

LITTLEJOHN

brokingbusiness

The newsletter for
insurance brokers

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Risk transfer

Why it's a risky business

Brokers' survey

Setting your sights on growth

Brand management

Make sure yours isn't bland



Welcome to Broking Business

In times of economic strain, you need all the help you can get as competition inevitably increases. In this issue we bring you three articles that focus on how you can help your business to stand out from the crowd.

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Macquarie Relationship Banking recently carried out a benchmarking survey (see opposite) which highlights some key characteristics of successful intermediaries. It asks insurance brokers how they are approaching the future amid uncertain conditions. The results are surprisingly upbeat.

And when did you last consider your brand? The director of City-based Lamb Creative Marketing & Consultancy explains why having a strong brand is more vital than ever, and offers guidance on how to improve yours. See our final article.

The newly-established Managing General Agents' Association (MGAA) will focus on MGA best practice and Littlejohn will be supporting this through seminars to its members. The association's focus on special interests is behind our main feature in this issue, in which I consider why some firms get caught out over risk transfer in relation to client monies.

We're always interested in your views on the newsletter, so please don't hesitate to get in touch.



In Brief

John Needham is a partner in the firm's financial services division, specialising in insurance. He's also a member of the Littlejohn broking team, which caters for the needs of insurance brokers and other intermediaries.

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APB client money guidance

The Auditing Practices Board (APB), in conjunction with the FSA, has released new guidance to UK auditors on how to tackle client money audits. It sets out more clearly what is expected of auditors and asks them for a change of approach. The new guidance suggests auditors should consider whether the controls in place will work in an insolvency situation, asking client money auditors to adopt an insolvency mind-set. The document is likely to lead to a change in the work done by auditors, with a much greater emphasis on controls and also on reporting issues found.

Wholesale firms bulletin concerns

The FSA's latest Small Wholesale Insurance Intermediaries bulletin comments on the quality of brokers' client money reconciliations and oversight of financial issues. It says that brokers aren't carrying out detailed checks between their underlying financial records and their client money reconciliation. The FSA also asks firms to make sure they take into account its guidance on credit writebacks and encourages them to properly consider bad debt issues. These are all relatively easy things for brokers to do, so it's worth going through the questions posed by the FSA and making sure you have addressed them. See the full document here http://www.fsa.gov.uk/pubs/newsletters/wholesale_newsletter_7.pdf

Client money/risk transfer seminar

Over 100 brokers attended our broking team's seminar in October on client money issues, held in conjunction with solicitors Elborne Mitchell. As well as current client money issues, the seminar focused on how to handle legacy balances. You can get copies of the slides from our website www.littlejohnllp.com/events.php

Littlejohn's MGAA involvement

Littlejohn is proud to be a founding member of the Managing General Agents' Association (MGAA). The association is a focal point for all issues affecting MGAs in the UK. We hope to provide support through regular seminar participation and thought leadership on financial issues affecting MGAs. For more information please see the MGAA's website www.mgaa.co.uk/



Insurance brokers set their sights on growth

Earlier this year Macquarie Relationship Banking surveyed 109 insurance brokers to identify current market trends and benchmark best practice among brokers. Division Director, Aden Nguyen, reports.

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The survey focused on revenue and profitability, as well as some of the broader industry dynamics such as staffing and HR practices, M&A activity and succession planning.

Although the majority of brokers have a level of concern about the economic outlook, they have set their sights firmly on growth, with 79% expecting an increase in revenue in the next 12 months.

