Insurance Brokers – In the horns of dilemma

Indian insurance market has recently been opened for insurance brokers. Till now, around 35 medium and large broking houses have been given license segments by the regulator, Insurance regulation and development Authority (IRDA), to start insurance broking in direct, reinsurance and composite segments.

This article deals with some of the issues related to insurance brokers in the direct segment, who service individual and corporate segments, unlike reinsurance brokers, who service insurance companies only.

Brokers are an insurance intermediary, who represent their clients, unlike the insurance agents, who represent their insurance company. In many markets, brokers have played significant role in bringing sophistication in the industry and some of the large trans-national brokers are as big as many insurers, in terms of their operational breadth and size. Top three international broker control around 80 percent of brokers business procured by top 20 brokers!

Internationally, direct brokers help their client plan their insurance needs, identify insurance companies, negotiate prices and place business. They also provide post-sales services like changes in policies, negotiation with insurers in case of claims, policy renewal support etc.

A very significant service provided by brokers is risk management, under which the brokers look at the client's business in totality and identify risks, plan out mitigative steps and recommends suitable steps for handling contingencies such as accident, fire etc. Insurance constitutes only a part of overall planning and is best suited for large but infrequent risks. Other means of contingency planning includes internal & external funding and non-insurance risk transfer etc.

Some of the large brokers manage the global insurance requirements of transnational corporations, through a common insurance program across nations. The latest trend is to develop bespoke financial tools to transfer part of risk to capital market, through what is known as "Alternative Risk Transfer".

Internationally, most brokers operate in the non-life segment, especially the corporate sector. Insurers have learnt to manage the channel conflict between brokers and their agency force and they usually reward their loyal agents by giving them higher commission. Agents act as the eyes and ears of the insurer, especially in the life insurance and are further compensated through bonus, if the quality of business procured by them is better than average.

If we were to look at India, most brokers are in their incipient stage and are striving to carve an independent identity vis-à-vis insurance agents. Barring a few having international tie up and a few others who have been active in India in the reinsurance broking, most brokers are starting small, either as entrepreneurial venture or promoted by well-known business houses. A majority of direct brokers are expected to eye the non-life market.

However, there appears to be a pall of gloom, in view of recent regulation, which effectively discourages brokers from handling fire and engineering lines of business in respect of Government & public sector units. The regulation, further, restricts brokers commission on these lines of business for other corporates, based on the paid up capital of the client.

Some brokers feel that brokers have been allowed in this market after a lot of thinking and deliberations and hitherto a consultative approach to brokers regulation has been adopted. However, these brokers feel. that such significant changes in remuneration structure should have been made after due deliberations and transparent consultations, as was being done till now.

The Indian non-life insurance is driven largely by controlled pricing, through a tariff mechanism, which prevents the premium from falling below a minimum rate. Nearly 80 % of business, especially fire, engineering and motor are under tariff, as of now. Besides premium rates, tariff imposes some other inflexibilities such as control over policy wordings in some cases, restrictions in offering enhanced cover in some lines of business, disallowing credit terms to pay premium etc.

No doubt, these are meant to help in orderly development of the market, but it offers very little room for the broker to help his clients "shop around", as most clients see the value in the best possible price.

The other value that a broker could bring is in evaluation of the insurer, in terms of their service standard and credit rating, especially in developed markets where the number of insurers may be large. Due to the rigorous licensing followed by the regulator, fortunately, most Indian insurers are well capitalized, leaving little distinction in this area too.

Hitherto, most large corporates were enjoying discount in premium, in lieu of agency commission, at around 5% of premium in some lines of business. Now, if the broker is to serve this business, either the client has to lose the premium discount or the broker has to forego the broking commission. A Hobson's choice indeed! Thus a significant part of non-life business are effectively unavailable to the brokers.

This leaves brokers with small and medium industries and retail customers in life & non-life insurance as its potential target. In respect of large corporates, business other than fire and engineering (viz. Liability, marine etc.) is still available to the brokers, where they can help develop these lines of business with their professional approach.

Life insurance, with its myriad of products and associated complexity is an attractive segment, but then internationally, few brokers deal in retail life products. Many life-insurers favour their agency channel, rather than the independent brokers. The silver lining is that unlike LIC, most private insurers are concentrated in urban market and any opening in the semi urban and rural market through brokers will be most welcome.

Retail customers, especially in the personal lines of business (health, accident, property etc.) remains an attractive area, but this is a volume game and the brokers need to have proper strategy in place to attract this segment. One innovation could be product innovation and co-branding with preferred insurance company.

Opportunity matrix for brokers

	Life Insurance	General Insurance
Personal Lines	✓ Explore rural market for Pvt insurers	✓ Product innovation and co-branding ✓ Develop ability to handle volume
Commercial Lines	✓ Explore Group Life, Pension business opportunity	✓ Explore non-tariff business ✓ Develop Risk Management practice

Internationally there is a shift from commission based service to fee based service in the insurance broking. This is partly due to the conflict between maintaining independence of the brokers vis-à-vis their commercial interests while favouring an insurer. In the USA, many brokers are either disclosing their commission rate to their clients or simply passing the commission benefit to the client, in lieu of a placement fees from the client. In the UK, it is perfectly legal for the intermediary (called IFA) to give up commission thereby increasing the policy value of the clients.

One of the concern in Indian scenario could be that brokers may pass on some of the commission to the client, directly or indirectly, as an inducement. Not that agents are impervious to it. But, a greater transparency, like ones mentioned above, could be a possible approach.

Another fee-based service is risk inspection and risk management. However, most insurers provide risk inspection service free of cost to their large customers. Brokers will do well to develop risk-modelling technique for small-medium enterprises and create awareness about superiority of planned risk management over ad-hoc insurance placements.

As the market develops, brokers shall have many more exciting opportunities with their clients. These could include, developing uniform insurance program for Indian transnational & global insurance and reinsurance placements for them, helping to design and manage self insurance funds, contingency planning, post loss surveys, designing employee benefit plans and developing alternative risk management tools. No doubt, they shall face competition from the consulting firms and investment bankers, but the key lies in deepening expertise in the niche area of insurance. Favourable tax regime, especially for self-insurance funds and alternative risk transfer could hasten their growth.

Recently, brokers have been instructed to provide the regulators with a monthly statement giving details of their clients, premium and commission. Surely, many brokers will find it unsavory to part with this information. An alternative approach could be advising the brokers to maintain a transparent accounting system that could be available for audit and inspection, any time. Possibly, they may be encouraged to deploy some software system to support their operations, thereby making unhealthy practices difficult.

We are witnessing some interesting times in the Indian insurance industry, which is poised for explosive growth. It is necessary that all channels-agency, broking and direct sales be optimally tapped to reach our potential. A harmonious growth of broking will go a long way to bring in professional expertise in the Indian insurance industry.

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