

Wholesale Insurance Broker Market Study

Final Report

Market Study

MS17/2.2

February 2019

How to respond

In this final report we set out our final findings of the Wholesale Insurance Broker Market Study.

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1 Executive summary

- 1.1** In November 2017, we published the Terms of Reference for our market study into the wholesale insurance broker market. We launched the study in response to evidence we had heard from practitioners of potential competition concerns in this market and to our own analysis in this market. To assess these concerns we have looked at the role insurance brokers play, how well competition is working and how the market is developing.
- 1.2** Insurance brokers' business models are evolving. We found that a number of factors are driving change including availability of underwriting capital, technological change and international competition. But the London market remains strong, particularly in complex and speciality risks. Large brokers are increasingly using their expertise and data to drive new revenue streams, and placing risk through facilities. These were areas we particularly focused on given the evidence we had received. For example, indicating that brokers may compel insurers to pay for consultancy style services or participate in facilities.
- 1.3** Our work has not found clear evidence in relation to the competition concerns explored. Overall, we have not found evidence of significant levels of harm to competition that merit the introduction of intrusive remedies. We have, however, identified some areas which warrant further action, in relation to conflicts of interest (Col), the information firms disclose to clients and certain specific contractual agreements between brokers and insurers. These areas can be addressed within our usual supervisory processes and/or competition law enforcement processes, if appropriate. We are closing our market study at this stage and this is our final report. This step is feasible within our market study process, and this is the first time the FCA has done so. Given the dynamic nature of the market, we will continue to monitor developments in broker business models and the effectiveness of competition.

The market

- 1.4** The London Insurance Market (LIM) is one of the largest global centres for placing and underwriting large-scale, complex commercial and speciality risk. In 2017, it controlled approximately £60bn in gross written premium (GWP).¹
- 1.5** It serves as a hub for large commercial and speciality risk underwriters and attracts clients from the UK and all over the world. It has traditionally had a reputation for underwriting large, complex or unusual and high severity risks. Domestic underwriters in other countries may choose not to write or hold this type of business. They may steer away from its 'non-standard' risk characteristics, or consider the risk too large, or they may not have sufficient capacity to take it on.
- 1.6** The LIM is almost exclusively intermediated, with brokers placing the risks that are written by UK and international insurance companies and Lloyd's syndicates. An efficient broking market that works in the interests of policyholders benefits UK and international clients and makes the UK an attractive place to conduct insurance business.

1 'Overall total for the London Market of £59.905Bn', IUA London company market Statistics Report, October 2018. Available at: https://iua.co.uk/IUA_Member/Publications/London_Company_Market_Statistics_Report.aspx. This figure includes treaty reinsurance and overseas business managed by London operations.

- 1.7** Brokers in the LIM serve a wide variety of clients. These include UK and international corporations, public sector organisations, retail insurance brokers looking to place risks in the LIM for their own clients, and insurance companies.
- 1.8** The role of the London broker is to place their clients' risks with insurers with the capacity, risk appetite and financial strength to underwrite them. This intermediation service is complex, requiring expert knowledge of the risks faced by each client (typically large corporates with complex risk-placement needs). It also requires good knowledge of how these risks can be underwritten and by whom, to ensure risks are placed appropriately. When placing risks for clients, brokers receive remuneration from the client (as a fee) and/or from the insurers who underwrite each risk (as commission).
- 1.9** In recent years some London brokers, particularly the larger ones, have developed additional consultancy-style services, which they sell to insurers. These services typically include: basic data provision, more complex data analytics, consultancy-style reports on specific sectors, insurer feedback services and discussions of pipeline business. Brokers earn additional revenue from insurers through these services. The provision of the services and the revenue they generate for brokers is growing. In 2016, among the brokers sampled for this market study, 15 brokers offered such services, which accounted for approximately 8% of their revenues overall.²
- 1.10** There has also been a growth in the number of brokers using facilities. These facilities are intended to make the placement process for insurance more efficient. The broker firms creating these facilities ask underwriters to commit capacity to write certain risks, or classes of risks, upfront. They then create a placement offering designed to meet the needs of a particular sector or client group. There is a trend towards increasing amounts being placed using facilities. The data from brokers showed that 8% of GWP was placed using facilities. On average, business placed into facilities yields a higher commission rate for the broker, raising questions regarding the extent to which the increasing use of facilities is producing real efficiencies and economies.
- 1.11** Our work has identified a number of inter-related trends which will shape the market and competition within it. Technological change may further increase the risk and modelling expertise of brokers. This may have a significant impact on the relative positions of brokers and underwriters, and small and large brokers. It may be compounded by the increasing ability of larger brokers to leverage their data, and may lead to further market concentration, reducing competition. These changes and increasing global competition and EU withdrawal may challenge the competitiveness of the LIM.
- 1.12** All of these changes will require brokers individually to consider their business models and innovate, to ensure London remains competitive. It will also necessitate our ongoing monitoring to assess the impact of market developments on competition and the potential for harm.

Our focus

- 1.13** Our market study has focused on understanding whether competition in the London broking industry works effectively in the interest of its clients. Following evidence

2 See Annex 4, section 'Analysis using data provided by brokers'

received before we launched the study, and as set out in our terms of reference, we have focused on the following areas of potential concern:

I. Market power

High levels of concentration in the market could lead to some brokers being able to exercise market power and earn high profits. There could also be barriers that make it difficult for firms to enter the market or expand their businesses into different market segments.

II. Pay-to-play

Brokers could compel insurers to sign up to consultancy-style service agreements to win placement business, or require insurers to participate in placement facilities. The consultancy-style service agreements may have inflated prices. Brokers could also demand higher standard commissions (or additional commissions) from insurers in exchange for awarding them placement businesses.

III. Onerous conditions in contractual agreements

Brokers could impose restrictive clauses in their agreements with insurers.

IV. Broker conflicts³

Brokers could receive higher revenue for business placed in certain ways, such as through placement facilities or MGAs, than they do in the open market. This may not always be in the clients' best interest. Brokers could also tie reinsurance with their other brokerage services. This could interfere with the operation of the competitive market, which could result in harm to clients.

V. Broker coordination

Co-ordination can happen when firms operating in the same market recognise that they are mutually interdependent. They realise they can reach a more profitable outcome if they coordinate to limit their rivalry. The effects of coordination could include higher prices or lower quality service than would otherwise be the case.⁴

1.14 Broker market power would be limited if the demand side could put pressure on brokers. This could be by regularly reviewing and, if necessary, switching brokers. This would limit brokers' ability to exploit any information asymmetries. We therefore also focused on the ability of brokers' clients to do this.

1.15 We also sought to place our analysis in the context of possible market developments.

Our approach

1.16 We investigated the above areas and drew our findings from various sources and analyses:

- Responses to our Terms of Reference – we received 27 responses.
- Data request – Quantitative and qualitative analysis of 73 brokers' and 49 insurers' responses to our request for information.

³ In this study, we assessed conflicts of interest under our operational objective of promoting effective competition in the interests of consumers.

⁴ As set out in the terms of reference, the purpose of the market study is not primarily to investigate infringements of competition law, and we have not investigated whether there is evidence of explicit collusion in this industry.

- Remuneration econometric analysis – econometric analysis of policy-level data, to analyse brokers' remuneration. Annex 2 provides details of our analysis.
- Financial analysis – financial analysis which assessed brokers' profitability and business model. Details of our approach and findings are in Annex 3.
- Pay-to-play analysis. A quantitative analysis to determine the occurrence of pay-to-play practices. Annex 4 provides full details of our methodology.
- Client research – client research based on responses to a quantitative survey and to client interviews conducted for us by FWD Research, a consultancy firm. Our findings are in Annex 5.

1.17 Throughout the work we had discussions with a range of stakeholders, including brokers, insurers, clients, trade bodies and other interested parties.

Our findings

1.18 This section sets out the key findings of our analysis.

Market power

1.19 We set out our findings relating to market power in Chapter 3. At an aggregate level, combining all risk classes, the wholesale insurance broking sector does not appear to be highly concentrated. In some segments of the market (specific risk classes and risk codes), we have found evidence of high concentration levels.

1.20 We have not found evidence of excessive profitability. Segmenting firms by scale, we find that, as firms grow, their average margin improves. This is driven primarily by economies of scale. We find that differences in concentrations between risk segments do not systematically lead to increased profitability in those segments for brokers.

1.21 We have found that average remuneration rates vary materially across brokers. However, the largest brokers do not appear to be consistently earning the highest remuneration rates, controlling for risk class. This suggests if larger brokers have market power, it is not reflected in elevated commission rates or client fees.

1.22 We have found that there are some barriers to entry and expansion in the market which may adversely affect competition at the margin. These barriers do not appear to be large enough to lead to a significant restriction of competition. Barriers to entry and expansion are most likely to occur for niche risks and when servicing customers with global risk programmes. In some niche risk segments, there are a smaller number of brokers with the level of expertise and reputation required to win business.

1.23 Our analysis of the demand side finds that clients appear to be able to exert a reasonable constraint on brokers. This limits the potential harm that could arise from broker market power.

Pay-to-play

1.24 We have explored whether there is pay-to-play in 3 different ways:

- i. We analysed insurers' responses to our data request, which included questions about their reasons for entering into agreements with brokers, for instance the

existence of pay-to-play. The data request also included questions on insurers' experience of using facilities. The insurers' responses provided us with no evidence of pay-to-play.

- ii. We constructed a quantitative model to measure the impact that insurers' payments for non-placement services may have on the amount of business received. Our quantitative analysis does not provide robust evidence of pay-to-play.
- iii. We reviewed a large number of contractual agreements between brokers and insurers to see if agreements are unfairly in favour of brokers, such that insurers would only enter into them if brokers were able to exercise market power. Our review has not provided clear evidence of pay-to-play.

1.25 As explained in Chapter 4, we recognise that, taken individually, neither the quantitative nor qualitative analysis can necessarily determine that there is no pay-to-play. As we have observed in other wholesale markets, there may be an unwillingness on the part of participants to disrupt commercial arrangements. However, after considering insurers' responses to our questionnaire, together with the results of our analysis, we are unable to conclude that pay-to-play exists at scale or that there is any basis for us to intervene at present.

Onerous conditions in contractual agreements

1.26 As part of our review of contractual agreements (Chapter 4), we have identified some clauses that can restrict competition in certain circumstances. This is potentially concerning. This does not appear to be a market-wide issue as these agreements are concentrated in a small number of brokers. We intend to follow up with the individual relevant firms, and then consider whether any additional steps are appropriate. We have not found any evidence of brokers being able to require insurers to place facultative reinsurance⁵ of the same risk with their brokerage services.

Broker conflicts

1.27 Our analysis shows that brokers receive higher remuneration rates from placing risks into their own facilities and MGAs than in the open market. Using these placement methods can be in the interest of the client, particularly where the risks are less specialised and hence easier to commoditise. But the higher remuneration may incentivise the broker to use a facility or MGA when this is not the case. Research shows that most clients can get the information they need to help make informed decisions, which helps minimise the potential harmful impact of conflicts.

1.28 The issues listed above could be mitigated through effective conflicts of interest policies to reduce the possibility of harm. We have reviewed brokers' conflicts of interest policies to assess their impact on competition and to assess the impact on clients of possible broker conflicts. We found that not all of them demonstrate the same level of completeness in identifying the relevant conflicts inherent to their business models.

1.29 The conflicts and mitigating factors are often articulated at a high level and do not set out how the conflicts will be managed. This has implications for whether there are

⁵ An insurance company enters into a reinsurance contract with a reinsurance company to pass off some of their risk in exchange for a fee. This fee may be a portion of the premium the insurer receives for a policy. The primary insurer that cedes risk to the reinsurer has the option of ceding specific risks or a block of risks. Facultative reinsurance allows the reinsurance company to review individual risks and determine whether to accept or reject them.

appropriate control frameworks in place which enable firms to effectively manage their conflicts in practice. We want to remind firms of their obligations under our rules. These include the need to manage any conflicts of interest arising from their activities and mitigate the risks these pose to their customers. The level of work required to meet these obligations may be greater where firms introduce new services and revenue streams which increase their exposure to conflicts of interest. These new services involve larger brokers using their expertise, infrastructure, and data capabilities to develop data analytics and other services targeted at insurers. We will continue to look at compliance with these obligations as part of our supervisory work.

- 1.30** We also remind firms that they need to consider the information needs of their clients, and to communicate in a clear, fair and not misleading way. We also publish alongside this report the findings of qualitative analysis undertaken on our behalf by FWD.

Coordinated effects

- 1.31** Our analysis concludes that the industry's characteristics mean that tacit coordination between firms is unlikely. This is set out in Chapter 5 and Annex 6.

Possible changes in industry dynamics

- 1.32** We have explored in Chapter 6 the possible developments discussed above and how they may affect competition between brokers in the LIM and the interaction between brokers and insurers. We will continue to monitor the market to determine at an early stage whether regulatory attention is required.

Next steps

- 1.33** This is our final report into the wholesale insurance broking market. We have not found evidence of significant levels of harm that merit the introduction of intrusive remedies at present. Our next steps are limited to market monitoring, supervisory activities and ensuring firm compliance with competition obligations.⁶
- 1.34** We plan to continue to monitor the market as part of our normal supervision function, including in relation to broker business models and the effectiveness of competition. This will help us determine at an early stage whether regulatory attention is necessary because of developments in the market. We will assess the impact of EU withdrawal, and possible further consolidation in the industry and their impact on business models.
- 1.35** We remind firms they must manage conflicts of interest. We will continue to assess compliance with these obligations as part of our supervisory function.
- 1.36** We intend to follow up bilaterally with the small number of firms who have clauses in their agreements with insurers which could potentially restrict competition in certain circumstances.

⁶ We consider these to be exceptional circumstances, as provided for in our guidance on the FCA's powers and procedures for market studies and as explained in Chapter 7 of Final Guidance 15/9: Market Studies and Investigation References, July 2015: www.fca.org.uk/publication/finalised-guidance/fg15-09.pdf

2 Introduction

Wholesale insurance broking is a key part of the intermediated London Insurance Market. We launched this Market Study in response to evidence from practitioners of potential competition concerns as well as our own analysis of this market.

