MS17/2.2: Annex 2

Market Study

Wholesale Insurance Broker Market Study

Final Report: Annex 2 – Broker remuneration

February 2019

Annex 2: Broker remuneration

Introduction

1. The Wholesale Insurance Broker Market Study seeks to understand whether competition in the London broking industry works effectively. To do this the market study focuses on several areas of potential concerns on, among others, market power and brokers' conduct (see Chapter 3 and Chapter 4 of the Final Report).

2. This Annex lays out the details of the analysis of brokers' remuneration that feeds into our overall assessment of market power and brokers' conduct.

3. In this Annex we use a detailed, policy-level dataset to examine how brokers' remuneration varies across policy, policyholder and broker characteristics.

4. Brokers are typically remunerated for their placement services through brokerage commissions and/or fees. When commission is charged, brokers are remunerated based on a deduction from the GWP. This is expressed as a percentage. When a fee is charged, brokers are remunerated based on an agreed absolute amount with their clients. Brokers may also receive fees from insurers.

5. Commissions vary across policy characteristics and they are typically bilaterally negotiated between broker and insurer. There may be further negotiation between the London broker and other brokers in the distribution chain to agree shares of this commission.

6. Commissions may vary by method of placement, class of business, GWP, clients' characteristics, complexity of the insurance coverage, expected amount of work for the broker and market conditions.

7. The most common types of commission in the market include:

   - Ordinary commission (as defined on the slip agreed by underwriters)
   - Additional commission (variously described as Subscriptions Market Brokerage (SMB), Insurance Services Brokerage (ISB), line slip administration fee, etc.)
   - Profit commission (paid to the broker where 1 of its divisions is acting as coverholder / MGA under a binding authority issued to it by the Syndicate)

8. Brokers may instead (or also) charge the policyholder a fee directly and in this case, may partly or fully rebate the commission received from the insurer.[1] Fees may also be negotiated between the broker and the policyholder.

[1] If the policyholder is charged a fee then the policyholder will typically pay a net written premium ie the gross written premium less the commission the broker would otherwise have received.

9. We found that remuneration rates for like-for-like polices (calculated as a percentage of each policy's GWP) vary materially across risk classes. We discuss potential reasons and implications in paragraphs 42 to 53.

Data and sample construction

10. This section provides details on how we constructed the sample we use for the analysis.

11. We use a policy-level dataset that includes insurance policies placed in the LIM in 2016, based on a sample of 23 brokers.[2] The dataset includes information about characteristics of the policy (such as the high-level and generic risk class, the GWP and broker remuneration[3]) and additional descriptive information about the broker, the underwriters and the policyholder.

12. We include policies in 8 Lloyds' high-level risk classes. Facultative reinsurance policies are included, while treaty reinsurance is out of scope.

13. We dropped observations where the brokers have reported negative GWP, where the remuneration is equal to zero or negative, or where total remuneration is equal or above 60% of the policy's GWP. We also dropped policies where brokers were not able to provide the information requested. Note that, as a result of dropping incomplete observations, the sample used for our analysis, despite being representative of the LIM, is slightly different from the larger sample used in the rest of report. Thus, descriptive statistics in this annex may be slightly different from the rest of the report.

14. Table 1 provides descriptive statistics of our sample which contains 272,986 insurance policies amounting to around £17.5bn worth of GWP. Property (D&F) is the largest business class with around £4.8bn GWP while Accident & Health is the smallest business class with around £414m GWP. Policies in Energy, Aviation and multiline policies are on average the largest in our sample (respectively averaging approximately £192,000, £140,000 and £304,000).

Table 1: Number of policies and GWP by high-level risk class, 2016

High-level Risk Classes	Number of policies	Total GWP (£'000)	Average GWP (£'000)
Accident & Health	8,828	414,276	47
Aviation	12,613	1,764,705	140
Casualty FinPro	47,641	1,772,744	37
Casualty Other	34,632	2,187,019	63
Energy	12,500	2,405,435	192
Marine	49,957	2,313,412	46
Property (D&F)	63,937	4,821,159	75
Specialty Other	41,246	1,295,208	31
Other (eg multiline)	1,632	496,805	304
All classes	272,986	17,470,763	64

15. Table 2 shows the number of policies placed in the LIM broken down by the client's geographic location. In 2016, brokers placed 165,303 policies for clients based in Europe. These policies represent around 61% of the total number of policies and 35% of the total GWP placed in London.

[2] We requested policy-level data from 30 brokers but only 23 could provide it at the granular level requested.

[3] We understand that this includes mainly placement revenues.

16. 56,479 policies were placed for clients based in North America. These represent around 21% of the total number of policies in our sample and around 38% of the total GWP placed in London.[4]

Table 2: Number of policies and GWP by client's geographic location

Client's geographic location	Number of policies	Total GWP (£'000)	Average GWP (£'000)
Europe	165,303	6,079,169	37
North America	56,479	6,632,801	117
Asia	11,776	1,231,869	105
Middle East and Africa	13,598	1,116,805	82
Oceania	9,227	473,695	51
South America	7,998	866,008	108
Global	8,605	1,070,416	124
Total	272,986	17,470,763	64

17. Table 3 shows the number of policies by method of placement. The majority of policies in our sample (55%) were placed in the open market while around 33% were substantially placed in a facility.[5] On average, policies placed in the open market are larger than policies placed in a facility.

