Business Insurance

Amid softening, push is on to ensure revenue growth

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Last year was pretty good for brokers, but growth is going to be tougher to manage in the near future than it has been in the recent past.

While brokers posted big gains in revenues and net income in 2003, organic growth has slowed for many this year with the quicker-than-expected softening of property insurance pricing.

Brokers are taking a variety of steps to ensure continued revenue growth. Mergers and acquisitions are proceeding at a frenetic pace, ranging in size from Marsh & McLennan Cos. Inc.'s $1.9 billion takeover of security consultant Kroll Inc. to the ongoing absorption of dozens of small agencies by their larger national competitors.

A softening market may actually encourage merger activity, as the prices demanded by takeover targets in a competitive insurance market may fall, some brokers suggest.

Many are pushing to expand in areas with growth potential. Depending on the broker, these areas may include middle-market and small-commercial risks, surplus lines, reinsurance, employee benefits and niche property/casualty lines, brokers report.

Meanwhile, the biggest brokers face a potential threat to one source of revenues: the contingent commissions that they collect from insurers based on the volume or profitability of the business they produce. Law enforcement and regulatory officials in New York, Connecticut and California are investigating these commission payments as a possible conflict of interest (see story, page 36).

Brokers say they are cooperating with the inquiries and concede that greater disclosure of such commissions to clients may be one outcome of the investigations.

2003 was another banner year for the brokerage industry, with all of the world's 10 largest brokers reporting double-digit revenue growth and six of them recording growth of more than 20%.

Arthur J. Gallagher & Co. came in at the low end of the top-10 spectrum, with a 14.3% jump in revenues, while BB&T Insurance Services Inc. recorded a 70.6% revenue increase, largely on the strength of its November 2003 takeover of McGriff, Seibels & Williams Inc.

Organic growth-including rising commissions on higher client property and casualty premiums-accounted for a large part of the rising revenue tide for several brokers. On top of its acquisition-fueled growth, BB&T managed a 24% organic growth rate last year, its officials reported. At Marsh, about 13% of the expansion of the broker's risk and insurance services revenue last year was from organic growth, which excludes the impact of foreign exchange, acquisitions and dispositions.

The second half of 2003, though, began to see a softening trend, especially in property pricing, and that trend has accelerated through the first half of 2004.

"The market has changed pretty abruptly, and I think most people did not forecast how quickly this market would change," said Roger E. Egan, president of MMC's Marsh Inc. brokerage unit.

The change showed in several companies' first-quarter results.

Marsh, for example, posted a 12% increase in first-quarter risk and insurance services revenue, but the organic component of that growth slowed to 7%. Gallagher likewise reported brokerage and risk management revenue growth of 9% in the first quarter, but organic growth amounted to only 4%.

Mr. Egan pointed out that the softening is not universal: "There are certain parts of the market that are not soft at all," he said, including casualty lines, such as professional liability and workers compensation in the United States, and most coverages for non-U.S. risks other than property.

The swings in pricing in recent years have actually made trouble for brokers, who have to explain to their clients why the same risks that saw sudden premium increases a couple of years ago now just as suddenly cost less to insure, noted Mario Vitale, chief executive officer of Willis North America in New York.

"What (buyers) want from their insurance program is stability and predictability. So any drastic market (change), whether it's up or down, destabilizes that foundation," Mr. Vitale said. "There's some credibility that is lost in that entire process."

At the same time, though, the softening market has made it easier for brokers to win favorable pricing and terms quickly, freeing up time to concentrate on identifying and mitigating client risks, Mr. Egan added.

"There are more opportunities to do that than there were in the harder market before," he said.

In any case, brokers are relying on a variety of strategic moves to expand revenues in the face of an increasingly competitive market.

Growth by acquisition

One is the old standby: acquisitions. The takeover deals are meeting a variety of needs, in some cases adding new services to a broker's existing offerings and in others simply expanding a broker's network of offices.

Marsh earlier this year announced its takeover of New York-based Kroll, which generated $485 million in 2003 revenue and brings the company new capabilities in corporate security, forensic accounting, financial crisis management and other advisory services.

Marsh had previously announced its acquisition of risk management information systems provider Corporate Systems Inc. and brokerage operations in Alaska, Australia, New Zealand and Papua, New Guinea.

