Different forms of cooperation between insurance companies and their respective impact on competition

Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)
Different forms of cooperation between insurance companies and their respective impact on competition

Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)
Europe Direct is a service to help you find answers to your questions about the European Union.

Freephone number (*):

00 800 6 7 8 9 10 11

(*)The information given is free, as are most calls (though some operators, phone boxes or hotels may charge you).

LEGAL NOTICE

The information and views set out in this study are those of the author(s) and do not necessarily reflect the official opinion of the Commission. The Commission does not guarantee the accuracy of the data included in this study. Neither the Commission nor any person acting on the Commission’s behalf may be held responsible for the use which may be made of the information contained therein.


Catalogue number: KD-02-16-918-EN-N


doi: 10.2763/034615

© European Union, 2016
Reproduction is authorised provided the source is acknowledged.
This study was prepared by Europe Economics

Europe Economics is an independent consultancy specialising in the application of economic thinking and practice to a wide-range of public policy and market issues.
Table of contents

Table of contents.............................................................................................. 1
Abstract ...................................................................................................... 4
1 Executive Summary .......................................................................... 5
  1.1 Disclaimer ....................................................................................... 5
  1.2 Motivation for this study ................................................................. 5
  1.3 Methodology .................................................................................... 5
  1.4 Main findings and conclusions ............................................................. 6
    1.4.1 Definition of unconventional and emerging risks ....................... 6
    1.4.2 Types of co(re)insurance schemes ............................................... 7
    1.4.3 Legal findings ........................................................................... 7
    1.4.4 Scheme assessment .................................................................. 8
    1.4.5 Identification of scheme features non-essential to maximisation of efficiency ........................................................ 10
  2 Purpose and structure of final report .................................................. 12
  2.1 Purpose of this report ...................................................................... 12
  2.2 Context ............................................................................................ 12
  2.3 Structure of report .......................................................................... 12
  3 Methodology .................................................................................. 14
  4 Literature review ............................................................................ 16
  4.1 Introduction ................................................................................... 16
  4.2 Risk insurability and the concept of unconventional risk ................... 17
    4.2.1 Academic literature on risk insurability ....................................... 17
    4.2.2 Industry definitions of emerging risk .......................................... 23
  4.3 Insurance cooperation arrangements ................................................. 25
    4.3.1 Categories of cooperative arrangements and distinctive dimensions 25
    4.3.2 Allocation of risks and wealth among pool participants............... 27
    4.3.3 Rationales for the existence of pooling arrangements ................. 29
    4.3.4 The benefits of pooling arrangements........................................ 30
    4.3.5 The limitations of pooling arrangements .................................... 32
  4.4 The role brokers play in the formation of cooperation agreements ...... 34
    4.4.1 General description of the role of brokers in underwriting risk ...... 35
    4.4.2 The role of brokers in the formation of cooperation insurance schemes ................................................................. 35
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.4.3</td>
<td>Competition in the insurance brokerage market</td>
<td>38</td>
</tr>
<tr>
<td>4.4.4</td>
<td>The compensation of insurance brokers</td>
<td>39</td>
</tr>
<tr>
<td>4.5</td>
<td>The role of the State in co(re)insurance schemes</td>
<td>40</td>
</tr>
<tr>
<td>4.6</td>
<td>Key findings and conclusions from the literature review</td>
<td>41</td>
</tr>
<tr>
<td>4.6.1</td>
<td>Definition of unconventional risks</td>
<td>41</td>
</tr>
<tr>
<td>4.6.2</td>
<td>Definitions of types of cooperation schemes</td>
<td>42</td>
</tr>
<tr>
<td>4.5</td>
<td>The role of the State in co(re)insurance schemes</td>
<td>40</td>
</tr>
<tr>
<td>4.6</td>
<td>Key findings and conclusions from the literature review</td>
<td>41</td>
</tr>
<tr>
<td>4.6.1</td>
<td>Definition of unconventional risks</td>
<td>41</td>
</tr>
<tr>
<td>4.6.2</td>
<td>Definitions of types of cooperation schemes</td>
<td>42</td>
</tr>
<tr>
<td>5</td>
<td>Conceptual framework</td>
<td>46</td>
</tr>
<tr>
<td>5.1</td>
<td>Rationales for the formation of cooperation schemes</td>
<td>46</td>
</tr>
<tr>
<td>5.1.1</td>
<td>Market failure in the primary insurance market</td>
<td>46</td>
</tr>
<tr>
<td>5.1.2</td>
<td>Market failure in the reinsurance market</td>
<td>47</td>
</tr>
<tr>
<td>5.1.3</td>
<td>Public policy objectives</td>
<td>50</td>
</tr>
<tr>
<td>5.1.4</td>
<td>Maximising the use of regulatory capital</td>
<td>50</td>
</tr>
<tr>
<td>5.1.5</td>
<td>Inefficiencies of an existing cooperation scheme</td>
<td>50</td>
</tr>
<tr>
<td>5.2</td>
<td>Distinctive features of cooperation schemes</td>
<td>50</td>
</tr>
<tr>
<td>5.2.1</td>
<td>Scheme formation mechanism</td>
<td>51</td>
</tr>
<tr>
<td>5.2.2</td>
<td>The number and type of insurers participating in a scheme</td>
<td>53</td>
</tr>
<tr>
<td>5.2.3</td>
<td>Rules governing the entry of new members/exit of existing members</td>
<td>55</td>
</tr>
<tr>
<td>5.2.4</td>
<td>Liability regimes with regards to members’ insolvency</td>
<td>56</td>
</tr>
<tr>
<td>5.2.5</td>
<td>Premium determination</td>
<td>56</td>
</tr>
<tr>
<td>5.3</td>
<td>Other factors affecting the role of cooperation schemes within the broader sector</td>
<td>62</td>
</tr>
<tr>
<td>5.3.1</td>
<td>The presence of different reinsurance layers</td>
<td>62</td>
</tr>
<tr>
<td>5.3.2</td>
<td>Supply side substitutability and asset-switching</td>
<td>63</td>
</tr>
<tr>
<td>6</td>
<td>Synthetic Analysis</td>
<td>66</td>
</tr>
<tr>
<td>6.1</td>
<td>General description and necessity of schemes</td>
<td>66</td>
</tr>
<tr>
<td>6.2</td>
<td>Assessment criteria</td>
<td>68</td>
</tr>
<tr>
<td>6.2.1</td>
<td>Formation phase</td>
<td>68</td>
</tr>
<tr>
<td>6.2.2</td>
<td>Functional features</td>
<td>73</td>
</tr>
<tr>
<td>6.3</td>
<td>Assessment of insurer-led pools</td>
<td>74</td>
</tr>
<tr>
<td>6.3.1</td>
<td>Formation phase characteristics</td>
<td>74</td>
</tr>
<tr>
<td>6.3.2</td>
<td>Functional features</td>
<td>76</td>
</tr>
<tr>
<td>6.3.3</td>
<td>Efficiency implications</td>
<td>77</td>
</tr>
<tr>
<td>6.3.4</td>
<td>Identification of concerns over insurer-led pools</td>
<td>78</td>
</tr>
<tr>
<td>6.4</td>
<td>Assessment of broker-led pools</td>
<td>80</td>
</tr>
<tr>
<td>6.4.1</td>
<td>Formation phase characteristics</td>
<td>80</td>
</tr>
<tr>
<td>6.4.2</td>
<td>Functional features</td>
<td>80</td>
</tr>
<tr>
<td>6.4.3</td>
<td>Efficiency implications</td>
<td>81</td>
</tr>
<tr>
<td>6.4.4</td>
<td>Identification of concerns over broker-led pools</td>
<td>81</td>
</tr>
</tbody>
</table>
6.5 Assessment of ad hoc agreements .............................................................. 83
  6.5.1 Formation phase characteristics ........................................................... 83
  6.5.2 Functional features ............................................................................. 85
  6.5.3 Efficiency implications ........................................................................ 86
  6.5.4 Identification of concerns over ad hoc agreements ................................ 86
6.6 Comparison of efficiency across types of scheme ..................................... 87
6.7 Identification of potentially non-essential features .................................... 89
  6.7.1 Formation phase features .................................................................... 89
  6.7.2 Functional features ............................................................................. 91
7 Conclusions .................................................................................................. 93
8 Appendix: Stakeholder engagement ............................................................. 98
  8.1 Selection of relevant stakeholders in the insurance and insurance
      brokerage sectors for interview ................................................................ 98
  8.2 Development of questionnaire to support stakeholder engagement
      in the insurance and insurance brokerage sectors ..................................... 98
      8.2.1 Company profiling .......................................................................... 99
      8.2.2 The rationale for formation of cooperation schemes ....................... 99
      8.2.3 The distinctive features of cooperation schemes ............................ 101
      8.2.4 Premium determination and scheme formation mechanisms .......... 102
  8.3 Client engagement ................................................................................... 104
      8.3.1 Demand for unconventional risk insurance .................................... 105
      8.3.2 Demand for reinsurance .................................................................. 106
  8.4 Development of questionnaire to support client engagement .................. 107
      8.4.1 Company profiling .......................................................................... 107
      8.4.2 The rationale for selection of cooperation schemes ....................... 108
      8.4.3 The distinctive features of cooperation schemes ............................ 109
      8.4.4 Premium determination and scheme selection mechanisms .......... 110
9 Appendix: Legal Analysis ............................................................................. 112
  9.1 Legal Framework ..................................................................................... 113
  9.2 Impact of Supply-Side Substitutability on Competitive Assessment .......... 115
  9.3 Overview of the case law analysed .......................................................... 117
      9.3.1 European Case Law .......................................................................... 117
      9.3.2 US Case Law .................................................................................... 177
10 Appendix: Cross-country comparison of State
    involvement in co(re)insurance schemes .................................................. 183
Abstract

The Insurance Block Exemption Regulation (IBER) grants an exemption to the application of competition rules to two categories of agreements in the insurance sector: information- and risk-sharing agreements. The latter category encompasses the common coverage of risks by co-insurance and co-reinsurance pools. Such cooperative structures are exempted subject to certain conditions concerning their functioning and the market share held for the relevant insurance products. Such arrangements are most common in the insurance of large, unconventional non-life risk, such as nuclear, cyber and natural catastrophe.

Europe Economics’ study compares different forms of cooperative insurance structures, not limited to pools, setting out the advantages and disadvantages of each type of cooperative structures for both insurers and clients.

This research also analyses the different competitive dynamics associated with each form of insurance cooperation scheme. The research also identifies potentially non-essential features, from the perspective of maximising the efficiency of these schemes.
1 Executive Summary

1.1 Disclaimer
The information and views set out in this study are those of the author(s) and do not necessarily reflect the official opinion of the Commission. The Commission does not guarantee the accuracy of the data included in this study. Neither the Commission nor any person acting on the Commission’s behalf may be held responsible for the use which may be made of the information contained therein.

1.2 Motivation for this study
On 24 March 2010, the European Commission (EC) adopted a new Insurance Block Exemption Regulation (IBER), valid until 31 March 2017. The IBER applies Article 101(3) of the TFEU and grants an exemption to the application of competition rules to two categories of agreements in the insurance sector: information- and risk-sharing agreements.

The first category concern the exchange of information, in particular for the creation of joint compilations, tables and studies. The second category encompasses the common coverage of risks by co-insurance and co-reinsurance pools. Such cooperative structures are exempted subject to certain conditions concerning their functioning and the market share held for the relevant insurance products. An exception can be made for a ‘new’ risk, when pooling arrangements are exempted without market share thresholds.

The EC has engaged in a public consultation regarding the IBER, aiming at assessing its functioning and future.

This study by Europe Economics aims to provide a comparison of different forms of cooperative insurance structures, including those other than pools, and to examine their respective impact on competition. To this end we:

- Analyse the different forms of insurance cooperation.
- Discuss the advantages and disadvantages of these (for both insurers and consumers) based on empirical findings and theoretical considerations.
- Analyse the different potential effects on market structure and market dynamics (such as pricing and capacity) deriving from each existing or possible insurance cooperation scheme.
- Identify potential non-essential features, from the perspective of maximising the efficiency of the scheme.

1.3 Methodology
In undertaking this study we have performed various analytical and information gathering tasks:

- Literature review. The output of this is set out in Chapter 4. The objective of this section was to review the economic literature relevant to developing a conceptual framework to analyse the potential benefits and the competition impact of cooperation schemes between insurers. This included academic literature, as well as policy statements, working papers and consultation reports prepared by both regulatory bodies and the industry. Our academic adviser, Prof. Dr. Martin Eling, helped us to identify relevant material and also reviewed the resultant work.

- We developed a conceptual framework for the systematic assessment of the rationale behind the formation of cooperation schemes, their distinctive features,
their role within the broader insurance sector, the determination of the premium and the scheme formation mechanisms. The framework is intended to apply to all types of cooperative (re)insurance schemes. As with the literature review, we were aided in this work by our academic collaborator, Prof. Dr. Martin Eling.

- Legal analysis. This work was conducted by our collaborator, competition law advisers, CMS-Hasche Sigle. The purpose of this section was to perform a legal analysis of cooperation schemes in both primary insurance and the reinsurance market. To date, the analysis has focused on the crucial role of the definition of the relevant market in the overall assessment of cooperation schemes, followed by an overview of the case law with regard to competition issues in cooperation schemes. This section also illustrated the commonalities and differences in the understanding of the relevant market from this case law.

- Stakeholder engagement. This section probes further into the areas identified previously. We conducted structured interviews with (re)insurance firms, insurance brokerage firms, and commercial buyers.

1.4 Main findings and conclusions
As a starting point, we observe that co(re)insurance is more frequently used for "unconventional" and/or "emerging" risks than for mass risks, such as car accidents or home insurance. Thus, we begin by examining what is meant by "unconventional" and "emerging" risks.

1.4.1 Definition of unconventional and emerging risks
In order to define what constitutes an unconventional risk, we engaged in a two-fold approach. First, we used a well-established framework (Berliner’s) for assessing risk insurability, which takes into account actuarial, market and societal conditions. This framework is frequently used by market participants in order to determine whether a risk can be insured on a stand-alone basis or not. Second, we also examined industry definitions of emerging risks, which may occasionally overlap with what are understood to be unconventional risks. However, not all emerging risks are unconventional.

In this study we consider as an unconventional risk, any risk that imposes insurability challenges as defined by Berliner’s criteria. The application of these criteria has identified the following as possessing characteristics that are typical of unconventional risks. (This is not intended to be an exhaustive list).

- Cyber security;
- Natural catastrophe;
- Nuclear incidents;
- Terrorism; and
- Ecological damage, e.g. due to large-scale industrial accident.

Indeed the above risk categories are predominantly insured by cooperative agreements, suggesting the approach is valid.\(^1\) One exception is the market for cyber

---

Different forms of cooperation between insurance companies and their respective impact on competition

risk, which is still fairly nascent. However, discussions over the development of cooperation schemes in this area have been initiated and the establishment of such schemes appears likely to be a work in progress.2

1.4.2 Types of co(re)insurance schemes
One dimension that can be used to classify cooperative structures is the party that initiates their formation. Thus, co(re)insurance pools can be formed by:

- insurers, or their respective agents (i.e. insurer-led);
- brokers (i.e. broker-led); or
- can be mandated by the State (i.e. mandated).

In turn, ad hoc agreements are formed so as to cover bespoke customer needs and may also involve a broker, i.e. ad hoc agreements differ from pools in terms of their scope. In particular, pools are set up to cover a multitude of risks from multiple policyholders that fall within a specific risk category, whereas ad hoc agreements are established to cover an individual client’s specific risk. The characteristics of the different types of co(re)insurance arrangements are summarised in the following table:

Table 1.1: Characteristics of co(re)insurance schemes

<table>
<thead>
<tr>
<th>Scheme type</th>
<th>Client involvement</th>
<th>Selection of leader</th>
<th>Terms &amp; Conditions</th>
<th>Negotiation on terms &amp; conditions</th>
<th>Conditional acceptance of policies</th>
<th>Premium alignment3 for a given risk</th>
<th>Knowledge sharing</th>
<th>Involvement and commitment of members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurer-led pool</td>
<td>Limited</td>
<td>Insurer with or without tender</td>
<td>Uniform (specified by leader)</td>
<td>Limited</td>
<td>Yes and No</td>
<td>Mainly yes</td>
<td>Intense</td>
<td>Intense</td>
</tr>
<tr>
<td>Broker-led pool</td>
<td>Limited</td>
<td>Broker mainly with tender</td>
<td>Uniform (set by broker in discussion with leader)</td>
<td>Limited</td>
<td>Yes and No (DUA)</td>
<td>Mainly yes</td>
<td>Limited</td>
<td>Limited</td>
</tr>
<tr>
<td>Mandated pool</td>
<td>Limited</td>
<td>Insurer without tender</td>
<td>Uniform</td>
<td>Limited</td>
<td>No</td>
<td>Mainly yes</td>
<td>Limited or Intense (dependant on pool)</td>
<td>Limited or Intense (dependant on pool)</td>
</tr>
<tr>
<td>Ad hoc agreement</td>
<td>Intense</td>
<td>Client or Broker mainly with tender</td>
<td>Mainly uniform</td>
<td>Intense</td>
<td>No</td>
<td>Mainly yes</td>
<td>Limited</td>
<td>Limited</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

1.4.3 Legal findings
The core issue in conducting a legal analysis of co-operative insurance schemes is defining the relevant market. From the legal analysis conducted by CMS-Hasche Sigle

2 For instance, a recent UK policy paper advocates the need for a cyber risk pool as a means of addressing deficiencies in market capacity. Similarly, a study looking into the UK market, has suggested a public-private cyber-catastrophe reinsurance programme akin to those found for flooding (Flood Re) and terrorism (Pool Re). See e.g. Long Finance (2015) “Promoting UK Cyber Prosperity: Public-Private Cyber-Catastrophe Reinsurance” and HM Government (2015) “UK cyber security: the role of insurance in managing and mitigating the risk”.

3 We refer to cases of premium alignment across leader and followers, say for the risk of a particular client.
we conclude that no major competition issues in the assessment of mergers between insurance companies have arisen so far and, as a rule, it has been possible to leave the definition of relevant markets open.\(^4\)

The legal analysis has also focused on several aspects of co(re)insurance schemes under the prism of competition law. More specifically:

- A necessary condition to exclude restrictions of competition with regards to a pool, either insurer- or broker-led, is that its formation should be needed for the involved companies in aggregate, but also individually, to insure the risks in question.

- Broker-led pools may give rise to a conflict of interest if the commission agreed between the broker and insurers is dependent on commercial success (i.e. contingent commission). The conflict is between the obligation to provide objective advice to clients and the brokers' own financial interests.

- Ad hoc agreements, on the other hand, are likely to raise fewer competition concerns because ad hoc coinsurance is limited to covering an individual risk in an individual case and thus has less competitive relevance and intensity than other forms of cooperation.

1.4.4 Scheme assessment

Overall, co(re)insurance schemes are highly heterogeneous in terms of their intrinsic mechanisms, which suggests that a more accurate assessment needs to be conducted on a case-by-case basis. With regards to the layer of the insurance market in which cooperative structures occur (i.e. primary insurance or reinsurance), we note that, due to the high degree of geographical diversification that characterises the reinsurance market (i.e. large reinsurance firms operate on a global scale), the incremental diversification benefit of pooling agreements between re-insurance firms may typically be less pronounced than that achievable through pooling agreements between primary insurance undertakings that operate in a restricted number of geographical markets. However, by pooling reinsurance portfolios, diversification benefits can still be obtained if the arrangements involve reinsurers that are specialised in different risk categories.

Overall, irrespective of the layer of the market in which they manifest, each type of scheme is associated with several generic benefits and limitations thus creating a trade-off during the placement process of a given risk. Given their policy-driven instigation, mandated pools were excluded from the analysis. They were nevertheless considered insofar as they provide an alternative option for unconventional risk insurance provision.

Insurer-led pools provide a significant amount of coverage and are characterised by a considerable extent of knowledge sharing among members (e.g. decisions over the pool’s functioning may be made unanimously by all pool members). While the extent of knowledge sharing differs by pool, in cases where it extends to pricing decisions it

may enable scheme members to improve their ability to handle similar risks and, ultimately, become leaders in future schemes. It is possible, however, that, considering the significant human capital and IT resources entailed in the requirements for a leader, such an outcome may be limited to a small portion of (mainly large) members (e.g. members that are followers in pools for one unconventional risk category and leaders in pools for another unconventional risk category, thus using the expertise gained so as to also become leaders in the category in which they are currently followers). On the other hand, where there is no tendering process for the selection of the leader, this could render such schemes less efficient relative to alternative cooperative insurance structures (notwithstanding that the possibility for such an outcome to occur would vary on a case-by-case basis). However, their presence may still be required as for several unconventional risks, these pools may be the only available option.

In turn, broker-led pools involve more dynamic processes in their formation, which enables them to compete with insurer-led pools and provide, to varying degrees and depending on the risks covered, a more efficient alternative option. However, the limited extent of knowledge sharing within, relative to insurer-led pools, (as most administrative tasks are likely to be handled by the broker and the leader without involving the followers), may reduce the viability of such arrangements as an adequate alternative option.

A trade-off is also present regarding the involvement of the broker. On the one hand, the superior information held by brokers over current market conditions is likely to enhance the efficiency and necessity of the pool. On the other hand, the additional cost layer related to the remuneration of the broker and, particularly, the potential existence of contingent commissions may adversely affect the efficiency of such schemes, rendering them less appealing to potential clients and/or participants. The latter possibility, however, can be constrained assuming the European Federation of Insurance Intermediaries (BIPAR) principles are in effect.

In contrast to insurer- and broker-led pools, ad hoc agreements are established to cover a specific risk under bespoke customer terms and conditions. Thus, they are more tailored to the idiosyncratic needs of a client and may thus be perceived as a highly efficient means of addressing a customer's insurance coverage needs. As a general restriction to the provision of unconventional risk coverage, however, the number of undertakings that can effectively act as leaders is limited. In addition, such outcomes are unlikely to be ameliorated over time from scheme participation as the extent of knowledge sharing, similar to the case of broker-led pools, is limited.

Premium alignment between leaders and followers is generally efficient. Insofar as the leader is not additionally remunerated relative to the followers (either in terms of a top-up, or in terms of followers receiving a discounted premium), but is instead remunerated through an increased premium applicable to both leader and follower, then there is a potential concern that some costs that have been incurred only by the leader (e.g. risk assessment and underwriting costs) may be charged to the clients multiple times.

Overall, a snapshot of our efficiency assessment is presented in the following table:
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

Table 1.2: Comparative efficiency assessment

<table>
<thead>
<tr>
<th>Scheme Dimensions</th>
<th>Insurer-led pool</th>
<th>Broker-led pools</th>
<th>Ad hoc agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation phase</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formation initiator</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Process for selection of members</td>
<td>Neutral (but potential inefficiency without tendering in leader selection)</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Type of participating insurers</td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
<tr>
<td>Broker remuneration from insurers</td>
<td>Does not apply</td>
<td>Potentially problematic if contingent commissions</td>
<td>Potentially problematic if contingent commissions</td>
</tr>
<tr>
<td>Negotiation of terms and conditions between members</td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
<tr>
<td>Client involvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Leader-followers structure</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Neutral</td>
</tr>
<tr>
<td><strong>Distinctive functional features</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sharing arrangements</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Uniformity of terms and conditions</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Alignment of premiums</td>
<td>Potential inefficiency (in absence of tendering process)</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Renewal frequency</td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

1.4.5 Identification of scheme features non-essential to maximisation of efficiency

We have identified several features pertaining to the formation phase and functionality of cooperation schemes potentially non-essential to the maximisation of scheme efficiency. Non-essential formation phase features relate to:

- The presence of a tendering process for the selection of followers (albeit this is preferable).
- The restriction imposed on scheme members not to provide insurance for the same risk on a stand-alone basis in schemes that are not formed with the primary purpose of obtaining more favourable reinsurance quotes.
- The admission of insurance undertakings in a scheme based on credit rating.
- The type of broker remuneration.
- The negotiation of a scheme’s terms and conditions in case the scheme is formed encompassing a delegated underwriting authority.

In turn, the potentially non-essential functional features relate to:

- Information sharing arrangements in ad hoc agreements.
- Uniformity on terms and conditions (at least in principle).
- Alignment of premiums across leader and followers, insofar as the leader receives a compensation on top of the premium for the incurred risk-assessment costs.

- Rules limiting the frequency with which the insured can terminate a contractual relationship with a scheme.

- Lead clauses prohibiting clients from challenging the leader role within an ad hoc agreement.
2 Purpose and structure of final report

2.1 Purpose of this report
The purpose of this report is to analyse the different forms of cooperation that exist between insurance companies and the impact of these cooperation schemes on competition, including the impacts on pricing and capacity. The study is focused on analysing these issues in the context of non-life, unconventional risks.

This report will inform the European Commission in its review of the functioning of the Insurance Block Exemption Regulation (IBER) and in forming its views on the IBER’s future (with it currently set to expire in March 2017).

This study seeks to draw on extensive desk-based research and stakeholder engagement, the latter through a series of structured interviews with key industry players (insurers, reinsurers, underwriting agents, brokers and commercial buyers).

2.2 Context
On 24 March 2010, the European Commission (EC) adopted a new Insurance Block Exemption Regulation (IBER), valid until 31 March 2017.5 The IBER exempts agreements capable of falling within Article 101(1) TFEU. Such agreements are:

- information-sharing agreements; and
- risk-sharing agreements.

The first category concerns the exchange of information, in particular for the purpose of creating joint compilations, tables and studies. Thus, this type of cooperation can promote market entry and increase price competition by reducing uncertainty around the scale and/or the probability of losses.

The second category, which are the subject of this study, encompasses the common coverage of risks by co-insurance and co-reinsurance pools. Such cooperative structures are exempted subject to certain conditions concerning their functioning and the market share held for the relevant insurance products. An exception is the category of risks classified as ‘new’, with respect to which pooling arrangements are exempted without market share thresholds.

The purpose of this study is to compare different forms of cooperation between insurance companies and examine their respective impact on competition.

2.3 Structure of report
The report is structured as follows:

- Chapter 3 presents an overview of the methodology used across this study’s analytical tasks. (More detail is available in Appendix 8).
- Chapter 4 provides a literature review on unconventional risks, their properties and the types of cooperation schemes that have been developed to deal with these risks.

Different forms of cooperation between insurance companies and their respective impact on competition

- Chapter 5 sets out a conceptual framework for understanding the rationale for and mechanisms of scheme formation, the distinctive features of cooperation schemes and their role within the broader insurance sector.
- Chapter 6 presents our synthetic comparison of co(re)insurance schemes along with an identification of potential non-essential features.
- Chapter 7 offers some concluding remarks.
- Chapters 8–10 are Appendices, including:
  - The selection process of relevant stakeholders.
  - The development of the relevant questionnaires.
  - The legal analysis, including an overview of the case law analysed by CMS-Hasche Sigle.
  - A cross-country-comparison of State involvement in co(re)insurance schemes.
3 Methodology

In this chapter we briefly set out the methodology adopted in this study. We present further details at Appendix 8. We performed various analytical and information gathering tasks including:

- Literature review.
- Legal Analysis.
- Development of conceptual framework.
- Stakeholder engagement.

The purpose of the literature review was to examine the economic literature relevant to developing a conceptual framework to analyse the potential benefits and the competition impact of cooperation schemes between insurers.

Our academic adviser, Prof. Dr. Martin Eling, helped us to identify relevant material and also reviewed the resultant work.

The legal analysis was conducted by our collaborator, competition law advisers, CMS-Hasche Sigle. The legal analysis of cooperation schemes in both primary insurance and the reinsurance market focused on the role of the definition of the relevant market in the overall assessment of cooperation schemes, an overview of the case law with regard to competition issues in cooperation schemes, and also illustrated the commonalities and differences in the understanding of the relevant market from case law. The full legal analysis, including an overview of case law, is provided in Appendix 9.

The combination of the literature review and the legal analysis enabled the formation of a conceptual framework for:

- The systematic assessment of cooperation schemes and their features from a competition policy perspective. In so doing we considered:
  - the rationale behind the formation of cooperation schemes;
  - the scheme formation mechanisms; and
  - their distinctive features including the determination of the premium;
- The identification of those features that are not essential for scheme functioning.

The framework was intended to apply to all types of cooperative (re)insurance schemes. As with the literature review, we were aided in this work by our academic collaborator, Prof. Dr. Martin Eling. The key elements of the framework were allocated to two distinct categories (namely formation and functional features), which were used to develop an assessment matrix for co(re)insurance schemes.

We also conducted primary research (stakeholder interviews). The aim of the stakeholder engagement was to probe further into those areas identified through desk-based research, as well as to investigate any other relevant areas of interest. Appendix 8 describes this process more fully. The final status of our stakeholder engagement can be seen in the following table.
Table 3.1: Stakeholder engagement

<table>
<thead>
<tr>
<th>Stakeholder type</th>
<th>Number of requests sent</th>
<th>Number of participants in study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance firms</td>
<td>111</td>
<td>8</td>
</tr>
<tr>
<td>Brokerage firms</td>
<td>42</td>
<td>2</td>
</tr>
<tr>
<td>Commercial buyers</td>
<td>93</td>
<td>3</td>
</tr>
</tbody>
</table>

The stakeholder engagement generated a relatively low response rate. A number of factors were at play here, including potentially overlap with the previous work by Ernst & Young (E&Y) that broke ground in this area. Whilst thirteen interviews is a relatively small number the responses obtained complemented the study’s other research pillars, particularly the materials feeding into the conceptual framework — in order to give us a sufficient evidence base to form a balanced view of the themes relevant to this study. This means that the key findings presented are not reliant upon the views expressed by a particular stakeholder group. Rather, our findings represent an amalgamation of the key insights obtained from all of the study’s research elements including the views of stakeholders with different vested interests (i.e. insurance undertakings, underwriting agents, brokers and commercial buyers) and with a wide geographical scope.

---

6 E&Y (2014) “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market”.

4 Literature review

4.1 Introduction

It is common for unconventional risks to be covered by cooperation schemes, where multiple insurers devote capital and know-how through risk-sharing and/or information-sharing agreements. For such risks, it is sometimes perceived that a single insurer and delegated underwriting procedures in the open market would fail to provide appropriate capacity. This is to a large extent due to:

- The losses arising in the event the risk materialises being too large for any single company to be able to absorb on its own (“capacity constraint”).
- The limited understanding (e.g. due to lack of historical data) of the implications of the risk and/or of its probability of occurring (“assessment constraint”).

For example Gollier (1997) indicates that risks with low occurrence probability but severe impact impose particular challenges to the determination of an equilibrium price (i.e. premium) that is accepted by both the insurer and the insured. As a result, cooperative schemes tend to cover such risks, which are referred to as unconventional.

In light of the above, the objective of this section is to review the economic literature relevant for the purpose of developing a conceptual framework to analyse the potential benefits and competition impact of co(re)insurance schemes. We have focused our attention on the literature in the following areas:

- Academic literature on risk-insurability and industry definitions of emerging risk — this research task assisted us in constructing a definition of unconventional risk which is appropriate within the scope of the current study.
- Literary work on cooperative risk pooling arrangements — the review of this literature allowed us to:
  - identify different forms of risk-pooling arrangements, their distinctive features, and the rationale for their formation;
  - Highlight pooling arrangements’ benefits as well as their potential limitations.
- Literature on the roles that brokers play in the formation of cooperation arrangements — since brokers are directly involved in the formation of some of the cooperation schemes identified, understanding certain aspects of the brokerage markets (e.g. the nature of competition between brokers, the service they offer, and the way in which they are remunerated) allowed us to gain a better understanding of the functioning of such schemes.

---

7 The term capacity relates to the maximum exposure which a (re)insurer is permitted to underwrite or considers that it can prudently accept given its capital resources, risk appetite and reinsurance cover. In the context of the market as a whole, capacity refers to the collective ability of the (re)insurers to accept risks of a given type.

The overarching goal of this review was to shed more light on the different types of co (re)insurance schemes present in Europe. These are presented in the conclusion of this chapter. Along with the main findings of the legal analysis, presented in Appendix 9, the main findings of the literature review are fed directly into the development of our conceptual framework, presented in Section 5.

4.2 Risk insurability and the concept of unconventional risk

The insurance industry is confronted with several unconventional risks that give rise to significant capacity and assessment constraints.\(^9\) Whilst there is no such thing as a unique and widely accepted definition of unconventional risk, a number of approaches are available that can help define such risks:

- Academic definitions on risk insurability; and
- Industry definitions of emerging risks.

4.2.1 Academic literature on risk insurability

Berliner’s insurability criteria

Theoretical specifications of what constitutes an unconventional or emerging risk tend to relate to the extent of insurability characterising such risks. The seminal work within this context was provided by Berliner (1982)\(^{10}\) who devised a comprehensive approach for differentiating between insurable and uninsurable risks. In particular the insurability criteria are categorised into three broad categories that classify risks in terms of:

- **Actuarial conditions:**
  - Randomness of loss occurrence – the risks need to be independent, as the higher the number of mutually independent risks, the more closely aligned are average aggregate losses with expected losses, thus decreasing capital requirements.
  - Manageable maximum possible losses – the insurer’s solvency should not be in jeopardy.
  - Moderate average loss per event – the presence of loss outliers must be limited.
  - Sufficiently high number of loss events per annum – this facilitates the calculation of probabilities and thus the predictability of the event, as well as supporting diversification of the risk.
  - Limited concerns over information asymmetry – moral hazard and adverse selection issues between insurer and insured party must be non-excessive (see after list for more details).

- **Market conditions:**

---


• **Affordable insurance premiums** – premiums must be acceptable for the insured, whilst allowing risk-adequate for the insurers.

• **Acceptable cover limits** – the insurance cover provided must be adequate for the insured whilst not jeopardising the insurer’s solvency.

• **Societal conditions:**
  
  • **A public policy that is consistent with societal value** – the insurance provided must be compatible with certain policy objectives such as, e.g. not issuing insurance policies for trivial risks and making sure that policies provide no incentive for criminal actions

  • **Legal restrictions that allow the coverage of the risk** – dictating the types of activities an insurance company is permitted to engage in and prohibitions against insuring certain risks on a stand-alone basis, e.g. nuclear risk.

An aside on moral hazard and adverse selection – in the insurance market, buyers know more information about their own risk exposures than do potential insurance providers. With this better information, buyers have an incentive to conceal their actual exposure in order to get a lower insurance premium. This informational disparity is often referred to as asymmetric information. In the presence of informational asymmetry, insurance providers may be incentivised to charge one uniform price for a product and spread their costs across a diverse group of policyholders, thus using their large profits from low-risk customers to subsidise their losses from high-risk customers. This is called adverse selection. In case the uniform insurance price is above the high-quality policyholders’ reservation price, it may result in too much of the low-quality product entering the market, ultimately dissipating or even eliminating the market for the high-quality product and resulting in a market failure.

Another effect of information asymmetry relates to the tendency of insurance protection to alter an individual’s motive to prevent loss. For instance, policy holders may be less incentivised to take care against a certain risk once insured against its occurrence. This is called moral hazard and it affects the expenses for the insurer and, ultimately, the cost of coverage for individuals.

**Applicability of Berliner’s insurability criteria to cooperation schemes**

The two key types of cooperation schemes considered in this review are co(re)insurance pools and ad hoc agreements. Therefore, we consider how each type of cooperation scheme relates to Berliner’s insurability criteria set out above.

First, it should be recognised that an in-depth review of cooperation schemes operating across the EU found a key distinction in the motives behind the formation of co(re)insurance pools and ad hoc agreements. On the one hand, ad hoc co(re)insurance agreements may be perceived as extending the capacity of the insurance market so as to provide coverage for large and complex risks, including large aggregate exposures (e.g. natural disasters). On the other hand, co(re)insurance pools may be perceived as covering risks that are uninsurable, not because of their size and complexity, but because of other features such as individual

---

11 Ernst & Young (2014), “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market”.
volatility, moral hazard, small size of population or excessive claims cost (e.g. nuclear or terrorism pools).

Thus, in light of Berliner’s insurability criteria, co(re)insurance pools may be perceived as adhering primarily to the actuarial elements, whereas ad hoc co(re)insurance agreements, being market-driven, adhere primarily to the market elements. In this sense, pools are more suitable for clients wishing to cover new risks for which it is difficult to assess the probability of occurrence and the potential claims, whereas ad hoc agreements are suitable for bespoke needs of clients wishing to cover a precise risk.

Alternative methods for determining insurability

Alternative methods of determining the insurability of a given risk also exist. For instance, Jaffee and Russell (1996) attempt to condense the Berliner criteria to three factors impeding the insurability of a given risk, namely:

- Problems of adverse selection and moral hazard.
- The insured risk is “too large” in some sense.
- The probability of loss is not susceptible to precise actuarial calculation.

Along similar lines, Kunreuther and Michel-Kerjan (2007) propose five principles for assessing the effectiveness of insurance or other risk-transfer solutions against events encompassing catastrophic losses, such as terrorist attacks. These are:

- risk-based premiums — by reflecting the inherent risk, premiums should signal to individuals and firms the hazards they face and encourage them to engage in cost-effective mitigation measures;
- sufficient demand for coverage — the demand for insurance with risk-based premiums should be sufficiently high so that insurers can cover fixed costs (e.g. attributed overheads) and spread the risk broadly through their portfolios;
- predefined likelihood of insolvency — (re)insurers should determine how much coverage to offer and what premium to charge against the risk, so that the chances of insolvency are below some predefined acceptable threshold level;
- equitability — (re)insurance programs should be fair to (re)insurers, policyholders and the general taxpayer where there is governmental participation; and
- minimal gaming — there should be no economic incentive for (re)insurers or policyholders to take advantage of provisions in the (re)insurance risk transfer program by undertaking strategic behaviour. For instance, insurance companies may collect large amounts of premiums knowing that they would be financially responsible for only a small portion of the claims in anticipation of government intervention in case the event occurs. Similarly, if firms believe that the

---


government will assist them following a catastrophic event (e.g. terrorist attack), they may not purchase insurance and expect to be rescued by federal relief.

Overall, academic frameworks devised to assess risk insurability are particularly useful because they provide an authoritative and comprehensive check-list to assess risk insurability, whilst allowing a precise identification of those features that limit the ability to insure a given risk. In fact, Berliner’s insurability criteria are also extensively used by actuarial professionals in the industry. An example of an empirical analysis which relies on Berliners’ approach to assess risk-insurability is that of Biener et al. (2015) in which the authors emphasise the distinct characteristics of cyber risk, particularly within the scope of actuarial and market criteria, that prohibit its adequate insurability.

- **Actuarial criteria** — the authors suggest that the independence condition is unlikely to be satisfied when underwriting cyber risks as these might be correlated. The independence condition is an important precondition to insuring any type of risk as the larger the number of mutually independent risks within an insurance portfolio (or pool) the more likely it is that average aggregate losses correspond to expected losses, thus decreasing insurers’ safety loadings. Moreover, the number of contracts in cyber risk portfolios is limited, which results in sub-optimal diversification. In addition, regardless of how accurate cyber risk modelling becomes, the lack of available data constitutes a major problem that prohibits the adequate pricing and allocation of risk, thus resulting in what is described by Kraut (2014) as an illiquid market. Lastly, additional risks to insurers might be imposed in case of massive regulatory interventions in incumbent rules over cyber risk insurance.

In contrast, it is suggested that the maximum possible loss for cyber risk, as well as the average loss per event, are lower, relative to other operational risks and are therefore deemed unproblematic. Similarly, loss exposure is also unproblematic as cyber risk events are becoming increasingly more frequent and culpability is easily determined (e.g. actions of people are increasingly more likely to result in cyber risk events, relative to natural catastrophes).

- **Information asymmetry** — moral hazard considerations arise due to the possibility of a coordination problem as investments in cyber security generate positive externalities. Thus, the utility of cyber security investments by one firm depends on the cyber security investments by all other firms. Moreover, there is evidence that firms that have experienced cyber-attacks are more likely to purchase insurance, thus resulting in adverse selection.

- **Market criteria** — the authors document that cyber risk policies typically cover a maximum loss, but actual coverage limits may vary. This is due to policies containing several exclusions (e.g. self-inflicted loss, accessing unsecure websites, espionage and terrorism) and the possibility for indirect losses (e.g. reputational costs) to manifest, which cannot be measured and, hence, covered. An increasingly less problematic, yet still present, aspect of market criteria failures is

---


the determination of the premium. The latter is portrayed as particularly high for cyber risk due to geographic and industry variations in policies and the low number of competitors.

- Societal criteria — none of the included dimensions is characterised as problematic. Minor issues relating to public policy may refer to the potential for insurance fraud to materialise since hacking attacks are difficult to detect and/or trace back. Similarly, legal restrictions might pose a legal threat, particularly for insurance brokers that may limit their willingness to offer cyber risk related products. Legal restrictions might also prevent certain types of coverage of cyber insurance. Nevertheless, the societal insurability criteria relating to cyber risk are overall deemed unproblematic.

The following table illustrates similar academic attempts to determine the insurability of risks which are highly likely to be considered as unconventional:
Table 4.1: Insurability limitations of unconventional risk types

<table>
<thead>
<tr>
<th>Risk</th>
<th>Insurability limitations</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cyber-risk</strong></td>
<td>Correlation among risks</td>
<td>Biener et al. (2015)</td>
</tr>
<tr>
<td></td>
<td>Risk pools are too small and cannot be diversified; also lack of adequate reinsurance</td>
<td>Jaffee and Russell (1997)</td>
</tr>
<tr>
<td></td>
<td>Lack of data</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Changing/emerging nature of cyber risks (e.g. new regulations)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Moral hazard and adverse selection issues</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Problematic cover limits that do not account for indirect costs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>High premiums</td>
<td></td>
</tr>
<tr>
<td><strong>Natural catastrophe</strong></td>
<td>Excessive losses in case of event occurrence</td>
<td>Jaffee and Russell (1997)</td>
</tr>
<tr>
<td></td>
<td>Lack of data</td>
<td>Kraut (2014)17</td>
</tr>
<tr>
<td></td>
<td>Large capital requirements</td>
<td>Ibragimov et al. (2008)18</td>
</tr>
<tr>
<td></td>
<td>Correlation among risks</td>
<td>Dumm et al. (2015)19</td>
</tr>
<tr>
<td></td>
<td>Limited capacity</td>
<td></td>
</tr>
<tr>
<td><strong>Nuclear risk</strong></td>
<td>Excessive losses in case of event occurrence</td>
<td>Reichel and Schmeiser (2015)20</td>
</tr>
<tr>
<td></td>
<td>Limited geographical diversification</td>
<td>Paudel (2012)21</td>
</tr>
<tr>
<td></td>
<td>Correlation with other risks</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Lack of data</td>
<td></td>
</tr>
<tr>
<td><strong>Terrorism risk</strong></td>
<td>Lack of liquidity</td>
<td>Kraut (2014)</td>
</tr>
<tr>
<td></td>
<td>Lack of data</td>
<td>Kunreuther and Michel-Kerjan (2007)22</td>
</tr>
<tr>
<td></td>
<td>Correlation with other risks</td>
<td>Ibragimov et al. (2008)</td>
</tr>
<tr>
<td></td>
<td>Moral hazard and adverse selection issues</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Excessive losses in case of event occurrence</td>
<td></td>
</tr>
<tr>
<td><strong>Ecological damage</strong></td>
<td>Moral hazard issues</td>
<td>Liu (2013)23</td>
</tr>
<tr>
<td></td>
<td>Events not sufficiently statistically independent (i.e. lack of accidentalness)</td>
<td>Hollaender and Kaminisky (2000)24</td>
</tr>
</tbody>
</table>

4.2.2 Industry definitions of emerging risk

Another possible dimension of interest to constructing an adequate definition of unconventional risks is to consider the industry’s approach to emerging risks. Emerging risks, as defined by industry participants, can be thought of as adhering, in most cases, to the aforementioned capacity and assessment constraints and may thus be perceived as overlapping unconventional risks. However, although sometimes similar, so-called emerging risks need not always fall within the unconventional risk typology.25

- Lloyds defines “an emerging risk as an issue that is perceived to be potentially significant but which may not be fully understood or allowed for insurance terms and conditions, pricing, reserving or capital setting”.26
- Swiss Re defines emerging risks “newly developing or changing risks that are difficult to quantify and could have a major impact on society and industry”.27
- Hannover Re defines them as “new or future risks whose hazard potential is not yet reliably known and whose implications are difficult to assess”.28

In a recent report by Guy Carpenter emerging risks are described as “unforeseen risks whose potential for harm or loss is not fully known”.29 These are further classified into three broad categories, namely:

- Technological risks, which are genuinely new risks emerging from new technologies and processes. For such risks the limited availability of actuarial data poses significant challenges on the industry’s ability to assign probabilities of event occurrence and make proper risk assessments;
- Crystallising risks, which are not new but are characterised by a systemic component which makes their consequence less manageable than originally envisaged; and
- Aggravating risks, which are relatively well-known (i.e. these are essentially conventional risks) but their incidence and impact are becoming more intensified.

