Insurance Intermediaries in Europe

Report to BIPAR

Prepared by

London Economics

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Terminology abbreviations

GVA	Gross value added
GDP	Gross domestic product

Member State abbreviations

BE	Belgium	LU	Luxembourg
BG	Bulgaria	HU	Hungary
CZ	Czech Republic	MT	Malta
DK	Denmark	NL	Netherlands
DE	Germany	AT	Austria
EE	Estonia	PL	Poland
EL	Greece	PT	Portugal
ES	Spain	RO	Romania
FR	France	SI	Slovenia
IE	Ireland	SK	Slovakia
IT	Italy	FI	Finland
CY	Cyprus	SE	Sweden
LV	Latvia	UK	United Kingdom
LT	Lithuania		

Executive summary

The present report commissioned by BIPAR provides an overview of the role and economic contribution of insurance intermediaries.

Role of intermediaries

The theoretical and empirical literature on the role of intermediaries in a wide range of sectors identifies 4 core economic contributions of intermediaries. These contributions also apply to insurance intermediaries. In general, through their activities, intermediaries:

- decrease search and matching costs;
- allow economies of scale to be reaped;
- help reduce adverse selection; and,
- help overcome moral hazard issues.

The market for insurance products, like many other markets, is characterised by imperfect information by each party to the transaction, significant search costs to find the "best" deal, and asymmetric bargaining power. Insurance intermediaries play a key role in the marketplace by:

- identifying the risks faced by clients;
- reducing insurance distribution costs;
- reducing search cost for clients;
- reducing uncertainty about the riskiness of potential insurance clients and the reliability and financial robustness of the insurance companies;;
- reducing asymmetric bargaining power;
- supporting clients when filing a claim; and,
- more generally, supporting and promoting competition in the insurance market.

Structure of the insurance intermediary sector and contribution to EU27 GDP

While the precise structure of the insurance intermediary sector (i.e. all the undertakings and individuals involved in the sale of insurance products other than direct sales by insurance companies) varies across EU Member States, it is typically characterised by a pyramidal structure with a large number of very small intermediaries and a very small number of large and very large intermediaries.

In all the 20 EU Member States for which there exists detailed information on the relative importance of different insurance distribution channels, the insurance intermediary sector accounted for more than 50% of all premiums (life and non-life) in 2008.

Moreover, in 7 of these 20 Member States (Belgium, Germany, Italy, Luxembourg, Malta, Portugal and Slovenia), insurance intermediaries accounted for 80% or more of all insurance premiums.

The insurance intermediary sector is estimated to have generated directly an estimated €95 billion of value added in 2008 or 0.8% of total EU GDP (at current prices).

Taking into account the indirect effects (multiplier effects) of its activities, the contribution of the insurance intermediary sector to EU27 GDP in 2008 is estimated at €148 billion or 1.1% of EU27-wide GDP.

Remuneration of insurance intermediaries

Generally, there are two primary mechanisms by which insurance intermediaries are compensated for their services:

- a fee system under which the client directly pays for the services provided; and,
- a commission system under which the intermediary is paid a percentage of the premium paid by the client for coverage based upon the intermediary's agreement with the carrier.

Whether a fee or a commission is the best choice should be decided by the parties on a case by case basis and in transparent dialogue about the various possibilities with the intermediary.

From an economic perspective, overall, there exists no system which is preferable in all circumstances.

The co-existence of various remuneration systems, and in particular the freedom to decide about the remuneration systems between the parties, is the best guarantee for competitive, efficient and dynamic markets that work for the client.

1 Introduction

The present report commissioned by BIPAR provides an overview of the role and economic contribution of insurance intermediaries.

First, in Chapter 2, the report discusses the role of intermediaries in general and more particularly in the insurance sector.

Next, Chapter 3 provides information on the structure of the insurance intermediary sector.

Chapter 4 then presents information on the contribution of the insurance intermediary sector to E27 GDP.

Finally, Chapter 5 briefly addresses the issue of the remuneration of insurance intermediaries.

2 Role of insurance intermediaries

2.1 Core economic functions of intermediaries

Intermediaries operate in many different markets such leisure and business travel, real estate, credit, pensions, etc. Essentially, intermediaries can be found in many markets in which a customer only occasionally seeks to buy a product or a service.

The theoretical and empirical analysis of the role of intermediaries has identified 4 core economic contributions of intermediaries which also apply to insurance intermediaries[1]:

- *Through their activities intermediaries decrease search and matching costs*

  Intermediaries enhance market performance by coordinating market transactions. They act as a matching mechanism: they match consumers with specific needs to suppliers that offer particular products and, by doing so, they increase the overall volumes of trade.

