



## European Commission: Business Insurance Sector Inquiry

### Interim Report Consultation Response

#### Brighter Business Limited

##### Introduction

Brighter Business was created to provide a direct service for Small and Medium-sized Enterprises (SMEs) after identifying a niche in the insurance market for products created solely for small businesses in the UK.

The Brighter Business founders have extensive knowledge of the insurance and small business sectors and started the company because they believed they could create an offering that is tailored to the unique needs of SMEs.

As a UK based insurance business our response will relate solely to our experiences of the domestic market. However, our founders would also argue that many of our concerns are likely to be present in other EU markets with similar characteristics, for example, either a concentration of the supply of insurance, or a restriction over the number of suppliers.

More information about Brighter Business can be found at: [www.brighterbusiness.co.uk](http://www.brighterbusiness.co.uk).

##### Response Summary

Brighter Business broadly welcomes the findings of the Commission's EU Business Insurance Sector Inquiry Interim Report: January 2007. We believe that the Commission is moving in the right direction with many of its findings; however, we would argue that the investigations to date have underestimated key drivers of the UK SME market.

We believe that, in order to achieve its stated objectives, the Commission must probe further into these drivers and widen the consultation to engage directly with SMEs and other informed stakeholders.

The main issues Brighter Business believe are in need of further examination include:

- The market dynamics, especially in terms of the definition of an SME
- The market structure and
- Horizontal co-operation

## **Brighter Business' Response**

Brighter Business appreciates the opportunity to contribute to the Commission's inquiry into the Business Insurance Market. Our main points do not relate exclusively to the questions outlined in the consultation associated with the interim report, so our response will outline our thoughts on those areas and issues of specific interest to Brighter Business.

### **Market Dynamics**

Brighter Business welcomes the conclusions drawn by the Commission but wishes to highlight areas relating to the structure and dynamics of the UK SME insurance market where we feel that the Commission would benefit from further investigation. We believe that the characteristics of the UK SME market are very different to those reported, thus preventing the Commission from gaining an accurate understanding of the nature of competition in the SME sector of the market.

#### *SME Size Definition*

The first issue we wish to highlight is the definition used to determine the size of an SME. 99% of all businesses in the EU are SMEs<sup>1</sup>. Within the UK market over 90% of SMEs are sole traders or businesses that employ fewer than five people<sup>2</sup>. Businesses of this size typically spend under £1000 on their insurance premiums. The Commission assumes that a small business is one employing 250 people or fewer<sup>3</sup>.

Brighter Business would assert that a company employing 250 people would, for even the most simple business model, expect to pay over £10,000 on their insurance. Within the UK, it is likely given our competition levels that a risk this size would receive bespoke

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<sup>1</sup> 'Implementing the Community Lisbon Programme, Modern SME Policy for Growth and Employment', [http://ec.europa.eu/enterprise/entrepreneurship/docs/com\\_2005\\_en.pdf](http://ec.europa.eu/enterprise/entrepreneurship/docs/com_2005_en.pdf)

<sup>2</sup> 'SME Statistics 2005, UK and Regions, Small Business Service', DTi, [http://www.sbs.gov.uk/SBS\\_Gov\\_files/researchandstats/SMEStatsUKAndRegions2005.xls](http://www.sbs.gov.uk/SBS_Gov_files/researchandstats/SMEStatsUKAndRegions2005.xls)

<sup>3</sup> See Commission Recommendation 2003/361/EC

attention from both brokers and insurers whereas, using the UK market size and spend criteria, a small business would not. We therefore believe that the spectrum presented by the Commission's definition of an SME creates far too wide a spread of behaviours and treatment to allow the Commission to accurately assess the true state of the market at this level.

We would suggest that the Commission alter its definition to a cut-off point of 50 employees; as the Commission itself accepts that the industry will treat any business larger than this as a large corporate client, (LCC) with little or no homogenous risk.

We believe that the real issues are focused in the micro-business sector of the SME market where there is a highly asymmetrical market place. In this sector a large number of small businesses are purchasing via a large number of small brokers, who in turn work with a small number of large insurers.

### *Market Efficiencies*

Brighter Business shares the Commission's concerns on the market. We believe that the UK SME market is not working efficiently and feel that this is driven by two key factors.

Firstly, as highlighted above, there is a lack of real choice for small businesses when searching for an insurance provider. The current trend is for brokers to deal with a limited number of insurers, which tend to be the big five insurer groups. With virtually no specialist insurers of SMEs outside of the big five, this has resulted in a lack of buying power for both SMEs and brokers, which is one of the reasons that we founded Brighter Business.

Secondly, Brighter Business also believe that a number of current business practices constrain market efficiency. These can be summarised as:

- Our analysis shows that between 40% and 50% of SME premiums are taken up covering the costs of commission and insurer expenses, even before the impact of contingents and profit share, whilst the remaining 50-60% of the premium is actually used to cover the associated risk. The proportion covering commission and expenses is much higher than in the LCC sector.
- The use of non-price competition clauses within agency agreements by insurers to win business e.g. enhanced commissions, profit share and other forms of broker remuneration.
- The "Spitzer" investigation has changed business practice in a wider sense but not at the bottom end of the UK SME market. The impact of Spitzer on UK SME business practices has been minimal because the three major US owned brokers

involved have a very small share of the SME market – we estimate less than 3% of the market between them.