The usefulness of these definitions is twofold. First, they provide us with common understandings shared by industry participants of what are the key challenges associated with specific risk categories. Second, insurance companies have also come up with extensive lists of those risk categories that are believed to fall under the umbrella of emerging risks. For instance, the Guy Carpenter report as well as Swiss Re and Hanover Re identify the following specific examples of emerging risks:

---

25 For instance, there can be emerging risks that are known and well-understood (i.e. conventional), but are evolving in unexpected ways with unanticipated consequences (e.g. US home mortgage market, liability regimes/regulatory changes).
27 See e.g. http://www.swissre.com/rethinking/emerging_risks/.
28 See e.g. https://www.hannover-re.com/261349/emerging-risks.
29 See e.g. Guy Carpenter (2014) "Ahead of the curve: Understanding emerging risks".
### Table 4.2: Emerging risks identified by industry participants

<table>
<thead>
<tr>
<th>Guy Carpenter</th>
<th>Swiss Re</th>
<th>Hanover Re</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cyber attacks</td>
<td>Cloud computing security</td>
<td>Diacetyl</td>
</tr>
<tr>
<td>Legal liability</td>
<td>Contagious emerging market crisis</td>
<td>Power blackout</td>
</tr>
<tr>
<td>IT security breaches</td>
<td>Eurozone crisis leading to deflation</td>
<td>Genetic modified organisms</td>
</tr>
<tr>
<td>Privacy breaches</td>
<td>Short-termism of macro policy measures</td>
<td>Legal threat</td>
</tr>
<tr>
<td>Cyber theft</td>
<td>Air pollution as mortality driver</td>
<td>Obesity</td>
</tr>
<tr>
<td>Cyber espionage</td>
<td>Concussion crisis in sports</td>
<td>Megacities</td>
</tr>
<tr>
<td>Cyber terrorism</td>
<td>Democratisation of genetic testing</td>
<td>Pandemics</td>
</tr>
<tr>
<td>Loss of revenue</td>
<td>Digital slander</td>
<td>Asbestos</td>
</tr>
<tr>
<td>Recovery of costs</td>
<td>E-cigarettes</td>
<td>Endocrine disruptors</td>
</tr>
<tr>
<td>Reputational damage</td>
<td>Financial consumer protection regulation</td>
<td>Toxic Chemicals</td>
</tr>
<tr>
<td>Business interruption</td>
<td>Open business models</td>
<td>Resistance to antibiotics</td>
</tr>
<tr>
<td>Data privacy</td>
<td>Food and water safety</td>
<td>Nanotechnology</td>
</tr>
<tr>
<td>Regulation breaches</td>
<td>Secession risks</td>
<td>Climate change</td>
</tr>
<tr>
<td>First party loss</td>
<td>Pathogen in rubber production</td>
<td>Medical malpractice</td>
</tr>
<tr>
<td>Crisis management</td>
<td>Aluminium health risks</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Smart cities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Inclusion at workplace</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Urban farming</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Action cam liability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Epigenetics</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4D printing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Collapse of oceanic systems</td>
<td></td>
</tr>
</tbody>
</table>

Source: Europe Economics.

The above is a diverse list. It includes both risk areas and also drivers of loss in a wide range of risk categories, including conventional ones. Nevertheless, certain meta-categories of emerging risk can be identified: cyber risks, risks relating to emergent technology (such as nanotechnology and e-cigarettes), evolving understanding of established technology, and regulatory risk.

However, the main shortcoming of relying solely on industry definitions is the lack of uniformity across industry participants in both the definition of emerging risk and the associated list of risk categories. A more fundamental concern is that basing a definition of unconventional risk on industry definitions of emerging risk is not comprehensive enough, as it excludes risks which fail to meet the risk insurability
Different forms of cooperation between insurance companies and their respective impact on competition

criteria (set out in Section 4.2.1 above) but are no longer emerging, such as nuclear risk.

4.3 Insurance cooperation arrangements

The insurance market incorporates several risks which, however unlikely to occur, if manifested may impose significant damages to both insurers and insured parties. In order to alleviate such concerns, insurance firms often cooperate by means of:

- **coinsurance**, which occurs when multiple insurers are in direct contractual relationship with the insured for part of the same risk, while each of the insurers is liable for its share of any claim made; and

- **coreinsurance**, which occurs when an insurer transfers portions of risk to other domestic or international insurers (i.e. reinsurance) that are under a contractual relationship as in the case of coinsurance (i.e. coreinsurance).

Based on a recent report by the European Commission\(^{30}\) such cooperations, either in the insurance or the reinsurance markets, may manifest as:

- **co(re)insurance pools**, which are arrangements comprising multiple insurance undertakings and set up to cover risks pertaining to specific risk categories (e.g. nuclear pools, terrorism pools, natural catastrophe pools); and

- **ad hoc co(re)insurance agreements**, which are arrangements comprising multiple undertakings but are set up to cover a specific risk under bespoke customer needs.

We now present an overview of relevant economic literature focusing on:

- The categories of cooperative arrangements, along with several distinctive dimensions of each.

- The rules advocating the allocation of risks and wealth within such arrangements.

- The main rationales for the existence of pooling arrangements.

- The benefits and limitations of pooling arrangements.

4.3.1 Categories of cooperative arrangements and distinctive dimensions

There is a significant economic literature devoted to analysing risk pooling in insurance.\(^{31}\) Farny (2011) identifies pools as mutual organisations of several insurance companies founded for the purpose of insuring a special type of risk, whereas the collaboration of the insurance companies is limited to the coverage of this risk.\(^{32}\) (As above, a distinction can be made between coreinsurance and coinsurance pools.) In other cases, the risk assessment and pricing are conducted by an intermediary or by

---

30 European Commission (2014) “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market”


one of the insurers, holding a delegated underwriting authority (DUA) from the other insurers.

Similarly, Kraut (2014)\textsuperscript{33} defines multi-party risk pools as a setup in which several insurers bring in particular (sub-) portfolios of their exposure to jointly bear the risk with other pool participants. If a loss occurs to any of the included portfolios, it is jointly borne by all pool participants according to pre-determined shares. There can also be cases, however, where the terms and conditions that bind the members of a pool are not uniform for all participating firms.

Moreover, an additional and relatively novel type of risk pooling involves brokers (or underwriting agents) agreeing separately with insurers to take pre-agreed percentages of business potentially subject to acceptance by a lead insurer or, alternatively, via a delegated underwriting authority (DUA).\textsuperscript{34} It is characteristic of such arrangements that they are organised by the intermediary and not by the insurers.

The above show that there is no single accepted model for co(re)insurance arrangements. Moreover, regulatory references to co(re)insurance schemes offer limited insights as regards their definition. This due to regulation being focused on establishing the types of arrangements that are exempted, under certain conditions, from the application of Article 101(1) TFEU, rather than providing rigid definitions of their typologies. According to Article 1(4) of the IBER, coinsurance pools are:

\begin{quote}

groups set up by insurance undertakings either directly or through brokers or authorised
agents, with the exception of ad hoc co-insurance agreements on the subscription market,
whereby a certain part of a given risk is covered by a lead insurer and the remaining part of the
risk is covered by follow insurers who are invited to cover that remainder, which:

- agree to underwrite, in the name and for the account of all the participants, the insurance of a
specified risk category; or

- entrust the underwriting and management of the insurance of a specified risk category, in their
name and on their behalf, to one of the insurance undertakings, to a common broker or to a
common body set up for this purpose.
\end{quote}

Similarly, a coreinsurance pool is:

\begin{quote}

“a group set up by insurance undertakings either directly or through brokers or authorised
agents, possibly with the assistance of one or more reinsurance undertakings, with the
exception of ad hoc coinsurance agreements on the subscription market (whereby a certain
part of a given risk is covered by a lead insurer and the remaining part of the risk is covered by
following insurers who are invited to cover that remainder) in order to:

- reinsure mutually all or part of their liabilities in respect of a specified risk category; or

- incidentally accept, in the name and on the behalf of all of the participants, the reinsurance of
the same category of risks”.
\end{quote}

Thus, the helpfulness of definitions provided by the IBER is limited to distinguishing between coinsurance and coreinsurance pools. The former can be perceived as “a

\textsuperscript{33} See e.g. Kraut, G. (2014) "A fair pool sharing mechanism for illiquid catastrophe risk markets" MRIC Working Paper No. 19.

\textsuperscript{34} See European Commission (2014) “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market”
standing agreement to write specified business collectively” whereas the latter aim at “sharing specified risks originally underwritten individually, through mutual reinsurance”.\(^{35}\)

In contrast to pools, literature on ad hoc co(re)insurance agreements is narrow.\(^{36}\) The limited evidence available over such agreements suggests that each (re)insurance company agrees independently to account for a pre-determined share of a given risk that adheres to specific client needs. Brokers play an important role in such arrangements as they advise the clients and have a duty to secure the best deal. In particular, the start of the process involves the broker and the client discussing the client’s insurance coverage needs, and which insurers should be selected to underwrite the insurance, including the selection of one insurer who would act as a leader. There is also negotiation, which may be conducted solely by the broker but may involve the client as well, over the terms and conditions that bind the scheme members. These can be uniform, or vary by member (i.e. vertical underwriting).

Overall, the above suggest that co(re)insurance arrangements can be very heterogeneous in nature, thus impeding attempts to offer stylised descriptions of their business models.

### 4.3.2 Allocation of risks and wealth among pool participants

Existing literature suggests that, an important dimension to distinguish between different forms of cooperation relates to their internal functioning rules and, in particular, the allocation of claims and premiums among members.

First, at a very high level, there exists a distinction between arrangements where solely risk is shared within the pool (with individual insurers underwriting policies independently), and arrangements involving the sharing of both risk and premiums that are underwritten on behalf and for the account of all of the participating members. The first typology of arrangements is typically formed between primary insurance undertakings that agree to pool individual portfolios in order to obtain more favourable reinsurance quotes. The second type of arrangement results in the formation of an entity that operates directly in the primary market by providing collective capacity to insure risks in those areas where such capacity is lacking.

Irrespective of the typology of arrangement considered, its correct functioning depends on whether the inherent sharing arrangements are perceived to be acceptable by all participating members. For example, Kraut (2014)\(^{37}\) shows that for any pool it is possible to define a “fair” pool sharing mechanism (where each share reflects the size and nature of the risk, and the extent of diversification that each member’s portfolio brings to the pool), which ensures each member’s willingness to participate to the pool and limits free-riding concerns among members. Pools designed in this manner have a number of desirable properties:

- they increase the risk-bearing capacity of the aggregate capital of pool participants;

---

\(^{35}\) See e.g. Inderst, R. (2016) “Efficiencies of coinsurance pools” Association of the German Insurance Industry.

\(^{36}\) See European Commission (2014) “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market”

• they decrease the probability of default for all participants; and

• by preventing adverse selection problems they ensure mutual trust between participants who are therefore willing to share sensitive information on their respective risk exposures.

The author recognises that these types of pool agreements may be particularly desirable in the presence of illiquid catastrophic risks where the supply of risk transfer options in the reinsurance market is often limited or available only at a very high price.

Bourle and Henriet (2012)\(^3\) seek to identify an optimal mutual risk-sharing agreement between two heterogeneous agents in the presence of asymmetric information. Their results suggest that, under complete information, equal sharing is optimal when the agents are identical and remains optimal when they are different provided the heterogeneity of risks is not too high and risk aversion not too low.

Under asymmetric information, there is no impact on the optimal sharing rule when expected heterogeneity is low and risk aversion is high. In these cases, risk sharing does not entail any loss of efficiency due to asymmetric information. However, when risk heterogeneity is too high, or risk aversion is too low, the mutuality principle (i.e. the requirement that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund) is unlikely to hold. In this case, the optimal risk sharing arrangement is suggested to be unequal, particularly when both agents declare to be low risk. Notably, when the asymmetry of information leads to a loss of efficiency, this loss is entirely borne by low-risk agents.

Within a similar context, Fragnelli and Marina (2003)\(^3\) address the question of how to efficiently share the risk and the premium in a coinsurance framework. The authors use a game theoretic approach based on the principle that the agents facing a sharing situation (i.e. the insurance companies in the pool) will accept a division proposal if it adheres to certain fairness criteria. Accordingly, an important feature of fairness is suggested to be envy-freeness, meaning that no party should want to give up its portion for someone else’s. Based on the work of Haake et al. (2002)\(^4\), an envy-free allocation of risk and premium is presented via a division procedure that requires one compensation round. In this setup, each company has to receive the following three elements:

• a quota of the premium equivalent to its evaluation of its share of the risk;

• a compensation that eliminates possible envy towards the other companies; and

• a suitable amount of the residual of the premium.

The main message to be taken away from the studies above is that in order for pools to become a widespread and viable solution, the risk-sharing and wealth-sharing


mechanisms need to be properly designed. If the mechanisms are overly simplistic and not sufficiently risk-based then, moral hazard and mistrust problems are likely to emerge, and this may ultimately lead to the formation of pools with low loss-limits and modest risk bearing potentials.

Lastly, Doherty and Dionne (1993) examine contractual forms in the insurance industry for cases where insurance firms are unable to eliminate risk by pooling, i.e. diversification is not optimal. Two types of contracting are identified. In the first type, the risk is simply transferred to an external risk bearer (e.g. investors in the pool). In the second type, the risk is decomposed into risk arising from randomness of event occurrence (i.e. idiosyncratic component) and risk arising from the size of aggregate losses (i.e. non-idiosyncratic component) with separate allocations of these components being made between policyholders and external risk bearers.

Therefore, in the first type, the residual claims on the insurance pool are held entirely by external risk bearers, whereas in the second type the policyholder bears the non-idiosyncratic risk component. Thus, the second type satisfies Pareto optimality for risk-sharing agreements, which states that in the presence of social risk, the optimal arrangement is the one which allows participants to fully insure idiosyncratic risk and bear a share of the social risk. Moreover, the extent of risk that is borne by the policyholder depends upon his/her degree of risk aversion and on the cost of external risk bearing.

In light of the above, the authors illustrate that risk decomposition is superior to simple risk transfers and can be achieved when the policyholder bundles a simple insurance policy with an equity stake on the insurance pool. The authors further conclude that such contractual innovations may be particularly useful in mitigating the effects of potential liability insurance crises.

4.3.3 Rationales for the existence of pooling arrangements
The main motives behind the formation of a pool or an ad hoc agreement may differ:

Both co(re)insurance pools and ad-hoc agreements ease access to clients, however the pools are often seen as more suitable for clients willing to cover new risks for which it is difficult to assess the risk and the potential claims, where the market might be unable to provide a solution. The ad-hoc co(re)insurance market is seen as better able to satisfy bespoke needs of clients wishing to cover a specific risk.

In particular, pools are typically formed by (re)insurers who seek to co(re)insure risks that would otherwise be difficult to cover through other market arrangements. Risks covered in many pools typically have a low probability of occurrence that is difficult to estimate but with potentially severe foreseeable damages.


43 European Commission (2014) "Study on co(re)insurance pools and ad hoc co(re)insurance agreements on the subscription market".
Pools are therefore most typically formed to create capacity for particular types of risk, for which it is difficult to assess the probability of occurrence and the potential total size of claims payable. For instance, pools are usually established for new risks (e.g. large-scale environmental damage), or risks that have substantially changed in nature over time (e.g. terrorism), for which the market does not have sufficient information to estimate the probability of occurrence and price them efficiently.

Thus, the limited extent to which such risks can be insured through commercial market solutions may result in a lack of appetite. Moreover, in some cases of risks, pools may be established with state impetus (e.g. nuclear pools) as the perceived risks may far exceed the capacity of the domestic market.

In turn, ad hoc co(re)insurance agreements are suggested to be most suitable for risks entailing large potential losses, where:

- individual domestic insurance companies do not have sufficient capacity or resources to accept the risk on a standalone basis, which can particularly be the case in smaller countries; and
- alternative solutions (if available) are more costly.

Moreover, ad hoc co(re)insurance agreements allow for greater flexibility compared to pools in that they are structured so as to address bespoke customer needs for a specific risk (e.g. in terms of capacity, retention levels, claims handling processes).

### 4.3.4 The benefits of pooling arrangements

It is generally accepted that the formation of co(re)insurance pools is justified primarily for actuarial reasons, to offer cover in those insurance markets which fail to meet Berliner’s actuarial conditions for insurability. In other words, co(re)insurance pools can offer insurance cover in markets which exhibit large losses (and hence fail the criteria of manageable maximum possible losses and moderate average losses per event) and a high degree of uncertainty (thus failing the criteria of randomness of loss occurrence and of a sufficiently high number of losses per annum).

Actuarially calculated premiums usually comprise a fixed cost covering underwriting expenses, a component reflecting the value of expected losses, together with a safety loading that acts as a buffer against the probability of default in the event of extreme loss. An increase in the number of risks covered by a pool provides greater risk

---


46 Such lack of appetite may also relate to the increased volatility of the risk, small market size or excessive claims costs (e.g. nuclear disaster or terrorist attacks).

47 Although such continuity can also be achieved in pools that have established a joint liability regime.

Different forms of cooperation between insurance companies and their respective impact on competition

diversification (and hence a lower probability of extreme loss realisation) and, therefore:

- it leads to a lower premium whilst guaranteeing the same safety level (i.e. a constant probability of insolvency); or, alternatively,

- it leads to a higher safety level (i.e. a lower probability of insolvency) for a given premium.

Dumm et al. (2015) provide an empirical analysis of catastrophic wind risk in the US in order to assess the potential costs and benefits of aggregating catastrophic risk in pools covering wide geographic areas. The potential costs relate to the possibility that States that are less exposed to the risk cross-subsidise States with a greater risk exposure. The potential benefits arise from a greater diversification of the risk. The authors find that a wider geographic risk diversification (i.e. a pool with a wider geographical coverage) reduces uncertainty and the required reserves, relative to total exposure for the least frequent and more severe events, whilst it does not inherently result in a cross-subsidisation of the high-risk exposures.

Pooling arrangements can improve data availability, by the sharing of data between members of the pool. For instance, when information about losses is shared among pool members, the latter can obtain detailed information about the handling of specific claims as well as participate in settlement decisions. Moreover, depending on the degree of involvement of members in a given pool, the latter can also participate in the calculation of the premium and the overall pricing strategy of the scheme. For instance, decisions regarding the functioning of the pool (including settlements and pricing) may be made by a committee composed of all pool members.

In this respect, followers can increase their information sets with regards to the risks covered as well as their intricacies, ultimately being enabled to become leaders in future schemes. However, the extent of data sharing within a pooling arrangement differs on a scheme-by-scheme basis and may benefit few (mainly large) members. In particular, we consider that the role of the leader is likely to require the employment of significant resources in terms of human capital and IT in order to analyse actuarial data and generate a quote for a given unconventional risk. In this regard, we consider members that are leaders in one unconventional risk category and followers in another as more likely to benefit from scheme participation as they already have in place the means to become leaders in the risk category they are currently followers, but lack the necessary experience. Thus, relative to smaller followers, the incremental costs of

---

51 For example, our stakeholder engagement has indicated that, occasionally and depending on the pool, important decisions (e.g. regarding claims settlements and premium determination) may be made by a committee composed of all pool members.
52 We can draw an analogy from experimental work conducted by the Bank of England on decision-making in committees and individuals. Consistent with previous studies, the results suggest that committees enable members to improve their performance by sharing information and learning from each other. See e.g. Lombardelli, C., Proudman, J. and Talbot, J. (2002) “Committees versus individuals: an experimental analysis of monetary decision-making” Bank of England Working Paper no. 165 and Blinder, A. and Morgan, J. (2000) “Are two heads better than one: an experimental analysis of group vs individual decision making”, NBER Working Paper, No. 7909
becoming leader would be lower. On the other hand, where the relevant information is not shared outside the scheme, it may create entry barriers in the provision of insurance for the associated risks.

Pooling arrangements also have scale advantages by spreading the fixed costs of risk coverage over a larger base of (re)insurers. These cost efficiencies could, in turn, even be reflected in lower premiums (assuming the market is sufficiently competitive).

In this respect, Inderst (2016) points to the cost, allocative and quality efficiencies inherent in coinsurance pools.53 Regarding cost efficiencies, apart from the lower cost of insurance production achieved through the reduction in uncertainty and risk, Inderst points to cost efficiencies related to reduced transaction costs.

Allocative efficiencies result from a reduction in asymmetric information, both between insurers and the insured and between primary insurers and other parties that may take on some of the risk. In particular, allocative inefficiencies may be aggravated when competition leads to insurers “cherry picking” policyholders and when insurers have different levels of experience and information which may lead to a “winner’s curse”. A more efficient provision of insurance would be obtained when, along the insurance production value chain, there is less scope for different parties to extract margins and, thus, the associated deadweight losses are decreased through the pool. Finally, the realisation of quality efficiencies relates to the increased adequacy of the obtained cover and its reliability, thus increasing the “utility” of the buyer of insurance.

4.3.5 The limitations of pooling arrangements

Notwithstanding the actuarial benefits of risk-pooling, the literature has also highlighted some aspects that may limit their formation and functioning.

The most obvious aspect refers to the possibility that the losses may exceed the pool’s capital resources. However, the extent to which this constraint is indeed material depends on the nature of the risk insured. For example, whilst the risks of wars or the use of weapons of mass destruction have been noted to have the potential to generate losses that exceed the capital resources of the industry, the losses generated by other unconventional risks are likely to be well within the capital resources threshold. This is further reflected in the following table encompassing the ten costliest insurance events:

Table 4.3: The world’s ten costliest insurance events

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
<th>Country/Region</th>
<th>Insured losses (USD Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 24, 2005</td>
<td>Hurricane Katrina</td>
<td>USA</td>
<td>45</td>
</tr>
<tr>
<td>October 22, 2012</td>
<td>Hurricane Sandy</td>
<td>USA</td>
<td>35</td>
</tr>
<tr>
<td>March 11, 2011</td>
<td>Tōhoku earthquake$^{54}$</td>
<td>Japan</td>
<td>35</td>
</tr>
<tr>
<td>September 23, 1992</td>
<td>Hurricane Andrew</td>
<td>USA</td>
<td>22</td>
</tr>
<tr>
<td>September 11, 2001</td>
<td>World Trade Center</td>
<td>USA</td>
<td>20</td>
</tr>
<tr>
<td>September 6, 2008</td>
<td>Hurricane Ike</td>
<td>USA</td>
<td>20</td>
</tr>
<tr>
<td>January 17, 2004</td>
<td>Northridge Earthquake</td>
<td>USA</td>
<td>18</td>
</tr>
<tr>
<td>September 2, 2004</td>
<td>Hurricane Ivan</td>
<td>USA</td>
<td>12</td>
</tr>
<tr>
<td>July 27, 2011</td>
<td>Thailand Floods</td>
<td>Thailand</td>
<td>12</td>
</tr>
<tr>
<td>February 22, 2011</td>
<td>Christchurch Earthquake</td>
<td>New Zealand</td>
<td>12</td>
</tr>
</tbody>
</table>

Sources: Swiss Re website produces annual reports on the most costly insured catastrophe losses each year. This table is based on all insurance catastrophe events up to the end of 2014, as the 2015 data is yet to be published.

Another potential limitation to the formation of pools is represented by the presence of coordination problems between firms. This may ultimately lead to a market failure in the co-reinsurance market. Many insurance firms tend to operate and specialise in well-defined geographical markets and may not be willing to (or — due to regulatory constraints — be unable to) participate in pools that cover cross-border risks. However, an efficiently functioning reinsurance market should be able to overcome these constraints and enable the provision of sufficient coverage whenever the aggregate (industry-wide) capital resources are sufficient.

Ibragimov et al. (2008)$^{55}$ argue that market failures in the reinsurance market may be due to coordination problems. More specifically, the authors observe that the supply of (re)insurance coverage in the aftermath of catastrophic events can suddenly disappear and the market as a whole can fall into a so-called non-diversification trap. A non-diversification trap is a specific market equilibrium where the re-insurance market freezes. As a result, it becomes fully rational for any single reinsurer not to offer reinsurance at all. Whilst it is possible in principle to move away from this market outcome and towards a diversification equilibrium in which insurance is offered and there is full risk sharing through the reinsurance market, this move requires significant coordination efforts by a large number of insurers and reinsurers.

Ibragimov et al. (2008) also consider a more fundamental limit to the merits of risk pooling which is the possibility that the number of pool members may not be large enough to produce a desirable diversification outcome. The authors provide a theoretical framework which demonstrates that in the presence of risks with heavy-

---

$^{54}$ Tōhoku earthquake led to a tsunami, widespread flooding and the Fukushima Daiichi nuclear disaster.

tailed distributions (i.e. risks with a non-negligible probability of extreme loss, an actuarial property that is thought to be present in the case of catastrophic risks), their diversification through pooling may be non-desirable unless the number of pool participants is sufficiently large. In other words, in the presence of heavy-tailed risks, the value of diversification is non-monotonic: it decreases for an increasing, but small, number of pool participants and increases only when the number of pool participants is already sufficiently large.

The most extreme limitation to risk-pooling arises in cases where **diversification is never desirable**. More specifically, Ibragimov and Walden (2006)\(^56\) show that in the presence of risks with unbounded heavy-tailed distributions (i.e. risks with a non-negligible probability of extreme loss, and with no limit to the level of potential losses) the value of diversification always decreases as more risks are pooled together.

Another study that has revisited the benefit of diversification from a broader perspective is that of Gatzert and Schmeiser (2012).\(^57\) The authors examine the case of a mutual insurance company where policy holders are both equity and debt holders under two specific definitions of risk pooling. In the first case, ruin (i.e. default) probabilities are fixed and actuarially calculated premiums can be reduced for an increasing number of pool members. In the second case the premium level is fixed and the ruin probability converges to zero with an increasing pool size. Both definitions imply a benefit of risk pooling for the policyholder, which can nevertheless be misleading.

In the first case, the authors suggest that a decreasing premium for an increasing pool size can be separated into a decreasing present value of the claim and the present value of the indemnity payment, which decreases towards the present value of the loss. This partition however, does not alter the insurance company’s overall value of equity and debt positions as the latter always sum up to the initial contribution of the policyholder. Hence, in this valuation framework, **no additional value is generated through diversification**.

### 4.4 The role brokers play in the formation of cooperation agreements.

In the previous sections we presented views on cooperation arrangements and several of their distinctive operational features. However, in non-retail insurance transactions, there can often be a broker positioned between the potential policyholder and the insurance provider (or the insurance provider’s own agents), who plays the role of “market maker” assisting buyers to determine their coverage and risk management needs and matching them to the most suitable insurance firms. Moreover, as seen in Section 4.3.1, brokers may also be directly involved in the formation of some cooperation schemes.

Therefore, understanding certain aspects of the brokerage market (e.g. the nature of competition between brokers, the service they offer, and the way in which they are remunerated) allows us to gain a better understanding of the functioning of such schemes. This section aims to:

- provide a general description of the role brokers play in underwriting risk;


Different forms of cooperation between insurance companies and their respective impact on competition

- provide a more specific description of the role brokers play in the formation of cooperative insurance schemes; and
- illustrate examined dimensions in literature that may impede the effectiveness of the above, namely:
  - the extent of competition in the insurance brokerage market; and
  - the compensation schemes of brokers.

4.4.1 General description of the role of brokers in underwriting risk
An insurance product is a complex and multidimensional instrument that represents a promise to compensate the insured party according to pre-specified terms should some well-defined event occur. However, the value of the insurance company’s compensation commitment depends both on its reputation and on its financial capability. Therefore, a significant amount of information regarding the insurers’ reputation, financial strength and credibility is needed in order to ensure the efficient placement of a given risk. Evidently, insurance brokers play a key role in this task.

Overall, the process through which suitable insurers are identified is complicated as the broker needs to:
- Scan the market;
- Identify insurers who can underwrite the risk based on their:
  - skill;
  - capacity;
  - appetite; and
  - financial strength.
- Assist their client chose the most suitable among competing offers.

Thus, brokers may be perceived as information mediators who alleviate informational asymmetries that would likely exist in their absence. The final selection of insurer depends on several factors and not solely on price. More specifically, the most prominent criteria for the final selection of insurance offer are:
- the price quoted
- the breadth of coverage offered by competing insurers;
- the risk management services provided;
- the insurer’s reputation for claims settlement; and
- the insurer’s financial strength.

4.4.2 The role of brokers in the formation of cooperation insurance schemes
Apart from the evident role of liaising policyholders to the appropriate co(re)insurance scheme, brokers also play a key role in the formation of such arrangements. With regards to co(re)insurance pools, apart from the direct way of formation (i.e.

---

insurance companies agreeing to set up the pool or the Government mandating it), pools can be indirectly formed through brokers.\textsuperscript{59}

The role of brokers is significantly more profound in the case of ad hoc co(re)insurance agreements.\textsuperscript{60} In particular, the start of the process involves the broker and the client discussing the client’s insurance needs, in terms of the coverage required, and on which insurers should be selected to underwrite the risk, including whether one insurer should be approached to provide 100 per cent cover, or whether one insurer should be selected to lead.

The selection of the leader is where substantial negotiations occur and may involve insurers from multiple markets due to the international scope of brokers’ operations. The initial negotiation determines the details of the risk to be insured, and does not necessarily depend on the cheapest quote, as competition is not solely on price.\textsuperscript{61} More specifically, the selection of the lead insurer involves several factors including:

- the underwriting capacity of the (re)insurer;
- the reputation of the (re)insurer and its financial strength;
- the experience of the (re)insurer in the type of risk concerned as in many types of insurance, there are acknowledged market leaders;
- the service provided by the (re)insurer;
- the terms and conditions that the (re)insurer is prepared to offer; and
- the premium that the (re)insurer quotes for the negotiated terms

Moreover, the broker may advise the customer to enhance their diversification of exposure to a given risk by stratifying the risk into layers. These layers could potentially be placed separately with different insurers acting as leaders. In turn, the selection of insurers to approach as followers involves similar considerations to those for the selection of leaders. Unsuccessful leader candidates may also be approached as potential followers. More specifically, three classes of followers may be identified:

- followers that could have been leaders;
- followers who specialise in the type of risk covered but who would not be able to be leaders either due to lack of facilities or due to a strategic decision to specialise but follow rather than lead; and
- followers who do not specialise in the type of risk covered but are interested in absorbing some claims as followers in order to further diversify their overall exposures.

Nevertheless, it is expected that all followers will have the capability to assess the risk independently. This is in order to limit underwriting risk that may be caused by insurers "writing blind". Lastly, similar to co(re)insurance pools, ad hoc co(re)insurance agreements appear to be, to a large extent, contractually uniform and do not adhere to further classifications. In principle, terms and conditions may differ

\textsuperscript{59} See e.g. Inderst, R. (2016) “Efficiencies of coinsurance pools” Association of the German Insurance Industry

\textsuperscript{60} See e.g. European Commission (2014) “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market”.

\textsuperscript{61} This statement is supported by our interview with a client of co(re)insurance schemes.
Different forms of cooperation between insurance companies and their respective impact on competition

per scheme member as a result of the negotiations occurred. In practice, however, clients may wish for this as it may enhance the overall efficiency of the scheme. For instance, in case there is a claim, under variable terms and conditions every policy document would be different, thus likely resulting in claims not being settled satisfactorily.

Evidently, brokers will promote competition if they assist buyers to search intelligently and efficiently across competing insurers and select the offer that is best tailored to their needs. Accordingly, the European Federation of Insurance Intermediaries (BIPAR) developed in 2008 high level principles for the placement of risk with multiple insurers. The BIPAR principles are designed to promote transparency on the role of the broker, and on the nature of the relationship with the insurer in order to guarantee that the client's needs can be optimally satisfied within a dynamic co(re)insurance market. The BIPAR principles are presented in the following table:

**Table 4.4: BIPAR principles for placement of risk with multiple insurers**

<table>
<thead>
<tr>
<th>BIPAR</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principle 1</td>
<td>The intermediary shall, based on information provided, specify the demands and needs of the client as well as the underlying reasons for any advice</td>
</tr>
<tr>
<td>Principle 2</td>
<td>Before placing a risk, an intermediary will review and advise a client on market structures available to meet his/her needs and, in particular, will explain the relative merits of a single insurer or a multiple insurer placement.</td>
</tr>
<tr>
<td>Principle 3</td>
<td>If the client, on advice of the intermediary, instructs the latter to place the risk with multiple insurers, the intermediary will review, explain the relative merits and advise the client on a range of options for multiple insurer placements. Intermediaries will expect insurers, independently, to give favourable consideration to the option requested.</td>
</tr>
<tr>
<td>Principle 4</td>
<td>In the case of a placement of a risk with a lead insurer and following insurers on the same terms and conditions, the already agreed premiums by the lead insurer and following insurers will not be aligned upwards should an additional follower require a higher premium to complete the full risk placement. Indeed, the intermediary should not accept any condition whereby an insurer seeks to reserve to itself the right to increase the premium charged in such circumstances.</td>
</tr>
<tr>
<td>Principle 5</td>
<td>During the placement of the risk, the intermediary will keep the client informed of progress.</td>
</tr>
</tbody>
</table>

Source: BIPAR.

However, over the recent years, there has been an increasing amount of controversy over brokers’ operations. In particular, concerns have been raised with regards to:

- the extent of competition within the brokerage market; and
- the compensation of insurance brokers.

In what follows, we present empirical evidence on these dimensions based primarily on the seminal work of Cummins and Doherty (2006).

---

4.4.3 Competition in the insurance brokerage market

There are several interconnected features of the brokerage market that have been examined in order to assess the inherent extent of competition. These include:

- market concentration;
- barriers to entry; and
- firm size.

With regards to market concentration, evidence suggests that the brokerage segment of the industry is highly concentrated as, for instance, the world’s top two brokers account for roughly 40 per cent of revenues among the top 100 brokers in the USA. Outside the USA, the market can be at least as concentrated. The top ten brokers in Italy accounted for 78 per cent of revenues, with the corresponding figures for France and the UK 71 per cent and 62 per cent, respectively. The largest brokers tend to be dominant in providing insurance services to large national and international buyers, particularly for large risks the placement of which is challenging, i.e. many of the risks in which we are most interested here.

More specifically, it is suggested that the largest risks tend to be placed with the top three or four largest global brokers. Furthermore, as larger risk buyers are themselves likely to engage in coverage design, the role of the broker is focused towards making recommendations in complex or sophisticated areas of risk management where the buyer may lack the necessary expertise. Brokers are more likely to have better information about their clients and are thus rendered highly valuable to insurers, who want to avoid adverse selection problems, especially for risks entailing large losses. As a result, the broker’s extensive knowledge of the insurance market is critical. However, it is suggested that it is difficult to assess the extent of competition at this high level:

- on the one hand, the greater market power enjoyed by these players may enable them to take advantage of bargaining power asymmetries and negotiate advantageous terms for them at the expense of the buyers and the insurers with whom they transact. This effect is likely to be exacerbated during phases of “hard” insurance markets and even more when such phases coincide with periods of increases in demand for coverage in response to higher loss costs.
- on the other hand, competition between a few large firms can be fierce, as is the case in similar market structures with a few market leaders (e.g. airlines, automobile manufacturers, and telephone service providers), ultimately resulting in

---

64 See, for example, http://www.insuranceage.co.uk/insurance-age/news/2353706/uk-broker-market-most-rapidly-consolidation-in-europe-research-shows.
65 All market share figures are from Business Insurance, July 2004, and relate to 2003 revenues.
67 “Hard” and “soft” insurance markets refer to the tendency of commercial property-casualty insurance markets to go through alternating phases, also known as underwriting cycles. In a hard market, the supply of coverage is restricted and prices rise; whereas in a soft market, coverage supply is plentiful and prices are more moderate.
Different forms of cooperation between insurance companies and their respective impact on competition

...in a head-to-head level of competition and, thus, (potentially) exempting the brokerage market from the market power hypothesis in oligopolistic markets.

In general, the brokerage market is characterised by low **barriers to entry**. However, entry into the top tier of brokers is generally regarded as highly difficult due to:

- the global nature of the operations of large mega-brokers;
- their highly developed level of sophistication; and
- their wide range of services which would be difficult to duplicate.

Along these lines, it is suggested that ‘mega-brokers’ are highly capable in syndicating large and complex risks that newly-formed rivals would take years and significant resources to adequately compete against.\(^{68}\)

There also exist niche and regional brokers with a much smaller **firm size**, which can nevertheless effectively compete with the market leaders within their region of operations. This is due to the fact that such firms usually specialise in a specific insurance class or offer particular products and are hence regarded as experts with significant knowledge and experience, despite their size disadvantage.

**4.4.4 The compensation of insurance brokers**

We consider finally the types of compensation received by insurance brokers. It is important to understand the remuneration arrangements that exist, as this will have implications for brokers’ incentives and decision-making and may, therefore, ultimately affect the functioning of competition in the insurance and reinsurance markets.\(^{69}\)

There are three types of commissions enjoyed by brokers.\(^{70}\) These are:

- **premium-based commissions**;
- **commissions contingent to several performance criteria**, namely:
  - the profitability of the business placed with an insurer;
  - the persistence of the business placed with an insurer (i.e. the extent to which policies are renewed with the incumbent insurer); and
  - the volume of business placed with an insurer.
- **fee income from clients**.

**Premium-based commissions** are calculated as percentage of the premiums paid on each policy and constitute the vast majority of observed broker compensations. These percentages are suggested to be usually higher for risks that are more difficult to underwrite (i.e. are more information-intensive and complex in terms of client requirements).

**Contingent commissions** tend to prevail in case the brokers perform some underwriting functions or have superior information, relative to the insurer. Such

---

\(^{68}\) See Conning & Company (2005) “Prospects for Agents and Brokers – Producers, Consultants, or Distributors?”


\(^{70}\) See Cummins and Doherty (2005) “The Economics of Insurance Intermediaries”;
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

superior information is most likely to relate to the policyholder as the insurer may not be able to access relevant data or obtaining it would be too costly.

Fee income from clients mainly adheres to other services offered by the broker (e.g. risk modelling, risk management consulting, loss mitigation, and claims management). As these services are likely to be beyond the resources of small- or medium-sized players, unless specialised, fee income remuneration structures are primarily observed among large brokers.

Closely related to the above, Focht et al. (2013) compare commission-based compensation systems for brokers to fee-for-advice compensation systems. In the latter case, consumers who seek insurance against complex risks compensate the broker for advice over different insurance products covering their needs. Subsequently, consumers may once again approach the broker and purchase a product. Thus, advice and the insurance product are sold separately.

The authors suggest that the choice of compensation system is irrelevant as long as the broker acts completely non-strategically. This can be primarily achieved under a fee-for-advice payment structure between broker and potential policyholder, and efficient contingent commissions between broker and insurance companies.

In a pure fee-for-advice system, the broker is unable to exploit this bargaining power. This limitation, on the one hand, has the advantage that the broker’s incentives for mismatching are limited. On the other hand, the broker may be tempted to engage in side contracting with insurance companies so as to increase the amount of business directed towards them (in return for side payments in the form of contingent commissions) and capitalise on this superior bargaining power. Nevertheless, even in this case mismatching can be avoided as long as side contracting is efficient (i.e. all insurance companies pay, and explicitly compete in, contingent commissions to the brokers).

4.5 The role of the State in co(re)insurance schemes

Although state involvement can be observed in a number of co(re)insurance schemes, it is not a necessary requirement for such schemes to function effectively. In some cases state involvement may be more direct, where the state explicitly sets up and/or participates in the co(re)insurance scheme, while in other cases it may be more indirect, such as where the state enacts relevant legislation so as to enable such a co(re)insurance scheme to be formed. Where states are directly involved in co(re)insurance schemes, there can be still further differences in terms of: the amount of risk retained in the insurance pool and at different reinsurance levels; the extent of the state’s guarantee; the duration of the state’s involvement; and how, and to what extent, the state is remunerated (through premiums) for providing such protection.

72 Strategic broker behaviour may be the result of the inherent incentive problem in the brokerage market. Because of their private information with regards to consumer characteristics and the ability to mismatch uninformed consumers, the broker has increased bargaining power when dealing with insurance companies.
73 There are also cases where the state has intervened in the field of unconventional risk, but not through the formation of co(re)insurance schemes. See the Annex for more details.
Different forms of cooperation between insurance companies and their respective impact on competition

There is an established literature on state involvement in co(re)insurance schemes, which we have used to draw out in more detail these different ways in which the state can play a part in co(re)insurance schemes. In the Annex (see Section 10), we provide a more detailed review of co(re)insurance schemes with state intervention based on an analysis of existing literature. In particular, the analysis compares state intervention in co(re)insurance schemes in the field of terrorism risk, in order to help illustrate the different types of state intervention which may exist, and then concludes by briefly considering state intervention in other areas of unconventional risk.

4.6 Key findings and conclusions from the literature review
Overall, the above research tasks enable us to draw conclusions around the definitions of:

- Unconventional risks.
- Types of co(re)insurance schemes

These are presented below.

4.6.1 Definition of unconventional risks
The literature review has enabled us to provide a definition of unconventional risks. We consider as an unconventional risk, any risk that imposes insurability challenges as defined by Berliner’s insurability criteria. In the literature, the application of these criteria has identified the following risk categories as possessing characteristics that are typical of unconventional risks (see Table 4.1).

- Cyber security;
- Natural catastrophes;
- Nuclear incidents;
- Terrorism; and
- Ecological damage, e.g. due to large-scale industrial accident.

The validity our approach in defining unconventional risk is further suggested by the risk categories listed above being predominantly insured by cooperative agreements. One exception is the market for cyber risk, which is still fairly nascent. However, discussions over the development of cooperation schemes in this area have been initiated and their establishment appears to be a work in progress.

We also note that emerging risks may fall within the unconventional risk typology, at least until they are well-understood. Notwithstanding the above, there can also exist...

---


75 For instance, a recent UK policy paper advocates the need for a cyber risk pool as a means of addressing deficiencies in market capacity. Similarly, one study looking into the UK market, has suggested a public-private cyber-catastrophe reinsurance programme akin to those found for flooding (Flood Re) and terrorism (Pool Re). See e.g. Long Finance (2015) “Promoting UK Cyber Prosperity: Public-Private Cyber-Catastrophe Reinsurance.” and HM Government (2015) “UK cyber security: the role of insurance in managing and mitigating the risk”.

41
so-called emerging risks that are largely conventional. Similarly, a risk that is generally not perceived as unconventional could suddenly become so in the event of an abrupt change in the industry’s perception of its characteristics, thus necessitating its mutualisation (e.g. a risk which is relatively well-known but its incidence and impact become more intensified, or a risk which is not new but is characterised by a systemic component which makes its consequences less manageable than originally envisaged). The above suggest that the dividing line between conventional and unconventional risk is not static in nature. Rather, it shifts based on the market and actuarial properties of the specific risks in question.

4.6.2 Definitions of types of cooperation schemes

Our examination of cooperative (re)insurance schemes identified the following key issues pertaining to their categorisation:

- There are different types of cooperation schemes, which are designed to address different concerns of risk insurability. The precise design of pooling agreements is very complex, as it balances a number of different issues, while a badly designed scheme can lead to suboptimal outcomes. The literature on ad hoc co(re)insurance agreements is extremely limited (see Sections 4.3.3).
- There exists a range of different cooperation schemes found across the market for unconventional insurance risk, including the precise involvement of the State, cover limits and the premiums charged (see Section 4.3.1).
- Cooperation schemes are often led and formed by brokers, the presence of whom adds to the complexity of assessing competition issues in the insurance and reinsurance markets (see Section 4.4).

However, one dimension that can be used to adequately classify such cooperative structures, despite their inherent functional heterogeneity, is the party that initiates their formation. More specifically, co(re)insurance pools can be formed by:

- insurers, or their respective agents (i.e. insurer-led);
- brokers (i.e. broker-led); or
- the State (i.e. mandated).

In turn, ad hoc agreements are formed so as to cover bespoke customer needs (i.e. they are formed by the policyholder/client) and may also involve a broker.

In what follows we provide definitions for the above types.

- An insurer-led pool is an agreement formed by insurers, or their respective agents. In this setup, the potential followers obtain the terms and conditions from the lead insurer and decide whether to participate, and, if so, for what percentage of the risks/claims shared. Participating followers can agree to adopt the premium and conditions of the lead insurer and negotiate only with regards to the quota. Alternatively, followers can perform their own premium calculation, although the frequency of such arrangements is limited given the inherent pricing difficulties. The degree of homogeneity in the risks covered by such pools is usually higher than in alternative cooperative structures. From a theoretical perspective, harmonised premiums could in principle be charged, i.e. the same premium being
charged for all risks across all policyholders.\textsuperscript{76} In practice, the effectiveness and applicability of such a concept in practice is limited. In order for a harmonised premium to be a viable market alternative, a very high degree of homogeneity across policyholders’ risk profiles is necessary.\textsuperscript{77} If this is not the case then a harmonised premium may result in clients with a lower-than-average risk profile paying too much and effectively cross-subsidising clients with a higher-than-average risk profile. Such outcome is unlikely to be sustainable in the long run as it provides incentives for new entrants to exploit such pricing inefficiency (e.g. by offering non-harmonised premiums to attract clients that have a lower risk-profile).\textsuperscript{78} Thus, while from a theoretical perspective harmonised premiums could in principle be charged, the frequency of such a pricing strategy in practice is very limited.\textsuperscript{79} Insurer-led pools are typically characterised by a high degree of commitment and involvement of all, or of a significant fraction of, pool members.\textsuperscript{80} Depending on the degree of involvement of the following insurers, the latter can obtain knowledge over the handling of specific claims and may also be involved in deciding on the settlement as well as on the pricing strategy of the pool.

