Winds of change

'Hurricane Merger' is one storm that the insurance world cannot avoid. In recent years, global captive player Marsh has been the most notable victim. Rory Gorman tells the tale

The merger of the operations of Johnson & Higgins and Marsh & McLennan was announced in early 1997. The consolidation of the captive management operations of the two entities worldwide posed the usual merger-related problems of motivating and retaining key staff, reassuring clients, leasing larger premises from which to operate, integrating computer systems, and adopting uniform standards and procedures. It was a difficult and painful task in most domiciles. It occurred at a time of global economic expansion and Y2K awareness, when demand for accountants and computer programmers - key staff in captive management companies - was high.

In late 1998, just when the newly renamed J&H Marsh & McLennan was beginning to find its feet, Marsh announced the acquisition of Sedgwick. In the J&H and Marsh & McLennan merger, both parties had generally had leadership positions in the captive industry in most domiciles, whereas Sedgwick's captive operations, with the exceptions of those in Singapore and the Isle of Man, were generally smaller, catering to a predominantly UK or Commonwealth client base. The Sedgwick operations were remarkably complementary to J&H Marsh & McLennan's, often covering geographic areas where J&H Marsh & McLennan had no significant presence. This smaller size and lack of geographic overlap, coupled with the experience gained from the earlier merger, made it easier to assimilate the Sedgwick captive business.

Where do the re-branded Marsh Management Services, its clients, and the captive management industry find themselves in 1999? Marsh is now by far the largest captive manager in virtually every significant domicile, as the table below indicates. However, the captive management industry is a very fragmented one. Based on the numbers of captives managed, Marsh has approximately a 25% market share, which although impressive, is hardly a monopoly. Its greater dominance in terms of premium volume is easily

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explained; since Marsh is the world's largest insurance broker, and its brokerage clients tend to be large corporations, it is not surprising that its captive clients, many of them owned by those same large corporations, have larger premium volumes than the average captive.

Have the mergers been a success? Early indications are positive. Clients have not left in droves; in 1997 and 1998, many industry gurus (and even, privately, many insiders) predicted that Marsh would lose a significant number of clients who had been co-brokered by some combination of J&H, Marsh & McLennan and Sedgwick. This in fact has not occurred. Most clients quickly came to realise that they were going to benefit from the combined strength of the three predecessor entities. Just as many of our clients were themselves pursuing mergers and acquisitions in order to increase their market share, spread research and development costs, or gain access to new markets or rival technologies, so the insurance industry has had to consolidate for much the same reasons. Some would argue that there is a decreased choice of large-scale competitors (many of whom have undergone their own mergers and acquisitions), and that this is inherently bad. However, clients still have a wide choice of competing captive managers from which to select - over 40 in Bermuda, for example. Although many will opt to have their captive managed by their broker's affiliate, some clients will deliberately choose a captive manager owned by another broker.

The captive industry is not just extremely competitive, but has been for many years confounding predictions of its imminent demise, even when it is faced with competition from the traditional commercial insurance marketplace, and from increasingly sophisticated alternative insurance products. Worldwide, the number of captives continues to grow, and is nearing the 4,000 mark. Constantly, new domiciles like Panama, New York and even Lloyd's announce the introduction of captive legislation, seeking to carve out their own niche in this arena. Older, established players like Bermuda, Vermont and Cayman have to work even harder to remain attractive to captive owners, and the same is true of the managers themselves.

Being the largest captive manager is a mixed blessing. Marsh has a larger pool of talent available to assess, develop and spread new ideas, and the fixed costs of operating can be spread over a larger client base. (For example, the huge expense of writing and maintaining the software required to handle a captive's business is beyond the reach of any but the largest managers.) However, some clients and prospects have admitted to being daunted by the sheer size of Marsh's operations; we have had often to struggle against the presumption that "Marsh won't be interested in my business because it's probably too small for them" when in fact we have no predetermined minimum client size or fee level. Captive owners, accustomed to demanding high levels of value added from their own staff, consultants and suppliers, expect even higher levels of service from Marsh than they might ask of smaller competitors, and with some justification. Clients should expect that Marsh, which already manages numerous complex captives, and which works with clients in so many diverse industries, would be able to bring to the table a greater expertise and variety of solutions than its smaller rivals. And by and large they have found this to be the case. We continue to introduce new members to our Green Island facility - a pool of high-frequency, low-severity casualty business that provides loss stabilisation and is a ready source of third party business for the participants - which now, in its third year of operation, has 18 members and over US$200m in premiums. Rich Inserra of Union Carbide, one of Marsh's clients, has succeeded in getting a Department of Labor authorisation for UC's captive to write employee benefits for UC employees. This has been the Holy Grail of many US captive owners for several years. Now that one captive has been granted this authorisation, and as the Department seems receptive to new applications, it is likely that others will follow the same path. This offers captives the opportunity to diversify their risk, and to retain and share with employees and shareholders the profits currently earned by the benefit providers.

Other hot topics in the captive domain are rent-a-captives and segregated cell legislation, risk securitisation, weather hedges and extended warranty programmes. Several domiciles have introduced segregated cell legislation to simplify the process of setting up a rent-a-captive; some of our clients who are commercial insurers, and groups of agents, have been offering to their insureds and clients participation in the potential profits of their business via a rent-a-captive.

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Marsh has always played a significant role in assisting corporations who no longer wish to self manage their captives, partly in response to a general trend towards outsourcing, and partly as many captives find their role diminished by competition from commercial carriers. In July 1999, GTE RE, a large self managed captive owned by GTE Corp, outsourced its management to Marsh in Bermuda. Equally, clients from time to time find they have reached a critical mass that warrants them becoming self managed. Such transitions are a normal though relatively infrequent event in the captive world.

Marsh continually seeks to consolidate and increase its leadership position in the captive industry. Being the largest manager does not automatically translate into being the best, and in common with any service provider, Marsh has to work hard to build and maintain client relationships. It doesn't matter how big or small Marsh is: at the end of the day service is delivered by the individual staff. They are expected to be technically prepared and trained, to be good managers of their time and above all are encouraged to care for their clients and treat them as their employers, which in a sense they are.

Will Marsh be a player in other significant consolidations in the future? Probably not. Its worldwide network is largely established now, and while there will probably be a number of acquisitions, they will be of smaller brokers with regional or niche operations. Any attempt to acquire a large rival would be unlikely to survive the scrutiny of regulators worried about the creation of a monopoly.