Sigma

Commercial insurance and reinsurance brokerage – love thy middleman

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Summary

In the insurance market, policies are sold through brokers or direct channels controlled by insurance companies. In contrast to captive agents, brokers act on behalf of the insured, typically serving corporate clients with complex and large exposures. Direct distribution channels are more suitable for personal lines and small commercial risks. This sigma focuses on the large commercial risks and reinsurance brokerage market segment. Brokers help clients determine their exposures, structure their insurance programs, negotiate rates, terms and conditions, and place their risks with one or more insurance companies. In addition, they provide multiple services along the insurance value chain.

Corporations with large commercial and industrial risks rely on the expertise of insurance brokers to obtain adequately priced insurance coverage and provide risk management consulting services. In the past few years, terrorism, corporate scandals, rising medical costs and increased litigation in the area of asbestos, for example, have made it increasingly difficult for corporations to obtain coverage for their risks. There is a growing demand for brokers to find protection for their clients particularly for risks for which capacity is scarce.

The significance of the broker distribution channel varies widely by country. Commercial lines brokers have traditionally played an important role in the Anglo-Saxon markets, holding stable, long-term market shares. Brokers’ market shares are increasing from low levels in some countries in continental Europe. They occupy a strong position in Latin America and Southeast Asia, but are virtually non-existent in the key markets of Japan, South Korea, China and India.

In 2002, global commercial brokerage revenues were estimated at about USD 27 billion. The broker industry is highly concentrated, with Marsh and Aon accounting for 54% of revenues. As a subset of that market, the 2002 global revenues from reinsurance brokerage are estimated at USD 3 billion. This market segment is highly concentrated, with the top four companies accounting for 78% of the total market.

The growth of offshore insurance markets – particularly the Bermuda market – has increased the share of brokered business in commercial lines and reinsurance, and is responsible for the recent decline or brokered commercial business in US insurance market statistics. Brokers have played a very active role in setting up some of the new Bermuda players and serve as the sole distribution channel for offshore insurance carriers.

During the last two decades, the role of the broker has evolved from marketmatcher to service provider to clients and insurance companies. These services include claims management and risk management services that go beyond the structuring and placement of insurance cover. Brokers have also developed a strong position in the alternative risk transfer (ART) market (captive solutions, etc), while some of the larger players also provide corporations with employee-benefit solutions.
Brokers’ average after-tax return on revenue was around 9% over the last decade. The profitability of the brokerage business tends to follow the insurance cycle, however, it is more stable compared to insurance carriers. Increasingly, revenues are based on fees for services rather than solely on commissions, which vary with the brokered premium volume. A broker’s core service – finding insurance cover at a reasonable price – is in particularly high demand in a hard market. In soft markets, in contrast, brokers find themselves under pressure to branch out into alternative fields in order to sustain growth. This was the case during the last soft market when many started to sell additional consulting services.

Concentration in the insurance brokerage industry has increased tremendously over the last decade. Between 1996 and 1999, there was a wave of mergers and acquisitions (M&A) amongst the leading brokerage firms, resulting in Marsh and Aon accounting now for over half of the industry’s revenues. Both companies pursue a similar global business model, integrating retail and wholesale brokerage business. The other large players are either London-based international brokers or US-based brokers that mostly service their domestic markets including a globally operating client base.

Besides the current hard market, there are several long-term trends that are having a positive effect on brokers’ market opportunities: the growing complexity of global business, the emergence of new risk classes and the increased use of ART products. Consolidation will continue as companies build global organizations that can benefit from the high growth potential offered by these new markets.

This study examines the role and significance of brokers in the global non-life commercial insurance and reinsurance market. Section II looks at insurance brokers’ value proposition, including fee-based services, such as risk management consulting, captive management and risk analysis. Section III summarizes the trends that are evident in the key markets of the US, UK, and Bermuda. Consolidation in the global insurance brokerage industry is reviewed in Section IV, along with brokers’ profitability. Section V looks at long-term trends and the outlook for the brokerage industry. The Appendix examines the importance of the broker distribution channel, breaking it down by major geographic region.
The value proposition of broking in commercial insurance

What is the role of the commercial insurance broker?

The broker acts as an intermediary between corporations and insurers, representing the insurance buyer. Brokers differ from agents, which ultimately represent an insurance carrier and not the client. The reinsurance broker’s client is the insurance company (cedant), which the broker represents vis-à-vis reinsurers for the purpose of purchasing reinsurance cover. Reinsurance brokers can also be involved in a reinsurer’s retrocession of parts of its risk. Lloyd’s, for example, the world’s largest marketplace for retrocession, is entirely brokered. Brokers can become involved in the transfer of the same risk on several steps of the risk chain as large commercial risks are transferred and diversified in the global (re)insurance market.

Source: Swiss Re Economic Research & Consulting

What are the typical functions of an insurance broker that represents commercial insurance buyers?

- Brokers assess and analyze the insurance risks faced by a corporate client. This is a global task for many large corporations.
- Brokers provide market research and analysis. Clients often request independent advice on what is being provided by insurance carriers. Modeling services are important for those clients lacking the resources to do this themselves.
- Brokers structure, market and negotiate an insurance program. This includes, for example, aggregate policy limits, deductible/retention levels and coverage terms.
- Brokers match a client’s needs with one or several suitable insurance carriers, thereby increasing the options available to the insurance buyer and helping select appropriate products and providers. Clients also rely on brokers for advice on the financial strength of their carriers.
- Brokers handle the premium and loss payment cash flows between corporates and insurance carriers and, in the case of reinsurance brokerage, between insurers and reinsurers.
- Brokers provide actuarial, loss control and claims management services. This ties in with risk management services for corporations that optimize the balance between reducing exposure, purchasing insurance cover, and retaining the remainder of risk. These services provide important feedback for the risk assessment process, as described at the beginning of the broker’s value chain (Figure 2).

Source: Swiss Re Economic Research & Consulting

1 Market statistics frequently fail to distinguish between brokers and independent agents.
The value proposition of broking in commercial insurance

Survey results confirm the value brokers generate for their clients.

According to a survey conducted by Reactions, 73% of the clients surveyed considered their brokers to be very important or essential to the insurance markets (see Figure 3). Even in the case of the most standardized insurance products, it appears that customers frequently solicit the internet for information on the insurance products, but buy the product via brokers. Clients rely heavily on brokers for more complex products, where customized advice is critical. It is interesting to note that the respondents in the survey were large insurance buyers, sellers and service providers who are experienced market players. Small clients may demand even more expertise and advice from a broker.