The study details our analysis and our findings to assess whether competition is working effectively. These include:

- the competitive landscape and evidence of market power
- an assessment of whether brokers are compelling insurers to pay-to-play or if they are imposing onerous conditions in agreements
- the management of conflicts of interest by brokers
- if there may be tacit collusion in the market
- future market developments

2.1 In this chapter, we set out the background and scope of this study. We then present the structure and features that characterise the wholesale insurance broking market. Finally, we set out the issues we have explored and evidence we have gathered to support our analysis.

2.2 In Chapter 3 we cover the competitive landscape and market power which includes:

- Market definition assessment. We set out the characteristics of this market that could affect competition.
- Market structure. An analysis of market shares and levels of concentration for different risks classes.
- Profitability analysis. Explores the evidence of existence of excessive profits.
- Barriers to entry and expansion. Sets out our conclusions on the existence of barriers and its potential impact on competition in the market.
- Demand-side constraints. Reviews the evidence available that consumers act to mitigate harmful impacts of market power.

2.3 Chapter 4 explores if brokers may be:

- compelling insurers to pay to play
- imposing onerous conditions in their contractual agreements with insurers
- or earning extra revenues using placement methods that give them higher commissions when it might not be in their clients' interest

Then, we look at firms' management of conflicts of interest and how that might reduce the likelihood of harm to clients. Finally, we explore the role of disclosure.

2.4 Chapter 5 sets out our assessment of whether the broking market is susceptible to tacit co-ordination. This examines whether brokers come to an implicit understanding that could restrict competition, leading to clients facing higher prices or receiving lower quality service.

2.5 In Chapter 6 we explore some developments that may affect competition between brokers. In particular we look at:

- changes in the concentration within the broking market
- market hardening
- changes in international competitiveness
- Brexit and regulatory change
- technological change

2.6 In Chapter 7 we set out the summary of our findings and next steps.

Reasons for launch

2.7 In 2017, the LIM accounted for approximately £60Bn in GWP.⁷ Effective competition is important in this sector since even modest improvements in its efficiency could significantly benefit the wider economy.

2.8 We launched the Wholesale Insurance Broker Market Study in November 2017 in response to evidence of potential competition concerns arising from the evolution of the market. The wholesale insurance broking market has been changing in response to a number of factors over the last 10 years. This may have ramifications for the way in which competition works and the level of competitive pressure experienced by brokers. We outline these changing market conditions below:

- **Ongoing 'soft'⁸ market conditions.** There has been abundant underwriting capital and hence intense competition among insurers to access brokers' business. The unusually prolonged soft market has caused insurance premium rates to fall. As brokers' commission is set as a percentage of premiums, falls in premium rates can adversely impact brokers. Brokers can attempt to mitigate this impact by using the competition amongst insurers for business to obtain enhanced commissions and revenues for existing business, or by seeking alternative revenue streams.
- **Increasing consolidation amongst broker firms.⁹** As broking firms continue to merge, the market may be becoming increasingly consolidated and this is likely to change the way competition in the market works. It could possibly lead to fewer brokerage firms or concentration in specialist areas. It could also affect the way brokerage services develop, for example, greater global coverage and opportunities for consultancy services.
- **Data.** Larger firms have been able to combine their expertise, infrastructure and data capabilities to develop data analytics and other services targeted at insurers. These firms can do this due to the large volume and variety of data they have access to, which often exceeds that available to insurers. Expanding into these services creates a more diversified revenue stream, and contributes to broker profitability during soft market conditions.
- **Alternative markets.** We know that the LIM is increasingly facing competition from other global insurance markets, for example wholesale insurance centres in Miami, Zurich or Singapore, in which brokers can organise groups of underwriters with which to place their clients' risks. Increasing competition from outside the LIM could affect how firms compete within the LIM, for example by encouraging brokers

7 'Overall total for the London Market of £59.905Bn', IUA London company market Statistics Report, October 2018. Available at: https://iua.co.uk/IUA_Member/Publications/London_Company_Market_Statistics_Report.aspx. This figure includes treaty reinsurance and overseas business managed by London operations.

8 The underwriting sector moves in cycles. During the 'soft' phase there is a greater supply of capital available for underwriting, placing downward pressure on premiums (holding other factors constant, such as risk).

9 For example, <https://integrogroupp.com/uk/news/integro-news/integro-completes-acquisition-of-tysers>

to find new sources of revenue. It also accentuates the need for London to be regarded as an efficient insurance marketplace as well as an expert one.

- **Growth of facilities.** Brokers say that competitive pressures have been an important trigger for the increased use of facilities intended to improve the efficiency of placing risks in the LIM, and for which brokers receive higher remuneration from insurers.

2.9 The evolution of the market can deliver efficiencies, helping to create new markets, new products and new services. At the same time, the evolving market could reinforce existing market power. This could encourage behaviour that is harmful to brokers' clients and to the process of competition itself.

2.10 This report sets out our analysis of whether competition in the wholesale insurance broking market is working effectively in the interests of clients.

Scope of the study

2.11 Brokers are part of a wider value chain that stretches from the end client, through various retail and wholesale brokers, to the underwriters in the LIM. We have included facultative reinsurance in our analysis but excluded treaty reinsurance.

2.12 Our market study looked specifically at the role of brokers in the LIM.¹⁰ Brokers match clients with groups of underwriters, where the client is looking to insure risks too large or complex for traditional insurers. This process is known as risk placement.

2.13 We have gathered information from brokers, underwriters, clients and other stakeholders.

Market features

2.14 This section looks at the role brokers play in the market and the economic features of the market that are key to our investigation.

2.15 Brokers act as agents for clients wishing to place large or complex risks within the LIM. There are generally 2 different types of wholesale broker: those who place business coming from a third-party intermediary¹¹ and those where a global broker handles a major corporate from initial client contact to placement.

2.16 The role of the London broker is mainly focused on placing their clients' risk(s). The broker intermediary role includes negotiating on behalf of the client. It can also encompass a broader risk management role, as well as handling the administration of the placement and claims process. These are known as placement services.

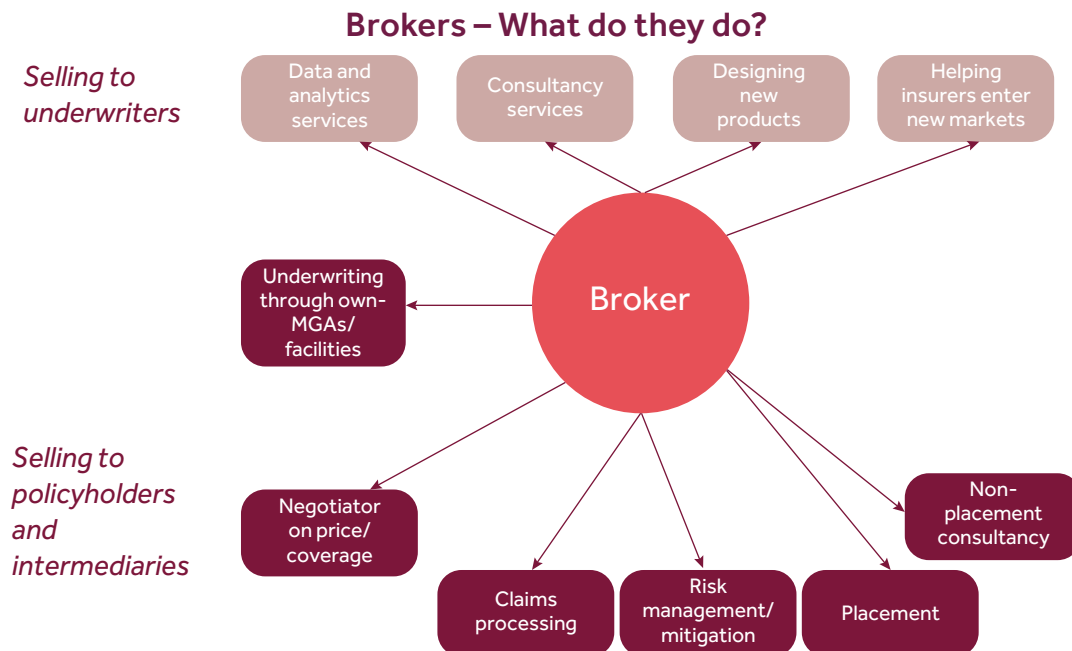
Brokers also provide other services to clients and insurers based on their market knowledge but not directly related to placing a client's risk with an insurer. We refer to

¹⁰ We have not reviewed the competitive landscape of other markets, outside the LIM. Our remit is limited to the UK and we would not be able to gather data from firms in other jurisdictions.

¹¹ This intermediary is typically a third-party retail broker.

this range of services as non-placement services. Figure 1 outlines the different areas that make up the broker business models.

Figure 1: Activities that wholesale insurance brokers may perform



- 2.17** The wholesale insurance broking market is characterised by the following features, which have important implications for how competition works.
- 2.18** **Intermediated market:** The central feature of the LIM is that brokers act as clients' intermediaries for almost all transactions. This creates a market structure where the broker is the route to market for underwriters. This tends to strengthen brokers' bargaining position. Soft market conditions have enhanced this feature of the market.
- 2.19** **Principal-agent structure:** The intermediated market also creates a principal-agent structure. Principal-agent problems occur when the incentives of an agent (in this case a broker) do not always align with the interests of the principal (in this case the client), creating a conflict of interest.
- 2.20** **Asymmetric information:** The principal-agent problem can be exacerbated by asymmetric information. Where a broker's expertise and market knowledge is greater than a client's, asymmetric information can make assessing value for money harder for clients.
- 2.21** **Two-sided market:** Brokers can sell services both to clients (placement) and to insurers (non-placement services), creating potential conflicts of interest when selecting an insurer for clients.
- 2.22** **Agreements:** For certain types of risk, brokers can set up a range of agreements with underwriters to speed up the process of risk placement. Such agreements can take several forms, for example, line slips delegate authority to a lead underwriter to provide insurance on behalf of a group of underwriters.

More recently, brokers have started creating facilities to help standardise risk and provide a guaranteed volume of underwriting capability for clients. On average, risks placed through facilities have higher commission rates than comparable risks placed in the open market. We also know that some brokers have started to sell some non-placement services through these facilities. There may be incentives for brokers to place business into facilities, even where it would be in a client's interest for that risk to be placed in the open market. This is more likely where there is asymmetric information or weak demand.

2.23 Returns to scale: Brokers' business models are built on expertise and human capital. Brokers' marginal cost is low and scale can allow for greater efficiency. The scale and scope of a broker's network may further strengthen bargaining position.

2.24 Data as a joint product: Brokers gather market data as part of their intermediary role. Analytics based on this data can be sold on to underwriters and clients but only when it reaches a critical mass. For this reason, brokers' scale may determine which brokers are able to sell data-driven consultancy services as an adjunct to their placement and non-placement business, with some larger brokers having access to a wider volume and range of data than many insurers due to the business flows they intermediate.

2.25 Commission-based remuneration: Brokers are typically compensated for their placement activities in the form of commission, paid by the insurer as a deduction from the GWP.¹² All things being equal, clients would prefer that the broker charge a lower commission rate as this should be reflected in a lower premium.

Brokers, on the other hand, may prefer to award business to an insurer willing to pay a higher rate of commission. This represents a misalignment of incentives between the principal and agent. If competition is effective, we would expect brokers to place business with the most competitive provider. However, features such as asymmetric information, and weak demand can potentially encourage brokers to award business to insurers willing to pay them higher commission rates.

Evidence we gathered to support our analysis

2.26 Our findings are drawn from multiple pieces of analysis:

- **Data request.** Quantitative and qualitative analysis of 73 brokers' and 49 insurers' responses to a questionnaire we sent to firms. We used the responses to assess a range of market features including conflicts of interest management, market shares and entry and exit.
- **Remuneration econometric analysis.** Econometric analysis of around 273,000 policies, worth around £17.5bn, that looks at how brokers' remuneration varies at the policy level. Annex 2 provides details of our analysis.
- **Financial analysis.** Financial analysis which assessed how brokers generate revenues, brokers' operating margins, the relationship between size and profitability. Further details of our approach and findings are in Annex 3.

¹² Brokers may instead (or in addition) be remunerated by charging a fee directly to the client. This is usually a fixed fee, expressed as an absolute amount, as opposed to the more typical commission rate (expressed as a percentage of GWP).

- **Pay-to-play analysis.** A quantitative analysis to determine whether there is empirical evidence of brokers engaging in pay-to-play practices. Annex 4 provides full details of our methodology.
- **Client research.** Client research based on a quantitative survey sent to 4,250 brokers clients and client interviews conducted for us by FWD, a consultancy firm. FWD conducted 53 in-depth interviews with senior executives from firms, both intermediaries and policyholders, that are clients within the LIM. Our findings are set out in Annex 5.

2.27 In addition, we met with over 25 brokers and underwriters and 14 UK and international industry bodies prior to the launch of our study. We spoke to and received information from our sample of firms, as well as industry groups, throughout the study.

3 Competitive landscape and market power

In this chapter, we assess the competitive landscape in the broking market, the degree to which concentration may limit competition, and if that might lead to higher profitability. We set out:

- how we define the market
- the findings of our market structure analysis, including concentration levels and pricing analysis
- an analysis of brokers' profitability
- a discussion on the potential barriers to entry and expansion in the market
- an analysis of the extent to which clients can exert competitive pressure on brokers

At an aggregate level, combining all risk classes, the wholesale insurance broking sector does not appear to be highly concentrated. However, when examining market shares within some segments of the market (specific risk classes and risk codes), we have found evidence of high concentration levels.

We have not found evidence of excessive profitability. We find that as firms grow their average margin improves, driven primarily by economies of scale. Differences in concentrations between risk segments do not systematically lead to increased profitability in those segments for brokers. The largest brokers are not consistently earning the highest remuneration rates, which suggest that if these brokers have market power, this does not reflect in elevated commission rates or client fees.

There are some barriers to entry and expansion in the market which may adversely affect competition at the margin. These barriers do not appear to be large enough to lead to a significant restriction of competition. Barriers to entry and expansion are most likely to occur for niche risks and when servicing customers with global risk programmes. In some niche risk segments, there are currently a smaller number of brokers with the level of expertise and reputation required to win business.

