When Greg Case joined Aon in April 2005, the firm was in turmoil as a result of Eliot Spitzer's probe of the broking industry. Two years on, he tells Michael Loney why he believes Aon is ready to enter a new and better era.

Aon's special Case

A few years ago, Aon employees would have been forgiven for thinking it was the beginning of the end. When former New York attorney general Eliot Spitzer shocked the broking industry in October 2004 by revealing corruption at Marsh & McLennan Companies (MMC), many were looking around to see who would be next on Spitzer's hit list. As the world's number two broker, Chicago-based Aon was put under a lot of scrutiny, and speculation was rife about whether it would suffer a similar fate to MMC.

Although Aon was forced to settle with regulators over behaviour that led to conflicts of interest, the scandalous behaviour uncovered at MMC – with some of its brokers scheming to rig bids and steering clients to insurers that paid them the largest contingent commissions – never emerged at Aon.

The broker celebrates its 20th anniversary this year, and finds itself in a strong position. Greg Case, a former financial services consultant at McKinsey & Company, has been CEO for two of those years, after taking over from Pat Ryan. Far from being at the beginning of the end, Case feels his firm is ready to enter a new chapter.

"We are certainly not at the beginning and we are certainly not at the end," he says. "We're at the end of the beginning, and we feel like we have some good momentum. We've made some good progress, but we have some tremendous upside ahead of us."

Right place, right time

Rather than killing Aon off, Spitzer's investigation may have awoken a sleeping giant. The broker's organic growth and profitability has traditionally been off the pace of its rivals. It jumped quickly to the number two spot in the global broker rankings through a number of acquisitions in the late 1990s. These were never integrated entirely convincingly.

Case has taken quick action to restructure Aon. But although he has impressed in his time at the firm, some believe Aon's strong position has as much to do with luck as design.

> **"When I came in it was right on the heels of our famous investigations by the attorney general. So it wasn't exactly a glamorous time, but I didn't see that. What I saw was a tremendous opportunity around the globe, because client need was going up not down."**
> Greg Case

"Aon is in a good spot," says Meyer Shields, equity analyst at investment bank Stifel Nicolaus. "This is because of two issues. For the longest time it was an underachiever. It had good ideas and strategies but the execution was terrible. This is where Greg Case and [Aon's chief financial officer] Dave Bolger have done an excellent job. The second issue is the trouble Marsh & McLennan Companies has been in since 2004, having sullied a reputation that was previously unrivalled. Aon is probably the only truly global broker competitor to Marsh, so almost by accident it has been able to take advantage."

So much so that it can legitimately claim to have overtaken its arch rival as the world's biggest broker, measured by risk and insurance revenue. According to Standard & Poor's, despite Aon's modest risk and insurance revenue growth over the past three years – revenue increased to $5.6bn in 2006 from $5.5bn in 2004 – it has overtaken Marsh, whose risk and insurance revenue plummeted to $5.5bn in 2006 from $6.2bn in 2004.

Shields says Aon has made particularly good progress in winning large accounts off Marsh. Aon's client satisfaction among large clients is improving, while Marsh's is falling. A study of risk managers with middle market to large accounts, undertaken last December by investment bank UBS, found that Aon's approval rating was 24%, a sharp increase on the previous year's 14%. By contrast, Marsh was ranked first by 41% of insurance buyers surveyed, down from 48% the year before.

Marsh has been hard hit by the loss of contingent commissions, an $850m settlement with regulators, a drastic restructuring that included laying off thousands of staff, and top brokers and clients fleeing the firm. S&P says contingent commissions were the equivalent of 52.6% of Marsh's net income in 2003 – it made a $1.6bn net profit that year, and received $845m in contingent commission revenue.

Aon suffered too, though not on the same scale. Contingent commissions were the equivalent of 21.4% of Aon's net income in 2003, with the broker making a $791m net profit and receiving $169m in contingent commission revenue.

"Short term, there was a negative effect," says Shields. "It had to change its business model. There was some reliance on contingent commissions, and because it was an underachiever it was probably over-reliant on them because its underlying profitability was worse. The company also had some defections."

Getting going

Case took over at Aon in April 2005 – exactly one month after the firm announced a $190m pay-out to regulators to settle investigations of contingent commissions and other business practices that could lead to a conflict of interests.

He was eager to start with a clean slate.

"When I came in it was right on the heels of our famous investigations by the attorney general. So it wasn't exactly a glamorous time, but I didn't see that. What I saw was a tremendous opportunity around the globe, because client need was going up not down. And I will tell you my high expectations have been exceeded," he says.

