

MS17/2.2: Annex 5

Market Study

Wholesale Insurance Broker Market Study

Final Report: Annex 5 – Demand-side characteristics

February 2019

Annex 5: Demand-side characteristics

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 concern. This Annex explores whether clients have the necessary capabilities to foster competition between brokers and is relevant for two main areas:
 - the extent to which market power may be affecting outcomes in the market (see Chapter 3 of the Final Report)
 - whether brokers are engaging in conduct that could give rise to harm (see Chapter 4 of the Final Report)
2. For clients to be able to foster competition, appropriate information should be given about the service proposed and products offered. Communications should be comprehensible and delivered at the appropriate time. The information must also allow clients to benchmark and compare brokers if competition is to work effectively.
3. Once the information is available, clients must have the capability to assess that information and act on it in a way that promotes competition.
4. The Annex is structured as follows:
 - an outline of our methodology
 - the types of client in this market and how they decide to work with a broker
 - a description of client satisfaction with their broker
 - our assessment of the transparency of information from brokers about their service and its cost and
 - a description of how clients evaluate their broker, and how they switch brokers

Methodology

5. We used 3 sources of information for our analysis:
 - **Quantitative survey.** We sent an online survey to brokers' clients asking them about their experiences with brokers. We invited a total of 4,250 clients (including both policyholders and brokers who place business in London via a London broker) to complete a short online survey. The questions included geographic split, reasons for placing insurance in the LIM, awareness of broker activity and remuneration, longevity of the relationship, reasons for switching broker, individual relationships with brokers, important factors considered when choosing a broker and when renewing, satisfaction of quality and choice.
 - **Third-party client research.** We commissioned FWD to conduct 53 in-depth phone interviews with senior executives from national and international

companies, both intermediaries and policyholders. Interviews lasted between 40 minutes and an hour. Fieldwork dates were from 10th September to 8th November 2018. We publish their findings alongside this report. We had a particular interest in understanding the level of switching in this market, so given the low levels of switching in the market as a whole the sample is biased towards clients who have switched. The distribution of clients interviewed is detailed at paragraph 4, Section 2.5 of the FWD Research report published alongside this market study.

- **Data provided by brokers, including contracts to clients, terms of business agreements (TOBAs), and brokers' communications to clients.**

Type of clients and determinant of the choice of broker

6. In this section, we present the main characteristics of London wholesale brokers' clients. Then we present the main considerations of clients when choosing to enter into a relationship with a London wholesale insurance broker.

Client type

7. Clients in the London brokerage market within the scope of this market study fall in 3 categories: brokers who use London brokers to place risk on the LIM (intermediaries); very large corporates and slightly smaller corporates. We refer in this annex to the last 2 types as policyholders.
8. Different categories of clients are likely to have different levels of understanding of the services the London brokers does for them:
 - Intermediaries are likely to have specific industry knowledge and regular contacts with their London wholesale broker, which may result in relationship-driven interactions
 - Policyholders are less likely to have the same knowledge of insurance. However, policyholders are not homogeneous; larger corporates generally employ in-house specialists (the majority of the respondents to our online survey indicated that they employ in-house specialists). Due to scale, it may be that smaller corporates do not employ such specialists

Drivers of the decision to appoint a broker on the LIM

9. In this section, we discuss the relevant decision factors for clients who contract on the LIM.
10. The main considerations for clients in placing risks in the LIM are:
 - Lloyd's of London is an intermediated market, requiring clients to work with a Lloyd's broker
 - No one insurer may be able or willing to accept larger risks, and so a broker is required to assemble the cover from multiple insurers
 - Brokers can provide expert advice and ensure clients have appropriate coverage
 - Brokers can manage the placement of risk at a price that represents value
 - Relationships with the broker are also very important