Our analysis of the demand side finds that clients appear able to exert a reasonable constraint on brokers, although there are potential aspects where this could be strengthened. These are considered further in Chapter 4.

Introduction

- 3.1** This chapter assesses the competitive landscape of the London wholesale insurance broking sector. We have considered a range of evidence to determine whether London wholesale brokers could raise 'prices' or reduce service or quality (of both brokerage services and services to insurers) above competitive levels.¹³

¹³ Or equivalently, reduce quality or service levels.

3.2 Our analysis looks at the following areas:

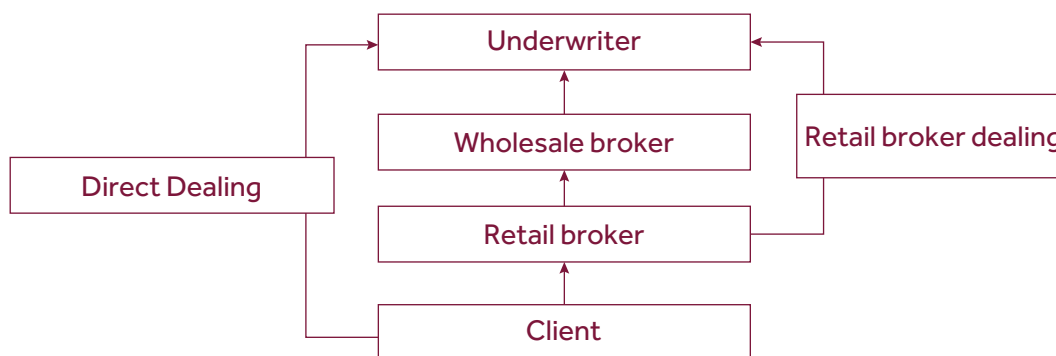
- Market definition assessment. We set out the characteristics of this market that could affect competition.
- Market structure. An analysis of market shares and level of concentration of brokers for different risk classes.
- Profitability analysis. Explores the evidence of existence of excessive profits.
- Barriers to entry and expansion. Sets out our conclusions on the existence of barriers and its potential impact on competition in the market.
- Demand-side constraints. Reviews the evidence available that consumers act to mitigate harmful impacts of market power.

Market definition assessment

3.3 To assess how effectively competition is working in the wholesale insurance broking sector and assess market power, we need to consider the definition of the relevant market.

3.4 As set out in Figure 2, the LIM provides a venue for various activities, including underwriting and broking. In our study, we have focused on the activities of wholesale brokers, which differ from other activities in the LIM value chain.

Figure 2: Insurance broking market structure



3.5 Insurance brokerage is specific in several respects. While brokers and underwriters have many overlapping skills, there are differences. Brokerage is primarily a distribution service. Underwriting requires the financial capital to take on risk, as well as the ability to undertake detailed risk modelling. This is then converted into the calculation of premiums through actuarial skills. We consider these to be fundamentally different economic activities. We have therefore analysed the way competition works for brokerage services in the LIM (and excluded the provision of underwriting services from this potential economic market).

3.6 In the market for brokerage services, clients differ substantially. There are differences in the complexity of their risk programme, their risk location(s), the types of risks that need to be insured, and their sophistication. Brokers' ability to service these needs depends on their expertise and operational scale. The result is that clients may not find all brokers in the market to be strong substitutes. We acknowledge, therefore, that competitive conditions are likely to differ across the market. These could differ along several aspects, which in some cases interact with each other.

3.7 However, the data required to assess the degree of substitutability between every combination of client risk type, location and size and broker specialism would have placed a disproportionate burden on firms. Our segmental analysis does not seek to define every potential granular economic market serviced by brokers. Instead it uses a series of parameters, for example, risk location or client type, to identify areas where there could be material differences in competitive conditions.

3.8 In the following section, we have outlined the types of firm which supply competing or alternative products and services to brokers. We describe the 2 elements of the economic market relevant to our study:

- the 'product dimension' which examines the products or services that provide an alternative to wholesale insurance broking services
- the 'geographic dimension' which examines the extent to which brokers in other countries compete to supply the same services undertaken by London brokers

3.9 We also consider the alternative risk solutions clients may have.

Product dimension

Risk class

3.10 We considered whether the product dimension could be delineated by risk class.¹⁴ Risk classes are the grouping of insurance products into identifiable segments, such as Aviation or Marine insurance. On the demand side, insurance clients generally require a product that provides a specific type of coverage, with limited ability to switch between products in different risk classes (eg an airline company cannot substitute airline cover for marine cover).

3.11 We found, on the supply side, that larger brokers appear to structure themselves according to risk classes, with limited substitutability between classes. The majority of brokers state that they arrange their business by product line (ie risk class, at different levels of specialism) and customer type. Smaller brokers tended to say that they were not formally structured according to either risk class or customer type, and were willing to take on business if they have the necessary expertise.

3.12 The number of brokers operating in each high-level risk class reflects a degree of specialism in the risk class. Out of 69 brokers that responded to our data request, over 55 brokers operate in the Casualty Finpro, Casualty Other, Speciality Other, Accident and Health, and Marine classes. Fewer than 40 operate in the Aviation (38 brokers) and Energy (36 brokers) classes. This shows that presence in the LIM broking market does not equate to presence in different risk classes.

3.13 Our analysis of broker pricing supports the hypothesis that the market could be defined at the level of risk classes. Our pricing analysis (Annex 2) finds that broker remuneration varies materially across risk classes. This is after taking into account policy characteristics and controlling for the brokers and insurers used. While costs and segment size are likely to be responsible for some of this variation, the results could reflect differing competitive conditions in different risk classes.

¹⁴ Lloyd's lists risks with three levels of aggregation: High-level categories (such as Marine insurance), the intermediate 'generic' risk classification (for instance, 'Marine Hull', or 'Marine War'), and 'risk classes' which represents the lowest level of granularity.

- 3.14** Responses to our broker questionnaire indicated clients commonly use multiple brokers due to their requirements for different risk class specialisms. This confirms our findings on client 'multi-homing' (see later in this chapter). It suggests that there is a limit to supply-side substitutability between risk specialisms. For example, a specialist broker in Energy is unlikely to be able to supply broking services related to Casualty risks.

Client type and risk location

- 3.15** We considered whether it is appropriate to segment the market by client type. We did this to assess whether different clients would get different outcomes from using different products or services, or get different treatment from brokers. Clients' levels of sophistication vary in engaging broker services, and they have different requirements that restrict their choice of broker.
- 3.16** Because brokers' prices are negotiated bilaterally, having engaged or sophisticated clients does not necessarily improve outcomes. Hence, outcomes could vary even for similar risks. This creates the possibility that the market is segmented by customer type. We have limited evidence on demands or conditions that each class of client faces, but below we assess the broad types of client and their potential sophistication.
- 3.17** Based on our client research, the largest distinction can be drawn between clients of LIM brokers who are policyholders (the end client holding the risk) and those who are retail brokers. Among policyholders, around two-thirds of respondents to our survey were corporates. Not-for-profit and public-sector organisations represented only a small proportion.
- 3.18** We also considered how sophisticated clients were, as brokers might segment the market according to client sophistication. One proxy of client sophistication is whether clients employ specialist in-house risk managers to manage their insurance programme. The majority of respondents to our customer survey did have these capabilities. However, it may be that larger firms with risk managers were more likely to respond.
- 3.19** The results of our multi-homing analysis could potentially be consistent with market segmentation based on clients' sophistication (see 'Demand-side constraints on market power'). Larger policy holders are more likely to use multiple brokers. This may reflect differences in client sophistication, but could equally reflect other unobserved factors. Therefore there is no strong evidence of segmentation.
- 3.20** We have considered the extent to which competition among brokers may vary according to the location of the risk.¹⁵ We have limited additional evidence on whether risks from different locations have different characteristics, or whether brokers segment the market according to risk location. Based on the information available, there is no evidence to suggest that competitive conditions differ according to risk location.
- 3.21** Clients with global risk programmes may require their broking firm to have particular experience in these areas, and a global network of offices. These conditions may be sufficient for these clients to be considered a separate market segment. We explore this further in Table 1 (page 24 below).

¹⁵ This refers to risk location as a product-related dimension of the market, as opposed to the geographic dimension of the market which is concerned with whether overseas brokers compete with LIM brokers.

- 3.22** In summary, apart from clients with global risk programmes, we did not find clear evidence that brokers distinguish types of customer by virtue of their size or level of experience or sophistication, or the risk location.

Geographic dimension

- 3.23** We considered the relevant geographic area in which competition takes place, to investigate whether brokers operating in the LIM face constraints from other global insurance centres. We find that the LIM remains a global leader in 'global speciality' (Marine, Energy and Aviation) risks. The most recent available data shows that these classes of business comprised about \$40 billion globally in 2015. Around 40% of this was placed in London.¹⁶ In recent years London has been estimated to have lost market share in reinsurance and risks from emerging markets, particularly Asia.¹⁷ We therefore analysed the extent to which insurance centres in other countries impose competitive constraints on London brokers.

Competition for local risks

- 3.24** There is some qualitative evidence that regional insurance centres may represent a competitive constraint for certain simpler or local risks. In recent years, some brokers in our sample¹⁸ report losing clients who moved to brokers in smaller insurance centres. Respondents to our client survey highlighted that there was a trade-off between the high quality, but higher-cost, service of London compared to cheaper but more limited local brokerage and placement.¹⁹

- 3.25** Only a few global brokers can place certain types of risk. Risks more likely to require a broker in an insurance hub such as the LIM include: complex and specialist risks; high severity and low frequency risks; large risks that require significant capacity (often at short notice); risks with poor loss history; and risks where pooling across the world is required. In these cases, local insurance centres may exert much less competitive constraint on the LIM.

Competition for speciality risks

- 3.26** World Federation of Insurance Intermediaries (WFI) member submissions suggest LIM brokers face some competition from brokers in other insurance centres for speciality risks. They perceive that certain non-London insurance centres are increasing their share of global underwriting, possibly at the expense of London, and specialising in certain risk classes. For example, 1 submission noted that Dubai was seen to be growing in the Energy and Construction sectors, while Miami was seen to be specialising in Latin American speciality business.

- 3.27** Geographic competition between international insurance centres is likely to be mitigated if London brokers have unique advantages. Submissions indicated that international clients choose London brokers for their expertise and ability to access London insurers. London insurers are also seen to have a unique appetite to develop new products and insure new risks.²⁰ In this sense, competition among brokers in different insurance centres may depend on the access that they provide to unique features of the local underwriting market they serve.

16 London Matters – LMG report on the competitive position of the London Insurance Market (2017). Note these figures do not directly correspond to the definitions adopted in our market study.

17 *ibid*

18 Responses to our questionnaire sent to 73 brokers.

19 London Matters – LMG report on London market's competitiveness (2014).

20 London Matters – LMG report on London market's competitiveness (2014)

3.28 Geographic competitive constraints may vary by risk class. One WFII respondent noted that casualty business tends to be more likely to stay within countries, whereas sectors such as Aviation are more internationally traded.

3.29 Overall, for some types of risk, brokers in other international insurance centres are credible substitutes to London brokers and may be increasingly competing with London over time. Our evidence also suggests that there are many types of risk for which there are few feasible alternatives to London brokers. This suggests that the LIM should be considered a standalone market for some risk types.

Alternative risk placement solutions

Disintermediation

3.30 Some stakeholders commented on the potential for retail brokers to undertake business directly with LIM insurers and, to a much lesser extent, the potential for certain clients to deal directly with LIM insurers. This type of disintermediation would suggest that LIM brokers compete with a wider set of actors than their immediate broker rivals (see Figure 2). However, we received limited evidence to support the theory of disintermediation.

3.31 There are a number of hurdles to disintermediation by retail brokers. Submissions from WFII members indicated that retail broker disintermediation was only plausible if the local broker and insurer have an existing relationship, and if the local broker was relatively sophisticated. In our customer survey, some retail broker customers said that they were not authorised to broker directly into the LIM.

3.32 Indeed, one hurdle to retail brokers bringing risks directly to the LIM may be Lloyd's regulations – for example, Lloyd's underwriters must meet additional due diligence standards when dealing with non-Lloyd's brokers.²¹ For the Lloyd's and company markets, retail brokers usually require contractual terms of business agreement (TOBA) with insurers. These incur fixed costs and potentially prohibitive conditions (such as a minimum amount of business) that could deter retail brokers without substantial volume. More generally, a lack of existing relationships and market knowledge may prevent retail broker disintermediation.

3.33 Another form of disintermediation could be policyholders placing risks directly with London market insurers. Customer interviews indicate a general acceptance that customers are not able to approach underwriters directly without a broker (see FWD Research final report published alongside this report). Most customers stated that a wholesale broker was needed to access insurers, for the same reasons noted above for retail brokers. Direct placement would likely only be viable for large clients with their own risk management capabilities and extensive market knowledge. Based on the evidence we received, it does not currently seem prevalent.

3.34 Overall, we do not consider that retail brokers or policyholders dealing directly with London underwriters without a wholesale broker are a competitive constraint for London market brokers.

21 These rules are designed to maintain intermediation quality and prudential standards in the Lloyd's markets, which may play into the competitive dynamics of the market in other ways. However, the establishment of service companies by Lloyd's syndicates that allow them to write direct business with retail brokers may mean this barrier is less important than in the past.

Self-insurance

- 3.35** We assessed whether self-insurance was an alternative to brokerage (and underwriting) services in the LIM, and therefore could be considered as being in the same economic market.
- 3.36** Predominantly, it is large corporates which have the financial strength to self-insure. This can involve the establishment of a 'captive' insurance company to self-insure 'working' or 'attritional' exposures, and, beyond that, retaining catastrophe exposures on the firm's balance sheet.
- 3.37** The extent of this constraint is uncertain, and it would only exist for certain risk types, not all. While there is little data available, there is some indication that captive insurance companies are particularly suitable for property and casualty risks. As a result, self-insurance is unlikely to be a strong competitive constraint on London brokers.

Market concentration analysis

- 3.38** We assessed the levels of market concentration in the wholesale insurance broking sector in the LIM. This analysis aims to evaluate the degree of competitive pressure on this market. We observe that overall the wholesale insurance broking sector does not appear to be highly concentrated. However, we have found evidence of high levels of concentration in some segments (specific risk classes and risk codes). We set out more detail below.