The changing market environment has increased responsibilities and obligations, which in turn has resulted in a higher exposure to E&O claims. The traditional claims for failing to find coverage have been supplemented by claims for the failure to find adequate coverage, misrepresentation of risks, delays in processing, and for placing transactions with insurers who subsequently became insolvent. While inadequate coverage and misrepresentation account for 60% of all claims made on brokers, delays in processing coverage, description and identification errors, improper cancellation and policy change errors are other major types of claims being made on brokers.

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2 The Reactions survey was carried out with risk managers, reinsurance buyers, underwriters and consultants. See Reactions October 2002.
To protect themselves against such claims, brokers buy E&O insurance. Premium volume for brokers’ E&O insurance in the US is currently approximately USD 300 million. As a result of the increasing claims on brokers, premium rates for E&O coverage increased by more than 20% in 2003. In the same year, Bradstock, a Lloyd’s broker, filed for liquidation because it could not afford to renew its E&O policy.

Economic explanations for the role of the insurance broker

What is the role of intermediaries in a market? Intermediaries reduce search costs, uncertainty and asymmetric bargaining power.

1. Search costs: Brokers reduce the resources or the costs incurred by insurance buyers when searching for insurers and those incurred by insurers searching for insurance buyers. Repeated interaction with market participants provides brokers with information on the risk appetite of the various insurance carriers. This information and long-term broker relationships are useful when placing business, especially when capacities are tight.

2. Uncertainty: Buyers and sellers have asymmetric information on the product or service being sold, making it difficult for them to agree on the price and terms and conditions of a service transacted. The insurance buyer has more information about the risk in question and, in the interests of reducing the cost of insurance, has an incentive to represent it as being a low probability risk. In addition, once insurance has been purchased, the insured may be less careful about the insured risk, and the insurance carrier may be confronted by a moral hazard issue. On the other hand, the insurance buyer is normally less informed about prevailing market conditions and generally assumes a credit risk vis-à-vis the prospective insurer. An insurer might not have sufficient funds to pay for a valid claim, which is an important consideration, particularly for long-term liability risks. Brokers solicit and provide information on buyers and sellers and make this information more easily understood to both parties. As they rely on long-term relationships, brokers have a strong incentive to ensure that the market transactions are completed and that no party acts opportunistically after an agreement has been signed.

3. Asymmetric bargaining power: Small- and medium-sized buyers may have significantly less bargaining power in dealings with large sellers. By leveraging their business volume with individual insurance carriers, brokers are able to obtain better terms and conditions for their clients, thus dealing with the problem of asymmetric bargaining power between buyers and sellers.

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4 Rate increase reported in The Council of Insurance Agents and Brokers quarterly surveys (www.CIAB.org).
The value proposition of broking in commercial insurance

The evolving role as service provider

Commercial insurance and reinsurance brokerage business has evolved during the last two decades from its core function of matching pre-defined insurance coverage needs with insurance supply. This required primarily detailed market knowledge on the part of the broker. Over the last decade, brokers have begun to offer additionally new services and have changed the market's perception of their role. Some of the reasons for this change are the following:

- Excess capacity and falling insurance prices during the 1990s put pressure on the added value provided by brokers, making it easier for clients to negotiate rates and terms and conditions with insurers. Adding new services, such as risk management advice, was one way for brokers to increase the value of the services they offered.
- Consolidation among brokers has increased their size and resources, enabling them to leverage these resources and offer sophisticated services to clients. By offering more services, they have been able to gain an edge over their rivals.
- Revenues from fee-based products are not as sensitive to insurance premiums as are commissions on traditional brokerage services. This provides brokers with an incentive to offer new fee-based products, particularly when they find their traditional commissions coming under pressure.
- The improvements in technology and computing power witnessed in the 1990s have encouraged large insurers and reinsurers to make more use of sophisticated risk management technologies. Brokers have invested in these technologies and offered them to their clients in the form of services.

Commercial insurance brokers now employ sophisticated risk-modeling skills in combination with market knowledge to structure risk solutions for their clients before placing the risk with the appropriate carriers. Such an improvement in risk analysis methodology has meant that brokers have evolved from being providers of basic brokerage services into risk advisors offering a wide variety of fee-based risk management and consultation services. Table 1 provides an overview of the range of services provided by commercial and reinsurance brokers, while Figure 4 illustrates how brokers are involved in the insurers’ value chain.

### Table 1
Consulting and risk management services provided by brokers

<table>
<thead>
<tr>
<th>Commercial line broker services</th>
<th>Additional consulting services</th>
<th>Reinsurance broker services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims administration and advice</td>
<td>Asset management</td>
<td>Catastrophe exposure modeling</td>
</tr>
<tr>
<td>Loss control and engineering services</td>
<td>Employee-benefit consulting</td>
<td>Actuarial consulting</td>
</tr>
<tr>
<td>Captive management</td>
<td>Management consulting</td>
<td>Run-off services</td>
</tr>
<tr>
<td>Risk management services</td>
<td>HR outsourcing</td>
<td>Catastrophe management consulting</td>
</tr>
<tr>
<td>Merger and acquisition advice</td>
<td>Environmental risk</td>
<td>Risk securitization</td>
</tr>
<tr>
<td>Alternative risk management advice</td>
<td>Sabotage and terrorism</td>
<td>Web-based services</td>
</tr>
<tr>
<td>Information services</td>
<td>Political risk advice</td>
<td>Dynamic financial analysis (DFA)</td>
</tr>
<tr>
<td>Policy finalization and adminstration</td>
<td>Business continuity and planning</td>
<td></td>
</tr>
<tr>
<td>Actuarial services</td>
<td>Pre-emergency planning and evacuation services</td>
<td></td>
</tr>
</tbody>
</table>

Source: Swiss Re Economic Research & Consulting
According to a Business Insurance (17 February 2003) survey of risk management consulting firms, some brokerage houses are leaders in risk management, as measured by their number of risk management staff and unbundled revenues generated by risk management consulting. Marsh’s risk consulting service was the largest overall risk management firm by number of staff and by revenues. Interestingly, Marsh’s risk consulting revenues are more than double those of the next largest risk management consulting company mentioned in the survey, Deloitte & Touche. Tillinghast-Towers Perrin ranked fifth in terms of revenue and number of staff. In a separate Business Insurance (5 May 2003) ranking for 2002, Aon Capital Markets and MMC Enterprise Risk, (a subsidiary of Marsh) are listed as two of the top 10 specialists in risk securitization.

Risk managers are increasingly looking for enterprise risk-management tools that allow them to understand their risk profile, identify cost drivers and analyze enterprise-wide risk. Large brokers, along with insurance companies and independent software vendors, are active in the provision of such tools, referred to as risk management information systems (RMIS). In a Business Insurance (1 December 2003) ranking of RMIS products by number of installations, Marsh’s STARS was the leader, with Aon’s RMIS ranking fifth.

