GEICO - CEO and Co-Founder at Kin Insurance

Interview conducted on May 09, 2023

Topics

Insurance Industry, Regulatory challenges, Capital Requirements, Market dynamics, Surplus Notes, Reciprocal Insurance, Quota Sharing, Risk Transfer

Summary

The Tegus Client is seeking information about the insurance market, including CAT-exposed areas in Florida and Texas, reciprocal exchanges, reinsurance, and regulatory risks. The CEO and Co-Founder at Kin Insurance explains that the insurance industry is currently in a hard market phase with less capacity and higher pricing due to underwriting and capital losses. They discuss the challenges faced by primary carriers compared to reinsurers and the regulation of reciprocal insurance companies. The CEO also explains the difficulties of getting money out of a reciprocal insurance company and the need for stability in capital. They discuss the profitability of underwriting insurance policies and the market for surplus notes. The CEO also discusses the regulatory environment in Florida and the challenges of balancing investor interests with regulatory requirements. They mention the role of rating agencies and regulators in overseeing insurance companies. The conversation concludes with a discussion on the factors that separate profitable reciprocal exchanges from less profitable ones, including claims administration, acquisition and servicing, and distribution. The CEO also discusses reinsurance structures and quota sharing. The expert provides more information on quota sharing, retention amounts, and the cost of excess of loss reinsurance. They mention the Florida Hurricane Catastrophe Fund and the increased reinsurance rates in Florida. The Tegus Client expresses concerns about regulatory risk and starting an insurance company, and the expert recommends looking into Howden Tiger for more information on reciprocal exchanges.

Expert Details

CEO and Co-Founder at Kin Insurance.

CEO and Co-Founder at Kin Insurance. The expert founded Kin Insurance in 2016 and can speak in-depth about the company, the growth, and market trends in this space. The expert works on fixing the homeowner's insurance industry and can speak about this space extensively. Prior to Kin Insurance, the expert was the Board Member at Accion USA, leaving October 2019. The expert helped Accion USA on all matters relating to technology, distribution, and strategy.

Q: Can you discuss the state of the reinsurance market in Florida?
A: Yes, I buy about $1B of reinsurance / year, much of which is Florida exposure.

Q: Can you discuss the state of regulators in Florida and oversight over reciprocal exchanges, why don't the bigger plays participate as much in reciprocal exchanges given the economics appear to be very favorable?
A: I certainly can. I would point out that there are many large insurance carriers structured as reciprocal exchanges, including Farmers, Erie and USAA.

Q: Can you speak to some of the uncertainties and risk that you envision for a reciprocal exchange in Florida
A: Yes, I am the CEO of a company that manages two reciprocal exchanges, one of which is domiciled in Florida (the other is domiciled in Arizona).

Tegus Client

Hello, I appreciate your time. The topic at hand here is really the typical insurance market. Maybe specifically focused on more CAT-exposed areas in markets such as Florida and Texas. I want a better understanding of how exactly the exchange and the related AIF works and sort of dig through some of what makes reciprocal exchanges attractive, how it differentiates from traditional insurance providers.

And I think I really want to dig into the reinsurance market. And then also just understanding how reinstatement works. And then another one is digging at is the regulatory environment. So I just want to understand the regulatory risks associated with the exchanges. And obviously, it would be great to hear about your experience with regulators. But I also want to understand sort of what their purview is regarding the AIFs.

If there's any precedence of them trying to intervene with the economics of AIF, that's going to be very important for us to understand and assess the risk profile there. So just wanted to get your view, obviously, you're in the industry, about the current state of the insurance industry. And I know you had mentioned that you have a reciprocal exchange in Florida. So maybe you can focus on Florida as well as any markets that you're in, just to understand what the current state is, how you've seen it evolve over the past five to 10 years.

CEO and Co-Founder at Kin Insurance

Yes, sure. So the insurance market is in like what they call hard market where there's less capacity and there is higher pricing. So it's harder to get insurance right now when the prices are higher. Because the insurance pricing is sticky, like it's regulated, you end up having these sort of hard, soft the soft markets tend to last longer than the hard markets because basically like every 10 years, you'll have like three years or four years where capital is scarce. This is a pretty big hard market.

It sort of started like at the end of COVID. And the two things that are driving, and this is across insurance lines, across geographies, and then I'll get into the specific geos. The reason why the market is hard is twofold. First of all, underwriting losses have been high across the industry, across insurance. They've been particularly high in auto insurance, like historically high. They have also been high in property insurance, largely driven by catastrophe losses. There also have been some just sort of weird things where like no one expected to take losses.

But it happened anyway. So an example of that is like a bunch of reinsurers lost money on financial guarantees they had made on airplanes. You never expect to have a claim in that line of business. So it's priced really flip. It's basically just the cost of capital with no risk premium. But of course, Russia invaded Ukraine, you have a lot of western airliners that are stuck in Russia or in Ukraine or places where you can't get to them. So that's the first part, and there's less capital available because they're underwriting losses.

The second part is there's less capital available because everybody took a loss on their balance sheet. And that's because insurance companies or reinsurance companies, they take the premiums and they invest them for a profit. Well, but interest rates went from zero to five. The fixed income portfolios and the equity portfolios, a lot of the reinsurers got hammered. So there's no like run-on-the-bank type situation because you don't have that sort of like, oh, I have to get my money out first.

But if you look at the balance sheets of some of these guys, like they're ailing, they went down like by a quarter almost. And it's actually even worse in some cases because like if you look at Swiss Re, for example, they have a lot of stuff where if they marketed it to market, it would look even worse. So those are the two things that are driving the hard market. Reinsurance prices are, typically reinsurers have lower margin over the cycle because they're doing less, like they're closer to being a pure commodity.

And then you have a primary carrier like an Allstate, for example, well, they're doing more work. Like they're doing all this origination and servicing work. They have a brand, they have stickiness with their customers and agents. And then the agents have the most sticky position because they actually own the relation, agents or brokers, they own the relationship with the customer. It's very hard to unseat them. They sort of have the highest margins. So the reinsurers have the lowest margins across the cycle.

But they also have the fewest regulatory constraints. So if a reinsurer is like, I had an underwriting loss last year. I need to raise my prices across the board by 20% to make up for it. They can do that pretty much immediately. I mean there's a little bit of a lag because these are contracts. They're usually a year long. But they have a shorter lag versus if you're a primary carrier like an Allstate or like my company, you have more constraints. You actually have to go ask the regulator and say, hey, my reinsurance costs went up 20% last year.

Reinsurance is 40% of my cost structure. I need to raise rates on customers by 10%. Also, my losses were higher last year because it was all of this extreme weather that wasn't reinsured. I had to raise my rates another 30% on top for that. Well, the regulators are going to think about that for a while. And they may say no. And depending on the state, you might have to do like a public rate hearing. So it could take a year actually to adjust your prices.

