Executive Insights

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# The Goldilocks Effect: 5 Reasons Why Mid-tier Lloyd's Brokers Are Just Right for Growth

The Lloyd's of London insurance broking market has seen significant consolidation over the past decade, and the global dominance of Lloyd's itself is being gradually undermined. This has led many to expect the demise of the traditional smaller Lloyd's broker.

However, the reality is that the same reasons that have driven consolidation by the top-tier brokers, and the indirect impact of this consolidation, are creating new opportunities for strong midsize brokers and investors in the space. This *Executive Insights* looks at the evolution of the Lloyd's markets and the position of Lloyd's today, and explains why the current environment presents an exciting time for ambitious mid-tier players.

## Battle of the giants

The top Lloyd's brokers have driven the market's consolidation in the past five years via a series of sizeable acquisitions. Most notable were Willis' takeover of Miller in 2015, creating the largest wholesale Lloyd's broker, and Hyperion's market entry via subsidiary Howden's acquisition of Windsor in 2012, followed by the takeover of RK Harrison two years later. As a result of this process, the global and vertically integrated brokers now control approximately 55% of Lloyd's gross written premium. This consolidation strategy is expected to continue, driven by ongoing pressure on margins and profitability and by the benefits of being able to operate more effectively at increasing scale. 2015 also saw significant consolidation in Lloyd's underwriting capacity providers, including XL's acquisition of Catlin, the largest managing agent at Lloyd's. The top 10 syndicates now write 45% of Lloyd's GWP.

## The global dominance of Lloyd's is being challenged (but only a little bit)

Founded over 300 years ago, Lloyd's was, for most of its history, the only place where big and/or complex specialist risks from anywhere in the world could be placed. London's central time zone and the concentration of broking and insurance expertise and infrastructure built up over centuries seemed to be unshakeable competitive advantages.

However, over the past decade, Lloyd's has faced increasing international competition for its global position, as alternative markets across the world have gradually developed underwriting expertise and capacity. Markets into which Lloyd's had expanded, such as Dubai, China and Singapore, for example, now act as regional hubs for insurance underwriting. Non-Lloyd's markets have also seen significant expansion: Bermuda now hosts 15 of the world's top 50 reinsurers, for instance, and Miami has gained critical mass as a reinsurance center, especially for the Latin American and Caribbean markets (see Figure 1).

In response, in 2012 Lloyd's launched its Vision 2025 with the objective of retaining its leading global position for specialist insurance and reinsurance, irrespective of location. It had been in

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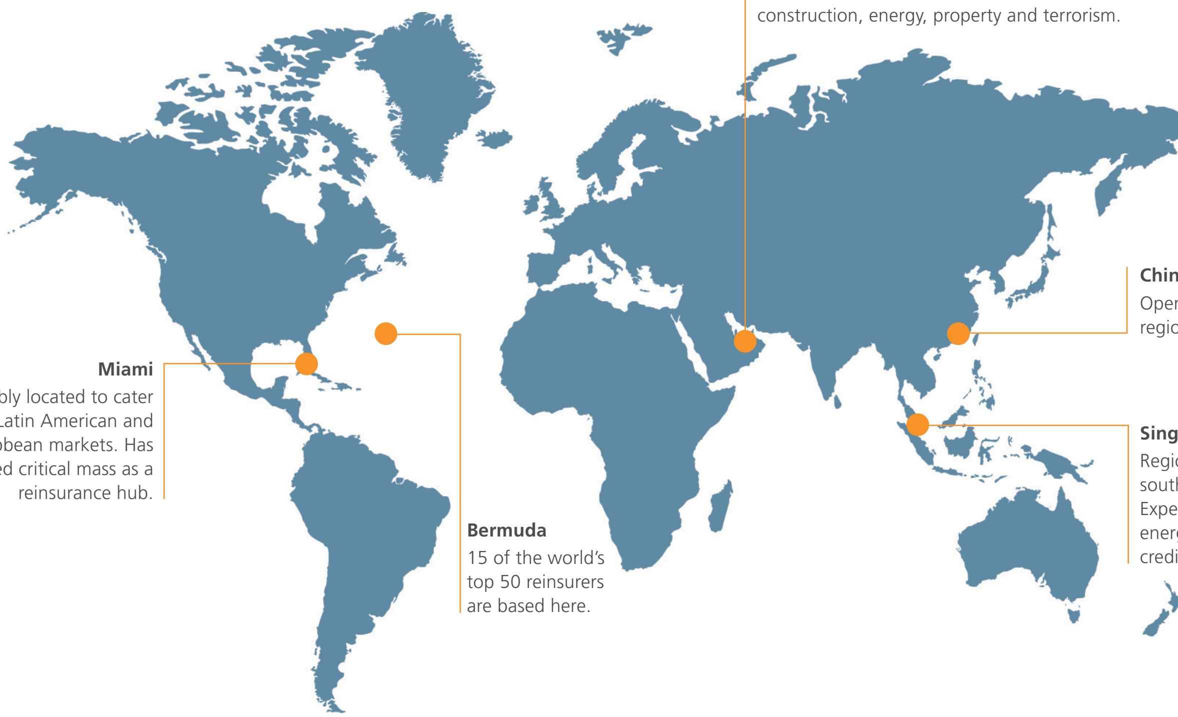
Figure 1
New insurance market hubs developing in emerging economies