- A broker-led pool is an arrangement formed by brokers whereby insurers take percentages of business sold by the brokers. Such arrangements are organised by the broker and involve common terms and conditions for all members, specified by the leader. Thus, a characteristic of broker- and insurer-led pools is that they do not necessitate the involvement of the client. Each risk that could be underwritten by the pool may be subject to acceptance by the leader insurer. Alternatively, the broker may be authorised to accept certain risks on certain terms and within certain limits on behalf of the participating insurers under a DUA. In this sense, while the generic terms and conditions are pre-agreed with the pool members, the premium is quoted on a case-by-case basis and agreed upon with the pool members for each individual risk that the broker proposes to be included in the pool. In broker-led pools the degree of commitment of pool members is typically lower, relative to insurer-led pools, as key managerial activities are often performed by the broker and, therefore participation in the pool may be restricted to providing insurance capacity and underwriting the respective risks. As a result, the replacement of a pool member is rather easy and there are limited entry requirements. Moreover,

\textsuperscript{76} We use the term “harmonised premium” to refer to cases where for all risks the premium charged by a pool is the same across all policyholders. A harmonised premium is not to be confused with a uniform premium, which refers to cases of premium alignment across leader and followers. The extent of premium harmonisation reflects the degree of homogeneity in the risks covered by a given pool. See for example Inderst, R. (2016) "Efficiencies of coinsurance pools", Association of the German Insurance Industry.

\textsuperscript{77} For instance, an old nuclear plant with relatively out-dated security standards is not expected to be quoted the same premium as a newly-built plant.

\textsuperscript{78} By price efficiency we mean the ability of charging a premium that reflects accurately client’s underlying risk profile

\textsuperscript{79} Therefore, in our analysis of insurer-led pools, no significant weight was placed on the extent of premium harmonisation.

\textsuperscript{80} For instance, evidence from our stakeholder engagement suggests that there exist insurer-led pools where decisions are made unanimously by a committee composed of all pool members.
knowledge sharing among participating insurers is limited due to the heightened number of activities engaged by the broker.\textsuperscript{81}

- A **mandated pool** is a structure instigated by policy that is usually not for profit. It is frequent for such pools to involve the mandatory participation of all insurance firms active in the market by State impetus. This type of agreement usually involves an insurer who accepts an insurance risk of a defined type in the name and for the account of all of the participating insurers, while risk is shared between members in a predetermined manner.

- An **ad hoc agreement** is a form of cooperative scheme in which each insurance company agrees independently to account for a pre-determined share of a given risk. Brokers play an important role as they advise the clients and have the duty to secure the best deal (as also dictated in the BIPAR principles). The start of the process involves a discussion over the client’s insurance needs, including the total coverage sought, and subsequently a "tender phase" is initiated during which each interested insurance firms will give a quote and indicate the share of risk they are willing to undertake. On the basis of the quotes received, the broker, either on its own or with the client, will select one set of terms and one insurance firm to act as leader. The selection of the leader is where substantial negotiations occur and may involve insurers from multiple markets. This negotiation determines the details of the risk to be insured, and does not necessarily depend on the cheapest quote. The final terms, including the premium, are then communicated to potential followers and negotiation primarily takes place over the share which each follower wishes to subscribe (i.e. the "subscription phase"). The selection of followers involves similar considerations to those for the selection of leaders. Unsuccessful leader candidates may also be approached as potential followers. If a follower accepts the share offered but requests additional conditions, these are usually proposed to the other participants in the agreement by the broker in order to have a final set of uniform conditions. Alternatively, terms such as the price and possibly the deductible and/or reinstatement terms may differ amongst participants subscribing the risk, while basic terms and conditions may remain the same. Nevertheless, there can also be cases where even basic terms and conditions vary. However, although possible in principle, the extent to which ad hoc agreements may involve non-uniform terms and conditions is limited given the potential consequences on the scheme’s functioning (e.g. claims settlement might become dysfunctional). In this respect, uniformity of terms and conditions may even be requested by the customer, who wishes to limit potential inefficiencies in the scheme’s functioning.

The characteristics of the different types of co(re)insurance arrangements are summarised in the following table:

\textsuperscript{81} For instance, if the broker also manages the handling of claims, information over losses is largely retained by the broker and is only shared with pool members when they are required to pay their share of the claim.
Different forms of cooperation between insurance companies and their respective impact on competition

Table 4.5: Characteristics of co(re)insurance schemes

<table>
<thead>
<tr>
<th>Scheme type</th>
<th>Client involvement</th>
<th>Selection of leader</th>
<th>Terms &amp; Conditions</th>
<th>Negotiation on terms &amp; conditions</th>
<th>Conditional acceptance of policies</th>
<th>Premium alignment</th>
<th>Knowledge sharing</th>
<th>Involvement and commitment of members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurer-led pool</td>
<td>Limited</td>
<td>Insurer with or without tender</td>
<td>Uniform (specified by leader)</td>
<td>Limited</td>
<td>Yes and No</td>
<td>Mainly yes</td>
<td>Intense</td>
<td>Intense</td>
</tr>
<tr>
<td>Broker-led pool</td>
<td>Limited</td>
<td>Broker mainly with tender</td>
<td>Uniform (set by broker in discussion with leader)</td>
<td>Limited</td>
<td>Yes and No (DUA)</td>
<td>Mainly yes</td>
<td>Limited</td>
<td>Limited</td>
</tr>
<tr>
<td>Mandated pool</td>
<td>Limited</td>
<td>Insurer without tender</td>
<td>Uniform</td>
<td>Limited</td>
<td>No</td>
<td>Mainly yes</td>
<td>Limited or Intense (dependent on pool)</td>
<td>Limited or Intense (dependent on pool)</td>
</tr>
<tr>
<td>Ad hoc agreement</td>
<td>Intense</td>
<td>Client or Broker mainly with tender</td>
<td>Mainly uniform</td>
<td>Intense</td>
<td>No</td>
<td>Mainly yes</td>
<td>Limited</td>
<td>Limited</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

While the above generic types of cooperative schemes may manifest in both the primary and reinsurance markets a distinction needs to be made between the two. More specifically, relative to coinsurance, coreinsurance may be perceived as a similar form of risk pooling, but one which occurs at a different layer of the market. Furthermore, relative to coinsurers, coreinsurers can benefit more from diversification of risk types. For instance, reinsurers that are globally active and specialise in different risk types may be incentivised to pool their underwriting, thus benefiting from the diversification effects of holding underwritings related to different risks. In contrast, coinsurers are likely to benefit more from the geographic diversification of underwritings adhering to similar risks, thus also lowering the reinsurance premium charged to the pool, as opposed to each individual insurer.
5 Conceptual framework

This section describes a conceptual framework for the systematic assessment of co(re)insurance schemes (presented in Section 6). More specifically, the purpose of this section is to use the key insights from the literature review (presented in Section 4) and legal analysis (presented in Appendix 9) in order to:

- Further elaborate on the rationale for the formation of cooperation schemes.
- Identify distinctive features of cooperation schemes.
- Lastly, this section concludes with a discussion of other factors affecting the role of cooperation schemes to be taken into consideration.

5.1 Rationales for the formation of cooperation schemes

As illustrated in Section 4.3.3, cooperation schemes may be formed as a result of capacity and/or appetite constraints in the primary or reinsurance market, State intervention, as well as bespoke customer needs. Schemes involving only the pooling of risks (with each primary insurer underwriting risks independently) can also be formed with the purpose of obtaining more favourable reinsurance quotes. In this section, these factors are expanded, elaborating further on the following scheme formation determinants:

- Market failures in the primary insurance market.
- Market failures in the reinsurance market.
- Public policy objectives.
- Prudential capital requirements.
- Inefficiencies in existing schemes.

5.1.1 Market failure in the primary insurance market

Market failure in the primary insurance market refers to a situation where the insurance coverage provided is below what is considered socially optimal. This outcome results from an interaction between demand and supply side aspects. Within the insurance sector, such aspects relate to:

- insurance policies only being provided at an excessively high price, thus limiting the demand for insurance cover; and
- the supply of insurance cover is limited, e.g. because some consumers (those that would benefit the most from insurance) are perceived as being to be too risky, or because the policies are characterised by excessively strict cover limits.

The sources of such market failure can stem from a number of dimensions (which are considered standard criteria for assessing risk insurability (see Section 4.6.1) and which, to varying degrees, apply within the realm of unconventional risk:


Different forms of cooperation between insurance companies and their respective impact on competition

- the actuarial properties of the risk in question:
  - risks which are too highly correlated and limit significantly the diversification benefits within a single insurer;
  - the presence of extreme value losses that can threaten the insurers’ solvency;
  - an excessively high average loss per event; and
  - a limited historic loss exposure which makes the calculation of probabilities too difficult.
- the presence of asymmetric information problems:
  - moral hazard problems, i.e. a situation where the insureds are not taking appropriate actions to prevent negative events and/or to limit their impact; and
  - adverse selection problems, i.e. a situation where only highest-risk consumers seek insurance cover.

5.1.2 Market failure in the reinsurance market

In a simplified manner, reinsurance is the insurance of insurers. It is therefore logical to assume that, from the demand side, the same determinant factors of the insurance market influence significantly the reinsurance market. In turn, from the supply side, reinsurance provides additional capital, which increases the solvency of insurers, and therefore allows them to increase the capacity offered.84

By further elaborating on the above it becomes evident that the key role of the reinsurance market is to allow the redistribution and diversification of risks underwritten in the primary market. As the reinsurance market’s behaviour is linked to that of the insurance market,85 where the claims distribution has notable tail risk (i.e. as with unconventional risks) the two markets need to function properly in order for the insurance industry as a whole to function well.

More specifically, on the one hand, we consider that a well-functioning reinsurance industry requires that primary insurers are willing to write policies on their expectation that other insurers are doing the same, so as to provide reinsurers with a sufficiently large primary insurance market and thus a sufficiently diversified pool of risk.

On the other hand, the primary insurers’ appetite for underwriting certain risks depends on their expected ability to pass some of this risk to reinsurers when and if needed. Therefore market failure in the reinsurance market almost inevitably translates into a market failure in the primary market by means of a non-diversification trap.86

The sources of market failure in the reinsurance market are the same as those that can be found in the primary insurance sector and listed in Section 5.1.1 above. A

A stylised illustration of the relationship between market failures in the primary insurance and reinsurance market is provided in the charts below.

**Figure 5.1: Market failure resolved by a cooperation agreement in the primary market**

In Figure 5.1 we describe a case where, for a specific risk category, there are three different consumer segments (A, B, and C), and that each segment is in principle willing to purchase insurance cover in the primary market. We denote the purchase of insurance cover by an upward pointing arrow (that indicates a transfer of risk from consumers towards insurers) and the price charged in exchange for this risk transfer by a downward pointing arrow.

In Figure 5.1, a situation of market failure is illustrated on the left. Without the possibility of pooling Risk A, Risk B and Risk C, primary insurers charge three separate premiums $P_H(A)$, $P_H(B)$, and $P_H(C)$ for the three market segments. In this stylised model, we assume that the insurance premium charged is dependent on two factors:

- The ability to diversify risk — by pooling the risk of A, B, and C, some risk diversification is possible so that the actuarially determined premium for the pooled portfolio is lower than the premium charged for any single portfolio.
- The reinsurance options available — e.g. all else being equal, primary insurers are willing to charge a lower premium if they know that they have the option to pass on some of the risk underwritten to the reinsurance market at an acceptable price.

The result on the left of Figure 5.1 is taken to mean that the premiums are too high for consumer segment B and consumer segment C, so that only consumer segment A buys insurance. This limits the diversification options available in the secondary market (since only Risk A is available) and leads to reinsurers charging a high reinsurance premium, $\Pi_R(A)$, which further contributes to maintaining a high level of premiums in the primary market. This market failure results in only one consumer...
segment (i.e. the one with a willingness to pay that exceeds the premium charged) being insured.

One way in which this market failure can be resolved is by a cooperation agreement between the primary insurers (denoted by the dotted rectangle) as illustrated in Figure 5.1 on the right. The insurers form a cooperation agreement that allows pooling Risk A, Risk B and Risk C together. By virtue of such diversification they are able to offer insurance at a lower price, \( P_L(A, B, C) \), and, as a result, all consumer segments are now willing to purchase the insurance. The diversified risk of the pooled portfolio can then be reinsured at a lower premium, \( \Pi_L(A, B, C) \), and the presence of a cheaper reinsurance option further contributes to lowering the premium in the primary market. In this situation insurance cover is provided to all consumer segments.

A situation in which market failure is resolved by the creation of a cooperation agreement in the reinsurance market is very similar and is illustrated in the figure below.

**Figure 5.2: Market failure resolved by a cooperation agreement in the reinsurance market**

On the left hand-side of Figure 5.2 we assume that reinsurers are not able to pool together their portfolios and therefore charge relatively high premiums, \( \Pi_H(A) \), \( \Pi_H(B) \), and \( \Pi_H(C) \), for reinsuring on a stand-alone basis the risks underwritten in the primary market. This results in primary insurers also charging high premiums and, as a result, some consumer segment are unwilling to purchase insurance cover.

On the right hand-side it can be observed that, as a result of a pooling agreement, reinsurers are able to offer reinsurances at a lower premium, \( \Pi_L(A, B, C) \), and this price reduction is passed onto the primary market rendering insurance cover affordable to all consumer segments.

We note that, due to the high degree of geographical diversification that characterises the reinsurance market (i.e. large reinsurance firms operate on a global scale), the
incremental diversification benefit of pooling agreements between re-insurance firms (as in Figure 5.2) may typically be less pronounced than that achievable through pooling agreements between primary insurance undertakings (Figure 5.1) that operate in a restricted number of geographical markets. However, by pooling reinsurance portfolios, diversification benefits can still be obtained if the pooling arrangements involve reinsurance firms that are specialised in different risk categories.

5.1.3 Public policy objectives
As seen in Section 4.3.3, specific public policy objectives may incentivise or even mandate the formation of cooperation schemes (e.g. with the Government mandating the formation of a scheme and/or operating as an insurer of last resort). For example, insurance cover for certain risks may be associated with a number of positive externalities and therefore governments may incentivise the formation of cooperation agreements in order to provide a greater insurance cover than the one which would be achievable through the market alone.87

5.1.4 Maximising the use of regulatory capital
New EU regulation (Solvency II) stipulates risk-weighted capital requirements that (re)insurers must adhere to in order to ensure their solvency, with higher risk exposure placing higher regulatory capital requirements on the (re)insurer.88 Therefore, insofar as cooperation schemes between insurers allow for greater diversification and thus lower overall risk exposure, these cooperation schemes can allow participants to free up capital for use in underwriting new risks while maintaining their regulatory compliance.

5.1.5 Inefficiencies of an existing cooperation scheme
Cooperation schemes may be formed in response to the inefficient functioning of an already existing cooperation agreement. For example, if the premium charged by a pool is not appropriately calibrated then it may, in principle, create incentives for other means of risk distribution to emerge (see also Section 5.2.1). For instance, as mentioned in Section 4.3.3, when existing solutions in the market are perceived too costly, an ad hoc agreement may be formed. The latter would compensate for potential inefficiencies of existing schemes.

5.2 Distinctive features of cooperation schemes
In this section, we discuss the dimensions along which an assessment of cooperative (re)insurance structures can be conducted. These are:

- The mechanisms at play during the scheme formation phase.


Different forms of cooperation between insurance companies and their respective impact on competition

- The number and types of participating scheme members.
- The rules governing the potential entry/exit of a member in/from a scheme
- The scheme’s liability regime.
- The premium determination process

5.2.1 Scheme formation mechanism

The way in which cooperation schemes are formed in practice provides information regarding the intensity of competition between market players. It would thus play a key role in helping us to assess whether seemingly anticompetitive practices do in fact harm competition dynamics. For example, if there is sufficient competition between brokers and sufficient efforts are being put into identifying the (re)insurers that offer the best terms and conditions (e.g. by establishing a competitive tendering process for the identification of leader and followers), then the alignment of premiums within cooperation schemes is likely to be less of a concern because competition dynamics are actually at play during the scheme identification/formation phase.

Since brokers play a lead role in the formation of many schemes, an understanding of scheme formation necessarily relies on understanding the role brokers play in the (re)insurance market. As mentioned in Section 4.4.1, brokers are intermediaries and their presence can allow matching demand needs to the appropriate supply options available. As such, brokers fulfil a number of important economic functions:

- they can exploit economies of scale — since they handle a large volume of transaction with multiples buyers and insurance firms, brokers can achieve economies of scale in administrative and due diligence activities (e.g. collecting data and documents, assisting in the negotiation process, formalising contracts, etc.);
- they can decrease search and matching costs — insurance, especially when it covers unconventional risk, is a complex multidimensional product where price is only one dimension. Insurance buyers need tailored products and therefore the brokers’ understanding of their clients’ needs is essential to ensure that the most suitable insurers are selected based on a multitude of relevant factors. By providing clients with a range of options (e.g. on price), brokers can also play a key role in ensuring that the selection of insurers is carried in a competitive manner. At the same time, brokers can represent an important distribution channel that allows insurers to access a broader client base;
- they can alleviate asymmetric information problems — brokers act as specialist information mediators between insurers and clients. An insurer needs to know as much possible about their clients’ risk exposures, and clients need to know as much as possible about the insurers’ reputation and the features of the products they offer. Brokers play a key role in facilitating the exchange of this information; and

they can mitigate moral hazard issues — the post-contractual behaviour of the
insureds can increase the risk of loss (e.g. because the insureds do not put enough
effort to limit the probability of experience a risk-related loss and/or to limit its
potential impact). Similarly, insurers can initiate claims settlement disputes with
their clients in an attempt to limit or postpone their liability. In principle, brokers
could perform a monitoring function to limit the occurrence of such opportunist
behaviour.

On the other hand, the extent to which the brokerage market does indeed deliver the
economic benefits described above would depend on:

- market concentration in the intermediary market — in order for customers to
  benefit from healthy competitive dynamics it is important that sufficient
  competitive pressures be present not only in the insurance market but also in the
  brokerage market. Even if in the presence of a generally competitive brokerage
  market, with a large number of players involved, the market of brokers specialised
  in unconventional risk could be much more concentrated;

- barriers to entry — some brokers have unparalleled capability to syndicate large
  and complex risks and it could take new entrants a long time to develop such
  know-how;

- switching costs — the insurance of unconventional risks is relatively service-
  intensive compared to conventional risks, as insurers provide a range of important
  complementary services (e.g. loss control, mitigation programs, benefits
  administration, and rehabilitative services) in addition to the standard insurance
  contract. If a policyholder wishes to use a different insurer, then the new insurer
  would need to dedicate time and resources to understanding this policyholder, in
  order to appropriately develop these complementary services. As a result, the cost
  of switching insurers in such cases could be relatively high;

- frequency of switching options — whilst for less complex commercial insurance
  products brokers may resubmit business to the market very frequently in order to
  provide an existing client with a more advantageous offer, the complexity of
  insurance covering unconventional risk makes a comparison across products more
  challenging and, as a result, business resubmission could be much less frequent

- remuneration and its transparency — the specific way in which brokers are
  remunerated can have important implications on the brokers’ credibility to deliver
  the economic benefits listed above.

Schemes can also be formed directly by insurance undertakings in which one of them
acts as a lead insurer (i.e. insurer-led pools) without the involvement of a broker.
Overall, as we might expect insurers to hold inferior information with regard to client
preferences (and hence demand trends), relative to brokers, the initiation of a scheme
by the lead insurer is not likely to decrease search and matching costs as in the case
of broker-formed schemes (see above). Moreover, the selection of the leader in
insurer-led pools does not in all cases involve a tendering phase, an alignment of
premiums across followers may raise concerns as to whether premiums are set
efficiently.

We believe that a crucial aspect here is whether alternative options exist in the market
for the placement of a given risk. Insofar as there is sufficient competition in the
market (i.e. the insurer-initiated scheme competes with alternative options, such as
other pools, ad hoc agreements, mutuals, or stand-alone insurers), such concerns are less likely to materialise. In other words, the competitive pressure applied to the scheme in the market is likely to reduce the possibility of inefficiencies in its functioning. Such competitive pressure may also result in relatively inefficient schemes, either becoming more efficient in order to survive in the market, or eventually exiting it.

In this respect, another important aspect with regards to the formation of insurer-led pools is the timing of their establishment. Evidently, the earlier the establishment of the scheme the lower the number of competing alternatives and, hence, the greater the likelihood to observe inefficiencies in the scheme’s functioning. Even in this case, however, an efficiency gain is achievable through an increase in the total capacity offered in the market.

Where the market is sufficiently competitive, we consider that the establishment of a scheme by a lead insurer can result in important economic benefits. More specifically:

- It can increase capacity — by introducing a new option for the placement of a given risk, schemes initiated by insurers can increase the overall capacity of the market, thus benefiting potential policyholders facing limited available coverage.

- It can increase learning — a greater extent of information sharing between scheme members is expected to increase the ability of members to handle risks similar to those covered by the pool. Ultimately, this could enable them to become leaders in future schemes (at least, if they have existing or prior exposure to leadership of schemes elsewhere) and compete with the incumbent ones, thus increasing competition in the market (see Section 4.3.4).

- It can alleviate asymmetric information problems — information asymmetry exists when buyers know more about their own risk exposures than do potential insurance providers (see Section 4.2.1). A reduction of asymmetric information can be achieved by increasing the information that is available to insurers. However, this typically involves costs related to the acquisition of the relevant information/data. In light of such frictions, insurers may choose to offer less than maximum coverage to compensate for the inherent adverse selection and moral hazard risks. However, if one insurer has better information about a client and this information is shared then the potential for cover insufficiency is reduced. Thus, if such information is shared within the pool (e.g. with regards to historical losses, or the settlement of claims), information asymmetries could be lowered, allowing for an increase in the overall capacity offered.

### 5.2.2 The number and type of insurers participating in a scheme

In principle, one would expect the benefit of insurance cooperation schemes to be greater the larger the number of participating members. Along these lines, Cummins (1991) illustrates that the insurer’s total buffer fund necessary to ensure a given safety level (i.e. an acceptably low insolvency probability) increases with the number of pool members, while the required buffer for each policy decreases, thus implying a

---

diversification benefit.\textsuperscript{91} In turn, when an acceptable insolvency probability is achieved, diversification effects lead to decreases in the premiums charged.\textsuperscript{92} Lastly, coordination within large schemes is expected to be more difficult, thus limiting collusion concerns.\textsuperscript{93} Overall, the above suggest that larger schemes should be associated with:

- greater risk diversification benefits;
- lower insolvency risk for their members;
- higher cover limits;
- lower premiums (compared to a situation where the same scheme involved less members); and
- lower risk of members engaging in collusive behaviour (because coordination is more difficult).

However, involving a large number of firms can also be disadvantageous when for example:

- lower diversification benefits are accessible and hence premiums are higher (but only if the risk covered has specific actuarial properties, i.e. unbounded potential losses);\textsuperscript{94} and
- greater coordination challenges exist and there is consequently a greater risk that the risk/premiums sharing rules are not appropriately designed.

Overall, we consider that the number and the types of insurers that can participate in an agreement can have implications from a competition policy perspective. In the case of cooperation agreements set up by clients (or brokers acting on their behalf), a wider range of candidate members to choose from is likely to result in a more competitive tendering process. It should be noted, however, that if members are direct competitors and, moreover, are able to position the product offered by the scheme in the market on a stand-alone basis, then the information sharing that takes place within the scheme has the potential — at least in principle — to affect the independent market behaviour of the undertakings. It is nevertheless possible that this restraint on competition is indispensable in order to achieve the efficiency gains (e.g. better terms and conditions) associated with a scheme.

In turn, our overall assessment of cooperation agreements that are set up without client involvement is more ambiguous. On the one hand, a market wide participation has the potential of providing cover for risks for which capacity would otherwise be lacking. In such situations, even if the agreement does effectively act as a monopolist in the market, it may lead to an overall welfare improvement (represented by the creation of a market for insurance cover, albeit at a relatively high premium). On the

\textsuperscript{94} See the discussion at the end of Section 4.3.5, and for further information see: Ibragimov, R. and Walden, J. (2007) “The limits of diversification when losses may be large” Journal of Banking and Finance, Vol 31, No 8, p. 2551-2569.
other hand, the coexistence of a number of smaller cooperation agreements competing with each other produces benefits in terms of lower premiums, but such benefits could be outweighed by a loss of capacity (e.g. due to the lesser degree of diversification, the aggregate capacity provided by a number of competing schemes might be lower than the one that could be provided by a single larger scheme).

In addition, we view that the mere size of a scheme and the nature of the members composing it can have important implications for its functioning. For example, a situation where a scheme member is also present in different layers of the supply chain for the same risk category (e.g. a member of a primary market scheme operating also in the reinsurance market) can be seen as a some form of vertical integration. However it should be noted that a situation in which a member of a cooperation scheme in the primary market decides to provide reinsurance for a portion of scheme’s risk, is effectively a risk-transfer mechanism by which the member can increase its risk exposure within the primary market scheme beyond the one that is pre-determined by the scheme’s sharing agreement.

Finally, we note that any assessment of potential competition impacts cannot rely solely on an assessment of how different cooperation schemes operate, but it also depends on the extent to which alternative products (other than the scheme in question) constitute available options. If such alternatives are available, one could expect that any potential inefficiency of a given scheme would be mitigated by the competitive pressure imposed by other products available in the market. It is important to stress that this is often a dynamic process. For example the “high” premiums charged by cooperative agreements that have a monopolistic position can incentivise the emergence of alternative more attractive products.

5.2.3 Rules governing the entry of new members/exit of existing members

Co(re)insurance agreements are highly likely to have standard admission criteria. As mentioned in Section 4.4.2, the key dimensions of these requirements are the following:

- the financial strength of the insurance company, determined by:
  - the credit rating of an individual insurer; and
  - the capacity of an individual insurer (e.g. the proposed capacity capital of a candidate member cannot be higher than a pre-defined proportion of its entire equity capital);
- the reputation and the associated inherent experience of an insurance company in dealing with a particular type of risk;
- the willingness to commit to premiums as prescribed by the pool in case these are determined within;
- the willingness to participate in the pool for a minimum time period;
- the ability of an insurance company to underwrite certain types of risk (e.g. a member must be authorised to write Belgian fire insurance); and
- the establishment in certain EU Member States — this is more relevant in case a pool operates in multiple jurisdictions.
Insofar as the strictness/slackness of admission criteria has an impact on both the number and the types of insurers that can participate in an agreement, these may have implications from a competition policy perspective. These impacts are discussed in more details in below in Section 6.2.

5.2.4 Liability regimes with regards to members’ insolvency

Different liability regimes have an impact on policyholder’s counterparty risk and, by determining the extent of financial solidarity between participant members. Along these lines, Reichel and Schmeiser (2015)95 identify two regimes, namely:

- A joint liability regime: solvent members commit to a joint indemnification of one (or more) insolvent members.
- A regime of several liability: substitutional indemnification from solvent members is not possible.

The importance of distinguishing between liability regimes becomes apparent in lengthy claims settlements, which ultimately expose a pool insurer within a regime of joint liability to a long-lasting counterparty risk. Similarly, the different liability regimes affect the policyholder’s counterparty risk as well since the payoffs in case of insolvency vary between the two regimes.

An implication of the above is that different liability regimes are further likely to affect the premiums charged to policy holders. In particular, the regime of joint liability requests financial solidarity among the insurers. Consequently, if insurers have fixed equity available, the regime of joint liability justifies a higher premium due to the lower insolvency costs96 for the policyholder. Inversely, if expected insolvency costs are fixed (e.g. due to regulatory requirements) the regime of joint liability results in lower equity commitment by insurers. By incorporating taxes as friction costs, the authors illustrate that the equity saving in a regime of joint liability reduces costs for the policyholder.

5.2.5 Premium determination

The specific way in which premiums are determined can act as an important signal for the potential presence of practices that restrain competition. For example, the alignment of premiums between the leader and the followers in an (re)insurance pool may raise concerns regarding potential distortions in competition: followers have low incentives to bid for the leading role and, as a result, the insured end up paying too much. Whenever such potentially concerning pricing practices are present, particular attention needs to be paid to determining whether countervailing factors exist that may justify them. For example, uniform pricing could be justifiable for the following reasons:

- alignment of premiums might be justified due to the presence of asymmetric information: if the leader is better placed to assess a certain risk, the premium can convey important information on the likelihood of such risk occurring and,

---


96 Insolvency costs are measured by the default put option.
therefore, can act as focal point for coordination among the less experienced followers; and

- in situations where risks are particularly challenging to assess, uniformity of premiums can act as an indirect form of (limited) risk-sharing between the (re)insurers participating in the scheme as it limits the possibility of some participants (i.e. those charging a lower premium) being worse off than others (those charging a higher premium) in the event a claim materialises.

We provide below a mathematical illustration that highlights the main economic considerations that should be taken into account in order to assess the extent to which the alignment of premiums within a cooperation scheme may raise concerns. We stress that this mathematical illustration serves only the goal of clarifying (through the use of some simple formulae) some of the economic considerations set out at the end of this sub-section. Moreover, the mathematical illustration is based on a number of assumptions, which represent a fair reflection of the market practices often observed in reality — but does not reflect all real-world possibilities. These are:

- The selection of a leader role is achieved through a competitive process in which several candidate leaders compete with each other by offering the lowest possible premium quote — even though in reality the competition does not depend only on price, price is one of the most important dimensions considered.

- Competition for the leader is separate from competition for the followers — from our stakeholder engagement process it has emerged that, for a given unconventional risk, the number of firms that possess the necessary expertise to fulfil a leading role is often limited. It is therefore natural to consider a situation where the formation of a cooperation agreement is done in two separate stages: in the first stage, a leading insurer is selected from a sample of competing candidate leaders; in the second stage, followers are selected from another set of insurers. We acknowledge that it is possible that a firm that has competed unsuccessfully for the leading role, ends up participating as a follower. We shall see below that the implications derived from our mathematical illustration are robust to such a possibility.

- The superior expertise of candidate leaders over potential followers is represented by their superior knowledge of the underlying risk and their greater ability to price it.

### A mathematical illustration of an economic rationale for premiums alignment

Let us consider a situation where the membership of a cooperation agreement is selected in two stages. In the first stage a leading insurer is selected from a sample of candidate leaders; in the second stage followers are selected from another set of insurers.

For the sake of simplicity, we assume that insurers are selected only on the basis of the quote offered (thus, we explicitly abstract from any quality consideration). We also assume that each member contributes the same level of cover (e.g. in a cooperation agreement with one leader and n followers, each insurer provides \(1/(1+n)\) of total cover).

In order to illustrate the benefits of premiums alignment we rely on the two following assumptions:
First, there is uncertainty concerning the risk to be insured: such risk can be “high” or “low” and, consequently, the actuarial cost (i.e. the probability of a loss occurring times the monetary value of the loss) of insuring the risk can be “high” ($c_H$) or “low” ($c_L$).

Second, we assume that leading insurers have perfect knowledge of the underlying risk — i.e. they know precisely whether the risk is “high” or “low” — whilst followers do not — i.e. they have only an expectation that risk is “high” with probability $\alpha$ and “low” with probability $(1 - \alpha)$.

The analysis is carried out under two alternative scenarios.

- Scenario 1. Followers can observe the premium charged by the selected leader before providing their quotes, so that an alignment of premiums is possible.
- Scenario 2. Followers do not observe the leader’s premium before providing their quotes so as to prevent alignment of premiums.

**Analysis under Scenario 1**

If there is sufficient competition between potential leaders (i.e. there are at least two leading insurers competing on price), then the selected leader will always charge an actuarially fair premium, i.e. a premium equal to $C_H$ (if the risk is assessed to be high), or $C_L$ (if the risk is low). Since the premium charged by the leader is observed by the followers, it serves as a signal about the true level of risk. Having learned whether the level or risk is “high” or “low”, followers compete by offering an actuarially fair premium identical to the one charged by the leader. The resulting equilibrium premiums under this scenario are:

- $P_{Leader} = P_{Followers} = C_H$, if the underlying risk is high
- $P_{Leader} = P_{Followers} = C_L$, if the underlying risk is low

Therefore, under this setting, uniformity of premiums between the leader and the followers emerges as a competitive outcome reflecting the learning process taking place through the signalling of the leader’s pricing.

**Analysis under Scenario 2**

Since the price charged by the leading insurer is not observable, competition between followers will lead followers to offer premiums equal to the expected costs, i.e. $\alpha C_H + (1 - \alpha)C_L$.

The resulting equilibrium premiums under this scenario are:

- $P_{Leader} = C_H$ and $P_{Followers} = \alpha C_H + (1 - \alpha)C_L$ if the underlying risk is high
- $P_{Leader} = C_L$ and $P_{Followers} = \alpha C_H + (1 - \alpha)C_L$ if the underlying risk is low

Therefore, competitive pricing under this setting can lead to two different situations. One where the premiums charged by followers are higher than the one charged by the leader (because followers overestimate the actual risk), and one where the premiums charged by followers are lower than the one charged by the leader (because followers underestimate the risk). It is important to note that, in both situations, some sort of inefficiency arises. In the first case the customer ends up paying more because the followers’ premium is high relative to the risk covered. In the second case consumers
Different forms of cooperation between insurance companies and their respective impact on competition

pay less because followers’ premiums do not fully reflect the level of risk and, as a result, the cooperation agreement is likely to be exposed to a greater risk of default.

The illustration above clarifies the intuitive idea that, insofar as potential discrepancies in premiums arise solely due to information asymmetries (i.e. some insurers being better placed than others in assessing a given risk), then an alignment of premiums to the one charged by the best informed insurer is a preferable option. Such alignment may also be associated with dynamic efficiencies. By matching the leader’s premium, followers can obtain reassurance that the price they charge is a fair reflection of the risk underwritten. In turn, this incentivises competition for follower roles and, ultimately, can lead to followers gaining enough experience to be able to compete for leading roles in the future.

However, it is important to acknowledge that, in reality, differences in premiums may not necessarily reflect only differences in the ability to assess risk, but may also result from differences in costs. For example, in order to be able to assess a given risk, lead insurers must bear risk-assessment and underwriting costs that are reflected into the premium quote offered. In such situations, an automatic alignment of followers’ premiums with the leader’s quote could be potentially problematic for two reasons:

- Premiums charged by less informed insurers (followers) may include a component of risk-assessment costs that have already been incurred and priced-in by the leader. This may result in cost over-recovery with customers paying multiple times for risk assessment costs that have been incurred only once.97

- Free-riding problems may arise as natural leader candidates may prefer to participate as followers. By doing so, they could enjoy the same premium without incurring the risk-assessment costs borne by the leader. Ultimately, this may result in a significant decrease in the competition for the leading role.

Before illustrating the intuition behind the two concerns described above, we note that these are not likely to be material in situations where risk assessment is not conducted by an insurance scheme member. For example, risk-assessment activities may not necessarily be a prerogative of lead insurers, but could be carried out by an underwriting agent, operating as pool manager, that analyses the risk (possibly in cooperation with the broker).98 In this setup the insurance firms do not get involved in the assessment directly.

---

97 We note that, if a firm fulfils a follower role after having competed and failed to win the leading role, concerns related to over-recovery of costs are less material because such firms will have effectively incurred risk-assessment costs.

98 See e.g. the role of NRI (Nuclear Risk Insurers) as the underwriting agent in the British nuclear risk pool at https://www.nuclear-risk.com/
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

Figure 5.3: Alignment of premiums that may cause concern

In Figure 5.3, the premium charged by the leader is decomposed into three main components:

- A component reflecting the value of expected losses, which we assume the leader is capable to assess more accurately than followers.
- A safety loading component (that the leader is also better placed to assess), which acts as a buffer against the probability of default in the event of extreme loss.
- A component reflecting the underwriting and risk-assessment costs — incurred only by the leader — that are necessary to estimate expected losses and the losses arising in case of an extreme event.

In situations such as the one described above, an automatic alignment of premiums between leader and followers may result in the latter enjoying an additional profit margin, relative to the leader. In turn, this may not only lead to clients paying an excessive premium but may also disincentivise firms from competing for a leading role and choosing to participate as followers instead. However, the above concerns could, in principle, be alleviated if premium alignment across all scheme participants concerned only the expected loss and safety loading components. This is illustrated in Figure 5.4 and can either be described as a situation in which the premiums are aligned across followers but the leader receives a “top-up” compensating for the risk-assessment and underwriting activity undertaken or, alternatively, as a situation in which followers’ premiums are discounted, relative to the one charged by the leader.

Source: Europe Economics.
The main conclusions we can draw from this discussion (and which are summarised in the table below) is that alignment of premiums between leader and followers could be rationalised as being the result of a competitive process involving firms with different risk-assessment abilities. The only residual concern associated with this pricing practice is represented by the possibility that some costs that have been incurred only by some firms (i.e. those that have competed for the leading role) are duplicated among all participating members (including followers that may not have competed for the leading role and have thus not incurred such costs). However, such concerns could be effectively alleviated by introducing some form of premium decomposition (either in the form of a top-up payment for the leader or in the form of a discounted premium for the followers).
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

Table 5.1: Potential benefits and concerns of premium alignment

<table>
<thead>
<tr>
<th>Potential benefits</th>
<th>Potential concerns</th>
<th>Premium decomposition (through leader “top-up” or followers’ discounted premiums, where applicable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>More efficient pricing: the prices charged by all scheme members represent a more accurate reflection of risk (which is best understood by the leader).</td>
<td>Over-recovery of costs passed onto customers: if risk assessment costs are reflected into the premium, then alignment of premiums across members may lead to a duplication of costs incurred only once.</td>
<td>The leader’s top-up (or the discounted premium charged by the followers) ensures that premiums reflect the actual costs incurred by each participating member and thus avoid potential cost over-recovery at the expense of clients.</td>
</tr>
<tr>
<td>Incentives to compete for follower roles: by matching the leader’s pricing choice, followers have more confidence that premiums reflect the underlying risk appropriately.</td>
<td>Lower incentives to compete for leading role: insurers that could compete for the leading role may prefer to participate as followers in order to free-ride on the risk-assessment carried out by the leader.</td>
<td>Incentive to compete for the leader position are not distorted</td>
</tr>
<tr>
<td>Dynamic efficiency: followers learn from participating in cooperation schemes that cover unconventional risks so that in the future they may be in the position to compete for a leading role.</td>
<td>Static inefficiency: lower competition for the leading role increases the chance that the premiums are significantly above marginal cost.</td>
<td>Static inefficiency is avoided.</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

5.3 Other factors affecting the role of cooperation schemes within the broader sector

Understanding the nature as well as the vertical and horizontal relations present in risk segments where cooperation schemes operate is important as it can provide insights on the correct functioning of the market as a whole. More specifically, the following features appear to be particularly relevant:

- the presence of different reinsurance layers; and
- supply-side substitutability.

These are discussed in more detail below.

5.3.1 The presence of different reinsurance layers

In order to be able to provide an assessment of the impact of cooperation schemes it is important to have a clear picture of the role that such schemes plays within the broader industry. Typically, the insurance cover of unconventional risk is provided in different layers and cooperation schemes may be present in only one or multiple layers. It is therefore important to take into consideration the following aspects:

- whether a cooperation scheme is present only in the primary market, only in the reinsurance market, or in both, and the reasons why; and
- the role played by the Government and its potential impact.
As illustrated in Figure 5.1 and Figure 5.2 market failure problems can be, at least in principle, addressed appropriately by the formation of cooperation schemes in both the primary and the reinsurance market. However, in practice, there might be market frictions that render the emergence of agreements in the reinsurance market more feasible. Several possible reasons for this are provided below:

- regulatory constraints — some cooperation schemes (e.g. nuclear pools) are mandated by the State and their operations are limited within domestic boundaries.
- cooperation constraints — coordination problems related to the geographic fragmentation of risks underwritten in the primary market could make it difficult for primary insurers operating in different jurisdictions to form cooperation agreements. Such constraints are likely to be less material for the reinsurance market given its international nature.
- sudden changes in the perception of risk — there is an important distinction to be made between:
  - market failures that are due to insurability constraints of risks that have always been known to impose particular challenges; and
  - market failures that emerge from a sudden change in the perception of risks for which cover is already provided in the primary market.

The first type of market failure results in a poorly developed primary market (i.e. primary insurers lacking the appetite or capacity to underwrite policies in the first place). The second type is typically observed in the aftermath of significant events and leads to a freezing of the reinsurance market ultimately resulting in primary insurers becoming suddenly incapable of unloading the risks of policies that have already been underwritten. In this case, the formation of cooperation agreement in the reinsurance market is needed to re-establish the correct functioning of the primary market.99

Finally, in the presence of risks for which cooperation schemes are necessary, the State often fulfils the role of insurer of last resort. The unconditional commitment of Government to cover risk liability can result in cooperation schemes not functioning at their full potential, e.g. by limiting the cover that these provide or by introducing moral hazard problems.

5.3.2 Supply side substitutability and asset-switching

Supply-side substitutability (SSS) is the ability “to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices”.100 This is an important concept because the ability to switch production into another market can impose competitive constraints on the existing producers in that market, and thus limit anti-competitive practices.

We have considered one aspect relevant to SSS in a parallel study, namely the ease with which insurers are able to switch assets in order to increase production of a particular risk segment. The key constraints in this context are:

- **Regulatory constraints** – the principle constraint in this regard are the requirements imposed by the EU’s Solvency II Directive. The key development in this regard are the risk-based capital requirements imposed on (re)insurers, which means they must value their assets on liabilities by taken into account their various underlying risks and adjust their capital holdings accordingly. Such requirements may make timely entry into a new market difficult if a (re)insurer cannot source sufficient capital to cover the additional risk. Asset-switching may also be limited by national level constraints such as the tax and accounting of surplus capital holdings, as well as geographical restrictions on access.

- **Spare capacity constraints** – asset-switching will also be affected by the amount of spare capacity the (re)insurer has, i.e. the extent to which their current capital holdings exceed the regulatory capital requirement. If they have more surplus capital, then it should be easier to substitute, as this surplus capital can be used to absorb the additional risk. If the (re)insurer does not have any surplus capital, then they would have to look at ways of reducing their risk exposure in existing markets, in order to free up capital to cover new risks in other markets.

- **Constraints on the ability to transfer risk** – as noted above, if insurers lack sufficient surplus capital, then they would have to look into transferring existing risk exposures. This could either be through traditional reinsurance or through alternative risk transfer mechanisms, either through insurance-linked securities in financial markets or through hybrid products which combine features of traditional reinsurance and financial instruments. However, the extent to which these risk transfer channels can allow for a timely switching of production may be limited. Reinsurance, for example, tends to exhibit a cyclical pattern of soft and hard markets, with the latter characterised by high prices and low availability of reinsurance. While alternative risk transfer mechanisms may provide support at these times, and provide additional support by diversifying other types of risk, they too have limitations in terms of costs, illiquidity etc.

- **Constraints imposed by current asset profile** – the current asset profile of the (re)insurer may have significant implications for supply-side substitutability, in particular, in terms of their liquidity and the current risk diversification. Those holding more illiquid asset profiles may find it more difficult to transfer risk for the purpose of switching production. Furthermore, a (re)insurer’s ability to enter a new area of risk would depend on the correlation between this new risk and the risk of its existing underwriting portfolio. If the new risk segment is positively correlated then the (re)insurer’s ability to switch may be limited unless they have sufficient surplus capital to cover the additional risk. However, if the new risk is uncorrelated, or negatively correlated, then supply side substitutability may be more realistic.

It is, therefore, important to understand how, and to what extent, cooperation schemes may mitigate or exacerbate these supply side substitutability constraints. The different cooperation schemes that exist will have different implications for a (re)insurer’s risk exposure and, therefore, on their capital requirements. Furthermore, the extent of backing these cooperation schemes get through private reinsurance and the state would also affect, the risk exposure of individual scheme members and hence their ability to switch production to other areas. Cooperation schemes are also
beneficial to the extent that they allow (re)insurers to enter risk markets that it would be infeasible to do so independently. It may be particularly beneficial to ‘followers’ who do not have the internal expertise to price the risk in question.