But first the firm needed to be knocked into shape. Case has honed Aon into a more efficient firm. One of his biggest initiatives so far has been to attack expenses, delivering greater than expected cost savings in his first full year. Case promised $100m of cost savings in 2006, but delivered $119m, mainly through layoffs in the company's brokerage business. Aon expects $235m in savings this year, and is targeting $280m in savings annually by the end of 2008.

The firm has so far incurred $335m of restructuring charges as a result of offshoring activities and outsourcing activities. Its claims business, for example, is now being outsourced. A further $30m of restructuring charges will be incurred for the rest of this year.

The expense reductions have helped counter the loss of contingent commissions.

The firm has also shed some units. Aon sold its wholesale brokerage Swett & Crawford in November 2005, and sold most of its holdings in Bermudian class of 2001 start-up Endurance.

Risk and insurance brokerage

Growth and revenue ($bn)

	Year			% change	
	2006	2005	2004	2004-2005	2005-2006
Aon	5.628	5.367	5.468	-1.8	4.9
Marsh & McLennan Companies	5.463	5.592	6.205	-9.9	-2.3
Willis	2.341	2.194	2.205	-0.5	6.7

Source: Standard & Poor's

Risk and insurance broker organic revenues

Year-to-year growth (%)

	2006	2005	2004
Aon	2	1	0
Marsh & McLennan Companies	0	-11	-2
Willis	8	5	4

Source: Standard & Poor's

As well as raising funds, these two moves removed any perceived conflicts of interests over having both retail and wholesale businesses or owning a stake in an insurer and reinsurer to which Aon gives business.

Last year, Aon also sold Aon Warranty Group and its construction programme group, and placed its remaining speciality property/casualty underwriting business into run-off.

But Case says that Aon has not been on the defensive.

"To me this is not about expenses," he says. "Aon is very much in growth mode, and certainly has been in growth mode in my time here and before. We have brought in hundreds of people. We ▶

also made between $150m and $200m of acquisitions last year, and we are on track to do more than that this year. So this is very much an investment time for Aon."

Aon hired more than 150 new staff in 2006. It poached Benfield's facultative reinsurance team – for which it had to pay Benfield a £9.5m ($19m) settlement in March – and added to its financial advisory and litigation team, among others.

Case says one of his biggest restructuring initiatives has been to establish a global sales platform, Aon Global, this January. This will help Aon serve large clients better by centralising resources in one unit. The unit includes the captives services group, international risk management group, risk consulting and risk engineering business units, and its former global large corporate business unit. Dennis Mahoney, former CEO of Aon UK, has moved to Bermuda to take the role of chairman of Aon Global. Steve McGill is CEO of Aon Global, but has also kept his position as CEO of Aon Risk Services Americas.

The growth challenge

Aon's revenues were up 5% last year to $9bn. Net income, however, was slightly down on the year before, falling to $721m from $737m.

Risk and insurance brokerage, which amounted to $5.6bn of revenue in 2006, is not Aon's sole source of income. Although it put its property/casualty operations into run-off, it still has an accident and health and life underwriting business, which brought in $1.9bn of revenue last year. And revenue from Aon's consulting business was $1.3bn.

Observers warn that Aon must improve its organic growth if it is to keep up with its smaller rivals' growth. In a report released in May, S&P says: "Results, however, remain hampered by Aon's low 2006 2% organic growth for its risk and insurance brokerage unit, which lags similar and lesser positioned peers. Continued improvement in operating performance to a level expected from Aon's strong competitive position will depend on whether it can successfully implement organic growth initiatives to improve its top line."

Some believe the restructuring will have a big effect on Aon's ability to improve on its historically lagging performance.

Rating agency Fitch said in a report released in December last year: "Fitch believes all of these steps will allow Aon to increase its focus on its core brokerage business and, specifically, improve operating margins and foster organic growth, two areas where it has historically lagged competitors."

The firm posted encouraging results in the first quarter of this year. Net income was up 8% to $213m, compared with $198m in the same period last year. Organic growth in the quarter was 5%, with 3% organic growth in the risk and insurance brokerage business.

Another short-term challenge is the resignation of Bolger as CFO. Bolger, who was so instrumental in the drive to cut costs, will step down as soon as a successor is found.

"It is not an insignificant loss," says Shields at Stifel Nicolaus. "He did a very good job of implementing the first wave of expense control. Greg Case and Dave Bolger have done a good job of going through expenses and saying: 'This is silly that we are paying for this.' Bolger will be very difficult to replace. They are fairly large shoes to fill."