Source: Insurance POST; L.E.K. analysis

Hong Kong and Singapore since 1999 but opened in China and Dubai in 2015.

Some of this competitive challenge is coming from within the London market: underwriters with strong London heritage themselves are expanding overseas. By establishing local presence, these insurers are ensuring that they continue to see a broad pool of risks at source, to mitigate against the risk that some of these may not come to London in the future.

The global market share of Lloyd's is likely to shrink in the coming years, but it will be a slow process. A combination of the broker's natural strengths in both existing and new risk classes and a defensive strategy will ensure that gradual leakage of share is an inconvenient backdrop rather than a transformational change. For mid-tier Lloyd's brokers with the right strategies to gain market share, this means that there is still plenty of opportunity for growth, provided they pursue the right strategy. For the largest brokers who already own the lion's share of the market, the underlying trends are harder to avoid.

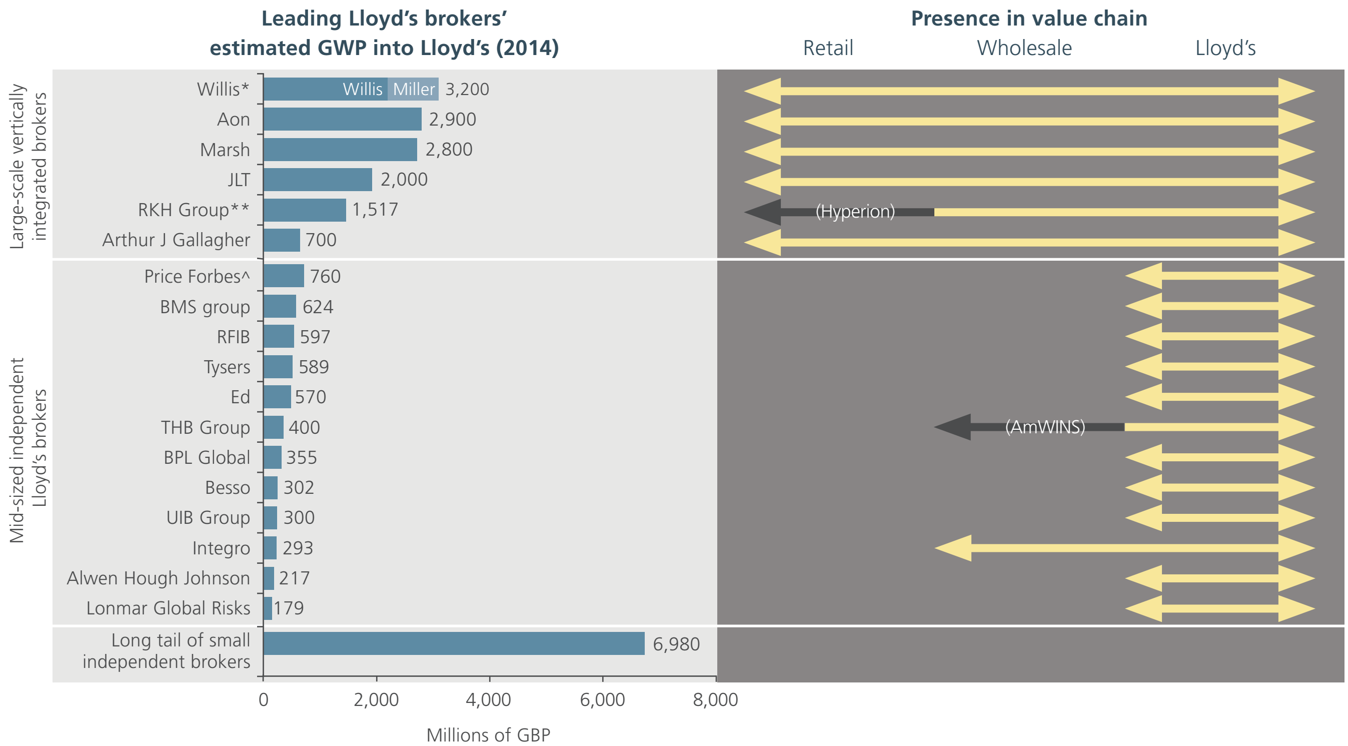
## The mid-tier broker opportunity

Many industry participants expect that only the broking giants have room for expansion, leaving little prospect for smaller players — and their investors — to grow as independents. The assumption is that they'll either fall prey to acquisition or gradually go out of business.