Concentration among brokers

Aggregate concentration

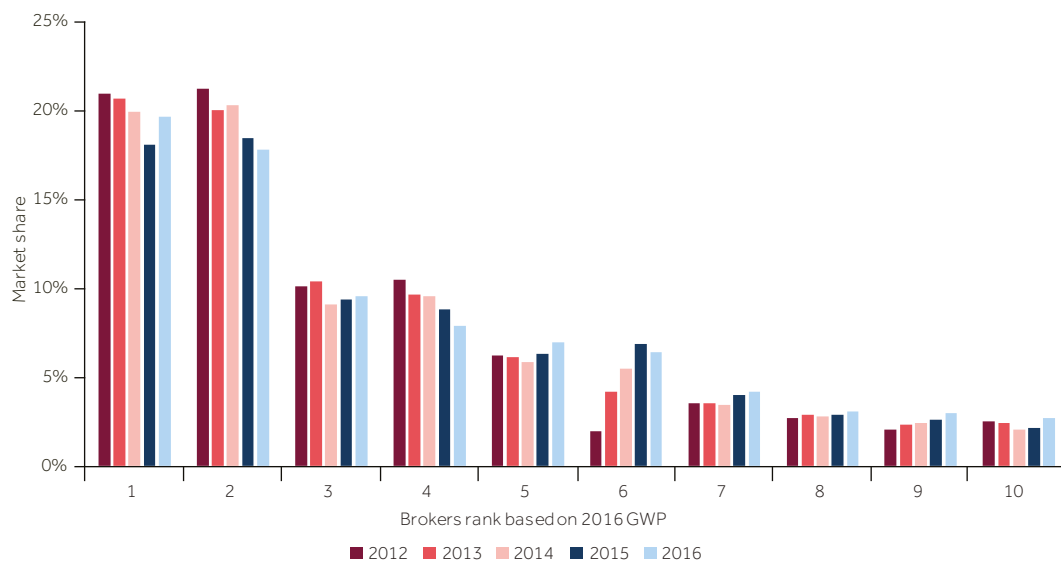
- 3.39** Based on the data we received from our sample of brokers, the largest 3 brokers account for an estimated share of the market of 19%, 17% and 12% respectively.²² The data received from our sample of insurers support this general picture (see Annex 1).

Market shares over time

- 3.40** We analysed the evolution of the largest 10 brokers by GWP between 2012 and 2016 (see Figure 3 below). The combined market shares of the largest 10 brokers were broadly stable between 2012 and 2016, though some of the largest brokers saw a small decrease in market share. Some brokers grew through acquisition in this period.

²² Market shares in this section here refer to relative market shares over the sample of 64 brokers from whom we gathered information. We have provided broker market shares derived from our sample of insurer information as a comparison in Annex 1.

Figure 3: 2012-2016 trend in relative market shares based on GWP for the largest 10 brokers²³



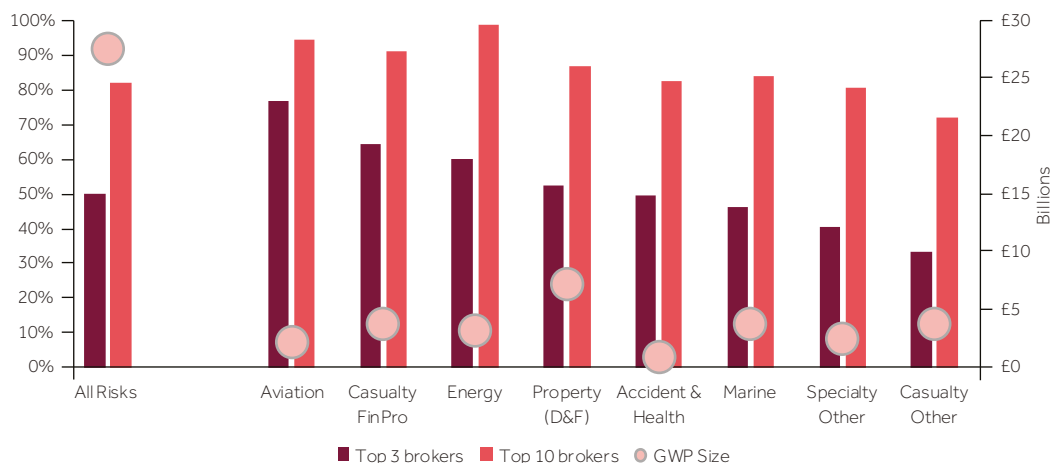
Source: FCA analysis of broker data request.

Market concentration by risk class

3.41

Our analysis shows that certain individual risk classes, such as Aviation, may be highly concentrated. Figure 4 shows the relative market share accounted for by the largest 3 and largest 10 brokers in each risk class. The largest 3 brokers in Aviation account for around 80% of GWP, compared to just over 40% in the Casualty Other class. Energy has the highest share of GWP accounted for by the largest 10 brokers, at nearly 100%.

Figure 4: Relative market share of largest 3 and largest 10 brokers by GWP by high-level risk class, and total GWP of risk class, 2016



Source: FCA analysis of broker data request.

3.42

As outlined in Annex 1, analysis at a more granular risk level shows a similar picture, with pockets of high concentration. Generally, instances of higher concentration occur in relatively small 'generic'²⁴ risk classes compared to others in the same high-level risk class. For example (as shown in Figure 6 in Annex 1) in the Space risk class, the 2

²³ One broker was unable to provide GWP figures for part of their business. Shares for this broker are not adjusted in this Figure.

²⁴ We define generic risk classes as an intermediate risk classification, more granular than high-level risk classes but less granular than risk codes.

largest brokers have a combined share of almost 80% and in Aviation Excess of Loss the 2 largest brokers have a combined share above 90%. Note that the overall value of Aviation Excess of Loss policies is relatively small compared to, for example, Airline and General Aviation.

3.43 Overall, in 32 out of the 44 generic risk classes (for which we have data) the 2 largest brokers have a combined share of more than 60%. The share of the 2 largest brokers tends to be smaller in the larger (in terms of GWP) generic risk classes, and larger in the smaller generic risk classes.

3.44 Some of the most concentrated classes are relatively small. A few large generic classes are very concentrated.²⁵ However, as detailed in Annex 2, we have not found that higher concentration at generic risk class level is generally associated with higher broker remuneration as a percentage of GWP.

Concentration among customer segments

3.45 We compared the combined market share of the largest brokers overall and among only the largest clients (measured as total insured premium). We find that the 3 largest brokers have a larger share among large clients compared to the overall market. This is consistent with our understanding of the market, where clients with global risk programmes are more likely to use larger brokers.

Table 1: Relative market share of the 3 and 10 largest brokers among 10, 100, 250 and 500 largest insurance clients (respondents to policy-level data question only)²⁶

Relative share	10 largest clients	All clients
Top 3	75.2%	55.3%
Top 5	86.4%	69.5%
Top 10	99.6%	90.8%
Total insured premium (£'000)	5,314,222	25,518,142
Percentage of the total insured premium represented by these clients	21%	100%

Source: FCA analysis of broker data request. N = 26.

Insurer concentration

3.46 The effect of brokers' concentration on the overall wholesale insurance market must be considered along with the degree of concentration among insurers. Outcomes for clients will depend on the balance between the 2 levels of the supply chain.

3.47 Specifically, insurer concentration could be associated with higher insurance premiums for customers, or worse claims repayment or other conditions. As customers for wholesale insurance are numerous and disparate, a greater bargaining position of brokers relative to insurers could reduce prices and improve conditions for customers. Sufficient competition is required in the broking market for this beneficial effect to hold.

²⁵ This is based on the policy-level dataset provided by 26 brokers (while market shares at high level risk class are calculated on a larger sample). While the sample of 26 brokers includes the largest firms, it is possible that some small firms specialising in a niche segment are excluded. In any case, the combined share is an overestimate, because every additional firm would automatically decrease the share of the two largest brokers.

²⁶ Given that Table 1 is based on the policy-level dataset while Figure 3 is based on the aggregate data request, relative shares are not directly comparable.

- 3.48** Annex 1 outlines our analysis of the market shares of insurers, both in aggregate and for high-level risk classes. Aviation is the most concentrated class, and Marine the least concentrated. Overall, the wholesale insurance underwriting market appears to be less concentrated than the broking market.

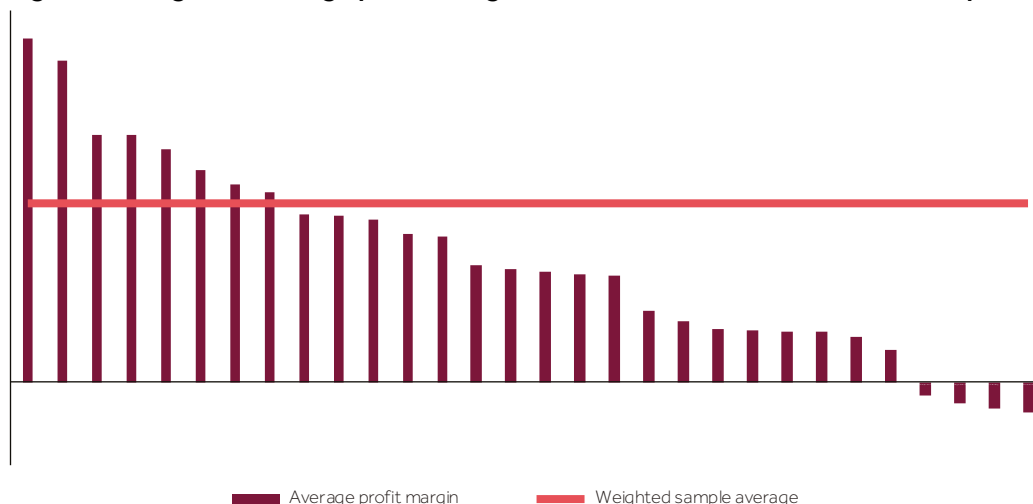
Profitability analysis

- 3.49** Profitability analysis can be a useful indicator of competitive pressure in a market. Where competitive pressure is low, firms are able to earn excessive profits for sustained periods of time. Our analysis indicates that the level of market power is not excessive at an aggregate market level. It also does not show excessive profitability in any particular risk segment.
- 3.50** In this section, we analyse aggregate profitability and we look at the implications of scale and risk class on profitability.

Aggregate profitability

- 3.51** The presence of highly-profitable firms does not necessarily mean there is a competition problem. However, high and sustained profitability for all firms in a specific market point to lower levels of competitive pressure.
- 3.52** Our analysis shows that weighted average profitability²⁷ across our sample is 22% over the period 2012-2017. Average profitability over time ranges between 18% and 23% with peaks in 2013 and 2016 and reduced financial performance in 2014. This is representative of many of the firms in our sample but not all.
- 3.53** This average, however, is not representative of individual firms' financial performance. Figure 5 below shows that over two-thirds of the sample are making profit margins below the weighted average. Another 4 firms in our sample were overall loss making for the period and 9 firms in our sample reported at least 1 loss-making period.

Figure 5: Weighted average profit margin 2012-2017 for each firm in our sample



Source: FCA analysis of broker data request.

²⁷ Defined as all relevant revenue less all cost excluding tax. See Annex 3 for further details.

3.54 Firms' financial performance across our sample seems consistent with our market share analysis suggesting moderate overall concentration. In such a market, we would expect a mix of different profitability levels determined by how well each firm was competing for business.

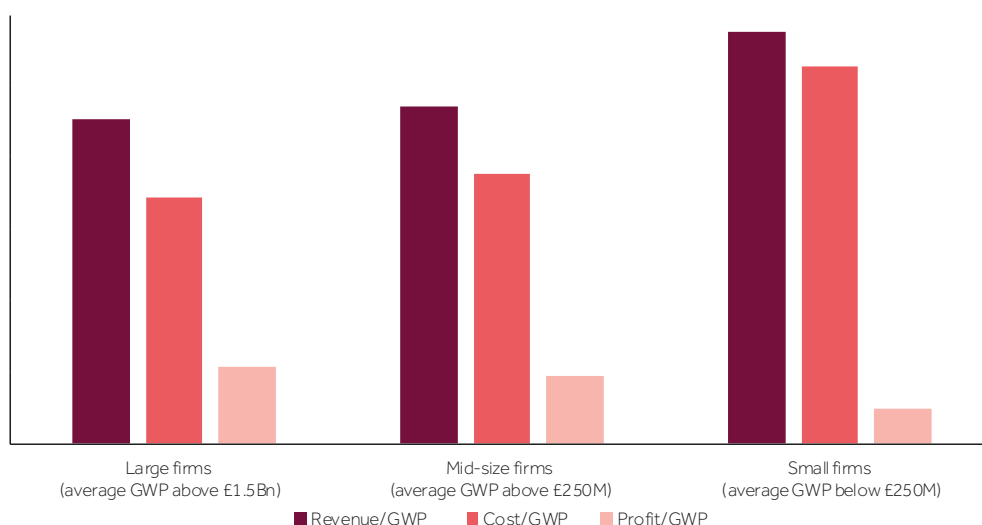
3.55 The presence of some persistently loss-making firms means we cannot conclude that the broker market is making excessive returns or that there is a systematic lack of competitive pressure reflected in the data.

Profitability and scale

3.56 We have examined 2 possible sub-markets based on scale and risk class. To examine scale, we have split firms into large, medium and small firms²⁸ and looked at the revenue, cost and profit per pound of GWP placed.

3.57 Figure 6 shows that small firms earn the highest revenue per pound of GWP of the 3, but also the lowest level of profit per pound of GWP placed. They make an equivalent to a profit before tax margin of around 9%, as a result of much higher per pound of GWP costs.

Figure 6: Revenue, cost and profit per pound of GWP (2012-2016)



Source: FCA analysis of broker data request.

3.58 Mid- and large-scale firms generate lower revenue per pound of GWP than small firms. The difference in pound per GWP is not large, but the proportional fall in cost per pound of GWP translates into a material difference in margins. Mid-sized firms are earning margins around 19% and large firms' margins around 25%. This suggests that differences in profitability are driven not by higher prices, as we would expect if firms were exercising market power, but by economies of scale.