And then another year to get all the policies in your book renewed onto the new price. Because those policies are also on your policies usually. And then because of the way insurance accounting works, it actually takes another year to actually see the financial benefit of those higher prices flow through the portfolio. So it could take like a three-year-long lag on the outside. On an average basis, it's a little more like one and a half to two years.

Tegus Client

The same is, I think, for reciprocal insurance too or if it's the policy holders effectively having.

CEO and Co-Founder at Kin Insurance

So for the most part, our reciprocal insurance company is regulated in exactly the same way that a stock company is regulated. So you have three major structures for insurance companies in the U.S. One is a stock company, where the shareholders own the balance sheet and the shareholders through a Board of Directors appoint the management team. That would be like Allstate. At the other end of the spectrum, you have a mutual and that's actually where there are no shareholders.

And the policy holders own the company, the balance sheet and the policy holders appoint the management. So that would be like State Farm. Now in reality, the policy holders don't really own. So State Farm management appoints State Farm management. In the middle, you have a reciprocal exchange. And that's where the balance sheet is actually owned by the customers. But they appoint an outside for-profit company to be the manager. So it works kind of like a private equity fund almost. Like the policy holder.

Tegus Client

And outside for profit managers, is that what's called attorney-in-fact?

CEO and Co-Founder at Kin Insurance

Correct. So the ownership structure is different, but the reciprocal exchange is regulated exactly the same as a stock company or a mutual company. So there's not any in there.

Tegus Client

This attorney-in-fact business sounds like an amazing business because it's effectively just a management company for the owners of the insurance. The attorney-in-fact takes no insurance risk but effectively guaranteed stream of payments from the insurance underwriter, whatever, to manage underwriting. Am I mistaken? Is this like attorney-in-fact? Like it's almost too good to be true. Like why are the policy holders not benefiting from the ownership of attorney-in-fact?

CEO and Co-Founder at Kin Insurance

Well, so that's a good question. I think it is a very good structure. So if you can get it working and if you can get it to stability. So like the question would be like, because it is like a short fee asset management business basically. So you feel like being a private equity firm, like isn't that an amazing business? You have all these assets under management, you just charge a fee every year and.

Tegus Client

Right. Because you have the assets under management.

CEO and Co-Founder at Kin Insurance
Yes, that's a great business if you can get the assets under management. Similarly, with the reciprocal exchange, if you can get this thing to scale and you can get the reciprocal to sustainability, which is very difficult, by the way, then yes, it's a great business. But those are two big ifs.

Tegus Client
Why is it difficult?

CEO and Co-Founder at Kin Insurance
Yes. So insurance companies like there aren't a lot of new insurance companies started every year. Like maybe 10 in the U.S. across the whole country. And the reason why is like there are a lot of impediments. There's a lot of regulatory impediments, you have to come up with some initial capital, the way that reinsurance buying works, you basically have to pay upfront for the reinsurance, but you don't get the revenue until spread over the course of the year, basically.

Also the way that the statutory accounting works is in GAAP accounting, if you pay some money to acquire a customer, you usually get to amortize that customer acquisition cost over the length of the contract. In stat accounting, statutory accounting, which is the accounting regime that the regulators use and the rating agencies use to look at insurance companies, you actually have to take that customer acquisition cost upfront. And so it makes all your like risk ratios look worse.

Also, the risk-based capital calculation that they use to calculate the capital position has a big built-in growth penalty. And those probably aren't all the reasons. You also like don't have a lot of underwriting data. Insurance is a business where the longer-duration customers tend to perform a lot better. First of all, because there's less like incremental costs associated with them but also, you sort of have this history with them. So they tend to have a lower loss ratio, too. And that's largely because they're less price elastic.

Like in insurance, people are very price elastic to buy the policy and then they become price inelastic after the policy has been written on the renewal, like no one looks at their insurance. It's not very many people anyway. So there are a lot of reasons why it's like difficult to get one of these to scale. With the reciprocal, you have the additional issue, I would say, of you don't actually get to own the capital in it.

So now over time, if you run this thing in balance, the customer premiums cover all the costs of the reciprocal, including the management. That's not going to be the case at the upfront and also you're going to need to provide some additional capital to this reciprocal. The only way to do that because you can't own equity in the reciprocal and debt doesn't count for the leverage ratios by the regulator and the rating agencies. You give them this thing called a surplus note, which is basically like a subordinated debt.

And you're subordinated to the claims of the policy holders. So you basically have to seed fund the reciprocal with all the regulatory capital that it needs to fulfill its initial leverage requirements to fulfill the minimum statutory capital requirement and to cover any operating losses that the reciprocal might have.

Tegus Client
When you say subordinated to the claims of the policy holders and presumably, so how does the water flow work?

CEO and Co-Founder at Kin Insurance
So you can put the money into the carrier, into the reciprocal using a surplus note. The regulator has to be asked proactively if you want to make a payment, if you want the reciprocal to pay you either interest or principal under that note. And so what you'll see is like even for successful reciprocals, like PURE would be a good example. PURE with a Florida domicile, high net worth focused reciprocal like homeowners, insurance companies. It was started by StoneRidge and then KKR came in later.

StoneRidge never got back, like even though PURE was really successful for the whole like 15 years that

PURE existed, StoneRidge was never able to really get that capital out. Now eventually, they sold the company to Tokio Marine, the big Japanese, they sold the AIF and Tokio Marine replaced the capital that had been used. They basically bought the surplus notes as part of the deal. But long story short, like it's really tough to get that out.

Because you're asking the regulator like, hey, I want to take capital out of this thing that's still probably growing fast, that probably doesn't have a lot of other capital in it, that may have operating losses because, well, it's a new carrier. And the regulator in all likelihood is going to say, no, or even like, why the hell are you asking me this question right now? Like you should be smart enough to know that we're going to say no. So that's sort of how it works.

Tegus Client
So even at maturity.

CEO and Co-Founder at Kin Insurance
Yes, even at maturity.

Tegus Client
But so you basically get just current yield coupon?

CEO and Co-Founder at Kin Insurance
If you can get that out.

Tegus Client
Oh, you may not be able to get that out either?

CEO and Co-Founder at Kin Insurance
Correct. To make any payment against the surplus note, you have to ask the regulator and they don't really have any incentive to say yes. They have every incentive to say no because they want the reciprocal to have stability in capital. And in all likelihood, just because of the way the economics work in these things, it's probably going to be a long time before you can even get an interest payment. Now you can accrue the interest.