11. Once a decision has been made to use this market, as mentioned in the Terms of Reference (paragraph 2.13), there are practical reasons to use a broker to access it:
 - **Capacity:** this is the main reason quoted by clients in FWD’s work – capacity for large, complex and bespoke risks is often only available via London
 - **Cover/proposition:** half of the corporates and approximately one-fifth of brokers interviewed by FWD said that the proposition was also a factor. The proposition is not always just a financial arrangement, for most it means the breadth of cover, claims service, underwriting flexibility, reputation of the underwriters, reputation of the broker, and/or bespoke limits
 - **Expertise and knowledge:** two-thirds of clients interviewed by FWD cited the expertise and knowledge available in the London Insurance Market
 - **Value:** while customers say that the London Insurance Market does not provide the cheapest cover, many are still price sensitive and look for value. Once a decision has been reached to use the broker, the relationship the client develops with the broker is very important.
12. When we asked clients what is important to them in their choice of broker, the main reasons quoted were the quality of service provided, followed by the ability of the broker to secure the best terms, placement speed, strategic advice services and claims handling experience.
13. The FWD research report confirms the view that price is only a secondary factor in selecting a LIM broker. The FWD research ranks price and value for money as the sixth most relevant factor, after in order: Knowledge and expertise; trust and individual; broker’s relationship with insurers; quality of service; and claims expertise.¹

‘I would use one word to describe our relationship: partnership. Because we see them as part of our team. They are an outsourced part. We have operational meetings together regularly. If things go well, we celebrate together; if things go badly, we resolve things together. We really try to foster that approach and not treat them as a service provider.’²
14. The importance of relationships is developed at length in the FWD Research report. Interviewees stressed the importance of being able to trust the broker who represents them. This appreciation was nuanced by a few end-clients (corporates), who view the relationship in more contractual terms.³
15. In summary, the primary selection factors in choosing a broker relate to factors such as expertise and trust. Second tier factors include the quality of the service and its value for money, with price being a secondary consideration.

Client satisfaction

16. In this section, we present our results on the clients’ levels of satisfaction. We have engaged with clients to better understand how satisfied they are with the brokers’ services and also whether they believe the services provide good value for money.

¹ See FWD Research Report, section 5.3

² See FWD Research report section 4.2.1

³ See FWD Research Report, section 4.2.2

Satisfaction with brokers' services

17. While the general theme was that clients were happy with the services provided by their brokers, there were instances where clients felt it could be improved, for example by being clearer about how they review the market when quoting for insurance.
18. According to the FWD Research report on the in-depth interviews, satisfaction with brokers services is generally "very high, especially among intermediaries".⁴ Specifically, FWD Research found that 49 respondents out of 52 interviewed were satisfied by their LIM broker services.
19. A small number of interviewees raised specific issues to illustrate their discontentment. For instance, 1 (US) intermediary explained that their wholesale broker was trying to poach their clients.

Value for money

20. According to the FWD Research report, 'almost all respondents find that their current wholesale broker offers great value for money'. More specific statements include clients explaining that it would be more expensive to them to take in-house the services their broker provide. Others illustrated their satisfaction with the value provided by the broker by stressing that they have not had to pay increased fees in several years.⁵
21. Accordingly, the majority of interviewees also believe that their broker works to provide them with the 'best deal' possible.⁶ This is consistent with high-level results of the online survey, where a large majority of respondent agreed that they received good value from their London broker.
22. However, when it came to renewing a broker agreement, there were a couple of clients who expressed a sense of apathy towards challenging payment:
*'They do not have to do a lot for it. There is not a lot of interaction but as it hasn't changed in 10 years... It's a bit like the electric bill, you just pay it, don't you?'*⁷
23. In addition, it is worth noting that, while the majority of interviewees stressed the benefits of the close relationship with their broker, a small proportion felt that it made it difficult to challenge if they had concerns with the value they were receiving.

*'The relationship is good. They are nice people who focus a lot on relationship building, and they know us inside out. But on the other hand it's difficult. Service delivery could be improved and they are not innovative.'*⁸

Other characteristics

24. Clients also expressed their satisfaction with the available choice of broker on the LIM, and also stressed that they feel attached to the individual broker, rather than with a firm.

⁴ See FWD Research report, section 4.4

⁵ See FWD Research report, section 6.2.6

⁶ See FWD Research report, section 4.4, paragraph 3

⁷ See FWD Research report, section 4.2.2

⁸ See FWD Research report, section 4.4

25. On the variety of broker options, FWD research concluded that clients were generally satisfied with the choice available to them.⁹
26. Clients of LIM brokers value the long-lasting relationship they have with specific individuals. Therefore, in evaluating the quality of the service they receive, an important distinction is made by many clients as to the trust they hold for the firm and the trust they have for the individual facilitating their broking requests with clients explaining that the latter plays a more important role in shaping this relationship. From our sample, there were examples of long-lasting relationships where clients followed individuals as they moved across firms:
- 'My brokers have moved around in the 20-30 years I have been doing business with them. Typically, it is the individual, this is how it works. Each broker will have something special, specific expertise.'***¹⁰
27. In terms of satisfaction, our findings are therefore that clients are generally satisfied and find value in the services.