However, cooperation schemes may limit supply-side substitutability insofar as their members may be restricted in freeing up their assets which support their membership in cooperation schemes for which they are already a member, e.g. because of the requirement to provide assets to a central fund supporting the scheme and to serve a specified length notice period before exiting the scheme. (Re)insurers may also have difficulty in joining cooperative schemes in order to enter new risk segments, because of the entry requirements for joining the scheme. These requirements could be quite specific to the type of cooperation scheme in operation, e.g. limits on the amount of capital that can be invested in the pool relative to the (re)insurer’s capital, minimum time requirements for participation in the pool, requirements on geographical and sectoral activity, and limits on the amount of assets that can be hold which are exposed to certain risk types. Overall, therefore, these features of cooperation schemes could exacerbate constraints on asset-switching.
6 Synthetic Analysis

This chapter aims at applying our conceptual framework (Section 5) to the material gathered from our literature review (Section 4), legal analysis (presented in Appendix 9) and stakeholder engagement in order to:

- Provide a comparison of different forms of cooperative (re)insurance structures.
- Examine the impact of different inherent features on scheme efficiency.
- Identify features potentially non-essential to maximising the efficiency of scheme functioning.

This analysis is conducted through the prism of key aspects of the formation and functioning of co(re)insurance schemes, with the exception of mandated pools. The latter, given their policy-driven instigation are excluded from the analysis. They are, however, considered insofar as they provide an additional option for insurance coverage that competes with other co(re)insurance and stand-alone (re)insurance options.

This section is organised as follows:

- First, we recap the primary reasons for the necessity of co(re)insurance schemes in dealing with different types of unconventional risks. In so doing, we also illustrate the dynamic nature of these risks.

- Second, we present our assessment criteria which are based on the application of our conceptual framework on key scheme mechanisms, namely:
  - the extent to which the formation phase of the scheme contributes to enhanced efficiency; and
  - the distinctive features of schemes that set out the nature of interaction between participants.

- Third, these criteria are used across co(re)insurance types based on evidence from all the research tasks we have engaged in thus far.

- Lastly, based on the outcome of our comparison, we conduct an analysis aimed at identifying non-essential features of cooperation schemes.

6.1 General description and necessity of schemes

As identified in Section 4.3.3, it is common for unconventional risks to be covered by cooperation schemes. For such risks, a single insurer and delegated underwriting procedures in the open market may fail (or be unwilling) to provide appropriate coverage. This is to a large extent due to:

- the losses arising in case of event occurrence being too large to be absorbed on a stand-alone basis, or the coverage offered being constrained by very small cover limits ("capacity constraint"); and

- the presence of significant margins of error (e.g. due to lack of historical data) when assessing the implications of the risk and/or of its probability of occurrence ("assessment constraint").

Moreover, as noted in Section 4.2.1, co(re)insurance pools, can be more suitable for clients wishing to cover new risks (where it is difficult to assess the probability of occurrence and the potential claims, i.e. mainly assessment constraints, whereas ad
hoc agreements are suitable for the bespoke needs of clients wishing to cover a precise risk under and within a given capacity (i.e. mainly capacity constraints).101 Drawing from academic literature and observed market practices, we have identified as unconventional (see Section 4.6.1) those risks related to:

- Cyber security;
- Natural catastrophes;
- Nuclear incidents;
- Terrorism; and
- Ecological damage (e.g. due to an industrial accident or explosion).

The particular aspects of these risks that limit their insurability are further depicted in Table 4.1. However, the unconventionality of the above risks should not be perceived as static. Rather, there is a more dynamic interplay as, for instance, a risk that is generally not perceived as unconventional could suddenly become so in the event of an abrupt change in its characteristics (e.g. rapid rise in the average size of claims). This is particularly the case for cyber risk as, originally, risks related to cyber security were primarily placed within the broader “business continuity” risk category. However, the aggravated uncertainty over the operational and monetary implications of cyber breaches have resulted in an increased interest towards treating cyber risk as a discrete product. This transition has progressed further in the USA than in the EU, where such a shift remains nascent.

A similar effect may be observable in some parts of the natural catastrophe market, where climate change may be increasing unconventionality (e.g. by increasing reliance on models and lessening reliance on historic data).

Similarly, some risks are broad in scope. This is particularly the case for risks related to natural catastrophes. Flood risk is more unconventional and difficult to insure in the Netherlands, say, than in most other countries — or, indeed, other forms of natural catastrophe risk (e.g. windstorm) within the Netherlands.

Lastly, for risks such as those related to terrorism, there can be a cyclical element related to the immediate past (e.g. terrorism cover was harder to arrange immediately subsequent to 9/11 than several years later).

The dividing line between conventional and unconventional risks can shift based on the market and actuarial dynamics. This is depicted in a simplified way below. The length of the arrows indicates the direction of travel. (NB: The size of the bubbles does not mean anything beyond the fact that any such locations are approximate. They do not represent an approximation of market size).

101 See e.g. European Commission (2014) “Study on co(re)insurance pools and ad hoc co(re)insurance agreements on the subscription market”
6.2 Assessment criteria

In order to assess co(re)insurance arrangements we consider several key scheme mechanisms related to:

- the formation phase of the scheme; and
- the distinctive functional features of the scheme.

The assessment is conducted under the prism of the effects of the mechanisms pertaining to the above dimensions on efficiency (i.e. both in terms of the contribution of schemes to the ability of the market as a whole to adequately provide coverage and the associated costs).

6.2.1 Formation phase

As noted in Section 5.2.1, the dynamics involved in the formation phase of cooperation schemes provide important information on the intensity of competition between market players, which is expected to impact scheme efficiency. In this part of our assessment approach, we consider the following dimensions:

- **The initiator of the formation of the scheme** — the party that initiates scheme formation plays an important role in our assessment. More specifically, in the schemes that are formed with explicit client involvement (e.g. ad hoc agreements) one would expect efficiency concerns not to be an issue provided that the clients’ interests and needs are adequately reflected during the scheme formation phase (the extent to which this is the case is discussed further below). In the presence of schemes that are formed without the client’s involvement, an assessment of the potential impacts depends not only on the process used for selecting the scheme members, but also on the extent to which alternative products (other than the scheme in question) are available as (re)insurance options. If this is the case then one could expect that any potential inefficiency of the scheme would be mitigated as a result of the competitive pressure imposed by other products available in the market. It is important to stress that this is also a dynamic process. For example the “high” premiums charged by cooperative agreements that have a monopolistic position
could incentivise the emergence of alternative more attractive products. This is especially evident for the natural catastrophe segment which has witnessed the emergence of new market solutions, i.e. ART.\textsuperscript{102}

- **The process for the selection of members** — the particular selection process followed is important because it serves the purpose of providing sufficient capacity for covering a specific risk, whilst ensuring that such capacity is provided under competitive dynamics. The majority of cooperative schemes are characterised by a leader-followers structure and therefore the presence of a tendering process to select a firm that is qualified to lead and adequately respond to the requirements of this role is essential for the efficient provision of risk coverage. In principle, the wider the range of tenderers that could potentially act as leaders the more competitive the process would be expected to be. However, it is possible that the number of firms possessing the skills and reputation needed to fulfil a leading role is limited for certain risks, which implies that the selection outcomes may gravitate towards a limited number of firms. Provided that the selection of the leader, even among few candidates, is competitive, the process for the selection of followers is not likely to bear as much weight. Moreover, as Solvency II ensures at least the financial solvency of insurance undertakings, thereby limiting insolvency concerns in case of participation in a scheme, admission rules based on credit ratings could be unnecessarily restrictive.

- **The types of insurers participating in the schemes** — if members are direct competitors and, moreover, are able to position the product offered by the scheme in the market on a stand-alone basis, then the information sharing that takes place within the scheme has the potential — at least in principle — to affect the independent market behaviour of the undertakings and, hence, the efficiency of the market for the placement of the risk in question overall. It is however possible that this restraint on competition is indispensable in order to achieve the efficiency gains (e.g. better terms and conditions) associated with a scheme.

- **Broker remuneration from insurers** — notwithstanding that a broker may not always be involved in the scheme formation phase, the type of broker remuneration should, in principle, not affect the adequacy of risk coverage. However, commissions agreed between insurers and brokers (acting for third-party clients) that are dependent on commercial success (i.e. contingent commissions) can provide an incentive for the brokers to prefer insurers with which such remuneration contracts can be concluded. Ultimately, this would lead to a conflict of interest between the objectivity of advice and the brokers’ own financial interests. The possibility for such outcomes is limited, however, provided the BIPAR principles are followed.\textsuperscript{103} Furthermore, in the commercial business segment — where insurers, naturally, have a good understanding of the market and its

\textsuperscript{102} Catastrophe bonds (also known as cat bonds) are tradeable securities that transfer a specified set of natural catastrophe risks from a sponsor to investors (e.g. hedge funds, catastrophe-oriented funds, and asset managers). They are issued by insurance companies through an investment bank and usually reach maturity within three years. If no catastrophe occurs during that period, the insurance company pays a coupon to the investors. If a catastrophe does occur, the principal of the bond is forgiven and the insurance company uses this amount to settle claims with policyholders.

\textsuperscript{103} We note that in some European countries contingent commissions are no longer allowed, e.g. in Denmark.
products and a loss of trust and reputation can lead brokers to lose important clients — any exploitation of misaligned incentives by brokers is significantly less likely than in the retail sector.

- **Negotiation on terms and conditions between members** — a competitive and efficiently operating market should be characterised by a dynamic process in the determination of the final terms and conditions pertaining to the agreement. In the presence of a tendering phase (e.g. issued by a client /broker for the selection of the leader and followers in ad hoc agreements/broker-led pools, or by a lead insurer for the selection of followers in insurer-led pools, or, where applicable, amongst insurance undertakings in a pool to select the leader) such a process would involve undertakings responding to the invitation, proposing amendments and settling on a final set of conditions which may or may not be uniform across all participating insurers.

- **The extent of client involvement in the formation phase** — closely related to the previous dimension, a considerable extent of client involvement in the determination of the terms and conditions for the placement of a risk, as well as the selection of insurers and their respective roles should be regarded as a factor enhancing the efficiency of a given scheme.

- **The presence of a strict leader-followers structure** — in a healthy market one would expect a dynamic exchange in the companies comprising the leader and follower roles. Moreover, to varying extents, participation in a co(re)insurance scheme enables knowledge sharing among members, which enhances the followers’ pricing capabilities. In the long run, this dissemination of knowledge could result in an increasing number of companies being able to compete for leader position or form pools within which they are leaders and compete with the incumbent pools (although we note that not previously established leaders could also suffer from reputational concerns around the ability to attract adequate capacity). Ultimately, this process should ameliorate the functioning of the market and benefit purchasers.

The chart below illustrates how the dimensions described above could be used in order to conduct a high-level assessment.
Outcome 1— refers to situations in which cooperation agreements that are formed without any client involvement (e.g. broker-led pools, insurer-led pools, mandated pools) experience competitive pressure from alternative products (e.g. ad hoc agreements, or stand-alone undertakings’ offers).
- Outcome 2 — refers to situations where cooperation agreements that are formed without client involvement represent the only option for insurance cover. In this situation, whether or not potential competition concerns are material would depend on two aspects:
  - First, on whether the procedures that apply during the identification of members at the formation phase of the scheme are adequately competitive.
  - Second, on whether product innovation ensures that competitive dynamics apply in the longer term (e.g. through the emergence of new insurance options).

- Outcome 3 — refers to an ad hoc agreement formed through a competitive tendering process involving a wide range of market players. The selection of the leader by a competitive process is fundamental to produce the efficiency outcome foreseen in the mathematical illustration presented in Section 5.2.5.

- Outcome 4 — refers to an ad hoc agreement formed through a tendering process involving a selected number of tenderers and in which the pre-selection is based on the brokers’ expertise (e.g. knowledge of which insurers have the reputation and expertise needed to adequately fulfil the leading role). The lack of a misalignment of the broker’s incentives with that of the client does not give rise to any concern. However, a broker may not always be present in the formation phase of an ad hoc agreement (hence the dotted lines surrounding this section).

- Outcome 5 — refers to an ad hoc agreement formed through a tendering process involving a selected number of tenderers and in which the pre-selection is based on the brokers’ expertise (e.g. knowledge of which insurers have the reputation and expertise needed to adequately fulfil the leading role). A misalignment between the broker’s incentives and those of the client may give rise to conflict of interest concerns as to whether this pre-selection represents the best possible outcome from the client’s perspective. However, as explained above, the client’s greater sophistication (cf. retail customers) and brokers’ reputational concerns, are likely to largely mitigate the likelihood of such concerns. Moreover, a broker may not always be involved at this stage of the formation phase of an ad hoc agreement.

- Outcome 6 — refers to an ad hoc agreement formed through a tendering process involving insurers that would not be able or willing to provide cover on a stand-alone basis. In this situation, the scheme fulfils the crucial goal of providing capacity that would otherwise not be available.

- Outcome 7 — refers to an ad hoc agreement formed through a tendering process involving insurers that would also be capable to provide cover on a stand-alone basis. In this situation, the information-sharing that takes place within the scheme has the potential to have detrimental impact on the independent market behaviour of the undertakings. Therefore, concerns on the optimality of the product arise if the client has limited ability to negotiate the specific terms and conditions.

- Outcome 8 — refers to an ad hoc agreement formed through a tendering process involving insurers that would also be capable to provide cover on a stand-alone basis. The client’s ability to negotiate the terms and conditions of the final product can mitigate any concerns associated with the possibility of information-sharing affecting the independent market behaviour of the undertakings.
6.2.2 Functional features

The precise design of a cooperation agreement plays a key role in assessing its overall functioning. While the precise functional features pertaining to a co(re)insurance scheme differ on a case-by-case basis (and thus impede attempts to incorporate in the assessment all functional elements identified in Sections 5.2.2 to 5.2.5), several generic characteristics emerge. Accordingly, our assessment involves the following dimensions:

- **Sharing arrangements** — it is generally agreed by all categories of stakeholders, as well as evidence from literature, that cooperation (re)insurance agreements are necessary in order to provide (re)insurance for risks whose characteristics would impede their placement on a stand alone basis (See section 4.3.3). With regards to the extent and nature of the sharing arrangements within an agreement (i.e. purely claims-sharing, or both claims- and premium- sharing), these should not be regarded as constraining its efficient functioning insofar as:
  - it is necessary to allow its members to gain knowledge and provide a type of (re)insurance that they would not have been able to provide otherwise; and
  - the members of the agreement are not actual or potential competitors in the relevant product market, due to their inability to individually cover the relevant risk categories.

- **Uniformity of terms and conditions** — insofar as they remove the possibility of participation in a scheme in a manner which is tailored to the specific needs of each member, uniform terms and conditions may restrict the number of potential participants and, hence, the overall capacity that the scheme can provide. However, the presence of uniform terms and conditions (e.g. liability of members) can result in significant efficiency implications (e.g. in relation to the facilitation of claims settlement procedures).\(^{104}\)

- **Alignment of premiums** — although premium determination is part of a scheme’s overall terms and conditions, particular assessment is required in relation to the potential merits or limitations of premium alignment. An alignment of the followers’ premiums to the one charged by the leader can be justified given:
  - the superior ability of the leader to efficiently price the risk. Such a possibility also enhances the potential for followers to benefit from knowledge sharing and be able to price similar risks in the future; and
  - the potential to limit the possibility that certain participating insurers are worse off in case an excessive claim materialises.

---

As described in the mathematical illustration presented in Section 5.2.5, the selection of the leader by a competitive process supports the selection of a high-quality leader. That in turn supports the ability of the leader to efficiently price risk. On the other hand, premium alignment could still — at least in principle — give rise to some residual concerns associated with the possibility of cost over-recovery within the scheme. However, the presence of a “top-up” payment compensating the leader for such costs, or of a discount lowering the premium proceeds of followers, decreases significantly the materiality of such concerns (see Section 5.2.5).

- **Renewal frequency and rules renewal frequency** — Provided that the process for the coverage of a risk is competitive, frequent replacement in the market should be regarded as enhancing scheme efficiency. Such an assertion would be further strengthened given an increasing ability of followers over time to compete for leader position, or establish pools themselves in which they are leaders. One factor, however, that could impede this outcome relates would be the presence of a ‘lead clause’ under which the position of the leader cannot be challenged upon renewal.105 It is unclear whether these clauses are common practice. Insofar as they are used, such arrangements could ultimately prevent reductions of premiums or improvements of conditions for the policyholder. Nevertheless, there is also the possibility that the customer does not wish for frequent renewal periods so as to minimise uncertainty over insurance coverage.

### 6.3 Assessment of insurer-led pools

This section presents the findings of our analytical tasks with regards to insurer-led pools. First, we present the general characteristics of the formation and functioning phases of these schemes, followed by a discussion over their respective efficiency implications. Lastly, we identify scheme mechanisms that may give rise to concerns.

#### 6.3.1 Formation phase characteristics

Insurer-led pools are set up directly by insurance undertakings, in which one will act as the leader within the pool, albeit likely responsible to a pool committee representing the pool’s members. Our stakeholder engagement suggests that there are cases where decisions within a pool are made unanimously by a committee composed of all pool members.

The committee addresses all issues pertaining to the function of the pool (e.g. amendments in cover limits proposed by brokers, underwritings distribution across members and extensions) which may be brought to its attention by a secretariat exclusively affiliated with the pool and financed by its members. Occasionally, the secretariat may also be assigned the task to calculate the pool’s premium.

As regards the pool formation process, this is on a case-by-case basis. The selection of the leader does not in all cases involve a tendering phase. The identification of

---

105 These clauses might exist only in some markets and in particular Member States. For instance, such clauses were found within the “Model” general conditions for guarantee insurance, the machines-business interruption insurance, the electronic insurance and the building stock insurance of The German Insurance Association. Available at: [http://www.gdv.de](http://www.gdv.de). These model terms are not necessarily applied, even by German insurers. However, they have appeared in cases, e.g. Higher Regional Court Cologne, VersR 2008, 1673; Higher Regional Court Hamburg, VersR 2008, 1249; [2014] EWHC 163 (Comm) (UK).
followers could involve a tendering phase, or it may be restricted to insurance undertakings with whom the leader has successfully collaborated in the past, or it may be composed of the insurance undertakings involved in the leader’s selection (or some combination of these).

Our stakeholder engagement has indicated that there is a variety of risks, both conventional and unconventional, that are covered by insurer-led pools in Europe. The rationales for scheme formation differ to some extent although similarities exist. The latter mainly relate to the limited willingness (risk appetite) to underwrite these risks or capacity of insurers. An additional factor revealed during our stakeholder engagement relates to the reinsurance premiums charged, which can be considered prohibitively expensive.

Typically, alternative primary insurance options to insurer-led pools do exist and include:

- Stand-alone (mainly large) insurance firms.
- Mutual insurance associations, which are not licensed insurers (e.g. EMANI, ELINI where the owners are European energy firms).
- Group captives.¹⁰⁶
- Broker-led pools.
- Ad hoc agreements.
- Alternative risk transfer mechanisms (e.g. cat bonds and other capital market solutions).¹⁰⁷

However, the extent of alternative options available greatly depends on the nature of the risks in question. In particular, there are a limited number of alternative options with regards to nuclear risks – with limited capacity – resulting in the latter being consistently covered by pools. This is mainly due to the considerable size of claims that would be sought in case of event occurrence. As a result of the limited availability of alternative options, global mutualisation of nuclear risk is observed. For instance, nuclear pools from one Member State or even the USA may participate in pools in another Member State and vice versa.

Although price is not the sole determinant for a buyer’s final scheme selection,¹⁰⁸ as an overarching observation, pools are considered to be relatively expensive. In particular, evidence from our interviews with commercial buyers suggests that pools’ premiums are consistently higher relative to alternative options. In order to address this issue, commercial buyers of unconventional risk insurance frequently use a tendering process, either with the help of a broker or done in-house, inviting potential insurance providers, including pools, to tender for a given capacity that needs to be achieved. The success of this approach, however, depends to a great extent on the size of the purchaser. In particular, smaller commercial buyers are likely to struggle in their attempts to achieve a wide variety of available options. More specifically:

---

¹⁰⁶ Captive insurance is a type of self-insurance in which insurance companies are established by a parent group with the specific objective of covering the risks to which the parent is exposed. Captive insurance companies may also insure the group’s customers.

¹⁰⁷ These are most relevant as an alternative in Natural Catastrophe, although ART has also been used on terrorism risk, e.g. around FIFA World Cup 2006.

¹⁰⁸ Other factors, such as the coverage offered or the claims handling processes, have also been suggested as important determinants during our interviews with commercial buyers and insurance undertakings participating in schemes.
• Small domestic firms whose operations are not geographically spread across multiple jurisdictions cannot leverage between countries when searching for the appropriate insurance provider.

• Small firms are unlikely to possess group captives of sufficient size, thus increasing reliance upon pools and the capacities that these may offer.

• Mutual insurance associations, although composed of many members and thus adequately diversified internally, are often subject to contingent liability should there be claims. Ultimately, this may result in mutuals’ members limiting the extent of their participation and, hence, the amount of capacity offered.

Moreover, the stakeholder engagement also indicated that small buyers face competitive constraints in their attempts to effectively negotiate the total amount of coverage sought, the premiums charged and/or other terms and conditions put forward. More specifically:

• The average coverage that small players are likely to seek insurance for ranges between €500 million and €1 billion. In turn, the total amount of capacity for a loss event offered by mutuals usually amounts to €600 million. Thus, the constraint being imposed on small players relates to the fact that the premium associated with the €600 million coverage is used to calculate the contingent liability exposures. Placing the relevant amount in their books can be a significant issue for the buyer’s solvency as the actual size of the amount is uncertain, ultimately resulting in obtaining less than maximum/optimal coverage.

• The capacity provided by new market entrants is limited and amounts to $100-150 million per event.

• Small buyers are not likely to have insurance captives to provide part of coverage and, thus, increase their negotiating power.

• Pools are capable of buying reinsurance globally, which should allow them to provide capacity where the remaining options cannot. However, the prices quoted when not buying the full capacity of the pool are greater, thus effectively penalising small buyers for seeking less than maximum cover. This tendency, however, can be rationalised given the uncertainty over the actual amount of total losses incurred in case an event materialises. Thus, focus is given on what may be considered as the ‘optimal’ cover, which is usually the maximum available cover provided.¹⁰⁹

Overall, the above limit the ability of smaller commercial buyers to mix capacities and diversify their exposures across multiple insurance providers at a sensible cost.

6.3.2 Functional features

It is usual for insurer-led pools to be characterised by uniform terms and conditions, including the calculation of a premium and the distribution of proceeds and/or claims among participants.¹¹⁰ These terms and conditions are specified by the leader during the formation phase. In principle, potential followers can propose amendments until one final set of uniform rules is agreed upon.

¹⁰⁹ In theory, depending on the way the risk is assessed, maximum and optimal cover should coincide.

¹¹⁰ See Section 4.6.2
Among the terms and conditions, the estimation of premiums can be conducted by the leader, or can be outsourced to a secretariat. As data for several unconventional risks (e.g. nuclear, terrorism) is to a large extent unavailable, in order to calculate the premium pools usually rely on a number of different methods. In this respect, the possibility to actually observe harmonised premiums across clients is very limited.

Historical underwriting evidence for similar risks is used whenever this data constitutes an appropriate proxy. This might be a useful approach for say pricing cyber risk, where analysis of comparable risks may be based on historical underwriting data for catastrophic risks (e.g. earthquakes, floods). However, since the availability of such comparable risks is limited, premiums are often determined on the basis of theoretical actuarial simulation models, which may be purchased from specialised actuarial agencies, or developed in-house.\(^\text{111}\)

The main challenge, however, is securing coverage as the extent to which pools can cover the maximum losses if an event occurs cannot be accurately assessed and remains a hypothetical question. Most frequently, losses and premiums are distributed among pool members in a fixed percentage.

The typical duration of a co(re)insurance arrangement ranges between 1-3 years. Our interviewed stakeholders indicated the presence of a trade-off inherent in the minimum renewal period. On the one hand, longer renewal periods offer greater security and protection from current market conditions to policyholders. On the other hand, given the presence of competition in the primary insurance market, a shorter renewal period may facilitate the underwriting of a policy under more favourable terms.

The underwritings of the pool as well as the corresponding premiums are predominantly distributed across participating insurers in a pre-determined manner. In this sense, pools can be pure claims-sharing arrangements, as well as arrangements involving the sharing of both premiums and losses. There may exist penalties in case of early exit from the agreement, but these tend to differ on a case-by-case basis. Similarly, retention levels and cover limits also vary. For instance, in the UK, pools are particularly restricted in terms of retention levels as there is not much flexibility to retain losses through other vehicles. On the other hand, cover limits are not an issue in the UK as these are the largest in this jurisdiction.\(^\text{112}\)

In terms of reinsurance, not all pools are reinsured. This is mainly due to the fact that, given the inherent mutualisation of risk, coinsurance may be perceived as a substitute to reinsurance. Noticeably, our stakeholders engagement revealed that large insurance groups that participate in pools may also be involved in reinsuring the same pool. By doing so, insurers can effectively re-balance the risk sharing arrangements of the pool and increase the amount of risk underwritten, depending on their appetite.

### 6.3.3 Efficiency implications

In this section we discuss how the above features of insurer-led pools interact with efficiency. We are aiming here to generalise — naturally this means that on a case-by-case basis some or all of the efficiency arguments presented below might not fully apply.

As mentioned above, insurer-led pools are set up by insurance undertakings or by underwriting agencies. Typically an insurer will act as the leader within the pool. Whilst there is not in all cases a tendering process for the selection of the leader, the

\(^{111}\) This paragraph draws heavily on our stakeholder engagement.

\(^{112}\) This paragraph draws heavily on our stakeholder engagement.
formation of the pool can increase market efficiency by introducing a new coverage option for risks where such cover is lacking or limited.

In this respect, the presence of potential competitors in a pool need not impede efficiency, insofar as it is essential for the provision of coverage and product provision on a stand-alone basis is infeasible. Similarly, the likely non-amendable nature of the terms and conditions of insurer-led pools (given that these are specified by the leader) is also less likely to affect efficiency, insofar as their acceptance by followers ensures the placement of an additional risk coverage option in the market. It might even be the case that uniformity in the terms and conditions specified by the leader, including premium determination, increases efficiency by rendering other aspects of the scheme’s operations (e.g. claims settlement processes) more functional.

As the primary rationale for the formation of insurer-led pools is to provide insurance options in areas where these are limited (see Section 4.3.3), thereby increasing market efficiency, client involvement is not necessary as industry-driven solutions create such capacity. In this sense, the leader-followers structure of insurer-led pools allows the pool to cover risks for which only a few (leading) players have the required knowledge to price. Similarly, pooling risks (irrespective of whether premiums are also shared) implies a diversification benefit, which is ultimately expected to increase the available capacity for unconventional risks in the market.

Lastly, the ability to renew contracts frequently increases efficiency where the knowledge sharing effects inherent in pooling arrangements should allow new leaders and schemes to emerge over time. Thus, in principle, frequent resubmissions would result at least in more cost-effective placements of a given risk given the concurrent increase in the extent of competition in the relevant market. However, clients may prefer a longer renewal period as a form of hedging against the possibility of sub-optimal coverage during the time of resubmission.

6.3.4 Identification of concerns over insurer-led pools

The above discussions allow us to identify potential areas of concern over insurer-led pools. Overall, such schemes are characterised by a significant degree of heterogeneity. Thus, an adequate assessment of the inherent formation and functioning dynamics, including the extent and nature of sharing, needs to be conducted on a case-by-case basis. There are certainly efficiencies involved in such cooperative schemes and, occasionally, it can be the case that insurance provision would be problematic in their absence. This is particularly the case for nuclear- and terrorism-related risks, which are mainly covered by pools.

Insurer-led pools are formed directly by insurance undertakings in which one of them acts as a leader. The selection of the leader does not in all cases involve a tendering phase. The absence of a tendering process for the selection of the leader may result in the charging of relatively high premiums. Indeed, an interview with a client of co(re)insurance schemes suggested that, relative to alternative placement options, pools are generally more expensive. It must be noted that, even so, insurer-led pools may represent the only option available to insure a specific risk and therefore, any potential costs associated non-competitive pricing may be offset by the provision of additional capacity that would be otherwise unavailable. When there are more than one insurance undertaking capable of acting as leader and/or there are not sufficient competitive pressures on the market outside the pool, a way to ensure an efficiency-maximising outcome could be a premium-based competitive process for the designation of the leader.

Moreover, in case of absence of a tendering process for the identification of followers, there is the potential for a concentrated placement of several unconventional risks among few undertakings. In the absence of reputational elements (e.g. ease of claims
settlement processes) that necessitate the participation of specific insurers this could result in collaborations between competitors with significant market shares in the relevant product markets.

In addition, there is limited scope for negotiation with a client or followers over an insurer-led pool’s terms and conditions. This may restrict commercial buyers, particularly smaller ones, in their attempt to mix capacities and diversify their exposures. It may also limit the extent to which potential followers can participate and benefit from knowledge sharing within the pool. Similarly, penalties in place for buying less than maximum coverage can also limit buyers’ diversification preferences.

On the other hand, the increased knowledge sharing among members in insurer-led pools, which should be heightened under the presence of an administrative committee composed of all members, enhances the potential for more insurance undertakings to increase their pool administration and pricing capabilities. Ultimately, this could allow them to act as a leader in other insurer-led pools, or lead in broker-led pools and ad hoc agreements in the future. Thus, the available options for the placement of a given risk would increase, at the benefit of purchasers. An element that might restrict this effect, however, relates to cases where premium determination is entirely outsourced to a secretariat, thus limiting the potential for members to enhance their pricing expertise.

The above are further reflected in the following table:

**Table 6.1: Assessment of insurer-led pools**

<table>
<thead>
<tr>
<th>Scheme Dimensions</th>
<th>Dimension characteristics</th>
<th>Efficiency effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formation phase</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formation initiator</td>
<td>Formation initiator: Insurance undertakings with lead insurer</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Process for selection of members</td>
<td>Process for selection of members: Tender for selection of leader does not always apply. Tender for selection of followers may or may not be used</td>
<td>Neutral (but potential inefficiency without tendering in leader selection)</td>
</tr>
<tr>
<td>Type of participating insurers</td>
<td>Type of participating insurers: Both competitors and not competitors</td>
<td>Neutral</td>
</tr>
<tr>
<td>Broker remuneration from insurers</td>
<td>Broker remuneration from insurers: Does not apply</td>
<td>Does not apply</td>
</tr>
<tr>
<td>Negotiation of terms and conditions between members</td>
<td>Negotiation of terms and conditions between members: Limited</td>
<td>Neutral</td>
</tr>
<tr>
<td>Client involvement</td>
<td>Client involvement: Absent</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Leader-followers structure</td>
<td>Leader-followers structure: Static</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Distinctive functional features</td>
<td>Sharing arrangements: Risk-sharing, premium-sharing or both</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td></td>
<td>Uniformity of terms and conditions: Typically yes</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td></td>
<td>Alignment of premiums: Typically yes</td>
<td>Potential inefficiency (in absence of tendering process)</td>
</tr>
<tr>
<td></td>
<td>Renewal frequency: Typically 1-3 years</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Source: Europe Economics.
6.4 **Assessment of broker-led pools**

This section presents the findings of our analytical tasks with regards to broker-led pools. First, we present the general characteristics of the formation and functioning phases of these schemes, followed by a discussion over those identified mechanisms that may give rise to competition concerns.

### 6.4.1 Formation phase characteristics

Our interviewed stakeholders expressed the view that, over the recent years, the insurance brokerage business has departed from its traditional scope of intermediation for the placement of individual risks towards a state where brokers, mainly the largest ones, also build entire portfolio solutions. This is the case with broker-led pools (also known as line slips in the UK) who are set up and most frequently administered by brokers. Such solutions increase brokers’ income, yet at the expense of insurers who are left with fewer means to attain adequate risk diversification.

In order to identify pool participants, brokers may engage in a tendering process or contact insurance undertakings directly taking advantage of their wide business network. However, for unconventional risks, the number of insurers that can satisfy leader requirements is rather limited. In particular, evidence from our stakeholders suggests that there exist four to five insurers that could be leaders in schemes designed for unconventional risks.

Once a leader has been identified, a common set of rules and terms, including premium calculation and distribution, is drafted and subsequently communicated to followers. In principle, potential followers can propose amendments in the rules pertaining to the agreement and negotiations occur until one final set of uniform guidelines are determined. In particular, uniform terms and conditions have been described during our interview with a brokerage firm as “withstanding the test of time”. This can be attributed to the leader’s expertise in price setting and the value added from the negotiation that precedes the formation of the pool.

In broker-led pools the degree of commitment and involvement of pool members once the scheme starts functioning is typically low as key activities (e.g. sales, underwriting, claims settlement) are primarily performed by the broker and to a lesser extent by the lead insurer (e.g. premium determination). Therefore, participation in the pool for followers may be restricted to solely providing capacity. Evidently, this limits the extent of knowledge sharing within the pool.

### 6.4.2 Functional features

A distinctive functional feature that separates broker-led pools from insurer-led pools is the fact that each underwriting may be subject to acceptance by the leader insurer. Alternatively, the broker may be authorised to accept certain risks on certain terms and within certain limits on behalf of the participating insurers under a DUA. Moreover, the premium for each underwriting differs as it is calculated on a case-by-case basis by the leader for each risk underwritten. Therefore, uniformity in the terms and conditions is maintained with the exception that it is made conditional on the dynamics of each line of business directed within the pool.

In order to calculate the premium the leader may engage in similar methods as the ones discussed above (e.g. analysis of comparable risks). It could be argued that, given the superior information held by brokers (e.g. historical data, general trends in demand for unconventional risk insurance) their presence in the scheme would in principle facilitate this process and render pricing more efficient. However, this is

---

113 See Section 4.6.2.
unlikely to be the case as it could dilute the broker’s negotiating power when interacting with insurers in the formation phase of the scheme.

The broker’s remuneration varies. The starting point is a commission although sometimes brokers may be awarded alternative types of remuneration. The latter may involve contingent commissions. However, in our stakeholder engagement, an insurance company (which frequently acts as the leader in cooperation schemes) indicated it was cautious of such broker remuneration clauses (at least between broker and insurer, although ultimately concerns about potential conflicts of interest at the broker are on a case-by-case basis). In particular, it is not infrequent for insurers to refuse participation in a pool, or make their participation conditional on key changes in the functional features of the scheme, including the broker’s remuneration. Occasionally, such non-standard terms may relate to additional services provided by the broker to the client, such as risk assessment, drafting white papers and premium recovery.

Similar to insurer-led pools, policy renewal usually takes place every 1-3 years. Moreover, given the limited involvement of follower insurers in the functioning of the scheme, replacement of pool members is easy and, in addition, it is usual for broker-led pools to have limited entry requirements. Lastly, similar to insurer-led pools, reinsurance may occur covering either the entire scheme, or the individual insurers’ risk proportions.114

6.4.3 Efficiency implications

In this section we focus solely on those features of broker-led pools whose efficiency impacts are expected to differ, relative to those specified in Section 6.3.3. In particular, given the limited extent of knowledge sharing and the heightened administrative role of the broker within broker-led pools, efficiency improvements sourced from uniform terms and conditions are likely to be present, yet of reduced importance. As before, we are aiming here to generalise, and on a case-by-case basis some or all of the efficiency arguments presented below might not fully apply.

There are, nevertheless, several aspects of broker-led pools that may be perceived as increasing their cost effectiveness. In particular, additional efficiency benefits are likely to stem from:

- The presence of a competitive tendering process for the identification of the leading insurer.

- The fact that each line of risk is subject to approval by the lead insurer before being underwritten by the pool, thus ensuring the stability of the scheme and the expectation that the premium quoted will be reflective of the client’s idiosyncratic characteristics.

Lastly, particular attention needs to be paid to the remuneration that brokers receive from insurers in such schemes and, specifically, the presence of contingent commissions (these are discussed in more detail in the next section).

6.4.4 Identification of concerns over broker-led pools

Similar to insurer-led pools, broker-led pools are highly heterogeneous and a precise assessment of the inherent extent and nature of sharing needs to be conducted on a case-by-case basis. As with the initiation of insurer-led pools, the formation of broker-led pools is associated with efficiency improvements.

114 This paragraph relies on our stakeholder engagement.
More specifically, the presence of a dynamic process for the selection of leaders (i.e. tendering process) is expected to increase further the efficiency of the scheme and render it more appealing to commercial buyers, relative to alternative options. However, since the involvement of a broker in the formation phase constitutes an additional cost layer, the potential efficiency gains achievable through the use of a broker might in principle be offset by the additional costs of the brokerage service. This is likely to be true especially in those situations where the number of insurers that have the technical expertise to act as a leader is very limited.

Another market-wide element that may restrict such an outcome is the currently limited number of insurers that could potentially be leaders in schemes addressing unconventional risks. Moreover, since in broker-led pools the involvement of followers is often limited to providing capacity (as opposed to being actively engaged in pricing, risk-assessment, or other administrative tasks), knowledge sharing within the pool might be minimal. By extension, this limits the possibility for followers to gain sufficient expertise to become able to compete for leader position in the future.

Similar to insurer-led pools, there is limited scope for negotiation with a client, or potential followers, over a broker-led pool’s terms and conditions. With respect to followers, this may limit participation and, hence, the potential to benefit from knowledge sharing within the pool. With respect to clients, however, the potential for sub-optimal insurance coverage is lower, at least relative to insurer-led pools. We argue that, given the superior information held by brokers over current market conditions, client preferences and demand trends, broker-led pools should be better equipped to address limitations (appetite- or capacity-related) in the market and, thus, satisfy more adequately clients’ preferences.

The alignment of premiums across leader and followers may also give rise to a concern. In particular, as premiums differ for every risk underwritten by the pool, their calculation needs to account for the client’s idiosyncratic elements. This implies that the leader, who is in charge of pricing, needs to engage in a due diligence process in order to assess the client’s actual risk exposure and reflect it in the final premium quoted. As followers do not engage in such a task, there is the potential for cost over-recovery. Apart from the added costs incurred by the client, this may also give rise to free-riding issues as potential leaders could rather follow and enjoy the same premium as the leader, yet without the associated costs. However, such issues can be alleviated in case the leader receives a higher premium (i.e. either in the form of a top-up, or in the form of followers receiving a discounted premium) in order to be compensated for these costs.

Lastly, one element of potential concern is the broker’s remuneration and particularly, the presence of contingent commissions. More specifically, if brokers are rewarded based on commercial success, this may give rise to an incentive to prefer the formation of pools comprised of members with whom such contractual agreements can be concluded. Ultimately this may give rise to a conflict of interests between the mandate to satisfy client preferences and the brokers’ own financial interests. Such incentives may also result in specific insurers consistently participating in broker-led schemes, thus limiting the potential for broader knowledge sharing.

The above are further reflected in the following table:
### Table 6.2: Assessment of broker-led pools

<table>
<thead>
<tr>
<th>Scheme Dimensions</th>
<th>Dimension characteristics</th>
<th>Efficiency effects</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation phase</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formation initiator</td>
<td>Broker</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Process for selection of members</td>
<td>Typically tender for</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td></td>
<td>selection of leader and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>followers</td>
<td></td>
</tr>
<tr>
<td>Type of participating insurers</td>
<td>Both competitors and not</td>
<td>Neutral</td>
</tr>
<tr>
<td></td>
<td>competitors</td>
<td></td>
</tr>
<tr>
<td>Broker remuneration from insurers</td>
<td>Varying</td>
<td>Potentially problematic in</td>
</tr>
<tr>
<td></td>
<td></td>
<td>case of contingent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>commissions</td>
</tr>
<tr>
<td>Negotiation of terms and conditions between members</td>
<td>Varying</td>
<td>Neutral</td>
</tr>
<tr>
<td>Client involvement</td>
<td>Absent</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Leader-followers structure</td>
<td>Static</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Distinctive functional features</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sharing arrangements</td>
<td>Risk-sharing, premium-</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td></td>
<td>sharing or both</td>
<td></td>
</tr>
<tr>
<td>Uniformity of terms and conditions</td>
<td>yes</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Alignment of premiums</td>
<td>yes</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Renewal frequency</td>
<td>Typically 1-3 years</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

### 6.5 Assessment of ad hoc agreements

This section presents the findings of our analytical tasks with regards to ad hoc agreements. First, we present the general characteristics of the formation and functioning phases of these schemes, followed by a discussion over those identified mechanisms that may give rise to competition concerns.

#### 6.5.1 Formation phase characteristics

Ad hoc agreements are present in numerous European Member States. Among the latter, the UK and the Netherlands are the most active markets. In general, ad hoc agreements are formed so as to provide insurance coverage for a single risk subject to bespoke customer needs. Therefore, brokers are actively engaged in the formation of such schemes, especially regarding unconventional risks as their placement is heavily concentrated among the largest players in the brokerage market.

Overall, an ad hoc agreement is formed via a tendering process that the broker initiates on behalf of the client. In this process, the broker places a pre-determined risk in the market and different undertakings will usually respond by specifying the share of the risk they are willing to undertake and the relevant price. Our stakeholder engagement indicated that the total number of participating members in an ad hoc agreement varies between two and 20, although the most usually observed case involves two or three members in total. It can also be the case where insurers respond

---

115 See for example E&Y’s 2014 study.
116 See Section 4.4.
to these invitations as consortia, thus presenting the broker with a ready-made ad hoc agreement structure. In such consortia, the lead insurer selects followers based on the success of past collaborations and current credit ratings.

Most frequently, however, the broker will perform a market analysis and select a range of options to be presented to the client, based on customer-centric values, while rejecting some other options. In order to assess an offer, brokers may use an “assessment matrix” which encompasses all the factors of importance to the client.

The extent of the client’s involvement in the selection of leaderfollowers and the determination of the terms and conditions of the agreement varies. Our stakeholder engagement indicates that it is frequent for the customer to opt out from such obligations and outsource them to the broker. In this sense, negotiations do not always occur between the client and the leaderfollowers as their selection is based on market-driven dynamics. Price is not always the sole selection determinant. Rather, emphasis is given on the amount of coverage provided.

More specifically, our interviewed stakeholder suggested that it is normal for the insurer willing to underwrite the largest percentage of the risk to be the leader as long as the client accepts the price quoted. Where the client is satisfied with the amount of coverage provided but not with the price, amendments may be proposed. In other cases where a single insurer is able to provide 100 per cent coverage, the client may come back to the insurer and propose that a part of the risk (e.g. 20 per cent) be shared with another insurer on a coinsurance basis. In this case, the insurer with the biggest proportion of the risk would be the leader.

Other terms and conditions pertaining to an ad hoc agreement may also render it more favourable, relative to other ad hoc agreements, or pools. For instance, a commonly mentioned term during our stakeholder engagement relates to the ease offered to the client during the claims settlement process. In this sense, several insurance undertakings have developed a reputation for being particularly helpful during the process of settlement of claims. Thus, their presence in a proposed agreement is likely to be deemed favourable. Similarly, the potential for multi-jurisdictional coverage is also greatly considered.

For instance, during our stakeholder engagement, an interviewed buyer described that the options offered by the broker consisted of:

- An ad hoc agreement with insurer A as the leader and insurers B and C as followers.
- 100 per cent placement with insurer A.
- 100 per cent placement with insurer B.
- 100 per cent placement with insurer D.
- An ad hoc agreement with insurer D as the leader and insurers B and E as followers.

Eventually the first, albeit more expensive, option (i.e. the ad hoc agreement with insurer A as leader and insurers B and C as followers) was chosen due to the level of cover, the superior terms and conditions and the claims settlement reputation of the leader.

Our stakeholder engagements suggested several advantages associated with being a leader in an ad hoc agreement:

- There is more control over coverage in accordance to the leader’s risk appetite and business plan.
• The leader gets to negotiate with the broker and influence the terms and conditions of the arrangement, although the overall policy wording is determined by the broker.

In contrast, it was suggested that there are no pricing benefits associated with being a leader. It is generally accepted that in an ad hoc agreement the purchaser has greater bargaining power as all, or at least the vast majority of, members in the agreement could in principle provide coverage. Thus, by offering greater diversification on the supplier’s side, coinsurance appeals to insurers as they are less affected by single events occurring.\(^{117}\)

### 6.5.2 Functional features\(^{118}\)

As a general observation, the terms and conditions pertaining to an ad hoc agreement (i.e. risk details, cover required, extensions, cover limits, retention levels etc.) vary between transactions and are not standard. Normally, the functional features of the agreement are part of the documentation that is communicated by the broker to all interested insurers as part of the tendering process. The leader sets all terms for the agreement, including the premium, and followers abide by these rules.

The leader undertakes all the work involved in premium determination including analysing the client’s idiosyncratic elements and risk profile. Moreover, it is usual for the broker to also assess the client’s risk exposure, thus enhancing the overall cost-effectiveness of the placement of the risk.

