Dog eat dog

MICHAEL CLAYDON SURVEYS THE COMPETITIVE LANDSCAPE FOR UK INSURANCE BROKERS IN THE LARGE CORPORATE ACCOUNT ARENA.

There is no shortage of insurance brokers in the UK. The British Insurance Brokers Association (BIBA) is the trade group representing over 2,000 FSA-regulated firms. Larger corporate clients tend to use larger firms. The three largest, Aon, Marsh and Willis, feature prominently in the FTSE 350, acting for around 85% of the FTSE 100 and 70% of the FTSE 250.

Each of the Big Three has invested heavily in building global networks to serve their multinational clients. None of them provides any meaningful data on the size or profitability of the large corporate client sector. Industry insiders estimate the aggregate remuneration of the Big Three to be in the £175–£200m range. By contrast, the four largest accounting firms earn audit fees of around £700m from their FTSE 350 clients, a sector in which they have even greater dominance; their total revenue from this sector is around £1.1bn.

There are, of course, large corporate clients that are not in the FTSE 350. And there is no common definition of a large corporate client. Each broker, and insurance company for that matter, defines large corporate clients differently. Typically, though, there is a sales threshold level (at least £250m but usually much higher) and a high degree of buyer sophistication.

The large corporate client segment is attractive to brokers for a number of reasons:

- It offers large fees with higher margins than on commercial business generally. I estimate margins across this area to be in the 20–25% range, although this will vary greatly between clients.
- It offers opportunities for cross-selling other services, such as captive management and actuarial services.
- It allows the broker to gain industry sector knowledge that can be shared around the firm. This is a controversial issue that was addressed in an article ("An Honest Bargain") in the June 2011 of The Treasurer, which offered guidance on how clients should negotiate remuneration with their broker.
- It allows leverage in negotiating market-derived revenue.
- A large corporate client confers prestige – bragging rights.

It would be easy to imagine that the three global brokers operate a cosy cartel to achieve high margins. If this was ever the case, it does not obtain today. They compete against each other with a tigerish ferocity for the prized large corporate segment. They also have to face competition from a number of well-regarded smaller brokers, notably Jardine Lloyd Thompson together with Lockton and Gallagher Heath. While these three firms may not possess a global footprint comparable to Aon, Marsh or Willis, they each have their own attributes that help determine client choice, such as sector-specific skills and quality staff.

All of the brokers operating in this segment are trying to gain market share. Since the sector is broadly static, it's a zero-sum game. There are also a number of impediments to expanding market share:

- While more regular competitive reviews have had some impact, a high degree of client loyalty remains. A former colleague describes this as "stickability". Client retention is the Holy Grail of insurance brokers – auditors to the FTSE 100 have a remarkable average tenure of 48 years.
- Brand identification and differentiation are difficult concepts to sell where service offerings are broadly similar. No one broker has an undisputable reputation of superior service delivery.
- There are often switching costs involved, which can make changing brokers and insurers an expensive proposition. There may also be resistance from subsidiaries to changing a valued local service provider.

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- There is little innovation in what is a mature market. Intellectual property is often given away in new business bids, and any new idea is swiftly imitated and often improved on.

The broker is left therefore with the familiar weapon of price to gain competitive advantage. Whenever a competitive tender is undertaken the only certain outcome is that the fee will be reduced. There is a strong body of evidence for this. One notable case involved the former incumbent regaining a large client lost two years earlier and then being paid half its former fee. Well-informed clients have realised that the merest hint of a review strikes fear into the heart of the incumbent and a fee reduction will be swiftly proffered (see the "Policies on Parade" article in the April 2011 issue of The Treasure for how to manage an insurance broker review). Insurance brokers simply do not possess the fee negotiating skills of lawyers, investment bankers and management consultants.

There are also threats to the current broker model. The internet has marginalised the broker in the personal lines market and is now making inroads into the SME market. It is not difficult to envisage this phenomenon being played out in the large corporate account arena, notwithstanding the bespoke nature of risk transfer programmes. While capital markets have started eating into the reinsurance business with the issuance of catastrophe bonds, there is as yet no meaningful penetration in the large account arena. Again, this may change.

It all seems pretty bleak, so what does the future hold for brokers? Both Aon and Marsh have expanded their service offerings through heavy investment in employee-benefit consulting businesses, branded Hewitt and Mercer respectively. No other broker has anything approaching the scale or depth of Aon and Marsh in this business. According to both their 10K filings, margins on this business are in the 10–12% range, well below the margins on their large corporate client business.

There is also a strong likelihood of a further round of consolidation. Two decades ago the list of top 10 brokers worldwide included Frank B Hall, Sedgwick, Alexander & Alexander, Johnson & Higgins, and Minet. All of these firms were progressively absorbed into Aon or Marsh. Aggregate global revenues of the top 10 brokers is around $35bn, with Aon, Marsh and Willis accounting for around 70% of that.

The aims of achieving economies of scale, increasing revenues and expanding margins will drive further consolidation. Aon, Marsh and Willis will undoubtedly be protagonists and will strengthen their position in the large account arena, both in the UK and globally.

Michael Claydon is founder and CEO of Michael Claydon Consulting.
michael@claydonconsulting.com
www.claydonconsulting.com

Farewell to amateurs

IS THE LAY TRUSTEE MODEL AN ANACHRONISM?, ASKS **KERRIN ROSENBERG**.

Imagine, if you will, that somebody suggested your company shouldn't be run by a CEO and professional management team. In their place a group of lay people with experience of other industries (but not yours) will meet quarterly and take all material decisions, aided by their common sense and a specialist adviser. Preposterous? Yet this is more or less how the UK's pensions industry works.

Over 30,000 trustees, drawn from all walks of life, meet on average five times a year to take almost every material decision in relation to the £1 trillion in final salary pension assets they oversee. The complexity of the trustees' role has grown exponentially over the last decade, at the same time as investment markets have caused deficits to balloon.

Trustees have responded with increased training and education, co-opting professional trustees onto their boards and trying to spread the workload by setting up subcommittees and simply spending more time on their trusteeship duties.

But to be successful going forward, pension funds need

- state-of-the-art risk management;
- access to a wide range of investment tools, including derivatives and alternative assets; and
- an ability to be agile and dynamic.

How can lay trustees, well intentioned and perhaps experts in their own, non-investment related fields, be expected to rise to this challenge?

Perhaps it's time for more trustees to seriously consider having their funds managed by a group of full-time investment professionals? For large schemes this could mean building an in-house team (which many have done). For smaller schemes it could mean delegating their investment powers to a fiduciary manager.

Under this model, trustees would act as non-executive directors, employing, mandating and monitoring their day-to-day management team. Far from an abrogation of responsibility, well-structured delegation allows trustees to be in better control of the outcomes. This is good corporate governance for publicly listed companies and it is good corporate governance for pension funds too.

Kerrin Rosenberg is CEO of Cardano UK.
www.cardano.com