Table 3: Number of policies and GWP by method of placement

Method of placement	Number of policies	Total GWP (£'000)	Average GWP (£'000)
Open market	149,210	12,726,724	85
Facility	89,928	1,525,366	17
Business Book placed in the LIM (e.g. MGA,[6] binding authority[7])	33,848	3,218,673	95
Total	272,986	17,470,763	64

18. Table 4 shows the average GWP by risk class and by method of placement as well as the usage of different placement methods by risk class. The average premium of policies placed in the open market is larger compared to policies placed in facilities for each high-level risk class. For example, the average premium of Energy policies placed in the open market is around £247,000 compared to £91,000 for Aviation policies placed in facilities. The average premium in other risk classes is materially lower. For example, Specialty Other policies placed in the open market have an average premium of around £71,000 which compares to around £6,000 for Specialty Other policies placed in facilities.

19. Table 4 also shows the use of facilities varies across risk classes which ranges from 3% of total GWP (for energy policies) to 21% of total GWP (for aviation policies). This table shows that the majority of policies are still placed into the open market.

[4] We defined a group called 'global' which represents clients that are located in more than one geographic macro area, as defined in Table 2.

[5] We define facilities as those arrangements whereby insurers commit capacity to write certain risks – or classes of risk – upfront and in conjunction with brokers create a placement offering designed to meet the needs of a particular sector or client group.

[6] We defined a Managing General Agency (MGA) as a specialised type of insurance intermediary which has been assigned authority to underwrite on behalf of an insurer and to which it owes its primary fiduciary responsibility.

[7] We defined binding authority as an arrangement where an insurer delegates to an intermediary in the UK or overseas the authority to accept business, typically retail or SME risks, within strictly defined terms and conditions.

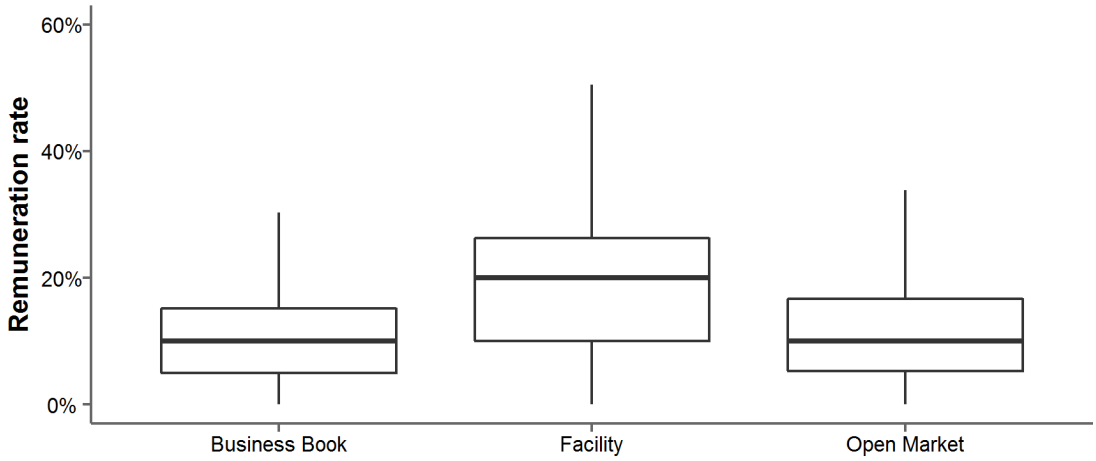
Table 4: Placement methods and average GWP by high-level risk class

High-level Risk Classes	Average GWP (£'000)			Proportion of GWP placed in			
	Open market	Facility	Business book	Open market	Facility	Business book	Total
Accident & Health	57	19	128	60%	17%	23%	100%
Aviation	166	91	134	73%	21%	6%	100%
Casualty FinPro	56	12	45	75%	13%	12%	100%
Casualty Other	86	20	55	66%	6%	28%	100%
Energy	247	69	56	91%	3%	6%	100%
Marine	66	12	75	74%	10%	16%	100%
Property (D&F)	66	24	236	65%	5%	30%	100%
Specialty Other	71	6	70	74%	12%	14%	100%
Other (eg multiline)	314	29	468	93%	1%	7%	100%
All classes	85	17	95	73%	9%	18%	100%

20. Figure 1 shows the distribution of policy-level remuneration rates (calculated by dividing total remuneration by GWP) across methods of placement in our sample of firms. The upper side of each box indicates the 75th percentile of the distribution while the lower side indicates the 25th percentile. The horizontal line within the box indicates the median. The median remuneration rate on a policy placed in a facility is around 20% while the median remuneration rate in the open market is around 10%.

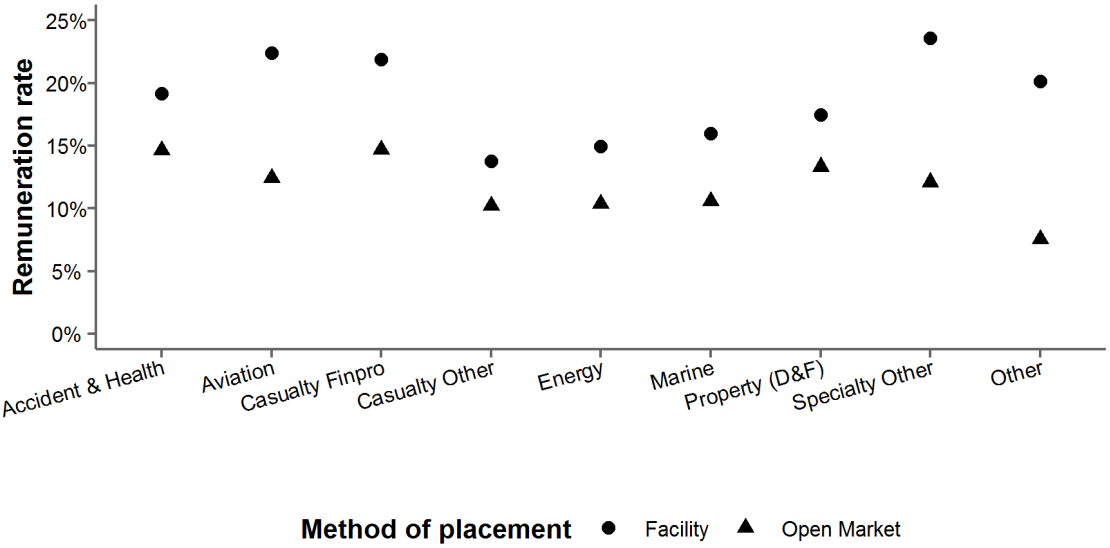
21. Figure 1 combines all policies together and therefore policies placed in facilities may not be directly comparable to policies placed in the open market. For example, policies placed in facilities may differ from policies placed in the open market because of riskiness or size of the premium.