Transparency

28. In this section, we explore the information that clients receive and the information they consider in order to make informed decisions.

Clients' awareness and ability to assess broker remuneration

Client knowledge of their broker's business model

29. The majority of respondents to our survey said they understand exactly what their broker does for them. Awareness was generally better among brokers acting as clients than for end clients.
30. Similarly, half of respondents to FWD's client interviews said they can get all the information they need to make decisions.¹¹ Some respondents, however, suggested transparency could be improved.

'I would like to see 'more transparency' about which markets each LIM broker went to so that, if needed, they could send to another LIM broker who could contact markets not yet approached. This would be fairer for the customer.'¹²

31. Information is mostly gathered through discussions with brokers, peers and colleagues.

'The more interest in them, the more they will share. There is incredible knowledge in Lloyd's but you need to ask the right questions. Ask better questions and then get better answers and engage with them and then they will open up. They will be eager to share with you their knowledge and the insights they have gained over time.'¹³

⁹ See FWD Research report, section 5.1.1

¹⁰ See FWD Research report, section 4.3

¹¹ See FWD Research report, section 5.1.3

¹² See FWD Research report, section 4.4, paragraph 5

¹³ See FWD Research report, section 5.1.3

32. FWD reported that less frequent or less experienced users are less likely to find it easy to find the right information.¹⁴

Client knowledge of their broker's remuneration

33. The majority of respondents to our online survey said they understand exactly how their broker is remunerated when placing risks.

34. Most respondents to the FWD interviews felt that disclosure of broker charges is better now than in the past. Almost all said they were aware of the remuneration.

'100% clear on what fees we pay... Fee for placement of transaction as try to get insurance premiums net rated from insurers so it is completely transparent. All extra services are on separate contract, e.g. risk engineering and clear separate amounts.'¹⁵

35. The majority of intermediaries respondents find remuneration transparent. Some corporate clients, on the other hand, sometimes have more difficulty understanding their broker's remuneration and whether everything has been disclosed.

'I certainly wouldn't say [broker's charges] were transparent.'

'The only concern, and it is a large one, is that remuneration needs to be more transparent so that people know what they are paying for and "who is getting a cut".'¹⁶

36. Further, the large majority of respondents to FWD research interviews did not identify persistent current conflicts of interest.

37. Yet a small number of respondents expressed concerns in relation to conflicts of interest. The two main concerns were the perceived closeness between their broker and their underwriter, and commission earner by the broker when it acts both to place an insurance contract and reinsurance. The reinsurance of the risk is a separate contract and information about that contract is not generally disclosed to the end-client.

'Never sure when there are hidden commissions. What is up front is transparent but then could place as a separate contract.'¹⁷

'There is an inherent conflict of interest with placing the reinsurance. The broker gets a commission on placing the risk, but then could get another commission on placing the reinsurance. That should be declared to the client from the broker. There is an enormous incentive to place the initial risk with an insurer who can also to the reinsurance.'¹⁸

38. This is backed up by our survey, in which a substantial minority of respondents said they do not know if their broker receives additional money (i.e. over and above money paid by the customer in commission and fees).

39. FWD reported that those clients whose broker is paid by a fee, rather than commission, are more satisfied with the disclosure of remuneration.¹⁹

¹⁴ See FWD Research report, section 5.1.3

¹⁵ See FWD Research report, section 6.1.1

¹⁶ For both quotes, see FWD Research report, section 6.1.2

¹⁷ See FWD Research report, section 6.1.2

¹⁸ See FWD Research report, section 6.3.3

¹⁹ See FWD Research report, section 6.1.5

Client ability to compare broker remuneration

40. The majority of respondents to the FWD research said it is easy to compare remuneration among brokers.

*'Yes it is very easy [to compare fees from different brokers] because it is all upfront and clear.'*²⁰

41. However, a small number of respondents found it harder to compare broker remuneration. These clients tend to be those who use only one broker, who never conduct tender exercises or who do not understand the current charges.