Another area in which commercial brokers have been especially active is captive management. According to the Business Insurance (10 March 2003) rankings of the world’s largest captive managers, Aon Insurance Managers was the leader, with 1,142 captives in 2002, followed by Marsh-Captive Management Service with 983 captives. Willis Management Ltd was ranked 4th with 227 captives and JLT Risk Solutions 7th with 71 captives.

Commercial brokers also play an important role in the claims administration of self-insurance programs. According to Business Insurance (2 February 2004), three of the five largest claims administrators for self-insurance programs were brokers’ affiliates. These claims management companies were Gallagher Basset Services Inc (rank 1, parent Arthur J. Gallagher), Sedgwick Claims Management Service Inc (rank 3, parent Marsh) and Cambridge Integrated Services Group Inc (rank 4, parent Aon).
The value proposition of broking in commercial insurance

The new range of services is reflected in a general change in perception of the role of the commercial broker. According to a Reactions survey, 30% of the risk managers, reinsurance buyers, underwriters, and risk consultants view brokers as being risk consultants and not just as placers/facilitators of transactions. However, the majority still considers placement of business to be the broker’s core business.

Figure 5
Market’s perception of the role of the broker, 2002

Source: Reactions
Commercial brokers’ main business models

There are three general business models in the commercial insurance broker industry — the global broker, the regional or niche player, and the wholesale broker. These generalizations provide an indication of how brokers are organized. Some brokers have adopted one model, while others have taken on characteristics of more than one model.

Some global brokers have organized their operations into three specialized units: retail, placement and service. The retail unit works with corporate clients directly, drawing up an insurance program after having analyzed the risks involved. It then proceeds to pass on the program to the in-house insurance placement unit, which places the risks with insurers. By concentrating their insurance placement services, large brokers gain leverage and bargaining power with insurers and are able to negotiate better terms and conditions for their clients. The service unit provides the client with services for the duration of the insurance program.

Regional commercial brokers design and structure risk programs for their clients, but often work with a global wholesale broker to place the risks in the global market. Besides regional brokers, there are brokers who specialize in a particular industry or in a particular type of risk transfer, such as the alternative risk transfer ART market. Since these small- and medium-sized brokers may not have their own in-house risk consulting group, they sometimes work with an independent risk management company to enable them to provide services on a par with those provided by large brokers.
The value proposition of broking in commercial insurance

Some clients prefer such brokers due to their specialized industry expertise, the specific services they offer, the relationships they already have with them or for the purpose of diversifying demand among several companies. About the same fraction of insurance buyers prefers the large global brokers. In a survey conducted by Reactions (October 2002), 36% of respondents stated that the smaller and more specialized regional brokers provided a better service. Another 21% considered that the services provided by large and small brokers were equally good or depended on the situation or type of risk in question, while 39% preferred the service of a large global broker.

Wholesale brokers without retail operations but with expertise in global risk placement work with regional – and sometimes – global brokers when placing risk in the global insurance market. Wholesale brokers often provide these brokers with advice and help in drawing up their risk analyses and insurance design programs. Some wholesale brokers may also have retail units in some parts of the world.

In addition to the above description of the function of the commercial insurance broker, some of the major players have branched out into providing non-brokerage services. Besides providing growth potential, such diversification is aimed at reducing their dependence on the underwriting cycle. Notably, the insurance broker operations of Marsh and Aon belong to conglomerates, which include large business units offering non-broking/brokerage services.
Marsh & McLennan Companies (MMC) consist of three main divisions: Marsh (insurance brokerage and services), Mercer (consulting) and Putnam (asset management). Mercer provides consulting and retirement services, health care and group benefits, management and organizational change, human capital and economic consulting services. Putnam is one of the largest asset managers in the US. Of the total USD 10.5 billion revenues reported by MMC in 2002, insurance (brokerage) services, consulting and investment management accounted for 56%, 23% and 21% respectively.

The Aon group also has three broad segments: insurance brokerage and risk management services, human capital consulting, and insurance underwriting. The Aon group carries out three types of insurance underwriting, namely supplemental life, accident and health, extended warranty and select property and casualty. In 2002, risk management and insurance (ie brokerage), insurance underwriting and employee consulting accounted for 59%, 29% and 12%, respectively, of Aon’s total USD 8.8 billion revenues.
Trends in the major commercial broker markets

The US and UK are traditionally the two most important commercial broker markets and where the largest brokers are domiciled. Over the last decade, Bermuda has made inroads into this dominance to become the world’s third largest marketplace for brokered commercial insurance and reinsurance business, with the US as its largest source of business. In the US, brokers have lost market share in the traditional commercial lines market since the mid-80s, although, when including the (mostly brokered) premium flow to offshore markets, their market share has remained fairly stable. Brokers continue to hold a very high share – close to 80% – of the UK domestic market, but have lost significant ground in personal lines. The London market comprises virtually only brokered business.

The brokers’ share of commercial insurance business varies widely by region and country. In the Anglo-Saxon countries, the brokers’ market share is very high, while it is low – but still significant – in continental Europe. Brokers’ services are employed heavily in the Latin American countries, while they are called upon rarely in the major Asian countries. The Appendix to this sigma provides more detailed information on the regional importance of brokers.

Western Europe and North America are also dominant sources of brokered reinsurance business. According to a survey by Global Reinsurance (December 2003), North America accounted for 39% of total brokered cession in 2002. Western Europe followed suit with 26%, with the London market representing Europe’s largest source of brokered reinsurance business, including the World’s largest market for retrocession. The following Figure 9 illustrates the regional split of brokered ceded business.

Source: Global Reinsurance
The US commercial insurance market

In the US, brokers (including independent agents) play a much more significant role in commercial lines than in personal lines. For several years, the share of broker writers remained stable at around 75%, before starting to decline in 1998 (see Figure 10). It reached its low point of 67% in 2001, only to increase to 69% in 2002. Since 1998, most major commercial lines have experienced a decline in broker share, which is primarily due to the strong growth of offshore insurance markets. Lines with a large share of small business clients, such as commercial multi-peril and medical malpractice, have registered the greatest decline (see Figure 11).