Figure 1: Remuneration rates by method of placement



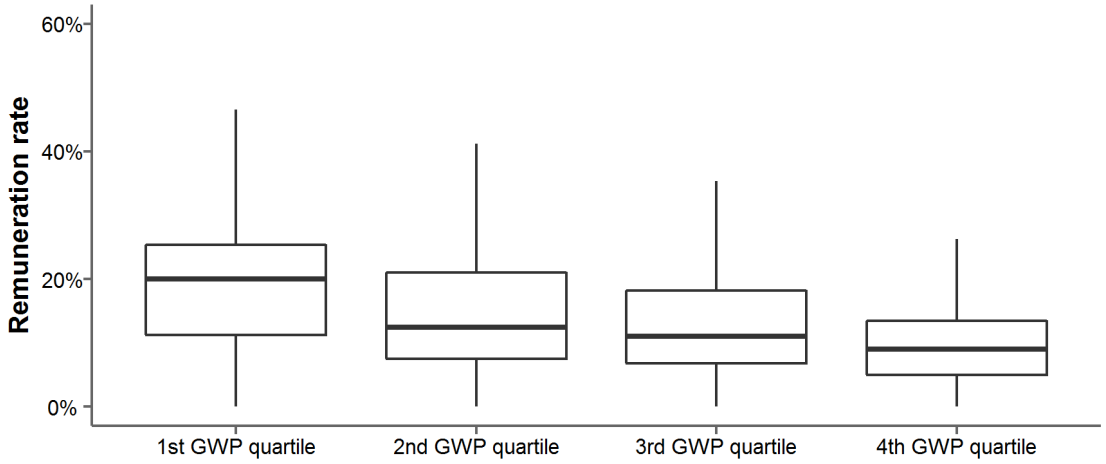
22. Figure 2 shows the average remuneration rates on policies, but this time split by different business classes. Average remuneration rates on policies placed in facilities are consistently higher compared with open market placements in each high-level risk class. The difference is up to 10 percentage points in Aviation and Specialty Other.

Figure 2: Average remuneration rates on policies placed in facilities and open market across different business class



23. Figure 3 shows that average remuneration rate on small policies (ie in the bottom quartile of the GWP distribution) is around 20%, while remuneration rate on larger policies (ie in the top GWP quartile) is around 10%.

Figure 3: Remuneration rates vs. policy size



24. Table 5 shows that average remuneration levels per policy for placing business in the open market range between £5,619 in Marine and £21,589 in Energy. In facilities, average remuneration levels range between £754 in Specialty Other and £9,824 in Aviation (which reflect the lower average size of policies placed in facilities).

Table 5: Remuneration levels by high-level risk class and placement methods

	Open market		Facility	
High-level Risk Classes	Average (£)	Median (£)	Average (£)	Median (£)
Accident & Health	5,665	725	3,459	357
Aviation	11,630	1,558	9,824	1,332
Casualty FinPro	6,332	1,817	1,438	227
Casualty Other	6,656	1,018	1,848	382
Energy	21,589	3,163	9,504	2,423
Marine	5,619	550	1,477	198
Property (D&F)	5,638	362	2,154	404
Specialty Other	7,145	853	754	8
Other (eg multiline)	14,887	2,311	1,558	101
All classes	6,694	683	1,843	120

Econometric approach

25. We have assessed how remuneration rates vary using the following model:

$$\text{Remuneration rate}_{bpi} = \theta X_p + f_b + f_i + e_{bpi}$$

Where $\text{Remuneration rate}_{bpi}$ is the remuneration rate (calculated as a percentage of the GWP) that broker b receives for placing policy p with insurer i. X_p are characteristics of policy p such as risk class, method of placement, gross written premium. f_b are broker fixed effects and f_i are insurer fixed effects. θ are the regression coefficients.

26. We ran our baseline regression, ie model (1), on the sample described at paragraphs 10 to 12 and we then run several robustness checks. The first set of models (1) to (5) control for high-level risk class and broker fixed effects to account for unobservable characteristics of brokers.

27. In addition to the controls in model (1), model (2) controls for whether the policyholder is renewing the policy.[8] Model (3) drops observations where the remuneration rate is above 40% (instead of 60% as in the baseline), in case these remuneration rates are errors.[9] To take into account differences in policy size across placement methods and risk classes (as illustrated in Table 1 and Table 3), model (4) controls for the interaction between GWP quartiles and placement methods and the interaction between GWP quartiles and high-level risk classes. Finally, model (5) controls for insurer fixed effects, to account for unobservable characteristics of insurers.