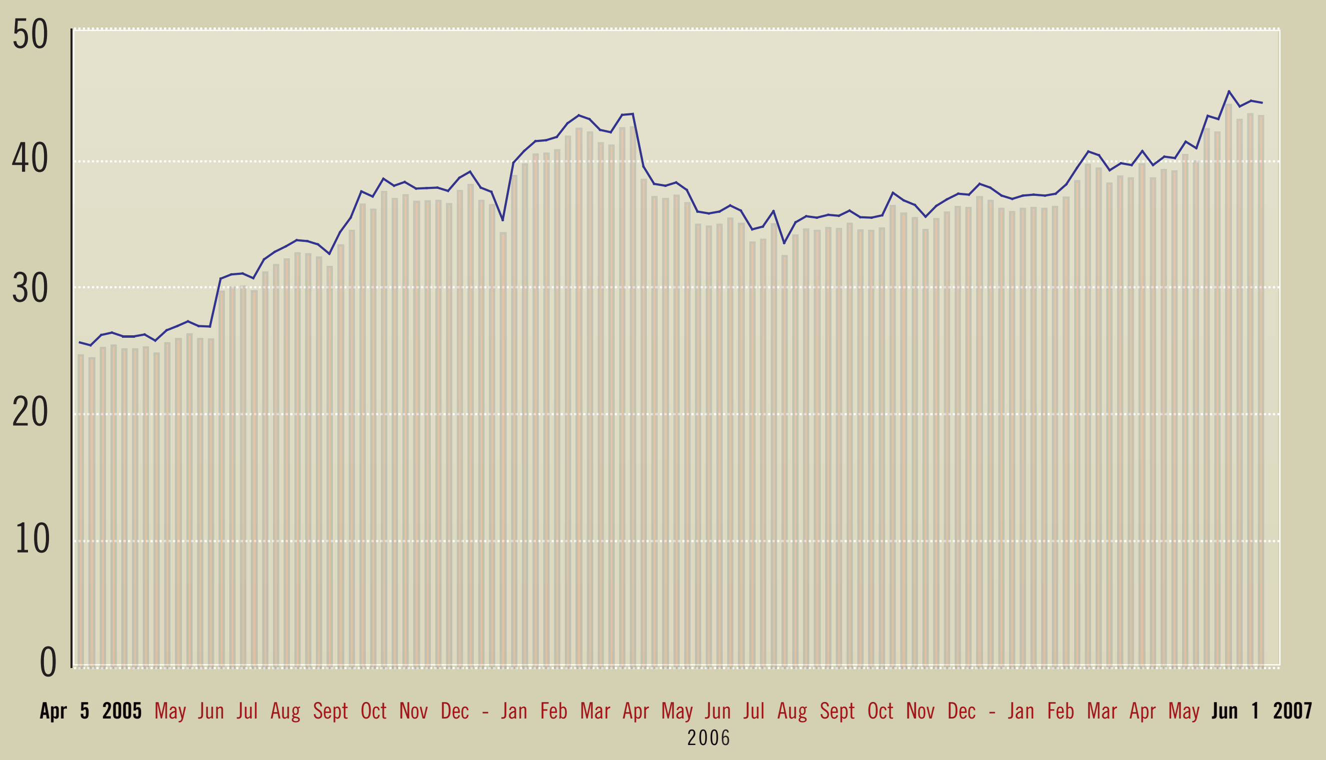
Doing without

Another issue facing Aon is that it is operating in a world with one set of rules for the big four brokers, who cannot accept contingent commission, and another set of rules for everyone else, who can. Case says he is frustrated that his smaller rivals do not have to disclose as much.

"The primary outcome of Spitzer is transparency and the recognised importance of transparency," he says. "What I would hope is that over time the entire industry recognises the importance of

Aon's stock price performance under Greg Case

April 5 2005 to June 1 2007



Source: Yahoo Finance

making sure clients know what they get and what they pay for. Operating in a world where that is not the case does not seem right or prudent."

While some of Aon's larger rivals bemoan the fact that small and regional players can still accept contingent commissions, and demand that all brokers should forgo receiving these payments from insurers for placing business with them, Case stops short of this.

"There is a two-tier system, and there are suggestions of even going to a three-tier system with supplemental commissions," says Case. "Aon is never, never going to do anything that jeopardises the trust we have with clients. We believe the contingent commissions do that. But it is not about commissions, it is about transparency. If you take contingent commissions that is fine, but you have to disclose them and tell your clients what you are being paid. The clients have a right to understand that."

The big brokers received a slight reprieve last year when regulators said they could receive contingent commissions when they are acting in a managing general agent capacity.

And there are signs that contingent commissions may make a comeback in a different form. US insurers Travelers and Chubb have proposed a supplementary income plan that would allow insurers to compensate brokers based on how much business the broker brought the insurer in the previous year, and would be fully disclosed. Willis CEO Joe Plumeri has said his firm would not accept this form of payment, saying that just because regulators may say they are fine does not make them right.

No other brokers have followed Willis's lead yet. Case says it is too early to take a stance.