Figure 10
Market share of brokered business in US commercial and personal lines as a % of total NPW, 1986–2002

Sources: A.M. Best, Swiss Re Economic Research & Consulting

An analysis of the most important commercial lines of business reveals that the significance of the broker varies by business line. In 2002, brokered business accounted for a 75% market share of general liability, commercial auto, workers’ compensation and commercial multi peril business, but only 39% of medical malpractice net premiums. However, brokers carry more significance than these statistics suggest in those lines that make heavy use of alternative market carriers. A large portion of ART business is brokered, although it is not included in US market statistics.
Trends in the major commercial broker markets

Figure 11
Market share of brokered business by major line of commercial business as a % of NPW, 1998 and 2003

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>1998</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial auto</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical malpractice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General &amp; product liability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Workers’ comp</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Multi peril</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: A.M. Best, Swiss Re Economic Research & Consulting

The US broker reinsurance market

US reinsurers can be broken down into two groups: direct writers and broker reinsurers. The direct writers deal directly with the insurance companies that are seeking reinsurance cover. They include most of the large reinsurers. The broker reinsurers are generally smaller, but greater in number. Their share of the US reinsurance market (which excludes foreign reinsurers writing US business) has been between 55% and 61% since 1990, averaging around 58%. An analysis of the broker reinsurers’ market share between 1990 and 2002 shows a cyclical upward and downward movement in market share: it reached its peak in 1996 only to decrease during the soft market. The hardening of the market over the last two years has increased the share of brokered reinsurance at the expense of direct writers. In the long run, however, there is no clear trend towards US-domiciled broker reinsurers.

6 Most reinsurers generate 95% of their business from their main channel of distribution. See Conning, Conning Commentary, July 2000.
According to Conning, customers like to use both direct and broker distribution channels. For insurers, it is not the distribution channel that is important when deciding which reinsurers to use, but rather the financial condition, willingness to partner, past relationships, expertise and reputation of the reinsurer. Over 80% of cedants use a combination of broker and direct channels, while only 14% use brokers exclusively, and 5% use direct writers only.\(^7\)

Unlike in the London market, US broker reinsurers write more proportional business than direct writers. Proportional business is simpler and does not require as much investment in human capital and technology as non-proportional business. Hence, brokers with lower fixed costs (more variable costs) can adjust more easily to changes in the market.

The UK domestic commercial market

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\(^7\) See Conning, Conning Commentary, July 2000.
Trends in the major commercial broker markets

Most commercial business is brokered in the UK. Brokers play a very important role in the UK domestic market, channeling over 80% of premiums in commercial lines. Direct marketing (for smaller standard risks) holds a share of 7%, while only 6% of business is conducted through insurance tied-agents.

As illustrated in Figure 13, the brokers’ share of commercial business was relatively stable in the 1990–2002 period, while the share of personal lines declined sharply in the UK. About 32% of personal lines premiums in 2002 were placed through independent intermediaries, which is high compared to other markets, but down from over 71% in 1990, as measured as a percentage of premiums. In 1990, 18% of personal lines went through company agents and 11% through direct marketing. By 2002, the landscape had changed dramatically, with new distribution channels, such as bancassurance, gaining a 13% share. Alternative channels — such as utilities, retailers and affinity groups — increased their share to 12%. Direct response marketing — particularly call centers — made the greatest strides, advancing 31%, while company agents lost ground of 10%.

The London market

The London market is all but brokered and specializes in large, complex risks. The London insurance and reinsurance market is almost 100% brokered. The share of business transacted directly from insurance clients and insurers is negligible. What has changed is the number of players in the London market.

Figure 14
Development of the number of Lloyd’s brokers and their average brokered premium volume (GBP millions), 1985–2002

Sources: Lloyd’s, Swiss Re Economic Research & Consulting
Between 1985 and 2001, the number of London market brokers fell from over 250 to 126. The number rose in 2002 primarily because Lloyd's opened its doors to overseas brokers — which pushed down the number of UK-based brokers further. The decreasing number of brokers since the mid-1990s has been the result of substantial merger and acquisition (M&A) activity from two sources: within the London market and from large US players buying into the London market.

The London Market is the trading place for large, sometimes unusual, and often complex industrial risks. This also applies to reinsurance covers, making London the world’s most important marketplace for non-proportional covers and facultative reinsurance business. Additionally, London is pre-eminent in the retrocession market. London is also an underwriting “subscription” or co-insurance market, where risks are usually shared between several insurers. Consequently, to place risk appropriately in this market requires the monitoring and evaluation of an insurer’s risk appetite, creditworthiness and past claims-paying record. For example, in certain lines there are as many as 200 underwriting units of Lloyd’s syndicates and insurers in the City of London. Monitoring them becomes an extremely difficult and complex task, which only a professional broker can accomplish.

The Bermuda market

Despite the decline in market share of brokered business in the US and the UK outlined above, interviews with industry participants and a review of the trade press indicate that the demand for brokers has risen over the last decade and is expected to continue rising. This is particularly relevant for large commercial business. One possible explanation for this discrepancy is that the share of offshore insurance carriers in the global market has increased. Offshore insurance is almost exclusively brokered business, with Bermuda the premier marketplace. The Bermuda insurance and reinsurance market has been thriving over the last two decades with premiums, capital and invested assets growing rapidly. The market development heated up particularly over the past couple of years. Areas of significant market positions are property cat reinsurance, professional liability, directors’ and officers’ liability, professional liability, and employment practices liability. Due to the current hard market, Bermuda has developed from a market for excess layers into one that also offers cover for working layers. In several waves, Bermuda has evolved from a captive location into a complete insurance and reinsurance market. All major brokers are represented on the island, with many of them also offering captive management services.

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8 Brokers who wish to place risks with Lloyd’s need to be authorised. They also have to be a member of and thus accept the regulations of the General Insurance Standard Board.
Trends in the major commercial broker markets

Figure 15 illustrates how Bermuda has outpaced the US domestic commercial P&C market. The majority of Bermuda business is US-originated, and essentially all of the non-affiliated transactions are brokered. This enormous flow of US commercial business to Bermuda – and other offshore locations – explains the divergence between the declining share of brokered business for US onshore carriers and the growing role of brokers for insurance buyers.

Since the mid-1980s, brokers have played a very active role in setting up major Bermuda players. Not only have they sent business to the island but have also actively provided venture capital for some of the new companies. Marsh helped to create ACE (1985), XL (1986), Mid Ocean Re (1992) and Axis (2001). Johnson and Higgins sponsored Global Capital Re (1993), Aon sponsored LaSalle Re (1993) and Endurance (2001), Arthur J. Gallagher helped to set up Allied World (2001), and Benfield sponsored Montpelier (2001).

The majority of Bermuda business is US-originated and brokered.

Brokers were instrumental in the success of the new Bermuda insurers.
Structure and profitability of the global broking industry

Market size and growth

In 2002, large commercial brokers generated worldwide revenues of USD 27 billion. The vast majority of these revenues originated from commercial business. Although there are a large number of small independent brokers, the broker industry is highly concentrated. In terms of size, Marsh and Aon account for 54% of the industry’s brokerage revenues. Willis and Arthur J. Gallagher are ranked third and fourth with revenues of more than USD 1 billion each.