28. Given that insurance policies in the same high-level risk class may cover very different risks, to control for potential product mix effects we run robustness checks using different levels of granularity for the risk classes. We use Lloyd's classifications as an industry reference. Lloyd's underwrites 8 main high-level classes of (non-treaty re-) insurance business:[10]
    - Accident & Health
    - Aviation

[8] Several brokers did not provide this information and thus the sample is reduced from 274,623 to 228,153 observations.

[9] By dropping observations with remuneration between 40% and 60% the sample size is reduced from 274,623 to 269,314.

[10] Treaty reinsurance is out of the scope of the market study and so business classes contained treaty reinsurance are not included.

- Casualty & Financial & Professional liability
- Casualty Other
- Energy
- Marine
- Property (direct & facultative)
- Specialty Other

29. Each of these high-level classes consists of a number of sub-classes referred to by Lloyd's as 'generic class of business'. Each generic risk class can be further divided into risk codes, which is the most granular risk level available to us.[11]

30. Models (6) and (7) control for generic risk classes and models (8) and (9) control for risk codes. Note that we have information about the Lloyd's risk codes only from 6 brokers, representing 131,084 observations.

31. The models are estimated using OLS, with standard errors clustered by broker to account for correlation in the policies sold by the same broker.

Results

32. In this section, we present the results of our econometric analysis. We found that, controlling for client's location, risk class, policy size, placement method, average remuneration rates vary across the following policy characteristics:
    - **Method of placement:** remuneration rates for policies placed in facilities are around 4-5 percentage points higher compared to other methods of placement. Note that this difference is lower than the difference shown in Figure 2 because the econometric analysis compares like-for-like policies (across different placement methods)
    - **GWP:** like-for-like policies with higher GWP are on average associated with lower remuneration rates. According to model (5) the average remuneration rate on policies in the top GWP quartile is around 3% lower than remuneration on policies in the bottom GWP quartile.
    - **Client's geographic location:** average remuneration rates are higher on policies for policyholders located in Europe than the rest of the world.
    - **High-level risk class:** remuneration rates vary across high-level risk classes. Average remuneration rate on like-for-like policies in Aviation and Casualty FinPro is higher than in other classes. Remuneration rates in other classes are between 3% and 6% lower on average.
    - **Number of underwriters:** average remuneration rate is lower for policies with a larger number of insurers.

33. Table 6 shows the results of the models (1) to (5).

[11] Further information regarding the risk codes can be found at Lloyd's website: https://www.lloyds.com/market-resources/underwriting/risk-codes

Table 6: Results of models controlling for high-level risk class

	(1) Baseline		(2) Baseline with renewal variable		(3) Baseline dropping remuneration above 40%		(4) Baseline with interactions with GWP quartiles		(5) Baseline with insurer FE	
Intercept	0.154	***	0.153	***	0.135	***	0.163	***	0.144	***
High-level Risk Class (ref: Aviation)										
Accident & Health	-0.012	-	-0.018	-	-0.008	-	-0.019	-	-0.020	*
Casualty FinPro	0.004	-	-0.013	-	0.007	-	0.012	-	-0.007	-
Casualty Other	-0.045	***	-0.053	***	-0.035	***	-0.039	-	-0.048	***
Energy	-0.027	**	-0.034	**	-0.020	*	-0.016	-	-0.031	***
Marine	-0.018	-	-0.025	-	-0.011	-	-0.027	-	-0.029	**
Multiline	-0.047	-	-0.057	-	-0.034	-	-0.114	***	-0.056	*
Other	-0.071	***	-0.078	***	-0.067	***	0.001	-	-0.064	***
Property (D&F)	-0.027	**	-0.035	**	-0.020	*	-0.044	**	-0.039	***
Specialty Other	-0.013	-	-0.014	-	0.000	-	-0.021	-	-0.034	***
Client Location (ref: Europe)										
Asia	-0.029	***	-0.034	***	-0.028	***	-0.027	***	-0.020	***
Global	-0.031	***	-0.036	***	-0.028	***	-0.032	***	-0.027	***
Middle East and Africa	-0.009	-	-0.011	-	-0.009	-	-0.008	-	-0.010	-
North America	-0.034	***	-0.035	***	-0.032	***	-0.033	***	-0.034	***
Oceania	-0.047	***	-0.047	***	-0.046	***	-0.045	***	-0.047	***
South America	-0.012	-	-0.014	-	-0.012	-	-0.012	-	-0.015	*
Method of placement (ref: Facility)										
Business Book (eg MGA, binding authority)	-0.055	***	-0.048	***	-0.053	***	-0.095	***	-0.044	***
Open market	-0.056	***	-0.046	***	-0.055	***	-0.068	***	-0.049	***
Number of insurers (ref: 1 insurer)										
2-3 insurers	-0.015	***	-0.016	**	-0.013	***	-0.013	***	-0.013	***
4+ insurers	-0.010	-	-0.010	-	-0.009	-	-0.008	-	-0.013	***
GWP (ref: GWP 1st quartile)										
GWP 2nd quartile	-0.009	-	-0.011	-	-0.007	-	0.001	-	-0.005	-
GWP 3rd quartile	-0.024	***	-0.022	***	-0.020	***	-0.048	***	-0.018	***
GWP 4th quartile	-0.043	***	-0.040	***	-0.037	***	-0.090	***	-0.033	***
Renewal	-		-0.007	-	-		-		-	
Generic Risk Class FE	No		No		No		No		No	
Broker FE	Yes		Yes		Yes		Yes		Yes	
Insurer FE	No		No		No		No		Yes	
Placement x GWP quartile	No		No		No		Yes		No	
High-level risk class x GWP quartile	No		No		No		Yes		No	
Number of observations	272,986		226,516		267,717		272,986		272,986	
BIC	-574,479		-489,623		-615,097		-579,143		-592,685	
Adjusted R-squared	0.299		0.266		0.317		0.312		0.371	

