leading the way by embracing new technologies, emerging capital, attracting good underwriting skills and experience, and identifying new distribution opportunities.

David Coupe
Partner
0203 5534884
david-coupe@birketts.co.uk

MGA means Managing General Agent and covers any person and/or entity who manages the underwriting function for an insurer...

What is an MGA?

MGA means Managing General Agent and covers any person and/or entity who manages the underwriting function for an insurer acting always as agent of the insurer and not that of the insured. MGAs are now the vital link connecting wholesale insurers with specialist retail distribution. MGAs are useful for traditional insurers as they not only provide professional underwriting services, but most importantly access to niche and specialist markets without the need for insurers to set up their own distribution channels.

The role of a Managing General Underwriter (MGU) differs slightly as the latter offers not only underwriting and access to distribution, but also a whole range of other services such as actuarial and analytical support. Effectively, the MGU business will undertake all the functions and services for customers in the same way an insurer would, with the one crucial difference being that they do not bear risk nor manage regulated capital.

What form of entity?

It is most likely that a limited company or a limited liability partnership will be used. LLPs have become increasingly fashionable for underwriting teams starting afresh. Each structure has its own distinct advantages, but for the purposes of regulation, both will be treated the same. However, tax and ownership issues will often prevail in respect of either corporate structure, therefore you are advised to seek advice before committing.

The ultimate decision one needs to make when deciding which corporate structure best suits the proposed business plan relates to its intended future, both in the short and long term. Is the business intended only to be a short term proposition, or do you wish to keep the business running as a medium to long term vehicle? Is a capital value to be sought in the future, and if so, which entity will create the greatest value for the initial investor(s)? What are the tax and operational benefits of each along the journey and upon any realisation event occurring?

The main features of both corporate structures are set out below.

Limited Liability Company

> *As a shareholder, your liability is limited to the amount invested in the company.*

A limited liability company has a separate legal identity from its shareholders. The business can only cease to continue following the winding up of the company. If you plan to grow a business, then a limited company is a good legal entity to use since it offers the flexibility to sell shares to outside investors. However, you should be careful about who you allow to become shareholders of your company. Shareholders will share in the ownership and possibly the decision-making of your business.

As a shareholder, your liability is limited to the amount invested in the company. You risk greater losses if you stand as a personal guarantor for any of the company's debts and if the company goes into liquidation with debts, the creditors are paid out of the sale of the assets of the company. Under normal circumstances, creditors have no legal right to obtain repayment from the directors or other shareholders of the business. The debts of the company should not affect the directors' personal credit ratings.

A limited liability company can raise capital by taking on a loan or issuing new shares in the company. When selling a stake in the business to a key manager, you may decide to tie him in, or introduce good or bad leaver provisions. Unlike private companies, a public limited company can sell their shares openly on a market such as the London Stock Exchange. A private company cannot offer shares to the general public. To set up a private limited company, you will need to register with Companies House.

Limited Liability Partnership (LLP)

> *An LLP is a corporate body with its own legal identity and capacity which requires registration at Companies House.*

Limited liability partnerships are most often set up by professional services firms such as accountants or solicitors, but can be used in the MGA space. An LLP is a corporate body with its own legal identity and capacity which requires registration at Companies House. A limited partnership has the organisational flexibility of a partnership but offers limited liability to members. Members are self-employed and taxed in the same way as in an ordinary partnership. Annual accounts must be prepared and filed, and other requirements similar to those for a limited company will also apply.

What sort of regulated vehicle is required?

The first regulatory consideration for the new MGA is to consider what kind of business will be conducted and transacted through the vehicle. It is widely assumed that the conduct of intermediated insurance business is always regulated under the Financial Services & Markets Act 2000 (FSMA). However, this may not always be the case due to a number of exemptions. Advice on this may be needed.

There are various methods of undertaking regulated MGA business in the UK:

Birketts
Clear Legal Advice

> *Which of these routes is preferable will depend on the circumstances and business class of the MGA.*

> *Costs initially and on-going can obviously be an issue with each of the chosen routes and choice of business partner should be selected wisely and with care.*

- Direct Authorisation with the FCA – this process can take up to six months, which requires detailed business plans and the provision of much information to be submitted to the FCA in respect of business and financial controls, board composition, IT systems, PI insurance and the business process. It is a long and sometimes expensive process, and the continuing costs of regulation thereafter should not be ignored. A prescriptive governance plan will also be required in order to show full compliance with the Senior Managers & Certification Regime (SMCR).
- Acting as an Appointed Representative – this is a regulated intermediary (the Principal which may be another MGA or broker) which effectively supports the start-up MGA business by taking on all the regulatory responsibility and liability from day one. The process of appointment and approval by the regulator takes little time, and the costs are considerably less. The senior regulated person within the MGA will need to comply and be approved under the approved person's regime.
- Gibraltar – whilst it was possible pre-BREXIT for EU regulated entities to passport into the UK and undertake regulated insurance activities, this will cease from 31 December 2020 unless such entities have applied to the FCA to extend their licences under the Temporary Permissions Regime. Gibraltar follows the UK out of the EU. However, the above does NOT apply to Gibraltar based intermediaries. The UK and Gibraltar Governments have respectively passed new laws ensuring reciprocal licencing arrangements between them, and permitting intermediaries to set out to operate in each jurisdiction. The requirements for operating in the UK are quite stringent and are to be in the set out the new Financial Services Act. To authorise a Gibraltar MGA will take approximately three months.

