RISK & INSURANCE®

AGENT/BROKER

# Beefing Up

**This isn't your father's brokerage business. The days when a desk, a phone and the right contacts were enough to make it as a reinsurance broker are gone. These days it takes lots of computing power, a host of actuaries and sophisticated modeling techniques. Today's reinsurance brokers are working to add value for clients with services from catastrophe modeling to credit analysis and portfolio optimization.** BY MICHAEL FITZPATRICK

Dee Megna remembers when there were no actuaries at reinsurance broker Guy Carpenter. Those days are gone. "When I first started at Guy Carpenter, we didn't have an actuary," says Edmund (Dee) Megna, vice chairman of Marsh & McLennan's reinsurance brokerage unit. "Now we have well over 60 actuaries."

That change highlights a transformation in the role of reinsurance brokers. In addition to placing reinsurance, the big brokers now provide a host of services and risk management tools from catastrophe modeling to runoff services, risk securitization, financial analysis and portfolio optimization. They help ceding companies evaluate reinsurers with credit analysis, and help insurers improve their own financial strength—and their ratings with the rating agencies.

"I've been in the business almost 30 years. I've seen the role of the broker change very dramatically over the last 10 years or so," says Megna. In the past, brokers were seen mostly as market matchers who would find capacity and pricing to fit a client's coverage needs, he says, but the job doesn't stop there anymore.

"It's become very popular to talk about how the role of the broker has changed to the point where we're consultancies," Megna says. "That is very true."

"As exposures have become larger and more complex, the role of broker has evolved to encompass a range of value-added, consultative activities—catastrophe and financial modeling, actuarial analyses, portfolio analysis and capital allocation modeling—along with placement services," Megna says.

Among the factors driving the change in the business has been a desire by brokers to insulate themselves from market swings and to strengthen their ties to their clients. As brokers become more entwined with ceding companies, it becomes more difficult for a client to switch solely based on price considerations.

"Brokers have added a lot of service capability in the second half of the '90s as a measure to retain business during low-growth market periods," says Thomas Holzheu senior economist with Swiss Re and editor of a study published earlier this year on commercial insurance and reinsurance brokers.

Brokers also see new services as a way of diversifying their revenues in order to cushion the shock of soft markets. In this way, brokers can generate revenues from fees for services as well as from commissions.

"It's something that they've been doing in terms of diversifying their revenue, while pursuing the same sales channel," says Steven Ader, associate director at Standard & Poor's. "It has been used as a way of stabilizing the results, because if you just have a commission-based structure—which is how the industry was a couple of years ago—then you're more dependent on the transactional flow of your business ... the premium volume going through," Ader says.

Brokers also have seen services as a way to better compete with—and win market share from—direct writers, such as General Re and Swiss Re. "Reinsurance brokers have dramatically increased their value-added proposition at the expense of the directs," says Paul Karon, president of U.S. operations for reinsurance broker Benfield.

For its part, Swiss Re says the direct writers have been ahead of the curve. "I would claim that the direct writers have been leading the development regarding services," Holzheu says.

## CONSOLIDATIONS PLAY A ROLE

The wave of consolidation among brokers in the prolonged soft market of the late '90s gave them the needed expertise and financial clout to support the expansion into a variety of services.

Among those deals, Marsh & McLennan bought Johnson & Higgins for $1.8 billion and paid $2 billion for London broker Sedgwick Group; Aon bought Alexander & Alexander for $1.2 billion; Benfield merged with Greig Fester and later with EW Blanch to form the largest independent reinsurance broker.

"Large brokers have consolidated very heavily in the second half of the 90s. For the global business, it is now a small number of players," Holzheu says. That consolidation means that the top four brokers, Aon, Guy Carpenter, Willis Re and Benfield now account for about three-quarters of the roughly $3 billion in global reinsurance brokerage revenues.

In more recent deals, Marsh & McLennan paid $1.9 billion this summer for corporate security and risk consulting firm Kroll Inc., a leader in corporate investigations, forensic accounting and data recovery. That followed the 2003 acquisition by Marsh of financial services consultant Oliver Wyman, which added to its credit risk expertise.

And these days, size does matter for companies that want to compete in the top ranks.

"If you're of significant size in the market, it is evident that you have to be able to play in all areas of the field and to add value in the sense of what the client demands or needs," Holzheu says.

Adding value for clients is a top priority these days.

"What we're trying to do with reinsurance is to minimize volatility. We use our tools to help people get the best value, not the cheapest cost," says Karon. Services offered by Benfield include catastrophe modeling, dynamic portfolio optimization, dynamic financial analysis, A.M. Best consulting, among many others.

In a market where insurers are worried about liabilities lurking in their books of business, where ratings are under continual pressure and Wall Street is demanding better returns, the new tools and services can help clients strengthen their own business. brokers say. Tools such as catastrophe modeling and liability modeling allow clients to better manage their risks and their reinsurance program, Megna says.

"It's allowing the client to look at their book of business, and understanding what their risk appetite is, and making a more intelligent decision as to what kind or reinsurance program they need," Megna said. "We have to understand what their financial needs are, what their financial requirements are."

## THE NEW BROKER

While there is a lot of talk about the more sophisticated services, a key service is making sure that a reinsurer is willing and able to pay a claim. That has become especially crucial due to rating downgrades and also concerns that insurers who are too heavily reliant on reinsurance could be put in jeopardy by a slow-paying reinsurer.

That has made credit analysis critical.

"You can look at it two ways: From the standpoint of reinsurers, it's becoming critical because of the downgrades," Megna says. "Flip it around, there are some clients who depend on us to work with them on their credit ratings with the rating agencies. A lot of work is being done in that area."

While reinsurance brokers have put a lot of effort and capital into developing new services, those services are being used to strengthen the core business and client relationships under the risk management umbrella, rather than move into unrelated businesses.

"However, the way we view it, the enhanced understanding that comes with the provision of these consultative services supports the core broking business," Megna said.

"Our core business has always been and continues to be broking and that is where we derive the vast majority of our revenue," Megna said. "What has changed over the past decade or so is how one defines the term 'broking.' "