Most frequently, the premium charged is uniform across all participating insurers. Such an outcome is mainly due to the costs and expertise limitations implied in case followers, particularly small underwriters, had to calculate the premiums themselves. Moreover, in case there is a claim, every policy document would be different resulting in claims not being settled satisfactorily. In light of the above, clients often prefer the formation of an agreement under uniform terms and conditions. The distribution of the premium proceeds among members, however, is proportional to the amount of risk each insurer is underwriting.

Despite the cost and efficiency limitations in case each member of the agreement had to individually survey the risk and calculate the premium, the extent of pricing knowledge sharing among participants is limited. In particular, it was suggested that following insurers do not rely on scheme participation in order to enhance their pricing expertise. Rather, as efficient pricing is to a large extent dependent on the leader’s expertise, followers prefer to induce key leader human capital to join them, thus enabling them to lead in future placements of the same or similar risks.

Ad hoc agreements do not normally involve any joining requirements. There are, however, administration requirements which only involve the participating insurers and not the client. The latter is confined to expressing solely coverage requirements during the formation phase. Re-submission to the market is also up to the broker. This can be subject to a lead clause (at least in some markets). However, depending on the time horizon of the agreement, the client may also request a leader review, which may result in a switch in leader position. In general, a long-term agreement is considered to last roughly three years, but there are also short-term agreements (i.e. lasting one year). For agreements lasting at least three years, there is usually a premium discount.

---

\(^{117}\) Pricing benefits enjoyed by the leader would also not be in accordance with the broker’s subscription model. Subscription models are different from traditional fee-for-service models. Under the latter, the customer pays on a per-procedure basis. In a typical subscription model, the customer pays a fixed recurring monthly fee for specified access to services.  

\(^{118}\) This section relies heavily on the outcomes of the stakeholder engagement process.
When forming the scheme, the broker receives a commission which varies based on the agreement. The presence of contingent commissions cannot be ruled out but can be limited as, usually, all members must agree on the broker's commission. For larger risks, however, the broker's remuneration is on a net premium basis involving a fee from the client. Lastly, the extent and nature of reinsurance (i.e. facultative, treaty) in an ad hoc agreement varies and ultimately depends on the insurers' preferences. For instance, an individual insurer participating in an agreement may choose to individually reinsure its risk share. Alternatively, the entire agreement may be reinsured.

6.5.3 Efficiency implications

In this section we focus solely on those features of ad hoc agreements whose efficiency impacts are expected to differ, relative to those specified in Section 6.3.3. More specifically, in contrast to insurer- and broker-led pools, ad hoc agreements are established so as to cover a specific risk under bespoke customer terms and conditions. Thus, they are more tailored to the idiosyncratic needs of a client and, given their limitation to covering one risk, they have less competitive relevance, as also illustrated in the legal analysis (see Appendix 9). This is further indicated by our interviews with stakeholders suggesting that the same risk could be placed both within an ad hoc agreement and the individual insurers comprising it. As before, on a case-by-case basis, some or all of the efficiency arguments presented below might not fully apply – and since, by their nature, ad hoc agreements are idiosyncratic, additional care is likely needed here.

Apart from resulting in similar efficiencies as broker-led pools (and, by extension, insurer-led pools as well), ad hoc agreements are likely to entail several additional benefits. The latter are mainly attributed to:

- The possibility for the client to also engage in the inherent negotiations so as to tailor the terms and conditions of the agreement more accurately to the relevant requirements.

- The ability of the client to dictate to the broker the selection of a preferred leader, based on past experiences and/or preferences over other aspects of the leading firm’s involvement (e.g. claims handling).

However, one factor that may limit the inherent efficiencies of ad hoc agreements, which is not present in any form of pool, would be the potential presence of a lead clause in the agreement (such a possibility and its effects are discussed in the next section).

6.5.4 Identification of concerns over ad hoc agreements

As mentioned above, the dynamics of ad hoc agreements render them an efficient alternative to pools (either insurer- or broker-led) that is more tailored to customer requirements. There is a trade-off, however, as the extent of knowledge sharing within such schemes is limited and mainly relates to claims handling. In addition, some functional concerns can emerge. These are presented below:

First, as with broker-led pools, the leader in the agreement is in charge of determining the premium based on the client’s idiosyncratic features. Therefore, the leader needs to engage in a due diligence process in order to assess the client’s true risk exposure and reflect it in the premium quoted. In the absence of a top-up compensating the leader for these costs (or of a discounted premium received by followers), followers may rely on the leader’s due diligence work whilst charging the same premium as the leader and, therefore, over-recover costs. However, the costs incurred by the leader
Different forms of cooperation between insurance companies and their respective impact on competition

(and the associated free-riding concerns) are likely to be lower, relative to broker-led pools, given broker’s involvement in the assessment of the client’s risk exposure.

Second, ad hoc agreements can be subject to a lead clause, at least in some markets in particular Member States, which restrict the client’s ability to challenge the position of the leader upon policy renewal. The potential for such an outcome can be counterbalanced, however, by the ability of the client to request a leader review throughout the scheme’s duration, which may result in a switch in leader position. It may also be the case, however, that the client wishes for a specific insurer to be the leader, mainly due to reputational factors (e.g. superior claims handling processes).

Lastly, similar to broker-led pools, brokers may be incentivised to include in the final selection of options to be presented to the client only those ad hoc agreements involving contingent commissions between the broker and the insurers comprising them. Evidently, this may restrict the set of available options to the client and concentrate the placement of the relevant risks to specific insurers. Assuming the BIPAR principles are in effect, however, such outcomes should not manifest, at least on a systemic basis.

The above are further reflected in the following table:

Table 6.3: Assessment matrix of ad hoc agreements

<table>
<thead>
<tr>
<th>Scheme Dimensions</th>
<th>Dimension characteristics</th>
<th>Efficiency effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formation phase</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formation initiator</td>
<td>Client (typically via a broker)</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Process for selection of members</td>
<td>Tender</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Type of participating insurers</td>
<td>Does not apply</td>
<td>Neutral</td>
</tr>
<tr>
<td>Broker remuneration from insurers</td>
<td>Varying</td>
<td>Potentially problematic if contingent commissions</td>
</tr>
<tr>
<td>Negotiation of terms and conditions</td>
<td>Extensive</td>
<td>Neutral</td>
</tr>
<tr>
<td>between members</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Client involvement</td>
<td>Extensive</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Leader-followers structure</td>
<td>Dynamic although client may request specific leader</td>
<td>Neutral</td>
</tr>
<tr>
<td>Distinctive functional features</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sharing arrangements</td>
<td>Risk-sharing, premium-sharing or both</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Uniformity of terms and conditions</td>
<td>Typically yes</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Alignment of premiums</td>
<td>Typically yes</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Renewal frequency</td>
<td>Typically 1-3 years with a possibility of leader review</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

6.6 Comparison of efficiency across types of scheme

The above analysis has provided an assessment of key formation and functional mechanisms of co(re)insurance schemes. Overall, co(re)insurance schemes are highly heterogeneous in terms of their intrinsic mechanisms, which suggests that a true assessment would need to be conducted on a case-by-case basis. However, each type
of scheme is associated with several generic benefits and limitations thus creating a trade-off during the placement process of a given risk.

More specifically, insurer-led pools, provide a significant amount of coverage and are characterised by a considerable extent of knowledge sharing among members. On the other hand, where there is no tendering process for the selection of the leader, this could render such schemes less efficient, relative to alternative cooperative insurance structures (notwithstanding that the possibility for such an outcome to occur would vary on a case-by-case basis). However, their presence may still be required as for several unconventional risks, these pools may be the only available option.

In turn, broker-led pools tend to involve more dynamic processes in their formation, which enables them to compete with insurer-led pools and provide, to varying degrees and depending on the risks covered, a more efficient alternative option. However, the limited extent of knowledge sharing within such pools, in addition to the potential for cost over-recovery (insofar as the leader is not additionally remunerated, relative to the followers), may reduce the viability of such arrangements as an adequate alternative option.

A trade-off is also present regarding the involvement of the broker. On the one hand, the superior information held by brokers over current market conditions is likely to enhance the efficiency and necessity of the pool. On the other hand, the additional cost layer related to the remuneration of the broker may adversely affect the efficiency of such schemes, rendering them less appealing to potential clients and/or participants. The latter possibility, however, is greatly constrained assuming the BIPAR principles are in effect.

Lastly, in contrast to insurer- and broker-led pools, ad hoc agreements are established so as to cover a specific risk under bespoke customer terms and conditions. Thus, they are more tailored to the idiosyncratic needs of a client and could thus be perceived as a highly efficient means of addressing a customer’s insurance coverage needs.

As a general restriction to the provision of unconventional risk coverage, however, the number of undertakings that can effectively act as leaders is limited. In addition, such outcomes are unlikely to be ameliorated over time from scheme participation as the extent of knowledge sharing, as in the case of broker-led pools, is more limited.

The above are further reflected in the following table:
Table 6.4: Comparative efficiency assessment

<table>
<thead>
<tr>
<th>Scheme Dimensions</th>
<th>Insurer-led pool</th>
<th>Broker-led pools</th>
<th>Ad hoc agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation phase</strong></td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Formation initiator</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td><strong>Process for selection of members</strong></td>
<td>Neutral (but potential for inefficiency without tendering in leader selection)</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td><strong>Type of participating insurers</strong></td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
<tr>
<td><strong>Broker remuneration from insurers</strong></td>
<td>Does not apply</td>
<td>Potentially problematic if contingent commissions</td>
<td>Potentially problematic if contingent commissions</td>
</tr>
<tr>
<td><strong>Negotiation of terms and conditions between members</strong></td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
<tr>
<td><strong>Client involvement</strong></td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td><strong>Leader-followers structure</strong></td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Neutral</td>
</tr>
<tr>
<td><strong>Distinctive functional features</strong></td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td><strong>Sharing arrangements</strong></td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td><strong>Uniformity of terms and conditions</strong></td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td><strong>Alignment of premiums</strong></td>
<td>Potential inefficiency (in absence of tendering process)</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>** Renewal frequency**</td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

6.7 Identification of potentially non-essential features

As a natural extension of the above research task, we have engaged in the identification of those features that are potentially “non-essential” for the maximisation of the efficient functioning of a scheme (whether or not they are common market practice). Depending on the scheme in question (and considering the necessity of a case-by-case analysis as one model cannot be imposed across all cooperation schemes), the identification focused on features pertaining to the formation phase and functional features, as presented in Section 6.2. These are presented in the following paragraphs.

6.7.1 Formation phase features

The identification of non-essential features commenced by assessing the essentiality of those characteristics pertaining to the formation phase of a scheme. In doing so, we considered the fact that the essentiality of a given feature might also depend on the scheme in question. Overall, features identified as potentially non-essential are presented below:

- Selection of scheme members through a tendering process — the essentiality of this feature varies dependent on the scheme in question. The presence of a competitive selection dynamic is less important in those schemes in which the client plays an active role during the formation process but more so in schemes that are industry-driven. In the former, given the market knowledge and
understanding of the parties initiating their formation (e.g. the superior knowledge of brokers about potential leader candidates) the presence of a tendering process is less likely to be as vital. Similarly, with regards to followers, we consider the presence of a tendering phase not to be essential but preferable. As long as the selection of the leader is adequately competitive, the selection of followers is not likely to affect considerably the overall functioning of the scheme.

- **Scheme members are restricted from also providing insurance for the same risk on a stand-alone basis** — The European Commission considers a requirement to bring all risks into the pool (so-called obligation d’apport) as excessive and not exemptible in a block exemption regulation. However, we think that this feature could be essential in some cases for the maximisation of efficiency of insurer-led pools that are formed with the primary purpose of obtaining more favourable reinsurance quotes due to the implied diversification benefits of the scheme. In this case, such an outcome would not be feasible if insurers sought to reinsure non-mutualised risks. For schemes that operate in the primary market, the fact that participating members are also active on a stand-alone basis may be beneficial to the functioning of the scheme as members can learn from each other’s expertise. However, this feature is not essential to efficiency maximisation as the same benefits would likely manifest, irrespective of the stand-alone market position of the scheme members.

- **Admission of insurance undertaking in scheme based on credit rating** — since Solvency II ensures at least the financial solvency of insurance undertakings, thereby limiting solvency concerns in case of participation in a scheme, admission rules based on credit ratings represent a non-essential feature, and could even be restrictive. Höring (2012) compares the risk capital required under Solvency II (“regulatory capital”), with the risk capital required to maintain a credit rating of A under the Standard & Poor’s rating model (“rating capital”), finding that the capital requirements of the ratings agencies are more stringent than Solvency II. Replacing credit rating requirements with regulatory capital requirements could lower the barriers to entry to participation in pools, without imposing substantial threats to solvency (as the Solvency II capital requirements are set to ensure solvency to a 99.5 per cent confidence level).

- **Broker remuneration from insurers** — brokers should be able to provide adequate services to their clients irrespectively of the remuneration structure. Insofar as the form of the broker’s remuneration does not give rise to conflicts of interest, it should be regarded as a non-essential feature in terms of efficiency maximisation.

- **Negotiation of scheme terms and conditions** — this is an essential feature for the functioning of most schemes: given the inherent complexities in order to be able to participate effectively, members need to agree on fundamental aspects of the scheme’s functioning with each other (in the case of insurer- or broker-led pools) or with the clients (e.g. in ad-hoc agreements). However, this feature is less

---

121 Additionally, we note that regulation requires the presence of a disclaimer ensuring that the broker’s remuneration will not give rise to conflicts of interest.
essential in the presence of schemes formed through a delegated underwriting authority as in this case insurers tend to commit only a predetermined capacity to the schemes, whilst the risk-assessment and underwriting duties are carried out by the underwriting agent. Similarly, this feature is non-essential to efficiency maximisation where the scheme’s terms and conditions are already specified by the leader and have been communicated to potential followers in order to indicate the capacity they are willing to commit. Lastly, in ad hoc agreements, this feature is also non-essential in case the client wishes to opt out from the negotiations and out-source all relevant obligations to the broker.

Overall, the above are summarised in the following table:

**Table 6.5: Formation phase features non-essential to maximisation of efficiency**

<table>
<thead>
<tr>
<th>Feature</th>
<th>Insurer-led pool</th>
<th>Broker-led pool</th>
<th>Ad hoc agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selection of scheme members through tendering process</td>
<td>Essential (at least where possible) for leader. Not essential but preferable for followers</td>
<td>Not essential but preferable for both leader and followers</td>
<td>Not essential but preferable for both leader and followers</td>
</tr>
<tr>
<td>Restricting the provision of insurance for the same risk on a stand-alone basis</td>
<td>Essential only for those schemes seeking more favourable reinsurance quotes</td>
<td>Non-essential</td>
<td>Non-essential</td>
</tr>
<tr>
<td>Admission of members based on credit rating</td>
<td>Non-essential</td>
<td>Non-essential</td>
<td>Non-essential</td>
</tr>
<tr>
<td>Broker remuneration arrangement</td>
<td>Non-essential if conflicts of interest are absent</td>
<td>Non-essential if conflicts of interest are absent</td>
<td>Non-essential if conflicts of interest are absent</td>
</tr>
<tr>
<td>Negotiation of terms and conditions</td>
<td>Negotiation between members is essential</td>
<td>Negotiations between members is useful but not-essential if the broker plays a pivotal negotiating role and makes direct negotiations between members unnecessary</td>
<td>Negotiations between members is useful but not-essential if the broker plays a pivotal negotiating role and makes direct negotiations between members unnecessary.</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

### 6.7.2 Functional features

We now proceed to identify functional features present in cooperation schemes that are potentially non-essential to the maximisation of efficiency. As above, we considered the point that the relative essentiality of a given feature might also depend on the scheme in question:

- **Information sharing arrangements** — sharing of information is essential, particularly in insurer-led pools as the latter comprise a large degree of member involvement which may also apply to pricing and/or settlement decisions. In contrast, due to the high degree of information held by brokers in broker-led pools and ad hoc agreements, information sharing in such schemes is less vital. On a related aspect, exchange of information between scheme members during the time period preceding the renewal of an ad hoc agreement could be non-essential for maximising the efficiency of the scheme’s functioning. Rather, the time period preceding the renewal of an ad hoc agreement is of particular importance in the
case that the policyholder does not wish to renew the current arrangement and would rather seek to explore alternative placement options

- **Uniformity of terms and conditions** — a distinction is more challenging in this case as, in theory, uniform terms and conditions should be non-essential to maximising efficiency. However, in practice, uniformity is *de facto* essential as, in its absence, several aspects of the scheme’s functioning (e.g. claims settlement processes) would likely be dysfunctional.

- **Alignment of premiums across leader and followers** — insofar as the leader receives a compensation on top of the premium for the incurred risk-assessment costs, this is an essential feature that reflects the leader’s superior expertise and pricing knowledge.

- **Rules limiting the frequency with which the insured can terminate a contractual relationship with a scheme** — whilst a minimum termination notice period would be preferred to provide necessary stability and predictability for all parties concerned, termination periods longer than one year are likely non-essential.

- **Lead clause prohibiting clients from challenging the leader role within a scheme** — this relates to the inability to challenge the leader position. The existence of these in practice may be restricted to particular markets in certain Member States. Even so we note that, such a feature would not be essential – and in fact would be undesirable – for ad hoc agreements. Given the customer-centric aspect of such arrangements, clients should be able to easily request a leader change if deemed preferable.

Overall, the above are summarised in the following table:

**Table 6.6: Functional features non-essential to maximisation of efficiency**

<table>
<thead>
<tr>
<th>Feature</th>
<th>Insurer-led pool</th>
<th>Broker-led pool</th>
<th>Ad hoc agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information sharing arrangements</td>
<td>Essential</td>
<td>Non-essential</td>
<td>Non-essential</td>
</tr>
<tr>
<td>Uniformity of terms and conditions</td>
<td>In principle non-essential</td>
<td>In principle non-essential</td>
<td>In principle non-essential</td>
</tr>
<tr>
<td>Alignment of premiums</td>
<td>Essential insofar as the leader receives a top-up</td>
<td>Essential insofar as the leader receives a top-up</td>
<td>Essential insofar as the leader receives a top-up</td>
</tr>
<tr>
<td>Rules limiting contract termination frequency</td>
<td>Only minimum termination notice period essential</td>
<td>Only minimum termination notice period essential</td>
<td>Only minimum termination notice period essential</td>
</tr>
<tr>
<td>Inability to challenge leader</td>
<td>Not essential but preferable</td>
<td>Not essential but preferable</td>
<td>Non-essential</td>
</tr>
</tbody>
</table>

Source: Europe Economics.
Different forms of cooperation between insurance companies and their respective impact on competition

7 Conclusions

In this section, we highlight the main lessons learned from the examination of cooperation schemes (i.e. co(re)insurance pools and ad hoc co(re)insurance agreements) between insurance companies, their impact on competition and potential non-essential features pertaining to their functioning.

In order to conduct the above research tasks we collected evidence from various sources on the risks that are most likely to be covered by such schemes. These risks usually impose difficulties in terms of their actuarial properties and are often referred to as unconventional. However, there is no such thing as a rigid definition of what constitutes an unconventional risk. In this sense, the first contribution this study makes relates to the construction of such a definition.

We thus consider as an unconventional risk, any risk that imposes insurability challenges as defined by Berliner’s insurability criteria. In the literature, the application of these criteria has identified the following risk categories as possessing characteristics that are typical of unconventional risks.

- Cyber security;
- Natural catastrophes;
- Nuclear incidents;
- Terrorism; and
- Ecological damages, e.g. due to large-scale industrial accident.

The validity our approach in defining unconventional risk is further evidenced by the fact that the above risk categories are most likely to be insured by cooperative agreements.

In addition to providing a definition for unconventional risks the second contribution of this study relates to the classification of cooperative structures based on the party that initiates their formation. Prior to this classification a distinguishing factor separating cooperative schemes was the number of risks underwritten. More specifically:

- Pools are set up to cover a multitude of risks pertaining to a specific risk category.
- Ad hoc agreements are set up to cover a specific risk under bespoke customer needs.

By relying on evidence from literature and observed market practices it became apparent that co(re)insurance pools can be formed by:

- insurers, or their respective agents (i.e. insurer-led);
- brokers (i.e. broker-led); or
- can be mandated by the State (i.e. mandated).

ad hoc agreements are formed so as to cover bespoke customer needs and may also involve a broker, i.e. pools differ from ad hoc agreements in terms of their scope.

Overall, the characteristics of the different types of co(re)insurance arrangements are summarised in the following table:
Studies on issues pertaining to the insurance production process with regard to the application of the 
Insurance Block Exemption Regulation (IBER)

Table 7.1: Characteristics of co(re)insurance schemes

<table>
<thead>
<tr>
<th>Scheme type</th>
<th>Client involvement</th>
<th>Selection of leader</th>
<th>Terms &amp; Conditions</th>
<th>Negotiation on terms &amp; conditions</th>
<th>Conditional acceptance of policies</th>
<th>Premium alignment</th>
<th>Knowledge sharing</th>
<th>Involvement and commitment of members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurer-led pool</td>
<td>Limited</td>
<td>Insurer with or without tender</td>
<td>Uniform (specified by leader)</td>
<td>Limited</td>
<td>Yes and No</td>
<td>Mainly yes</td>
<td>Intense</td>
<td>Intense</td>
</tr>
<tr>
<td>Broker-led pool</td>
<td>Limited</td>
<td>Broker mainly with tender</td>
<td>Uniform (set by broker in discussion with leader)</td>
<td>Limited</td>
<td>Yes and No (DUA)</td>
<td>Mainly yes</td>
<td>Limited</td>
<td>Limited</td>
</tr>
<tr>
<td>Mandated pool</td>
<td>Limited</td>
<td>Insurer without tender</td>
<td>Uniform</td>
<td>Limited</td>
<td>No</td>
<td>Mainly yes</td>
<td>Limited or Intense (dependent on pool)</td>
<td>Limited or Intense (dependent on pool)</td>
</tr>
<tr>
<td>Ad hoc agreement</td>
<td>Intense</td>
<td>Client or Broker mainly with tender</td>
<td>Mainly uniform</td>
<td>Intense</td>
<td>No</td>
<td>Mainly yes</td>
<td>Limited</td>
<td>Limited</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

Overall, co(re)insurance schemes are highly heterogeneous in terms of their intrinsic mechanisms, which suggests that a more accurate assessment needs to be conducted on a case-by-case basis. However, each type of scheme is associated with several generic benefits and limitations thus creating a trade-off during the placement process of a given risk. More specifically:

- Insurer-led pools provide a significant amount of coverage and are characterised by a substantial extent of knowledge sharing within. However, schemes where a tendering process for the selection of the leader is absent could be rendered less efficient, relative to alternative cooperative insurance structures (notwithstanding that the possibility for such an outcome to occur would vary on a case-by-case basis).

- Broker-led pools involve a more dynamic process in their formation, which enables them to provide, to varying degrees and depending on the risks covered, a more efficient alternative risk placement option. However, the limited extent of knowledge sharing within, in addition to the potential for cost over-recovery across followers (provided that the leader is not compensated additionally, relative to followers, either in the form of a top-up or in the form of followers receiving a discounted premium), may reduce their viability as an adequate alternative option. Moreover, the superior information held by brokers over market conditions is likely to enhance the efficiency and necessity of the pool, provided that the additional cost layer related to the remuneration of the broker does not cause any adverse effects.

- Ad hoc agreements are more tailored to the idiosyncratic needs of a client and may thus be perceived as a highly efficient means of addressing a customer’s insurance

---

122 Given their policy-driven instigation, mandated pools were excluded from the analysis. They were however considered insofar as they represent an alternative option in the market for the placement of a given risk. For the role of the State in co(re)insurance schemes see Section 4.5. For a cross-country comparison of State involvement in co(re)insurance schemes see Appendix 10.
Different forms of cooperation between insurance companies and their respective impact on competition

coverage needs. As a general restriction to the provision of unconventional risk coverage, however, the number of undertakings that can effectively act as leaders is limited. In addition, the extent of knowledge sharing is limited.

A snapshot of our efficiency assessment is presented in the following table:

Table 7.2: Comparative efficiency assessment

<table>
<thead>
<tr>
<th>Scheme Dimensions</th>
<th>Insurer-led pool</th>
<th>Broker-led pools</th>
<th>Ad hoc agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation phase</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formation initiator</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Process for selection of members</td>
<td>Neutral (but potential inefficiency without tendering in leader selection)</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Type of participating insurers</td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
<tr>
<td>Broker remuneration from insurers</td>
<td>Does not apply</td>
<td>Potentially problematic if contingent commissions</td>
<td>Potentially problematic if contingent commissions</td>
</tr>
<tr>
<td>Negotiation of terms and conditions between members</td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
<tr>
<td>Client involvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Leader-followers structure</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Neutral</td>
</tr>
<tr>
<td><strong>Distinctive functional features</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sharing arrangements</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Uniformity of terms and conditions</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Alignment of premiums</td>
<td>Potential inefficiency (in absence of tendering process)</td>
<td>Efficiency improvement</td>
<td>Efficiency improvement</td>
</tr>
<tr>
<td>Renewal frequency</td>
<td>Neutral</td>
<td>Neutral</td>
<td>Neutral</td>
</tr>
</tbody>
</table>

Source: Europe Economics.

As a natural outcome of the above assessment, we have identified several non-essential features pertaining to the formation phase and functionality of cooperation schemes. Non-essential formation phase features relate to:

- The presence of a tendering process for the selection of followers (albeit this is preferable).
- The restriction imposed on scheme members not to provide insurance for the same risk on a stand-alone basis in schemes that are not formed with the primary purpose of obtaining more favourable reinsurance quotes.
- The admission of insurance undertakings in a scheme based on credit rating.
- The type of broker remuneration.
- The negotiation of a scheme’s terms and conditions in case the scheme is formed encompassing a delegated underwriting authority.

In turn, the non-essential functional features relate to:
- Information sharing arrangements in ad hoc agreements.
- Uniformity on terms and conditions (at least in principle).
- Alignment of premiums across leader and followers, insofar as the leader receives a compensation on top of the premium for the incurred risk-assessment costs.
- Rules limiting the frequency with which the insured can terminate a contractual relationship with a scheme.
- Lead clauses prohibiting clients from challenging the leader role within an ad hoc agreement.

As an overarching concluding observation, the cooperation schemes examined in this report can be positioned on a spectrum reflecting:

- The extent to which their formation is driven by industry dynamics.
- The inherent extent of knowledge sharing.

At the lower end of the spectrum (which suggests the prevalence of industry-driven dynamics in their formation and substantial knowledge sharing within) lie insurer-led pools. This is due to the following reasons:

- The formation of insurer-led pools is usually industry-driven without necessarily involving a tendering process. In this sense, insurer-led pools increase efficiency in the market by providing capacity where it is lacking or limited, but — being the only option— might be expensive.
- Insurer-led pools encompass the highest degree of information-sharing between members, and therefore may raise competition concerns. However, this can facilitate knowledge transfer and learning.

At the upper end of the spectrum (which suggests the prevalence of customer-centric dynamics in their formation and limited knowledge sharing within) lie ad hoc agreements. This is due to the following reasons:

- Ad hoc agreements are tailored to meet specific needs and are formed through competitive tendering processes. They therefore increase efficiency by providing an additional risk placement option.
- Ad hoc agreements require a much lower degree of information-sharing between members, and therefore they raise much less competition concerns than insurer-led schemes. However, this also results in a lower degree of knowledge transfer and learning.

Lastly, broker-led pools can be perceived as lying in the middle of the spectrum.

- Broker-led pools are also industry-driven in their formation dynamics. However, the superior information held by the broker in terms of client characteristics and demand trends is likely to render these schemes more relevant to customers’ coverage needs.
- The degree of knowledge sharing within broker-led pools may be limited as the broker usually holds the majority of administrative duties.

The above were complemented by legal analysis of co(re)insurance schemes (presented in Appendix 9). The core issue in conducting such a research task is defining the relevant market. Following from the legal analysis by CMS-Hasche Sigle,
we conclude that, no major competition issues in the assessment of mergers between insurance companies have arisen so far and, as a rule, it has been possible to leave the definition of relevant markets open.\textsuperscript{123}

The legal analysis has also focused on several aspects of co(re)insurance schemes under the prism of competition law. More specifically:

- A necessary condition to exclude restrictions of competition with regards to a pool, either insurer- or broker-led, is that its formation should be necessary for the involved companies in aggregate, but also individually, to insure the risks in question.

- Broker-led pools may give rise to a conflict of interest if the commission agreed between the broker and insurers are dependent on commercial success (i.e. contingent commissions). The conflict is between the obligation to provide objective advice to clients and the brokers' own financial interests.

- Ad hoc agreements, on the other hand, are likely to raise fewer competition concerns because ad hoc coinsurance is limited to covering an individual risk in an individual case and thus has less competitive relevance and intensity than other forms of cooperation.\textsuperscript{124}


\textsuperscript{124} Such clauses are within the “model” general conditions for guarantee insurance, the machines-business interruption insurance, the electronic insurance and the building stock insurance of The German Insurance Association. Available at: http://www.gdv.de. These model terms are not necessarily applied, even by German insurers. However, they have appeared in cases, e.g. Higher Regional Court Cologne, VersR 2008, 1673; Higher Regional Court Hamburg, VersR 2008, 1249; [2014] EWHC 163 (Comm).
8 Appendix: Stakeholder engagement

8.1 Selection of relevant stakeholders in the insurance and insurance brokerage sectors for interview

Our initial search for relevant stakeholders was driven by the pools identified in the E&Y report. Our search focused on pools in the major EU (re)insurance markets, namely: France, Germany, the Netherlands and the UK. For each of the pools domiciled in these countries, we identified their members through their respective websites. The rationale behind this approach is that these pools operate primarily within the unconventional risk segment. Pool members are also likely to be engaged (or to have been engaged in the past) in ad hoc agreements within the same risk category.

The second stage of stakeholder selection involved identifying relevant persons to interview within these (re)insurance companies. The focus was on identifying the person who represented that company within the pool in question, or otherwise a person who we expect to have a more general knowledge of pool operation. However, if this were not possible, then the focus was instead on finding a regulatory or public affairs contact at the company of interest, to act as a starting point for making contact with that company, and identify the most relevant person(s) within the organisation.

The overall outcome of this task was an Excel spreadsheet summarising the relevant points of contact for our study, as shown in the following table:

Table 8.1: Contact list

<table>
<thead>
<tr>
<th>Pool name</th>
<th>Country of pool</th>
<th>Insurance company (pool member’s) name</th>
<th>Insurance company’s country (HQ)</th>
<th>Potential contact person within insurance company</th>
</tr>
</thead>
<tbody>
<tr>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>

8.2 Development of questionnaire to support stakeholder engagement in the insurance and insurance brokerage sectors

The questionnaire was developed with the intention of providing a framework for discussion, rather than a strict set of questions to be answered. Overall, the questionnaire was structured along the following dimensions:

- Company profiling.
- The rationale for the formation of schemes.
- The distinctive functional features of schemes.
- Premium determination and scheme formation mechanisms.

The above are presented in more detail below:

---

125 E&Y (2014) “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market” Report for European Commission.
8.2.1 Company profiling

The questionnaire was designed to support the structured interview programme. The first section of the questionnaire profiles the respondents in terms of their participation in cooperation schemes. This profiling of respondents helped us understand to what extent the views expressed through the interviews were applicable to the industry as a whole, or to certain types of players within the industry.

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>General profiling information</td>
<td>The general profiling information is important in understanding whether, and, if so, how, stakeholder responses may vary for different types of stakeholders (e.g. by size, geographic coverage and risk type).</td>
</tr>
<tr>
<td>What is the total amount of risk you have underwritten in the past year?</td>
<td></td>
</tr>
<tr>
<td>In which areas of unconventional risk do you operate?</td>
<td></td>
</tr>
<tr>
<td>Do you wish to enter any areas of unconventional risk in which you do not currently provide coverage?</td>
<td></td>
</tr>
<tr>
<td>In which EU market(s) are you active?</td>
<td></td>
</tr>
<tr>
<td>In which EU markets are the cooperation schemes, for which you are a member, active?</td>
<td></td>
</tr>
</tbody>
</table>

**Information on scheme involvement**

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>How many cooperation schemes are you involved in?</td>
<td>This information helps in further profiling the respondents and, in particular, in understanding variations across the type of market (insurance or reinsurance), type of cooperation scheme, (re)insurer role and number of members.</td>
</tr>
<tr>
<td>Is the scheme in the primary insurance or reinsurance market?</td>
<td></td>
</tr>
<tr>
<td>What is the typology of cooperation’s scheme? (ad hoc / multi-lateral pool / collective pool / other)</td>
<td></td>
</tr>
<tr>
<td>What is your role in the scheme(s)? (leader / follower)</td>
<td></td>
</tr>
<tr>
<td>When was the scheme formed, and since when were you a member?</td>
<td></td>
</tr>
<tr>
<td>Which type of risks do they cover? (catastrophe / cyber / nuclear / terrorism / other)</td>
<td>As well as considering the most common types of unconventional risk that are known to be better dealt with by cooperation schemes, we also investigated the extent to which “other” categories may share some of the insurability features common among unconventional risks.</td>
</tr>
<tr>
<td>How many members adhere to the scheme(s)?</td>
<td><strong>Larger schemes are, in principle, likely to deliver more benefits (e.g. greater diversification) and more members should, other things being equal, lead to lower premiums.</strong></td>
</tr>
</tbody>
</table>

8.2.2 The rationale for formation of cooperation schemes

We sought to understand the reasons for the formation of the schemes and, in particular, whether they are the result of a market failure in the insurance or
reinsurance markets. We also sought to understand whether there were any other factors behind the formation of the cooperation scheme, namely: state intervention to achieve public policy objectives; legal and regulatory risk mitigation; regulatory capital maximisation; and replacement of existing, inefficient cooperation schemes.

Table 8.3: Rationale for scheme formation – information sought and its relevance to the study

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>What were the reasons for scheme formation? Where appropriate, can you rate relative strength of these factors (e.g. to a great extent/ to a limited extent/ etc.) Can you rank these reasons in order of importance?</td>
<td>The benefits of cooperation schemes in the primary markets are generally well understood, e.g. since many insurers operate in local/national markets, cooperation schemes in the primary market can lead to significant geographical diversification benefits. Rationalising the benefits for a cooperation scheme in the reinsurance market is less obvious. Reinsurers are international companies with globally diversified portfolios. However, diversification benefits (across a broader risk spectrum) may still be achievable for reinsurance companies that are highly specialised in specific risk segments. These questions help, among other things, in identifying any systematic differences in the rationales for the formation of schemes within the primary and reinsurance markets.</td>
</tr>
<tr>
<td>What are the actuarial properties of the risk(s) covered by the scheme?</td>
<td></td>
</tr>
<tr>
<td>To what extent would you be able to diversify this risk on a stand-alone basis?</td>
<td></td>
</tr>
<tr>
<td>To what extent would you be able to absorb the associated losses on a stand-alone basis?</td>
<td></td>
</tr>
<tr>
<td>To what extent would you be able to estimate the probability of risk occurrence on a stand-alone basis?</td>
<td></td>
</tr>
<tr>
<td>What are the market-related properties of the risk(s) covered by the scheme?</td>
<td></td>
</tr>
<tr>
<td>What premium would you charge to cover the risk(s) on a stand-alone basis and how does it compare to the premium charged by the scheme?</td>
<td>These questions are only relevant in the context of schemes in the primary insurance market. *This could provide a rough quantification of the monetary benefit (e.g. lower reinsurance premiums) of a cooperation scheme.</td>
</tr>
<tr>
<td>To what extent are asymmetric information problems present in the risk(s) covered by the scheme?</td>
<td></td>
</tr>
<tr>
<td>Did reinsurance premiums play a role in the formation of the scheme? (If so, please elaborate...)</td>
<td></td>
</tr>
<tr>
<td>Does the cooperation scheme reinsure some or all of the risk? (And if yes...)</td>
<td></td>
</tr>
<tr>
<td>How does the reinsurance premium charged to the scheme differ from those applied on a stand-alone basis?*</td>
<td></td>
</tr>
<tr>
<td>Were there other rationales for the scheme’s formation, e.g. state-mandated? (Please provide more details).</td>
<td>This helps to understand whether there are other factors at play in driving scheme formation, aside from market failure in the primary insurance and reinsurance markets.</td>
</tr>
</tbody>
</table>
8.2.3 The distinctive features of cooperation schemes

The focus of this section is to understand how risk and/or premiums are allocated in the cooperation schemes for which the respondent is a member. This helped us understand the role of cooperation schemes in the broader insurance sector.

In particular, we wish to understand: the share of losses borne by each insurer in the cooperation scheme; the associated retention levels and cover limits; the sharing of premiums (if such sharing occurs); and the type of liability regime in place. This section of the questionnaire also asks respondents what conditions they had to meet in order to join the cooperation scheme, how the selection of members took place, and to what extent they had to change their existing practices in order to meet these requirements. We also wish to understand whether there are any conditions in place that may make exiting the cooperation scheme difficult.

In the case of a cooperation scheme in the primary insurance market, we wish to know how many layers of reinsurance cover are provided and whether cooperation schemes are present at these different levels. For each level of reinsurance it is important to understand who is providing that reinsurance (domestic or international reinsurers, or the state), the corresponding retention levels and cover limits in each case, and the implications of this for cooperation in the primary insurance market. In the case of a cooperation scheme in the reinsurance market, we wish to know both regarding the relationship downstream with the primary insurance market and, if applicable, any relationships upstream to further tiers of reinsurance or state support.

Table 8.4: Distinctive features of cooperation schemes – information sought and its relevance to the study

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the rules/requirements (if any) for joining and exiting the scheme?</td>
<td>Information provided here helps us to consider if there are any potential competition implications of scheme entry and exit requirements.</td>
</tr>
<tr>
<td>Were these rules/requirements determined via negotiation (and, if so, by whom?) or were they established ex ante?</td>
<td></td>
</tr>
<tr>
<td>Do the same rules/requirements apply to both leader and followers?</td>
<td></td>
</tr>
<tr>
<td>How many followers are there in the scheme, and, if known, how many (re)insurers applied to be a follower?</td>
<td></td>
</tr>
<tr>
<td>To your knowledge, how many other insurance firms in the market could potentially be followers in the scheme?</td>
<td></td>
</tr>
<tr>
<td>Would any of the followers currently present in the scheme be able to fulfil the role of the leader?</td>
<td></td>
</tr>
<tr>
<td>How many (re)insurers applied to be leader?</td>
<td></td>
</tr>
<tr>
<td>To your knowledge, how many insurance firms in the market could potentially lead the scheme?</td>
<td></td>
</tr>
</tbody>
</table>
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

What are the risk/premium sharing agreements?
- Retention levels and limits.
- Shares of premiums and losses among members.
- Liability regime (e.g., joint or several).

Do insurers feel that the risk and premium sharing agreement among members are fair?

What other rules and contractual terms are in place (e.g., claims handling, underwriting rules, contribution fees etc.)?

How many upstream reinsurance layers are there, and of what type (relative to the cooperation scheme in question)?
- None.
- National reinsurance market / national reinsurance cooperation scheme.
- International reinsurance market / international reinsurance cooperation scheme.
- Government.

How many downstream insurance layers are there, and of what type (relative to the cooperation scheme in question)?
- None.
- National reinsurance market / national reinsurance cooperation scheme.
- International or national primary insurance market / international or national primary insurance cooperation scheme.

This information provides an understanding of the role that a cooperation agreement plays within the broader insurance industry.

It is important to understand the amount of coverage assumed at each level of the value chain, so as to understand the extent of risk exposure at the different levels. The exact coverage structure may also raise moral hazard issues.

8.2.4 Premium determination and scheme formation mechanisms

Here we wish to understand, in greater depth, how premiums are determined for the cooperation scheme. We ask respondents whether they have been/are leaders or followers for the cooperation schemes in which they have participated or are participating. Regarding the leaders, we wish to understand the factors taken into account in setting premiums when bidding to be the leader, and how the selection of the leader is determined. We also seek to understand the rationale for deciding whether to be a leader or a follower, for example, whether acting as a follower allows them to enter new risk markets for which they do not currently have the expertise to estimate actuarially fair premiums internally, but which they wish to develop over time. This section of the interview also looks to uncover the relationship of the (re)insurer with the broker (if a broker is indeed involved), including: how many brokers were approached by in a given risk segment; how the brokers went about the
selection of leaders and followers; and how the brokers were remunerated for their involvement.

**Table 8.5: Premium determination & scheme formation – information sought and its relevance to the study**

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was a broker involved in the scheme formation?</td>
<td>This provides an indication of the degree of competition in the brokerage market for a given risk segment.</td>
</tr>
<tr>
<td>Was the formation of the scheme <strong>initiated</strong> by the broker? (And if so...)</td>
<td></td>
</tr>
<tr>
<td>- Did the broker have specific client instructions to form a cooperative scheme?</td>
<td></td>
</tr>
<tr>
<td>- Did the broker propose the scheme formation to the client?</td>
<td></td>
</tr>
<tr>
<td>- Did the broker also propose coverage by a single (re)insurer?</td>
<td></td>
</tr>
<tr>
<td>- Has the broker obtained pre-agreement on the subscription market to cover the</td>
<td></td>
</tr>
<tr>
<td>risks covered by the scheme?</td>
<td></td>
</tr>
<tr>
<td>- Did the broker put the business out for tender to a select number of insurers</td>
<td></td>
</tr>
<tr>
<td>that could cover the risk? (i.e. as opposed to all insurers in the market that</td>
<td></td>
</tr>
<tr>
<td>could potentially cover the risk)</td>
<td></td>
</tr>
<tr>
<td>- Did the broker negotiate on behalf of the client with each potential leader and</td>
<td></td>
</tr>
<tr>
<td>follower?</td>
<td></td>
</tr>
<tr>
<td>How many brokers would be able to underwrite the same type of risk?</td>
<td></td>
</tr>
<tr>
<td>Did the selection rely on identifying a leading member first, and followers</td>
<td>This provides an understanding of the nature of competition in the selection process.</td>
</tr>
<tr>
<td>afterwards?</td>
<td></td>
</tr>
<tr>
<td>Which of the following criteria are most important in selecting leaders and</td>
<td></td>
</tr>
<tr>
<td>followers?</td>
<td></td>
</tr>
<tr>
<td>- The insurer’s reputation with the broker from previous working experience.</td>
<td></td>
</tr>
<tr>
<td>- The insurer’s knowledge of the risk.</td>
<td></td>
</tr>
<tr>
<td>- The premium offered by the insurer.</td>
<td></td>
</tr>
<tr>
<td>- The insurer’s willingness to meet customers’ needs.</td>
<td></td>
</tr>
<tr>
<td>How long did the selection process take?</td>
<td>This provides an indication of the competition available for the different roles in the cooperation scheme.</td>
</tr>
<tr>
<td>How many candidate leaders and followers were involved in the selection process?</td>
<td><em>This provides an indication as to whether there might be a lack of incentives to compete for the leading role.</em></td>
</tr>
<tr>
<td>Was the final number of members in the scheme higher, lower or the same as the</td>
<td></td>
</tr>
<tr>
<td>number originally envisaged?</td>
<td></td>
</tr>
</tbody>
</table>
### Information sought

| Did some potential candidate leaders only compete for a follower role?* | role (particularly useful in combination with questions on the alignment of premiums, and the criteria used for selecting the leader). |
| Did some of the followers compete also for the leading role?* | This may indicate potential barriers to entry in the brokerage market (as the more services that are provided, the more time it could take for a new entrant to acquire the relevant know-how). |
| Besides selecting members, what other services does the broker provide? | This provides information on potential barriers to entry in the brokerage market (as the more services that are provided, the more time it could take for a new entrant to acquire the relevant know-how). |
| - Risk assessment. | |
| - Risk mitigation. | |
| - Claims handling. | |
| - Other (explain). | |
| How frequently can the customer ask for the business to be resubmitted in the market? | This provides information on switching costs for customers. |
| What is the broker’s remuneration arrangement? | This provides information on potential misalignment of incentives between brokers and clients. |
| Are the premiums charged uniform across scheme members? | This may indicate competition concerns (in a static or dynamic sense), especially in combination with information on the extent of competition for leader and follower roles and the criteria for selecting leaders. |

### 8.3 Client engagement

The identification of commercial buyers of insurance provided by cooperative schemes is the most challenging part of the stakeholder engagement process. This is due to such information not being disclosed neither from the schemes, nor from the individual insurers comprising them. In order to address this concern, we have researched the likely clients of co(re)insurance schemes. The approach we followed is two-fold.

First, we considered companies within sectors that are mostly exposed to unconventional risks. The largest players within such sectors would be most likely to seek cover through cooperative insurance schemes, either in the form of a pool or an ad hoc agreement, given their size and potential losses in case an adverse event materialises. Second, following the same logic, insurance firms are likely to seek reinsurance in order to mitigate underwriting risk. Thus, insurance firms, particularly large ones, may be considered as clients of coreinsurance schemes. Similarly, coinsurance pools may be reinsured through an ad hoc agreement.126

---

126 See E&Y (2014) “Study on co(re)insurance pools and on ad hoc co(re)insurance agreements on the subscription market” Report for European Commission.
8.3.1 Demand for unconventional risk insurance

Risk coverage for certain events, such as terrorism, nuclear catastrophes, natural catastrophes, cyber breaches, or environmental damages is not readily available on the free market. However, in the modern world, these forms of insurance are becoming increasingly necessary, especially within certain industries that are highly exposed to such risks. It is therefore intuitive to assume that unconventional risk insurance is being sought after by companies, particularly large ones, seeking coverage for events with grave operational consequences, if occurred.