Figure 16
Leading brokers by revenue 2002, USD millions

Figure 17
Concentration in the global insurance broker market (global brokerage revenue, USD 27 billion in 2002)

9 The source is Business Insurance “Market Sourcebook 2003/2004”, covering some 170 brokers worldwide. Although a large number of small brokers are not covered, we use the data as best estimate of the size of global commercial brokerage. Many of the small brokers that are not part of our data sample focus on personal lines or small commercial business, which is not the subject of our analysis.
Of the leading 10 insurance brokers, six are US companies and three are based in London. This includes Willis, which has its headquarters in London, although formally domiciled in Bermuda, and whose shares are quoted on the New York Stock Exchange. The tenth-placed Alexander Forbes is from South Africa. While Marsh and Aon and the non-US brokers have an international presence of varying degrees, the US brokers mostly concentrate on the US market including a globally operating client base. One exception is Arthur J. Gallagher, which has expanded to London and other marketplaces, although it still derives 90% of its revenues in the US. Eight of the 10 largest brokers are public companies. Heath Lambert (HLF) is a privately owned stock company and Acordia has been a subsidiary of Wells Fargo, the US banking and financial services group, since 2001.

The strong presence of US players can be explained by the sheer size of the US market in relation to the rest of the world. About 74% of the global brokerage revenue of USD 27 billion currently originate from the US. Although the US brokerage industry is highly concentrated; it is less concentrated than the global brokerage industry. Marsh and Aon account for 25% and 16%, respectively, of the revenue of the 100 largest brokers in the US. The top 10 US brokers account for 62% of the revenues of the top 100 brokers.

While there are no time series available on the growth of the global broker industry, there are Business Insurance survey data on the revenues of the world’s 10 largest brokers. The strong growth of the top 10 brokers over the last decade reflects the consolidation of the brokerage industry. To realize economies of scale and scope, brokerage houses have been merging and acquiring smaller brokers. This has resulted in the growth of global brokers exceeding the underlying insurance premium growth. Figure 18 shows the growth of brokerage revenues of the 10 largest global brokers as reported by Business Insurance. Since 1992, the top 10 brokers’ revenues have doubled, while global non-life premiums have increased by 44% over the same time period. The growth differential occurred particularly in the years 1996 through 2000, driven by a wave of consolidation. In 2002, the brokerage revenues of the top 10 brokers increased by 13%, in line with global non-life premium growth.

Sources: Business Insurance, A.M. Best, Swiss Re Economic Research & Consulting
Reinsurance brokerage

In 2002, global reinsurance brokerage revenues are estimated to be around USD 3.2 billion. The revenue figures above include reinsurance brokerage. The aggregated revenue of the leading 40 reinsurance brokers was around USD 3.2 billion in 2002. This segment shows similar characteristics to overall P&C brokerage: highly concentrated with US and London-based players dominating and Bermuda holding the upcoming number three marketplace. According to Global Reinsurance (December 2003), the London market accounted for 30% of the placement of brokered reinsurance, North America for 26%, and Bermuda for 14% in 2002. Other important markets in terms of placement were Germany, France and Switzerland.

The leading 10 reinsurance brokers account for 78% of revenues. Six of the largest broking groups are also amongst the Top 10 reinsurance brokers, with the three leading direct brokers — Aon, Marsh and Willis — also topping the league of reinsurance brokers. In addition to the reinsurance arms of JLT, HLF and Arthur J. Gallagher, there are four pure reinsurance brokers amongst the Top 10. Benfield, the largest, and BMS are London-based, while Towers Perrin and John B. Collins are US-based.

**Figure 19**
Most important markets for the placement of brokered reinsurance

<table>
<thead>
<tr>
<th>Market</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>30%</td>
</tr>
<tr>
<td>US</td>
<td>26%</td>
</tr>
<tr>
<td>Bermuda</td>
<td>14%</td>
</tr>
<tr>
<td>Germany</td>
<td>9%</td>
</tr>
<tr>
<td>France</td>
<td>5%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: Global Reinsurance

**Figure 20**
Revenue of the leading reinsurance brokerage firms 2002, USD millions

- Aon
- Guy Carpenter
- Willis Re
- Benfield Group
- JLT Risk Solutions
- HLF Group
- Towers Perrin
- A.J. Gallagher
- BMS Group
- J B Collins

Source: Business Insurance
Structure and profitability of the global broking industry

Consolidation of the brokerage industry

There has been a tremendous increase in concentration in the commercial insurance brokerage industry over the last decade. Particularly the period between 1996 and 1999 witnessed an extraordinary wave of M&A activity among the leading brokerage firms, changing the landscape of the broking industry (see Table 2). Within a twelve month period, Aon more than doubled its revenues by acquiring, among others, its London-based competitors Bain Hogg (1996), Minet (1997), and the former fourth-largest broker, US-based Alexander and Alexander (1997). These years also saw the completion of a number of large M&A deals by other acquirers.

Table 2
Major broker M&As, 1996–1999

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Year</th>
<th>Target</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Marsh (US)</td>
<td>1997</td>
<td>Sedgwick Group (UK)</td>
<td>3788</td>
</tr>
<tr>
<td>Aon (US)</td>
<td>1996</td>
<td>Bain Hogg (UK)</td>
<td>1115</td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td>Alexander &amp; Alexander (US)</td>
<td>1282</td>
</tr>
<tr>
<td></td>
<td>1997</td>
<td>Minet (UK)</td>
<td>310</td>
</tr>
<tr>
<td></td>
<td>1997</td>
<td>Jauch &amp; Hübener (D)</td>
<td>216</td>
</tr>
<tr>
<td></td>
<td>1997</td>
<td>Willis (UK)</td>
<td>1115</td>
</tr>
<tr>
<td>2 Aon (US)</td>
<td>1997</td>
<td>Johnson &amp; Higgins (US)</td>
<td>1083</td>
</tr>
<tr>
<td>4 Alexander &amp; Alexander (US)</td>
<td>1997</td>
<td>1282</td>
<td></td>
</tr>
<tr>
<td>9 Minet (UK)</td>
<td>1997</td>
<td>371</td>
<td></td>
</tr>
<tr>
<td>13 Jauch &amp; Hübener (D)</td>
<td>1997</td>
<td>216</td>
<td></td>
</tr>
<tr>
<td>5 Willis (UK)</td>
<td>1997</td>
<td>1115</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mergers</th>
<th>Post-merger name</th>
<th>Year</th>
<th>Pre-merger names</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>JLT Group</td>
<td>1997</td>
<td>10 Jardine Ins. Brokers UK</td>
<td>360</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Lloyd Thompson (UK)</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td>HLF Group</td>
<td>1999</td>
<td>12 Heath (UK)</td>
<td>310</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1997</td>
<td>16 Lowndes Lambert (UK)</td>
<td>161</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Fenchurch (UK)</td>
<td>53</td>
<td></td>
</tr>
<tr>
<td>Benfield</td>
<td>1997</td>
<td>82</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Benfield (UK)</td>
<td>73</td>
<td></td>
</tr>
</tbody>
</table>

Note: Ranking and revenues are based on 1995 figures.
* Acquisition of 33% minority share

Sources: Business Insurance (July 1996), Reinsurance Market Report (July 1997); Swiss Re Economic Research & Consulting

Reinsurance brokers consolidated as well.