"The consolidation movement will keep on as far as we can see, and we expect to be a player in that," Marsh's Mr. Egan said.

Brown & Brown Inc., the most aggressive buyer of smaller U.S. brokerage rivals in recent years, acquired 23 agencies last year. It took over another 17 agencies through mid-June, adding a total of $121 million in annual revenues in the process.

Hilb Rogal & Hobbs Co. used acquisitions to move into new areas of the market, buying surplus lines specialists Maclean, Oddy & Associates of Dallas and Bliss & Glennon Inc. of Redondo Beach, Calif., along with London-based reinsurance broker Alexander, Brooks & Stephens Ltd.

While digesting its acquisition of McGriff, Seibels, BB&T is simultaneously buying up midsize agencies in locations where its parent company-the nation's 12th-largest financial services holding company-has banking operations.

It is also expanding the managing general agency segment of its wholesale unit with acquisitions, including the 2003 takeover of Jackson, Miss.-based Southern Cross Underwriters Inc.

Not all brokers have relied on aggressive acquisition programs to build revenues: Gallagher, for example, has instead followed a strategy of hiring top producers away from rival brokerages with the expectation that new business will follow.

The strategy has begun to work as the noncompete restrictions on about 130 new hires started to expire at the end of last year, according to J. Patrick Gallagher, president and CEO.

"As of early last year, we said, `The nets are full, let's go to shore"' with the catch of producers Gallagher had landed, he observed.

Some brokerage officials lament most firms' heavy reliance on consolidation for revenue growth.

"We think it's a real shame that most of the growth in the insurance industry on the brokerage side has come from acquisitions," Willis' Mr. Vitale said. "What happens is, as a business we get away from organic growth, and to be good at organic growth you have to be good at being an insurance broker.

"That doesn't mean Willis won't do acquisitions; it means that acquisitions won't be the main substitute for running a good company and the only way to grow," he said.

Willis, in fact, has done some acquisitions: In the last year, it has bought out local partners in brokerage operations in Germany, Italy and Denmark and has increased to majority ownership its stakes in Spanish and Argentinian affiliates. It also bought a 50% stake in a Chinese broker.

Some distractions

Apart from the normal pressures of dealing with a softening market, some brokers have had to grapple with unusual and high-profile problems.

Marsh & McLennan executives were forced to deal with the mutual fund market-timing scandal that engulfed its Putnam Investments Inc. unit. In April, Putnam agreed to pay $110 million to settle charges by the Securities and Exchange Commission and Massachusetts regulators that the firm allowed improper trading in its mutual funds.

The company fired 15 employees after a review of their trading activity and pushed out Lawrence J. Lasser, Putnam's president and CEO since 1986. MMC named Charles E. Haldeman, co-head of investments, to replace Mr. Lasser and installed A.J.C. Smith, a former MMC chairman, as chairman of Putnam.

The market-timing scandal has taken its toll on Putnam: The company reported a $60.7 billion outflow of investor funds last year, most of it in the fourth quarter after the SEC filed suit. Putnam's revenues fell 8% last year, and while revenue rose in the first quarter of 2004, assets under management continued to drop, to $227 billion as of March 31 from $240 billion at year-end 2003.

Numerous Willis executives, meanwhile, had to devote considerable time this year to testimony defending client Silverstein Properties Inc.'s claim that it was entitled to a double payout under the $3.55 billion property insurance program covering the World Trade Center.

Silverstein and its roughly two dozen insurers wound up in court over the claim largely because no final policy wording-and no definition of "occurrence"-had been agreed to before the Sept. 11, 2001, terrorist attacks, which came two months after Willis initially placed the coverage.

Despite days of testimony by several Willis brokers on Silverstein's behalf, a jury found in May that 10 of the program's insurers bound coverage under a form that requires them to pay only one limit.

The trial of Silverstein's claims against 10 other insurers-which represent $1.13 billion of the program's limit-is expected to begin next month.

Willis' SEC filings disclose the potential for errors and omissions liability claims related to the Sept. 11 attacks, though Mr. Vitale points out that Willis has not been sued by any parties in the Silverstein litigation.

"Silverstein Properties has gone on record stating how satisfied they are with the terrific job our people did in securing this extremely large property insurance placement," Mr. Vitale said.