  In a market characterized by differentiated products and by consumers with various needs and preferences, the activity of searching plays an important role as it allows consumers to gather information about products and price quotations. Consumers can avoid costly market search by relying on intermediaries that present them with a range of products or services. Similarly, lenders seeking to reach consumers can make use of credit

[1] See, for example, Cotter (2005), Europe Economics (2009), Spulber (1996).

intermediaries, thus avoiding the need to open branches, advertise, and promote their products.

The magnitude of this benefit depends on whether the intermediary is tied to a single supplier or a few suppliers, or covers the market at large

Typical intermediation activities reduce customers' search costs by:

- searching themselves for the appropriate products and services,
- providing price information (e.g., price quotes or estimates).

Intermediaries also assist suppliers establishing links with potential clients, distributing products and services and promoting and advertising suppliers' products and services.

- *Through their activities intermediaries allow economies of scale to be reaped*

In many instances, parties trading directly between themselves engage in a variety of costly and time consuming activities (e.g. bargaining, negotiating, and writing contracts). Where intermediaries handle a high volume of transactions with multiple buyers and sellers, they can potentially achieve significant economies of scale.

For instance, clients may have high opportunity costs of undertaking administrative tasks related to the process of obtaining a good or service, and might prefer dealing through an intermediary. Similarly, an intermediary may assist a supplier in the preparation of the sales agreement (e.g. by writing contracts and undertaking associated administrative tasks).

- *Through their activities, intermediaries help reduce adverse selection*

In some markets, information asymmetries between the trading parties may be so severe as to cause a form of market failure known as "adverse selection". This is a market process in which consumers select a product of inferior quality (or do not purchase it at all) due to having access to a different information set to the provider of the product.

In economic theory it has been argued that adverse selection that arises in a direct exchange market can be alleviated if the two sides of the market deal through an intermediary.

In a credit market setting, asymmetric information works at two levels: on the one hand consumers are not fully aware of the characteristics of a credit product and, on the other hand, lenders do not know the risk of default of borrowers.

In this context, problems of adverse selection are represented by trading opportunities that would be lost due to consumers' lack of confidence (e.g. a borrower does not purchase a potentially suitable product because he does not fully understand its characteristics), or lenders' reluctance to offer credit to a potentially valuable client (e.g. a lender's inability to recognise the creditworthiness of borrowers).

If they are perceived as experts and succeed in acting as quality guarantors for both sides of the market, credit intermediaries may alleviate these problems. For instance, credit intermediaries may assist borrowers in the purchase of products or services by:

- Suggesting suitable products and services
- Warning clients about the risk associated with specific products or services; and
- Explaining contract terms.

Typically, intermediation activities aimed at alleviating borrowers' asymmetric information are more significant for relatively complex products or services. In contrast these activities are relatively less important in the case of relatively simple and standardised products or service.

- *Through their activities, intermediaries help overcome moral hazard issues*

Moral hazard arises when a party insulated from a risk may behave differently from the way it would behave if it were fully exposed to that risk. In order to mitigate moral hazard problems significant resources must be allocated to collect information in order to monitor the post-contractual behaviour of a party in cases where such a post-contractual relationship exists. Economic theory suggests that, in many markets, intermediaries are able to collect information more efficiently and to do so at lower opportunity costs than individual clients.

2.2 The role of insurance intermediaries

The market for insurance products, like many other markets, is characterised by imperfect information by each party to the transaction, significant search costs to find the “best” deal, and asymmetric bargaining power.

Insurance intermediaries play a key role in the marketplace by contributing to identify the risk faced by clients, reduce insurance distribution costs, search costs, uncertainty and asymmetric bargaining power.[2] They also provide assistance in the claims process to insurance policyholders and more generally support competition in the insurance market

Identifying risks

Insurance intermediaries typically assist clients in identifying the risks they face. Without their expert knowledge and advice, clients would often have only imperfect knowledge of the risks they face, and, as a result, may take ill-informed decisions which could be highly detrimental to their welfare.

Reducing distribution costs

In the absence of intermediaries, each insurance company would need to develop its own fully-owned distribution network to reach its potential client base.

Such a distribution network entails high fixed costs which can act as a deterrent to entry into the insurance market and/or lead to the emergence of an oligopolistic market structure as the minimum efficient scale may be large relative to the total market.

The intermediary function overcomes the issue of distribution costs by allowing insurance companies to reach the client base without having to develop a distribution network.

Reducing search costs

While personal and business customers venture only infrequently into the insurance market, intermediaries are in repeated interaction with insurance providers and have a good knowledge of the products available, their terms and conditions, and, more generally, the risk appetite of the various insurance carriers.

[2] See, for example, Eckardt (2007).

Households and businesses can significantly economise on the costs of searching for the "best" deal by using an intermediary to meet their insurance needs. In other words, intermediaries contribute to reduce the effective price of insurance by reducing search costs and improve welfare by reducing customer detriment.

Insurance companies also benefit from the activities of intermediaries as the latter reduce the cost of finding customers.

