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# THE NEXT PHASE OF GROWTH FOR INSURANCE BROKERS

Financial sponsors need to integrate businesses and drive cross-organizational effectiveness


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The US insurance market has seen a prolonged period of growth driven by supportive macroeconomic conditions and an increasingly complex set of risks that are actively managed by corporates, small to medium-sized businesses (SMBs), and individuals alike. Insurance brokers have been central in helping end-insureds navigate this evolving risk landscape — ranging from an increased rise of climate-linked catastrophic events to more sophisticated and frequent cybersecurity and data privacy incidents. As a result of the Covid-19 pandemic, insurance brokers have needed to take actions and incorporate new ways of working.

Insurance brokers have also inadvertently benefited from the buoyant interest rate environment in the last two years. The hardening market helped offset temporary malaise in the insurance sector at the start of the pandemic and laid the foundation for what was an unprecedented year in 2021, as many insurance brokers, listed and private, delivered significant value to their shareholders.

While this overall narrative bodes well for the insurance brokerage ecosystem, it does mask somewhat diverging fortunes for different constituents within that ecosystem. Our analysis suggests that a handful of insurance brokers — such as the Top 4 Global Insurance Brokers (Marsh, Aon plc, Willis Towers Watson and Arthur J Gallagher & Co.)[1] and, highly acquisitive sponsor-backed insurance brokers (for example, Hub, USI, Acrisure) — have experienced significantly higher premium and revenue growth, while many others in the long-tail struggle to remain competitive without the same scale benefits.

Sponsor-backed insurance brokers now account for more than half of the top 30 brokers in the US across commercial, personal, and employee benefits (EB) lines. Many, if not all, of the sponsor-backed brokers have employed a methodical approach to mergers and acquisitions (M&A) by laying out an attractive proposition to smaller brokers who recognize the benefits of being part of a bigger whole. The difference in appetite for acquisitions and ability to close deals have been stark. This group accounted for approximately 76% of all deals in 2021,[2] a year where insurance brokerage M&A volumes hit record highs.

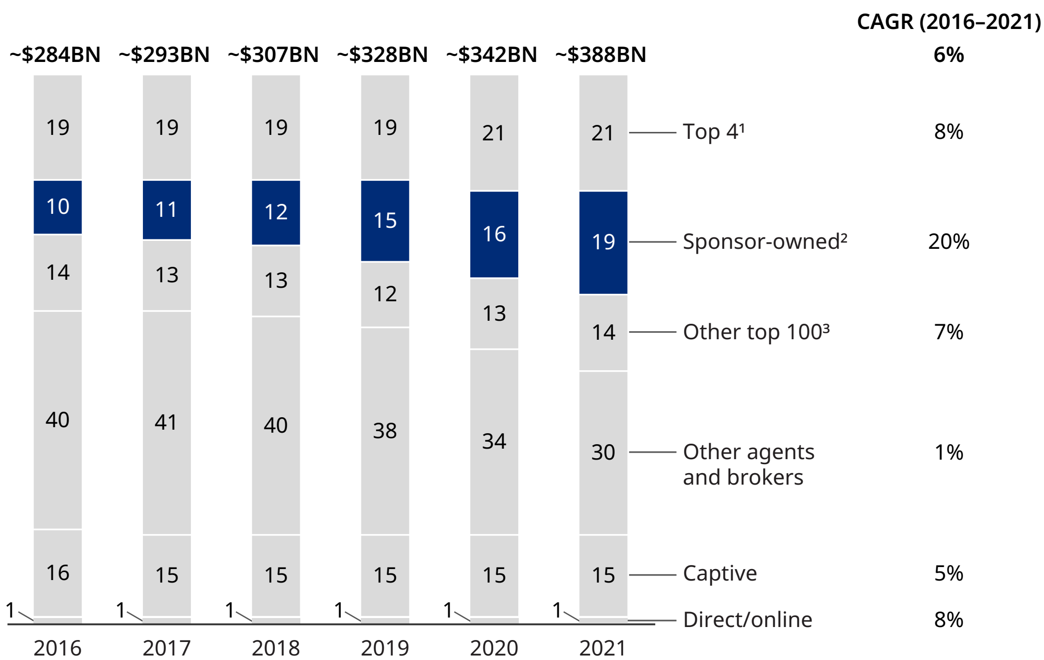
Within the highly fragmented independent insurance agent and broker landscape, sponsor-backed brokers use similar inorganic or acquisition roll-up plays to achieve growth, but there are significant differences in the integration approach. These differences have benefited the smaller businesses being acquired — as they are presented with offers from brokers with different DNAs. Different platforms present them with a range of offers, from completely “hands-off” approaches with integration limited to centralized administration functions to “one broker” acquisitions with significant rationalization of brand identity, technology, and processes.