"I am not even sure what supplemental commissions are. We have seen multiple things out in the marketplace, so it's really difficult to understand what they are talking about. Would we take action on supplementals based on what we know today? Absolutely not," he says.

"Continued improvement in operating performance to a level expected from Aon's strong competitive position will depend on whether it can successfully implement organic growth initiatives to improve its top line."
A Standard & Poor's report

For Case, Aon's challenge is simple – it must provide the best value for money. "We will serve clients so that it is clear the value that Aon brings is substantially greater than the price clients pay for that value. The ratio of value versus the price charged has got to be the highest in the world, and it has got to get better over time."

He continues: "If you work with Aon you should understand we have a very specific objective, which is we want to improve your operating performance. Are we tangibly helping clients improve their income and/or are we helping them strengthen their balance sheet?"

An expanding opportunity

Aon claims it is now the number one broker for primary insurance, reinsurance, affinity programmes and captive management. But it cannot rest on its laurels.

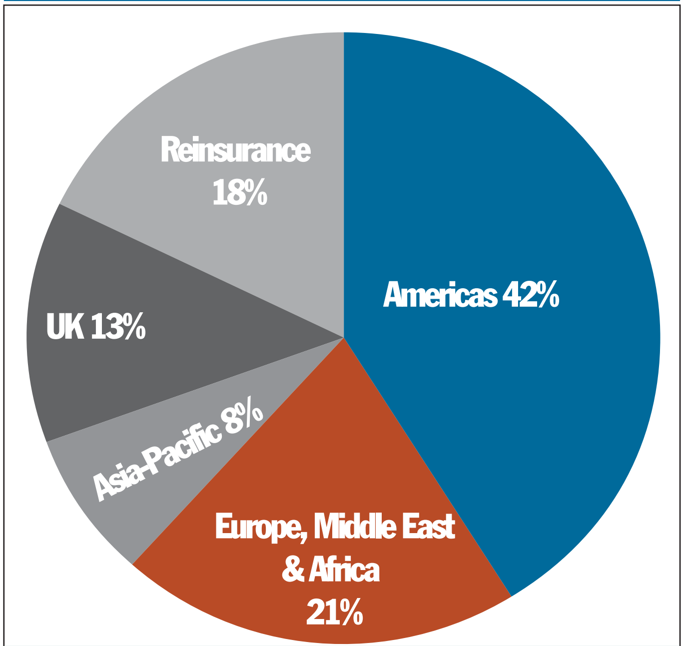
It is targeting a pre-tax margin of more than 20% in its risk and insurance broking business. This may be hard to achieve. Its margin last year was 16.1%, up from 15.4% in 2005, and 11.6% in 2004.

It must increase margins against a backdrop of falling insurance premiums. Some believe it will do well despite this.

"Its growth prospects are pretty good," says Shields at Stifel Nicolaus. "Declining rates don't help but most years tend to be soft market years, and it doesn't stop brokers thriving. It will be helped as more business migrates from Marsh to Aon and others."

Case points to Aon's 8% organic growth in North America in the first quarter as an example of his firm's ability to grow in a down market. He says Aon's organic growth is coming not only from new clients but also existing clients increasingly using Aon for more than just traditional broking services.

Revenue breakdown for risk and insurance broking
For 2006



Source: Aon

Aon sees growth opportunities in increasing its share of large corporate accounts through Aon Global and growing business from emerging markets such as China, Russia, India and Latin America. It also expects an increasing amount of business from its facultative reinsurance and construction and environmental practice groups, as well as through captive management, capital markets transactions and new product development.

Case has been busy in his two years in charge. He has travelled the world, meeting more than 35,000 Aon employees and speaking to more than 2,000 clients. Aon has more than 43,000 employees in 120 countries. He is convinced Aon has a great chance to grow its business because the world is becoming riskier and there is a lot more pressure on corporations to manage their risks better. This is creating plenty of opportunity for brokers.

"What I hear from clients is very consistent. The aggregate level of risk is going up in the world. It truly is – when you think about pandemics, global warming, terrorism, whatever you want to look at, the magnitude is going up. Our clients tell us the complexity is going up substantially. And scrutiny of risk continues to go up with boards, CEOs, CFOs and treasurers – in addition to risk managers – wanting to understand what you are doing to think about overall risk," he says.

As Aon celebrates its 20th anniversary, it seems well positioned to flourish heading into the next 20 years. Case is determined not to let the opportunity slip.

"My biggest challenge is the opportunity that stands before Aon," he says. "I believe we have a unique opportunity to have a wonderfully positive impact on the global economy, and our clients in the context of the global economy. We want to be able to reflect back five years from now and say we came together as a firm and captured that full opportunity. That keeps me up every night." ●