Reducing uncertainty

Insurance markets are also characterised by major asymmetric information on both sides of the transaction.

- Uncertainty facing insurance providers

  Insurance buyers have an incentive to represent the risk as being a low probability risk so as to pay an as-low-as-possible premium. Moreover, once insurance has been obtained, the insurer faces the classical moral hazard issue – that the insured party may not take necessarily all the appropriate measures to prevent the risk from materialising.

  As intermediaries depend on repeat transactions with insurance providers and their reputation for their livelihood, they have every incentive to solicit and present risk information in a balanced and professional manner to insurance providers. The intermediary also advises the client about his own on-going responsibilities in the framework of the insurance contract.

- Uncertainty facing insurance buyers

  As noted above, the use of an intermediary reduces search costs. Individuals seeking insurance may not know fully what products exist on the market or the terms of those products in relation to the coverage of policies.

  Intermediaries have the knowledge or expertise to help the client identify the risks to which he is exposed and to identify solutions.

  The gathering of such information by the insured party directly would be very costly and the information would risk being incomplete as the party seeking insurance does not have the same knowledge of the insurance market due to only infrequent participation in the marketplace.

An intermediary would suffer severe damage to its reputation if it were known in the marketplace that he or she recommended placing insurance with an insurance provider that has the reputation of being unreliable in paying claims correctly.

Because of the potential damage to reputation, the incentives of the intermediary are aligned with those of his or her clients as well as those of the insurance provider. In short, because of its repeated interactions with insurance companies and clients, the intermediary helps overcome the imperfect information that would otherwise hamper the market.

Reducing asymmetric bargaining power

Finally, smaller and medium-sized buyers of insurance may be subject to the bargaining power of large insurance providers when dealing directly with such providers.

As intermediaries place a considerable amount of business with insurance providers, they are in a position to obtain better terms for their smaller and medium-sized clients than the latter would be able to obtain directly. For example, a number of intermediaries have developed schemes to aggregate risks.

Additionally, many intermediaries develop specialist schemes and facilities based on their in-depth knowledge of a particular sector. This knowledge and the ability to aggregate risks enable them to negotiate better terms and broader policy conditions for their clients. Such schemes are usually accessible to other intermediaries.

Providing support to insurance buyer following an event

When an insurance policy holder experiences an event which gives rise to an insurance claim, the insurance intermediary will assist the policy-holder with the filing of the claim and any related interactions with the insurance company.

Support and facilitate competition in the insurance product markets

Intermediaries facilitate competition in insurance markets in a number of additional and important ways[3].

[3] See, for example, Cummins and Doherty 2007).

- The existence of intermediaries means that it is not necessary for new insurers to build up a distribution system in order to enter the insurance markets. Intermediaries provide a distribution channel for new entrants. As a result, insurers do not have to incur the large fixed costs associated with rolling out a distribution system; they only have to carry the costs associated with dealing with the risks which intermediaries present them. For example, a number of international insurers have entered the EU business insurance market over the last 10 to 15 years. Without insurance intermediaries, these new carriers would have found entry into the market very, if not prohibitively, costly because they would have had to build up a distribution network de novo.
- The benefits of a strong insurance intermediary sector have been recognised by international organisations such as the UN/ECE who view such a sector as one of the important elements of the necessary service infrastructure of a prosperous service sector.
- Moreover, because intermediaries sell a variety of competing insurance products, they also make customer switching from one insurer to another relatively easy. The issue of switching is discussed further in Section 4.4.

Not all insurance intermediaries undertake every activity. Generally, the larger intermediaries operating on a world-wide scale provide a very wide range of services to their clients while smaller intermediaries operating on a more local basis will tend to focus more on the traditional intermediation activities reflecting largely different client needs.

Typically, the choice of a particular intermediary by a client depends of a range of factors such as proximity and ease of access, specialisation and knowledge of the intermediary of particular personal or business needs, word-of-mouth reference, Internet search, etc.

Not only do only insurance intermediaries promote competition in the insurance market but they also face considerable competition within in the insurance intermediation market as alternative distribution channels become more prevalent such as direct and indirect distribution through the internet.

3 Structure of the insurance intermediary sector

3.1 Overview

Insurance products are sold through a range of distribution channels, of which the channel of insurance intermediaries is a very important one. In a number of Member States, the intermediary channel is by far the most important. The other channel includes direct sales by insurance companies.