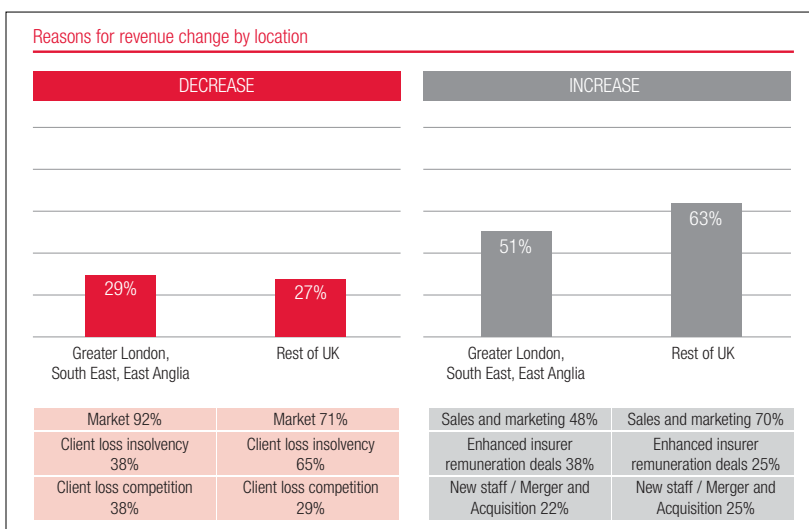
Despite difficult economic conditions across the UK, more than 50% have grown their income in the last year, with most attributing this to their focus on new client acquisition.

It seems that rates are showing signs of hardening across some policy classes and there is a general feeling of cautious optimism in the market. But the past has shown us that those who take active control of their business are those who really succeed.

Brokers who achieved revenue growth during the past financial year referred to sales and marketing and better insurer remuneration deals as the main contributing factors, all of which are largely within their control.

Conversely, those who experienced a drop in revenue said it was due to external factors, namely market conditions and loss of clients to competitors and insolvency.

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Risk transfer: a risky business

The recent launch of the MGAA (Managing General Agents Association) raises the question as to why the interests of Managing General Agents (MGAs) need representation separately from those of insurance brokers. The current ambiguities of 'risk transfer' may be a case in point. Is the contractual framework between MGA and insurer always clear enough? David Roberts reports.

David Roberts is head of the firm's financial services division and of the broking team. He specialises in advising the London insurance market and is a regular commentator on market activity in the insurance press.

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Let's start by asking why MGAs and brokers differ in important respects. The fundamental distinguishing feature of an MGA is that, in arranging insurance policies, it acts as the agent of the insurer rather than of the client. Generally, a broker acts as the agent of its client. Brokers also do business under binding authorities from insurers; in those cases they are acting as agents of the insurers. This can lead to obvious conflicts of interest for brokers who do business both under binding authorities and on open market terms – and they need to have systems and controls in place so that these conflicts are managed properly. On the face of it, an MGA's position is more straightforward: so long as its disclosures to clients are clear and unambiguous, its duties as agent will be simply to the insurer.

Client money

But there is a grey area. One way in which MGAs and brokers differ most clearly is in the status of the monies handled by MGAs, and the application of the FSA's rules on those monies. Most terms of business agreements (ToBAs) between MGAs and insurers will make it clear that the MGA is acting as agent of the insurer in all key respects. These include handling premiums received from clients and claims monies for onward payment to clients. So long as the ToBAs concerned are clear and unambiguous, the client will be able to rely on any such monies held by the MGA as being effectively held by the insurer. So premiums paid to the MGA are effectively paid to the insurer, so far as the client is concerned, and the credit risk for the client is not that the MGA fails, but rather that the insurer does so.

The FSA refers to such arrangements as providing 'risk transfer', and monies covered by risk transfer do not count as client monies under the client assets (CASS) rules. Since the FSA views handling client money as a serious source of risk, that should considerably reduce the regulatory burden on MGAs.

Clarity is all

So far so good. The MGA doesn't want the money it handles to be client money under the CASS rules, and the FSA is happy if risk transfer is in place, as insurers' balance sheets tend to be a lot stronger than MGAs'. The problem is that in some cases the contractual framework (the ToBA) may not actually provide risk transfer clearly enough. If that happens, the FSA will take the view that the monies concerned are client monies; that as no non-statutory trust deed is in place, a statutory trust over the monies concerned arises, and that the relevant provisions of CASS apply.

Meanwhile, the MGA will not have been treating the monies as client monies, and will almost certainly therefore be in breach of the CASS rules. So in the event of the MGA becoming insolvent, the client money trust may well not protect the money for the client, and both client and insurer will simply rank as unsecured creditors – with the client monies subsumed into the general pot of the MGA's assets.

“... monies covered by risk transfer do not count as client monies under the client assets (CASS) rules.”