The reinsurance brokerage market has undergone a similar development since 1996. In addition to the above-mentioned M&As, Benfield and Greig Fester merged in 1997 to become the Benfield Group, which in turn merged with US reinsurance broker EW Blanch in 2001 to form the largest independent reinsurance intermediary.

Consolidation continues, particularly in the US.

Although the top players have remained unchanged since 1999, consolidation has continued at a rapid pace. Despite its concentration in the US and the UK, the brokerage industry is still fragmented, thereby offering the opportunity for further consolidation of small and regional brokers. Table 3 only shows the acquisitions made by large brokers since January 1997, without accounting for the mergers of smaller players. In regional terms, most acquisitions have been made in the US, where three of the five largest players have concentrated their expansion. The four largest brokers have widened their geographical reach via acquisitions.
Although economies of scale and greater global reach have been driving consolidation among brokers, M&As have not always led to improved performance. The absence of integration of newly acquired brokers into the acquiring firm has resulted in far from ideal coordination across different units in the organization, overstaffing, duplication of effort and other friction. These growing pains have adversely affected some brokers’ efficiency and profitability as has been evident in the numerous special charges that have been attributed to integration over the last couple of years. Some brokers are still grappling with such issues.

Banks are playing an ever-more important role in insurance distribution. In 2003, BB&T acquired McGriff, Seibels, the 13th largest broker in the US, after having acquired Cooney Rikard & Curtin Inc in 2001, one of the largest independently owned wholesale insurance brokers in the US. In 2001, too, Wells Fargo purchased Acordia, the 5th-largest insurance broker in the US. Wachovia, Bank of America/Fleet Boston and a number of small regional banks are seeking a greater presence in P&C brokerage, according to Fox-Pitt, Kelton.11 Banks are seeking to take advantage of cross-selling opportunities by focusing on insurance distribution rather than on competing with insurers in the area of underwriting. Some industry experts expect the banks to continue with broker acquisitions. In 2002, the 10 largest bank-owned US brokers accounted for USD 1.6 billion in revenues, according to Business Insurance (July 2003), which accounted for 10% of P&C brokers’ market share.

Consolidation is expected to continue. Aon and Marsh both went through a major acquisition phase in the 1990s and now operate on a scale that makes further major broker acquisitions unlikely. Nevertheless, consolidation among medium-sized and regional firms is expected to continue. Consolidation is being driven by a desire to gain economies of scale and to widen geographical reach, either on a national scale for purely domestic players, or on an international scale for global players. Small firms, on the other hand, are increasingly willing to sell up in view of eroding margins brought about by the costs of complying with regulatory requirements and by the rising market expectations of clients and brokers’ associations. In the UK, the number of brokers is expected to decline by 10 to 30% over the next 18 months, implying a loss of 600 to 1800 independent brokers.12

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10 In September 2003, Hill, Rogal & Hamilton changed its name to Hill, Rogal and Hobbs.
Brokers’ profitability

The traditional source of brokers’ revenues is commissions, which have been somewhat invisible to the insured. Commissions are a percentage of the premium that the insured pays to the insurance company. This percentage depends on the line of business and the type of coverage being placed. For example, while average commissions for US ocean marine business were 16% of direct premiums in 2002, they were 8% for workers’ compensation (A.M. Best, Aggregates & Averages, 2003).

In the US, for example, commission rates fell between 1975 and the early 1990s, but have been relatively stable since. Over the last ten years, there has been no clear trend in the relative amounts that insurers pay out of their premium revenues for brokerage and commission. While there has been a slight decline in brokerage commissions as a share of property direct premiums written, they have increased as a share of liability lines’ direct premiums. Overall, the commission ratio for all commercial lines increased to 1.2.8% up to 1999 before declining to 1.2.1% by 2002.

According to the traditional commission concept, there is only one price from the client’s point of view as brokerage services are bundled together with the cost of coverage. Under the net basis concept, the client pays separately for coverage and brokerage services. With growing competition, brokers may be asked to rebate part of their commission — if permitted within the legal and regulatory framework — or to agree on a fee, which is usually less than the original commission.

On the other hand, by receiving a fee instead of a commission, brokers could increase the stability of their income since fees do not rise and fall in line with premium volume. This trend is of particular relevance to large accounts. Today, some brokers generate as much as one-quarter to one-third of their revenues from fees, but on average the share is still low. A survey of reinsurance brokers conducted by Global Reinsurance (December 2003) sheds some light on their compensation structure. 25% of respondents claimed to have no fee income at all, while those with fee income claimed it to be a small percentage of their income, accounting for only 1% to 18%.

Increased transparency could reduce revenues and profit margins.

Fee revenues are more stable than commissions.
Brokers usually provide clients with services, which are paid for by fees bundled together with the commission or fee for the placing of the risks. Their risk management and consulting services fees are generally negotiated individually, and there is no uniform market convention for determining them.

Finally, as an intermediary, an insurance broker also collects premiums from its clients and remits them to the insurance company net of brokerage commission. Under some circumstances, the broker also collects claim payments from the insurance carrier and forwards these funds to the insured. While the brokers are in possession of these funds in their function as intermediary, they earn interest known as “fiduciary income,” which is a minor source of their income. In general, fiduciary income has been low recently given the low interest rate environment.

The brokerage business is a people-intensive business, with employees representing a company’s major asset. For this reason, a broker’s biggest expense is the salaries and benefits paid to employees, which account for about 50–60% of total revenues. Overhead costs constitute another 20–30% of revenues. Taken from a small sample of large listed US insurance brokers, after-tax profit margins have remained at an average 9% over the last ten years. Allowing for the fact that Marsh and Aon took significant special charges for acquisitions and underwriting risk from group insurance carriers in 1997, 1999, and 2001, it can be said that profitability has remained stable.

