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Marsh & McLennan Cos. Inc. has moved out of the defensive position it adopted as a result of compensation scandals that tainted the company in 2004 and 2005, and is focused on developing products and services that meet the evolving needs of its global client base, the brokerage's senior executive says.

While observers agree that the world's largest brokerage has made progress in stabilizing its operations over the past 12 months, they say it still has major issues to contend with, including lingering concerns over its earnings performance, uncertainty over its compensation structure and speculation about its future.

Marsh Inc., MMC's brokerage unit, restructured its business following bid-rigging and client-steering investigations by then-New York Attorney General Eliot Spitzer in 2004. To settle those allegations, New York-based Marsh agreed in February 2005 to pay \$850 million into a compensation fund for its clients. Numerous other lawsuits seeking class-action status are still outstanding against MMC, its units, and current and former directors and officers related to the regulatory investigations.

As a result of fallout from the scandal, Marsh concentrated on protecting its franchise in 2004 and 2005. However, last year it refocused on growing its business, said Brian Storms, chairman and chief executive officer of New York-based Marsh.

A critical part of its strategy is innovation, he said. For example, in January of this year, Marsh helped form MaRI Ltd., an acronym for Marsh Risk Innovations, a sidecar insurer that offers working-layer property catastrophe capacity (BI, Jan. 15). Marsh plans to launch proprietary solutions for workers compensation and oil and gas risks later this year.

"You don't do those things when you're protecting your business," Mr. Storms said.

The issue of broker compensation, though, was once again thrust forward when rival brokerage Willis Group Holdings Ltd. announced that it would not accept supplemental commissions when it represents insurance buyers. Willis said the new form of compensation offered by some insurers does not avoid the conflicts of interest associated with contingent commissions (BI, April 30).

The Risk & Insurance Management Society Inc. followed by taking its strongest stance yet on the issue of broker compensation, calling for a prohibition on all "placement fees" paid to brokers by insurers. (BI, June 4).

The issue of compensation is more complex than simply debating supplemental vs. contingent commissions, Mr. Storms said. Marsh won't accept commissions tied to volume considerations, but the company also views the pricing relationship with insurers as important because the brokerage provides administrative services and support to insurers that should be paid for and that are unrelated to transactions, he said.

"No, we're not taking supplementals based on volume," Mr. Storms said. "Are we willing to have a discussion with markets about being paid for certain services? Yes, we are, and we think our clients understand that."

Marsh is analyzing proposals with various insurers to determine the level of operational service it provides and whether it can ascertain a value for that service unrelated to volume, Mr. Storms said. "We are working through that and when we have something publicly to disclose, we will," he said. "But not in the form of supplementals, not in the form of contingents. Anything that we ultimately arrive at will be fully disclosed, completely transparent. Everyone will know precisely what we're doing."

Given Marsh's history, the company's decision on compensation will be monitored carefully by its clients, analysts say.

"It's hard for me to believe that they would accept anything that looks like a contingent commission," said Mark Lane, a principal and research analyst with William Blair & Co. in Chicago.

The loss of contingent commission income was a key contributor to the company's reduced earnings in recent years, but in 2006 brokerage revenues increased 3.9% compared with 2005 to \$10.47 billion. Commercial retail brokerage revenue, though, slipped 3.9% to \$4.39 billion for a variety of reasons, including the decline in contingent commissions, the sale of claims management unit Sedgwick Claims Management Services Inc. and the soft insurance market, a Marsh spokesman said.

In the first quarter of 2007, MMC reported gross revenues of \$2.81 billion, a 5.2% increase over the same period in 2006.

The company demonstrated "substantial improvement" in its earnings performance in the past 12 months and is "very confident" it will reach targets of 3% to 5% revenue growth and 15% to 20% earnings growth over the next three years, Mr. Storms said.

Analysts, though, have taken a mixed view on the company's earnings performance, particularly in comparison with the growth experienced by its major competitors, Chicago-based Aon Corp. and London-based Willis.

Fitch Ratings last month revised its rating outlook for Marsh to stable from negative because the insurance brokerage's performance has "sufficiently stabilized," said Greg Dickerson, associate director of the insurance group of Fitch Ratings in New York.

Marsh is running a "much leaner operation" and has integrated many of its legacy systems, he said. "I do see margins improving, maybe not to the level of Willis or Aon, but I do see them inching up," Mr. Dickerson said.

While Marsh has made progress in adding new business and retaining clients and employees, the results have been somewhat disappointing, William Blair's Mr. Lane said. In particular, Marsh's organic growth in the first quarter was the worst of the

publicly traded brokerages, he said. "I don't think the outlook is any brighter today than it was 12 months ago," Mr. Lane said.

Continuing its efforts to divest noncore business units, MMC announced in February the \$3.9 billion sale of Putnam Investments, its investment management unit tarnished by trading scandals, to Winnipeg, Manitoba-based Great-West Lifeco Inc.