Why does this uncertainty arise in some ToBAs? There are a number of factors at play. Firstly, insurers understandably like to standardise ToBA terms as far as possible, to avoid having to re-work the agreement for each new relationship. This means that ToBAs often seek to cover very different types of relationship, incorporating terms that may be mutually incompatible. A typical example might be a requirement to deal with insurer's money in accordance with the CASS client money rules. Secondly, even where the terms do clearly provide risk transfer, that risk transfer is often qualified by reference to specified events, such as the insolvency of the MGA. In that case, the risk transfer could fail just when the FSA would want it to be at its strongest to protect the client.

FSA response

Small wonder the FSA is increasingly taking the view that such 'conditional' risk transfer terms do not provide risk transfer at all, and that the monies concerned are therefore client monies and have to be dealt with according to the CASS rules.

What should MGAs do to make sure they don't fall into this trap? Firstly, undertake a review of all ToBAs to ensure that risk transfer is clear, unambiguous, and unqualified.

Depending on the results of that review, it may be wise to establish a register of ToBAs showing all key terms, liaise with insurers to clarify terms where necessary, and possibly agree an insurer trust account framework for risk transfer monies. Whatever action is taken, it is far better to be ahead of the game than to have to react to a problem arising, perhaps identified by the FSA itself.



Insurance brokers set their sights on growth (continued)

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What is driving organic growth?

Looking to the future, more than 75% of brokers surveyed are expecting new client acquisition to drive their profit growth. And 16% of their revenue came from new business, slightly higher than expected given that retention rates for commercial brokers are generally 90 to 95%.

So organic growth is challenging, and brokers also say they are vigorously defending their client base. But as only 7% say they have spent more time with their existing clients during the global financial crisis, clients may be inclined to move to another broker for a better deal.

Our team has seen that brokers are indeed recognising the growing importance of new business. The survey indicates that more than 50% are intending to grow their teams in the next 12 months, with a firm focus on revenue-generating roles – in particular business development.

M&As popular

There's still a healthy appetite for mergers and acquisitions. More than 70% said they have either merged or made an acquisition in the past year, have made an approach to merge or acquire, or are considering doing so.

Independent brokers appear to have been just as active as consolidators when it comes to targeting acquisitions. Brokers also mentioned that whilst they would still be more likely to sell to the highest bidder, they would prefer to sell to another broker rather than to a consolidator.

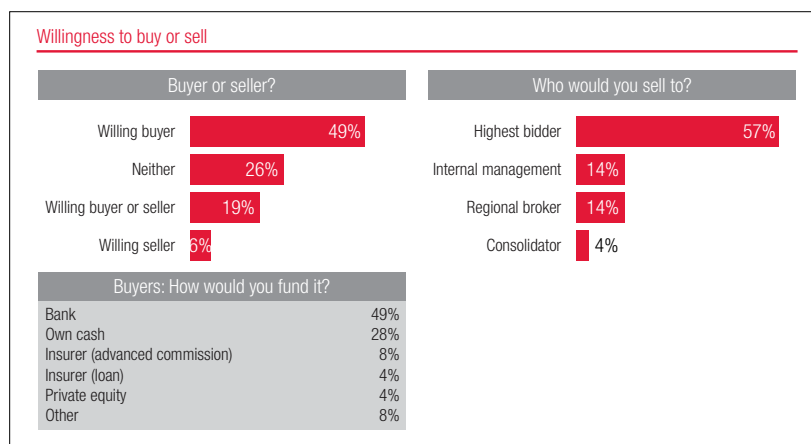
“...more than 75% of brokers surveyed are expecting new client acquisition to drive their profit growth.”

Our recommendations

Although it's encouraging to see such activity and optimism in this challenging environment, there are other issues arising. With such emphasis on growth, both organically and through M&As, the market will become increasingly competitive both for business retention and pricing of M&A deals. As brokers, you need to focus on efficiencies and business strategies to be in the strongest possible position to capitalise on the opportunities this market will present.

It's critical to identify key issues, trends and challenges in the industry. Performance benchmarking is a powerful business management tool that can help you critically assess how your business is performing against those of your competitors, highlighting your strengths and potential improvement strategies.