*'It is not easy to compare broker charges as it depends on many factors, such as the client situation, expiry dates, incumbent broker and the size of business.'*²¹

Review of the information provided by brokers

42. As well as asking clients for their perceptions, we reviewed the material provided by brokers to clients, to determine if it provides the information we consider necessary, in a clear way. Clarity is particularly important in a market such as this, where much of the information is inherently complex and customers are not always experts. Such complexity may lead to excessive broker remuneration and poor value insurance which can have a substantial impact on customers.

43. Information provided to prospective customers should be clear and, as far as possible, consistent across brokers. Both existing and prospective customers should be able to compare competing brokers on a like-for-like basis; this helps them to select the best broker for them and encourages competition on its merits. We recognise however that complete consistency can often be difficult to achieve.

44. One important element of this information is the remuneration that brokers receive from insurers. Such information, in principle could be used by a customer to select a broker therefore the omission of this information may lead to potentially uninformed decisions.

45. Given brokers can receive 2 sources of income (fees or commission), disclosure of either or both types of remuneration could be useful for a prospective customer in making their selection decision. We reviewed various information provided to customers from 50 brokers (including larger and smaller brokers) that covered: standard customer contracts, general governance and oversight policy documentation, terms of business agreements (TOBAs) as well as conflicts of interest policies.

46. The extent of disclosure by brokers varied. One-third of brokers responding to our data request said they disclose the amount of remuneration received from commission as a matter of course. Around half of respondents disclose the nature of the remuneration received but only disclose the amount of commission if the customer specifically requests it (and, of these, 3 said they only rarely receive such requests).

47. Our review of TOBAs identified inconsistencies as to what commissions are disclosed. One example demonstrating this was a firm that disclosed subscription market brokerage (SMB) and profit commissions only where it deemed it 'applicable' to do so. Another example we found stated that they disclose all types of commission voluntarily

²⁰ See FWD Research report, section 6.1.3

²¹ See FWD Research report, section 6.1.3

yet, where a customer wants to find out about the remuneration received from insurers participating in broker panels, this was only available on request.

48. To conclude, we identified that although most clients feel confident that they receive the right amount of information, a significant proportion of clients would appreciate greater levels of transparency. Also, our review of brokers' information disclosure to clients found that commission disclosure is not generalised or consistent.

Evaluation and switching

49. In this section we discuss how clients evaluate brokers' services and clients' switching among brokers.

Evaluating brokers' services

50. The ability of clients to evaluate the services provided by their broker should enable them to challenge their broker when appropriate. In this section, we analyse the clients' feedback on their experience of evaluating, challenging and monitoring their broker.

Appointment stage

51. First, we consider the information that clients may receive when appointing a broker. What information is received at this procurement time is crucial to effective competition since it is likely that clients may seek to compare several options, and therefore emulate competition between brokers.
52. Even if providing consistent procurement documentation could help clients compare services across brokers, it may only have a small effect. Indeed, brokers responding to our data request said the tendering process was not a large generator of business – instead referrals and networks were more important in generating leads.
53. This is confirmed by our customer survey. Apart from the relatively few clients who are required to have a formal tender and appointment process, responses to our survey indicate that there is very seldom a formal process to appoint or evaluate brokers. These are mainly done via internal discussions and meeting and talking to potential brokers.
54. It is more likely that, at best, clients receive information on broker quality more informally, through networks, trade bodies and other industry connections.

During the relationship: assessing brokers' performance

55. Assessing a broker's performance can take place in several forms. First, clients may challenge the advice from their broker: because the broker would typically present them with multiple quotes, they may go-ahead with their broker's preferred quote, or not. Second, clients may assess the performance of the broker services over the course of several transactions.
56. The information we have gathered suggests that while many of the respondents always follow their broker's first recommendation as to which insurer should be selected to

place the business, there were a number that would not necessarily follow the first recommendation. The on-line survey indicated that almost half of clients do not necessarily proceed with their broker's first recommendation.

57. Likewise, with respect to evaluating their brokers' performance, FWD's report mentions examples of intermediaries assessing alternative options:

'We have tested our broker to ensure they are doing what we need them to do. We found that other brokers could not match premiums or terms offered by broker, so yes we test competency from time-to-time and automatically on large business.'²²

58. Of the clients interviewed (intermediaries and large corporates), a significant proportion indicated that they maintain relationships with alternate brokers.²³ According to the questionnaire we sent to brokers, the most common reason, was to benefit from expertise in a specific class of business. The next most common reason, was to apply competitive pressure. This finding should be taken cautiously as our data analysis of multi-homing, presented in the Chapter 3, shows that most policyholders are linked to a single broker. It is possible that a minority of large and sophisticated clients, along with intermediaries representing policyholders, multi-home or maintain informal relationship with several brokers, which may have a significant disciplining effect on brokers.