But now if the reciprocal itself has been making an underwriting profit and everything is hunky-dory, it's doing great, it is built up the loss ratios were less than was expected, the reinsurance rates were less than was expected. It's built up, say, you put $50 million in on the surplus note in the onset, let's say, it's been growing.

It's generated another $50 million of underwriting profit, it's like overcapitalized relative to the RBC ratios, well, yes, then the regulator is going to say yes. I mean, a lot of things would have to go right for that to be the case because from a growth perspective, like there's so many parts of the way that insurance works that are sort of anti-growth.

Tegus Client
A lot of things can go wrong, meaning like you're underwriting catastrophic insurance in whatever, California or Texas and things are only getting worse, not better. You got to pay out. And so the first dollar comes out of the policy holders, the second dollar comes out of the reinsurance.

CEO and Co-Founder at Kin Insurance
Absolutely, you could be in a position where.

Tegus Client
But even if you're not on that, you can't get the money is the point, until it's like things go right.

CEO and Co-Founder at Kin Insurance

Correct. And the other thing I'll add is you could be in a position, actually very likely will be in a position where maybe you put that $50 million of capital in, say, the first year was okay, but it wasn't catastrophic. But now you had a $10 million operating loss at the reciprocal, you're going to need to put another $10 million in to keep it in balance, to keep it solvent. And you'll have to. I mean no one's going to make you.

Tegus Client

You have any right to do it?

CEO and Co-Founder at Kin Insurance

Absolutely, you can, but there's a lag. So that's how it works. You go to the regulator and you say, look, we lost money, the reciprocal lost money last year. Here's all the actuarial math around it. You told us we should price it in an actuarially sound basis. We're going to need to raise rates 20% because we lost 10% last year and loss trends look like they're getting worse. I mean to get ahead of it. And the regulator will probably say yes in most states. But it's going to take some time to say yes. It's going to take even more time.

Because they're going to want to know the details of it. So you look at some of these states like getting a rate filing approved in California can take 18 months. We're one of the worst states. But getting a rate filing approved in Florida could take six months, in Texas could take nine months. So you're behind the ball already.

And now you got the rate approved, it takes you 12 months to reprice all your old policies. And it could take another 12 months for all of the price to flow through. So you can, but if you start off, off the wrong foot, even if it's not disastrous, odds are, you're going to end up putting more capital in.

Tegus Client

And you're effectively overfunding capital that you're not going to be able to get back because of the regulatory reasons. It's not like they will be funding when things go wrong and continue to fund back. If things go forward and you're overfunding it, and then you cannot get it back for a long time because it's got to go right for a long time before you get it back, not just like a year.

CEO and Co-Founder at Kin Insurance

Yes. And you'll do it, too, because you don't want to kill the golden goose. So when you're doing these things, you kind of have to go in eyes wide open.

Tegus Client

The game effectively is can you make AIF but you have to look at it almost how it's going to underwrite the reciprocal, but just like money out the door effectively.

CEO and Co-Founder at Kin Insurance

Yes. Fix their own start-up cost.

Tegus Client

What is the value of the AIF that you've built up on the side? And so when you look at the math of the return, you almost have to ignore or at least discount significantly the return associated with surplus notes.

CEO and Co-Founder at Kin Insurance

Yes. I would say discount significantly is the way I think about it. It's like the second you put that money in, it's probably worth $0.80 on the dollar.

Tegus Client

Yes, I guess that's the question. You would discount it how much? 30%, 40%, 50%?

CEO and Co-Founder at Kin Insurance

If the reciprocal was in balance, and I was sure that it was in balance, I'd probably discount it like 30%, 40% just because of the illiquidity and the uncertainty around the regulator. If the reciprocal was new and it had underwriting losses or you had not proven underwriting profitability yet, I would discount it more.

And then if the surplus, the regulatory surplus in the carrier goes below the outstanding on the surplus note, I would basically not use the surplus note and discount off that, but I would use the surplus in the carrier and discount off that. Because like as the carrier, if you put $50 million in, the carrier loses kind of it in the first year at underwriting losses. Now there's only $40 million in the carrier's balance sheet. You probably should write it down to $40 million.

Tegus Client

So I'm putting $100 into the surplus note, into underwriting the insurance policies like you described, and I set up an associated AIF with it. That $100 is going forward but I don't know how much of it, what percent of maybe many different things, but it's going to underwrite x of insurance or insurance premium, I guess. And the AIF collects whatever, 10%, 20%, I don't know how much, 30% of that. So I'm trying to do the math or at least is there like a rule of thumb, for $100 of underwriting, how much should I expect in AIF profit?

CEO and Co-Founder at Kin Insurance

Yes. So if you look at an AIF and there are a couple ones where you can get access to their financials. They typically are pretty profitable. So on the 30% or whatever they're charging their management fee, they'll usually be able to make, when they're at scale, when everything is sort of up and running, they can make like, call it, 30% margins, EBITDA margins.

So up to 30%, they might drop 10% to the bottom line. But that's once they're at scale. And then the reciprocal if it runs in balance entirely, there won't be an operating loss or an operating gain, maybe a slight operating gain because you wanted to be able to accumulate capital.

So if you look at insurance distribution businesses, and a lot of this depends on what the AIF's business model is. So there are a couple of different lenses you can look at this. So one lens would be, let's look at Allstate. So Allstate is not a reciprocal. But they sort of are expecting to make, call it, a 10% margin over the cycle. It's going to be highly variable. It might be 15% for three years, then it will be a negative 10%.

If they're making a 10% margin on 100% of the premiums and they turned tomorrow to be a reciprocal and they said, look, we take it, Allstate is going to split into two things. One is just the balance sheet, that's going to be called Allstate reciprocal. The other is just the operations. We're going to call that Allstate operations. The 10 points of profit is still there. But instead, that's going to be broken up. So basically zero points of that profit is going to be left behind at Allstate balance sheet.

At Allstate operations, it's going to keep 30% of the total, of its revenue, and it's still going to have the 10% profit. Because nothing actually changed in the business. And so 10% into 30% is going to look like a 30% EBITDA margin. Now nothing changed. It's still exactly the same business. It's purely a legal/financial change. Now you can look at some different business models. Like one thing that we're doing in our company is, we're a direct-to-consumer, which has never been done in homeowners insurance before.

And so there's no external agent. So now you have another profit tool you can go after because the agents usually get paid 15% of the $100. So at Allstate let's take this new version of Allstate I just created. So Allstate management company or Allstate operations, it's going to collect 30% as revenue. It's going to pay out 15% of that to the agent. It's going to spend 5% on other operations and it's going to be left with 10% of profits. Now if you go and you look at those agents, of the 15% they're collecting, they're usually about 30% margin businesses too.