According to the Insurance Mediation Directive (IMD) the activities undertaken by an insurance intermediary include the "*introducing, proposing or carrying out other preparatory work to the conclusion of contracts of insurance, or of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim*". The IMD does not to the traditional distinction between agents and brokers, and adopts an activity-based approach. However, some Member States have retained the traditional distinction while others have adopted the IMD approach. A wide variety of legal definitions exists across the EU. In general terms, however, they reflect the following:

For example, the business insurance brokerage sector is divided into four major sub-sectors (see table overleaf):[4]

- The global and multinational business insurance brokers, which serve major multinational and domestic firms, and provide a wide range of services to these clients in addition to the traditional brokerage services.
- The major domestic brokers that provide services to larger and medium-sized companies. Such brokers are likely to be present throughout the country.
- Medium-size brokers serving both some of the larger companies and the smaller businesses
- Small private brokers which focus mainly on serving the "small" end of the business spectrum and occasionally larger companies on a relationship basis.

[4] In a range of EU Member States, a number of in-house brokers owned by the businesses seeking insurance also operate, mainly to get around the legal restriction which prohibits brokers from passing any discounts from insurance companies to their clients.

Some of the brokers which fall into the latter two categories belong to international networks. These arrangements allow smaller brokers to offer products to their clients in several countries.

Table 1: Typical structure of the inssurance business broker sector

	Type of businesses typically served				
Type of business insurance broker	**Large multinationals**	**Large domestic companies**	**Medium –size companies**	**Small businesses**	**Very small businesses**
A few, very large brokers operating worldwide					
Limited number of large broker (typically with more than 20 employees)					
Large number of medium size brokers (typically with 10 to 20 employees)					
Very large number of small brokers (typically with less than 10 employees)					

Source: London Economics

A clear illustration of the pyramidal structure of the insurance agents and brokers sector is provided by the French sector (see figure below) in which and very small and small businesses being by far the most common among agents and brokers.

Figure 1: Distribution by size (number of employees) of insurance agent and broker businesses in France

Source: DGCIS Ministère de l'Economie, Panorama des activités libérales, 2009

The exact structure of the insurance intermediation sector will vary somewhat from Member State to Member State. But, we expect that each will show a broadly similar pyramidal form.

From a legal perspective, the Directive on Insurance Mediation clearly takes an activity-based approach and the defines insurance intermediaries all those undertakings involved in "*introducing, proposing or carrying out other preparatory work to the conclusion of contracts of insurance, or of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim*".

In essence, all undertakings involved in the distribution of insurance products other than the insurance companies and their employees are insurance intermediaries. This includes agents, brokers, bancassurance and other distribution channels such as the post office, etc.

The contractual arrangements between the intermediaries and insurance companies can take many different forms and the intermediary may undertake some activities for or on behalf an insurance company provided the client of the intermediary is clearly informed that this is the case (article 12 of Directive on Insurance Mediation). For example, intermediaries may assist insurers with claims-related services and policy administration services.

In contrast to a number of other financial sector products and services, clients have a choice of whether or not to use an insurance intermediary as very often insurance companies also engage in direct distribution.

Insurance intermediaries bring value to clients by helping clients to

- Identify the risks clients face;
- Ensure that clients take informed decisions about the risk they wish to ensure;
- Design new and innovative solutions;
- Reduce clients' search costs;
- Put their knowledge at the service of the clients;
- Assist clients with claims related services and policy administration services.

Insurance Agents

Insurance agents, are, in general intermediaries who conduct business on behalf of one or more insurance companies with whom they have an "agency agreement". The insurer-agent relationship can take a number of different forms (multiple, tied, ...)

Insurance Brokers

Insurance brokers work for the policyholder in the insurance process and act on behalf of the client. Brokers assist clients in the choice of their insurance by presenting them with alternatives in terms of insurers and products. Acting as "agent" for the buyer, brokers usually work with multiple companies to place coverage for their clients. Brokers obtain quotes from various insurers and guide clients in determining the adequate policy from a range of products.

While most, if not all, brokers are active in commercial lines, some are also insurance intermediaries for personal lines policies. There are also distinctions between "retail brokers", who negotiate insurance contracts directly with consumers, and "wholesale brokers", who negotiate insurance contracts with retail brokers and agents, but not directly with consumers.

Reinsurance brokers solicit, negotiate and place reinsurance cessions and retrocessions on behalf of ceding insurers seeking coverage with reinsurers. Reinsurance brokers can also be involved in a reinsurer's retrocession of parts of its risk.

Bancassurance

In this case, banking institutions act as insurance intermediaries, selling a range of insurance products alongside a variety of other financial products and services.

3.2 The insurance intermediation sector in the EU

In almost all of the 20 EU Member States for which there exists detailed information on the relative importance of different insurance distribution channels, insurance intermediaries (agents, brokers, bancassurance and other non-direct sales distribution channels) are a very important channel, in all cases accounting for more than 50% of all premiums (life and non-life):

- Overall, in this group of 20 Member States, intermediaries accounted for slightly more than 80% of all insurance premiums (life and non-life) collected in 2008 (see Table 2)
- In 7 of these 20 Member States, intermediaries accounted for 80% or more of all insurance premiums.
- Moreover, in none of these Member States is the intermediaries' share of total premiums (life and non-life) smaller than 50%.

