FINANCIAL CONDUCT AUTHORITY

MS17/2.2: Annex 7

Market Study

Wholesale Insurance Broker Market Study

Final Report: Annex 7 – Insurer data cleaning

February 2019

Annex 7: Insurer data cleaning

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. We gathered a range of data in relation to these concerns.

2. This Annex outlines our approach for cleaning the data we received from insurers in response to our request for information.

Process

3. We originally selected a sample of 49 London market insurers for our data request, intended to cover both larger insurers and a number of smaller underwriters. Five small insurers were subsequently removed from the sample after discussions regarding applicability or non-response, thus we received data from 44 insurers. The majority of insurers reported data for the years 2012 to 2016, though a small number of insurers only came into existence during the period and report for the years available.

4. Insurers were asked to supply data on (i) London market business by broker, year, distribution channel and Lloyd's high-level risk class, including net written premium and breakdown of gross and net premium, (ii) agreements with brokers and (iii) reinsurance net ceded premium in 2016 by the same or different broker. We contacted all insurers in May 2018 to ask them to verify their interpretation of London market business and to address firm-specific questions.

Data cleaning

5. Insurers reported brokers by name. To match brokers across the sample we cleaned around 10,000 unique broker name variations supplied by insurers, first applying a fuzzy matching algorithm followed by manual checking. Outdated broker names were updated to their 2016 equivalent.

6. During the period of our analysis several brokers merged or were taken over by other brokers. We wanted to reflect this in our analysis, even in cases where the original broker brand was maintained. We therefore grouped brokers who merged during the period 2012 to 2016. We sourced information on mergers and takeovers from regulatory information and desk research, prioritising the largest broker groups. We merged observations for brokers that merged or were taken over, starting from the calendar year after the announced merger or takeover.

7. A handful of insurers listed their own MGA as the source of some business instead of broker names. In many cases there may have been a London market broker that

originally allocated this business, but some insurers' systems were not able to identify the original brokers. We coded all cases where the broker was identifiable as an insurer MGAs as 'Others', but otherwise kept the observations in our dataset. In 2 cases, the GWP concerned was a substantial proportion of those insurers' total GWP, but was a small fraction of the total market. The alternative strategy of excluding observations with insurer MGA as the source makes no difference to any of our conclusions presented in this report.

8. We removed any observations where the source was identifiable as direct from clients as this is not within scope of the market study. We also excluded a small number of other observations with sources such as 'Exclude' and 'Not applicable'.

9. In terms of risk classes, in 2 cases insurers were unable to fully separate 2 high-level classes of business because their internal risk code spanned both high-level classes. In these cases, we asked the insurer to code the risk class to which the majority of the business was likely to relate. In addition, we manually removed any remaining risk classes that were identifiable as consisting of treaty reinsurance as this is out of scope of the market study. We removed a small number of remaining observations where we were not able to match the class to high-level categories (total GWP circa £60,000).

10. In Tab 1 of the data request, most firms were not able to provide a comprehensive breakdown of the difference between gross and net written premium. Around half of firms were not able to provide any breakdown. This limited the analysis we could conduct on pricing as in most cases we could not distinguish commissions and fees paid to London brokers versus other acquisitions costs such as payments made to coverholders or tax. We identified major categories of commissions among groups of insurers that reported similar breakdowns, which were used in preliminary analysis.

11. Insurers provided a number of different descriptions of distribution channel that we mapped to either open or non-open market business based on supervisory knowledge or verification with the firm.

12. We kept all GWP figures as nominal, ie without correcting for inflation. For any fees denominated in foreign currencies, we converted to Sterling using Bank of England annual average exchange rates, accessed July 2018. We assumed all fees were exclusive of VAT unless otherwise specified, and adjusted fees labelled as inclusive of VAT, assuming a rate of 20%.

Agreements

13. In Tab 3 of the request for information insurers were asked to report details of agreements with brokers, including the dates of contracts, fees and commissions, and details of services. We then matched this data by insurer-broker pair and year with the placement data submitted by insurers. We use the matched data in the pay-to-play analysis in Annex 4.

14. Using the description of services, we labelled agreements as to whether they contained some form on non-placement services. We searched for keywords consistent with a broad definition of non-placement services including data analytics, pipeline information, consulting and other services. In cases where the description was unclear, we either checked the agreement contract or asked the insurer to classify agreements as predominantly placement or non-placement. We recognise that the distinction

between placement and non-placement is not a clear one and so we conducted appropriate robustness checks of our analysis in Annex 4. A few smaller agreements refer to administration services and minor marketing contracts, which are not the focus of our analysis but were not excluded.

15. Some agreements explicitly refer to services provided at a global level. In these cases, we created a dummy variable for global services and used this as a robustness check in our analysis. It is possible that other agreements are global but were not explicitly reported as such, or vice versa.

16. When matching agreements and GWP, we aggregated at the level of the insurance group. Some agreements were signed by insurers' individual syndicates, whereas others were signed at the group level. For consistency, we assumed that the agreement covered all the syndicates in the group.

17. In deriving a fee for agreements, we were not able to estimate fees that were expressed as percentage of GWP placed with the broker. Most agreements that included a percentage commission refer to more granular risk classes than we could observe, a time period we could not observe, or contained various exclusions meaning that we could not reliably estimate the fee in these cases. Where a fee was reported as a combination of a fixed and variable fee, we kept the fixed component. Similarly, in a few cases the reported fee included conditional elements such as profit commission or performance bonuses, or referred to an upper bound figure, in which case we included all such fees if observable.

18. We manually cleaned fees that were reported on a different time basis (i.e. over the period of the contract, annual equivalent fee, or quarterly fee). We referred to the original contract in cases of ambiguity. In addition, we verified with insurers whether in cases where identical upfront and ongoing costs were reported whether these represented 1 fee or 2.

19. Regarding the dates of agreements, in cases where insurers only reported the start and end month, we recorded the start date as the beginning of the month and the end date as the end of the month. This approach appears consistent with most contracts lasting 12 months. For firms that only supplied years instead of dates, we assume that the contract runs from the beginning of January to end December. For cases where the end date was reported as a phrase such as 'ongoing', 'evergreen' or 'until terminated', we assumed that the contract was renewed over the course of our sample period. We corrected for various issues with dates, and checked any outstanding issues directly with insurers.

20. For some of our analysis we use a dummy variable of whether an insurer-broker pair had an agreement in a calendar year. Since agreements often straddle calendar years, we assumed that an agreement was in place for a calendar year if it applied for at least 6 months of that year. For example, if an agreement ran from 10 July 2015 to 10 July 2016, then we consider it was in place in 2016 but not in 2015. We varied this assumption by using 3 months and any duration as the qualifying period.

21. For apportioning fees into calendar years, we use a basic pro rata approach. For each calendar year we multiply the fee by the number of days it applied during that year divided by the total number of days it applied. For instance, if a contract applies for 3 months of 2015 and 9 months of 2016, 1 quarter of the fee is allocated to 2015 and 3

quarters to 2016. This may obscure the timing of some upfront fees but appears the most prudent method. We made manual changes according to notes or after checking the original contract terms.

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12 Endeavour Square
London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk
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