Or maybe even higher, like they're very good businesses. Like if you look at Brown & Brown, would be a good example of a publicly traded insurance distribution business and their margins are in like the high 30s. So if you include, if you have a way to sort of not pay the agents, you can maybe capture like another five to seven points of margin there. But if your business model is just that you're going to do the same thing that all the legacy stock insurance companies are doing, there's not actually any reason to believe that the economics are going to be different.

Now they're sort of split up in this different way. And there is benefit to this financial engineering. I really think there is, there are a bunch of reasons we can talk about, but it doesn't actually change the underlying margin structure of the industry. So you see this happening actually. Like there are some stock carriers that are converting or trying to convert in the reciprocals. The most notable is a company called Kemper, which is like a mid-sized carrier, they mostly do auto insurance. Right now, it's a stock carrier. And they basically said that we're going to switch.

We're going to switch everything to be a reciprocal exchange. Now it's going to take them some years to do it, et cetera. But people are looking at like the Wall Street research analysts who cover them, and they're like, this is maybe a slight positive because we do get to sort of leave the attractive part with the shareholders.

And put the less attractive part with the policyholders and the regulator, but it's not going to make Kemper a better business. So there's maybe some beneficial transfer value or like risk segregation, but it's not going to change Kemper's underlying margin structure.

Tegus Client

So I guess to kind of go back a bit, it seems like the play from an investment standpoint, like you've mentioned, is to try to get out of the notes even if you were to get out at a discount and then you're still retaining the AIF. So to that end, how do credit agencies generally view and write these notes? And is there a market for this from other investors?

CEO and Co-Founder at Kin Insurance

There's not a big one. They're not super attractive. So there are guys who will invest in surplus notes. And this is not an area where I know a lot, but I believe that other mutual companies because the reciprocal is kind of mutual, they actually get beneficial statutory credit for investing in the notes, in surplus notes of other mutuals. Now those guys don't have a lot of money right now, but that is a thing. So there are, like you can go on to like Capital IQ and get a list of all the surplus notes that are out there and who owns them and who bought them.

There aren't a lot of them. It's like much, much smaller than any other sort of debt instrument. Just because there aren't that many of them. It's an instrument that's only used, well, it's used by three types of companies. It is used by reciprocals and mutuals because it's the only way for them to get capital. It's also used as actually a subordinated debt instrument for regular stock insurance companies. So there are all three kinds of surplus note issuers, but there's not, they don't trade very often.

So PURE is a good example actually because after about, I think it was probably about 10 years of operations at PURE, they actually did start issuing. And the way they did it was, they started issuing senior surplus notes to new investors. And so they found an outside investor, I don't remember who it was. There are a couple of funds that will buy these. There's one called Hudson Structured Capital Management. There's another one called Gallatin Point. So there are a few investors who will do it.

But anyway, to go back to PURE, like 10 years later, they were able to get out of part of the surplus note business. But they kept the junior position. So they were actually still on risk. Stone Point and KKR were still on risk because they held the junior position on the surplus notes. So if you can get the reciprocal exchange to break even and like be able to demonstrate that over a period of time, you'll be able to sell the notes at some price or sort of refinance your way down or just keep raising the incremental capital.

Because that's the other thing, is like insurance companies, even if they're generating an underwriting profit or an underwriting breakeven, I remember like if you're taking all the economics out into the AIF, it's unlikely that the reciprocal itself is going to generate an underwriting profit. So the best case scenario is to probably break even. Even if you're breaking even, if you're growing, you're going to need to put more capital into it.

So that was sort of the situation PURE was in. It was like the company is performing well. It's breaking even on underwriting, which is what you would expect because that's not a reciprocal designed, but it was growing, so they needed incremental capital. And at a certain point, they were able to sort of get third-party capital versus sponsored capital.

Tegus Client
You mentioned a couple of investors that you've said have invested in these notes, is there any inherent benefit to those investors owning those notes, you'd say? Whether that's relationship with regulators or just generally knowing how to navigate that environment a little bit better.

CEO and Co-Founder at Kin Insurance
Well, no, I think they're just willing to look at the instrument. Like this is such a weird part of the economy, like no one really understands it. So like the guy at Gallatin Point at his prior firm, he did business with PURE, and he was like, look, I can get a 10% return on these things. And it's only a 5% risk because it's, so far, the money and the sponsor has a junior position in the surplus notes, that's a good trade.

And it's a better trade for me because I'm willing to understand it, than it is for, there are a lot of people who won't do that trade. So it's not as efficient a market as maybe another fixed income investment. So I think that's usually how it is. Like these things are harder to understand. They do have this sort of weird to quantify risk of like maybe the regulator won't pay you back, won't let you get paid back. So the guys who do it sort of expect to get paid extra for it.

Tegus Client
And then I guess just going back a little bit about just talking about how it's going to be tough to get some of this capital up and the notes from regulators. So you also mentioned in the very beginning that there's some capacity issues with where we're at in the market. So is that do regulators not look at that and have been more reluctant to sort of work, especially, I guess it depends on market by market. But if we were to look specifically at Florida, how would you say that environment has looked recently?

CEO and Co-Founder at Kin Insurance
I mean, the Florida market is sucking wind, even worse than insurance in general, like Florida homeowners insurance companies lost $1 billion in aggregate in the last three years, and that does not count the extra billions that were lost by the reinsurers. So it's not been great. So the Florida regulator is very, very keen to have new companies come in because they have an insurance availability and affordability problem there. They also passed, not the regulator, but the legislature finally passed some significant improvements.

Legal improvements that should help the insurance companies. But it's going to take a while to play out. Like it's probably going to take a few years before anybody really believes that those reforms work because it's like their fourth crack at solving that issue through legislative action. And the prior three, now anyone would have told you, look, these three, they're not going far enough. They're not going to work, and they didn't. So the industry kept like getting hammered by this, which I'll just put a pin in it for right now, and we can talk about it in more detail later.

But the industry has been getting hammered. Now this time, people who look at it, like legal experts, say it probably is a big enough change that it will have a really beneficial impact. But it's still too early to tell. So anyway, there's been some really helpful legal reforms in Florida. The regulator really, really wants new capital to come in. In some states like Louisiana, the state is actually giving away capital to people who want to form insurance companies. Not a lot, but they have been giving away some money.

Tegus Client
When you say like the Florida regulator is keen, obviously, there's a big market world like you mentioned. So if they're keen for new companies to come in and they're keen for additional investments in the space, I mean how do you marry those, how are they going to marry that with not having investors get paid out interest. They can't provide any assurances but like they really want capital from investors and you have to be able to let investors get their interest out of the notes.