Which of these routes is preferable will depend on the circumstances and business class of the MGA. However, supporting start-ups through the appointed representative route has become increasingly popular. It is not only authorised intermediaries offering to do this, as a handful of other providers are now offering full start up and turnkey options as well. With the new laws, Gibraltar, with its beneficial tax regime, experienced local insurance managers, and a responsive approachable regulator in the Gibraltar Financial Services Commission, will undoubtedly pick up traction over the next few years.

Setting Up Costs

Costs initially and on-going can obviously be an issue with each of the chosen routes and choice of business partner should be selected wisely and with care. Independent providers are not aligned to MGA or broking houses, and thus are not likely to be potential competitors for MGA's clients going forward. This is an obvious attraction but many of these providers do not have the name and associated goodwill that goes with the established intermediaries, and often they will ask for an equity stake in the business.

The other aspect of undertaking London market business is Lloyd's accreditation which is outside the scope of this article. However, the Principal may be required to provide Lloyd's passes, and some service providers are not able to offer this.

Birketts
Clear Legal Advice

In our experience, the preferred and chosen route to market has been the Appointed Representative route...

...there is also usually a mechanism by way of options that allow for this stake to be bought or sold on a pre-agreed basis at a certain future date or upon certain agreed events occurring...

With the Gibraltar route now available, tax may be a consideration with no VAT made on any supplies (not just insurance supplies) and lower employee social security costs too.

Preferred route to market

In our experience, the preferred and chosen route to market has been the Appointed Representative route and it is perhaps not difficult to understand why when you consider the fact that the UK has perhaps the most highly regulated and expensive intermediary regulatory regime in Europe. These costs, and the time taken, are often seen as prohibitive for start-up businesses, where budgets are tight, and the future relatively uncertain.

In the longest soft market experienced in the UK, this was perhaps inevitable. Perhaps matters will change in a hardening market, such as post COVID? Perhaps the use of Gibraltar will, with time, become a popular alternative. Only time will tell.

Setting Up an Appointed Representative Structure

This article now focuses on what is needed to set up an Appointed Representative (AR) structure for a finite period of three years and thereafter applying for full regulatory status.

The principal legal agreements are as follows:

Incorporation documents – when registering a company, the following are required:

'Articles of Association' – these are written rules concerning the running of the company agreed by the shareholders and state how the company is run, governed and owned. The articles can put restrictions on the company's powers – which may be useful if shareholders desire safeguards to ensure directors will not pursue certain courses of action, at least without shareholder approval.

Shareholders' Agreement – this regulates the rights of the shareholders between themselves dealing with constitution of the Board, dividends policy, transfers of shares and 'restricted matters'. This is usually a list of those material things upon which all shareholders need to agree. The Principal may wish to consider whether it wishes to be a shareholder or have an appointee on the board. This is a matter of individual negotiation in each case. It is suggested that if such an interest is taken, it is for less than 20% as this is a FSMA threshold controller limit going forward when a full application is made. This also avoids certain issues of accounts consolidation under current accounting rules. However, there is also usually a mechanism by way of options that allow for this stake to be bought or sold on a pre-agreed basis at a certain future date or upon certain agreed events occurring.

Birketts
Clear Legal Advice

- Appointed Representative Agreement – this agreement is very important as it is the agreement that gives the MGA authority to operate. However, it should also give the Principal full protection against the MGA breaching FCA regulations and full rights of inspection. It should be understood that all premiums and claim monies are accounted for within the Principal, not the MGA. There will of course be reserved to any insurer significant rights of audit under the terms of any binding authority agreements that are entered into.
- Turnkey agreement – this agreement provides for all of the back office arrangements and is largely uncontested. There are a number of pressure points, which typically include:

  -PI and D&O insurance – The MGA will usually be insured on the Principal intermediary's insurance and should be obliged to pick up the total cost of claims not covered by such insurance in respect of its own defaults (including excesses and deductibles). It should also pick up the additional premium cost arising as a result of such claim. Unlike PI insurance, D&O insurance is not compulsory, but has become more prevalent since it provides some limited protections against claims that may arise for breach of FCA Regulations.