Table 2: Market share of intermediary channel in Europe 2008

Member State	Share of total insurance premiums (life and non-life) by the intermediary distribution channel (%)	Value of insurance premiums (life and non-life) originated by the intermediary distribution channel (€ million)	Share of total life insurance premiums originated by the intermediary distribution channel (%)	Share of total non-life insurance premiums originated by the intermediary distribution channel (%)
Austria	64.6	10,471	79.7	52.0
Belgium	80.5	23,558	80.8	79.8
Bulgaria[2]	75.2	688	64.9	77.1
Czech Republic		2,350		71.0
Cyprus				
Denmark				60.0
Estonia	52.2	194	18.0	70.0
Finland[3]	61.8	9,759	70.0	30.0
France	78.4	143,543	84.0	67.0
Germany	89.9	160,968	96.6	99.0
Greece				

Hungary				
Ireland	58.1	7,801	52.5	75
Italy	89.8	82,764	87.5	93.5
Latvia				
Lithuania	56.0	249	56.8	55.6
Luxembourg[1]	92.9	1,765	92.3	94.0
Malta	88.2	242	97.5	70.0
Netherlands	75.2	29,704	72.8	80.0
Poland	77.0	12,682	77.1	76.8
Portugal	91.9	14,080	93.6	87.4
Romania	75.4	1,843	96.0	70.0
Slovenia	86.4	1,745	97.8	81.1
Slovakia[2]	68.4	1,347	38.0	100
Spain	79.2	48,560	89.8	76.8
Sweden				100
United Kingdom	78.4	193,547	78.6	77.6
Total	81.0	786,201	81.0	81.0

Note: Unless otherwise specified, the estimates of the volume of life and non-life insurance premiums originated by insurance intermediaries is based on 2007 market share and actual premium collected in 2008. Notes regarding market shares of intermediaries: (1) New business for Germany (life and nonlife), Luxembourg (non-life)), (2) 2009 data, (3) excluding workers' compensation insurance and statutory pension insurance

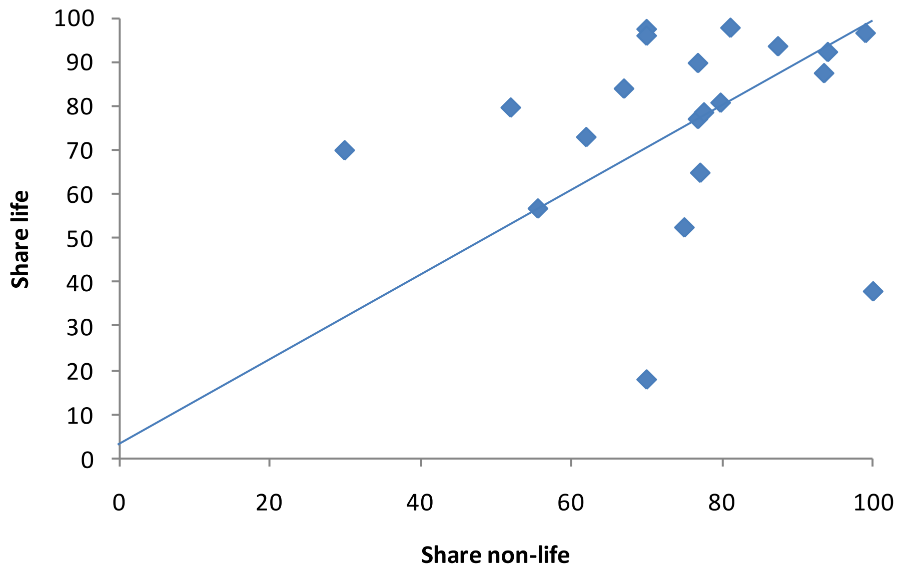
Source: London Economics based on BIPAR, its member associations and CEA (2009 and 2010)

In terms of the split between life and non-life insurance premiums, the intermediary channel in the group of 20 Member States is equally important in the life and non-life sectors, accounting in each for about 81% of total premiums.

However, as shown in the Figure below, the relative importance of intermediaries in the life and non-life sectors varies markedly across the EU27.

- The intermediaries' market share in life is larger than in non-life in Austria, Finland, France, Slovakia and Spain;
- The intermediaries' market shares in life and non-life are broadly identical in Belgium, Germany, Italy, Lithuania, Luxembourg, Poland and United Kingdom;
- The intermediaries' market share in non-life is markedly larger than in life in Bulgaria, Estonia, Ireland, Malta, Netherlands, Romania and Slovenia.

Figure 2: Markets shares of intermediary channel in life and non-life insurance- % , 2008



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Source: London Economics based on BIPA, its member associations and CEA (2009 and 2010)

The relative importance of the agents[5] and brokers' channels within the intermediary channel varies across Member States.