Upon renewal / review

59. With the exception of the relatively few clients who are required to have a formal tender and appointment process, responses to our survey indicate that there is very seldom a formal process to appoint brokers. Around half of brokers responded to our survey saying that they did not have a typical review period. A quarter of respondents outlined that reviews take place on an annual basis and a significant proportion said reviews take place on an ongoing basis.

60. This lack of formal process carried forward into the way clients monitor and evaluate their existing brokers, with few having measurable key performance indicators (KPIs) or formal review mechanisms. As many as 9 out of 10 brokers in our survey did not have KPIs. Despite this, examples could be found where clients were not concerned at the lack of performance parameters:

'No need for KPIs. We have plenty of knowledge to know if they are providing a good service. Since 2009 we have an audit in place. We send letters to both the broker and the underwriters to confirm that they are placing the risks in the contract.'²⁴

61. While this lack of formal review mechanisms may suggest concern is warranted, wholesale insurance broker clients are to a large extent either intermediaries (themselves risk professionals) or corporates that may employ specialist risk managers. This may mean they have the capability to assess brokers' service.

Switching

62. In terms of perceived ability to switch, clients indicated that the administrative process is not difficult:

²² See FWD Research report, section 4.5.1

²³ See FWD Research report, section 5.4.1

²⁴ See FWD Research report, section 4.5.1

*'It is very easy all you need is just a letter of authority.'*²⁵

63. However, clients who have switched report that they experienced certain non-monetary costs to switching. In particular, clients explained that the process of finding an adequate counterpart and developing the relationship may take time and effort on their end:

*'It was "laboursome" but not impossible! There is a lot of documentation needed to insure vessels and not all are produced in the UK, so there is a time delay. All documents have to be checked. It is just setting everything up. When you switch there is a lot of information you need to provide because they have different procedures.'*²⁶

64. This suggests that competition should be considered constrained by at least some barriers to switching, most within the client's organisation.
65. The FWD research report also includes an estimate of switching rates in the broader LIM.²⁷ Based on biannual interviews conducted between 1993 and 2007 among 250 UK large corporate insurance buyers on behalf of General Insurance Market Research Association, FWD has found that about 8% of large corporate clients "invite other brokers to pitch" and that among those, the frequency of asking an alternative broker(s) to quote was approximately 5 years.
66. For those who do switch, as the broker market is based on strong relationships, the reasons quoted by clients that have switched brokers tend to follow an external trigger, among which the desire to follow an individual broker who moves to a new firm.²⁸
67. It is worth noting that low levels of observed switching do not, on their own, mean that clients are disengaged. However, we note that the observed level of switching is consistent with other characteristics identified, such as lack of generalized review, importance of relationships and high degree of client satisfaction.
68. To conclude, the market for brokerage services is relatively static, driven by non-price considerations and relationships. This is unsurprising for a market where all parties are professionals (i.e. a wholesale market). The consequence of this is that even if most clients were actively engaged and scrutinizing their broker, the threat of switching may not appear very strong to brokers. This reinforces the need for brokers' transparency.

Conclusion

69. Our client work has found that most clients are satisfied with their brokers and are confident of their own ability to access and process the relevant information to evaluate broker options.
70. Clients said they understand their broker's proposition and charges, and that they can compare broker remuneration. However, when we reviewed broker information, we found inconsistent practice as to disclosure. Firms need to pay due regard to the information needs of their clients, and to communicate information to them in a way which is clear, fair and not misleading.

²⁵ See FWD Research report, section 5.6.1

²⁶ See FWD Research report, section 5.6.2

²⁷ See FWD Research report, section 5.4

²⁸ See FWD Research report, section 5.2.2

71. Where we have concerns over transparency, we will raise them with firms to improve the standards of disclosure.
72. Clients tend to have informal processes to appoint and review their brokers and, while they say the administrative process to switch brokers is easy, there are non-monetary costs to switching e.g. in terms of finding a new broker and developing a new relationship. This reduces the competitive pressure on brokers and increases the need for adequate disclosure to help clients engage.