1 Sources: Business Insurance Reports (2017–2022), S&P Market Intelligence, Conning, IIABA (Association for Independent Agents), Oliver Wyman Analysis.

2 Source: OPTIS Partners (2021); Totals include US and Canadian property & casualty and employee benefit brokerages, third-party administrators, and managing general agents.

As we discuss in this paper, while a plurality of integration approaches has worked until now, we believe that models espousing greater standardization are likely to win in the long-term. Financial sponsors and the management teams they support will have to work harder to integrate businesses and drive cross-organizational effectiveness to realize continued growth, especially considering the turning economic environment.

**Exhibit 1: Financial sponsor-backed players have arrived in force in the insurance space, causing insurance brokers to reshape business models, technology, and capabilities**
US P&C Commercial Direct Written Premium (DWP) by broker segment




1. Top 4 Global Insurance Brokers include Marsh, Aon, Willis and AJ Gallagher

2. Sponsor-owned include Alliant, Brown & Brown Insurance, HUB International, Acrisure Insurance Solutions, USI Insurance Services, Assured Partners, BroadStreet Partners — Insurance Brokerage, OneDigital Health and Benefits, Alera Group, PCF Insurance Services, The Hilb Group, World Insurance Associates LLC, High Street Insurance Partners, Patriot Insurance Company, and NFP

3. Total number of agents and brokers profiled in the "Top 100" is typically greater than 100 (for example, 117 included in 2021); additionally, some agents and brokers do not report revenue and are not included in the total for "Remaining top 100 brokers" (for example, three agents and brokers in 2020)

Sources: Business Insurance Reports (2017–2022), S&P Market Intelligence, Conning, IIABA (Association for Independent Agents), Oliver Wyman Analysis

# UNDERLYING FUNDAMENTALS REMAIN RESILIENT AND SUPPORT THE ATTRACTIVENESS OF INSURANCE BROKERS

As we navigate a period of high inflation and rising interest rates, expectations are that the economy will likely face a "hard landing" in coming months as the Federal Reserve approved an interest rate increase to 5.25% in May 2023, which is the 10th increase in a little more than a year.

The impact on the Property and Casualty (P&C) insurance sector will likely remain bi-directional. On the one hand, a less inflationary environment will provide insurers with some much-needed relief as they look to control claims inflation. On the flipside, significant increases in interest rates may dampen borrowing and result in fewer new property, vehicle, and inventory purchases, slowing the growth of insurable risk exposures in the economy.

## IMPACTS TO THE BROKERAGE ECOSYSTEM

The associated brokerage ecosystem is likely to experience the impact of less insurable risks, though we do not expect this impact to be outsized for the following reasons:

### End clients will continue to require risk management advice to address growing exposures

Corporates and SMBs are recognizing the importance of appropriate risk management, especially as it relates to high-priority concerns, such as their employees well-being and retention, cyber risks, and the impact of climate change (such as the inability to predict catastrophic events). As these risks continue to percolate and magnify across different industries within the economy, we believe end clients will seek more comprehensive and "fit-for-purpose" insurance solutions even in a more bearish market.

### Insurance brokers have historically been a resilient category

While many of the largest brokers did see dampened revenues in 2009 and 2010 as a result of the 2008 global financial crisis, they also saw a relatively swift return to top-line growth thereafter, even as many other industries continued to grapple with the ramifications of the downturn. The "must have," often mandated nature of insurance means it is not an expense that is cut in times of cost rationalization, and instead primarily impacted by asset value related declines (for example, contract risk exposures) that may be observed disproportionately at the beginning of a turning economic cycle.

**With the changing macro environment, executives will need to re-focus on margin management and support continued profit pool expansion**

### Brokers remain highly relevant — despite the continued growing relevance of direct-to-customer models

Direct-to-customer (D2C) distribution models sustained strong growth, particularly in personal and SMB lines during the bull market years, as technology-led businesses prioritized growth at all costs. As the market sees a shift in paradigm towards "profitable growth," D2C channels may face a relative slowdown in the US. In the medium term, we anticipate a proportion of the client population may adopt a D2C proposition, but we expect that many end-insureds (especially larger corporates) will continue to require a broker's support to evaluate risk management strategy and determine the appropriate insurance markets. The "modern" broker is however likely to incorporate a significant amount of technology and digital tools going forward — both in facilitating their interactions with the end-insured as well as in streamlining how to place business with carriers.