With a somewhat stable 50% ratio of shareholders’ equity to revenues, the average ROE for brokers between 1984 and 2002 was 18% and roughly followed the pattern of commercial lines insurers (Figure 23). Over the longer term, it appears that brokers’ profitability is influenced by the underwriting cycle, although it is not severely impacted by soft market phases. Given the structural differences between the people-intensive brokerage industry and the capital-intensive insurance industry, it is hard to draw any conclusions from a comparison of industry ROEs. However, see “Box: How do brokers influence the P&C industry’s profitability?” for some arguments on the relation between brokers’ and insurers’ profitability.
Structure and profitability of the global broking industry

Figure 23
US brokers’ ROE vs. commercial lines insurers, 1984–2004

35%
30%
25%
20%
15%
10%
5%
0%
−5%

Insurance brokers
Comm. lines insurers

Sources: Compustat, Fox-Pitt, Kelton, A.M.Best, Swiss Re Economic Research & Consulting
How do brokers influence the P&C industry’s profitability?

How brokers affect the insurance industry can be examined by applying Michael E. Porter’s basic framework of five competitive forces. These forces determine whether the industry’s players are able to capture the value that they create for their clients. Interestingly, brokers affect all five forces in a way that increases the competitiveness of the (re)insurance markets. Brokers

- lower the barriers to entry into the insurance market and even sponsor Bermuda companies;
- facilitate the use of alternatives to traditional insurance (ie ART);
- increase the bargaining power of their insurance clients;
- lower the bargaining power of (re)insurers; and
- increase competition among (re)insurers by enhancing market transparency.

Sources: Michael E. Porter, Swiss Re Economic Research & Consulting

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**Long-term trends and outlook**

<table>
<thead>
<tr>
<th>Brokers face many opportunities and challenges.</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are several long-term trends that affect brokers’ market opportunities: the P&amp;C underwriting cycle, increased demand for analytical services, increased globalization, which necessitates global risk management skills, the emergence of new risk classes, demand for customized risk solutions, demand for multi-channels of distribution, the growth of the insurance needs of the emerging markets and increased consolidation.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>For the last few years, the underwriting cycle has dominated brokers’ agendas.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial lines distribution is improving due to changes in the underwriting cycle and long-term economic trends. The P&amp;C commercial lines markets are emerging from two years of substantial price increases. Some lines have been disrupted by severe rate increases and limitations on the availability of cover. Many (re)insurers have been downgraded by rating agencies over the past two years. Further improvements in underwriting profitability are required in view of the current low-yield investment environment. Focusing on underwriting quality, insurers are demanding tighter terms and conditions, longer lead-times and more underwriting information. On the other hand, insurance buyers face rate increases, coverage restrictions and a limited choice of carriers, while they continue to operate in a fragile economic environment. To take advantage of the strong revenue growth potential presented by the current hard market, commercial insurance brokers are having to bridge the expectations gap of the two markets.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Clients are better informed and require more analytical services.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditionally, commercial clients have had limited know-how of their risk landscape, products and insurance carriers. Brokers filled this gap, providing information and analysis. However, information has become much more accessible with the rapid proliferation of new technologies, thereby eroding brokers’ value proposition as a source of information. Analytical software is also readily available for use by risk managers. Hence, information requirements have increased dramatically, providing an opportunity for brokers to market their advisory and additional services to their clients. Some brokers are trying to spearhead these technological developments and capture some of the value created for the insurance buyer.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Globalization is increasing the demand for the services of global brokers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>International trade continues to outpace the growth in world output, as countries import and export more goods and services. Fortune 500 corporations have been a driving force behind this increased globalization and need global solutions for their risk management needs. Some foreign markets are changing rapidly with the advent of deregulation and insurance market liberalization, making it increasingly difficult for corporations to decide on a carrier. This is where global brokers have a competitive advantage, making it increasingly difficult for small players to participate in the global client segment.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The risk landscape is becoming more complex, increasing the need for risk management services from brokers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies are facing a shifting risk landscape brought about by structural changes in the economy, changes in the legal environment and the emergence of new risk classes due to new technologies, globalization, deregulation and geopolitical changes, for example. Cyber risks and terrorism are prime examples along with directors’ &amp; officers’ liability in the wake of the recent corporate scandals. Exposures and risk measurement tools have become more complex and require growing amounts of information and expertise. Brokers are experiencing a steady rise in demand for assistance in risk management services.</td>
</tr>
</tbody>
</table>
Corporations need increasingly more customized solutions that expand the limits of insurability and require the development of new alternative risk transfer (ART) products. These ART products range from qualified self-insurance programs and structured products, such as finite insurance, to risk retention programs through to captives.\footnote{See sigma No. 1/2003 “The picture of ART”.} Many ART products involve offshore carriers, indicating that some business will be redirected from the traditional commercial insurance markets to different marketplaces (eg Bermuda). Brokers are being frequently involved in designing complex and tailor-made ART solutions. This trend favors brokers that offer services complementary to ART solutions, such as captive management.

Many emerging markets are privatizing and deregulating their insurance markets, which offer attractive growth opportunities given their exposure to the unfamiliar challenge of global competition. Insurers and clients in these markets also need advice and know-how. These can be supplied by insurance brokers, who play an important role in instructing them in the use of commercial insurance and reinsurance. At the same time, global brokers offer local expertise to foreign entrants into these markets, enabling them to operate successfully. For both brokers and insurers, expansion into emerging markets offers an attractive alternative to the limited growth potential of mature insurance markets. According to a survey conducted by Global Reinsurance (December 2003), a quarter of reinsurance brokers have offices in Singapore, one fifth have offices in China and more than 15% have an office in India.

Mergers and acquisitions and consolidations of brokers are expected to continue as medium-sized and regional companies seek revenue growth and expansion into additional markets. Aon and Marsh went through a major acquisition phase in the 1990s and now operate on a scale that makes further large acquisitions look unlikely. However, banks are likely to continue to buy into P&C distribution channels, thereby sustaining mergers and acquisitions and stimulating competition.
Appendix: Regional significance of brokers as a distribution channel

The brokers’ share of the global insurance market varies widely by region. In the Anglo-Saxon countries their share is very high, usually over 50%, while in continental Europe, their share is frequently below 20%. Brokers are used heavily in the Latin American countries where data are available, but their services are rarely called upon in the major Asian countries.

Distribution channels in the Anglo-Saxon markets

Brokers have a large market share in the Anglo-Saxon countries, with about 50 to 70% of written premiums. They have a particularly strong position in commercial lines business, while their share of personal lines business has begun to shrink as direct marketing and other alternative distribution channels gain ground.