CEO and Co-Founder at Kin Insurance
Well, I think, yes, that is the dilemma for them. But I think what they would say is, look, if the reciprocal is

solvent and well-capitalized, yes, well, you get your money out. We're not going to be vexed about it. But those are two big guests. And their view of what's solvent and well-capitalized might not be what you're viewing. So you might end up in sort of a thing where you're like, look, the companies that have 300 RBC ratio, that's above the statutory requirements. It's efficient for us to get the credit rating for the reciprocal itself.

Let us take the RBC down from 325 to 300. Let us take out this $10 million. Let us make this interest payment. And the regulator would look at it and say, well, you've only been at 325 for like four quarters. Why don't you come back to us when you have, well, let's say, 10 quarters? If you're still at a 325, we could talk about it then. No promises, but we'll talk about it then. Now that hasn't been the situation. Like they're not going to promise you that you can get cash out. I think they'll tell you like, look, if it's solvent, yes, we're not going to unnecessarily stop it.

But it's got to be solvent. And by the way, all the insurance companies, like we had five companies go out of business in Florida last year, like, are you sure you're going to be solvent? Like here, go talk to the solvency guys, like, what's the plan there. So you do have like some real inherent contradictions because even within the regulator, there are multiple divisions. So within the Florida Department of Insurance, there is one group who is responsible for rates and forms.

And they're going to be looking at your rates every time you change your rates and say, well, I don't know, I think you're raising rates too much. This is customer unfriendly. We questioned these three actuarial assumptions that you made, and we really think you wanted to raise them 20%. We think you should only raise it 11%. Go back to the drawing board and come up with something else. The solvency group at the same time is going to say, woah, you guys had an underwriting loss last year. What the heck? What are you doing about this?

You've got to pump on the brakes. You've got to tighten the underwriting, you've got to raise prices. And you'll say, oh, well, we do have a rate filing in front of the rates importance group. It's been there for six months, and we wanted 20%, that's what we thought we needed, and they said we could only have 11%.

And the solvency guys are going to look at you and be like, oh, that's a drag. Are you going to put any more capital into the carrier because we think you should. That's practically how it ends up going. So yes, there are inherent contradictions. I think it's something to navigate.

Tegus Client

And just I guess continuing on the regulators, I know we focused on the notes, but do they have any purview over anything related to the AIF or particularly an agent?

CEO and Co-Founder at Kin Insurance

Yes, not really. So from a legal perspective, when you create the reciprocal, you have to get the attorney-in-fact agreement approved by the regulator. And if you want to change that attorney, you also have to get the surplus notes approved by the regulator. If you want to change any of those things or if you want to change or add any other, they would call it interparty agreements. And they do see it that way, even though you don't technically own the reciprocal. They're going to need to approve any changes to those.

Now they're not going to go and say proactively, hey, guys, I know we approved your attorney-in-fact fee five years ago, but now we're looking back at it, we think it was too high. We think it should be lower. They've never done that before. And actually, if you look at these attorney-in-fact agreements, basically, everybody copied the PURE agreement, that PURE used like 15 years ago. Everybody has basically a slightly modified version of that. The reason why is because they know the regulator will approve it. So we have two reciprocals.

One is domiciled in Florida. Florida is, they have more reciprocals than any other state. They're reasonably friendly to them. There are some states that are very unfriendly to them like California. Now paradoxically, California has the largest reciprocal, which is Farmers. But they hate them. There's no way you would start a new California domicile reciprocal. They just won't let you. They'll say, yes, we have Farmers. We get it. But they've been around for 120 years. There's nothing we can do about it. We're not keen on new reciprocals.

Now our second reciprocal is domiciled in Arizona. They're a little bit less familiar with it. Arizona is a very business-friendly regulator. So they've been sort of willing to kind of look at the way Florida has done things and copy it to a certain extent, which is fine. But now you could have an Arizona-domiciled or Florida-domiciled reciprocal and still get a license, a certificate of authority to operate in California. They won't stop you from that. They might put extra friction in, but California is kind of the king of friction to begin with.

But yes, new reciprocal, the different regulators think about them in a different way. But most of that friction is on formation. And it's not that much on sort of the day-to-day operations and the expansion. Although there are exceptions to that. Like I'll tell you right now, we have this bad back and forth with Michigan on our Arizona-domiciled reciprocal. And it's like, we actually want to change the name of that reciprocal and they're giving us all kinds of friction about other stuff, our financials, whatever.

Even though we already precleared it with them when we set that reciprocal up in the first place a year ago, and it's largely just because they don't really understand reciprocals. So they're asking a lot of fundamental questions around like how does the surplus contribution work? And like, well, how does debt flow through the income statement? It's like, these are dumb questions. You're not our home state regulator, shut up. But they can add friction that way.

The area where the regulator is going to be and there's a rating agency to consider too. And that's something we haven't talked a lot about. But are you interested in specific lines of business? It sounds like there's a specific opportunity because it's, the way the rating agencies work is a little different depending on the line of business.

Tegus Client
I would say, probably focus on P&C.

CEO and Co-Founder at Kin Insurance
Yes, within P&C. And reciprocal is not a thing outside of P&C.

Tegus Client
What do you mean specifically by that?

CEO and Co-Founder at Kin Insurance
Well, like auto versus home versus commercial versus pet.

Tegus Client
Yes. I think probably focus on home.

CEO and Co-Founder at Kin Insurance
So home, you have a very specific rating agency issue, so nobody cares about the credit stability of their insurance company, that's what the mortgage companies do. And so Fannie and Freddie, basically, almost every mortgage ends up with Fannie and Freddie. They basically define the market standard. And so there are like five rating agencies that they see as being acceptable. There's AM Best, which is sort of the grandfather of insurance. Financial Stability Ratings.

There's S&P, which no one really uses for insurance ratings. There's Demotech, which is the most popular for small homeowners insurance companies. And then there's a new one, there's Kroll, which just got accepted by Freddie like two months ago. And they'll look at it and say, look, you guys, this isn't adequately capitalized. The plan you put out at the beginning made sense to us.

But now we're two years in. The capital has declined by 10%. Your underwriting losses didn't look good that year. We're kind of having a funny feeling about the market. You guys should put more capital in if you want to maintain the rating. And so one thing that you're seeing is sometimes, a lot of the times, actually, Florida homeowners is a good example, it's not that they become technically insolvent, it's that they get the rating pulled, and then they're effectively insolvent because their contracts with Fannie and Freddie are no longer good.

Furthermore, a lot of the reinsurance contracts have an out on that. They'll say, look, the contract is void, you no longer have reinsurance if you lose your rating. So that also so you have a cascading effect where the rating agency downgrades you from an A to an S and now you can't sell any more policies. You can't renew any more policies and you no longer have reinsurance.

Well, you're going to be putting the receivership right then. And that's ultimately it because if they put the reciprocal into receivership, you just killed the golden goose, like they're not going to pay anyone's bills. They're not going to pay the reinsurance bills, they're not going to pay your AIF bills, they're not going to pay anything unless it's paying a claim to a policy holder.