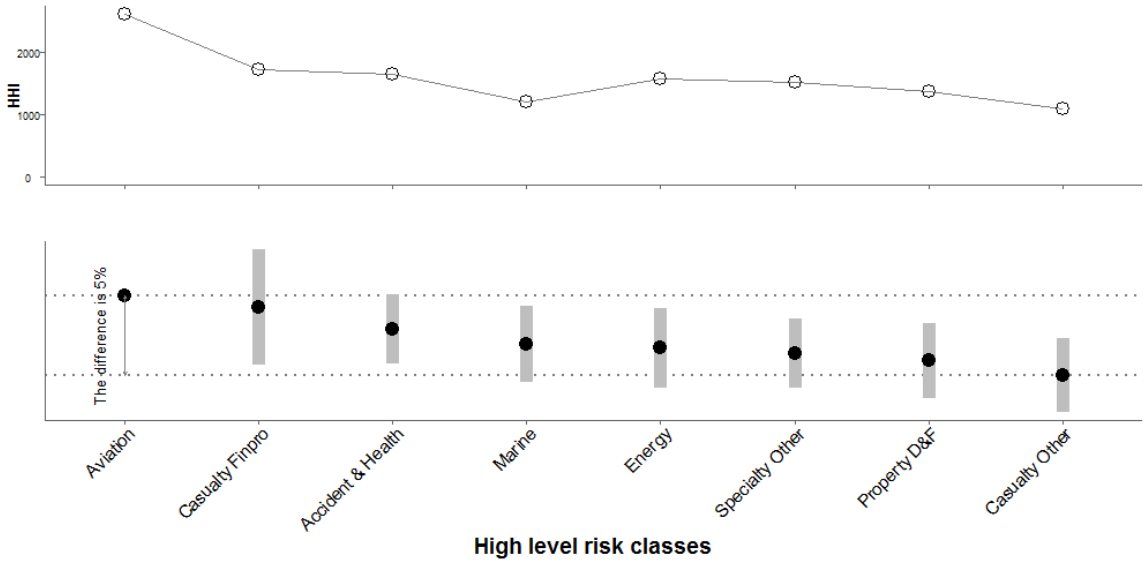
Standard errors are clustered at broker level. *** significant at 1%, ** significant at 5%, * significant at 10%

Remuneration across risk classes

34. Figure 4 plots the high-level risk class fixed effects based on model (5) and concentration levels measured with the Herfindahl-Hirschman Index (HHI) in a given high-level risk class.[12] Figure 4 illustrates that Aviation and Casualty FinPro have higher concentration levels and higher remuneration rates compared to other high-level risk classes.

[12] HHI is calculated as follows $HHI = \sum s_i^2$ where s_i is the share of total GWP sold by broker i

Figure 4: Remuneration rate dispersion and concentration levels across high-level risk classes



35. As a robustness check, we ran the same analysis described in paragraph 25 controlling for generic risk class instead of high-level risk class. Our results do not vary materially. Table 7 shows the result of the econometric analysis when controlling for the (more granular) generic risk class.

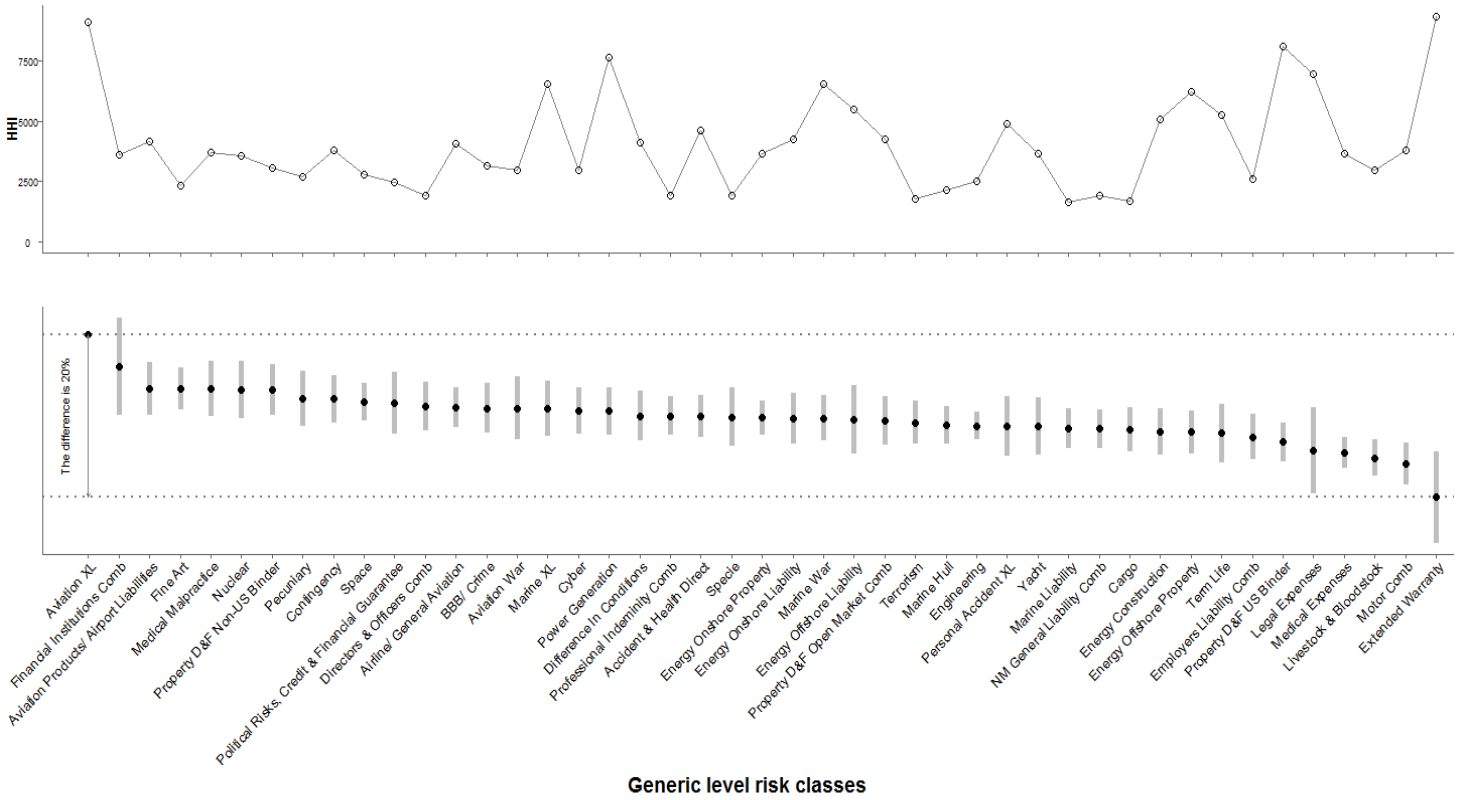
Table 7: Results of models controlling for generic risk class