  -Run-Off - termination can occur in many ways. If the MGA voluntarily decides to terminate the AR and leave the Principal, the Principal will not wish to bear the cost or conduct the run-off of risks introduced through MGA. Indeed, the MGA will not wish to leave this behind since it is part of its goodwill. Arrangements need to be put in place to affect this transfer. The issue is that the primary responsibility remains with the Principal unless the clients novate the entire historic relationship across. This is cumbersome and unlikely to occur. As a result, Principal should ensure that it is protected against this, both in terms of contractual terms and indemnification, but ensuring the run-off PI cover remains in place at the cost of MGA.

  -Employment contracts – these can either be with the MGA, Principal intermediary or both. It is suggested that both is the correct approach, since the employee can be deemed an employee of MGA, and that his employment with the Principal will terminate when the appointed representative arrangement ends without liability to the Principal. This employment with Principal gives the employee the authority to conduct business.

  Loan/ Working Capital Facility - these are often needed because the MGA will struggle for cash for the initial working period of MGA. This facility bides them over for this period, and is repaid from commissions going forward. Alternatively, venture capital or subordinated debt can be provided from external sources. Speak to us to understand more.

"Appointed Representative Agreement – this agreement is very important as it is the agreement that gives the MGA authority to operate.

Birketts
Clear Legal Advice

> *In our experience, the preferred and chosen route to market has been the Appointed Representative route...*

Key Considerations when starting a new MGA business

MGAA – Managing General Agents' Association - Membership is recommended. The MGAA aims to represent and support 75% of the UK MGA market, being in 2020, some £6.4bn GWP. The MGAA is a not-for-profit organisation that works both within the professionalism framework of the Chartered Insurance Institute (CII) and observes its own code of conduct. The MGAA was formed in 2011 to lobby on behalf of MGAs, to communicate their considerable benefits and to drive best practice. The MGAA, and its board of directors and specialist committees focus 100% on shaping the future of delegated underwriting in the UK.

Retention of Business - The MGA and its founders will want protection from the Principal that the clients, data and business that are warehoused through the Principal arrangement belong to the MGA. As such, it is proper for MGA to seek restrictive covenants from the Principal that it will not solicit or undertake business after termination for such clients (apart perhaps from regarding the run-off of pre-termination business). Confidentiality is also important.

> *...please note that if client monies and risk transfer monies are mixed in the same bank account, then they must all be treated as client monies.*

Client Monies and Monies Held subject to 'risk transfer' - Each MGA and its supporting markets need to decide how they wish to deal with premiums and claims monies i.e. 'client' monies. The handling of such client monies will be governed by the FCA's rules and requirements set out in 'CASS 5'. Whilst an authorised principal can be authorised to hold client monies, an AR cannot do so. However, a Principal or AR can agree to hold such monies if it has agreed with insurers that effective risk transfer is in place. What this means is that the AR receives the money on trust for the insurer, and from that point, the insured is deemed to have paid the premium to the insurer, whether or not the MGA does so. In effect, the credit risk attaching to the MGA holding the premium monies shifts from the insured to the insurer. Most MGA's operate on the basis of this 'risk transfer'. However, please note that if client monies and risk transfer monies are mixed in the same bank account, then they must all be treated as client monies. They would therefore be covered by the strict provisions of CASS 5. Gibraltar now has a very similar regime relating to 'customer' monies.

Capital Requirements - The FCA have prescribed requirements for the amount of capital that an authorised Principal must be maintain, both in respect of its own business and that of its AR. If it holds client monies, then 5% of its turnover is required. If it holds monies by way of 'risk transfer', then 2.5% of its turnover is required. In Gibraltar, it is 4% of turnover.

Client documentation - Both the AR and the Principal will require access to these both during and after the arrangement.

Birketts
Clear Legal Advice

5 Point Checklist when establishing an underwriting agency

1. Business Model

MGU ☐ MGA ☐

2. Corporate Entity Structure

Ltd Co ☐ LLP☐

3. Capacity

Insurer ☐ Emerging Capital ☐ Other market☐

4. Regulation

Regulated Activity	Yes ☐	No ☐
Regulatory Authorisation	Yes ☐	No ☐
Appointed Representative	Yes ☐	No ☐

If yes, Broker or turnkey provider Broker ☐ Turnkey ☐

5. Legal Agreements Required

i Memorandum of Association	Yes ☐	No ☐
ii Articles of Association	Yes ☐	No ☐
iii Shareholders Agreement	Yes ☐	No ☐
iv Appointed Representative Agreement	Yes ☐	No ☐
v Turnkey Agreement	Yes ☐	No ☐
a. PI Insurance	Yes ☐	No ☐
b. Employees	Yes ☐	No ☐
c. Run-Off	Yes ☐	No ☐
vi Employment Contracts	Yes ☐	No ☐