Tegus Client

Got it. So yes, that's very interesting color. So I mean, the mortgage agency could, like you said, just stop or if the rating agencies give a downgrade to the reciprocals.

CEO and Co-Founder at Kin Insurance

Yes. It more basically, when you get downgraded. And so Florida put a backstop in because there was actually sort of a feud last year where Demotech, which is the sort of small rating agency, it rates a lot of homeowners carriers, particularly in Florida. They sort of threw a fit last year, and they said, we're sick of the environment being so bad in Florida. We've said it needs to be addressed over and over again. We're going to downgrade 1/3 of the companies in Florida. And Florida then was like, what are we going to do?

We can't afford this. I'm going to run for presidency and I can't do this." So Florida actually put a backstop in and they said it took advantage of a little loophole in the way the regulation is written with Fannie and Freddie, that says that you don't need the rating basically if you have another insurance company that's willing to backstop it in its entirety, all your losses. And so what Florida said is for any company that we choose to, that loses its rating, will temporarily put Florida as the counterparty.

Like we'll write a reinsurance agreement between Florida and Florida has a reinsurance entity. They have a couple of different insurance entities, and we will backstop that risk. So last summer, this company called UPC, which was public, is still publicly traded actually, the ticker is UIHC. They lost their credit rating from Demotech and Florida stepped in, and they said, all mortgage servicers, you don't need to non-renew these policies and do force-placed insurance for those customers.

We can't have one million Florida guys do without insurance. So we'll backstop through this agreement. And they passed the law really quickly to do that. Now ultimately, UPC had a really, really bad outcome, so they sort of got a stay of execution a little bit. But ultimately, they had a really bad result in Hurricane Ian and they were put in the receivership last fall. So they sort of restructured the company. They took most of the business, and it's now with the state receiver.

They took part of it and they sort of folded kind of for free to another start-up insurance company and they've kept part of the business. Basically, the part that ensures commercial condo building, they kept that. That's still within the public company. So they have different insurance entities. So the reciprocal exchange, not older. But the other way that small homeowners companies do the reciprocal exchange concept ends up being somewhat similar, is they have a regulated entity the statutory entity.

It's an insurance company. And then they just have another business, an MGA basically. That's the management company. And so in some sense, they keep the management company out of the purview of the regulator, which is why they do it. Now last year, Florida specifically passed the law saying that those management companies will no longer be outside the purview of the regulator. Because people got sick of it. Basically, you had all these really lightly capitalized insurers and a management company that was making a lot of money.

And the insurer was just barely solvent and the management company, they trickle a couple of bucks into the carrier just to keep it solvent, but just barely just. And meanwhile, are like buying yachts. So the regulator doesn't like that. The press doesn't like it. That game is over. TBD, how that affects reciprocal exchanges. Because reciprocal exchanges are even in Florida, where there are a handful of them. They're not something people think about very often. So we'll see actually. I don't know how the regulator is going to start to handle the AIFs.

I understand it's not an insurance company, but we're going to look at your financials anyway. That's sort of TBD. Now if you're doing things the right way, that doesn't probably matter that much. But it actually could be helpful. Because to the extent that the AIF has financial resources that can be used to make sure that the reciprocal stays in business, it doesn't create a solvency problem, that's actually sort of a positive for the state.

And Florida is a very commercially-oriented state. So they're one of the best, I would say, at least commercially-oriented regulators out there. And they're reasonably sophisticated. They're very understaffed. They've had a lot of turnover. They don't have enough budget. That's probably like a lot of other regulators. So anyway, that was a lot of information, but I forget even what question you were asking.

Tegus Client

So I think previously, you had said that regulators in the past have really been or got involved with the AIF or the economics from the AIF. It sounds like that's a potential risk that could.

CEO and Co-Founder at Kin Insurance

Yes, I think it's a little bit of a risk, but also like the thing is, the regulator doesn't want to do things. If everything is solvent and everything is working, they're largely going to be along. Now you'll still need to have a good regulatory team. You're still going to need to have a meeting with them every quarter. You're still going to need to like go through the process of getting your rates and forms approved.

You'll need to provide actuarial justification when you change your rates. You'll need to do all that stuff, you need to have a good regulatory team for it, both on the finance and legal side. But like they're not going to mess with you unless they need to is probably the way I would put it.

Tegus Client

I mean obviously, they're going to see, like you said, potentially in exchange that's fairly solvent and compare that to AIF, which is at the 30%, 40% EBITDA margins or whatever it is. So obviously, like probably not.

CEO and Co-Founder at Kin Insurance

Yes. But you don't know if it's going to lose money at the onset too. So that actually might be the bigger concern. They're going to look at this other business where the operations and these guys have been burned by a lot of insolvencies. Now I don't know that it's stopping them from a whole lot.

Like I think they're approving new companies literally right now because they're like, well I don't know this for a fact, but I imagine what they're saying is, they're like, well, this may not be like the most stable thing, but it's better than nothing. Like we'd rather have another carrier in the market. Even if we're a little bit worried about their plan and their finances, et cetera.

Tegus Client

So why do you say the AIF will lose money in the beginning? They would just need to scale first to cover that up, just the start-up cost. But it's not much there though, is it?

CEO and Co-Founder at Kin Insurance

It depends on what you're doing, I mean even at the basic, like if you're not developing your own software, if you don't have any sort of like actual differentiation, you'd probably still need a team of like 15 or 20 to run the thing. You're going to need a finance team. You're going to need a CFO or you'll need a controller. Maybe you can get away without the CFO if you have a really good controller that the department is familiar with.

You're going to need probably two or three people in addition to that on that team. You're going to need an actuary, okay, well, you can pay a Milliman or another, Merlinos, somebody to do the actuary work for you.

But that costs money. Those guys aren't cheap. They bill high rates. You're going to need claims adjusters, now you can outsource that, but again, that costs money, too. So I guess operating an insurance company isn't something that's that easy to do at a very, very small scale.

Now 20 people if you say 20 people, $200,000 per person, $4 million of expenses, that's probably the bare, bare minimum. So you can do that and say, okay, in the first year, we're going to generate $20 million of premiums. Our management fee is going to be 32%. We're going to get $7 million of revenue. We think we can keep our costs below that. Maybe you can, if you're really, really lean. But now keep in mind, like you're going to be a bare, bare basics insurance company.

Like you're not going to have any competitive differentiation. So you're going to look just like, call it, the worst or smallest or newest carrier in the market. Those guys aren't making money right now. If you want to have a really great pricing algorithm, you want to have really great data science, you want to have really great software, well, you're going to need to hire people to do that. It's probably going to take time to figure it out.