In what follows, we present our thinking for the likely buyers of insurance adhering to the above risk types. Although it remains to be investigated whether firms exposed to such risks are indeed covered by some form of cooperative insurance scheme, as opposed to following conventional channels (e.g. engaging with a single insurer), this approach represents an adequate starting point, allowing for a thorough investigation.

- **Terrorism risk**: This form of unconventional risk insurance relates to coverage for any damages that would be caused by a terrorist attack. The policy would include any property (e.g. buildings, equipment, and inventory) that could potentially be destroyed/damaged by a terrorist attack as well as losses associated with the disruption of any business activities. Terrorism risk insurance would also cover life insurance (in case of casualties) and health/workers compensation insurance (in case of any injuries). Therefore, in identifying likely buyers of such form of insurance coverage, one would need to first identify areas that are most likely to be victims of a terrorist attack. Accordingly, businesses located in urban places with a large number of daily customers, such as an airport or a train station (and the associated aviation/railway companies that travel to and from these stations) may be considered as highly likely to purchase terrorism risk insurance. Similarly, businesses operating in the energy sector or venues with lots of people (stadiums, arenas) may also be considered as highly likely to purchase this type of insurance.127

- **Natural catastrophe risk**: With the proliferation of major storms, specifically hurricanes, in recent years (but also earthquakes, floods and major winter storms), companies have been faced with an increasing need to manage the risk of a natural catastrophe negatively affecting, or even completely halting, their business operations. Catastrophe risk has two features that make it different from other forms of insurance. The first is the fat-tailed loss distribution. From an insurance perspective this means that the premium must be much higher than the expected loss since the insurer has to suffer substantial losses in case the event occurs. The second relates to the spatial correlation of losses. This means that in case the event occurs, companies closely located to one another would be affected.128 Although it would make sense for all businesses to have catastrophe insurance (despite the high cost), the industries that need it most are those located in geographic areas that are susceptible to flooding and storms. Therefore, businesses that are located on the coast or at low elevations (e.g. hotel resorts) are at greater risk along with businesses that rely on advanced forms of technology and their smooth operation.

---

127 See [http://www.iii.org/article/does-my-business-need-terrorism-insurance](http://www.iii.org/article/does-my-business-need-terrorism-insurance)
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

(e.g. utilities, telecommunications) are expected to be most likely to seek coverage against natural catastrophes.

- **Environmental and/or nuclear risk**: Environmental damages caused from business operations can have detrimental effects on company performance. This becomes particularly apparent taking into consideration the strict environmental regulatory provisions in place and the major financial penalties associated with damaging the environment. Environmental incidents have also become more high-profile in the media and this increased awareness is likely to have incentivised companies to seek the necessary insurance. It is therefore logical to assume that companies, whose operations are likely to pollute the environment are most likely to seek environmental risk coverage. Such companies may be agrochemicals firms, which frequently rely on the use of fertilisers and are therefore exposed to the risk of contaminating the soil, water supplies and even the air. Similarly, companies involved in the extraction and transportation of fossil fuels face the risk of spills. Shipping companies along with nuclear power plants and other manufacturing industries run the risk of polluting the environment as well, as do food processing companies due to the waste produced from their operations (e.g. methane emissions).\(^{129}\)

- **Cyber risk**: It is logical to assume that companies with a large amount of information stored in digital means are most exposed to the risk of cyber breaches. For instance, bankers have stated that a single cyberattack can halt the operations of the entire institution, thus demonstrating the severity of the threat and the need for insurance coverage. Therefore, banks, which not only have an immense amount of financial—and sensitive—information held on servers but also make the majority of their transactions online are highly likely to purchase cyber risk insurance. Along with banks are data storage companies that hold personal and business related information for millions of households and companies. Furthermore, manufacturing companies have reported cyber theft on their product launch plans, trade secrets, company contact lists, marketing strategies, passwords, and more. In particular, in a survey of about 4,000 IT managers across 27 countries, over one in five manufacturing firms admitted to suffering losses from cyberattacks, exemplifying their need for cyber risk insurance.\(^{130}\) Other businesses that hold vast amounts of personal information in their computers from their customers are health care companies, which are also likely to benefit from cyber risk insurance.

### 8.3.2 Demand for reinsurance

Reinsurance constitutes a type of insurance involving the acceptance by an insurer (i.e. the reinsurer) of all or part of the risk of loss covered by another insurer (i.e. the ceding company). When reinsurance is ceded to the reinsurer, the ceding firm is able to lower the variation in its cash flows and its financial leverage. Therefore, purchasing reinsurance reduces insurers’ insolvency risk by stabilising loss experience, increasing capacity, limiting liability on specific risks, and/or protecting against adverse

\(^{129}\) See [http://www.chubb.com/international/uk/cci/chubb9924.html](http://www.chubb.com/international/uk/cci/chubb9924.html)

As a result, the decision to seek reinsurance may be justified under the prism of both risk management and capital structure.

In light of the above, it is almost straightforward to consider as purchasers of reinsurance stand-alone insurance firms, particularly large ones with an international scope of operations. Such large insurers would be likely to seek to mitigate underwriting risk (and therefore insolvency risk as well) by striking reinsurance agreements with larger insurance firms, insurance firms specialising solely on reinsurance, or cooperative schemes, either in the form of pools or ad hoc agreements. The latter are more likely in the case of large insurers seeking reinsurance, considering the potential large amounts of exposures entailed in their operations and the need to mitigate the associated risks.

Potential purchasers of reinsurance may also be insurance pools. Given the increased amount and/or size of claims within a pool, particularly in case the State does not participate as an insurer of last resort, such schemes may seek to strike a reinsurance agreement. This may involve a single stand-alone reinsurer, which is more likely to be observed in case of domestic pools with a national scope of operations, or, as also reflected in the EY report, ad hoc agreements, the latter being more likely to be observed in case of pools with a supra-national scope of operations.

8.4 Development of questionnaire to support client engagement

The questionnaire was developed with the intention of providing a framework for discussion, rather than a strict set of questions to be answered. Overall, the questionnaire was structured along the following dimensions:

- Company profiling.
- The rationale for the formation of schemes.
- The distinctive functional features of schemes.
- Premium determination and scheme formation mechanisms.

The above are presented in more detail below:

8.4.1 Company profiling

The questionnaire was designed to support the structured interview programme. The first section of the questionnaire profiles the respondents in terms of their participation in cooperation schemes. This profiling of respondents helps us to understand to what extent the views expressed through the interviews are applicable to the industry as a whole, or to certain types of players within the industry.

**Table 8.6: Company profiling – information sought and its relevance to the study**

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the total amount of risk you have sought to insure during the past year?</td>
<td>The general profiling information is important in understanding whether, and, if so, how,</td>
</tr>
<tr>
<td>Which areas of unconventional risk did you seek?</td>
<td></td>
</tr>
</tbody>
</table>

---

Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

stakeholder responses may vary for different types of stakeholders (e.g. by size, geographic coverage and risk type).

**Information on scheme involvement**

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>In which EU market(s) are you active?</td>
<td>This information helps in further profiling the respondents and, in particular, in understanding how the cooperative scheme might vary by client type.</td>
</tr>
<tr>
<td>In which EU markets are the cooperation schemes, of which you are a client active?</td>
<td></td>
</tr>
<tr>
<td><strong>Information on scheme involvement</strong></td>
<td></td>
</tr>
<tr>
<td>With how many cooperation schemes are you associated?</td>
<td></td>
</tr>
<tr>
<td>Is the scheme in the primary insurance or reinsurance market?</td>
<td></td>
</tr>
<tr>
<td>What is the typology of cooperation’s scheme? (ad hoc / multi-lateral pool / collective pool)</td>
<td></td>
</tr>
<tr>
<td>When was the scheme formed, and since when have you been a client?</td>
<td></td>
</tr>
<tr>
<td>Which type(s) of risk(s) do they cover? (catastrophe / cyber / nuclear / terrorism / other)*</td>
<td></td>
</tr>
<tr>
<td>Are you aware of the different insurance companies participating in the scheme and their roles (e.g. leader vs followers).</td>
<td></td>
</tr>
<tr>
<td>How many members adhere to the scheme(s)? **</td>
<td></td>
</tr>
</tbody>
</table>

**8.4.2 The rationale for selection of cooperation schemes**

We sought to understand the reasons for the selection of the schemes as a means of (re)insurance from the clients’ perspective.

**Table 8.7: Rationale for scheme formation – information sought and its relevance to the study**

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was the scheme the only available option for coverage, or was the scheme selected in favour of a single (re)insurer? (And if so, was this because of...)</td>
<td>The benefits of cooperation schemes in the primary markets are generally well understood.</td>
</tr>
<tr>
<td>The nature of the risk (e.g. low event occurrence, large losses)?</td>
<td>These questions should help rationalising the benefits of a cooperation scheme in the (re)insurance market, from a client’s perspective.</td>
</tr>
<tr>
<td>The premium quoted by a stand-alone firm? (And if so...)</td>
<td></td>
</tr>
</tbody>
</table>


Information sought | Relevance to the study
--- | ---
How does the premium charged by the scheme differ from that charged on a stand-alone basis?* | perspective, among other things. This will be facilitated by identifying any systematic differences in the rationales for the selection of schemes within the primary and reinsurance markets.

Were there other rationales for the selection of the scheme (e.g. selection obligatory by state mandate)? | This seeks to understand whether there are other factors at play in driving scheme selection, aside from market failure in the primary insurance and reinsurance markets.

---

8.4.3 The distinctive features of cooperation schemes

The focus of this section is to understand the technical and/or contractual features of the relation between the purchaser and the cooperation scheme; the associated retention levels and cover limits; how easy it is to exit the agreement, its average duration and contract renewal frequency; the type of liability regime in place. This section of the questionnaire also asks respondents what conditions they had to agree with in order to experience the benefits of being (re)insured by a cooperation scheme. We also ask whether there are any conditions in place that may make exiting the cooperation scheme difficult.

**Table 8.8: Distinctive features of cooperation schemes – information sought and its relevance to the study**

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the duration of a typical agreement with a cooperation scheme?</td>
<td>Information provided here help us to consider if there are any potential competition implications (e.g. lock-in effects) with regards to the scheme’s operations.</td>
</tr>
<tr>
<td>How often must the agreement be renewed</td>
<td>Information provided here helps address the extent to which cooperation schemes may not be optimally calibrated and could give rise to inefficiency and free riding problems among members, ultimately exposing clients to increased credit risk.</td>
</tr>
<tr>
<td>Are there any penalties in place in case of breach of the agreement</td>
<td></td>
</tr>
</tbody>
</table>
joint or several) of the scheme?

What other rules and contractual terms are in place (e.g., claims handling, underwriting rules, contribution fees etc.)?

8.4.4 Premium determination and scheme selection mechanisms

Here we wish to understand, in greater depth, how the client perceives the premiums quoted by the cooperation scheme. We ask the interviewees about the negotiation that took place in the determination of leaders and followers, in case of ad hoc agreements. We also seek to understand the factors that were mostly taken into account when selecting the leader, and how the selection of the leader was determined. This section of the interview also seeks to uncover the relationship of the client with the broker (if a broker was indeed involved), including: how many brokers they approached; how the brokers resulted in the selection of candidates to be leaders or followers; and how the brokers were remunerated for their involvement.

Table 8.9: Premium determination & scheme formation – information sought and its relevance to the study

<table>
<thead>
<tr>
<th>Information sought</th>
<th>Relevance to the study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was a broker involved in the scheme selection? (And if so...)</td>
<td>This provides an indication of the degree of competition in the brokerage market for a given risk segment.</td>
</tr>
<tr>
<td>How many brokers did you contact?</td>
<td>This provides an indication of the drivers of selection of pools as opposed to ad hoc agreements.</td>
</tr>
<tr>
<td>How did you select your preferred broker?</td>
<td></td>
</tr>
<tr>
<td>Overall, how many choices were offered, covering your (re)insurance needs, prior to final selection?</td>
<td></td>
</tr>
<tr>
<td>Did the broker offer a wide variety of choices in terms of risk coverage (i.e. stand-alone (re)insurance firm, co(re)insurance pool, ad hoc co(re)insurance agreement)?</td>
<td></td>
</tr>
<tr>
<td>What were the main criteria for the selection of a pool, as opposed to an ad hoc agreement, and vice versa?</td>
<td></td>
</tr>
<tr>
<td>In case of ad hoc agreement, did the selection of the scheme rely on identifying a leading member first, and followers afterwards? (And if so...)</td>
<td>This provides an understanding of the nature of competition in the selection process.</td>
</tr>
<tr>
<td>Which of the following criteria are most important in selecting leaders and followers?</td>
<td></td>
</tr>
<tr>
<td>The (re)insurer’s reputation with the broker from previous working experience.</td>
<td></td>
</tr>
<tr>
<td>The (re)insurer’s credit rating.</td>
<td></td>
</tr>
<tr>
<td>The (re)insurer’s knowledge of the risk.</td>
<td></td>
</tr>
<tr>
<td><strong>Information sought</strong></td>
<td><strong>Relevance to the study</strong></td>
</tr>
<tr>
<td>------------------------</td>
<td>---------------------------</td>
</tr>
<tr>
<td>The premium offered by the (re)insurer.</td>
<td></td>
</tr>
<tr>
<td>The (re)insurer’s willingness to meet customers’ needs.</td>
<td></td>
</tr>
<tr>
<td>How long did the selection process take?</td>
<td></td>
</tr>
<tr>
<td>How many candidate leaders and followers were involved in the selection process?</td>
<td>This provides an indication of the competition available for the different roles in the cooperation scheme.</td>
</tr>
<tr>
<td>Did negotiations take place with each candidate leader and follower?</td>
<td></td>
</tr>
<tr>
<td>Did the premiums quoted by leader and followers differ?</td>
<td>This may indicate competition concerns (in a static or dynamic sense), especially in combination with information on the extent of competition for leader and follower roles and the criteria for selecting leaders.</td>
</tr>
<tr>
<td>Was the final number of members in the scheme higher, lower or the same as the number originally envisaged?</td>
<td></td>
</tr>
<tr>
<td>Did some potential candidate leaders only compete for a follower role?*</td>
<td></td>
</tr>
<tr>
<td>Did some of the followers compete also for the leading role?*</td>
<td></td>
</tr>
<tr>
<td>Besides selecting members, what other services does the broker provide?</td>
<td>This may indicate potential barriers to entry in the brokerage market (as the more services that are provided, the more time it could take for a new entrant to acquire the relevant know-how).</td>
</tr>
<tr>
<td>Risk assessment.</td>
<td></td>
</tr>
<tr>
<td>Risk mitigation.</td>
<td></td>
</tr>
<tr>
<td>Claims handling.</td>
<td></td>
</tr>
<tr>
<td>Other (explain).</td>
<td></td>
</tr>
<tr>
<td>Were any of the above services offered to you? And if so were they charged separately?</td>
<td></td>
</tr>
<tr>
<td>How frequently can the customer ask for the business to be resubmitted in the market?</td>
<td>This provides information on switching costs for customers.</td>
</tr>
<tr>
<td>What is the broker’s remuneration arrangement?</td>
<td>This provides information on potential misalignment of incentives between brokers and clients.</td>
</tr>
</tbody>
</table>
9 Appendix: Legal Analysis

We consider the impact on competition due to the different forms of cooperation that can exist between insurance companies, and also between insurance companies and brokers. Several legal issues can arise within the context of merger control and concerted practices. These depend on the type of cooperation and the type of the contractual features. First, therefore, we will describe the various forms of cooperation and identify the possible legal issues. We subsequently analyse these legal issues in detail.

Table 10.1: Possible relevant contractual features

<table>
<thead>
<tr>
<th>Phases of Cooperation</th>
<th>Legal Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initiation of Cooperation:</strong></td>
<td></td>
</tr>
<tr>
<td>• By customers in the individual case</td>
<td>The main legal issues relate to the exchange of information and defining the relevant product market relevant both to merger control and the ban on concerted practices</td>
</tr>
<tr>
<td>• By brokers in the individual case</td>
<td></td>
</tr>
<tr>
<td>• By brokers as a pool</td>
<td></td>
</tr>
<tr>
<td>• By an insurer in the individual case</td>
<td></td>
</tr>
<tr>
<td>• By an insurer as a pool</td>
<td></td>
</tr>
<tr>
<td><strong>Set-Up</strong></td>
<td></td>
</tr>
<tr>
<td>• Separate determination of first the leader and then the involved party</td>
<td>The main legal issues relate to a possible agreement on premiums, offer conditions, commission and loss adjustment practice.</td>
</tr>
<tr>
<td>• Establishment of conditions</td>
<td></td>
</tr>
<tr>
<td>• Establishment of premium</td>
<td></td>
</tr>
<tr>
<td>• Establishment of shares</td>
<td></td>
</tr>
<tr>
<td><strong>Events of Damage or Loss</strong></td>
<td></td>
</tr>
<tr>
<td>• Leadership clause and involvement of all insurers</td>
<td>Here, too, the main legal issues that might arise relate to the exchange of information and concerted practices.</td>
</tr>
<tr>
<td>• Unanimous decision of the insurers</td>
<td></td>
</tr>
<tr>
<td>• Exchange of information</td>
<td></td>
</tr>
<tr>
<td><strong>Duration of the Cooperation</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Renewal</strong></td>
<td></td>
</tr>
<tr>
<td>• Who initiates the renewal?</td>
<td></td>
</tr>
<tr>
<td>• Does any distribution to different layers take place?</td>
<td></td>
</tr>
<tr>
<td>How are the layers composed?</td>
<td></td>
</tr>
<tr>
<td>On what terms?</td>
<td></td>
</tr>
<tr>
<td>• What information is exchanged?</td>
<td></td>
</tr>
</tbody>
</table>
9.1 Legal Framework

Financial services and more particularly insurance services fall within the scope of EU competition laws as laid down in Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU) (European Commission, Second Report on Competition Policy (1972), point 60; ECJ, Case 45/85 – Verband der Sachversicherer).

Cooperation between insurance undertakings and in particular co-insurance agreements (including co-reinsurance agreements) thus fall within the ambit of Art. 101 (1) TFEU which prohibits all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market.

Co-insurance agreements may give rise to a number of competition concerns in as far as they may involve restrictions of competition in particular regarding the standardisation of policy conditions, of terms or of financial aspects such as premiums or cover. Further, participants often exchange information when entering into co-insurance agreements. The exchange of information between competitors is a two-edged sword from a competition law perspective: information exchange between competitors may generate efficiencies and spur competition. On the other hand it may also lead to restrictions of competition, e.g. where it enables competitors to become aware of other rival's conduct on the market or of their market strategies (see, e.g. Case C-7/95 P – John Deere, para 88.). The latter may be the case with co-insurance agreements where competitors become aware of their rivals’ pricing or policy conditions and terms.

However, co-insurance agreements comprising such restrictions are not automatically prohibited under Art. 101 (1) TFEU:


Accordingly, co-insurance agreements between insurers who would not be in a position to fully insure a certain risk individually, normally fall outside the scope of Art. 101 (1) TFEU (see also Commission Regulation (EU) No 267/2010 of 24 March 2010 on the application of Article 103 (3) of the Treaty on the Functioning of the European Union to certain categories of agreements, decisions and concerted practices in the insurance sector (IBER), recital 13).

Whether a given co-insurance agreement is necessary in this sense needs to be assessed by reference to the actual circumstances of each individual agreement. Co-insurance may for example become necessary when particularly large or unconventional risks (e.g. nuclear incidents, natural disasters, terrorist acts) need to be insured. In such cases often no individual insurer has the relevant know-how to accurately predict insurance costs and often no individual insurer will be in a position to cover the entire risk or to provide the entire capacity alone.
"Appreciability/effect on trade between Member States": Further, in order to fall within the ambit of Art. 101 (1) TFEU the agreement must have (i) the object or effect of perceptibly restricting competition within the internal market and (ii) be capable of affecting trade between Member States (e.g. Case 5/69 – Völk, para. 7; Case C-7/95 P – Deere v Commission, para. 77; Case C-226/11 – Expedia, para. 13, 14).

Whether a given co-insurance agreement is likely to have an appreciable effect on competition and on trade between Member States needs to be assessed by reference to the actual circumstances of each individual agreement.

In this respect guidance is provided, inter alia, in the European Commission’s Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty (Effect on Trade Guidelines, OJ 2004 No C 101/81). The Effect on Trade Guidelines set out, with the help of a market share threshold in combination with a turnover threshold, the circumstances under which the European Commission quantifies agreements to appreciably effect trade on Member States.

Further, with regard to the question if an agreement appreciably restricts competition, the European Court of Justice has clarified that an agreement that may affect trade between Member States, and that has an anti-competitive object constitutes, by its nature and independently of any concrete effect that it may have, an appreciable restriction on competition (Case C-226/11 – Expedia, para 37). With regard to agreements which do not restrict competition by object guidance is provided by the De Minimis Notice that sets out, with the help of market share thresholds, the circumstances in which the European Commission considers that agreements – which do not restrict competition by object – may have an appreciable effect on competition. The market share thresholds vary, depending on whether the agreement is entered into between competitors or non-competing undertakings.

Co-insurance agreements which have the object or effect of restricting competition as described above may nevertheless be exempt from the prohibition in Art. 101 (1) TFEU by virtue of Art. 101 (3) TFEU and in particular the IBER:

- Under Art. 5 IBER certain co-insurance agreements are exempted from the general prohibition in Art. 101 (1) TFEU. Only institutionalised co-insurance pools benefit from the exemption provided for in Art. 5 IBER. Further, unless new risks are being covered, the exemption only applies to co-insurance pools on condition that (i) the combined market share held by the participating insurers does not exceed 20% (in the case of co-insurance) or 25% (in the case of co-reinsurance) and (ii) that the co-insurance agreement does not contain any of the restrictions as set out in Art. 7 IBER.

Whether a given co-insurance agreement falls within the ambit of the IBER needs to be assessed by reference to the actual circumstances of each individual agreement. In any event, given that in practice most, by far, co-insurance agreements are ad hoc co(re)insurance agreements on the subscription market, which are not covered by the IBER, the practical impact of the IBER for institutionalised co-insurance agreements appears consequently limited.

- Under Art. 101 (3) TFEU, even where the conditions set out in the IBER are not met by a given co-insurance pool, co-insurance agreements may still be exempted from the prohibition of Art. 101 (1) TFEU provided that (i) the agreement
Different forms of cooperation between insurance companies and their respective impact on competition

contributes to the production or distribution of insurance services, (ii) consumers receive a fair share of the resulting benefits, (iii) the restrictions are indispensable to the attainment of these objectives and (iv) the agreement does not afford the participating insurers the possibility of eliminating competition in respect of a substantial part of the insurance services in question.

Whether a given co-insurance agreement fulfils the conditions of Art. 101 (3) TFEU needs to be assessed by reference to the actual circumstances of each individual agreement. Valuable guidance in this respect can be found in the European Commission’s Guidelines on the applicability of Article 101 of the Treaty of the Functioning of the European Union to horizontal co-operation agreements (Horizontal Guidelines, OJ 2011 C 11/1), and, more generally on the application of Art. 101 (3) TFEU in general, in the European Commission’s Guidelines on the application of Art. 81 (3) of the Treaty, OJ 2004 C 101/97. The Horizontal Guidelines set out principles with regard to a number of aspects which are relevant in the context co-insurance, such as information exchange, or which bear similarities with the concept of co-insurance, such as joint research and development or joint production between competitors. The Horizontal Guidelines refer to market shares of the involved undertakings when analysing the competitive effects of individual practices.

In addition to the general prohibition of anti-competitive agreements and concerted practices, Art. 102 TFEU prohibits the abuse of a dominant position by one or more undertakings within the internal market. This provision equally applies to the insurance sector and to insurance pools. The IBER does not apply to Art. 102 TFEU infringements.

Finally, depending on the specific structure of the cooperation between insurers, cooperation can be subject to Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentration between undertakings (ECMR). While normally co-insurance agreements do not constitute a concentration within the meaning of Art. 3 ECMR, decisions under the ECMR nevertheless provide valuable guidance on market definitions in the insurance sector.

9.2 Impact of Supply-Side Substitutability on Competitive Assessment

It follows from the above that under the legal framework the viability of co-operation in the insurance sector as such and the extent to which insurers can benefit from the exemptions provided in the IBER or, and possibly more importantly in practice, fall within the principles set out in the Horizontal Guidelines, the De Minimis Notice or the Effect on Trade Guidelines, depends, inter alia, on the insurer’s market share and, consequently, on the definition of the relevant markets. Therefore, market definition and the concepts applied therein play an important role in the 'self-assessment' required under Council Regulation (EC) No 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.

Generally markets are defined based on the concept of demand-side substitution (see, e.g. Case 6/72 – Continental Can, para 32; case 27/76 – United Brands, para 11; case 31/80 – L’Oréal, para 25; European Commission Notice on the definition of relevant market for the purposes of Community competition law, OJ 1997 C 372/03 (Market Definition Notice), para 13). From a demand-side perspective the relevant product market comprises all those products and/or services which are regarded as
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

interchangeable or substitutable by the consumer, by reason of the products’/services’ characteristics, their prices and their intended use (Market Definition Notice, para 7).

However, also supply-side substitution has long been a central element of market definitions in EU competition law (see, e.g. Case 6/72 – Continental Can; case 322/81 – Michelin, paras 41, 44; Market Definition Notice, paras 20-23). Supply-side substitution essentially exists where alternative suppliers can switch to, or start offering, a product/service in response to a price increase of another product service.

In the insurance sector the European Commission's practice always attached a particular importance to supply-side substitutability. In fact it has even been argued that 'insurance is an exception to the usual principle' that demand-side substitution is the starting point of market definitions and that in insurance market definition 'must start with supply-side substitutability' (Faull & Nikpay, The EU Law of Competition, 3rd edition 2014, para 11.182). While this may overstate the importance of supply-side substitution, supply-side substitution is doubtless a crucial element in the European Commission’s practice in insurance markets:

- In its merger control cases the European Commission traditionally follows a tripartite market definition, distinguishing between (i) life-insurance, (ii) non-life insurance and (iii) reinsurance (see, e.g. Case COMP/M.7233 - Allianz/Going Concern of Unipolsai Assicurazioni; COMP/M.6957 - IF P&C/TOPDANMARK; COMP/M.6217 - Baloise Holding/Nateus/Nateus Life; COMP/M.6053 - CVC/Apollo/Brit Insurance; COMP/M.4284 - AXA/Winterthur; COMP/M.2676 – Sampo/Varma/IF Holdings/JV; COMP/M.2400 – Dexia/Artesia; COMP/M.2225 – Fortis/ASR; COMP/M.1989 – Winterthur/Colonial; COMP/M.1886 – CGU/Norwich Union; COMP/M.1910 – Meritanordbanken/Unidanmark; COMP/M.1816 – Churchill Insurance Group/Hig Holdings; COMP/M.1777 – CGU/Hibernian).

- In many merger cases the European Commission did not consider it necessary to define narrower markets within these three segments with a view to supply-side substitution:

  - The European Commission recognized that, from the demand-side, life and non-life insurance can be divided into as many product markets as there are different kinds of risks covered (see, e.g. Case No. M.2676 – Sampo/Vama/IF Holding/JV Decision; COMP/M.2400 – Dexia/Artesia; COMP/M.1453 – AXA/GRE; COMP/M.2343 – Toro Assicurazioni/Lloyd Italico; COMP/M.2225 – Fortis/ASR; COMP/M.1886 – CGU/Norwich Union; COMP/M.1712 – Generali/INA). The European Commission recognized that characteristics, premiums and purposes of each insurance are distinct and there is typically no substitutability from the consumer's perspective between different risks insured (for example, in non-life insurance, motor, fire, transport, health, property, general civil liability, casualty, litigation, working accidents would not be interchangeable from a consumer's perspective).

  - However, with a view to supply-side substitution, the European Commission has often considered that the conditions for insurance of different types of risk are quite similar and that most large insurance companies are active in several types of risk. From this, the European Commission concluded that different types of non-life insurance could be included in the same product market (see, e.g. Case No. COMP/M.2676 – Sampo/Varma Sampo/IF Holding/JV; Case No. IV/M.3556 – Fortis/BCP; COMP/M.2491 – Sampo Storebrand; COMP/M.1989 –
Winterthur/Colonial, COMP/M.1886 – CGU/Norwich Union; COMP/M.1712 – Generali/INA). For the same reasons it considered taking a similar approach to life insurance (see, e.g. COMP/M.5075 – Vienna Insurance Group / EBV; COMP/M.5728 – Crédit Agricole/Société Générale Asset Management; COMP/M.5925 – Metlife / Alico / Delam; COMP/M.4284 – AXA/Winterthur; COMP/M.6217 – Bâloise Holding / Nateus / Nateus Life; COMP/M. 4055 – Talanx/Gerling; COMP/M.3446. – Unica/Mannheimer).

\* On the other hand, the European Commission often did at least consider further submarkets within the three main markets, e.g. within the non-life insurance market a distinction between the segments (i) accident and sickness; (ii) motor vehicle; (iii) property; (iv) marine, aviation and transport (“MAT”); (v) liability; (vi) credit and suretyship and (vii) travel (see, e.g. COMP/M.6521 – Talanx International/Meiji Yasuda Life Insurance/Warta; COMP/M.4284 – AXA/Winterthur; COMP/M.4701 – Generali/PPF Insurance Business) and in at least one case also did define a narrower market within non-life insurance, namely the Irish market for health insurance (Case COMP/M.8010 – IRISH LIFE / AVIVA HEALTH / GLOHEALTH).

Consequently, in the insurance market supply-side substitution remains an important factor when analysing competitive effects and, more specifically, when defining relevant markets and establishing market shares. The concept of supply-side substitution accordingly is a significant element also with regard to the self-assessment undertakings need to carry out within the framework provided for by Council Regulation (EC) No 1/2003.

9.3 Overview of the case law analysed

9.3.1 European Case Law

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction:</strong> The subject of the decision is an agreement of the association of engineering insurers Nuovo Consorzio Centrale Guasti alle Macchine (New Central Engineering Insurers Association) (‘Nuovo CEGAM’).</td>
</tr>
<tr>
<td><strong>Decision:</strong> Exemption pursuant to Article 85 (3) of the TFEU granted.</td>
</tr>
</tbody>
</table>

**The Agreements**

Nuovo Cegam was founded with the aim of promoting and developing engineering insurance and its objects are defined in the preamble as:

- action to disseminate and promote insurance against risks of machinery breakdown or damage, including consequential indirect risks, risks during installation, and construction accidents,
- updating and analysis of technical and actuarial data to improve performance in this class of business,
- provision, whenever necessary, of technical assistance to members on underwriting and claims settlement.

The agreements contain also the maximum commissions members may pay their own commercial organizations and the maximum commission payable by the reinsurer to the ceding insurer.

**Legal Assessment**
The Commission stated that the object of the foundation of the Association and the effect of its activities restricted or distorted competition within the common market because:

- Under the agreements, a large number of direct insurers, who but for the formation of the Association would be in full competition with one another, have established machinery under which, on the basis of statistical information on claims experience communicated by the members to the Association's organs, a common tariff of basic premiums for various types of risk is drawn up which the members agree to apply.

- Although members are able to fix their own final premiums by adding to the basic premium a margin for expenses, commission and profit which they see to in their best commercial interest, the agreements nevertheless unquestionably have the object and effect of restricting the competition that would otherwise exist between the firms concerned.

- At the coinsurance level, the agreements restrict members' choice of coinsurers since they are obliged to choose other members of the Association for this purpose.

- In reinsurance, the anti-competitive effect of the Agreement is twofold: first, it restricts members' choice of reinsurers; secondly, it restricts the reinsurer's freedom to set his own premium rates and contract conditions, both in his business with members of the Association and in his business transacted within Italy with non-members.

Exemption under Article 85 (3) now Article 101 (3) of the TFEU

According to the Commission the formation of an association such as Nuovo Cegam improved the production and distribution of insurance services. The work being undertaken by Nuovo Cegam in the Italian insurance industry helped to enlarge its capacity, thereby widening the choice available to the consumer and offering him a technically more advanced product.

**EU Commission Official Journal 1985 No. L 376/2 – P & I Clubs I**

**Transaction:** The subject of the decision is an agreement an agreement known as the International Group Agreement (IGA), which came into force on 8 December 1981. After a preliminary examination, the Commission considered that the agreement contained a number of clauses that could not be exempted under Article 85 (3). On 27 July 1984 the P & I clubs notified the text of a modified IGA (IGA 1984) for which they requested negative clearance or alternatively an exemption under Article 85 (3) of the Treaty. That text came into force on 31 July 1984.

**Decision:** The Commission decided that the agreement as amended satisfies all the requirements of Article 85 (3) (old version) of the TFEU.

**P & I Clubs:** The P & I Clubs are mutual non-profit-making associations of ship owners, charterers, operators and managers of ships, who agree to share each other's liabilities on a non-profit-making basis. The P & I insurance covers contractual and third-party liability and has been traditionally insured by ship owner mutual associations. The insurance covers different types of risk: injury or death of crew, passengers and others; collision damage to vessels; other damage to third-party property (such as harbor equipment); pollution; cargo
and other (such as expenses of wreck removal). Most P & I insurers provide all these types of cover under a single contract.

### The agreement as originally notified

- The obligation on a club ('new club') not to offer, for a ship currently insured with another club ('holding club'), a lower premium than the holding club's rate (i.e. the rate at which the holding club is prepared to renew the insurance) unless the holding club's rate exceeds a bracket of 'going' rates.

This obligation had the effect of preventing or restricting competition on premiums, since the only possibility a new club had of gaining the business of an operator already insured with another club and of applying a new rate was to demonstrate that the holding club's rate exceeded the maximum amount considered to be reasonable in the particular case.

- The clause applying the quotation rules referred to in the clause above not only to ships currently insured, but also to new or newly acquired ships ('new ships rule').

This clause was a further restriction on the insured's freedom to choose his insurer.

- The clauses relating to release calls, i.e. the amounts members withdrawing a vessel or a fleet from a club are charged to cover their share of liabilities incurred during their membership but not settled at the time of withdrawal.

The Commission was of the opinion that the clauses relating to release calls, could be used to reinforce restrictions on transfers between clubs.

- The rules relating to a minimum 'estimated total cost' (ETC) for tankers.

These provisions constituted restrictions of competition in that the clubs agreed minimum basic rates which had to be observed in all their writing of tanker business.

- The clauses relating to the composition and procedure of the expert committee.

Although these rules did not give rise to clear-cut restrictions, the Commission was of the opinion that their object or effect was to reinforce the ties between the clubs and could have contributed to restrictions on movements between one club and another. That consideration applied on the one hand to the composition of the committee, which did not contain any independent member, and on the other hand to the committee's procedures, which did not make any provision for appeal and restricted access to the records of the committee's deliberations to 'persons authorized by the clubs'.

### The amended agreement

- Quotations for vessels already insured: In the amended version a ship operator is in principle free to change clubs provided that the rate quoted by the new club is not considered unreasonably low. This possibility is subject to the condition that a binding agreement has been concluded before 30 September between the new club and the operator with effect from the beginning of the
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

policy year which follows. It is further required that this binding agreement has been notified to the holding club within three days of the commitment being made.

Under the agreement, despite modifications, the insurer's freedom to conclude agreements with a new client is restricted, with the result that the insured party's freedom to take advantage of competitive forces is reduced.

- Quotations for new vessels: An operator who has reached a binding commitment with a new club according to the clause above is free thereafter to insure a new vessel, benefiting immediately from the new club's rate, provided that that rate is not held by the Committee to be unreasonably low.

The result from this stipulation is to limit the possibilities for an operator to choose an insurer for new vessels who can offer a rate more financially advantageous than that which is presently available from the holding club.

- The clauses relating to release calls

Despite the amendments, the Commission is of the opinion that the rules on release calls could be used to reinforce restriction on transfers between clubs.

- Minimum estimated total cost for tankers: The minimum rate provided for in the agreement as originally notified has been deleted. Instead it is provided that all quotations for tankers must make fair and adequate provision for the following elements of cost: claims within the club's retention, contributions to pool claims, reinsurance cost, administration costs.

Even though the obligation uniformly to apply a minimum tariff is no longer present, the freedom for the insurers to fix theirs tariffs for tankers is restricted.

Exemption under Article 85 (3) now Article 101 (3) of the TFEU

The Commission decided that the agreement as amended satisfies all the requirements of Article 85 (3).


**Transaction:** Subject to the decision are two agreements between a number of non-life insurance companies. The object of the agreements is to fix maximum rates of commission, calculated as a percentage of the premium, according to the kind of business and the quality of the intermediary.

**Decision:** No final decision was made, because the Irish Minister for Industry and Commerce introduced maximum commission rates in the area of property insurance by way of an administrative act.

<table>
<thead>
<tr>
<th>The insurance companies' arguments</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurance companies consider that the agreements do not have as their object or effect the prevention, restriction or distortion of competition, since the companies only agreed maximum percentages of commission.</td>
</tr>
</tbody>
</table>

| The premiums charged by insurance companies for household insurance |
and for employers and public liability insurance have varied greatly even after the implementation of the agreements. The level of commission paid is just one of the cost elements which determine the price of insurance cover. Competition between insurance companies is not only based on the actual premium rates they charge, but also on the level of cover and the standard of services provided. In addition, the agreement on maximum rates of commission still give the insurance companies a wide discretion in the commission rates they actually pay below those maximums.

Furthermore, the insurance companies concerned argue that the arrangements contribute to promoting economic progress in that policyholders benefit from lower premiums than would otherwise have been charged had the agreements not been concluded.


**Transaction:** The subject of the decision is an agreement on cooperation in machinery loss of profits insurance (since 1998 also including space insurance) for the purpose of joint and mutual reinsurance of machinery loss of profits insurance risks and the advising of the companies concerned in the conclusion and handling of such insurance.

**Decision:** The agreement does not raise any concerns as to its compatibility with the Common Market as it does fulfil the condition for exemption under Article 85 (3) of the TFEU.

There are no joint premiums and conditions. The individual companies are free to calculate the direct insurance premium and to decide on the insurance conditions for the policies concluded by them. They may, if they so wish, ask TEKO to carry out a risk assessment and premium calculation (gross premium) in each individual case or calculate the premium themselves, although in practice they do so only in exceptional cases.

The TEKO companies (pool members and 'friendly' companies) may, if they wish, bring the policies concluded by them into TEKO for reinsurance. There is no obligation to bring such policies in; the companies are free to reinsurance themselves individually outside TEKO. They may also participate in other similar reinsurance pools. However, as a general rule they make use of the joint reinsurance and seek reinsurance outside TEKO only in exceptional cases. For the purposes of the joint reinsurance of all the business brought in, two reinsurance treaties were concluded on the open market on behalf of the TEKO companies.

The Commission states that as far as direct insurance is concerned, the restriction of competition rose from the organization of TEKO as a joint information and advisory body, and in particular from the risk assessment and premium calculation carried out by TEKO, which in practice results in coordination of the market behaviour of the companies concerned. Since it was only in exceptional cases that the companies calculate their own premiums and conditions and since contract
negotiations were usually based on an offer established by TEKO, they applied identical or comparable premiums and terms in identical or comparable situations, with the result that they did not in this respect enter into competition with one another.

Furthermore it was not possible to argue, in rebuttal of the finding of a restriction of competition, that without recourse to TEKO, particularly for the purpose of risk assessment and premium calculation, the companies concerned would not be able to offer machinery loss of profits insurance. As far as reinsurance is concerned, the restriction of competition results from the fact that joint reinsurance contracts are concluded on the market for all the contracts brought into TEKO.

Space insurance

The insurance contracts are concluded either by the companies themselves or by TEKO in the name and for the account of the companies. If so requested by the companies, TEKO carries out premium calculation and risk assessment, in agreement with the reinsurers as far as premiums are concerned. TEKO settles the reinsurance for the companies and concludes facultative reinsurance contracts on the market in their name. Such contracts are administered by TEKO. Any claims must be notified immediately to the reinsurers and may be settled only in agreement with them.

The agreement on cooperation in space insurance, under which the companies concerned insure space risks on a coinsurance basis and thus apply uniform premiums and terms and conditions, also means that the companies do not enter into competition with one another. Even if, in view of the particular nature of the risks and the level of the sums insured, space risks can in general be underwritten only on a coinsurance basis, it would be possible for the individual companies to participate on a case-by-case basis in coinsurance contracts with various third party undertakings on the basis of differing premiums and terms and conditions and thus to enter into competition with one another. They do not do so and rely instead on cooperation in the form of a permanent and institutionalized coinsurance pool. As far as reinsurance is concerned, the restriction of competition arises once again from the conclusion of joint reinsurance contracts.

Exemption under Article 85 (3) now Article 101 (3) of the TFEU

However, the Commission decided that the agreement fulfils the conditions for exemption under Article 85 (3) of the TFEU, especially since the cooperation within the framework of TEKO results in substantial rationalization and cost-saving, also since the staff can now develop new know-how, which will be available to the companies concerned.

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction:</strong> The subject of the decision is a non-profit making association of insurance companies known as the 'Concordato Italiano Incendio Rischi Industrial'.</td>
</tr>
<tr>
<td><strong>Decision:</strong> The Commission declared, that the provisions of Article 85 (1) of the EEC Treaty (old version) are inapplicable to the agreement notified.</td>
</tr>
</tbody>
</table>
### Concordato Incendio

The objective of the Concordato is to implement the principles governing insurance by providing members with the means of establishing sound management practices and improving the quality of service. The activities of the Concordato concern industrial fire insurance and supplementary fire insurance cover, whether or not provided for in the industrial fire insurance tariff, including consequential loss insurance.

### Product market

The Commission calculates the market share of the members of the Pool according to the sub-sector of industrial fire insurance to the fire insurance sector in general only for the area of Italy, however, it does not give a further explanation.

### Restrictions of competition

The restrictions of competition stem from the decisions taken by the association as regards:

- the invitation to members to take as a basis for their tariff rates the required premium rates resulting from the industrial fire insurance tariff which are communicated to them by the Concordato. The required rates are based on statistics compiled by the organs of the Concordato on the basis of data concerning losses notified by members,
- the recommendation that members use the definitions and general terms and conditions drawn up by the Concordato.

These restrictions limit competition between members as they tend to make uniform two essential components of their business practices:

- the required premium on which the tariff rate is based, and
- the general terms and conditions.

The fact that members are free to derogate from the general conditions laid down by the Concordato does not eliminate the restrictive nature of the commitment since, in such cases, members are required to notify any derogations if they are likely to affect the statistics compiled in the interests of members.

### Inapplicability according Art. 101 (3) of the TFEU (new version)

**Improving production or distribution**

The activities of an organization, like the Concordato, which is designed to give its members the means of operating efficiently and improving the quality of service by facilitating the acquisition of essential specialized knowledge, may be regarded as a means of improving the production of the insurance service by its members.

In addition, the technical assistance and resources made available by the Concordato facilitate access by certain undertakings to a market such as industrial fire insurance which would otherwise have been acquired only with the greatest difficulty. Easier access is at least potentially capable of resulting in a larger number of operators on the market, which makes it possible both to increase the aggregate capacity of the market and the number of undertakings competing against each other, thereby improving the production and distribution of the insurance service.

**Benefits to users**

The member of the Pool can offer, through the specialized knowledge made available by the Concordato, policies adapted to every requirement as regards the assessment of the risk and prevention and calculation of the premium.

The existence of standard conditions also makes it easier for consumers
to compare the terms offered by various firms and come to a decision in full knowledge of the facts.

**Indispensability of the restrictions**

The recommendation that members use the required premiums and the general conditions established by the Concordato is necessary to attain the objectives of the agreement. Both recommendations are the logical follow-up to the activities of the Concordato, whose aim is on the one hand to facilitate access to the industrial fire insurance market and on the other to provide members with the means of establishing sound management practices and a better quality of service.

In this respect, the restrictions imposed on the undertakings concerned are limited to what is strictly necessary.

**Elimination of competition**

The notified agreement does not afford the members concerned the possibility of eliminating competition in respect of a substantial part of the insurance services in question. On the one hand, members are free to fix their tariff rates for any risk in respect of their own loading rates, and on the other they are free to depart from the recommendations of the Concordato and may replace or adapt the standard terms of the Concordato to suit a particular case, provided they notify any changes liable to affect the statistics.

The system as it stands therefore leaves considerable scope for competition between the members. Furthermore, although their share of the fire insurance and industrial fire insurance market is large, it must be taken into account that the members are in strong competition with other very powerful insurance companies.