### While brokers have made progress in "running a tighter ship," there remains a lot of opportunity for operational value creation

The vast majority of brokers have continued to meander through their operational optimization journey. A very supportive market for M&A coupled with continued organic growth has meant that broker executives have been disproportionately focused on top-line growth and market share gain. We anticipate a changing macro environment will nudge executives to re-focus on margin management and help support continued profit pool expansion even in a period of more muted top-line growth.

# FOCUSING ON THE BOTTOM-LINE

## GETTING THE BASICS RIGHT HAS NEVER BEEN MORE IMPORTANT

The long bull market run we observed through the 2010s and into the early months of 2022 was fueled by an extended period of cheap borrowing costs. Sponsors used the favorable lending conditions to craft highly accretive inorganic roll-up plays where local and regional brokers were consolidated into national broker platforms.

These roll-up plays thrived in an environment where deal multiples continued to trend up. As the market gifted at-scale businesses with higher valuations than their smaller peers, sponsors could always justify further deals through multiple arbitrage. For example, a broker's average cost of acquisition was brought down over time, while the value of the platform asset continued to increase as it became broader and deeper across regions and lines of business.

Through our work with a significant number of sponsors and management teams, we observed that acquisition philosophy was largely consistent, but there were greater divergences in integration strategies. Integrating a group of (often highly entrepreneurial) insurance brokers with pre-established ways of working into a platform is non-trivial and must be managed carefully, so as not to stifle productivity and drive unwanted attrition.

On the flipside, adopting a more "light-touch" approach runs the risk of creating a franchise with an inefficient and varied operating model, and possibly weak controls. Sponsors and management teams have generally confronted this conundrum by adopting one of these three strategies:

### Hands-off acquirers

Minimize change at the agency level with integration focused on control functions and HR administration

### Hybrid acquirers

Extend integration beyond control and human resources administration functions into finance, IT, real estate, brand, and aspects of sales support

### Integrated acquirers

Rationalize brand identity, finance, and control functions shortly after close, and over time align front office practices and functions

While all these models saw notable success in the bull market years, we expect some bifurcation in the relative success of these strategies in a more muted market, with flat to contracting deal multiples. We anticipate that high-quality broker platforms will continue to benefit from healthy multiples, whilst businesses with "work required" are likely to be disproportionately impacted in a dislocated market.

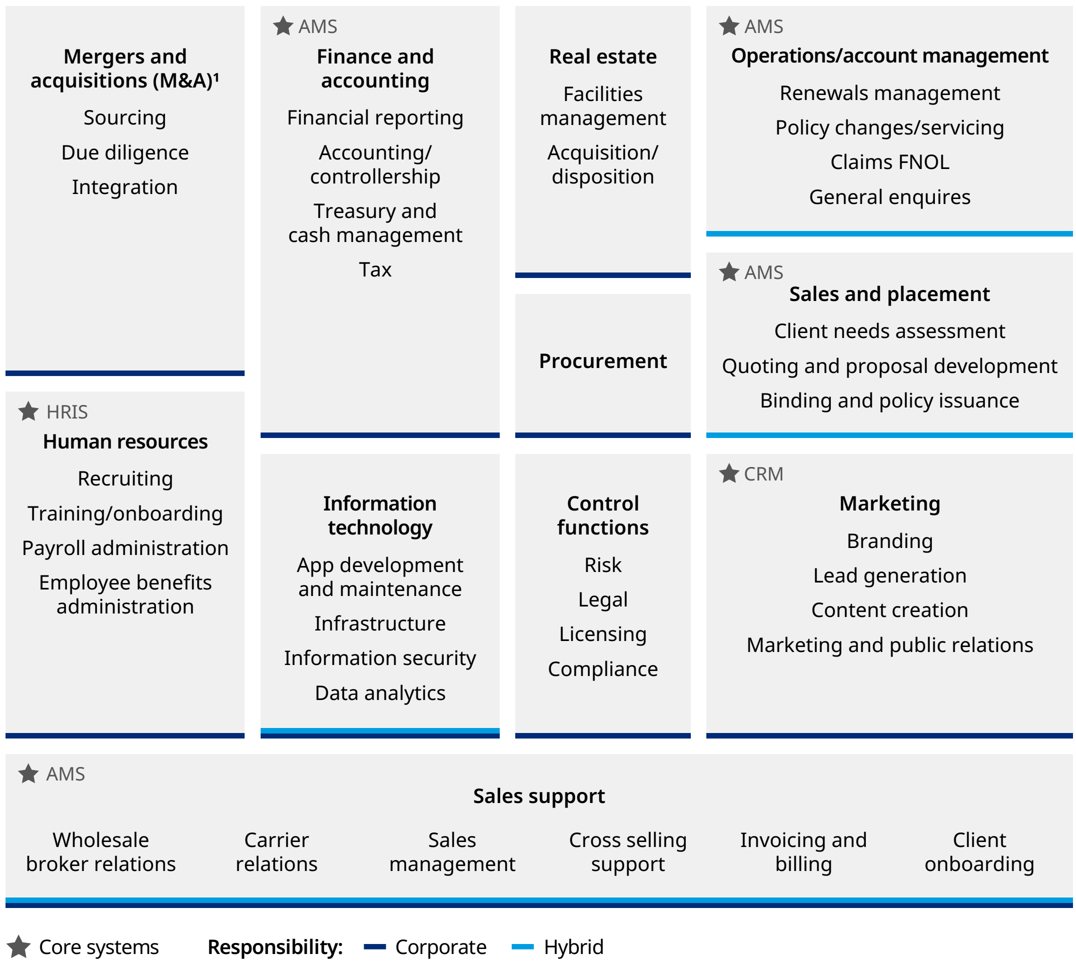
In relation to the three strategies above, we see "hands-off" acquirers as being at highest risk of being penalized. The market may mark hands-off acquirers down for having a broad swath of individually sub-scale agency businesses — operating on different systems and processes and requiring significant integration prior to being ready to recognize broader operational and financial synergies.