	(6) Baseline with Generic Risk Class FE		(7) Baseline with Generic Risk Class and insurer FE	
Intercept	0.349	***	0.346	***
Client Location (ref: Europe)				
Asia	-0.021	***	-0.017	***
Global	-0.022	***	-0.021	***
Middle East and Africa	-0.008	-	-0.009	-
North America	-0.033	***	-0.033	***
Oceania	-0.043	***	-0.042	***
South America	-0.013	-	-0.016	*
Method of placement (ref: Facility)				
Business Book (eg MGA, binding authority)	-0.049	***	-0.041	***
Open market	-0.044	***	-0.042	***
Number of insurers (ref: 1 insurer)				
2-3 insurers	-0.016	***	-0.013	***
4+ insurers	-0.010	*	-0.013	***
GWP (ref: GWP 1st quartile)				
GWP 2nd quartile	-0.006	-	-0.004	-
GWP 3rd quartile	-0.017	***	-0.015	***
GWP 4th quartile	-0.035	***	-0.029	***
Generic Risk Class FE	Yes		Yes	
Broker FE	Yes		Yes	
Insurer FE	No		Yes	
Number of observations	272,986		272,986	
BIC	-594,060		-604,908	
Adjusted R-squared	0.349		0.400	

Standard errors are clustered at broker level. *** significant at 1%, ** significant at 5%, * significant at 10%

36. Figure 5 plots the generic risk class fixed effects based on model (7) and concentration levels measured with HHI in a given generic risk class. There does not appear to be a relationship between remuneration rates and concentration at this risk level.

Figure 5: Remuneration rate dispersion and concentration levels across generic risk classes



37. We also ran the analysis controlling for Lloyd's risk codes instead of generic risk classes. Table 8 shows the result of the econometric analysis. The results do not vary materially compared to models (1) to (7).

Table 8: Results of models controlling for risk codes

	(8) Baseline with Lloyds risk codes FE		(9) Baseline with Lloyds risk codes and insurer FE	
Intercept	0.079	***	0.061	***
Client Location (ref: Europe)				
Asia	-0.031	***	-0.027	***
Global	-0.017	***	-0.013	***
Middle East and Africa	-0.012	-	-0.012	-
North America	-0.037	***	-0.032	***
Oceania	-0.041	***	-0.038	***
South America	-0.023	-	-0.022	*
Method of placement (ref: Facility)				
Business Book (eg MGA, binding authority)	-0.088	***	-0.069	***
Open market	-0.032	***	-0.025	***
Number of insurers (ref: 1 insurer)				
2-3 insurers	-0.014	**	-0.010	**
4+ insurers	-0.008	-	-0.009	**
GWP (ref: GWP 1st quartile)				
GWP 2nd quartile	-0.024	***	-0.019	***
GWP 3rd quartile	-0.029	***	-0.026	***
GWP 4th quartile	-0.043	***	-0.038	***
Lloyd's risk codes FE	Yes		Yes	
Broker FE	Yes		Yes	
Insurer FE	No		Yes	
Number of observations	131,084		131,084	
BIC	-267,400		-273,803	
Adjusted R-squared	0.260		0.323	

Standard errors are clustered at broker level. *** significant at 1%, ** significant at 5%, * significant at 10%

38. Figure 6 plots the coefficient of the risk codes fixed effects from Model (9). The dots represent the average remuneration rates in each risk code (relative to the risk code with the lowest remuneration rate). Error bars indicate the 95% confidence interval.