---


**Transaction:** The subject of the decision are several IATA agreements dealing with travel agencies concerning air travel agency services and the sale of air transportation for passengers through intermediaries.

**Decision:** Exemption pursuant to Article 85 (3) of the EEC Treaty granted.

**IATA:** IATA is an association of enterprises composed of 189 member air carriers.

**The Legal Assessment**

The Commission states that the agreements concerned restrict competition between individual IATA member airlines transport services, from the moment they agree to apply collectively an identical distribution scheme for a very important part of their sales.

Although the selective system is not exclusive for agents or for carriers and there is no territorial limitation imposed on agents, the IATA programme is in fact the favourite distribution channel for most airlines. The distribution and sales system agreed by IATA member airlines leaves little room for other forms of distribution based on a different type of policy that could be adopted by individual IATA airlines, and results in a
Different forms of cooperation between insurance companies and their respective impact on competition

<table>
<thead>
<tr>
<th>EU Commission 11 November 1991 COMP/M.141 – UAP/Translantic/Sun Life</th>
</tr>
</thead>
</table>

**Transaction:** The subject of the decision is a transaction whereby the shareholdings in Sun Life Plc ("Sun Life") held by Société Centrale Union des Assurances de Paris ("UAP") and Transatlantic Holding Plc ("Transatlantic") are combined and transferred to Rockleigh Corporation Plc, a new holding company. Therefore, through Rockleigh, Sun Life will be jointly controlled by UAP and Translantic.

**Decision:** The transaction does not raise serious doubts as to its compatibility with the common market.

**UAP:** UAP is a major composite French insurance group, engaged principally in life and non-life insurance and reinsurance.

**Translantic:** Translantic is a UK holding company engaged in strategic investments in the insurance, real estate and financial service sector.

**Sun Life:** Sun Life is the UK holding company of the Sun Life Group of companies whose principal activity is the undertaking of long-term insurance business, namely life insurance.

<table>
<thead>
<tr>
<th>Product market</th>
</tr>
</thead>
<tbody>
<tr>
<td>The only product market overlap between the parties is in the fields of life insurance and reinsurance.</td>
</tr>
<tr>
<td><strong>Life insurance</strong></td>
</tr>
<tr>
<td>Life insurance is a separate product market as it is, in contrary to non-life insurance, essentially long-term in that usually it involves payment of regular premiums over a period of years; in most cases a policy is written in the certainty that a claim will subsequently be made (on death or other maturity), and often involves a substantial investment element.</td>
</tr>
<tr>
<td><strong>Reinsurance</strong></td>
</tr>
<tr>
<td>Reinsurance constitutes a mechanism for the spreading of risk between insurers and is therefore a separate product market.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Geographic market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life insurance</td>
</tr>
<tr>
<td>There is no present overlap in terms of geographic market as far life insurance is concerned since the geographic markets are the national markets of each Member State:</td>
</tr>
<tr>
<td>• distribution channels vary between Member States (i.e. UK via brokers; in France via banks)</td>
</tr>
<tr>
<td>• consumer attitudes to life insurance vary between Member States (i.e. the UK life insurance is regularly utilized to supplement pension arrangements and in conjunction with mortgages, this is not the case in France)</td>
</tr>
<tr>
<td>• public supervision and regulation of markets differ</td>
</tr>
</tbody>
</table>
Reinsurance
Reinsurance is a worldwide market since no policies are sold to the public, reinsurance being traded between industry specialists, regulatory controls by national authorities tend to be much less extensive.


**Transaction:** The subject of the decision is a co-reinsurance pool for the purpose of covering certain environmental damage risks. The membership is made up of 50 French and foreign insurance enterprises and 14 French and foreign reinsurance enterprises. Among other classes, all the insurer members transact, general liability insurance.

**Decision:** Exemption pursuant to Article 85 (3) of the TFEU granted with attached obligations.

**Assurpol:** The purpose of the pool was the administering, reinsurance and retrocession for common account of the risks of damage to the environment, both accidental and non-accidental, originating in certain industrial and commercial installations.

<table>
<thead>
<tr>
<th>Product market</th>
<th>The members are active in the field of general liability insurance and through the pool in the field of covering the risks of liability for damage to the environment of an accidental or non-accidental nature.</th>
</tr>
</thead>
<tbody>
<tr>
<td>market for environmental damage liability</td>
<td>The insurance market</td>
</tr>
<tr>
<td>The product market consists of Assurpol policies and all cover for environmental damage liability, even if the cover concerns only risks of an accidental or of a gradual nature and even if other risks are covered by the same policy, such as</td>
<td></td>
</tr>
<tr>
<td>• the risks of damage to the environment of accidental origin are covered by a variety of policies falling within the general liability insurance class</td>
<td></td>
</tr>
<tr>
<td>• and the insurance of risks of non-accidental origin is not very widespread at world level</td>
<td></td>
</tr>
<tr>
<td>The reinsurance market</td>
<td></td>
</tr>
<tr>
<td>No division of the market was made in the decision.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Geographic market</th>
<th>The insurance market</th>
</tr>
</thead>
<tbody>
<tr>
<td>The relevant geographic market is France – even if foreign insurers are members of the pool – as it is only within national territories that the conditions of competition are similar for all economic operators in environmental liability insurance due to</td>
<td></td>
</tr>
<tr>
<td>• differences as regards environmental protection legislation, civil law, taxation, the insurance market legislative and regulatory framework and the safety and prevention measures required for industrial and commercial enterprises</td>
<td></td>
</tr>
<tr>
<td>• differences in geology and plant design</td>
<td></td>
</tr>
<tr>
<td>• no true freedom to provide services in the class in question as far as small-business risks are concerned</td>
<td></td>
</tr>
<tr>
<td>The reinsurance market</td>
<td></td>
</tr>
</tbody>
</table>
The reinsurance market is a world-wide market.

**EU Commission 27 April 1992 COMP/M.207 – Eureko**

**Transaction:** The subject of the decision is an agreement between the undertakings Coöperatie Avéro/Centraal Beheer Groep U.A. (AVCB), Friends' Provident Life Office, Topdanmark A/S and WASA Insurance Group to set up a joint venture, EUREKO B.V., to which they will transfer their non-life and life insurance business outside their respective home countries.

**Decision:** The Commission states that the transaction does not fall within the scope of the Merger Regulation.

**Parties:** The four parties are insurance companies or groups engaged in direct non-life and life insurance, except for Friends' Provident which is only active in the life insurance sector. Each operates primarily in its own country: AVCB in The Netherlands, Friends' Provident in the UK, Topdanmark in Denmark and WASA Insurance Group in Sweden.

**Eureko:** Eureko will be active in the life and non-life insurance market and the travel insurance market.

---

Co-ordination of competitive behaviour rather than a concentration

Eureko and its parent companies will be active in the same product markets with the exception that Friends' Provident is not present in the non-life insurance market and the parent companies will not be active in the travel insurance market, which will be entirely transferred to Eureko.

So far as the geographic area of activities is concerned, there is only a slight overlap as it was agreed that, in principle, the parent companies would retain their domestic business while their other "international" business would be transferred to Eureko.

However, the transaction will give rise to coordination of the competitive behaviour of the parties:

- according to the agreement Eureko must be considered, to a great extent, as an instrument for coordinating the parent companies in relation to its own business
- is emphasized by the aim of the initial shareholders to seek further shareholders on the basis of one participant per local market.
- This applies even assuming that the insurance markets (except of the reinsurance market) currently can be considered to be national since the parties will be operating in neighbouring geographical markets and will, therefore, remain potential competitors.

Also the currently assumed existence of national markets will not be maintained as a gradual process of opening of national markets is taking place which will be aided by the Community harmonization efforts in the field of insurance.

---


**Transaction:** The subject of the decision are two agreements referred to as the Joint Hull
Understandings (JHU) and the Respect of Lead Agreement (RLA). The Institute of London Underwriters (ILU) and Lloyd's Underwriters' Association (LUA) formally notified the agreements to the Commission for negative clearance or exemption.

**Decision:** The (amended) agreements do not raise any concerns as to its compatibility with the Common Market as it does not restrict competition.

**ILU:** The ILU is an association of insurers (underwriters) offering marine and aviation insurance in London, which provides the usual functions of a trade association including various administrative support services for members.

**LUA:** Lloyd's of London is an incorporated society of private underwriters who provide an international market for almost any type of insurance. There are currently some 31,000 members who are grouped into some 400 syndicates. LUA represents all Lloyd's syndicates which handle marine business (app. 230).

ILU and LUA represent the vast majority of underwriters active in marine insurance in London. Together, they account for app. 90% of the United Kingdom's total marine insurance capacity.

**The agreements as notified**

The JHU contained three clauses which limited the freedom of the members of ILU and LUA to determine their own prices, particularly on renewal.

- **Clause 3** set out recommended minimum premium increases for a given loss ratio.
- **Clause 2B** provided that where results call for an increase then the deductible should be increased by 50% of the percentage wise with a minimum increase of 10%.
- **Clause 11** stipulated that where payment was not made in cash immediately but was deferred, the rebate which is normally available for prompt cash payment was to be reduced from 15% to 10%.

The above mentioned clauses were deleted by ILU and LUA on 25 April 1991.

The RLA agreement provided essentially that the same leaders who first underwrote hull business should be allowed to continue as leaders when the policy came up for renewal. Following underwriters or other potential leaders were prohibited from attempting to 'lead' on the renewal. Furthermore, the members of the two Associations agreed not to subscribe to any slip unless two leaders from each Association were signatories.

**Restrictions of competition**

The **JHU**:

- **Clause 3:** The fact that there was an obligation to report deviations from the recommended minimum premium increases for a given loss ratio would have acted as a dissuasive factor and would have tended therefore to enforce the restrictive nature of the clause.
- **Clause 2B:** The clause limited the freedom of underwriters to set their own levels for increases in deductibles and was therefore restrictive of competition within the meaning of Article 85 (1).
Different forms of cooperation between insurance companies and their respective impact on competition

**Clause 11:** The clause contains an agreement as to the amount of rebate to be granted, which is caught by the prohibition against price-fishing in Article 85 (1).

However, the clauses were deleted and since the remaining clauses are of a technical nature, the JHU does not contain any provisions which appreciably prevent, restrict or distort competition within the common market.

The RLA restricted competition in the London market by effectively ensuring that the same leaders who first insured the risk continued to underwrite that risk at renewal. These leaders were thus protected from competition from potential competing leaders. This meant that other underwriters were deprived of the opportunity of bidding or competing for renewal business and that shipowners were deprived of the choice and possibly cheaper prices which competition between competing leaders would afford.

This agreement was abandoned by the ILU and LUA on 25 April 1991 and replaced by a new agreement.

The RLA also restricted competition between the ILU/LUA by providing that there should be two leaders from each Association on every 'slip'. Brokers were therefore not free to concentrate their attention on one Association where they so chose or where this might have produced cost savings and better prices.

The new RLA permits a competing group or groups of underwriters to challenge the existing group, obliges the latter to make available their records of fleet statistics so as to facilitate the competing group's task of assessing the risk and prohibits any discussion of renewal terms between the existing and competing group of underwriters.

For this reasons the Commission concluded that the new RLA does not contain any clauses which appreciably restrict, prevent or distort competition within the common market.

---

**EU Commission 25 June 1993 COMP/M.349 – Aegon/Scottish Equitable**

**Transaction:** The subject of the decision is a transaction whereby Scottish Equitable Policyholders Trust Limited and Aegon acquire joint control of Scottish Equitable plc, a newly formed company to which Scottish Equitable Life Assurance Society will transfer its entire undertaking and business.

**Decision:** The transaction does not raise doubts as to its compatibility with the Common Market.

**Aegon:** Aegon is active in life and non-life insurance, mortgage finance and property management. The Aegon group conducts its insurance operations mainly in the Netherlands and the United States.

**Scottish Equitable Life Assurance Society:** Scottish Equitable Life Assurance Society is a UK mutual company whose principal activity is the transaction of life assurance, pension and annuity business, which is carried out almost entirely in the UK.

**Product and geographical market**

Over 99% of Scottish Equitable's existing turnover occurs in the UK, where it is primarily active in the life insurance, individual and group pension business markets.

The precise relevant product and geographical reference markets can be
left open since, if the narrowest approach is taken considering each of the above type of policies as separate relevant product markets and restricting the geographical reference market to the UK, the increase in UK market share brought about by the concentration is minimal (or non-existent as is the case for group pension business) and the combined market share is below 10% for each. Moreover, there are many strong competitors with comparable or higher market shares.

<table>
<thead>
<tr>
<th>EU Commission 12 September 1994 COMP/M.498 - Commercial Union/Groupe Victoire</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction:</strong> The subject of the decision is a transaction whereby Commercial Union plc acquires a major part of the life assurance activities and the general insurance activities of Groupe Victoire (Victoire).</td>
</tr>
<tr>
<td><strong>Decision:</strong> The transaction does not raise doubts as to its compatibility with the Common Market.</td>
</tr>
<tr>
<td><strong>Commercial Union:</strong> Commercial Union is the holding company of the Commercial Union Group whose principal activities are the transaction of all classes of insurance and life insurance, other than industrial life, in the UK, continental Europe, North America and other territories throughout the world.</td>
</tr>
<tr>
<td><strong>Groupe Victoire:</strong> Groupe Victoire operates in most sectors of the insurance market, almost exclusively in France.</td>
</tr>
<tr>
<td><strong>Product and geographical market</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EU Commission 12 January 1995 COMP/M.520 – Direct Line/Bankinter</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction:</strong> The subject of the decision is an agreement between Direct Line Group Limited, a whollyowned subsidiary of The Royal Bank of Scotland, and Bankinter, S.A. whereby the parties acquire joint control of Bankinter Aseguradora Directa, S.A., Compañía de Seguros y Reaseguros, a newly established insurance company.</td>
</tr>
<tr>
<td><strong>Decision:</strong> The Commissions states that the transaction does not raise serious doubts as to its compatibility with the common market and with the functioning of the EEA Agreement.</td>
</tr>
<tr>
<td><strong>Direct Line:</strong> Direct Line concentrates its activities on motor and household insurance marketed by direct telephone sales in the UK.</td>
</tr>
<tr>
<td><strong>Bankinter:</strong> Bankinter is a medium size independent Spanish banking group active in commercial and investment banking and related activities. It also offers life insurance and insurance brokerage to a very limited extent.</td>
</tr>
<tr>
<td><strong>Product market/Geographic market</strong></td>
</tr>
</tbody>
</table>
different forms of cooperation between insurance companies and their respective impact on competition

different kinds of risk. Their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer between the different risks insured.

Although insurance markets are becoming more open to intra-community competition as a result of current and future measures to facilitate cross-border selling, geographical markets seem at present to be mainly national in view of the established market structures, the need for adequate distribution channels, fiscal constraints in some cases and differing national systems or regulatory supervision. However the exact product and geographic market definitions may be left open since, even the narrowest definition, the transaction does not pose competition problems.


Transaction: The subject of the decision is a transaction whereby Winterthur Swiss Insurance Corporation acquires control over the corporations:

- Schweiz Assicurazione S.p.A., Mailand
- Schweiz Vita S.p.A., Mailand
- Schweiz Compañía Anónima Española de Seguros y Reaseguros, Barcelona
- La Equitativa, S.A. de Seguros sobre la Vida, Madrid

by way of purchase of shares.

Decision: The agreement does not raise any concerns as to its compatibility with the Common Market.

The Commission states that non-life insurance on the demand side could be divided into as many product markets as there are different kinds of risks covered, since their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer for the risk insured.

The Commission regards assistance, fire, third-party liability, motor vehicle, credit/suretyship, life, legal expenses, property & financial, accident insurance and reinsurance markets as separate markets.

The Commission recognises that insurance markets are becoming more open to intra-Community competition, without however departing from its national approach in the present case.

EU Commission 27 September 1996 COMP/M.813 – Allianz/Hermes

Transaction: The subject of the decision is a transaction whereby Allianz Aktiengesellschaft Holding acquires control of Hermes Kredit Versicherungs-AG by way of purchase of shares.

Decision: The transaction does not raise doubts as to its compatibility with the Common Market and with the EEA agreement.

Allianz: Allianz has activities in all areas of the private insurance sector and is also one of
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

Hermes: Hermes is mainly active in the credit insurance sector and covers as reinsurer the risks, Allianz covers as insurer.

| Product market | The parties activities overlap in the credit insurance sector. Credit insurance
|                | According the notifying parties the market could be divided into the following sectors:
|                | • del credere insurance (including trade credit insurance, for export credit insurance and capital goods credit insurance)
|                | • consumer credit insurance
|                | • fidelity insurance business/computer abuse
|                | • surety-ship/guarantee insurance
|                | The Commission, however, defined the market for credit insurance as one market because:
|                | • There were similarities between the insured risks.
|                | • Despite the fact that not all credit insurance suppliers operated in each segment and that there were specialisations, all insurance companies could operate in each segment.

| Geographic market | Credit Insurance
|                  | Although insurance markets are becoming more open to intra-community competition as a result of current and future measures to facilitate cross-border selling, geographical markets seem at present to be mainly national in view of the established market structures, the need for adequate distribution channels, fiscal constraints in some cases and differing national systems of regulatory supervision.

In the area of del credere insurance, exporting companies with international customer relationships are the typical customers, according to the parties. This requires that the insurers have knowledge of the customers' international contractual partners, which also strengthens the trend towards the internationalization of the work of insurers as well. Market entries apparently take place to date primarily via national branches, however. For the purposes of this decision, therefore, national markets could continue to be assumed, from the perspective of the Commission.

However, the exact product and geographic market definitions may be left open since, even the narrowest definition, the transaction does not raise doubts as to its compatibility with the Common Market and with the EEA agreement.

EU Commission 11 November 1996 COMP/M.812 – Allianz/Vereinte

Transaction: The subject of the decision is a transaction whereby Allianz Aktiengesellschaft Holding acquires control over Vereinte Holding AG by purchase of shares.

Decision: The transaction does not raise doubts as to its compatibility with the Common Market.
The Commission stated that it has been the consistent practice of the Commission to draw a fundamental distinction between life and non-life insurance products.

Commission held that non-life insurance on the demand side could be divided into as many product markets as there are different kinds of risks covered, since their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer for the risk insured, however, left the final market definition open in this case.

The Commission found that markets for non-life insurance and life insurance products are generally national in scope due to the particular national distribution channels, established market structures, fiscal constraints and different regulatory regimes and might be wider than national for large/multinational corporate customers respectively. However, the Commission ultimately left the exact scope of the geographic market open.

**EU- Commission 20 December 1996 COMP/M.862 – AXA/UAP**

**Transaction:** The subject of the decision is a transaction whereby the undertaking AXA SA acquires control of the whole of the undertaking Compagnie UAP.

**Decision:** The transaction does not raise doubts as to its compatibility with the Common Market.

The Commission stated that it has been the consistent practice of the Commission to draw a fundamental distinction between life and non-life insurance products.

Commission held that non-life insurance on the demand side could be divided into as many product markets as there are different kinds of risks covered, since their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer for the risk insured, however, left the final market definition open in this case.

**EU- Commission 14 April 1998 COMP/M.1144 – Winterthur/ARAG**

**Transaction:** The subject of the decision is a transaction whereby the Winterthur Schweizerische Versicherungs Gesellschaft, Schweiz (Winterthur), controlled by the Credit Suisse Group, and the ARAG Allgemeine Rechtsschutz-Versicherungs-AG, Düsseldorf (ARAG) acquire joint control over the newly founded Joint Venture Winterthur-ARAG Rechtsschutzversicherungs-Gesellschaft (Winterthur-ARAG, Schweiz).

**Decision:** The transaction does not raise doubts as to its compatibility with the Common Market.

**EU Commission 6 May 1998 COMP/M.1142 – Commercial Union/General Accident**

**Transaction:** The subject of the decision is a transaction whereby Commercial Union plc will acquire the entire issued ordinary share capital of General Accident plc.

**Decision:** The transaction does not raise doubts as to its compatibility with the Common Market.

**Commercial Union and General Accident:** The parties are companies based in the UK, the principal activities of which are the transaction of insurance and life-insurance, other
than industrial life, in the UK, continental Europe, North America, Australia and other parts of the word.

| Product and geographical market | 1) On the demand-side, life and non-life insurance can be divided into as many product markets as there are insurances covering different kinds or risk. Nevertheless, even on the basis of the narrowest definition, the operation does not raise serious doubts as to its compatibility with the common market. |
| | 2) The Commission, however, considers there to be a distinct product market for travel insurance, which is normally sold as a package (including accident, luggage, cancellation and medical expenses), when calculating the market shares |
| | 3) Although insurance markets are becoming more open to intra-community competition, geographical reference markets are at present mainly national. |

**EU Commission 30 June 1998 COMP/M.1129 – Commercial Union/Berlinische Lebensversicherung AG**

**Transaction:** The subject of the decision is a transaction whereby the undertaking Commercial Union plc (“Commercial Union”) takes over the undertaking Berlinische Lebensversicherung AG by acquisition of all the shares in the target company.

**Decision:** The transaction does not raise doubts as to its compatibility with the Common Market.

| Product and geographical market | The parties activities overlap in the area of life insurance. According to the practice of the Commission, insurance can be subdivided into as many product markets as there are insurances covering different kinds of risks. Their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer between the different risks insured. However, for the purposes of the present decision the relevant product market can be left open because, even with the narrowest definition of markets, effective competition would not be significantly impeded in the EEA or any substantial part of that area. Even if it were necessary further to subdivide life-insurance into protection, investment and pension products, the market shares will not exceed 2%. Therefore, there will not be any significant overlap that could create or strengthen a dominant position in a German life-insurance market. |

**EU Commission 24 August 1998 COMP/M.1280 – KKR/Willis Corroon**

**Transaction:** The subject of the decision is a transaction whereby the undertaking KKR Associates II takes over the Willis Corroon Group by acquisition of the entire issued and to be issued share capital in the target company.

**Decision:** The Commission has concluded that the notified operation does not raise serious doubts as to its compatibility with the common market.

**KKR:** KKR Associates is a US company member of the KKR Group which invests capital in management buy-outs on behalf of itself and its investors.
Willis Corroon: The Willis Corroon Group is an international insurance broker and risk management consultant headquartered in the UK. It provides a range of risk management and broking services to clients worldwide.

<table>
<thead>
<tr>
<th>Product and market</th>
<th>Insurance Brokerage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The parties suggest to draw a distinction between brokerage in respect of life insurance, non-life insurance and re-insurance. The parties also suggest that within the non-life brokerage sector, a distinction can be made between personal and commercial lines.</td>
</tr>
<tr>
<td></td>
<td>The Commission states that from a demand side perspective, clients requiring different kinds of insurance policies could well turn to one and the same broker, provided that a broker is able to procure insurance coverage for different kinds of risks.</td>
</tr>
<tr>
<td></td>
<td>The parties claim that there is a high degree of supply-side substitutability in brokerage activities because of a common set of skills required which applies to all sorts of insurance products. While brokers in principle are free to offer a wide range of insurance products, it cannot be ignored, however, that at least for certain product lines or sectors, a considerable degree of knowledge and specialisation is required in order to compete effectively. This is true, for example, for credit insurance and reinsurance products.</td>
</tr>
<tr>
<td></td>
<td>In the present case, however, there are no overlapping activities between the parties and the creation or strengthening of a dominant position can be excluded with any alternative product market definition. Therefore, the product market definition can be left open.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Geographical market</th>
<th>Insurance Brokerage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>It can be observed that the international or cross-border activities of independent brokers have contributed to the increasing internationalisation in the insurance industry because in order to seek out the best offers for their clients brokers as a rule turn to insurers world-wide.</td>
</tr>
<tr>
<td></td>
<td>In the present case, however, the geographical market definition can be left open, given the fact that the parties are not engaged in the same business and the concentration with any alternative geographical market definition will not impede effective competition in the Common market or a substantial part of it.</td>
</tr>
</tbody>
</table>


**Transaction:** The subject of the decision was an agreement whereby Marsh & McLennon Companies Inc. will acquire control of the whole of Sedgwick Group plc by way of purchasing Sedgwick’s entire share capital

**Decision:** The transaction does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

**Marsh & McLennon:** Marsh & McLennon is an international professional services group with activities in the fields of insurance and reinsurance distribution, insurance underwriting management, investment management, human resources consulting, risk finance, insurance consultancy and economic and management consultancy.

**Sedgewick:** Sedgewick's activities are insurance and reinsurance distribution and employee benefits consulting. Insurance and reinsurance distribution consists of advising on and
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

<table>
<thead>
<tr>
<th>Product market</th>
<th>The parties' activities overlap in the areas of insurance and reinsurance distribution and human resources consulting.</th>
</tr>
</thead>
<tbody>
<tr>
<td>services/provision</td>
<td>The relevant market is the market for the distribution of insurance services.</td>
</tr>
<tr>
<td>life/non-life</td>
<td>A distinction can be made between the distribution of life and non-life insurance, as different providers tend to be involved and the distribution of life insurance in Europe is regulated separately from other types of insurance.</td>
</tr>
<tr>
<td>broker/insurance agents</td>
<td>A further distinction could be made on the basis of the distribution channels (brokers and other insurance distributors).</td>
</tr>
<tr>
<td>From a demand-side perspective, corporate customers distinguish between the kind of services they can procure from a broker and from direct dealing insurers or insurance agents.</td>
<td></td>
</tr>
<tr>
<td>• brokers act in the client's interests while underwriters are seen to act in their own profit interests, therefore brokers' services are requested where independent advice is needed</td>
<td></td>
</tr>
<tr>
<td>• range of services (especially large) corporate customers seek from brokers goes beyond the actual placement of insurance cover (may include identification/assessment of risk, independent risk management advice, security rating of insurers, insurance market intelligence, independent actuarial services and claims support)</td>
<td></td>
</tr>
<tr>
<td>From a supply-side perspective, brokers have a more complete range of skills to advise comprehensively on the best products across the whole insurance market and to provide services ancillary to broking.</td>
<td></td>
</tr>
<tr>
<td>According to the Commission, a distinction could also be made between the provision of broking services to commercial customers and to private customers as the service provided normally differs, or even on the basis of client size.</td>
<td></td>
</tr>
<tr>
<td>• just placement of insurance cover for the private clients, which is more easily substitutable by direct dealing insurers, insurance agents or other intermediaries</td>
<td></td>
</tr>
<tr>
<td>• so private clients are more likely to switch to direct sellers (also promoted by mass marketing, telesales, e.g. for private motor insurance or household insurance)</td>
<td></td>
</tr>
<tr>
<td>• while brokers are in a far better position to meet large customers' considerable requirements for risk management services and advice</td>
<td></td>
</tr>
<tr>
<td>The Commission claims that distinct markets may be identified as regards certain industries (i.e. marine, aviation and space, energy) as well as certain risk types (i.e. directors' &amp; officers' liability) by reasons of limited substitutability on both demand and supply-side.</td>
<td></td>
</tr>
<tr>
<td>The Commission concludes that the relevant product markets are the insurance broking market and, within this market, the sector of consumer broking, broking for commercial clients and in particular...</td>
<td></td>
</tr>
</tbody>
</table>
broking for large corporate clients. The final definition of the relevant market is left open, as serious doubts as to the compatibility with the common market can be excluded under any aspect.

**Reinsurance distribution**

The parties argue that, from the point of view of insurer and reinsurer clients, reinsurance companies and brokers are substantial and direct competitors because the top reinsurance companies all act as direct insurers for a substantial part of their business.

The final definition is left open by the commission, as in all alternative market definitions considered, effective competition would not be significantly impeded in the EEA or any substantial part of that area.

**Human resources consulting**

The human resources consulting activities mainly overlap with respect to Retirement and Employee Benefits consulting. The parties provide such consulting services almost exclusively to corporate clients and to individuals only within the framework of a corporate client mandate.

Retirement and Employee Benefits consulting is to be considered as a distinct product market, as consulting in this area requires specific sets of skills, qualifications and technical resources (especially actuarial competence).

<table>
<thead>
<tr>
<th>Geographic market</th>
<th>Insurance distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Customers normally procure broking services in countries they are active in.</td>
</tr>
<tr>
<td></td>
<td>Large/multinational clients tend to use one broker to place insurance for some types of risk, especially if the risk affects a number of countries in which the company is active, whereas different brokers may be used to cover risks of a more limited geographical scope.</td>
</tr>
<tr>
<td></td>
<td>The question as to whether the relevant geographic is larger than national is left open since in all alternative geographic market definitions considered, serious doubts about the compatibility with the common market can be excluded.</td>
</tr>
</tbody>
</table>

**Reinsurance distribution**

Risks for insurer and reinsurer clients are placed on a world-wide basis. Likewise, related broking services are provided on a world-wide basis.

**Human resources consulting**

Final definition left open as effective competition would not be significantly impeded in these markets.

- the different fiscal and regulatory environments with respect to pensions, healthcare and other benefits across the Member States could be seen as an indication that the geographic markets are national
- however part of the consulting services is procured by multinational corporations from large, internationally active consultants
**Transaction:** The subject of the decision is a transaction whereby AXA will take over the UK based insurance company «Guardian Royal Exchange» (GRE) by way of a public tender offer for the ordinary shares in GRE

**Decision:** The Commission has concluded that the notified operation does not raise serious doubts as to its compatibility with the common market.

**AXA:** AXA is an international group active in the provision of insurance and related financial services.

**GRE:** GRE is an UK based international insurance company providing life and general insurance including particularly health insurance and related services.

<table>
<thead>
<tr>
<th><strong>Product and geographical market</strong></th>
<th>The parties have overlapping activities in life and non-life insurance in UK, France, Germany and Luxembourg. When calculation the market shares, the Commission states that the UK life insurance market could be divided into three segments: regular premium life insurance, investment and pensions, however constitutes a uniform German life insurance market.</th>
</tr>
</thead>
</table>

**EU Commission 12 April 1999 Official Journal 1999 No. L 125/12 – P & I Clubs II**

**Transaction:** The subject of the decision are two agreements within the International Group of P & I, the International Pooling Agreement and der International Group Agreement.

**Decision:** The agreements do not raise any concerns as to their compatibility with the common market and with the EEA Agreement (with exception of the rules concerning costs for tankers).

**P & I Clubs:** The P & I Clubs are mutual non-profit-making associations that price Protection & Indemnity insurance to their members, the ship owners. The P & I insurance covers contractual and third-party liability and has been traditionally insured by ship owner mutual associations. The insurance covers different types of risk: injury or death of crew, passengers and others; collision damage to vessels; other damage to third-party property (such as harbour equipment); pollution; cargo and other (such as expenses of wreck removal). Most P & I insurers provide all these types of cover under a single contract.

| **Product market** | The members of the P & I Clubs have activities that overlap in the field of direct marine insurance. **Direct marine insurance** From the demand-side, direct marine insurance can be divided into hull and P & I insurance.  
  - they cover different needs and have traditionally been considered separately by ship owners: the latter obtain hull insurance from commercial insurers but create mutual associations in order to share their P & I risks  
  P & I insurance could be theoretically divided inter very specific segments, according to the type of vessels insured (tankers, fishing-vessels, dry-cargoes, etc.), the type of cover (property damage, pollution, crew injury, etc.) or even the level of this cover (unlimited, limited to a certain level, etc.)  
  From the supply-side, P & I insurance represents a single product market.  
  - P & I insurance requires some features that other insurance |
|-------------------|----------------------------------------------------------------------------------------------------------------|

**specific market for P & I insurance**

**further division of P & I insurance**
companies cannot develop in a short period of time: technical knowledge on P & I risks and large networks of representatives in the most important world harbours that may solve efficiently claims

- In the field of P & I insurance, the minimum scale required to offer cover is high in relation to the whole market dimension (represents high barriers to entry).
- Although marine hull insurers could develop their expertise and claims facilities in order to cover P & I risks more easily than other types of insurer, especially for lower levels of P & I cover, substitutability is weak.

Reinsurance
Direct hull and P & I insurance must be distinguished from marine reinsurance as the demand for each type of insurance is different:
- in the first two cases the demand comes from ship owners
- in the third one demand comes from professional insurers

With regard to P & I reinsurance a distinction must be made according to the level of cover offered.
- Up to around USD 2 billion, P & I reinsurance can be considered as part of the wider market of marine reinsurance as no regulatory or technical barriers play a significant role. Not only are the P& I Clubs able to provide reinsurance to other P & I insurers, but also marine reinsurers can provide it.
- P & I reinsurance for levels higher than around USD 2 billion should be considered a distinct market as for higher levels marine reinsurers do not reach at present the minimum dimension necessary to offer P & I reinsurance

<table>
<thead>
<tr>
<th>Geographic market</th>
<th>Direct marine insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The market for contractual and third party maritime damages insurance has a worldwide scope. Ship owners generally ensure that their fleets are placed on the best possible terms to be offered, no matter where the club is located.</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>The market for P &amp; I reinsurance has also a worldwide scope.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EU Commission 17 August 1999 Official Journal No. L 357, Celex No. 31999J0021 – Skandia/Storebrand/Pohjola</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction:</strong> The subject of the decision is an agreement whereby Försäkringsaktiebolaget Skandia, Storebrand ASA and Pohjola-Yhtyuiä Vakuntus Oyi will create a full function joint venture in Sweden (FFJV).</td>
</tr>
<tr>
<td><strong>Decision:</strong> The operation does not raise serious doubts as to its compatibility with the Common Market and with the EEA agreement.</td>
</tr>
<tr>
<td><strong>Skandia:</strong> Skandia is the parent company of the Skandia group which has focused on three strategic business units: Long-Term Savings (life and unit linked assurance), Asset Management and Property &amp; Casualty Insurance. SkandiaBanken, a telephone and Internet bank, completes the group's range of services by providing deposit and lending services,</td>
</tr>
</tbody>
</table>
mutual funds and advisory services.

**Storebrand:** Storebrand conducts financial activities in the areas on non-life insurance, life assurance and banking. The Storebrand group operates mainly within Norway and markets a wide range of direct insurance products, as well as in the savings sector, both for private individuals and companies and public bodies. The Storebrand group has focused on three business sectors: Long-Term Savings, Asset Management and Property & Casualty Insurance.

**Pohjola:** Pohjola is the parent company of the Pohjola Group, the business of which includes life, non-life and employment pension insurance. The Pohjola Group offers a wide range of insurance, claims settlement and risk management services. The Pohjola Group operates primarily in Finland, but also in the Baltic region.

**FFJV:** The FFJV will offer non-life (P&C) insurance products in Norway, Sweden and Finland.

<table>
<thead>
<tr>
<th>Product market</th>
<th>Non-life Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Geographic market</td>
<td>From the demand side, each different type of non-life insurance product may be considered to constitute a distinct product market for which the geographic market is usually national in scope.</td>
</tr>
<tr>
<td></td>
<td>A supply-side analysis shows that the conditions required to insure different types of risk are very similar. This suggests that many different types on non-life insurance should be included in the same product market definition. The conditions that must be analysed in order to group different types of risk into one product market include regulatory conditions, distribution channels, expertise required and characteristics of the risk (such as frequency of circumstances giving rise to the liability).</td>
</tr>
<tr>
<td></td>
<td>In this decision, the Commission examined the shares of the notifying parties by taking each non-life product separately notwithstanding the possibility that the product markets may in fact be broader. This was done on the basis that if such an analyses does not reveal a problem, then nor will an analyses based on broader product market definitions. Accordingly, it is not necessary in this decision to adopt a definitive position as to the precise product markets at issue.</td>
</tr>
</tbody>
</table>

**EU Commission 14 June 2001 COMP/M.2400 – Dexia/Artesia**

**Transaction:** The subject of the decision is a transaction whereby Dexia S.A./N.V. acquires 99.53% of the shares in Artesia Banking Corporation S.A./N.V. by purchase of shares.

**Decision:** The transaction does not raise doubts as to its compatibility with the Common Market and with the EEA agreement.

**Dexia:** Dexia is a European banking group with three main business lines: public finance, retail services (primarily in the Benelux countries) and investment banking.

**Artesia:** Artesia is a financial services group active in retail banking and insurance, mainly in Belgium and, to a lesser extent also in other countries, in particular The Netherlands, France and Luxembourg.

<table>
<thead>
<tr>
<th>Product market</th>
<th>The markets concerned by the transaction are retail banking, corporate banking as well as life and non-life insurance.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>Retail banking is the provision of services to household customers,</td>
</tr>
</tbody>
</table>
whereas corporate banking services are provided to large multinational companies and Small and Medium-sized Enterprises (SMEs). Household and corporate banking comprise different saving and lending services such as current (transaction) accounts, loans, mortgages, mutual funds and asset management services.

Credit to local authorities has been considered to be a product market in its own right, given that customers and conditions of the loans differ from normal bank loans.

In the present case the Commission has left open the final decision whether retail and corporate banking or the market for credit to local authorities could be further divided into narrower product market, since the transaction does not raise serious competition concerns with any possible alternative market definition.

**Insurance**

In the present case the Commission has left open the final definition of the relevant insurance markets, since the operation does not raise serious competition concerns with any possible alternative market definition.

However, when defining the market share, the Commission considered one market within life insurance, which is the so-called "segment 23" of the life insurance market in Belgium (life insurance connected to investment funds and comprising marriage and birth) as single product market.

<table>
<thead>
<tr>
<th>Geographic market</th>
<th>Banking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail and corporate banking (at least with regard to SMEs) as well as credit to local authorities are activities which can be considered to be largely national in scope.</td>
<td></td>
</tr>
<tr>
<td>Financial market services can usually be regarded as being of European or even international dimension.</td>
<td></td>
</tr>
<tr>
<td>Investment banking services are still to a large extent national.</td>
<td></td>
</tr>
</tbody>
</table>

**Insurance**

The Commission has left open the final definition of the geographic insurance markets, since the operation does not raise serious competition concerns with any possible alternative market definition.

However the Commission states that competition for life and non-life insurance primarily takes place at a national level, as a result of distribution channels, the established market structures, fiscal constraints and different regulatory systems.

For reinsurance the market can be considered to be world-wide in view of the need to pool risks on an international basis and the conduct of the reinsurance business.

---

**EU Commission 19 July 2001 COMP/M.2431 – Allianz/Dresdner**

**Transaction:** The subject of the decision is a transaction whereby the German Allianz AG acquires control over the German Dresdner Bank AG.

**Decision:** The agreement does not raise any concerns as to its compatibility with
The Commission states that non-life insurance on the demand side could be divided into as many product markets as there are different kinds of risks covered, since their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer for the risk insured.

In this case the Commission additionally considers that statutory rules like the new pension system, which enters into force in 2002 in Germany, promoting private post-employment provision in Germany may lead to a new market for private post-employment provision, however, it left the final market definition open in this case.

**EU Commission 27 July 2001 COMP/M.2491 – Sampo/Storebrand**

**Transaction:** The subject of the decision is a transaction whereby the Finnish undertaking Sampo Oyj ("Sampo") acquires control of the whole of the Norwegian undertaking Storebrand ASA.

**Decision:** The Commission has concluded that the notified operation does not raise serious doubts as to its compatibility with the common market.

<table>
<thead>
<tr>
<th>Product and geographical market</th>
<th>Note CMS:</th>
<th>The parties have overlapping activities in life and non-life insurance in Finland and Sweden.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Note CMS:</td>
<td>In the present case, the notifying party suggest to divide the non-life insurance market in the following way, while submitting that the relevant product markets may be broader:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Sweden - Accident &amp; health, Commercial &amp; real estate, Marine, aviation &amp; transport (MAT) and Transport liability.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Finland - Motor vehicle liability, Land vehicles, Fire and other damages to property and General liability.</td>
</tr>
</tbody>
</table>

During the course of the Commission's investigation it has been suggested by third parties that the non-life insurance products should be further subdivided into private and commercial insurance. In addition, it appears that the MAT insurance category may be further divided depending on the means of transport and the size of the risk (large commercial risks as opposed to insurance coverage sought by private vehicle owners).

For the purpose of the present case, however, it is not necessary to define conclusively the relevant product market(s).

According to the Commission's market investigation, the relevant geographic market for the individual products are either national or at least EEA-wide for MAT insurance, as MAT insurance is wider than national for large corporate customers and large risk insurance.

It is, however, not necessary to decide upon the scope of the relevant geographical market for the purpose of the present case, there are no indications that the operation would give rise to competition problems regardless of how the market is defined.
**EU Commission 11 December 2001 COMP/M.2602 – Gerling/NCM**

**Transaction:** The subject of the decision is a transaction whereby the German undertaking Gerling-Konzern Versicherungs-Beteiligungs AG "Gerling" acquires control of the Dutch undertaking NCM Holding N.V. (Nederlandsche Credietverzekerings Maatschappij) "NCM".

**Decision:** transaction does not raise doubts as to its compatibility with the Common Market and with the EEA agreement.

**Gerling:** Gerling offers insurance solutions for corporate and personal enterprises through four divisions: Industry, Commercial/Private, Credit and Reinsurance. It is represented in all five continents.

**NCM:** NCM, currently a subsidiary of Swiss Reinsurance Company "Swiss Re", is active in the field of receivables management with credit insurance as its core business. Swiss Re is a Swiss corporation active in the provision of risk transfer services, including life and non-life reinsurance, risk retention financing and asset management services on a world-wide basis.

<table>
<thead>
<tr>
<th><strong>Product market</strong></th>
<th>The product market affected by the present operation is the domestic and export credit insurance market, usually referred to as del credere insurance.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Del credere Insurance</td>
<td>In previous decisions, the Commission divided the global credit insurance business into four different market segments: del credere insurance (comprising domestic credit insurance, export credit insurance and capital goods insurance), consumers credit insurance, fidelity insurance and guarantee insurance. According to the parties, domestic and export credit insurance constitute one single product market. The parties however argue that capital goods credit insurance should constitute a separate market, because:</td>
</tr>
<tr>
<td></td>
<td>• Unlike del credere insurance policies covering only short-term accounts, capital credit insurance operates on a medium and long-term basis.</td>
</tr>
<tr>
<td></td>
<td>• Capital goods credit insurance policies relate to one specific business contract or risk which is evaluated individually, whereas, in contrast, del credere cover is provided for an unspecified number of contracts and customers.</td>
</tr>
<tr>
<td></td>
<td>On the other hand, the parties propose to include other products in the relevant market. In their view there are various possibilities for the supplier to deal with the risk of insolvency of the customer or non-payment based on other grounds. Such possibilities include self-insurance, letters of credit and factoring.</td>
</tr>
<tr>
<td></td>
<td>The market investigation of the Commission confirmed the parties suggestion that the capital goods credit insurance should constitute a separate market.</td>
</tr>
<tr>
<td></td>
<td>Further the market investigation did not confirm the necessity to include other products like letters of credit and factoring, as most of the customers consider letters of credit and factoring as specific instruments, non-substitutable to credit insurance.</td>
</tr>
<tr>
<td></td>
<td>Finally, the market investigation did not confirm the necessity for a further subdivision of the market according to the customer group. Even though the policies for SMEs tend to be more standardised and the policies for large multinational companies tend to be more tailor made,</td>
</tr>
</tbody>
</table>
the main features of both types of policies remain the same. Also from the supply side point of view the necessary know-how and resources of insurance companies to conclude policies with large multinationals and SMEs do not differ significantly.

| Geographic | The parties to the present case submit that the relevant geographic market for del credere insurance should be regarded as EEA-wide market because |
| market | | |
| | from the supply-side perspective: due to the scope of activity of the major del credere insurers, the low barriers to expansion into other Member States and the internationalisation of the product itself; |
| | from the demand-side substitutability: as Gerling and NCM achieve approximately 55% and between 50% and 60% of their respective premium income with customers having insurance that covers subsidiaries in more than one country. |
| | The parties further submit that, as a result of the single European currency, coupled with EU regulatory and legal actions designed to increase cross-border transparency, the share of international customers would be steadily growing. |
| | Furthermore multinational customers would require firm-wide policies covering their trans-national operations under a unified scheme and would not want to conclude different insurance policies for each Member State in which they are active. The parties consequently conclude that credit insurers in one Member State are competing for such customers with credit insurers with a seat in other Member States. |
| | Contrary to the parties’ suggestion of an EEA-wide market for credit insurance, the market investigation confirmed only a trend towards a growing internationalisation of the market. |
| | This trend is caused by the liberalisation of the European insurance markets and the internationalisation of business itself. As a result, multinational customers tend to conclude global group-wide policies covering all of their foreign subsidiaries. The market investigation, however, confirmed the national scope of the credit insurance business for the reasons outlined in the following paragraphs: |
| | Local presence is essential for the credit insurance business, as personal contacts are required during the customer acquisition phase and for policy handling. A precise knowledge of the local business community is equally crucial. The use of Internet cannot substitute personal contact; it mostly represents an additional service that the credit insurers offer to their clients. |
| | Even though multinational customers conclude global policies, in most of the cases their subsidiaries conclude additional sub-policies with subsidiaries or branches of the credit insurer. |
| | The market investigation has shown that the local presence is needed for achieving market shares above marginal levels in a given country. It also follows from the replies to the questionnaire that most of the customers would not contract or have not considered contracting outside their country. Therefore, credit insurers are currently setting up new branch offices in |
The market investigation showed additional elements, which clearly confirmed the heterogeneity of conditions of competition in different national markets, such as the use of brokers and the level of penetration of credit insurance in the national economies. The Commission therefore concluded from the above that the del credere insurance market is at this stage of its development still national in scope.