Stated differently, we increasingly see significant integration and an institutional focus on the bottom-line as a requisite for a high-quality insurance brokerage platform of the future. Through our work with a broad spectrum of brokers and their third-party software and service providers in the insurance ecosystem, we have identified the following four key drivers of tangible results from greater integration.

**Sponsor-backed brokers now account for more than half of the top 30 brokers in the US across commercial, personal and employee benefits (EB) lines**

**Exhibit 2: Three M&A archetypes exist for how platforms integrate acquired agencies**

**Key functional areas in a brokerage platform**




AMS — Agency management system
HRIS — Human resource information system
CRM — Customer relationship management

1. Integration activities can be based in operations or in M&A

Sources: Expert Interviews, Oliver Wyman analysis

## FOUR KEY DRIVERS FOR SUCCESSFUL INTEGRATION

### Tech and operational model optimization

Efficiency and effectiveness levers are necessary for attaining material savings post integration (for example, integrated IT infrastructure/data architecture/applications, organization streamlining, and operating model optimization). Focus should be placed on establishing an integrated technology stack, standardization and centralization of corporate services, process re-engineering to expand automation and self-service, and organizational streamlining.

### Effective use of third-party vendors

Optimizing procurement and vendor management can help extract savings in third-party expenses. This includes outsourcing non-core/low value activities, optimizing third-party spend (consolidating vendors, implementing a central expense management solution, reducing contracts, or renegotiating vendor agreements where possible), and establishing cost management governance.

### Pricing effectiveness

Opportunity exists to leverage scale to enhance revenue. Focus should be placed on ensuring commission alignment and driving yield optimization via standardizing commissions, optimizing performance commissions, and reducing commissions leakage.

### Salesforce effectiveness

Maximizing productivity should be the focus of initiatives addressing front office staff. Key focus areas include optimizing the front-office organization, implementing productivity management (for example, aligning incentives to metrics, centralizing support teams), analyzing customer profitability, and ensuring a structured coverage model.

The right combination of the drivers listed above (amongst others) will vary broker-to-broker. Nonetheless, we see universal value for brokers investing in these areas in lockstep with ongoing acquisition strategies. We generally recommend a staged approach, starting with levers that have the broadest level of organizational buy-in and are expected to deliver the greatest upside. Successful execution against the first few levers creates confidence in the approach and then gives management the authority to pursue other levers.

For a financial sponsor nearing the tail end of its hold period, demonstrating the organization's ability to execute against one of these levers establishes precedent and sets the organization to be viewed successfully against a longer-term management plan.

While we maintain that insurance brokers remain a very attractive category for private equity investment, the changing market conditions have necessitated a refresh in the playbooks for success. We believe that the market will disproportionately reward consolidators that deliver well-integrated and operationally efficient insurance brokerages. Brokerages that combine scale with a level of uniformity allow them to be nimbler and react to change as end insured demands and needs evolve.

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