- In the case of life insurance, the agent channel is the most important one in the intermediary channel in 11 Member States (Bulgaria, Germany, Italy, Lithuania, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia and Spain) of the 16 Member States for which detailed information is available. In contrast, the broker channel is the most important one Austria, Belgium, France, Ireland and United Kingdom) (see Table 3);

[5] The data on the agents channel produced by BIPAR and the CEA cover both tied and multi-tied agents.

Agents are also the most important intermediary channel in the case of non-life insurance in 11 Member States (Bulgaria, France, Germany, Italy, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia and Spain), 10 of which are also Member States where the agent channel is most important intermediary channel for life insurance. In contrast the broker channel is the most important intermediary channel in Austria, Belgium, Ireland, Lithuania and the UK.

Moreover, even if they are the most important intermediary channel for life and on-life insurance in many countries, typically the share of agents channel in the intermediary channel is somewhat smaller in the case of non-life insurance than for life insurance (see Figure 3). The main exception is France where the opposite pattern is observed.

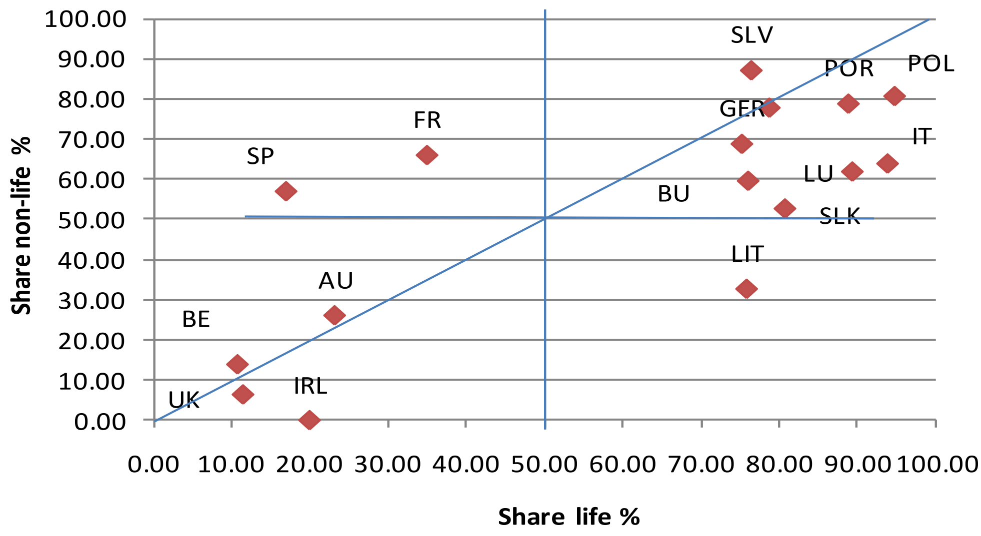
Table 3: Market shares of agents and brokers in the intermediary channel 2008

Country	Life insurance		Non-life insurance	
	Share of agents in intermediary channel - %	Share of brokers in intermediary channel - %	Share of agents in intermediary channel -%	Share of brokers in intermediary channel -%
Austria	23.2	76.8	26.1	73.9
Belgium	10.8	89.2	13.9	86.1
Bulgaria[1]	76.0	24.0	59.6	40.4
France	35.0	65.0	66.0	34.0
Germany[1]	75.2	24.8	68.8	31.3
Ireland	20.0	80.0	0.0	100.0
Italy	93.8	6.2	63.9[4]	27.4[4]
Lithuania	75.8	24.2	32.7	67.4
Luxembourg[1]	89.3	10.7	61.9	38.1
Poland	94.7	5.3	80.7	19.3
Portugal	88.8	11.2	78.8	21.2
Romania	78.7	21.3	77.8	22.2
Slovenia	76.4	23.6	87.1	12.9
Slovakia[1]	80.7	19.3	52.7	47.3
Spain[2]	17.0	5.2	57.0	24.6
United Kingdom	11.5	88.5	6.4	93.6

Notes regarding market shares of intermediaries: (1) New business for Germany (life and nonlife), Luxembourg (non-life)), (2) 2006 data for Bulgaria, Slovakia and Spain (4) In the case of Italy, the market share of brokers' business is underestimated in the CEA statistics as a large share of the premiums (about 19%) is paid to agents and not directly to the companies. The Italian Association of Insurance Companies notes in its Annual Report that adjusting the data by allocating to the brokers rather than to the agents the premiums paid by brokers to agents increases significantly the brokers' share of non-life premiums collected (by more than 25 percentage points) and reduces that of agents concomitantly by the same amount, Such adjusted figures are reported in the table for non-life

Source: London Economics based on BIPAR, its member associations and CEA (2009 and 2010)

Figure 3: Share (in %) of agent channel in intermediary channel – life and non-life insurance 2008



Notes regarding market shares of intermediaries: (1) New business for Germany (life and nonlife), Luxembourg (non-life)), (2) 2006 data for Bulgaria and Slovakia

Source: London Economics based on CEA (2009 and 2010)

4 Value generated by intermediaries

Many insurance intermediaries have broadened considerably the scope of their activities beyond the assistance they provide to their clients in obtaining insurance cover. Through their various activities they create considerable value in the insurance value chain.