To find out more about Macquarie Relationship Banking's 2011 Insurance Broking Best Practice Benchmarking Report please contact Aden Nguyen at aden.nguyen@macquarie.com, or visit <http://www.macquarie.co.uk/mgl/uk/business/industry-solutions/insurance-broking>





How not to be brand bland

In times of strong competition, brand matters more than ever. Mark Huxley, director of Lamb Creative Marketing & Consultancy Limited and an insurance specialist, offers guidance.

Mark Huxley, a former Lloyd's specialist, has been involved in the insurance industry for more than 30 years. He now uses his background in finance to help City businesses improve their brand identity.

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These uncertain financial times particularly resonate for the insurance industry, which apart from managing its own business, can have a significant influence on those of its clients. It is a time, therefore, that industry practitioners need to showcase their talents, attracting and keeping valuable clients. Simply put, it is a time for your brand to shine through and work positively for you.

So what is a brand?

Your brand is your business. It is the embodiment of who you are, what you do and what makes you the broker of choice. It must be clearly understood and recognised by your customers. After all, it is their opinion that governs your success.

Take coffee shops – Starbucks, Costa or Caffè Nero. Which do you and your colleagues frequent and why? Compare answers and I bet you'll defend why yours is the right choice and not theirs. The coffee shops have created their identity and we are disciples of it. This example will equally apply to those that choose to work with you.

So what makes a brand good? There are four elements that must function in unison.

- **Authentic** – is your brand fundamentally true to itself? It had a vision from the start, has it stayed true to it? It must never pretend to be something it is not.
- **Compelling** – does it engage people emotionally, creating an immediate affinity? It's this above all else that drives brand selection.
- **Distinctive** – it's innovators not imitators that really stand out from the rest. That point of difference makes you individual; convey it from the very core of your business.
- **Excellent** – brand leaders truly deliver; they do what they say and do it well. Make false promises or fail to live up to expectations and you will quickly kill your reputation!

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As marketers, how do we understand and deliver strong brands?

Investigation, analysis & strategy

We ask the key stakeholders in the business to share their beliefs and ambitions. We learn their common values and, just as important, where they differ. This insight allows us to distil these values into words, adjectives and phrases that get to the very heart of the business.

Building the brand

With the words from stage one we have all the tools necessary to undertake any brand creation or re-engineering. We showcase the brand in action across the range of media; stationery, brochures, online, presentational, promotional, advertising, and so on.

Introduction & launch

The newly-created brand needs to be delivered internally before being used anywhere externally. It should be properly documented and presented to everybody. Fail to do this and all the hard work will be undone with a brand that is poorly understood, poorly executed, diluted and likely to fail. Not to mention losing all those potential Brand Champions you employ who can be your greatest sales force.

Implementation

Now is the time to identify the marketing disciplines that best promote your brand. Print, online, communications, PR, advertising and events are just some of the methods. Every execution needs to be carefully thought out, not just for its own merits but also as part of the wider campaign. A specific date or future event can help build momentum, as well as keeping focus on the whole campaign.

Insurance is an industry where adjectives like trust, reliability and professionalism ring through. With its complex distribution channels and networks, word-of-mouth is still fiercely active. Reputations can be made or broken quickly. In these challenging times, it is therefore vital to actively manage your brand in all its parts. Do it well and you will instinctively gain clients, make a powerful impression on them, and build loyalty, based upon your reputation to deliver.

LITTLEJOHN

Littlejohn is an independent, top 30 firm of chartered accountants and business advisors. A leader in providing accountancy and audit services to the London insurance market, the firm has operated in the sector for over a century. Littlejohn's specialists help clients to overcome the challenges faced by the industry through a comprehensive commercial and technical understanding of its workings, and a high level of partner involvement. Clients range from owner-operated firms to some of the biggest names in the broking world.

Visit our website at www.littlejohnllp.com for a downloadable version of this newsletter and past editions.

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Strong relationships, substantial partner involvement, honest answers and intelligent solutions from a dynamic team of accountants and advisors. **We work with you to deliver the best for your business.**

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