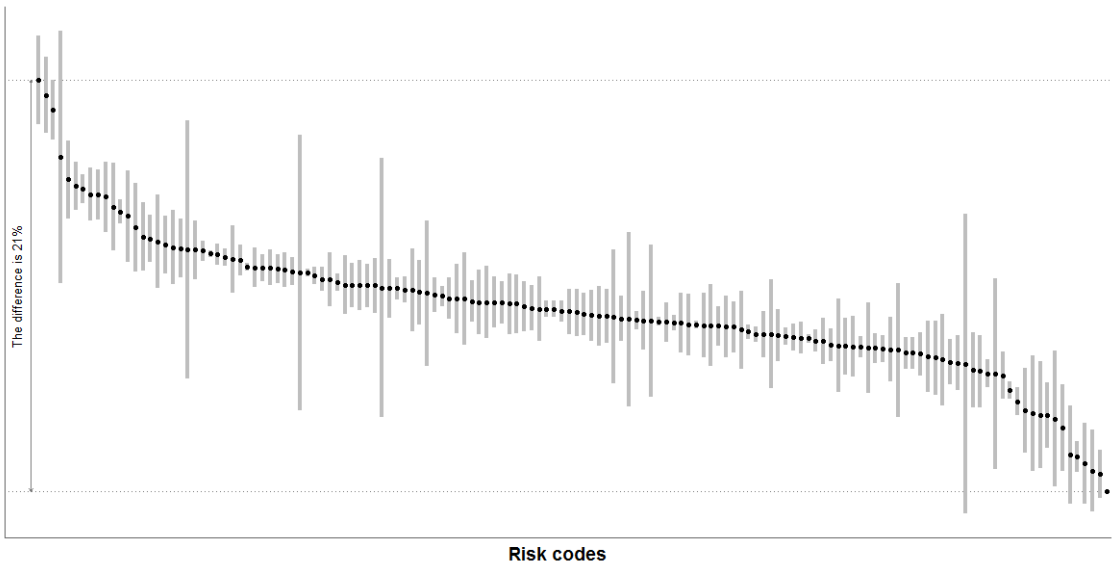
39. We found that there is a material difference between average remuneration rates across risk codes (up to 21%). The Lloyd's risk codes with the highest remuneration rates for like-for-like policies and methods of placement are: Aviation Whole Account (XY)[13], Personal Accident and Health Catastrophe XL (KX)[14], and Space Risk Liability (SL)[15].

[13] XY is in the generic class Aviation XL and in the high-level class Aviation.

[14] KX is in the generic class Personal Accident XL and in the high-level class Accident and Health.

[15] SL is in the generic class Space and in the high-level class Aviation.

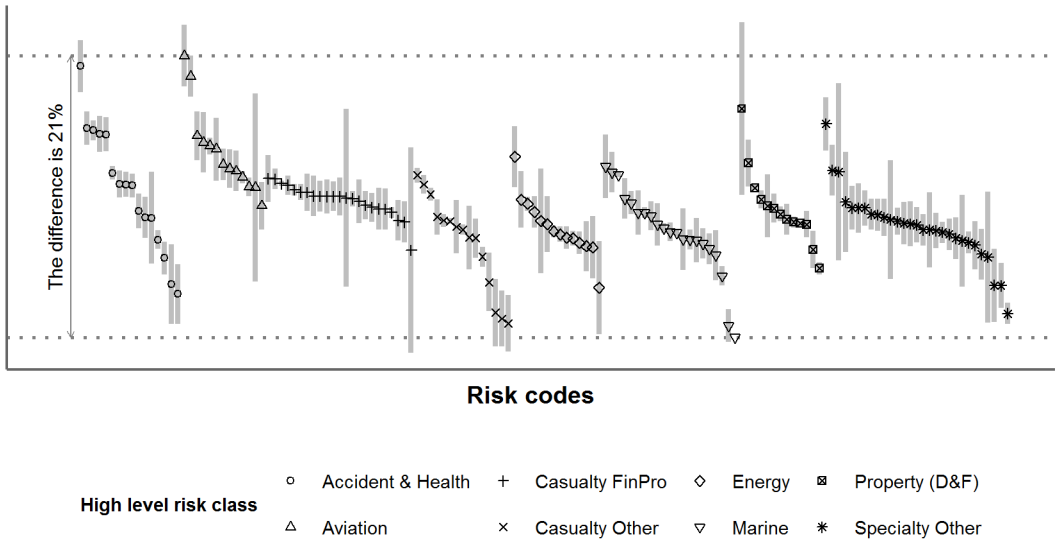
Figure 6: Remuneration rate dispersion across risk codes



40. The risk codes with the lowest remuneration rates for like-for-like policies and methods of placement are Cargo, War and/or Confiscation risks only (Q) [16], Motor Comprehensive and Non-comprehensive in the UK other than those falling under risk codes M2 and M3 (M4)[17] and Motor Vehicle Physical Damage and Third-party Liability in the EU and the EEA (MP)[18].

41. Figure 7 groups the coefficients of the risk codes shown in Figure 6 into the corresponding high-level risk classes. Figure 7 shows that remuneration rates vary materially across the risk codes within each high-level risk class.

Figure 7: Remuneration rate dispersion across risk codes, grouped by high-level risk classes



[16] Q is in the generic class Marine War and in the high-level class Marine.

[17] M4 is in the generic class UK Motor and in the high-level class Casualty Other.

[18] MP is in the generic class Overseas Motor and in the high-level class Marine.

Interpretation

42. The material variation in average remuneration rate across risk codes may be caused by differences either in the supply side (such as cost differences in providing brokerage services in different risk codes, or a limited choice of brokers in certain risk codes) or differences in the demand side (such as insurers' willingness to pay) or a combination of these factors.

43. Possible reasons that may explain cost differences across brokers include i) scarcity of technical broker expertise resulting in higher staff costs in certain risk segments, ii) differences in the complexity across risks and therefore differences in the time and work (ie cost) required to place a risk, iii) differences in the total size of the market segment and therefore different economies of scale across risk classes. Remuneration rates may also differ if competitive conditions differ by risk segment, with higher remuneration rates reflecting greater market power.

