As Brokers Merge; Pricing May Rise

With more broker M&As comes more depth. But there are still pros and cons to consolidation that insureds should know.

By Alex Wright

Brokerages are on a consolidation tear. Will insureds see any benefits?

The frenzy of wholesale brokerage consolidation continued at a rapid pace in 2017 and 2018, driven by a large capital surplus, advancements in technology and aging owners.

Wholesalers are also coming under increasing pressure to merge by large retail brokers seeking to reduce their pool of intermediaries to drive volume, increase commission and fee income and control premium flow.

There is also the need to keep up with the growing sophistication of distribution systems and the appetites of hungry private-equity firms entering the market. Added to that is the increasing consolidation of retail brokerages, meaning fewer companies for wholesalers to do business with as the Big Three global brokers continue to snap up more targets.

STEADY GROWTH IN M&AS

Last year alone was the highest in recorded history for U.S. insurance broker mergers and acquisitions (M&A) at 536, as well as the largest number of deals closed in the fourth quarter for six years, according to M&A advisory firm MarshBerry.

The top 10 acquirers accounted for 50 percent of announced deals in 2017, with Acrisure, HUB International, BroadStreet Partners and Arthur J. Gallagher comprising the top four.

Futhermore, consolidation in the specialty brokering space broadly mirrors M&A among insurers, many of whom have been buying up specialty teams to help manage their underwriting cycle in a low-rate environment.

But as companies are acquired or merge, new start-ups are springing up in their place, often formed by previous owners who have sold up, adding to the competition.

David Bresnahan, executive vice president, Berkshire Hathaway Specialty Insurance, said the current surge in wholesale brokerage consolation was the result of profitable wholesaler business and retailer capital surplus. It also stems from the larger retail brokers forcing smaller wholesalers to sell up by not doing business with them, he said.

"Generally, their margins are much better than the underwriters and insurers can generate; so, it's an attractive and profitable business," he said. "There also continues to be a surplus of capital interested in owning and investing in insurance brokers and encouraging growth and M&A.

"Third, the larger retail brokers are forcing many smaller wholesalers to sell if they choose not to allow their firms to trade."

But what does all this mean for the insurance buyer at the end of the insurance value chain?

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— *David Blades,* *senior industry analyst, A.M. Best*

BENEFITS OF CONSOLIDATION

One immediate advantage is that, as larger brokers take on the specialist expertise of small wholesalers, they can scale up their operations, bringing specialty capability to a wider market. David Blades, senior industry analyst, A.M. Best, said the key benefit of brokerage consolidation for insureds is working with a company with more efficiencies and economies of scale as part of a larger organization. It also provides them with a greater knowledge base and product range, he said.

"From a buyer's perspective, there may be fewer wholesalers to choose from, but they have the advantage of being able to access stronger and better capitalized organizations with more depth and the ability to move quickly in the market place," he said. "It also exposes them to a greater expertise and geographical and product reach."

Robert Raber, associate director, A.M. Best, said that despite the change, buyers will still have access to the same channels for placing their business. He added that as long as there is demand for E&S, there will always be well-capitalized companies with a strong financial rating willing to provide it.

"[The insurance buyer] may actually pick up some gains as a result," he said.

SUMMARY

- ***More brokerages*** are consolidating through mergers or acquisitions.
- ***These M&As*** bring a number of benefits to insureds, including technological advancement.
- ***Premiums,*** however, may rise in this era of consolidation.

"At the end of the day, they will still be able to deal with the same insurance carrier [as] in the past."

James Drinkwater, president of AmWINS Group, said consolidation enhances the technological capabilities available to insurance buyers. If anything, having this technology at their disposal puts added pressure on wholesale brokers to be more efficient in their delivery, he said.

"The larger acquiring wholesale brokers have greater sophistication and capacity," Drinkwater said. "There's more specialization of product, market access and technological capabilities."

Brady Kelley, executive director of the Wholesale & Specialty Insurance Association, said that as an insurance buyer itself, the Association benefited from the competitive environment that is driving brokerage consolidation.

"During my tenure, we have seen a big shift in the premium structure, including dramatic changes to the limits we can get and the enhancements we can negotiate," he said. "In certain cases, we have been able to enhance our coverage with very little change in our premium. I believe that consolidation for the purpose of acquiring best practice, advancing technology and enhancing depth of talent and expertise delivers far more value to the insurance buyer."

Jeremy Chaseley, head of specialty wholesale, Zurich North America, said an advantage of being moved to an acquisitive larger wholesale broker for the insured is their ability to benchmark coverage, pricing and claims more effectively. By strengthening in this way, they can also reinvest in these capabilities, he said.

"The larger and more sophisticated wholesale brokers are joining the data and analytics revolution not just in the insurance industry but in wider business," Chaseley said. "This has given them the capability to benchmark coverage, claims and pricing for those unique and complex risks they are acquiring."

RISING PREMIUMS

Bresnahan, however, said one of the potential downsides of brokerage consolidation is that it could result in higher premiums. With brokers looking for higher commissions and fees, that will put even greater pressure on insurers to increase rates.

"Arguably, in the longer run, it could lead to [higher premiums] as more wholesalers and retailers look to the insurance carriers for higher commissions and fees," he said. "There is not much margin in the underwriting results, so eventually premiums will have to reflect these higher acquisition expenses.

"All of these factors require the larger wholesalers to focus on providing their client with far greater resources. That way they can add real value to the insurance buyer."

As far as continuity of service, he said: "All of the issues relative to the service continuing at a high or satisfactory level need to be managed at a local level by the customer. Naturally, if an insured values the service provided by both the retailer and the wholesaler at the local level, then the main risks relative to retailer RFPs and following wholesale consolidation are when that wholesale broker could be foreclosed to continuing to work with the retailer and customer, or the wholesale broker leaves or is let go post-merger."

On balance, the advantages of M&A for the insurance buyer outweigh the disadvantages. But it remains to be seen how long this consolidation feeding frenzy will last and whether benefits for insureds will continue. &

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