3.59 Our analysis suggests non-placement revenue is proportionally higher for large firms compared to mid-sized and smaller firms. Estimates of revenue per pound GWP for large firms with data services stripped out would widen the gap between large and midsized firms. This would strengthen our conclusion that margin differences are driven primarily by economies of scale with larger firms earning the lowest rates. This

²⁸ Small firms have average GWP from 2012-2016 of under £250M, medium firms average GWP of above £250M and large firms average GWP of over £1.5Billion. See Annex 3 for further details.

is inconsistent with a conclusion that the larger firms have market power within the risk placement market.

- 3.60** We have also found that average remuneration rates vary across brokers. The largest brokers do not appear to be consistently earning the highest remuneration rates, controlling for risk class. This suggests that if larger brokers have market power, it is not reflected in elevated commission rates or client fees. See Annex 2 for a more detailed analysis of broker remuneration.

Profitability and risk class

- 3.61** To examine risk class, we have had to look at revenue less staff cost to calculate a measure of what we have termed 'gross contribution'. We have mapped different business segments together to establish a reasonably comparable data set. Having done so we calculated the ratio of gross contribution to revenue and, using a weighted average as a benchmark, compare it against the contribution margin for the Aviation and Energy segments, the 2 most concentrated markets in our market share analysis.
- 3.62** Aviation segment's contribution is higher than average in some periods. However, it is not that much higher than Marine, which we identified as being relatively unconcentrated and is broadly represented across our sample. We also found that the Energy segment was not significantly different from the average of the sample as whole.
- 3.63** We also examined the profitability of high-level risk segments, especially those identified by our pricing analysis as having high commission levels. Our analysis looked at revenue per pound of GWP less cost per pound GWP for a sub sample of firms (3 large firms, 2 medium-sized and a small firm) stratified by high-level risk code. We have not found evidence of persistently higher profit per pound GWP in segments of higher concentration (Aviation, Energy or Casualty Finpro).
- 3.64** We have not found a strong correlation between risk class, concentration and profitability. However, our segmental profitability analysis is only conducted at an aggregated risk class level. If economic markets exist at a more granular risk level then we would not necessarily expect to find a relationship between concentration and profitability at a more aggregate level.

Conclusion

- 3.65** We have looked at overall profitability of the wholesale insurance broking market, how profitability is impacted by scale, and market concentration. We have not found evidence of excessive profitability. Segmenting firms by scale, firms' average margin improves as they grow in size, driven primarily by economies of scale. We find that differences in concentrations between risk segments do not systematically lead to increased profitability in those segments for brokers.

Barriers to entry and expansion and economies of scale and scope

- 3.66** We have found that there are some barriers to entry and expansion in the wholesale insurance broking market. These may adversely affect competition at the margin, but they do not appear to lead to restricted competition. Brokers are likely to face some economies of scale and scope, especially outside straightforward risk placement.

- 3.67** Factors that restrict new entry or prevent existing brokers from expanding can increase the likelihood of brokers exercising their market power. To assess barriers to entry and expansion, we have assessed qualitative information from brokers. We refer to barriers to entry as barriers to new firms entering the LIM. Barriers to expansion affect existing LIM brokers seeking either to expand or to enter new risk classes.

Barriers to entry

- 3.68** Recent entry and exit from the LIM appears to be relatively limited, but there are examples of new entry during our sample period. In responses to our broker questionnaire, large brokers reported that entry and exit had been limited over the past 5 years. However, we are aware of at least 2 brokers in our sample that entered the market during 2012 to 2016, and at least 1 was founded following a buyout from a larger broker.
- 3.69** Among the brokers that commented on the extent of barriers to entry, there was a fairly even split between those that considered the barriers to be high, and those who considered them to be low. The most commonly cited barriers to entry were natural or intrinsic barriers and regulatory barriers. Brokers cited the biggest hurdles as the required knowledge and investment to meet regulatory standards, and the need to understand market practice and integrate systems to operate as a London market broker. Several responses noted Lloyd's market standards and regulations (accreditation, central settlement processes and electronic placing platforms) as potential barriers. But others noted that recent changes had reduced these barriers compared to the past. FCA regulations and capital requirements were also cited as potential barriers.
- 3.70** Most broker responses indicated that building a good reputation and establishing relationships with a network of partners are key factors to successful market entry. Of note, 2 brokers mentioned the length of non-compete clauses in individual broker employment contracts (up to 12 months) could prevent new firms from acquiring staff with the necessary skills. In addition, a few brokers noted that certain insurers' contractual TOBAs may be contingent on a minimum volume of business (see the section on disintermediation).

Barriers to entering a new risk class

- 3.71** Most large brokers in our survey sample indicated that they had expanded their business by entering into new sectors or activities. The most popular sector was cyber risk. Brokers did not generally perceive regulation to be a barrier to entering a new risk class, reflecting the fact that these firms already meet existing standards.
- 3.72** Most brokers thought that the barriers to enter a new risk class were similar. Some perceived that barriers may be higher for particular speciality risk classes such as Aviation, Marine, and Credit and Political Risk. Some brokers mentioned that certain insurers require minimum business over the first 12 months which can restrict small brokers from gaining traction in a new risk class.
- 3.73** Brokers who responded to our questionnaire perceived that the costs of entering a new business line were mainly associated with higher resource. This was generally for hiring new, specialised staff. Nine brokers who responded to our questionnaire

provided an estimate of the cost to enter a new business line, but the figures varied widely.²⁹

3.74 We understand that to service customers with global risk programmes, brokers must have particular expertise combined with a global network of retail offices.

3.75 Consequently, we have found that barriers to entry and expansion are most likely to occur for niche markets, or for servicing customers with global risk programmes. In some niche markets, there are currently few individuals with the level of expertise and reputation required to win or place business. Over time, some of this competitive advantage might erode as rival firms catch up or acquire staff with the right expertise. However, we consider that the barriers to servicing clients requiring global presence are likely to be difficult to overcome in the short term. These represent a barrier which we consider is likely to restrict the number of players in this segment.

3.76 We understand that to service customers with global risk programmes for smaller firms may require the acquisition of a wide range of different specialists. The emphasis placed on relationships by clients across the market (see Annex 5) also makes entering or expanding into this market difficult. The result is that only a few players operate in this segment.

Economies of scale and scope

3.77 Sufficiently large economies of scale and scope in wholesale insurance broking could represent a barrier to entry or expansion that could lead to market power being retained over time.

3.78 The costs of providing certain wholesale insurance broking services appear to be largely scalable. Where brokers compete on placing straightforward risks in the open market, the size of the broker does not appear to confer significant advantages. Placing a greater number of risks requires more staff time, though there could be some fixed costs (eg tendering).

3.79 Risk placement could be enjoying economies of scale if facilitation reduces the average costs of placement for brokers large enough to invest in and establish facilities. Our pricing analysis shows that remuneration rates in facilities are around 5% higher than in the open market controlling for policy characteristics, client location and insurers used (see Annex 2). The extent to which this reflects costs is unclear.

3.80 Other services of wholesale insurance brokers are likely to benefit from scale or scope. The ability to offer a broad range of complementary services to both clients and insurers such as in-house modelling, actuarial services, consulting services, and 'pipeline' information is likely to be confined to large brokers.

3.81 These services are characterised by upfront costs and advantages as the volume of risks placed increases. The larger a broker, the more valuable its data and analytics on risk and clients, both in terms of spreading upfront fixed costs and because the statistical power of analyses increases with the volume of data. By monetising their data, brokers can spread their fixed costs over more revenue streams. This may enable

29 The estimates provided had a median of the order of magnitude of £500,000, though estimates varied from low tens of thousands of pounds to recruit a new staff member to \$5 million for a large broker to enter a new risk class. However, we view these estimates only as indicative as we do not know how the estimates were compiled and brokers' interpretation of 'business line' could vary.

them to lower the costs allocated to placement business, enabling them to provide placement at lower cost than smaller brokers.

- 3.82** Recent consolidation amongst broker firms is another indicator of real or perceived economies of scale or scope. One implication of this merger and acquisition activity is that larger firms have been able to combine their expertise, infrastructure and data capabilities to develop data analytics and other services.
- 3.83** Overall, we consider that economies of scale do not appear to be sufficient to deter entry for placing relatively simple risks. However, brokers may be restricted in their ability to compete for certain types of business or grow organically beyond a certain size due to economies of scale and scope. This applies particularly to the type of services that large brokers offer insurers and clients. These reasons could (partially) explain why our profitability analysis suggests that larger brokers have higher profit per pound of GWP.

Demand-side constraints on market power

- 3.84** Broker market power will be limited if their clients are able to assess, compare and switch brokers. If so, brokers should be incentivised to compete on price and quality. Our analysis of the degree of competition and market power therefore needs to consider demand-side constraints.
- 3.85** Our research indicates that clients are aware of relevant information and can act in a way that constrains brokers. The majority of respondents to our survey said they understand exactly what their broker does for them. Similarly, most respondents to the client interviews said they can get all the information they need to make decisions.
- 3.86** We have found that most clients are satisfied with their brokers and are confident of their own ability to find and use the relevant information to evaluate broker options. Clients said they understand their broker's proposition and charges, and that they can compare broker remuneration. There is still room for improvement; in interviews some clients suggested that transparency could be improved.
- 3.87** A majority of respondents indicated that they maintain relationships with alternate brokers. According to the questionnaire we sent to brokers, the most common reason for this appears to be to benefit from expertise in a specific class of business. The next most common reason, was to apply competitive pressure on brokers.
- 3.88** There are some areas where demand-side constraints could be stronger. Clients tend to have informal processes to appoint and review their brokers. While they say the administrative process to switch brokers is easy, there are non-monetary costs to switching. For example, it can take time to find a new broker and develop a new relationship. This reduces the competitive pressure on brokers. Although this means additional demand-side pressure could be brought on brokers, we consider that clients appear to have the potential to exert a reasonable constraint on brokers.
- 3.89** The following section gives information we gathered from firms that helps us to understand demand behaviour. For example, we asked firms about their experience of whether clients use different brokers when placing multiple risks. We discuss these findings further in Annex 5.

Client engagement

- 3.90** Our client research finds that clients of wholesale insurance brokers are generally sophisticated and have a good understanding of the conflicts faced by brokers (see the discussion on client sophistication in the client type section above).

Switching

- 3.91** Regarding switching, our findings from the customer in-depth interviews conducted for this market study suggest that customer switching is relatively rare. Most respondents would switch broker only if there was a major reason for doing so. Most respondents have not switched brokers in the past 10 years and are not planning on switching in the near future.
- 3.92** The main reason customers cite for not switching is satisfaction with their existing broker and the value of consistency. Most customers state that the administrative costs of switching are not high. According to respondents, the financial costs associated with switching to a new broker include the time required to build a new relationship and for the new broker to develop an understanding of the customer's insurance cover preferences.
- 3.93** In the next section we explore the use of different brokers by clients. If clients are using more than one broker for their risk placement needs, the need for switching is reduced.

Multi-homing of clients

- 3.94** The use of different brokers by a client is known as 'multi-homing'. It can be a positive indicator that clients are actively engaged and shop around.³⁰ We analysed contract-level data to identify whether clients use different brokers when placing multiple risks, or whether they predominantly use the same broker.
- 3.95** We find relatively high levels of single-homing. This could reflect an unwillingness of clients to use different brokers, or the efficiency advantages of using a single broker. We find that across all risks, out of around 70,000 policy holders in our dataset, around 94% used 1 broker (this includes also clients with 1 policy).
- If we restrict the analysis to those clients with policies in more than 1 high-level risk class, the proportion of clients using 1 broker falls to 76%. Finally, 62% of clients with policies in at least 3 risk classes use 1 broker.
- 3.96** Looking at multi-homing within a single risk class, policy holders that buy multiple policies use on average a larger number of brokers. Table 2 shows that between 58% and 79% of clients buying more than 10 policies in a given risk class use 1 broker.

³⁰ It is important to note that the inverse is not necessarily true – the use of a single broker for multiple risks could indicate a lack of competition but could equally indicate client satisfaction, quality etc.

Table 2: Percentage of clients using 1 broker by high-level risk class

Risk class	Proportion of clients using 1 broker		
	All clients	Clients buying more than 1 policy in a risk class	Clients buying more than 10 policies in a risk class
Accident & Health			
Aviation	97%	89%	76%
Casualty FinPro	94%	88%	63%
Casualty Other	96%	88%	66%
Energy	95%	90%	69%
Marine	92%	86%	61%
Property (D&F)	93%	85%	58%
Speciality Other	98%	93%	79%

Source: FCA analysis of broker data request.

- 3.97** Our results show that larger policy holders (either by number of policies bought or by number of high-level risk classes used) are more likely to use more than one broker. These findings are potentially consistent with market segmentation based on clients' sophistication. However, as discussed in our 'Market definition assessment' above, there is no strong evidence that competitive conditions vary according to client sophistication.

Conclusion

- 3.98** Considering the evidence on consumer engagement, switching and multi-homing, clients appear to have the potential to exert a reasonable constraint on brokers, particularly the most sophisticated. There are, however, potential aspects where this could be strengthened, as set out in Annex 5, which provides our overall conclusions on demand-side conditions.

Conclusion

- 3.99** Overall, we have not found that the market displays characteristics indicative of a significant lack of competition. But, as we set out in Chapter 6, the market is changing. Increasing market consolidation and the global nature of demand and supply, may affect this.
- 3.100** At an aggregate level, combining all risk classes, the wholesale insurance broking sector does not appear to be highly concentrated. However, we have found evidence of high concentration levels in some segments of the market (specific risk classes and risk codes).
- 3.101** We have not found evidence of excessive profitability. Segmenting firms by scale, we find that, as firms grow, their average margin improves, driven primarily by economies of scale. We find that differences in concentrations between risk segments do not systematically lead to increased profitability in those segments for brokers.
- 3.102** We have found that there are some barriers to entry and expansion in the market which may adversely affect competition at the margin. These barriers do not appear to be large enough to lead to a significant restriction of competition. Barriers to entry and expansion are most likely to occur for niche risks and when servicing customers with

global risk programmes. In some niche risk segments, there are currently a smaller number of brokers with the level of expertise and reputation required to win business.