For example, Maas (2010) finds in survey-based study of intermediaries serving large business customers that, nowadays, such intermediaries are expected to be suppliers, transformers of the client risk management, partners and problem solvers. While the relative importance of each these functions may vary from client to client, they are essential and require "*an improved understanding of the client's specific needs, good personal relationships, extensive knowledge in the area of risk management as well as innovation skills*" (Maas, op. cit).

In fact, nowadays, the activities undertaken by insurance intermediaries, especially the larger brokers, encompass a wide range of risk advice and management consultancy services. These can be grouped into five broad categories:[6]Product buyer: this is the original function of business insurance brokers and involves the following type of activities: product description and comparison, price comparison, placement, and possibly also administration and claims assistance;

Risk transfer optimiser: the business insurance broker may also undertake qualitative risk analyses for the client and assist the client in designing a program which optimises the risk transfer on the basis of insurance costs and expected performance;

Risk controller: the involvement of the business insurance broker with the client may go deeper and imply an active involvement of the broker in helping the client control its various risks through the use of sophisticated analytical risk assessment tools and the development of appropriate policies and procedures. In doing so, intermediaries may also identify risk that a client is exposed to but is not aware of. In some instances the intermediary may advise alternative approaches to risk management which do not involve the purchase of insurance;

Risk manager: the business insurance broker may actually assist the client in managing its risks on a day-to-day basis, possibly even integrating the risk management into the general management systems, working with the client's risk manager; and,

Captive manager: a number of the major corporate clients own captive insurance companies and the major insurance brokers manage their clients' captives.

The intermediaries also undertake, in a number of cases, activities that the insurance companies would have to undertake otherwise such as, for example, the management of claim.

Some insurance intermediaries also develop specialised insurance programs and products for very specific risks and, in that capacity, act as wholesale intermediaries, through whom other intermediaries can channel the specific risks being insured.

[6] This typology of the activities undertaken by business insurance brokers is taken broadly from Funk (2002).

Contribution of the insurance intermediation sector to GDP

Overall, insurance intermediaries (agents, brokers, bancassurance and other non-direct sales distribution channels) account for a significant proportion of the value added created by the whole insurance value chain. The data reported in the previous section showed that, for the group of EU Member States for which detailed data on insurance distribution b y channel exists, insurance intermediaries accounted for 81% of total insurance premiums (life and non-life) collected in 2008.

The value added or GDP generated by the sector is much lower than gross premiums collected as GDP includes only the wage bill and profits and not the other costs of doing business. For example, in the case of the sector "Insurance and pension funding, excluding social security" (in the NACE classification), the ratio of GDP to gross premiums collected ranges from 10% to 20% across the EU27.

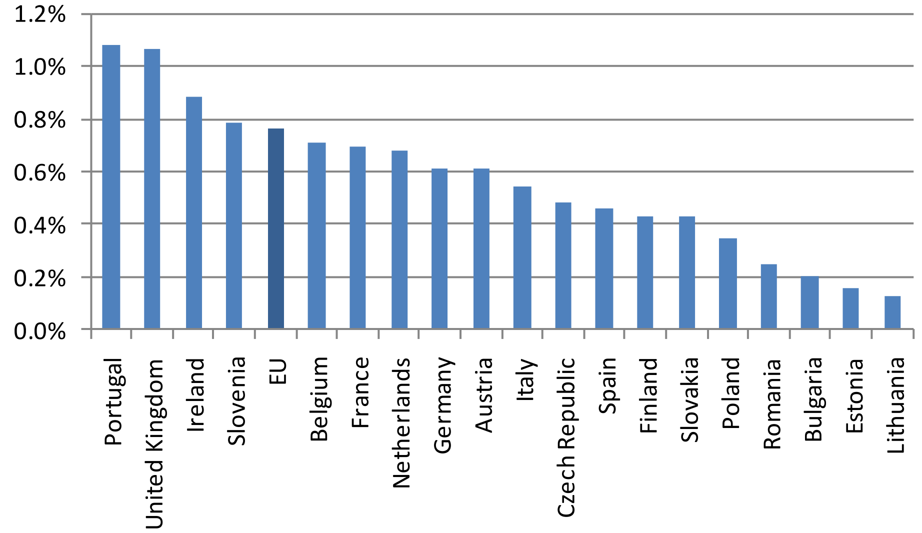
Estimates of the GDP generated can be derived by assuming that broadly speaking the ration of GDP to gross premiums collected observed for the sector "insurance and pension funding, excluding social security" applies also to the insurance intermediary sector. On this basis, **the insurance intermediary sector is estimated to have generated an estimated €95 billion of value added[7] in 2008 or 0.8% of total EU GDP (at current prices) (see Figure 4).[8]**