<table>
<thead>
<tr>
<th>Country</th>
<th>Total</th>
<th>Personal lines</th>
<th>Commercial lines</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>56%</td>
<td>32%</td>
<td>85%</td>
</tr>
<tr>
<td>UK domestic</td>
<td>&gt;95%</td>
<td>not meaningful</td>
<td>&gt;95%</td>
</tr>
<tr>
<td>London market</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>68%</td>
<td>40%</td>
<td>95%</td>
</tr>
<tr>
<td>United States</td>
<td>52%</td>
<td>34%</td>
<td>69%</td>
</tr>
<tr>
<td>Canada</td>
<td>75%</td>
<td>70%</td>
<td>90%</td>
</tr>
<tr>
<td>South Africa</td>
<td>70%</td>
<td>50%</td>
<td>90%</td>
</tr>
<tr>
<td>Australia</td>
<td>48%</td>
<td>9%</td>
<td>86%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>~50%</td>
<td>15%</td>
<td>90%</td>
</tr>
</tbody>
</table>

Sources: Axco, non-life reports, Swiss Re Economic Research & Consulting

Table 4
Brokers’ share of Anglo-Saxon non-life distribution, personal and commercial lines

With the exception of Australia and New Zealand, brokers still hold over a 30% market share of personal lines. In Australia, they have lost ground to call centers and other direct sellers. In New Zealand, personal lines business has traditionally been sold on a direct basis. However, the disappearance of branch insurance offices is opening up opportunities for banks and brokers to increase their market share.

Distribution channels in continental Europe

<table>
<thead>
<tr>
<th>Country</th>
<th>Total</th>
<th>Country</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>~10%</td>
<td>Russia</td>
<td>~5%</td>
</tr>
<tr>
<td>France</td>
<td>18%</td>
<td>Sweden</td>
<td>20–25%</td>
</tr>
<tr>
<td>Italy</td>
<td>7%</td>
<td>Denmark</td>
<td>~10%</td>
</tr>
<tr>
<td>Spain</td>
<td>22%</td>
<td>Norway</td>
<td>18%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>70%</td>
<td>Portugal</td>
<td>16%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>~15%</td>
<td>Poland</td>
<td>10%</td>
</tr>
<tr>
<td>Belgium</td>
<td>65%</td>
<td>Finland</td>
<td>9%</td>
</tr>
<tr>
<td>Austria</td>
<td>27%</td>
<td>Luxembourg</td>
<td>15%</td>
</tr>
</tbody>
</table>

* The brokers’ association claims to hold a market share of about 30%, since brokers channel the bulk of their business through agents.

Sources: Axco, non-life reports, Swiss Re Economic Research & Consulting
In continental Europe, the brokers’ market share varies widely by country. In the Netherlands and Belgium, their position is as strong as in the Anglo-Saxon world. Because of the size of its insurance market, France is the third-biggest source of brokered business after the UK and the US, although the brokers’ share is only 18%. Brokers hold less than 20% market share of the overall non-life business in most countries. However, the broker’s share of large commercial lines and industrial business is usually considerably higher, reaching levels of up to 75%.

Germany is traditionally a very strong tied-agent market, with a low market share for brokers. Any broker involvement in personal lines business is confined to niche markets, although they are assuming an increasingly significant role in the industrial market. In-house brokers of large multinational firms, such as Aventis, Bayer and DaimlerChrysler, take on a considerable share of this business. The number and importance of in-house brokers has increased substantially in recent years. Instead of using an independent insurance broker and eventually outsourcing risk management functions, such as in the US or the UK, German corporations prefer to keep the broker function in-house so as to retain income within their group. One major reason for this is the fact that the rebating of brokerage commissions is illegal in Germany.

The small broker share in the Italian market is apparently understated: 7% of business goes directly to insurance companies, whereas a considerably larger share is channeled through tied agents. The tied-agent system in Italy is often based on bilateral exclusivity rules — according to which all business within defined geographical areas must go through the agent.

In the Nordic countries, brokers only had a significant market presence after the late 1980s. Large industrial accounts were formally served directly by specialized departments of insurance companies. Today, brokers play a significant role in medium- to large-sized commercial/industrial risks. However, the main commercial insurers announced recently that they would only submit quotes to brokers based on premiums net of commissions. This is likely to have a major impact on brokers since they will now have to agree on a fee with their clients. Although brokers already place large risks on a fee basis, this move will probably lead to more price competition amongst brokers.

**Distribution channels in Latin America**

<table>
<thead>
<tr>
<th>Country</th>
<th>Total</th>
<th>Country</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>70%</td>
<td>Venezuela</td>
<td>30%</td>
</tr>
<tr>
<td>Mexico</td>
<td>50%</td>
<td>Colombia</td>
<td>20%</td>
</tr>
</tbody>
</table>

Sources: Axco, non-life reports, Swiss Re Economic Research & Consulting

Brokers play a significant role in almost all of the countries of Latin America where statistical data on distribution channels are available. The data are not of the highest quality, however. For example, in Brazil 70% of non-life business is estimated to be transacted through brokers. However, many brokers, particularly the small ones, act as agents and not as independent intermediaries.
Appendix: Regional significance of brokers as a distribution channel

Distribution channels in Asia

<table>
<thead>
<tr>
<th>Country</th>
<th>Total</th>
<th>Country</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>&lt;1%</td>
<td>India</td>
<td>&lt;1%</td>
</tr>
<tr>
<td>South Korea</td>
<td>&lt;1%</td>
<td>Malaysia</td>
<td>30%</td>
</tr>
<tr>
<td>PRC China</td>
<td>&lt;1%</td>
<td>Thailand</td>
<td>25–30%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>12%</td>
<td>Indonesia</td>
<td>20%</td>
</tr>
</tbody>
</table>

Sources: Axco, non-life reports, Swiss Re Economic Research & Consulting

In the northern Asian countries of Japan, Korea, and China, independent intermediaries are virtually unheard of, playing only a minor role in some niche markets, and then mostly in international lines such as marine and aviation. This is also true for India, which has a heavily regulated insurance sector with government-sanctioned monopolies. Personal lines business is conducted through a huge number of tied-agents, most of them operating on a part-time basis. The law lays down that commercial lines business must be directed to state-owned insurers. However, things are beginning to change with the advent of the liberalization of the insurance market. In 2002, a new regulation recognised brokers as independent insurance intermediaries. At the end of 2003, there were more than 130 brokers registered on the basis of this regulation in India.

On the other hand, brokers have a significant market share in the countries of Southeast Asia, where they handle roughly a quarter to a third of non-life business.
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No. 1/2004  Natural catastrophes and man-made disasters in 2003: many fatalities, comparatively moderate insured losses

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No. 7/2003  Emerging insurance markets: lessons learned from financial crises
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