- 3.103** Considering the evidence on consumer engagement, switching and multi-homing, clients appear to have the potential to exert a reasonable constraint on brokers.

4 Broker conduct

In this chapter we look at the evidence of whether brokers are engaging in conduct that could give rise to harm. We assess whether brokers:

- compel insurers to sign up to agreements to purchase consultancy-style services or to participate in placement facilities, or pay higher commissions, sometimes referred to as 'pay-to-play'.
- impose onerous conditions in the agreements signed by insurers which distort competition. This includes clauses limiting insurers' ability to serve the whole market or tying them to a broker for facultative reinsurance.
- face conflicts of interest when using higher-revenue generating placement methods.

Pay-to-play – We asked insurers about the existence of pay-to-play, but none of the respondents to our data request provided us with any clear evidence. Notwithstanding this lack of evidence, we also conducted quantitative and qualitative analysis to look for evidence of pay-to-play. Our conclusion is that, after considering insurers' responses to our questionnaire, together with the results of our analysis, we found little or no evidence that pay-to-play exists at scale, so we do not consider that an intervention by us to address it is necessary at this stage.

Onerous conditions – We have identified some clauses that may impair competition by seeking to limit how insurers engage with other brokers. This does not appear to be a market-wide issue. We intend to follow up with the individual relevant firms, after which we will need to consider our next steps. We have not found evidence of restrictions on the choice of broker for facultative reinsurance.

Conflicts of interest – Brokers receive higher revenue for business placed in certain ways, such as through placement facilities or MGAs, than in the open market. Using these placement methods can benefit the client. But the higher remuneration may incentivise the broker to use a facility or MGA even when it is not in the client's interest. Research shows that most clients can get the information they need to help them make informed decisions. This helps minimise the potential harmful impact of conflicts.

To ensure harm does not arise, we will, as part of our supervisory work, continue to look at compliance with existing obligations on the management of conflicts of interest. We also remind firms that they need to pay due regard to the information needs of their clients, and communicate information in a clear, fair and not misleading way.

Introduction

- 4.1** In Chapter 3, we discuss concentration and profitability in the broker market. In this chapter, we consider whether other aspects of broker firm conduct could give rise to harm, and could be compounded by clients (the demand side) failing to exert pressure on brokers. We assessed whether:
- brokers could be compelling insurers to pay-to-play
 - brokers could be imposing onerous conditions in their contractual agreements with insurers
 - brokers could be earning extra revenues by using placement methods that give them higher commission when it may not be in the clients' interest
- 4.2** In this chapter, we discuss each of these areas in turn. We also look at the evidence that firms are managing conflicts of interest in a way that would lessen the potential for harm. Finally, we explore the role of disclosure.

Pay-to-play

- 4.3** In our terms of reference, we highlighted pay-to-play as a potential area of concern, given the anecdotal evidence we had heard about it. Brokers may compel insurers to sign up to agreements on purchasing consultancy-style services provided by the brokers, or to participate in placement facilities.
- Under pay-to-play, insurers that do not pay for brokers' services, or pay relatively small amounts; or alternatively do not participate in broker-operated facilities or managing general agents (MGAs), may lose out on placement business from these brokers. Brokers with market power may also be able to inflate the prices for these consultancy-style services. Pay-to-play could also arise from brokers demanding higher standard commissions (or additional commissions) from insurers in exchange for awarding them placement businesses.
- 4.4** We considered 2 types of agreement:³¹
- Placement agreements: Specific agreements between brokers and insurers regarding how client risk will be underwritten. A facility is a type of placement agreement.³²
 - Non-placement agreements: These agreements cover a range of activities, primarily contracts for data provision and services from broker to insurers.³³
- 4.5** If pay-to-play is taking place then brokers can charge more for agreements than insurers would pay for them under competitive conditions. This increase in insurer costs could be passed on to policyholders. As there has been growth in the number of brokers offering these agreements, the potential for harm may also be increasing.³⁴
- 4.6** We have assessed the pay-to-play concern in 3 ways:

31 For clarity where we refer to the agreements in this document as placement and non-placement agreements.

32 See Annex 2. 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 sector or client group.

33 See Annex 4 for a full list of activities that can be covered by a non-placement agreement.

34 Annex 4 Figure 1.

- insurer feedback on their experience with agreements
- quantitative analysis to see if an insurer's decision to enter into an agreement impacts the amount of business they win from a broker
- qualitative review of the agreements which may allow us to see if agreements are unfairly in favour of brokers, such that insurers would only enter into them if brokers were able to exercise market power

Insurer feedback

- 4.7** We asked insurers in our data request about the reasons for their decisions on whether to enter into agreements with brokers and their experience using facilities.
- 4.8** 37 out of the 49 insurers responses stated that they have entered into agreements with 1 or more brokers. These participating insurers were positive about the value of the non-placement services provided by these agreements. They said that they regularly evaluate the value they derive from the associated services. The type of valuable benefits they quoted included: greater understanding of the broker's positioning, streamlined underwriting and claims processes, increased support for business development, and greater understanding of client's needs.
- 4.9** We also asked the participating insurers whether they would be at a competitive disadvantage if they had not signed these agreements. A large proportion of respondents stated that they would not, other than the loss of value that these services provide in terms of improving their businesses. This does not indicate to us that these insurers were 'paying to play'.
- 4.10** Of the insurers who do not participate in agreements, some stated that the reason they did not participate was because the services offered did not provide sufficient benefit to them. They did not suggest that the services would not be valuable to other insurers, or possibly clients.
- 4.11** A very small minority of insurers who responded to our survey expressed some concerns in relation to pay-to-play. We explored these concerns further. Most of this small minority of respondents expressed a general view that pay-to-play may take place in the market, but did not provide specific evidence. The remaining few expressed some discontent with specific relationships with brokers but these instances did not represent evidence of pay-to-play. Our investigation of these concerns did not find that any of the respondents (or indeed any other party) have been asked, or had had, to pay-to-play.

Quantitative assessment

- 4.12** Despite the lack of evidence of pay-to-play in the feedback provided by insurers, we undertook further analysis to see if we could find evidence of pay-to-play. We analysed the effect of placement and non-placement agreements and MGAs on the volume of business insurers win from brokers.
- 4.13** To do this we tested whether the share of business insurers win from brokers increases with: i) the share of a broker's total revenues paid for consultancy-style services by each insurer, ii) the subscription to broker-operated facilities, or iii) broker-operated MGAs. We used quantitative analysis on 2 samples of data for the period 2012-2016: 1 provided by brokers and 1 provided by insurers.

- 4.14** The data submitted by 59 brokers included: i) the value of business (GWP) placed in the LIM split by insurer; ii) revenues brokers earned from insurers from non-placement agreements; iii) revenues brokers earned from insurers from placement services; and iv) GWP placed in broker-operated facilities and MGAs.
- 4.15** The data provided by 44 insurers included: i) the total level of placement (GWP) between an individual insurer and individual broker; ii) data on a total of 2,221 agreements between brokers and insurers, of which 1,308 were identified as non-placement. The details of this analysis are in Annex 4.
- 4.16** We have not found a robust correlation between the share of business insurers win from brokers and the money they pay to brokers for consultancy-style services, or the subscription to broker-operated facilities and MGAs. Hence, our quantitative assessment does not provide robust evidence of pay-to-play.
- 4.17** There is widespread use of agreements and MGAs by insurers and brokers. This means that there is insufficient variation in the data for a quantitative analysis to find robust evidence, even if there is pay-to-play. We cannot rule out its existence based solely on this econometric analysis. However, these results could also indicate that pay-to-play does not exist, which is consistent with the insurer feedback detailed above.

Qualitative review of agreements

- 4.18** We also performed a qualitative review of over 500 broker agreements, both placement and non-placement, of which around 300 were non-placement.
- 4.19** We did this to assess if the existence of pay-to-play would lead to agreements that present little to no apparent benefit to insurers, compared to what they would obtain from brokers on the open market, or indications that they enable more placement business to be won.
- 4.20** A range of factors could help indicate the possibility of pay-to-play, including whether:
- the description of the services provided is clear – poorly articulated services could be an indication of the existence of pay-to-play
 - the magnitude of the payments seems, on the face of it, unreasonable relative to the services offered
 - there is evidence in the agreement of a mechanism that indicate that insurers are actively engaged in the evaluation and tailoring of the services provided
- 4.21** For non-placement agreements, we found that the services offered are wide-ranging and, generally, the contracts clearly detail the services to be provided. This includes features such as frequency of reporting, and timelines of delivery, and details of the precise data provided.
- 4.22** The facility agreements we reviewed do not contain any guarantees of a certain amount of business to the insurer. In addition, fees for facility agreements are generally commensurate to the level of service provided (ie the more services are provided, the higher the fee).
- 4.23** We acknowledge that analysis of an agreement may not be able to provide a good gauge of the value of the services provided. However, consistent with the insurer

feedback detailed above, our analysis of the agreements has not provided any clear evidence of pay-to-play.

Conclusion

- 4.24** We have endeavoured to determine if the concerns we have heard about pay-to-play are warranted.
- 4.25** We asked insurers about its existence but none of the respondents provided us with concrete evidence. Notwithstanding this lack of evidence, we have also performed the quantitative and qualitative analysis outlined above. We recognise that, taken individually, neither the quantitative nor qualitative analysis can necessarily determine that there is no pay-to-play. However, our conclusion is that, after considering insurers' responses to our questionnaire, together with the results of our analysis, we are unable to conclude that pay-to-play exists at scale or that an intervention by us to address it is necessary at present.

Onerous conditions

- 4.26** When reviewing the agreements between insurers and brokers detailed in the above section, we also considered whether they contained clauses that could have an adverse effect on competition.

Restrictive clauses

- 4.27** In our review of agreements between brokers and insurers, we found a limited number of clauses that could have an adverse effect on competition, clauses similar to 'most-favoured-nation' clauses or client exclusivity clauses:
- clauses akin to most-favoured-nation mechanisms would be ones which stipulate that insurers must work with brokers to ensure that the terms of the facility remain market-leading, or that the insurer may not offer better terms on the open market
 - client exclusivity clauses restrict insurers from providing quotes to other brokers for clients of the broker with which a facility is set up, or to these clients directly
- 4.28** These clauses are concerning because they might affect the way brokers compete. Exclusivity clauses aim to prevent an insurer interacting with an alternative broker in relation to a client of the broker in whose facility they participate. This could make it less easy for clients to shop around.
- 4.29** Most-favoured-nation clauses may prevent the insurer from offering its best terms or policy. This may lead to poorer outcomes for clients and lower brokers' incentives to compete.
- 4.30** These clauses were only found in a small minority of agreements, mostly for facility placement. We intend to follow up with the individual relevant firms, after which we will need to consider our next steps.

Choice of reinsurance broker by insurers

- 4.31** In our terms of reference, we noted a concern raised by some stakeholders that, when placing a risk with an insurer, some brokers may require the insurer to use them for any subsequent facultative reinsurance of the same risk. This could result in harm from insurers facing higher brokerage costs for facultative reinsurance, which could be reflected in higher premiums for clients.
- 4.32** Insurers usually use broker services for facultative reinsurance placement due to speed advantages and detailed knowledge of market appetite by brokers. Insurers can choose either the broker who originally placed the risk or a different broker. Choosing the original broker has potential efficiency advantages. The original broker is likely to understand specific details of the risk, and this efficiency could be reflected in a lower broking commission or better speed or quality of placement.
- 4.33** In addition, we understand that, in some cases and risk classes, a need for client confidentiality may prevent reinsurance being placed through alternative brokers (due to the need to share the client's data with new entities). Our insurer data request looked at 6,200 reinsurance placements from 2016. Of these, 3,800 were with the original broker, representing 65% of total net ceded premium. In total, 76% of net ceded premium in the property class was reinsured with the original broker, compared to 29% in accident and health.
- 4.34** These figures show that the original placing broker is not always used to place facultative reinsurance. In a substantial minority of cases (35% of total net ceded premium) the insurer chooses a third-party broker to arrange the facultative reinsurance.
- 4.35** However, harm may be caused if brokers unduly promote their own reinsurance services. To test this, we examined:
- responses to the questionnaire sent to insurers as part of our data request
 - quantitative data to assess the extent to which insurers use the original broker to place reinsurance risks

Qualitative evidence and assessment of harm

- 4.36** A small number of qualitative responses acknowledged that brokers face a potential conflict to promote their own facultative reinsurance services. In the 49 responses, only 2 insurers noted that the conflict could take other forms. These included brokers making the placement of open market business contingent on a guarantee of receiving reinsurance brokerage on other, separate risks. Overall insurers did not raise any substantive concerns that brokers are attempting to restrict choice in the facultative reinsurance broking sector.

Quantitative evidence

- 4.37** We tested whether an insurer's use of the original broker for facultative reinsurance risk placement is more likely for brokers with a greater market share. This would show that brokers have greater opportunity to insist on acting as reinsurance broker where they are in a stronger bargaining position compared to the insurer.
- 4.38** We did not find any evidence that the likelihood of a broker being named as facultative reinsurance broker is associated with a broker's share of total GWP in a high-level risk

class. Using data submitted by our sample of insurers, we ran a logistic regression model to test whether propensity for the reinsurance to be placed by the original broker is greater among brokers with higher market shares, controlling for other factors.³⁵ We found that there is a positive but statistically insignificant probability of a reinsurance risk being placed with the original broker.

- 4.39** Overall, based on our analysis of the qualitative and quantitative evidence, we do not find evidence of brokers being able to require insurers to place facultative reinsurance of the same risk with their brokerage services. We note that situations could arise that our approach would not be able to observe. For instance, we do not have price data, and cannot observe the other potential causes of bilateral bargaining power, so we cannot conclusively rule out this practice.

Broker conflicts

- 4.40** Competition may not be working effectively in the interests of consumers where broker incentives encourage business to be placed with a particular insurer.

This may occur for a variety of reasons. For example, when brokers place risks via vehicles such as placement facilities or in-house MGAs. Brokers receive higher remuneration for these. Using these placement methods can be in the interest of the client. But the higher remuneration may incentivise the broker to use a facility or MGA even when this is not the case. Our findings, set out below show that most clients can get the information they need to help them make informed decisions, which also helps minimise the potential harmful impact of conflicts.

