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Changing nature of the broker / underwriter relationship

Over 324 years have passed since the first risk was underwritten in the iconic surroundings of Edward Lloyd's coffee house, and although the fundamental roles of the broker and underwriter on that day have remained intact, their counterparts in 2012 have changed dramatically to adapt to the highly evolved and dynamic marketplace operating today.

When I began my career as a Lloyd's broker in the 1970s, underwriters at Lloyd's were wholly reliant on London brokers to bring them business. This dependence was exacerbated by an anachronistic financial structure that was rife with potential conflicts of interest.

Lloyd's brokers owned or partially owned many of the managing agencies and members' agents, so the provision and distribution of capital to the underwriting community was often in the hands of the brokers who also provided the business flow, giving them effective control over most aspects of the transaction. This manifest imbalance was addressed by the Lloyd's Act of 1982, which required the separation of ownership of managing agencies and Lloyd's brokers. Until that time, while the power to a large extent apparently rested with the broker, both the underwriting and broking communities were populated with numerous, smaller entities that unwittingly presented a natural hedge to any systemic abuse.

Contingent commissions

Further equilibrium was introduced in the 1990s during the period of modernisation around reconstruction and renewal, where the introduction of corporate capital naturally resulted in fewer and larger syndicates and a more stringent focus on corporate governance. This trend was mirrored on the broking side through the 1980s and the 1990s as the US mega broking houses cut a swathe through the insurance landscape on both sides of the Atlantic, creating a powerful US broker presence in the London market and concentrating influence in fewer hands. The controversial practice of contingent commissions was introduced to enhance diminishing insurance broking revenue, in part due to the introduction of fee based rather than commission based contracts.

During this period, some Lloyd's underwriters began to create overseas platforms, primarily to capture local business that was lost to domestic insurers and hedge against the single platform dependency of London and thereby reduce dependence on Lloyd's brokers and cut out a perceived high-cost link in the chain. Many of those enterprises have met with varying degrees of success, but a multi-access point platform is now de rigueur for most large Lloyd's businesses.

While Lloyd's underwriters still relied on London brokers for much of their revenue, the establishment of their own platforms outside London (or for some, platforms outside Lloyd's but still in London) combined with a more coordinated broking presence focused their attention on the evolving landscape of the broking community.

The wholesale brokers servicing London markets divided into two segments: local service arms of large US brokers, and independent UK brokers servicing independent brokers in the UK, the United States and internationally.

The nature of the broker/ underwriter relationship depended on which group you were in: the independents continued to aggressively court independent business sources, while the big brokers began to turn inwards to focus on revenue enhancing projects. The underwriting community resisted, but most eventually capitulated to the new contingent commissions required by the big brokers, while the independent broking community rejected the practice.

It is our job as brokers to identify the best markets for risks, in London and around the world, with the sole consideration being our clients' best interests

Lloyd's and the international insurance markets also weathered unparalleled losses arising from the tragedy of 9/11and some of the most destructive US hurricane seasons in living memory, survived the worldwide financial crisis of 2008–09 and emerged from these events structurally and financially robust

The new millennium heralded an era of unprecedented regulation within the London insurance markets. The Financial Services Authority was formed in 2001 and assumed responsibility for regulating Lloyd's (previously self-regulated). Shortly after, Lloyd's adopted the recommendations of the Chairman's Strategy Group and in 2003 established the Franchise Board to develop and protect the Lloyd's franchise.

Weathering the storms

During this period, Lloyd's and the international insurance markets also weathered unparalleled losses arising from the tragedy of 9/11and some of the most destructive US hurricane seasons in living memory, survived the worldwide financial crisis of 2008–09 and emerged from these events structurally and financially robust. The two regulatory developments have markedly increased the professionalism and expedited the modernisation of our market, while naturally and regrettably increasing the bureaucratic burden. The large loss events led to better use of modelling and capital adequacy tools, and had similar effects on both the professionalism as well as the regulatory burden within the underwriting community.

This wave of regulation offered temporary respite from the spectre of contingent commissions as the New York Attorney General declared some forms of the commissions unlawful in October 2004 and sought criminal prosecution for some of the worst offenders.

However, the payments soon recommenced, adapted to relate to services such as the provision of information, rather than business volumes.

A further development over the past decade has been the formation of broker owned MGA/MGUs. Arguably this has benefits for underwriters, who view it as an efficient distribution model, while the broker sees it as an effective method to place low valued business with greater levels of commission and an opportunity to share in the underwriting profits of that business.

The era of increased regulation has of course equally impacted the broking community. Brokers have also been the subject of increased regulation, resulting in stronger brokers, but again with increasing bureaucratic burdens, which has had a material impact on costs.

While the most meaningful contribution of a broker in 1688 may have been his ability to identify a counterparty that could or would pay in the event of a loss, today's broker/underwriter relationship requires far more knowledge but is probably equally as simple.

As brokers today, we should identify the most competitive and financially stable markets for our clients; we should direct business that we know is sought after to the markets that will provide the best terms; we should transact deals efficiently and transparently and collect claims rapidly and fairly should they occur.

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Simply put, our relationship with underwriters is our second most important; all that should be required to engender and perpetuate a mutually beneficial relationship with our underwriting markets is to treat them professionally, fairly and transparently – just as our clients would expect.

Our primary obligation is to our clients; this is not a surprise to our markets – it is what our underwriters expect of us. It is our job as brokers to identify the best markets for risks, in London and around the world, with the sole consideration being our clients' best interests. This alone will ensure the future success of the broker/underwriter relationship.