44. Alternatively, remuneration rates may vary if market features at the underwriter level vary across risk codes. For example, different profitability levels at the underwriter level may cause insurers to have different willingness to pay (commission to the broker) to distribute policies and find clients.

45. Finally, there may be policy characteristics that are not included in our dataset and therefore we cannot observe. Unobserved characteristics may also be responsible for some variation, however we consider that our analysis captures the main drivers of remuneration rates.

46. We have explored whether broker costs vary materially across risk segments. If they do then this could explain the observed differences in remuneration rates. By contrast, if broker costs do not vary substantially across risk segments this could suggest that higher remuneration rates reflect limited competition and/or differences in the size of the market segment.

47. Our financial data are drawn from brokers' management accounts. Not all brokers in our sample were able to provide a breakdown of their income statement and so our financial data set uses the segmented accounts of 6 brokers. The sub-sections of each broker's management accounts report the financial performance of different risk classes within a firm. These segments are drawn along commercial lines which differ by firm. However, the segments are broadly comparable with Lloyd's high-level business classes.

48. We were able to map partially the segmental financial data to these high-level business classes. However, not all management accounting segments can be mapped to these classes, and those that have been may contain business related to other high-level business classes. Consequentially, our results are at best indicative.

49. We have looked primarily at staff costs. This is because different brokers take different approaches to central cost allocation. Some hold these costs within their segmental accounts, others allocate the cost to the risk class segments we are interested in. By contrast, staff costs are often directly incurred and make up around 55% of most

brokers' cost base, and so represent a reasonably comparable cost base across our sample.

50. We looked at cost per pound GWP to normalise for scale between high-level business classes of different sizes. To test the sensitivity of our results we also look at cost per pound revenue which allows us to look not just at the high-level business class but also at each segment within a broker's management accounts. These metrics allow us to observe the extent of variation in cost across risk segments for each broker.

51. We found that cost per GWP varies substantially across segments for each firm in our sample. We observe a minimum range of 1.5 percentage points. More commonly, ranges are around 6 to 8 percentage points. As a benchmark, our profitability analysis indicates a difference of about 1 percentage point per pound GWP accounts for a difference of about 10 percentage points in terms of profit margin.

52. We also repeated this analysis focusing only on a data set at segmented management account level provided by the 6 brokers, but this time normalising by revenues (we do not have GWP data available for these segments). We also found that at this, often more granular, level there is material variation in cost per revenue between segments for each broker in our sample.[19]

53. This suggests that cost may be responsible in part for differences in remuneration rates across high level business classes. Our results do not rule out the possibility that 1 or more risk segments contain more granular risks that show less cost variation. However, our cost per revenue assessment at segmented management account level suggests that costs also vary within high level business classes. Consequently, we cannot conclude that higher remuneration rates are not driven by brokers facing higher costs in these areas.

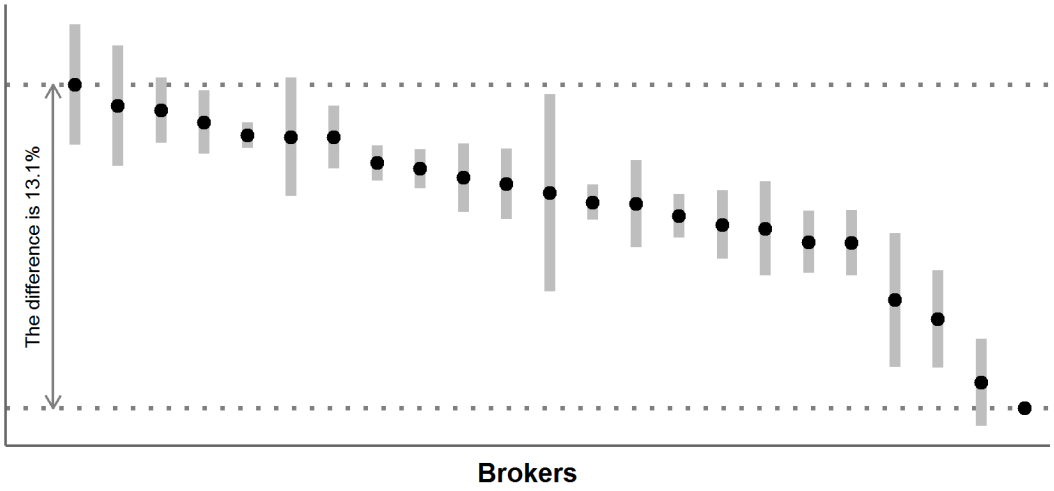
Remuneration across brokers

54. Figure 8 shows the remuneration rates across brokers plotting the broker fixed effects from model (5). The dots plotted represent the relative point values for brokers' remuneration rates, relative to that of the broker with the lowest rates. Each error bar indicates the corresponding 95% confidence interval.

55. We found that average remuneration rates vary materially across brokers. The difference in remuneration rates is up to 13%. We found that the largest brokers do not appear to be consistently earning the highest remuneration rate, controlling for high-level risk class. We found the same result at the generic risk-class level using model (7).

[19] See the segmented analysis section of Annex 3: Financial and Profitability Analysis

Figure 8: Remuneration rate dispersion across brokers



Conclusion

56. We found that broker remuneration varies materially across risk classes after taking into account policy characteristics and controlling for the brokers and insurers used. Costs are likely to be responsible for some of this variation, however it is also possible that other factors (such as limited competition and/or differences in the size of the market segment) may play a significant role. We also found that average remuneration rates vary materially across brokers, and that the largest brokers do not appear to be consistently earning the highest remuneration rate, controlling for risk class.

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