- 4.41** Brokers can earn higher revenues from facilities than in the open market, raising questions regarding the extent to which the increasing use of facilities is producing real efficiencies and economies.
- We found that brokers receive higher remuneration rates (calculated by dividing total remuneration by GWP) for business placed via placement facilities than they do for placing the risk in other ways, such as in the open market. On average, remuneration rates for like-for-like policies were between 4-6% higher via facilities than in the open market in 2016. This finding is in accordance with responses to our data request where the majority of insurers claimed that additional commissions are within the range of 2.5% and 7.5% higher than the open market.
 - Furthermore, average remuneration rates on policies placed in facilities are higher compared to open market placements in each high-level risk class – from around 4% higher via facilities in Casualty Other to around 10% for Aviation and Speciality Other, as shown in Figure 2 of Annex 2.³⁶
 - Similarly, we found an upward trend in the remuneration of broker-owned MGAs since 2012. The overall commission level as a percentage of premium has slightly increased between 2012 and 2016, from 10% in 2012 to 12% in 2016.³⁷

35 We take broker market shares at the high-level risk class level among our insurer sample as our proxy of market power, but also test alternative measure of a broker's market share for that particular insurer. We controlled for the insurer's market share, the size of net ceded premium, and the high-level risk class.

36 Examples of risk included in 'Casualty Other' are Employers Liability and Medical Malpractice and UK/Overseas Motor. Examples of 'Speciality Other' are Terrorism, Political Risks and Legal Expenses.

37 FCA analysis of data request.

- 4.42** We have considered the possibility that facilities may encourage conduct that gives rise to harm. However, according to the client interviews by FWD, most clients can get the information they need to help them make informed decisions. This suggests that clients would not use facilities for insurance unless it is in their interests to do so. This reduces the scope for harm as it reduces the ability of brokers to act on the incentive to sell more expensive placement facilities, compared to open market options.
- 4.43** Despite brokers potentially having an incentive to use facilities (because facilities generate higher commissions), we found that the current level of GWP placed through facilities is relatively small, only around 8% of the total (see Table 3 in Annex 2). MGAs represent an even smaller proportion. Notwithstanding the fact that in these cases we have no evidence suggesting that facilities did not produce the most competitive terms for the client, the low use of facilities suggests there is not a significant problem arising from their use from a competition perspective.
- 4.44** The risk of harm from conflicts can also be mitigated through effective conflicts of interest policies. Below we set out the findings of our review of brokers' conflicts of interest policies.

Conflicts of interest management

- 4.45** In order to assess whether a feature of competition in this market is that conflicts are not managed in a way which ensures clients are protected, as part of the data request we asked firms to submit a range of documents evidencing their approach to managing their conflicts. Primarily, these documents were their conflicts of interest policies and logs for 2017. We also asked for details of how they segregate their risk placement activities from their insurer services, and for examples of governance documentation.
- 4.46** We realise that these 2 sets of documents (the conflicts of interest policy and log) do not form firms' entire conflicts framework – some firms have submitted other documents in support of their framework. By reviewing their policies and logs, as well as their narrative responses, we had an indication of how firms are approaching their conflicts of interest management.
- 4.47** Just over half the firms who submitted documents had identified a reasonable range of potential conflicts. The documents from the remaining half only referred to a very limited range of conflicts inherent to their business model. Also, in just over half the cases, the conflicts were articulated at a high level with little description or explanation of the nature of the risk.
- 4.48** There was not always evidence of procedures, controls and management information (MI) built around the policies to lessen the potential harm that could result from incentives on brokers to use facilities or other placement structures. Firms often lacked clear processes for governance overseeing the placing business via facilities. This is important given that broker revenue is generally higher under facilities than open market.
- 4.49** There was a notable difference in the documentation submitted by different sized firms. Larger firms appeared to have a more considered approach to managing conflicts. For example, they more frequently identified a wider range of conflicts inherent in their business models.

- 4.50** The conflicts of interest logs provide some insight into how the conflicts of interest policies may be implemented in practice and how effective this may be. In at least a third of cases, rather than logging general business model risks, they had a focus on personal conflicts. Examples included staff members owning shares in companies with which the broker does business, or a director also acting as a director of a broker that provides business. In a significant minority of cases, the log contained no, or very few, conflicts.
- 4.51** Conflicts of interest policies are a critical element of firms' obligations and firms should be keeping appropriate records of conflicts. Firms currently have a range of obligations on conflicts of interest under our rules. These rules include the Principles for Businesses and our Senior Management Arrangements, Systems and Controls rules. These include the need for firms to identify and manage conflicts of interests appropriately.
- 4.52** Brokers should reflect on how they manage the conflicts of interest in their business model, and make any necessary changes to ensure that they are complying with regulatory requirements. These include the need to manage any conflicts of interest arising from their activities and mitigate the risks these pose to their customers. The level of work required to meet these obligations may be greater where firms introduce new services and revenue streams which increase their exposure to conflicts of interest. These new services involve larger brokers using their expertise, infrastructure, and data capabilities to develop data analytics and other services targeted at insurers. We will continue to look at compliance with existing obligations on conflict of interest management in our supervision work.

Information disclosure

- 4.53** We conducted a review of the disclosure documents provided by brokers and found inconsistent standards of disclosure. 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 the 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).
- 4.54** Our review of TOBAs identified inconsistencies as to what commissions are disclosed. One firm disclosed subscription market brokerage (SMB) and profit commissions only where it deemed it 'applicable' to do so. Another stated that they disclose all types of commission voluntarily. However if a customer wants to find out about the remuneration received from insurers participating in broker panels, this was only available on request.
- 4.55** Firms need to consider the information needs of their clients, and to communicate information to them in a clear, fair and not misleading way. Client pressure is more effective when supported by consistent and detailed disclosure documentation.
- 4.56** Annex 5 sets out findings in relation to disclosure and also on client behaviour.

Conclusion and next steps

- 4.57** In this chapter, we analysed whether the market features set out in Chapter 2 lead to broker conduct which may distort competition or have an adverse effect on clients' interests.
- 4.58** We have not found evidence of significant, market-wide issues that are leading to ineffective competition.
- 4.59** After considering insurers' responses to our questionnaire, together with the results of both our quantitative and qualitative analysis, we are unable to conclude that pay-to-play exist or that an intervention by us to address pay-to-play is necessary.
- 4.60** We have not found evidence of brokers being able to require insurers to place facultative reinsurance of the same risk with their brokerage services.
- 4.61** We have identified some contractual clauses in agreements between insurers that can restrict competition in certain circumstances. Most of these agreements are concentrated in a small number of brokers. We intend to follow up with the relevant firms and then consider whether any additional steps are appropriate.
- 4.62** We have found that brokers receive higher remuneration for business placed in certain ways, such as through placement facilities and MGAs, than they do in the open market. Research shows that most clients can get the information they need to help them make informed decisions, which helps minimise the potential harmful impact of potential conflicts.
- 4.63** Conflicts of interest policies are critical tools to mitigate any potential harm from conflicts. We will, as part of our supervisory work, continue to look at compliance with existing obligations on the management of conflicts of interest.³⁸
- 4.64** We have found inconsistent standards of disclosure of information. Firms need to consider the information needs of their clients, and to communicate information in a clear, fair and not misleading way.

38 See, for example, TR14/9, Commercial insurance intermediaries – conflicts of interest and intermediary remuneration, May 2014: / www.fca.org.uk/publication/thematic-reviews/tr14-09.pdf

5 Broker coordination

We have considered whether the broking market is susceptible to tacit coordination. This assessment is separate from the concerns that led us to launch a competition enforcement investigation in relation to airline insurance broking. This investigation was taken over by the European Commission in October 2017 and is ongoing.

Coordination can happen when firms operating in the same market recognise that they are mutually interdependent and that they can reach a more profitable outcome if they coordinate to limit their rivalry. The effects of coordination could include higher prices or lower quality service than would otherwise be the case.

Tacit coordination arises when, as a result of repeated interaction with competitors, firms decide on a strategy of avoiding or limiting competition. This strategy might be implemented when they are aware, and take into account, that reducing prices to win more business will lead to competitive responses by rivals, with the result that profits will ultimately be lower than if they avoided or reduced competition.

Following an assessment, we have concluded that tacit coordination is not likely in this market. We are not minded to pursue this theory of harm any further unless new evidence comes to light.

Introduction

5.1 We carried out our assessment by considering the 'Airtours criteria'.³⁹ These are 3 conditions that must all be met if coordination is to be sustainable. They are:

- firms need to be able to reach an understanding and monitor the terms of coordination
- coordination needs to be internally sustainable among the coordinating group – ie firms must find it in their individual interests to adhere to the coordinated outcome
- coordination also needs to be externally sustainable – i.e. competition from firms outside the coordinating group, or the reactions of clients, cannot undermine coordination

5.2 We discuss each of these conditions in turn.

Reach an understanding

5.3 Based on our understanding of the market, we consider that tacit coordination on 'price', ie broker commission rates and client fees, is unlikely. This is because there is no single price that captures the expenses clients face when employing a wholesale broker. Fees are bilaterally negotiated between the broker and client, and commissions are negotiated between the broker and insurer. These prices are not transparent

³⁹ The criteria are given this name after the judgment of the General Court of the EU, *Airtours v Commission* (2002), which introduced them.

and we have found that remuneration rates of brokers for comparable risks contain a substantial amount of price dispersion.

- 5.4** We also consider that coordination over non-price factors, such as expertise and claims processing, would be unlikely to succeed. It would be difficult to quantify and, therefore, to measure these factors, making it difficult to reach an agreement on them and to monitor them.
- 5.5** However, we consider that broking firms would, in theory, be able to reach and monitor an agreement involving client allocation. Firms in the coordinating group would tacitly allocate clients between themselves. This would lead to reduced competition and higher prices for these clients. Each firm in the coordinating group would monitor their client base for any gains or losses from other firms in the coordinating group. Firms would not need to agree a price for these clients; having implicitly allocated client, each broker in the coordinating group would be free to set the price for their own clients.
- 5.6** If a hypothetical tacit agreement were to exist on client allocation, it would be over a specific set of clients, for a similar group of broking firms. There would be a fairly small number of clients, allowing firms to monitor adherence to the agreement effectively. We have identified two candidate subsets of the marketplace: (i) clients with global risk programmes; and (ii) clients in niche market segments. As discussed in Chapter 2, there are features of each of these two segments that may act to restrict the number of firms in the short term thereby facilitating coordination.
- 5.7** Under (i), these clients have a restricted choice of brokers due to brokers needing particular expertise combined or a global network of retail offices or representatives. These barriers are likely to persist over the medium or long term.
- 5.8** Under (ii) we find that there are several segments with a fairly small number of brokers currently supplying brokerage services. This might arise because there are fewer brokers currently with the level of expertise and reputation required to win or place business. However, it is our view that, over time, some of this competitive advantage might erode as rival firms catch up or acquire staff with the right expertise. We have therefore decided that this form of coordination would not be sustainable over the medium term, even if it were possible in the short term. As a result we focus only on the possibility of an agreement over clients with global programmes.
- 5.9** Based on the evidence available to us there are only 3 or 4 firms that can fully compete to place clients with global programmes. We have considered the sustainability of a hypothetical tacit agreement comprising these firms. It should be noted that we are not alleging that such an agreement exists. We refer to these firms only to explain how such an agreement might work in practice.
- 5.10** Under the theory of harm, these 3 firms would tacitly agree not to compete for each other's clients falling under this definition. In the event of a client deciding to open their programme to tender, the 2 other firms would tacitly agree not to submit competitive bids to avoid retaliation in the future.
- 5.11** We consider that it would be possible to reach such an agreement because of its simplicity. Monitoring adherence to this hypothetical agreement is helped by there being a limited number of 'global clients' and losing such a large client would immediately be known. It is likely that a broker who deviated from the agreement to

take on another firm's global client would also be known in the marketplace, allowing targeted punishment to be inflicted.

Internal sustainability

5.12 We have concluded that such an agreement would not be internally sustainable. There are 3 key reasons for this. These all provide incentives for firms to win business and, therefore, to go against the incentive to reduce competition by not targeting each other's client base.

- First, we have found evidence of strong economies of scale. These give brokers an incentive to win additional business to reduce their average costs and to improve margins.
- Second, we have evidence that there are benefits to winning an additional brokerage client by giving the broking firm useful data concerning risks. Firms can monetise this data by selling it to insurers as part of their consultancy or data analytics business. This additional revenue from winning an extra client would also give an incentive to brokers to compete and grow market share in the supply of placement services.
- Third, at the human level, individual brokers have an incentive to win big-name clients themselves. Broker's front-line staff are incentivised to win new business. Some brokers explicitly encourage this through their remuneration KPI's weighting the acquisition of new business more heavily than retaining old business.

5.13 We consider that these incentives would be sufficiently strong to destabilise the hypothetical coordination, meaning that it would be unlikely to take place in practice.

External sustainability

5.14 In the interests of completeness, we also examined whether coordination would be externally sustainable, ie whether there are any outside factors that could destabilise the hypothetical agreement.

5.15 We focused on the competitive fringe, and the ability of clients to switch to brokers outside the coordinating group. We concluded that the competition from outside the coordinating group would not currently provide a sufficiently strong constraint, though it may do so in the future.

5.16 We also concluded that the main outside option available to large customers is captive insurance. However, this is an imperfect substitute and is not available for all risk categories.

5.17 As a result, we consider that a hypothetical coordinated agreement may be externally sustainable.

Conclusion and next steps

5.18 In conclusion, we have examined the susceptibility of the LIM, and sub-segments of the market, to tacit coordination.

- 5.19** We consider that an agreement could be reached, and would be externally sustainable. Our conclusion, however, is that coordination is unlikely to be internally sustainable. As all the conditions must be met for coordination to be considered sustainable, we have concluded that this is unlikely in the LIM. In addition, we have found evidence on cross-sales and multi-homing (see Annex 6) which suggests that client allocation is not currently occurring. We do not intend to pursue this theory of harm any further unless new evidence comes to light.