Tegus Client

I know you've touched on a couple of points, but can you just talk through what separates the great, profitable reciprocal exchanges from ones that are less profitable? And yes, I know you've touched a couple of times on being differentiated. What exactly that means within the reciprocal insurance landscape?

CEO and Co-Founder at Kin Insurance

Well, the way a reciprocal insurance company competes isn't any different than the way any other insurance company competes. So if you're good at administering claims, you're able to do it cheaply, if you're good at acquisition and servicing, this is a huge part of it. Now that might be through getting customers on your own. It might be through some sort of partnership angle. It might be just you have good relationships with the local agents, whatever. That's a big part of it.

Because like if you look at the insurance cost structure, the largest cost aside from paying claims is that customer acquisition. So if you're GEICO, well, yes, you're fricking great at customer acquisition. Like why is GEICO winning? They're winning because their cost structure is meaningfully lower than Allstate's and State Farm's. It has been for a long time. It's because they're really good at advertising because they don't have retail branches.

So they have a real significant competitive advantage because their cost structure is lower because they distribute differently. And that's enough. They built an amazing business. But you've got to be good at one or more of those things. And if you're bad at one of them, like there's an insurtech company or whatever, they went public, called Hippo. They've gotten destroyed. They destroyed like probably almost $2 billion of capital now. And they weren't really good at pricing, they just sort of copied what Travelers was doing on the pricing.

And they discounted it. They weren't really good at distribution because they basically appointed the same agents that Travelers had and they paid them more and had less selective underwriting. They were good at growing, but they'd been growing with negative margin. So like are they good at doing claims?

I don't know, probably not as good as Travelers. It's been doing it for 100 years. So yes, it's really, you need to have an angle and at least one part of the value chain. I would say the value chain is basically, it's like acquisition/advertising/distribution. It's servicing, although that's a relatively small part of the cost structure. And then it's claims administration. Those are sort of the biggies.

Tegus Client

I do want to talk a little bit about the reinsurance market. Can you just talk through generally how you approach reinsurance, what the typical and ideal, if that's a thing, reinsurance structures for exchanges are, whether it's quota sharing or XOL? And then also touch on how reinsurance reinstatement generally works and what the typical terms are there?

CEO and Co-Founder at Kin Insurance

Yes. So the best reinsurance structure is one where you don't have to give up very much margin, but you can transfer a lot of the risk. Now that's not a good structure for the reinsurer. So you're at odds there. And I would say the way that buying reinsurance works for a start-up reciprocal exchange isn't really any different than the way it works for a start-up's minimally capitalized any other kind of insurance company. Now quota share, you're basically splitting all of the risks proportionately.

So they're also called quota share proportional reinsurance. Typically, you'll have to give them like, call it, a 10% margin underwriting margin on that, and you'll have to pay the broker. They have to pay the broker, the reinsurance broker, another 10%. And they have their own cost structure, which might be another 15% or 20%. So having a quota share can be nice because it reduces the amount of capital you need.

But it's not great because you're giving up, call it, 40 points of margin almost. And so usually, quota shares end up being net income negative, like it's rare that you'll recover enough from the losses that it overcomes the expense. And the reason is just because the expense includes the losses but also includes their profit margin, broker fee, it includes their expenses and those add up. Furthermore, quota share.

Tegus Client

From an AIF perspective though, would that sort of make up the difference or be more attractive from that perspective because the quota share.

CEO and Co-Founder at Kin Insurance

No.

Tegus Client

But doesn't the quota sharing mean you can underwrite additional business, though?

CEO and Co-Founder at Kin Insurance

It can, yes. I mean it can. Basically, let's say you had a 50-50 quota share, all else equal, you're going to be able to underwrite twice as much in the reciprocal. And there are some other benefits like the way quota shares are accounted for is kind of stupid and this is beyond the scope of this conversation. But there's actually a statutory accounting benefit to having a quota share, which I don't have time to explain right now, that's only true if you're growing.

But if you're growing, you might want to have a quota share, even if it's not being used to transfer risk, you might actually just set up another entity to participate in the quota share because of the beneficial statutory accounting of the way the ceding commission works. So yes, all else equal, having quota share would be great. However, all else isn't equal, because you're going to have to pay them a pretty significant margin. And then second, most quota share deals, like it's great, it's amazing if you can find one without this.

But most quota share deals actually have significant risk sharing in them. So let's say, yes, like you say that this is going to have a 40% loss ratio in this business. And your fee that you want us to pay you, the ceding commission, is 30%. That leaves 30% margin left for us. We're happy with that. That's okay. That's enough for us. However, we really want to be sure about this loss ratio thing. So if that ends up being 50%, we're actually going to pay you less. If loss ratio is 10 points higher, we're going to pay you less by 10 points.

And they'll share on the upside, too. But the point I'm making here is, most quota shares are structured quota shares where the margin is guaranteed for the reinsurer. And so you're not truly transferring risk. Now that's not to say that there aren't any quota share deals where you are truly transferring the risk. There just aren't many of them. There are a few and far between, especially for a startup company where there's no loss history. These reinsurers are like, they don't believe something until they've seen it for like five years, at least.

So even if you had a really good first year, it's going to be really hard to convince them that you're going to have the deck in the second year. And they'll give you the capacity because they're locking in their margin. And it is useful leverage, but that's what it is. The quota share is leveraged, it's financial engineering. It's not usually true risk transfer.

Now you have to jump through some hoops, like technically, it has to transfer risk, could be counted as reinsurance by the regulator to give you that leverage ratio. But these things are basically structured to transfer the bare minimum of risk and still pass the risk transfer guidelines. So that's quota shares. It's leverage, it's not really risk transfer, usually. Although, there are.

Tegus Client

Would you not enter into a quota share agreement until you get approval from regulators that you were going to get capital credit?

CEO and Co-Founder at Kin Insurance

No, it's more mechanical than that. Like you will get capital credit for it if you structure it the right way. And you can get a layer, a regulatory consultant or presumably whoever is doing regulatory and finance at this company, knows how to structure it appropriately. The reinsurance brokers also know how to structure it appropriately. Like it's not a secret, it's not arbitrary.

Tegus Client

Got it. And then you said generally, it's pretty market standard to share in the upside as well. So you talked about if the loss ratio ended up being worse than expected, but if it's the other way, you.

CEO and Co-Founder at Kin Insurance

Typically, yes. Like a reinsurer might be like really greedy and say, wow, it's really a hard market right now. I have a lot of options. Everybody needs my capacity. Maybe I'll make this one-sided, but I think they'd have a hard time, like you'd probably find someone else who is willing to do it two-sided.

Tegus Client

And then do you mind just touching through, I think that's super helpful, to provide some additional color on quota sharing?

