



transparency

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The uproar over MSAs (Master Service Agreements) that many brokers had in place with their carriers has faded into the background, but the fundamental issue of transparency has not. Recently we have seen another push to increase brokerage income with so-called “off slip” agreements and brokers soliciting additional fees for various services.

The issue is not whether brokers should get paid or how much, but how best to compensate them for the services they perform in a manner that is transparent and minimizes potential conflicts of interest.

First, let's clear up a myth. The markets do not actually pay the brokerage commission. They simply gross up their net costs for the brokerage. So in reality the 2% to 15% brokerage commission is the cedant's money.

The solution is simple—

All markets should quote a net price, and the cedant should negotiate a separate fee with its broker for the actual services desired and delivered. There may be some accounting or expense ratio implications with this approach which I will come back to.

The benefits are straightforward.

Fee for Services Model

The approach (we'll call it the "Fee for Services" Model) eliminates the potential conflicts of interest that exist when brokers negotiate different fee arrangements with their markets that might encourage them to direct business to those markets paying the higher commissions or additional fees.

The Fee for Services Model diminishes the risk that a broker places business with lower credit quality markets because they have a flow of business with them or more lucrative incentives. Broker compensation is more than just a disclosure issue as many would like to describe it.

The broker industry talks about being an "advocate" for their clients. The purity of the Fee for Services Model would eliminate the commission conflict and facilitate the broker being a true advocate for their client.

In recent years, many ceding companies have negotiated brokerage sharing arrangements with their brokers in recognition that the commission dollars were the cedant's money, and that the standard commission levels were not sensitive to the services or value added created by the role of the broker. These arrangements lack the transparency of the Fee for Services Model.

The role of the broker has evolved over the past 25 years. As the value of placing risk with markets has decreased in a wired world, the brokers have remade themselves as risk consultants. They now offer capital management, enterprise risk management, cat modeling and advice, or reinsurance and capital market structures. These are all terrific consulting services that are needed by cedants, but best negotiated and paid for on a fee basis.

Accounting Implications

Going back to the accounting implications, eliminating the brokerage commission will increase the expense ratio—and the net written premium. Bottom line, the economics are better. Ignoring the accounting, the economics are simply the difference between the commission structures and the fee which drops to the bottom line.

The soft market is the perfect time to renegotiate your broker's compensation from a commission basis to a fee. It minimizes potential conflicts of interest, allows you to negotiate for the services you need on an annual basis, improves your bottom line and supports transparency.



The people behind the promise.

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