6 Possible future changes in industry dynamics

In this chapter we present some of the possible developments that may affect competition between brokers in the LIM.

We consider a range of scenarios and developments that may impact the effectiveness of competition. These include the possibility of further concentration, the insurance market hardening, global competition, EU withdrawal and technological change.

We consider that these developments could adversely impair effective competition and give rise to harm. We will continue to monitor how the sector develops to determine at an early stage whether regulatory attention is required.

Introduction

- 6.1** Our analysis and this report's key findings are based on recent market conditions and current market structure. We also considered how potential changes in the marketplace could affect market dynamics.
- 6.2** We have looked at several different scenarios:
- Further concentration of the broking market – this may strengthen concerns raised in this report.
 - A hardening of the insurance market – this would be expected to increase premiums due to a reduction in capital available for underwriting, and alter the competitive dynamics in the market.
 - A significant increase in global competition – the effects of this are likely to be complex. One plausible outcome is that stronger global competition leads to small and mid-tier London brokers leaving the market.
 - EU withdrawal – this may have a significant impact, the longer-term effect of which is uncertain.
 - Technological change – this may have a significant impact on smaller market participants but the ultimate effect is unclear.

Concentration within the broking market

- 6.3** We have concluded, in chapter 3, that the degree of concentration in the wholesale broking sector at the aggregate level is not currently of concern. Should brokerage activities in the LIM become significantly more concentrated, the market power of some brokers could increase, leading to potential consumer harm. For example, if some brokers increased their market power, prices (commission levels as well as brokerage fees) could increase. It could also decrease the quality of the risk cover provided to clients. Insurers' bargaining power would also decrease.

- 6.4** In the second half of 2018 there have been 2 announcements of acquisitions. Further concentration of market power could arise from acquisitions, organic growth of market share or through some brokers leaving the market. The impact of further concentration may particularly affect some market segments or some client categories.
- 6.5** The reasons for increased concentration appear to be global, rather than related to the LIM. But a possible consequence for the LIM is that smaller brokers may be adversely impacted if the LIM loses global share.
- 6.6** Alternatively, concentration may arise from the organic increase of market share by certain players. This could be further enhanced by smaller players leaving. We note that the growth of non-placement services is concentrated amongst larger brokers. This may increase the economy of scale advantages they currently enjoy in placing risk. This may then place further competitive pressure on smaller brokers who are less able to monetise their data, or otherwise less able to provide non-placement services.

Market hardening

- 6.7** The insurance market is currently characterised by soft market conditions.⁴⁰ As macroeconomic conditions change, capital may become more expensive eg interest rates may rise, which may have consequence in terms of availability of capital on the insurers' side. The insurance market may contract as a result.
- 6.8** There are several ways the market could develop if it hardens:
- withdrawal of capital from the market, with remaining insurers (and reinsurers) being more risk averse
 - the scope of cover being more restricted and premiums increasing, possibly sharply
 - risks being harder to place, and so placement facilities becoming less viable, as more risks ought to be placed on the open-market to meet its supply
- 6.9** In such circumstances clients may become relatively more reliant on brokers to secure their cover. Larger brokers, by virtue of their size, may be able to negotiate better premiums from insurers than smaller ones (see economies of scope and scale section in chapter 3). This could drive more concentration as smaller firms may lose business.
- 6.10** As premiums increased, so could traditional commission as it is calculated as a percentage of the premium. However, the increase in capital would place insurers in a stronger bargaining position than in the current circumstances. This may have a balancing effect, potentially changing the commission rates or calculation. It is unclear what the impact of a market hardening on broker's revenue, and ultimately on their business model may be. For instance, it may rebalance brokers' revenues stream towards more clients' fees, rather than insurer-based payments.

40 See for instance: <https://www.bankofengland.co.uk/prudential-regulation/letter/2018/market-conditions-facing-specialist-general-insurers-feedback-from-recent-pra-review-work>

The LIM becomes less competitive globally

- 6.11** A long-term trend has been for the LIM's share of global insurance business to diminish as the capacity and sophistication of national markets, and more recently regional hubs, has grown. Among the factors which might see this trend continue is that the cost of placing business in London may be higher than in more local markets, due to a combination of:
- The need to pay for the services of an extra party in the placement chain – the London broker.
 - The infrastructure costs associated with the LIM being a subscription market.
 - The premiums quoted by London underwriters – as we have been told – tending to be higher than those of more local markets. This may in turn be due to a combination of London underwriters being more experienced in evaluating complex risks, and the need to factor into premiums the costs of doing business in the LIM.
- 6.12** There will be an impact on how brokers compete if the LIM were to continue losing global share. The effect is likely to be different for various segments of the market.
- 6.13** As other international centres become more sophisticated, the LIM will face more competition for the least complex or bespoke risks. This should lead to lower remuneration for those brokers and lower GWP, and to further consolidation among that group.
- 6.14** Global (generally, larger) brokers are likely to be unaffected by this increase in competition because they have offices around the world and are less dependent on the dynamics of the LIM. Their position could be strengthened if smaller or mid-tier brokers in London leave, potentially leading to increased market power. Concentration of the larger insurers and possible exit of the smaller brokers will lead to the increased potential for harm described in the consolidation section above.

Brexit

- 6.15** The impact of Brexit on this market will need to be considered further once the outcome of political negotiations becomes apparent.
- 6.16** Some smaller firms have already withdrawn from the EU market. This is due to the additional potential burdens exceeding the advantages of scope associated with direct trading in the EU. This may reduce competition within the LIM for EU business and reduce choice for clients.

- 6.17** The necessary regulatory changes required by leaving the EU may present opportunities and challenges for the LIM. This market has a reputation for an agile approach to the insurance business. Larger global firms are more likely to be able to mitigate challenges and take advantage of opportunities presented. But nimble, innovative firms may be able to secure first mover advantage.
- 6.18** Given that London's historical reputation and specialist skills are driving customer demand, it is unlikely to be affected by the withdrawal from the EU, at least for larger, more complex risks.
- 6.19** It is possible to speculate that, over the long-term, EU withdrawal could lead to the emergence of a competing insurance marketplace in the EU after the UK has left. There is limited evidence that this will be the case. The effects of this may be similar to the development of other regional marketplaces discussed in the previous section.

Technological change and evolution of broker's business model

- 6.20** Lloyd's of London is currently undergoing a change programme to implement a new Target Operating Model. This programme is a significant step towards an integrated digital placing and claims management model. Standardised electronic placement could make the automatised placement and claims settlements in the LIM possible.
- 6.21** The development of low-cost underwriting solutions such as electronically-managed facilities may push the market towards disintermediation. This could shrink the potential demand for brokerage services. Larger, more complex clients may continue to need risk consultancy and methods of distributing significant insurable risk across multiple insurers or conditional capital sources.
- 6.22** Larger brokers are currently developing other revenues streams to diversify from pure placement revenue, such as the consultancy-style services.
- 6.23** The ultimate effect of technological change on our findings is unclear and depends somewhat on the broker's ability to diversify. It may further increase the risk and modelling expertise of brokers which, supported by increasing volumes of data, may have a significant impact on the relative positions of brokers and underwriters, and small and large brokers.

Conclusions and next steps

- 6.24** There are several possible future changes in industry dynamics that could affect how effective competition is in the wholesale insurance broker market. The market power of the larger brokers could increase for many reasons: increase in concentration through acquisitions, market hardening, or increased levels of international competition.

- 6.25** All of these changes will require brokers individually to consider their business models. More widely, the global competitiveness of the LIM may increasingly be challenged by these developments. Effective competition which promotes innovation will help ensure that London is better able to compete internationally.
- 6.26** We will continue to monitor the market to assess developments and to determine at an early stage whether regulatory attention might be required.

7 Summary of findings, and next steps

7.1 Overall, the market study has not found evidence of significant levels of harm that may merit the introduction of intrusive remedies. Thus we are closing our market study at this stage and this is our final report. This step is feasible within our market study process, and this is the first time the FCA has done so.

7.2 Our findings on the themes explored in this market study are set out below.

Market power

7.3 The wholesale insurance broking sector does not appear to be highly concentrated. Nor does our analysis provide evidence of market power resulting in excessive profitability at an aggregate level. Segmenting firms by scale, we find that, as firms grow, their average margin improves, driving primarily by economies of scale. We find that differences in concentrations between risk segments do not systematically lead to increased profitability in those segments for brokers.

7.4 We have found evidence of some barriers to entry and expansion in the wholesale insurance broking market which may adversely affect competition at the margin. These are most likely to occur for niche markets, and when servicing customers with global risk placing programmes. However, we do not consider the barriers to be large enough to lead to significant restriction of competition for the overall marketplace.

Pay-to-play

7.5 We have endeavoured to determine if the concerns we have heard about pay-to-play are warranted. We asked insurers about its existence but none of the respondents provided us with concrete evidence. Notwithstanding this lack of evidence, we have also performed quantitative and qualitative analysis to test for it. We recognise that, taken individually, neither the quantitative nor qualitative analysis can necessarily determine that there is no pay-to-play. Our conclusion is that we are unable to conclude that pay-to-play exists at scale or that an intervention by us to address pay-to-play is necessary at present.

Onerous conditions in contractual agreements

7.6 We have identified some clauses that can restrict competition in certain circumstances. This does not appear to be a market-wide issue. We intend to follow it up with the individual relevant firms and consider whether any additional steps are

appropriate. We have not found any evidence of brokers being able to require insurers to place facultative reinsurance of the same risk with their brokerage services.

Broker conflicts

7.7 Our analysis shows that brokers receive higher remuneration rates from placing risks into their own facilities and MGAs than in the open market. This is a relatively small, but growing, proportion of the whole market. Research shows that most clients can get the information they need to help them make informed decisions. This helps minimise the potential harmful impact of conflicts. Currently 8% of GWP is placed through facilities, which does not suggest a significant potential for harm.

7.8 The issues above could be mitigated through effective conflicts of interest policies to reduce the possibility of harm. We have reviewed brokers' conflicts of interest policies from a competition perspective. We see that not all of them demonstrate the same level of completeness in identifying the relevant conflicts inherent to their business models. We will continue to look at compliance with existing obligations on the management of conflicts of interest.

Broker coordination

7.9 We have examined the susceptibility of the LIM, and sub-segments of this marketplace, to tacit coordination. We concluded that the industry's characteristics mean that tacit coordination between firms is unlikely.

Possible changes in industry dynamics

7.10 We have explored some of the possible developments that may affect competition between brokers in the LIM. These developments could affect how effective competition is in this market. Hence, we will continue to monitor the market to determine at an early stage whether regulatory attention is required.

Next steps

7.11 We have considered the theories of harm set out in our Terms of Reference in the light of both the responses to our Terms of Reference and the findings from all the analysis we have detailed in this report. We have not found evidence of significant levels of harm that merit the introduction of regulatory intervention.

7.12 We have therefore considered the most appropriate course of action for us to take now given our findings. Our powers and procedures in relation to conducting market studies are set out in Final Guidance 15/9: Market Studies and Investigation References.⁴¹ The guidance establishes that, when doing market studies, we will publish an interim report, other than in exceptional circumstances.

7.13 We consider that our finding of a lack of material evidence of harm and need for regulatory intervention, despite the wide range of responses to our Terms of Reference and the detailed analysis we have undertaken, to be exceptional.

41 <https://www.fca.org.uk/publication/finalised-guidance/fg15-09.pdf>

We therefore consider that it would be inappropriate for us to publish an interim report, which would entail further consultation. Instead, this report is our final report and signals the closing of the market study.

- 7.14** Following the closing of this market study we plan to continue to monitor the market, to assess developments arising from the impact of EU withdrawal, possible further consolidation in the industry and as a consequence of any changes in business models.
- 7.15** We remind firms of their obligations to manage conflicts of interest. We will continue to assess compliance with these obligations.
- 7.16** We intend to follow up bilaterally with the small number of firms who have clauses in their agreements with insurers which could potentially restrict competition.

Glossary of terms used in this document

Captive insurers	Insurance company that is wholly owned and controlled by its insureds; its primary purpose is to insure the risks of its owners, and its insureds benefit from the captive insurer's underwriting profits.
Coverholder	An insurance intermediary authorised by a managing agent to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate managed by it, in accordance with the terms of a binding authority.
Facultative reinsurance	The reinsurance of single risks, or part of a single risk.
Gross Written Premium (GWP)	Original and additional inward premiums written by an insurer before deductions for reinsurance.
Lineslip	A document written by a broker that describes a prospective risk.
Lloyd's	From Lloyd's official definition: Depending on the context this term may refer to – (a) the society of individual and corporate underwriting members that insure and reinsure risks as members of one or more syndicates. Lloyd's is not an insurance company; (b) the underwriting room in the Lloyd's Building in which managing agents underwrite insurance and reinsurance on behalf of their syndicate members. In this sense Lloyd's should be understood as a market place; or (c) the Corporation of Lloyd's which regulates and provides support services to the Lloyd's market.
London Insurance Market (LIM)	A part of the U.K. insurance and reinsurance industry. Its main participants are insurance and reinsurance companies, Lloyd's of London syndicates, Marine Protection and Indemnity Clubs (P&I Clubs), and brokers who handle most of the business.
Managing General Agent (MGA)	An agency whose primary function is the provision of underwriting services and is vested with underwriting authority from an insurer.
Open market	Insurance business that may be offered to and placed with any managing agent that is willing to underwrite it on behalf of its managed syndicate. It excludes business that is underwritten pursuant to a binding authority.
Risk class	A group of individuals or companies that have similar characteristics, used to determine the risk associated with underwriting a new policy and premium that should be charged for coverage.

Syndicate	A group of companies or underwriters who join together to insure very high-valued property or high-hazard liability exposures. Lloyd's of London use syndicates to write insurance.
Treaty reinsurance	The reinsurance of an insurer's whole portfolio of risk or exposures – such as to storm or earthquake.

Abbreviations used in this document

Col	Conflicts of interest
FCA	Financial Conduct Authority
GWP	Gross Written Premium
KPI	Key Performance Indicator
LIM	London Insurance Market
MI	Management information
MGA	Managing General Agent
SMB	Subscription Market Brokerage
TOBA	Terms of Business Agreement
WFII	World Federation of Insurance Intermediaries

We have developed this work in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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