Brokers must change their business model to survive

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ABSTRACT

Insurance intermediaries are having to renegotiate their relationship with clients and risk carriers in a market place increasingly shaped by forces intent on displacing them in the insurance distribution chain. Based on trends in the UK and EU markets, US-based brokers can have insights into market access which may help them navigate an increasingly challenging threat to their own business models.

Brokers, even those in the specialty and large corporate space, are only too aware of the threat of being replaced by technology. It is now pretty much accepted that certain types of corporate risks, that have almost become commodity-like, will inevitably be distributed through technology platforms without the involvement of a broker.

But the pressure on brokers is equally intense at the large corporate end of the market where, over the past decade, the sophistication of companies in terms of managing their risk transfer requirements and strategies has grown considerably. These are entities with very significant balance sheets. And, depending on the licensing and the broader insurance regulatory environment, they will want to have as central a role in the insurance transaction as possible.

For example, many of the big German multinationals have their own brokerage operations, which they use to place their own business in the insurance market. In fact, many of these operations are regulated, licensed entities.

However, brokers insist they are not entirely regarded as redundant by the big multinationals as these companies do not totally trust the view they have of the market from their in-house broking operation. Most of them will employ a third-party broker to place a portion of their risk. This gives the multi-nationals the ability to benchmark the performance of their own broking operation.

For most medium to large commercial and specialty lines risk brokers, technological development on the one end and growing risk transfer sophistication of large multinationals on the other, represent the two big pressures between which they are being squeezed today.

The result is to force brokers to look at their middle-market clients in a new light. These are clients that do not comfortably fit in either the commodity-like-corporate-risks or the large risk categories.

It is less clear to these clients what type of insurance cover they should be buying, why they should be buying it, or from whom they should be buying it.. Brokers, consequently, are busily re-evaluating opportunities in this area of the market to help clients work through that process.

New role

However, the role of the broker, even in the middle market, will change significantly in the near-to-medium term as the broker becomes less involved in the transactional side of the business due to growing reliance upon digital applications , particularly around insurers' product portals and platforms which will only grow more sophisticated. In particular, the role of the broker will shift from occupying a position right in the middle of the transaction to a position where they provide advice around that transaction.

Brokers are already looking at those parts of the risk management and risk transfer processes that are outside the pure insurance transaction. This includes helping clients to manage risks to create value, helping them to optimise their balance sheet, and helping them work out what level of the insured risk they should be retaining.

The important point for brokers, however, is that these are not services that are in an insurance company's best interest to provide to their policyholders. As far as they are concerned, insurers want the client to spend as much money as possible for as little coverage as possible, according to brokers.

In addition, insurers come at the transaction from a different perspective from a broker in that insurers need to make as much money out of the transaction as they possibly can for their stakeholders. There is an inherent conflict for the insurer which does not exist for the broker. Alastair Swift, head of Corporate Risk & Broking in the UK at Willis Towers Watson, for example, does not see that conflict going away. On the contrary, he only sees it growing.

It is this need for brokers to provide an independent view of the insurance product or the transaction, particularly in the middle market, which they see as the key to their survival.

Indeed, the evolving role of the insurance broker is often compared with that of the real estate agent over the past decade or so. For example, at least in the UK, buying property should be one of the simplest transactions out there. But today, the reality of the property market is only 2% or 3% of the entire market is traded over platforms. The rest of it is still being traded in the traditional way.

Real estate brokers themselves have no doubt that, over time, more and more property transactions will inevitably migrate online. But the point for them is the speed and manner in which technology is adopted within a sector is often very different and slower than initially envisioned. This can be due to any number of factors. In the case of real estate brokers, it is clearly because of the need of one of the involved parties to have a trusted adviser, such as an independent broker, involved in the transaction.

For this reason, most real estate brokers take the view they are unlikely to be entirely removed from providing advice around a transaction. For them the trade is still going to happen. It is just a question of how the trade happens and where they, as real estate brokers, are positioned in relation to the trade.

Another area of opportunity for brokers in the future will be to help clients to mitigate risks for which at present there are no, or very limited, insurance solutions, such as reputational risks and certain types of cyber risk where the main focus is risk prevention rather than risk transfer. In this regard, the big challenge for brokers will be to change their income model from one that is based on earning a commission in relation to a transaction to one that is based on earning a fee for a service that helps the client to create value.

Most of the major brokers are already well down this road. For example, Willis Towers Watson’s specialty lines and large corporate risk operations, which includes its London market operations, is currently 50% commission and 50% fee-based.

However, it is different in different geographies and in different segments of the market. For example, business out of Latin America is still totally brokerage driven. But in the UK, the larger part of the business done in the large and complex risk sector by brokers is done on a fee basis. For example, almost all the work that Willis Towers Watson’s Corporate Risk & Broking division does with multinational companies in the UK is on a fee basis.

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Rasaad Jamie is Global Markets Editor at Insurance Day in London

He joined Insurance Day in 2009 after working on World Insurance Report, another Informa publication, for the previous nine years.

His focus is on the London wholesale and specialty insurance and reinsurance market. His other areas of interest are global insurance related regulatory developments and emerging insurance markets in Eastern Europe, Africa, Asia and Latin America, including the low cost and micro-insurance sectors in these regions