CEO and Co-Founder at Kin Insurance

Yes. So if you're doing CAT like you have to have it, the rating agency is going to be the biggest constraint there. They're actually going to say and the different rating agencies have different requirements. So they might say, like, we want you to have a retention, and I'll explain what that is in a second. We want your retention when there's a big hurricane or whatever. We want your retention to be no more than 1/4 of your capital. And we want the limit of that reinsurance to be at least enough to cover a statistical event of one-in-130-years.

And then we want you to have a second enough because you could have multiple hurricanes. You'd have a second event cover where the retention is also no more than 1/4 of your surplus and where it's statistically enough to cover a one-in-50-year storm. That's pretty common. Like that's sort of roughly what Demotech's requirements are. So if you have a carrier that has a $50 million balance sheet, you can't have a retention that's any more than $12.5 million.

Now when your portfolio is really small, in your first year or whatever, even if you get hit by a really, really big storm, maybe that will mean your loss ratio that year is 200% or 300%. 300% on $10 million of business, say, a medium-sized working loss ratio that year was 150%. If you're only writing $10 million of business, it would take a really bad storm. You might have $15 million of losses. Well, if you have a $10 million retention, that would take a pretty big storm to get there. So that wasn't the most clear way of saying it.

But the retention is kind of like your deductible at the insurance company. On your own home policy, you might have $1,000 deductible. The retention is just the deductible. So like last year at Kin, for example, we had a $5 million retention on our XOL program for the first event and $7.5 million for the second event. So that means for our portfolio last year, anything above like a one-in-three-year, one-in-four-year event, is going to start eating into the reinsurance. We're going to start seeing losses at that point. Now we got hit by a big hurricane last year.

We got hit by Hurricane Ian. For our portfolio, it was a $170 million event, which is still pretty small actually because we had bought last year about $1 billion of limit. So it's well below the limit. And Hurricane Ian was like a one-in-15 or one-in-20-year storm for the industry. So it wasn't like the one-in-100 that you hear about. Now there's never been a one-in-100 since I've been alive, anyway. So that's XOL. You have to buy it. It's really expensive. So in a normal market, the price of the XOL across the tower like that might be like 20% of the limit. No, that's high.

Maybe 15% of the limit, and it's broken up into layers. So lower layers, the ones that are like more in the money, like a layer that's going to start taking losses in a one-in-10-year event is going to cost a lot more than a layer that's going to start taking losses in a one-in-a-100-year event. The layer of the one-in-100 is going to cost probably 5% to 7% rate online in a normal market. So if you're buying $20 million of limit where it's covering from $100 million losses to $120 million losses, that might cost you 10% times $20 million.

So $2 million. At the lower layer, say you're buying $20 million of limit that kicks in at a five-year event, it's going to cost you 70%, maybe, rate online. So yes, basically, you'll break the tower into these different pieces. And Florida, if you're talking about Florida, Florida actually as the state reinsurer helped the Florida Hurricane Catastrophe Fund. And it takes a big slug of capacity at a very reasonable cost, at call it like 8% rate online kind of in the middle of the tower. So sort of for those like one-in-20-year event to one-in-50-year event.

But below that and above it, and actually, it only takes 90% of that slug, so you're going to be at 10% share sort of down the side of the FHCF. That's all private reinsurance, and it's quite a bit more expensive. And the parts above it will be a little bit less expensive. The parts below it are going to be a heck lot more expensive. Which is bad, it's really bad.

This year, till last year, Florida property reinsurance rates went up probably 30%. This year, they're probably going to go up at least that much again. People are still placing their reinsurance, but it's gotten quite a bit more expensive. And it's a huge financial drag on all of those carriers just because it takes them a while to catch up. We talked about this before. Even if they signed the new reinsurance contract on June one, they can go to the regulator on June two and say, hey, you need to pass this right through.

They probably don't actually get approval for that till like September almost. And that's a fast, smooth time frame. Now you're going to take from September to the next September to reprice all your policies because you can only reprice them when they renew. And then for each of the policies, you're going to have another 12 months lag for the new premium to earn into the statutory financial statements. So the rates go up like that, and they're going up a lot right now.

A lot of capacity has come out of the market, particularly at those lower layers because what the reinsurers are saying is, they're looking at their book like two years ago, and they're saying this is great, and it should be great because we've lost money like five years in a row, but this year, this is great because I can charge the same rate and buy risk that's way, way, way further out of the money than I used to.

So my profits are much more assured, my revenue is going to be maybe flat or even go up a little bit, but I'm going to be taking a ton less risk in exchange for that. And they are pumped about that. So they're all gravitating to the higher layers, the more out of the money, parts of the towers and away from the lower layers.

Tegus Client

Between the regulatory risk of having the right local regulators work and ability to get new business and ability to get the surplus notes out. I think it was super helpful. But fundamentally, not crazy, but also, I understand to the opening remarks that like, it seems too good to be true because just the risks are much higher. The returns might be there, but the risks are much higher.

CEO and Co-Founder at Kin Insurance

I think you summed it up well. Like if all else equal, right now, it's a good time to start an insurance company, like mostly you want to start an insurance company or grow an insurance company when there is scarce capacity where you're in a hard market. So that's good. If you can do it. Now of course, it's hard right now because there's not that much capital, whatever, maybe you guys have capital. So timing is good right now.

It's sort of like calling the bottom of the market a little bit. You might be off by a year. Like maybe next year is the bottom, not this year, but I can't predict that. But we're near the bottom, I think. So timing is good. And then aside from that, like if you have a business that you think is going to be able to operate at a competitive advantage for one reason or another, you'll do well, whether it's a reciprocal or not. However, all else equal, the reciprocal is a really good model. Because like, look, there's nothing in insurance where you're completely away from the risk.

Like even if you're an insurance agent, like the guy in your neighborhood or the branch or the store, if his loss ratio on his book is high, he's still going to have problems. The carriers are going to non-renew his customers. He might lose his contracts with certain carriers. He might have commissioned docs, like nobody is completely not exposed. But the reciprocal exchange is less directly exposed than the alternative.

So it gives you all the control of having, of owning an insurance company and somewhat insulates you from the risk, which all else equal, is beneficial. So I think it's a good model. But it's not like a free lunch. Like if you don't have another angle and then what's the angle was just market timing then the reciprocal is not going to give you a good business. It's just a helpful financial structure.

There's a company, one of the reinsurance brokers, it's like the fourth largest one. So it's not like Aon or A.J. Gallagher, but it's called Howden Tiger. They have some really good materials, like background materials on reciprocal exchanges, and they have a capital markets group that has been involved in many of the reciprocal formations.

Tegus Client

All right. Well, thank you very much, have a good rest of your day.
