The Commission’s sector inquiry into business insurance: outcome and next steps

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On 25 September 2007, the Commission published the Final Report of the sector inquiry into business insurance, following the Interim Report which was published in January of the same year (see CPN 2007 No 1, p. 63 ff.).

Whilst it contains a wealth of other information, the Final Report focuses in substance on two main issues. These are competition in the wholesale subscription markets, and conflicts of interest on the part of brokers.

Subscription markets

Subscription markets are those whereby an ad hoc syndication arrangement is set up by a broker or client in order to cover a given risk. The process characterises direct insurance for large commercial risks as well as reinsurance (both treaty and facultative) (2). Typically, it involves a restricted number of specialist insurers being approached to quote terms and conditions and to act as ‘lead insurer’ on the contract (we call this the ‘lead market’). The lead insurer, which manages the contract and any claims associated with it, offers to cover a certain quota of the risk, and, once selected, its terms and conditions are then communicated to a selection of insurers which may include those approached in the first round as well as other specialist and generalist insurers. These are invited to take a share of the risk, usually on identical terms, including premium (we call this the ‘following market’). It is usually the case that the share and terms of the lead insurer are guaranteed once it is selected at the end of the first stage. In certain national markets, however, this may not apply. Other variations that characterise certain markets are the use of a ‘lead provision’ which remunerates the specific role of the lead insurer, and the fixing of broker commission levels for all participating insurers already at the lead stage.

Although it is not the sole way of placing a risk with multiple (re)insurers, the subscription approach is probably economically the most important. Alternatives include ad hoc arrangements led by an insurer and standing arrangements (pools); these alternatives are not discussed in the Report but fall under general principles of competition law (including, potentially, the specific exemption for pools in the insurance Block Exemption Regulation).

In respect of subscription markets, the Report discusses the use of ‘Best Terms and Conditions’ (BTC) clauses whereby an insurer or reinsurer makes an offer conditional upon no other participant chosen by the broker or client to cover the same risk receiving better terms, in respect of either a higher price or more restrictive policy conditions. The Report notes that this type of conditionality may lead to upward alignment of premiums and/or contract uncertainty and appears scarcely justifiable from an economic standpoint. To the extent it does not constitute purely unilateral behaviour on the part of the insurer, the use of such a conditionality may be caught by, or be associated with a broader pattern of conduct caught by, Article 81(1) of the Treaty. Where this is the case, since the predominant if not exclusive effect of the practice is to increase prices, it is difficult to imagine efficiencies sufficient to exempt the behaviour under Article 81(3).

The Report goes on to note, however, that premium alignment almost always characterises the subscription markets, both in co- and re-insurance, independently of the use or otherwise of (explicit) BTC conditionality. Such alignment is not, however, a necessary feature of the process; certain markets exhibit premium variation, with or without variation in other terms.

Such price alignment inevitably attracts the attention of antitrust authorities. The Report suggests that premium alignment may result from behaviour caught by Article 81(1), and, whilst it recognises that transaction costs may be a defence in certain cases, questions whether this applies across the board and, therefore, whether the conditions of Article 81(3), including indispensability, are met in respect of such price alignment. The possibility is raised that broker commission arrangements may, in part, explain this outcome and that this may not be in the best interests of

(1) Directorate-General for Competition, unit D-4. The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the author.

(2) Facultative reinsurance is on an individual piece of business and may often be placed with a single reinsurer. Treaty reinsurance covers an insurer’s whole book of business for a given class of risk.
customers or final consumers. It also notes that arrangements in the following market might facilitate collusion in the lead market, although it finds no direct evidence of such collusion. Market participants were actively invited to comment on these observations.

In follow-up to the Report, Commission staff have engaged proactively in a dialogue with industry and it appears to us that the case for change has been generally acknowledged by customers, brokers and insurers alike. The specificities of some national markets, however, may affect the analysis of the efficiency of the process and do need to be borne in mind.

The most visible sign of a momentum for change has been the adoption by the EU brokers’ federation BIPAR of a set of placement principles designed to guide their members on how to comply with competition law in the placement of subscription business. These principles have also been endorsed by the insurers’ association, the CEA. To the extent they are implemented in practice, they should remove the essential part of the Report’s concerns. However, the practical implementation of the principles will clearly need to be monitored and the Commission will need to remain vigilant in this regard. It is also to be hoped that pressure from customers will result in brokers giving more systematic attention to alternative ways of placing the risk and discussing these with their clients.

**Broker conflicts of interest**

The Report contains an extensive description of the types of conflict of interest to which brokers may be subject. These arise from both conventional and contingent commission arrangements (3), and from additional remunerated services provided to insurers.

Although the prevalence of such conflicts is widely accepted, no simple analysis of them is possible since efficiency justifications can be and have been advanced in their support. The Report does not conclude that such practices, as a general matter, are likely to be caught by Article 81 but does express concern that they may undermine market efficiency, and particularly competition on the price of the intermediation service. In this regard, there is evidence that SMEs understate what they are paying. These issues are, of course, not specific to Europe — indeed, the information brought to light by the Spitzer inquiry in the US was one of the factors prompting the Commission’s investigation.

It has been suggested that disclosure and transparency may help alleviate these concerns but there are many questions as to how to design an effective regime. In many cases, smaller brokers also resist transparency, arguing, for instance, that the imposition of mandatory net quoting by insurers in a number of Scandinavian countries has restricted new market entry. Whilst there are calls from some quarters for prohibition of contingent commissions, there are reasons to believe that classical ad valorem commissions create greater conflicts of interest. Moreover, whilst brokers might compete on price by rebating commissions to clients, this does not appear to be a widespread practice, and is even forbidden by law in Germany. The extent to which broker switching may incur indirect costs in terms of premiums due to information asymmetries also remains unexplored.

In the final Communication which accompanied the Report, the Commission undertook to look at these issues in the framework of the review of the Insurance Mediation Directive, without prejudice to whether a regulatory solution was needed or what form it might take. The issue will therefore be in the forefront of the debate at European level, as it already is in a number of Member States. Whilst no ‘quick fix’ is to be expected, the credibility of brokers and overall confidence in the insurance market require clear and transparent arrangements to be in place and this is in the interests of the market as a whole. Input from, and initiative by, all stakeholders are therefore called for.

(3) In the case of contingent commissions, the amount payable by an insurer to a broker is based on the achievement of agreed targets relating to the business placed by the broker with that insurer.