In our view, the reality is more nuanced, with significant room for expansion for the dozen or so mid-tier generally specialist Lloyd's brokers, driven by five principal factors:

1. **The nature of the relationship business.** The backbone to this positive mid-tier outlook is that the Lloyd's broking business is fundamentally relationship-driven. Placing specialist risk is complex, requires extensive knowledge, and depends on a series of trusted relationships between the various tiers of brokers, their end clients and underwriters. Because the ambassadorial role of Lloyd's brokers in managing these relationships is so vital, their bond with wholesale and retail brokers is very strong. These introducers will tend to stick with the individual Lloyd's brokers they know and trust, choosing them personally rather than as a representative of the company they work for, even where previously preferred panel suppliers are not available to the broker after moving to a different "shop.

Figure 2
Lloyd's broker landscape




Source: L.E.K. analysis

2. **Advantages of the entrepreneurial spirit.** Independent Lloyd's brokers can never compete with the breadth of services offered by the biggest firms and their reach in the retail market, but many other features make them very attractive to introducers. At their core they embody a more entrepreneurial spirit and reward structure that is a more natural home to personal client service and new business generation. Their size and approach enable them to be more nimble, flexible and innovative in the solutions they can deliver for clients, thereby helping them to not only maintain their introducer relationships but also generate more work from those relationships. Furthermore, commissions play a small part in the decision to use a Lloyd's broker, so wholesale brokers will often give up additional remuneration to stay with their trusted Lloyd's intermediary. Working with independent Lloyd's brokers is particularly attractive to U.S. wholesalers who do not want to place business in London via their own or their retail brokers' competitors.

3. **Ability to attract the industry's star performers.** The stark cultural difference between the entrepreneurial independents and the industry giants provides a further opportunity for ambitious mid-tier brokers. This is because brokers from independents often do not like working within the hierarchy and bureaucracy of much larger organizations, or may find themselves unable to serve their closest clients due to new conflicts of interest that arise when joining a much larger organization with a correspondingly large range of existing and potentially conflicting relationships. These brokers will look for opportunities elsewhere when their companies are acquired. With the recent spate of acquisitions, the market is ripe for the movement of teams in this situation that have been newly acquired by the top-tier majors, giving growth-focused mid-tier companies the chance to recruit them.

4. **Opportunities for acquisitive growth.** Like their larger competitors, the mid-tier players could also have an acquisitive eye on the best performers from the long tail of about 160 boutique brokers focused on one or two key business lines and with revenues of less than £15 million (see Figure 2).

Some midsize companies have already adopted this strategy; Integro acquired Croton Stokes Wilson Holden in March 2016, for instance. An additional force here is increasing regulatory compliance costs. For small brokers, this is making survival harder and harder, ultimately leaving many of them little choice but to try to join a larger firm with the scale to provide the appropriate compliance infrastructure. For the same reasons as above, joining a mid-tier player may well be these brokers' preference

5. **Insurer preferences.** The way big brokers conduct some of their client business is also benefiting their smaller competitors. A contentious issue is "facilities," which are deals negotiated by a broker with groups of insurers (sometimes outside of London) to allow certain risks to be bundled together and automatically underwritten, within certain limits. The benefit to the brokers of bundling risks is that it places the business at lower cost and guarantees a good commission. Facilities also allow brokers to use their market power to place unattractive risks that would be more difficult to place on a stand-alone basis. Insurers, in particular smaller players, are seeking a natural hedge to this class of business by preferring to work with independent brokers to diversify their sources and risk classes of business.

## Developing a strategy for success

The key challenge for mid-tier company success is developing the right business strategy. The starting points are to review current competitive positioning, map distribution flows and changes, understand underwriter needs and decision-making processes, analyze potential acquisition targets and develop a series of scenarios giving due consideration to possible competitive moves.

It is a complex exercise, but those who think that only the giants have room for expansion are mistaken. There is no doubt about the opportunity in the mid-tier for both brokers and investors in the market. In spite of the slow-burn threat to the Lloyd's markets and the consolidation led by the biggest brokers, the current market dynamics provide focused mid-tier Lloyd's brokers with the chance to increase their market share substantially. The building blocks are in place, and the best-in-class brokers already have the elements required for success: the client and market relationships, the specialisms, the compliance structures and, most important, the service and go-getter approach to business, agility and innovation.

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