Within the EU, the contribution of the insurance intermediary sector to total GDP varies from 0.1% to 0.2% (Lithuania, Estonia, Bulgaria and Romania) to more than 1% in (United Kingdom, Portugal and Netherlands)

[7] The figure of €58 billion is derived by assuming that the ratio of industry gross value (GVA) to total premiums collected applies to insurance intermediaries as well. The data on insurance industry GVA are from Eurostat's national accounts (national accounts by 60 branches). In cases where data on insurance industry GVA are missing, the ratio of industry GVA to premiums collected is assumed to be 10%, the same as in the larger EU Member States for which the data exist (France, Germany and Italy).

[8] Averages of the Member States for which information is available was used for Member States for which information is lacking. This assumption has very little impact on the estimate EU-wide contribution of the insurance intermediation sector as without such an assumption the total contribution of intermediary sector was estimated at 0.7%.

Figure 4: GDP of insurance intermediairies as % of total GDP at current prices 2008



Notes regarding market shares of intermediaries: (1) New business for Germany (life and nonlife), Luxembourg (non-life)), (2) 2006 data for Bulgaria and Slovakia

Source: London Economics based on BIPAR, CEA (2009 and 2010) and Eurostat data insurance industry GVA and GDP.

So far, the analysis has focused only on the direct contribution of the intermediary sector to EU27 GDP and ignores the indirect impact arising from the spending by the intermediaries on wages and goods and services from other sector. This induced or multiplier effect is often significant. While there exist very little information on the multiplier of the insurance intermediary sector, multipliers complied for the UK and Scotland suggest that it is of the order of 1.5 (UK) to 1.9 (Scotland).

Thus, in order to estimate the total contribution to EU27 GDP of the insurance intermediary sector, a conservative assumption of 1.5 was used. As result, **the total contribution of the EU27 intermediary sector, including indirect effects, is estimated at €148 billion or 1.1% of EU27-wide GDP.**

5 Remuneration of insurance intermediaries

Generally, there are two primary mechanisms by which insurance intermediaries are compensated for their services:

- A fee system under which the client directly pays for the services provided;
- A commission system under which the intermediary is paid a percentage of the premium paid by the client for coverage based upon the intermediary's agreement with the carrier.

The remuneration of the intermediary being in principle commission–based with the possibility to agree fees, has been a major contributing factor to the successful and competitive development of insurance markets all over the world.

In the choice between commissions or fees, it is not only the size of the business that is important. Equally important are the nature and/or level of sophistication and the specific levels of service which are agreed. In any case, the decision to work on a fee or commission basis is a decision that should be taken between the parties based upon a transparent dialogue about the various options.

In 2003, in line with free market principles, BIPAR adopted the following principles related to remuneration:

- Principle 1: Every insurance intermediary has the right to be remunerated fairly for his or her services.
- Principle 2: Any remuneration or compensation for services of an intermediary should be considered as an issue between the parties.
- Principle 3: Legislation or concerted market agreements (or behaviour) limiting or imposing the rate or the means of remuneration is considered by BIPAR as a serious infringement of basic free market principles and would be against international market practice.
- Principle 4: Intermediaries may charge fees in addition to, in lieu of, or in combination with, commissions. In such case, the customer should be informed.

In a number of insurance lines and countries, insurance intermediaries offer the choice to the client to work either on a commission or a fee basis. When considering the choice between the two, the following factors are generally considered by both the intermediary and the client in their dialogue.

Commission is only payable if a contract ensues. A fee system creates uncertainty about the future cost, both at the time when the insurance is being effected, and when a claim occurs or when other services are rendered by the intermediary. In a fee system, clients should consider if they will be able to afford to pay fees based on time-spent in the event of a claim.

The commission system satisfies a need for services in the future. The consumer purchases a "product" that at the time of acquisition is incomplete. In addition to the guarantee, it comprises a whole range of services (issuing of policies, collecting of premiums, treatment of claims, amending the policy and sometimes advancing compensation) which are not quantifiable at the time of the purchase.

The commission system offers a form of service contract against the cost of the provision of services by the intermediary following the purchase of the insurance product whereby the intermediary will give service at no extra charge in the event of any service being required other than at the inception or renewal.

Whether a fee or a commission is the best choice should be decided by the parties on a case by case basis and in transparent dialogue about the various possibilities with the intermediary.

From an economic perspective, overall, there exists no system which is preferable in all circumstances and the co-existence of various remuneration systems, and in particular the freedom to decide about the remuneration systems between the parties, is the best guarantee for competitive, efficient and dynamic markets that work for the client.

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