- The recent trend for creating integrated brokerage and underwriting agencies creates even more conflicts of interest, and there is no regulatory requirement to disclose the full extent of such conflict. This is particularly of concern where the distributing entity provides a 'guaranteed' minimum underwriting return on capital around volume sales to insurers. We believe that it is currently also too easy to 'move' commission from one part of the group to another in order to, for example, artificially depress 'broking' commission, which might be disclosed to customers. There are also further issues around the transparency of remuneration, which is especially problematic in these groups of companies.
- There is currently a lack of transparency to clients about the levels and forms of commissions and other payments to brokers by insurers. In the UK SME market brokers dominate. However, the insurer often undertakes a financial arrangement with the broker so, to some degree, they act as the insurers' agent. The intrinsic problem with this model is that the clients are under the misapprehension that the broker is only representing them, combined with a widespread lack of disclosure of earnings. The Commission should note with interest the comments<sup>4</sup> made by John Tiner, Chief Executive Officer of the Financial Services Authority, on the issue of transparency. Brighter Business wholeheartedly welcomes his remarks.
- Brighter Business would also question the Commission's assertion that the mediation price does not matter to the client. Transparency will help clarify what the clients value and what they do not. The key to this issue is establishing what the client is willing to pay for a certain piece of advice.

### **Market Structure**

The UK Commercial insurance market is worth approximately £20 billion and is expected to reach £29.5 billion by 2009<sup>5</sup>. The average SME spends, on average around £1000 each, resulting in virtually non-existent individual buying power.

#### ***Brokers***

Brighter Business would question the Commission's view that brokers are making any purchasing power difference in the UK SME market, especially given the high levels of insurer profit. The Commission's report emphasises the role of international brokers in

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<sup>4</sup> Speech by John Tiner, CEO, FSA;

[http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0321\\_jt.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0321_jt.shtml)

<sup>5</sup> 'UK Commercial General Insurance', Datamonitor

distribution yet they are virtually absent from the SME market. We estimate that Marsh, Aon and Willis have less than 3% market share<sup>6</sup> and shrinking.

Until recently UK SME distribution was massively fragmented amongst around 3000 insurance brokers. However, over the last 5 years 'aggregators' have bought up small brokers and underwriting agencies, creating single businesses who count both SMEs and insurers as their clients. Datamonitor estimates that, if the consolidators hit their growth targets, they would control £7.6 billion in GWP, representing 13.7% of the total UK insurance market by 2010. Outside of this limited consolidation distribution remains highly fragmented.

Brighter Business would also question the report's view that "Brokers are able to secure better terms for such clients"<sup>7</sup>. The profitability of insurers in the UK SME market is much higher than the LCC market, despite brokerage penetration being very high. This would suggest that the SME market is not efficient and we would hope that the Commission further investigates why, in the UK, brokers consistently fail to secure better terms for SME clients.

### *Supply of Insurance*

Brighter Business agrees with the Commission's assumptions that there has been a high level of consolidation within the market over the last ten years. There has been very little real choice for SMEs, given the dominant role of a few large insurers and the way they choose to compete. The supply of insurance is even more concentrated in the UK SME market than the report suggests – we estimate 80% is controlled by 5 large European insurance groups. The UK market is characterised by a few dominant providers who do not offer products tailored to SME demands and requirements.

### *Banks*

Brighter Business would also argue that the assumptions outlined in the report relating to the involvement of banks are currently irrelevant to the UK SME market<sup>8</sup>. This situation is gradually beginning to change, however, the impact is minimal as it is the same large European insurers who are backing most of these initiatives.

### **Horizontal Co-operation**

There is significant formal collaboration between insurers on many matters, which we would argue are well beyond the Commission's stated examples<sup>9</sup>.

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<sup>6</sup> Statistic established through interview based research undertaken by Brighter Business.

<sup>7</sup> 'European Commission: Business Insurance Sector Inquiry: Interim Report', page 30

<sup>8</sup> 'European Commission: Business Insurance Sector Inquiry: Interim Report', page 43

<sup>9</sup> 'European Commission: Business Insurance Sector Inquiry: Interim Report', page 133

A significant UK example of this is a jointly owned technology standard body and software development supplier covering personal lines and SME. Whilst insurers and brokers jointly own the company, the brokers' share is almost insignificant. This went on to be the catalyst for a SME portal and web services platform owned by a group of insurers dominated by the big 5 insurance groups.

#### *Anti-Trust*

The US insurance industry manages to co-operate significantly yet is subject to anti-trust and racketeering laws. There is also a very high awareness amongst day-to-day practitioners of the legislative framework in which they operate.

We feel it is worth asking the question: why does the EU market need a block exemption?

### **Conclusions**

Brighter Business agrees with the broad findings of the Commission, as outlined in the Interim Report, which go a long way to highlighting the current business practices, both positive and negative, in the UK SME market. However, we believe that the Commission has not probed deeply enough and would argue that the assumptions about the size, structure and behaviour of the insurance market, with regards small businesses, are far more acute than the Commission has concluded.

We suggest that the Commission should look into these areas in more detail and take wider soundings including directly from SMEs, trade associations as well as McKinsey & Company and Bain & Company both of whom have an in-depth understanding of the UK industry's economics.

We hope that the insurance industry responds positively to the Commission's Interim Report, especially with regards to issues of transparency and consumer choice.



## **Contacts**

Brighter Business would be keen to meet with the Commission to continue this information exchange.

If you require any more information regarding the content of this submission or on any other matter, please contact Robert Bartlett.

This response is issued on behalf of Brighter Business Limited.

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