### EU Commission 28 March 2003 COMP/M.3035 – Berkshire Hathaway/Converium/Gaum/JV

**Transaction:** The subject of the decision is a transaction whereby Northern States Agency, Inc (belonging to Berkshire Hathaway group) and Converium AG acquire joint control of Global Aerospace Underwriting Managers Limited ("Gaum") by way of purchase of shares.

The share capital of Gaum was held equally by Aviva and RSA. According to the agreement, Converium and Munich Re will all acquire shareholdings in Gaum of 40 %, 25 % and 24.9% respectively. RSA will retain a shareholding of 10.1%.

**Decision:** The transaction does not raise doubts as to its compatibility with the Common Market and with the EEA agreement.

**Gaum:** Gaum provides services including the underwriting of (re)insurance risks and the management of policies on behalf of (re)insurers and their pools. Its main client is the Global Pool, a provider of aviation risk insurance, but it also serves third parties, which are active mainly in the aerospace risk sector.

**Northern States:** Northern States is a subsidiary of Berkshire Hathaway, engaged in a number of diverse business activities, the most important of which are property and casualty insurance.

**Converium:** Converium is mainly active in the provision of insurance and reinsurance for all major lines of non-life insurance.

<table>
<thead>
<tr>
<th>Product market</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>services/provision</td>
<td>The parties have activities in three areas: provision of underwriting and management services to (re)insurers, provision of insurance and reinsurance. Provision of underwriting and management services (re)insurers</td>
</tr>
<tr>
<td>insurance/reinsurance</td>
<td>Underwriting and managing services represent a market distinct from the provision of insurance or reinsurance, as many pools of insurers or reinsurers resort to external suppliers since the members of these pools do not want to rely on the expertise of one of them. In this regard it is irrelevant, whether the services are provided to insurance or reinsurance companies, as the services do not differ depending on whether they are provided to insurers or reinsurers. The provision of underwriting services and the provision of management services constitute one single product market, as these services are strongly complementary from both the suppliers’ and the customers' point of view. Underwriting and management services are usually supplied as part of the same package. The decision leaves open if there is a distinct product market for the provision of the services to the (re)insurers active in the aerospace field, as the transaction does not raise any competition concerns even on the narrower market definition. According to the parties, there is a high level</td>
</tr>
</tbody>
</table>
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

<table>
<thead>
<tr>
<th>aerospace risks? of supply-side substitutability between providing services for different types of risks, yet the Commission states that aerospace insurance has specific characteristics due to the particular nature and size of the risks it covers and that therefore the provision of services in this field requires specific expertise and skills.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Insurance</strong> Life and <strong>non-life</strong> insurance have different characteristics and are probably separate markets. <strong>Aerospace insurance</strong> has specific features due to the particular nature and size of the risks it covers, so that it could be regarded as a distinct product market. The aerospace insurance sector could possibly be subdivided into a number of separate markets (such as airline, products/airline, general aviation, hull, war/terrorism, satellite/space, etc.). There is no substitution for the insured from the demand side, however there exists a high supply side substitutability within the broad category &quot;aerospace risks&quot;. Exact definition left open, as the transaction does not raise any competition concerns.</td>
</tr>
<tr>
<td><strong>Reinsurance</strong> The parties submitted that while some reinsurers may specialize in particular types of covers, the relevant product market is that of the supply of reinsurance as a whole since any reinsurer could readily and swiftly offer reinsurance coverage for any type of risks. The Commission's investigation has largely confirmed this view. In particular, many respondents have explained that the barriers to enter a new risk are quite low since • the approval which is rarely required to offer reinsurance cover for a new type of risks easy to obtain • no specific additional distribution channels are needed since cover for a new type of risk could always be sold via brokers • relevant expertise could be acquired by recruitment relatively easily and rapidly. Nevertheless, owing to the particular size and nature of aerospace risk it may be regarded as a distinct product market within the broader (non-life) reinsurance sector, however can be left open, as the transaction does not raise any competition concerns.</td>
</tr>
<tr>
<td><strong>Geographic market</strong> Provision of underwriting and management services to (re)insurers The relevant geographic market is at least EEA-wide and probably worldwide, as competing suppliers include undertakings established in Europe, Asia and in the US, however the transaction does not raise any competitive concerns for each of these two geographic markets <strong>Insurance</strong> The market for provision of aerospace risk insurance is at least EEA-wide (may even be worldwide): • competition to provide this cover is contested on an international basis</td>
</tr>
</tbody>
</table>
Different forms of cooperation between insurance companies and their respective impact on competition

- no national distribution channels for these products since they are mainly sold via brokers which are established on a worldwide basis
- fiscal/regulatory constraints are not trade barriers

Reinsurance
The market is worldwide as the nature of the activity requires the pooling of risks on an international basis.

**EU Commission 5 April 2006 COMP/M.4055 – Talanx/Gerling**

**Transaction:** The subject of the decision is a transaction whereby Talanx Aktiengesellschaft, controlled by HDI Haftpflichtverband der Deutschen Industrie V.a.G. acquires control of all operational units of the Gerling Versicherungsgruppe by way of purchase of assets.

**Decision:** The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

**Talanx:** Talanx is a holding company operating through a number of insurance companies in all market segments of the life insurance, indemnity insurance and reinsurance sectors. The operative business is carried on by various subsidiaries. All of the shares of Talanx are held by HDI V.a.G.

**Gerling:** Gerling offers life insurance, indemnity insurance and reinsurance through the investment companies controlled by it.

<table>
<thead>
<tr>
<th>Product market</th>
<th>The planned merger will affect different markets of the insurance sector.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indemnity insurance</td>
<td>The Commission generally regards indemnity insurance of non-private persons as a uniform market because industrial insurers can often cover both the various risks of damage/deterioration/destruction and the liability risks.</td>
</tr>
<tr>
<td></td>
<td>Exceptions may be types of distinct special insurance such as credit insurance and commercial fidelity insurance. This also applies to liability insurance for pharmaceutical companies.</td>
</tr>
<tr>
<td></td>
<td>Liability insurance for pharmaceutical companies discloses a number of particularities that distinguish it from liability insurance for other industry sectors.</td>
</tr>
<tr>
<td></td>
<td>• Product liability for medicinal products entails considerable potential for claims because it is always about personal injury and there is the risk of related claims. The wide range of possible claimants may additionally lead to high defence costs.</td>
</tr>
<tr>
<td></td>
<td>• There is latent potential for losses incurred, but not reported and there are problems of allocation to terms of policies if a medicinal product has been applied for years, but does not show unforeseen harmful adverse effects until at a very late point in time.</td>
</tr>
<tr>
<td></td>
<td>• The risk assessment thus requires knowledge of the active agents in medicinal products and medical knowledge.</td>
</tr>
<tr>
<td></td>
<td>• Owing to the high potential for loss, the reinsurance capacities may be limited to a greater extent than in liability insurance for</td>
</tr>
</tbody>
</table>
Liability risk under German Medicinal Products Act (AMG) as separate product market

Within the product market for pharmaceutical liability insurance, the insurance for the liability risk under the German Medicinal Products Act (Arzneimittelgesetz, AMG) constitutes a separate product market. The reason for this being

• Particularities in terms of liability law

When pharmaceutical companies place medicinal products requiring approval on the German market, they are liable without fault for personal injury under the Medicinal Products Act and are statutorily obliged to provide for financial security to cover any claims.

• The existence of a pharmaceutical insurance pool

In practice, the financial security to cover any claims is provided by way of liability insurance. To this end, the pharmaceutical reinsurance association (pharmaceutical insurance pool) was founded.

Within the framework of the liability, pharmaceutical companies have to assume outside Germany, the liability programme is usually divided into several layers. A self-insured retention ("SIR") is followed by the working cover and excess cover in subsequent layers. The working cover constitutes a separate product market in this regard because the working cover imposes other requirements on the insurer than insurance in upper layers.

• The lower layers have to handle claims more often and are thus also designated as working cover. As a rule, coinsurance associations provide the coverage capacities in this case, the leading insurer in particular having to have insurance capacities, special knowledge to assess the active agents in medicinal products and an administrative structure that can handle complex claims cases.

• In the layers above the working cover, however, where the claims frequency is lower, coinsurance associations are only rarely found.

• Only a very limited number of companies act as leading insurers in the lower layers of liability insurance. The range of companies offering insurance capacities in the upper layers is considerably broader (also companies from the London market and from Bermuda come into consideration here).

Therefore, companies that have restricted themselves to insurance in the upper layers so far exert competitive pressure on the leading insurers in the lower layers only to a limited extent.

Apart from the liability insurance for pharmaceutical companies, it is not necessary for the purposes of the present decision to conclusively define the product markets of direct insurance because no serious competitive concerns arise with regard to any possible factual market definition.

Reinsurance

With regard to reinsurance, the Commission assumed in earlier decisions that a differentiation could be made between reinsurance in the indemnity and life insurance sector. However, more recent decisions take into consideration that reinsurance is a uniform product market because reinsurers can offer reinsurance cover for any type of risk without
In the present case, the Commission left the final definition open because no serious competitive concerns arise with regard to any possible factual market definition.

<table>
<thead>
<tr>
<th>Geographic market</th>
<th>Indemnity insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>As a rule, direct insurance markets are primarily defined nationally. Markets for industrial insurance can in the event be supranational. The relevant geographic market for the liability risk under the Medicinal Products Act is limited to Germany. The compulsory insurance for no-fault liability under the Medicinal Products Act applies only to medicinal products placed on the market in Germany. In addition, the insurance coverage must be obtained from an insurance company licensed to operate in Germany. Nearly all members of the pharmaceutical insurance pool have their registered office (as head office or subsidiary) in Germany. Regarding the pharmaceutical liability risks outside Germany, the geographic market in the upper layers is to be considered as international.</td>
<td></td>
</tr>
<tr>
<td>• Pharmaceutical companies in Germany can procure insurance capacities irrespective of the insurance company’s registered office. This option is also exercised use for the insurance capacities in the upper layers. Notably companies from Bermuda and the London market often provide German pharmaceutical companies with coverage in the upper layers. On the other hand, the relevant geographic market for liability insurance of pharmaceutical companies in the sector of working cover is limited to Germany.</td>
<td></td>
</tr>
<tr>
<td>• In the working cover sector, the market conditions in Germany deviate from those in other countries.</td>
<td></td>
</tr>
<tr>
<td>• The insurance programmes of the German pharmaceutical companies in which coinsurance in the lower layers prevails are structured differently from those of foreign pharmaceutical companies in which smaller layers of sole insurance per layer predominantly follow a usually higher self-insured retention. This kind of structure increases the need for coordination between the layers, whereas the leading insurer sees to the coordination for most of the coverage periods in the event of coinsurance.</td>
<td></td>
</tr>
<tr>
<td>• The majority of German pharmaceutical companies prefer a leading insurer that has its registered office or at least a subsidiary in Germany because they see a number of advantages in this: The insurance contract is governed by German law and drafted in German which reduces uncertainties as to interpretation; the place of jurisdiction is in Germany and in the event of damage or loss, a certain proximity facilitates making contact.</td>
<td></td>
</tr>
</tbody>
</table>

Reinsurance
According to previous decisions of the Commission, the reinsurance markets are to be considered as worldwide markets because the type of
activity requires distribution of risks on an international basis.

<table>
<thead>
<tr>
<th>German Federal Cartel Office 10 August 2007; German Higher Regional Court Düsseldorf 17 September 2008; German Federal Court 23 June 2009– Auditor’s Third-Party Liability</th>
</tr>
</thead>
</table>
| **Transaction:** Four insurers amalgamated to form a permanent insurance pool (Versicherungsstelle Wiesbaden) to operate provide professional indemnity insurance (PI insurance) in the form of coinsurance for auditors, accounting firms, sworn auditors and bookkeeping companies as well as tax consultants, tax consultancy firms, tax advisers and mutual auditing associations engaged in Germany and abroad.  
  
**Versicherungsstelle Wiesbaden:** The association of insurers is responsible for the conclusion and administration of the insurance contracts and claim handling. It acts independently vis-à-vis customers as a provider of PI insurance, in particular for auditors, accounting firm, sworn auditors and bookkeeping companies.  
  
**Insuring Parties**  
**Party 1:** Party 1 belongs to the head of the Allianz SE group. Its business purpose is the direct and indirect operation of all branches of the personal liability insurance industry in Germany and abroad and intermediation of insurance, savings and building society contracts and other business that is commercially closely linked to the operation of insurance business.  
  
**Party 2:** Party 2 is an allied company of AXA S.A. Its purpose is the direct and indirect operation of all branches of personal liability insurance. In the life insurance, legal expenses and health insurance sectors, Party 2 only provides reinsurance. In addition, it brokers insurance products of all kind.  
  
**Party 3:** Party 3 belongs to R+V insurance group which offers individual insurance solutions of all kind to private and corporate customers.  
  
**Party 4:** Party 4 belongs to the ERGO group. As a conventional insurer and financial service provider, Party 4 offers a broad scope of products in the areas of private and commercial insurance, pensions, financing and capital investments.  
  
| Market definition | General Federal Cartel Office, 10 August 2007, B 4-31/05  
  
**product market**  
The Federal Cartel Office defines the market for professional indemnity insurance for auditors/sworn auditors as the relevant product market.  
  
**geographic market**  
The Federal Cartel Office geographically limits the market to Germany.  
  
| Product market | German Higher Regional Court Düsseldorf, 17 September 2008, VI-Kart 11/07  
  
The Düsseldorf Higher Regional Court does not follow the factual market definition of the Federal Cartel Office. Instead, the court states that in the factually relevant areas at the minimum also the PI insurance products for the other so-called "RWS professions" (offering legal, business and tax advice) i.e., for tax consultants, notaries and lawyer, are to be included in the factually relevant market.  
  
In this respect, Düsseldorf Higher Regional Court states the following:  
  
From a demand-side perspective a distinction could be made between the relevant professional groups concerned.  
  
- All kinds of professional indemnity insurance have in common that |
they protect policyholders against liability claims of third parties arising from the policyholder's acting in performance of the professional occupation.

- What is exchangeable, from a policyholder's point of view, however, is only insurance with the same risk description tailored specifically to the policyholder's professional occupation.

- The reason for this is that the risk descriptions of individual kinds of PI insurance differ depending on the profession of the policyholder because the coverage is supposed to be adapted to the respective profession.

- In this respect, there are differences within the group of professional legal, business and tax advisers.

- Although identical General Insurance Terms and Conditions for all professional legal, business and tax advisers exist, they are supplemented by Special Terms and Conditions for Insurance for each individual profession however. The Special Terms and Conditions of Insurance contain different risk descriptions tailored to the respective branch of profession.

From a demand-side perspective there is only one specific product market for PI insurance products for so-called RWS professions (legal, business and tax advice areas).

Moreover, for PI insurance in the group of professional legal, business and tax advisers, contrary to the statements of the office, supply-side substitutability exists because it is possible, at economically reasonable costs and at short notice, to extend the corporate portfolio of PI insurance for lawyers, notaries and tax consultants by including in it auditors/sworn auditors, like it is possible to extend PI insurance for auditors/sworn auditors by including lawyers, notaries and tax consultants.

- From the insurer's point of view, the risks to be insured of lawyers, notaries, tax consultants and chartered accountants/sworn auditors are sufficiently similar.

- Experience with the frequency and level of claims of a certain group of risks makes it possible to draw a conclusion about the frequency and level of claims in the same group. Either a calculation basis then exists already at that point or can quite easily be established.

- In addition, concerning the content arrangement of the terms and conditions of insurance, the distribution, contract conclusion and claims handling as well as the knowledge of the employees required for this are comparable.

- It is typical of insuring so-called RWS professions (legal, business and tax advice areas) that statutory compulsory insurance is involved in each case, with regard to which numerous statutory requirements must be met to the effect that the insurer's scope to sort out the details is generally narrower than with regard to other professional groups.

- Furthermore, the product range of the insurance companies operating in the sector of PI insurance for so-called RWS
professions (legal, business and tax advice areas) clearly suggests that from the insurers' perspective the risks to be insured are similar.

- Furthermore, no significant difference in the risk assessment/risk calculation can be seen between the risk to be insured in relation to chartered accountants/auditors and the risks in relation to tax advisers, lawyers and notaries.

The determination of the Federal Cartel Office to justify the lack of supply-side substitutability that the tendency for claims incurred, but not reported that is generally applicable in relation to all professional legal, business and tax advisers was extraordinarily high with regard to auditors/chartered accountants compared to the other professional legal, business and tax advisers is opposed by the Office's own investigation results.

Nor can the Federal Cartel Office's view that the extension of the corporate portfolio of PI insurance for lawyers, notaries and tax advisers to PI insurance for auditors/chartered accountants required considerable financial expense and time be shared because highly specialised staff would have to be built up.

- Employees of the insurance company who have already been working in the PI insurance sector previously can be employed for the underwriting and claims handling of PI insurance for auditors/chartered accountants at short notice and without considerable financial expense.

- As already detailed, contract processing and claims handling requires a rather equal level of know-how on the part of the insurer in relation to all professional legal, business and tax advisers.

- Added to this are the already demonstrated parallels between the IP insurance of the individual so-called RWS professions (legal, business and tax advice areas), notably concerning the content arrangement of the insurance terms, distribution and processing of contracts.

- In addition, it is not obvious that relevantly qualified employees in the job market are not available and therefore not able to be employed in the short term.

Nor, ultimately, according to the Federal Cartel Office, do existing market structure-related market access restrictions for the area of IP insurance for chartered accountants/auditors argue against supply-side substitutability of the IP insurers within the area of IP insurance for chartered accountants/auditors.

- It is already doubtful whether barriers to market entry in this connection have to be taken into account at all.

- Market entry conditions and thus the existence of barriers to market entry are of decisive importance for potential competition.

- However, in terms of market definition, potential competition is precisely not adduced. This is an argument in favour of the scenario that the market entry conditions that are decisive for competition in terms of flexibility of product adaptation to be
Different forms of cooperation between insurance companies and their respective impact on competition

Geographic market

reviewed for market definition do not have to be taken into account.

• Ultimately, this can be left undetermined because the asserted barriers to market entry do not exist.

The court sets forth that no decision is necessary in terms of whether the relevant market for IP insurance for the so-called RWS professions (legal, business and tax advice areas) must be geographically restricted to Germany or whether it has to be restricted beyond this territory.

German Federal Court, 23 June 2009, KVR 57/08

Within the framework of the Federal Court of Justice decision, the Federal Cartel Office admonishes the circumstance that prior to the oral hearing no judicial instruction took place to the effect that the appellate court was not going to follow the market definition of the Federal Cartel Office. According to the Federal Court of Justice, however, as early as after the facts pleaded by the Federal Cartel Office there was no reason for such instruction.

Finally, the Federal Court of Justice rejects as inadmissible the miscellaneous appeal on points of law of the Federal Cartel Office.

EU Commission 3 December 2007 COMP/M.4701 - Generali/PPF Insurance Business

Transaction: The subject of the decision is a transaction whereby the undertaking Assicurazioni Generali S.p.A. ("Generali", Italy) acquires control of the whole of the insurance business in Central Europe to Central Asia of PPF Group N.V. ("PPF", the Netherlands) by way of purchase of shares in a newly created company, Generali PPF Holding B.V.

Decision: The Commission has concluded that the notified operation does not raise serious doubts as to its compatibility with the common market.

Generali: Generali is the parent company of an international group of companies active in the insurance and financial sector worldwide. Generali is primarily active in Italy but the group is also present in other EU countries (e.g. Germany, France, Austria and Spain). Recently, Generali group has opened offices in the main Central and Eastern European (CEE) countries.

PPF: PPF is the principal holding company of a financial group originated in the Czech Republic. PPF is now active in Central Europe, Central Asia, China and Vietnam. The group specialises in financial services for retail clients in insurance and consumer financing.

Product market

Life Insurance

The notifying party considers that the Czech life insurance sector should be divided into the following product markets: (i) life risk protection products (i.e. policies covering standalone life risks) (Life Risk Products); (ii) savings and investment products, which comprise both endowment policies as well as unit-linked insurance policies (Savings and Investment Products); and (iii) supplementary pension insurance (Supplementary Pension Products).

The market investigation conducted by the Commission appears to support the broad segmentation of life insurance market into three product groups: life risk protection products, savings and investment products, and supplementary pension products. Many respondents
Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

pointed out that there is a clear distinction between these product groups and that they form separate product markets. With respect to a possible further differentiation of group and individual policies as well as unit-linked and non unit-linked policies, the results of the market investigation were more mixed. Some respondents indicated that further segmentation into unit-linked and unit-linked life policies may be appropriate in the Czech Republic. On the other hand, the distinction between individual and group life insurance products did not appear to be relevant in the present case for the majority of respondents.

However, as the transaction does not give rise to competition concerns under any of the alternative market definitions considered, it can be left open whether distinct product markets based on the above described life insurance segments or sub-segments exist.

Non-life Insurance

The insurance companies distinguish between products from different segments, even though some of them indicated that, although from the perspective of the end customers the products belonging to different segments of non-life insurance are not substitutable for each other, there is still certain substitutability from the supply-side perspective – on the wholesale level. It is mainly due to the role of intermediaries who distribute the whole range of products to the end customers.

On the other hand, certain respondents in the market investigation indicated that some segments could possibly be further sub-divided. Several respondents indicated that motor vehicle insurance could be further subdivided into Casco insurance and motor third party liability (MTPL) insurance. While MTPL insurance is obligatory for each motor vehicle, the penetration of Casco insurance in the Czech Republic is much lower.

Geographic market

According to the results of the market investigation, the insurance companies active on the Czech market usually sell their products exclusively on this market and only a small number of them offer their products – to a limited extent and usually under different conditions – also on the Slovak market. Further, the regulatory framework is national in scope and the importance of cross-border sales by insurance providers from other EU countries under the freedom to provide services is negligible (except for MAT insurance discussed below).

On this basis and in line with its previous practice the Commission considers that – except for MAT insurance – the Czech insurance market is regarded as national in scope.

EU Commission 17 June 2008 COMP/M.5075 – Vienna Insurance Group/EBV

Transaction: The subject of the decision is a transaction whereby WIENER STÄDTISCHE Versicherung AG Vienna Insurance Group acquires control of the following enterprises: Sparkassen Versicherung AG, BCR Asigurari de Viata S.A., BCR Asigurari S.A., Pojišťovna České spořitelny, a.s., Poist’ovňa Slovenskej spôsťel'ne, a.s., und Erste Sparkasse Biztosító Zártkörűen Működő Részvénytársaság (together "EBV").
**Decision:** The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

**Vienna Insurance Group:** The Vienna Insurance Group is active both in the life and the non-life insurance sectors in Austria and Central and Eastern Europe.

**EBV:** The EBV is also active both in the life and the non-life insurance sectors in Austria, Romania, Czech Republic, Slovakia and Hungary.

**Product market**

The parties' activities overlap in the area of life insurance in Austria, Romania, Czech Republic, Slovakia and Hungary and in the area of non-life insurance mainly in Romania.

**Life Insurance**

According to the notifying parties there are two separate markets, one for pure risk protection products and one for pension products and investment products. The parties also argue that pension products and investment products belong to a broader market for "wealth-creation products", which would also include products of other financial service providers in addition to the pension and investment products in the life insurance sector, owing to the apparent particularities of insurance products.

The findings of the market study in the relevant countries also presented by the Commission, support a division of the life insurance market into risk protection products and non-risk protection products. However, the Commission denied due to the findings of the study a unitary market for "wealth-creation products".

The Commission also considered a further segmentation according to the distribution channel, however, the Commission decided that the exact market definition be left open, as the transaction does not raise any competition concerns.

**Non-life Insurance in Romania**

The Commission considered the motor vehicle insurance market in Romania. The market investigation, in that case, indicated that this market could be further subdivided into hull insurance and motor TPL insurance. The Commission determined that in Romania, there were indications that these should be viewed as two separate markets, but ultimately left this question open.

Further, the Commission considered whether the classes VIII and IX of the national insurance classification, including elementary insurance, fire insurance and theft insurance, are to be allocated to a uniform market although they insure against various risks and whether there should be a further segmentation according to products offered to private individuals or corporate customers.

The Commission, however, decided that the exact product market definition can be left open in this case as the proposed transaction does not raise competition concerns irrespective of the market definition.

**Insurance Distribution in Romania**

The findings of the market study have shown that the differences between the various distribution channels do not justify a segmentation according to the distribution channel, since insurance products are usually available on similar terms through various distribution channels.
The Commission found that markets for non-life insurance and life insurance products are generally national in scope, with the exception of MAT insurance, which in would be at least EEA-wide, due to the particular national distribution channels, established market structures, fiscal constraints and different regulatory regimes.

**OFT UK 25 March 2010 ME/4424/10 – HSBC/MMC**

**Transaction:** Subject to the decision is a transaction whereby MMC UK Group Limited acquires of all the shares in HSBC Insurance Brokers Limited.

**Decision:** The transaction does not raise competition concerns.

**MMC UK Group Limited (MMC):** MMC, an intermediate holding company, is part of the Marsh and McLennan companies Inc. MMC group provides risk and insurance, investment management, consulting and brokerage services globally.

**HSBC Insurance Brokers Limited (HSBC):** HSBC is currently a wholly owned subsidiary of HSBC Insurance Brokers Holdings Limited, which in turn is a wholly owned subsidiary of HSBC Bank plc, and of the ultimate parent company, HSBC Holdings plc. HSBC supplies insurance and reinsurance brokerage services globally.

**Product market**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Life insurance distribution</strong></td>
<td>The parties overlap in the supply of primary insurance, reinsurance and retrocessional brokerage services globally (including in the UK).</td>
</tr>
<tr>
<td><strong>Non-life insurance distribution</strong></td>
<td>In a previous decision the OFT considered the impact of the merger on the supply by brokers of insurance distribution, reinsurance distribution and retrocessional reinsurance separately, without concluding on the precise market definition, given that, even on a narrow approach, the proposed merger did not raise competition concerns. In addition in past OFT and the Commission cases insurance and reinsurance were considered to be distinct frames of references. Also, in previous decisions, a further distinction has been made between life and non-life insurance products. Consistent with this, the OFT has sought to analyse these overlaps separately in this case.</td>
</tr>
<tr>
<td><strong>Reinsurance distribution</strong></td>
<td>The parties do not overlap in the UK and when compared to the total value of global life insurance sales the parties share is minimal (0-10 %), therefore the OFT has not sought to analyse this market further or to conclude on the exact scope of the life insurance market.</td>
</tr>
<tr>
<td><strong>Non-Life Insurance distribution</strong></td>
<td>The OFT considered the impact of the merger on the narrowest frame of reference, namely the distribution of insurance via intermediaries excluding direct sales to customers. However, given that the merger does not cause competition concerns even on this narrow basis, it is not necessary to conclude on the issue of whether the market should be segmented according to the way primary insurance is distributed.</td>
</tr>
<tr>
<td><strong>Reinsurance distribution</strong></td>
<td>The OFT considered the impact of the merger on the narrowest plausible frame of reference, namely the reinsurance distribution via intermediaries (brokers) excluding direct sales to insurers as neither party is active in direct distribution of reinsurance policies. However, given that the merger does not cause competition concerns even on this narrow basis, it is not necessary to conclude on the issue of whether the</td>
</tr>
</tbody>
</table>
Different forms of cooperation between insurance companies and their respective impact on competition

market should be segmented according to the way reinsurance is distributed.

**Retrocessional reinsurance distribution**

The OFT considered the impact of the merger on the narrowest plausible frame of reference, namely retrocessional reinsurance brokerage services. Without prejudice to the precise market definition, the OFT did not consider it necessary to conclude whether retrocessional reinsurance distribution should be considered as part of the same market as reinsurance distribution and, in addition, whether retrocessional reinsurance brokerage services should be part of an overall retrocessional reinsurance distribution market, as the proposed merger does not raise concerns, even when considered on the narrow basis of retrocessional reinsurance brokerage services.

**Different categories on non-life insurance/reinsurance risk**

The parties submitted that it is not necessary to segment the non-life insurance distribution market into different types of risk (for example accident and health, aerospace, education, casualty and professional lines, energy, marine, motor and property). Even though there is no demand-side substitution between each category, the parties argued that there is sufficient supply-side substitutability. In particular, the parties argued that the skills required for insurance distribution are generally not specific to particular risk categories and a distributor of a specific category of risk could easy and readily switch to providing another category.

On the basis of the lack of any third party concerns and consistent with the previous decisions, the OFT concludes that brokers who specialize in certain areas are able to switch with relative ease between types of risk. This is consistent also with the Commission precedent which has accepted that there is a degree of supply-side substitutability between the different types of risks (s. COMP/M.3035 – Berkshire Hathaway/Converium/Gaum/JV). Therefore, the OFT examined the impact of the merger on insurance, reinsurance and retrocessional reinsurance distribution via intermediaries for all types of risks without delineating the market according to the type of risk insured and reinsured.

| Geographic market | The OFT considers that the geographic scope for primary insurance and reinsurance distribution is at least national and most likely global. However, for the purposes of the present case the OFT considered it prudent to consider the impact of the merger through a UK lens, as well as a wider global geographic market definition, and concludes that no concerns arise irrespective of the geographic market definition adopted. |

**EU Commission 19 January 2011 COMP/M.6053 – CVC/Apollo/Brit Insurance**

**Transaction:** The subject of the decision is a transaction whereby CVC Capital Partners SICAV-FIS S.A. and Apollo Management L.P. acquire joint control of Brit Insurance by way of public bid.

The proposed transaction involves the acquisition by CVC and Apollo of Brit Insurance Holdings H.V. through a newly-incorporated company – Achilles Netherlands Holdings B.V., jointly owned by CV Cans Apollo in equal proportions.
Upon completion of the transaction, Achilles will hold 100% of Brit Insurance. CVC and Apollo will hold substantially all of the shares in Achilles in equal proportions, with the remainder of the shares held by the management of Brit Insurance.

**Decision:** The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

**CVC:** CVC Group is providing investment advice to and/or managing investments on behalf of a range of CVC Funds. Among others, CVC holds controlling interests in AA/Saga, which provides non-life insurance, insurance underwriting services, distribution services and financial services products primarily in the UK. Additionally, CVC holds controlling interests in Evonik Industries A.G., which is active in specialty chemicals.

**Apollo:** Apollo is a private equity investment fund that invests in companies involved in numerous businesses throughout the world. Apollo Athene Life Re which is active in fixed life insurance annuity policies but has no non-life insurance activities. In addition, Apollo funds controls Momentive Specialty Chemicals, Inc., which is also active in specialty chemicals.

**Brit Insurance:** Brit Insurance is a general insurance and reinsurance group specialising in commercial insurance, underwriting a diverse portfolio of classes of insurance and reinsurance and offering protection for business worldwide, through a distribution channel centred on brokers and intermediaries.

<table>
<thead>
<tr>
<th>Product market</th>
<th>The parties have activities in four areas: Insurance underwriting, Provision of non-life insurance, Insurance distribution, Reinsurance.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Insurance underwriting</strong></td>
<td>The Commission accepted that the underwriting of insurance (and reinsurance) risks and the management of policies on behalf of (re)insurers constituted one single product market (distinct from the provision of (re)insurance itself). It has considered if the market should be subdivided according to types of risks. However, the Commission left the exact product market definition open.</td>
</tr>
<tr>
<td><strong>Provision of non-life insurance</strong></td>
<td>The market for non-life insurance is vertically related upstream to the market for non-life insurance underwriting. In previous decisions, it was noted that the different kind of risks covered by non-life insurance have different characteristics, purposes, and premiums to be paid and, therefore, are not substitutable from the customer’s perspective.</td>
</tr>
<tr>
<td><strong>Insurance distribution</strong></td>
<td>The market for insurance distribution involves procuring insurance cover for individual and corporate customers through different channels, comprising direct writers, tied agents and intermediaries such as banks and brokers. It is vertically related to the downstream market for insurance provision. Previously, the Commission has considered whether the market for insurance distribution comprises exclusively all outward insurance distribution channels, or if the sales forces and office network of insurance companies also fall within the market of insurance distribution. Nonetheless, the definition has always been left open. In this case, the Commission decided that the exact market definition be left open, as the transaction does not raise any competition concerns.</td>
</tr>
<tr>
<td><strong>Reinsurance</strong></td>
<td></td>
</tr>
</tbody>
</table>
Reinsurance consists in providing insurance cover to another party (the insurer) for part or all of the liability assumed by the latter party under the policy or policies of insurance which it has issued. It is a means of risk management, to transfer risk from the insurer to the reinsurer.

The Commission distinguished in the past the market for reinsurance from those for life insurance and non-life insurance, but left open whether, within the reinsurance market, a further distinction between life and non-life segments should be considered, and whether within the non-life segment, a segmentation according to the class of risk covered should be considered.

The Commission decided to leave open the precise market definition in this case.

### Geographic market

**Insurance underwriting**

As regards the geographical scope of the market, the Commission's previous decisions suggest that the geographical dimension of insurance underwriting market is at least EEA-wide.

**Provision of non-life insurance**

For the geographic market, previous Commission decisions found that competition for non-life insurance takes place primarily at a national level due to a variety of factors such as distribution channels, fiscal constraints etc.

**Insurance distribution**

In previous decisions, while recognizing the national nature of insurance distribution channels, the Commission left open the precise definition, in particular the question whether the relevant geographic market is wider than national.

**Reinsurance**

As regards the geographical scope of market, it has previously been defined as global by the Commission, due to the need to pool risks on a worldwide basis.

---

**EU Commission 4 April 2012 COMP/M.6521 – Talanx International/Meiji Yasuda Life Insurance/Warta**

**Transaction:** The subject of the decision is a transaction whereby Talanx International AG and Meiji Yasuda Life Insurance Company acquire joint control of Towarzystwo Ubezpieczeń i Reasekuracji Warta S.A., with the exceptions of its subsidiaries Powszechne Towarzystwo Emerytalne WARTA S.A. and KBC Towarzystwo Funduszy Inwestycyjnych S.A. by way of purchase of shares.

The notified transaction consists in the acquisition of joint control over Warta by TINT and MY. It is structured as follows: at first TINT will acquire 100% of the shares in Warta from KBC5, after, and subject to completion of this transaction, MY will acquire 30% of the shares in Warta from TINT.

As a result of the transaction, TINT and MY will hold 70% and 30%, respectively, of the shares in Warta.

**Decision:** The Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.
Talanx International AG: Talanx International AG is a direct 100% subsidiary of Talanx, which in turn is a 100% subsidiary of the German mutual insurance company HDI V.a.G. Talanx provides life and non-life insurance products and is active in the market for reinsurance. Its activities are worldwide in scope, and it is also active in Poland.

Meiji Yasuda Life Insurance Company: Meiji is a Japanese insurance company, providing both life and non-life insurance products and, to a much lesser extent, reinsurance. Outside Japan, MY operates through subsidiaries and affiliates in Asia, Europe and North America. Its activities in the EEA are marginal and related to the reinsurance market.

Towarzystwo Ubezpieczeń i Reasekuracji Warta S.A.: Warta is a Polish insurance company and currently wholly owned subsidiary of KBC Verzekeringen NV, part of the Belgian KBC Group NV ("KBC"). It provides life and non-life insurance products to individual and business customers, with a focus on maritime and aviation insurance products. It also has a limited reinsurance business.

<table>
<thead>
<tr>
<th>Product market</th>
<th>The companies' activities overlap among others in the distribution of motor vehicle insurance, property insurance, MAT insurance and cargo insurance.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor Vehicle Insurance</td>
<td>In the past, the Commission has often carried out its initial analysis on the basis of a segmentation by insurance class, following the classification used in the national regulatory framework, which transposes the relevant EU Directive. However, where necessary and in particular in relation to large commercial risks, the Commission has also looked at more narrow possible markets. The notifying parties note that this category comprises two classes of insurance, i.e. Class 3 – Overland vehicle hull insurance (&quot;casco&quot;), excluding railway, and Class 10 – Motor vehicle third party liability (&quot;TPL&quot;) insurance. The Parties argue that the motor vehicle insurance should be considered as a single market without any segmentation. As regards motor vehicle insurance, the Commission discussed whether or not supply-side substitutability might result in a single market in Poland across both classes of motor insurance at issue, i.e. Class 3 – Overland vehicle hull insurance (&quot;casco&quot;), excluding rail-way, and Class 10 – Motor vehicle third party liability (&quot;TPL&quot;) insurance, and also at whether a distinction between insurance of large vehicles (such as buses, trucks and off-road vehicles), on the one hand, and automobile and/or small commercial vehicle insurance, on the other hand. Although the market investigation was, according to the Commission, inconclusive as to whether a distinction should be made between TPL and hull insurance, it found evidence that there was a single market for both TPL and hull insurance at least for auto-mobiles (including two-wheeled vehicles) and small commercial vehicles due to supply-side substitutability and bundling of products. The Commission based its decision on the following observations:</td>
</tr>
<tr>
<td>• While certain customers demanded hull insurance in addition to liability insur-ance, in the vast majority of cases they purchased these two types of insurance from the same provider (in relation, at least, to automobiles and small commercial vehicles).</td>
<td></td>
</tr>
<tr>
<td>• Almost all providers offered both types of insurance and that there were no barriers for a provider of one type also to enter the market.</td>
<td></td>
</tr>
</tbody>
</table>
Different forms of cooperation between insurance companies and their respective impact on competition

<table>
<thead>
<tr>
<th><strong>Motor vehicle insurance</strong></th>
<th>other segment.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• While TPL insurance is provided on terms defined in relevant legislation, there is a greater scope for differentiation of product and service offering in relation to hull insurance.</td>
<td></td>
</tr>
<tr>
<td>• Both types of insurance were addressed to the same customers and, if both were purchased, they were often purchased together at the same time. It was typically more advantageous to do so from the same provider than from different provid-ers, although the latter was also theoretically possible and occasionally encountered.</td>
<td></td>
</tr>
<tr>
<td>While the parties claimed that no segmentation should be made between insurance of large vehicles and automobile and/or small commercial vehicle insurance, since this &quot;segmentation would not correspond to the commercial practice and normally there would be no distinction between the two groups in either the business organization, the distribution channels or the legal requirements&quot;, the Commission's investigations indicated that a distinction might indeed be appropriate because:</td>
<td></td>
</tr>
<tr>
<td>• The insurance of large vehicles typically concerns fleets of vehicles rather than single vehicles, and both TPL and hull insurances are individually priced based on claims history and the nature of the activity carried out.</td>
<td></td>
</tr>
<tr>
<td>• This type of insurance is often obtained by customers through brokers and re-quires specialized risk assessment.</td>
<td></td>
</tr>
<tr>
<td>• By contrast, automobile insurance is a more commoditised product with much less determination of individual risk.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Property Insurance</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>In previous cases, the Commission has generally not distinguished between property insurance on the basis of the origin of the risk. The notifying parties note that, according to the Polish Insurance Act, two classes of insurance are identified within the broader category &quot;property insurance&quot;, i.e. Class 8 – Natural disasters and Class 9 – Other property losses if the causes are not included in Class 8, but agree with the Commission's previous practice which tended to find that a single, overall market existed for property insurance. Nonetheless, the notifying parties provide the market shares also on the basis of a breakdown between Classes 8 and 9.</td>
</tr>
<tr>
<td>The Commission decided that the exact product market definition for property insurance can be left open in this case as the proposed transaction does not raise competition concerns irrespective of the market definition.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>MAT Insurance</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>In previous decisions, the Commission has considered MAT insurance as a separate segment within non-life insurance, but it has also considered whether a further segmentation would have been possible on the basis of the means of transport.</td>
</tr>
<tr>
<td>Regarding the MAT insurance market the Commission analysed whether the market should be further segmented according to the means of transport (like it was done in COMP/M.5010 – Berkshire Hathaway/Munich Re/Gaum), yet decided that the market definition for</td>
</tr>
</tbody>
</table>
the purposes of the present case could be left open since, regardless of the exact market definition, the proposed transaction did not raise serious doubts as to its compatibility with the internal market.

The Commission conducted a market investigation as regards supply-side substitution, however, the market investigation was inconclusive as regards supply-side substitution. Whilst certain segments such as rail could be viewed as relatively specialized and characterized by a small number of buyers and providers of insurance, in other cases the distinction between means of transport and between hull and liability insurance appeared less important than a distinction based on the size of the risk. Often the size of the risk was also correlated with the geographical scope of the market, such that, for instance in the marine segment, smaller pleasure vessels, fishing vessels etc. had access to a market defined along national lines, whilst larger vessels could access international markets for insurance. In such cases, whilst there might be fewer domestic providers active in the market, this was usually compensated for by the possibility to purchase internationally.

Ultimately, the Commission explains that the market definition for the purposes of the present case can be left open since, regardless of the exact market definition, the proposed transaction does not raise serious doubts as to its compatibility with the internal market.

Cargo Insurance

The Commission investigated further whether, within the cargo insurance market, it was possible to identify any relevant segmentation taking into account the means of transport, the type of cargo, and the place of origin or destination. In that case, the market investigation revealed that a distinction could be made based on size of risks and also between international and domestic shipments.

The Commission's investigation suggested "that, for smaller risks, there were a number of providers of cargo insurance and low barriers to entry. In these instances, the type of cargo and the means of transport were not significant factors impeding supply-side substitutability. Such smaller risks included most purely national shipments. Nonetheless, both international and national shipments of dangerous or perishable cargo and cargo posing a risk to human health or the environment could rely on access to a much smaller pool of insurers able to correctly assess the specialized nature of these risks and with the financial standing to honour claims both for cargo loss but especially for third party and public prejudice."

The investigation also showed that "there were (...) fewer providers of this type of insurance to Polish customers active internationally. For this reason a distinction could also be drawn between international and national shipments."

Ultimately, the Commission explained that the market definition for the purposes of the present case could be left open since, regardless of the exact market definition, the pro-posed transaction did not raise serious doubts as to its compatibility with the internal market.

Reinsurance

In the present case, the notifying parties argued for a broad product market definition of reinsurance, distinct from life and non-life insurance,
but not itself segmented.

But the Commission decided that the precise market definition can be left open in this case, since the transaction does not raise competition concerns with respect to the reinsurance market, however segmented.

**Geographic market**

With regard to the geographic scope of non-life insurance markets, the Commission has generally considered these markets as national, with some exceptions.

The notifying parties agree with the Commission's previous findings as regards the geographic market definition and consider that the geographic scope of the affected markets for non-life insurance is national, with the exception of MAT insurance, including cargo insurance, which in their view would be at least EEA-wide, if not international. In this regard they submit that international transport insurances are based on the international GATT agreement according to which the insurance of drop-shipment is a so-called "non-admitted business"; thus insurers do not require a national license in order to insure drop-shipments from one country to another and therefore there would be no significant national differences in this segment. Moreover, in support of a broader geographic market definition, the notifying parties submit that insurances in this segment are sold internationally by brokers and that insurance companies sell such insurances via centralized offices.

The market investigation in the present case did not fully support the position of the notifying parties, since it suggested that the geographic scope of the markets for MAT and cargo insurance was at least EEA-wide in the case of large risks, but nonetheless remained national for smaller risks and, in the case of cargo insurance, for most purely domestic shipments.

In relation to motor insurance for large commercial vehicles, if this were to be considered a separate market, the market investigation suggested that it would nonetheless also be national in scope: indeed whilst an insurance policy could cover more than one country, owners as regards third party liability are obliged to insure their vehicles in the country of registration of the vehicle and within its legal regime. Also as regards hull insurance, domestic claim-handling facilities are required.

In any event, the Commission decided that the exact scope of the relevant geographic market for each of the classes of non-life insurance considered can be left open for the purposes of the present decision since the notified transaction does not lead to serious doubts as to its compatibility with the internal market.

**Reinsurance**

As regards reinsurance, the Commission has previously defined this market as global, due to the need to pool risks on a worldwide basis. The Notifying Parties agree with this definition.

The Commission decided that the geographic scope of the reinsurance market can be left open for the purposes of the present decision since the notified transaction does not raise significant doubts as to its compatibility with the internal market regardless of whether the reinsurance market were to be considered at an EEA or global level.
EU Commission 23 July 2012 COMP/M.6649 – Allianz/Insurance Portfolio and Brokerage Services of Gan Eurocourtage

Transaction: The subject of the decision is a transaction whereby Allianz IARD SA, a member of the Allianz Group acquires control of part of the whole of a self-standing non-life insurance portfolio comprised of insurance contracts and their related brokerage businesses, assets and liabilities in France ("The Target"), hitherto belonging to Gan Eurocourtage SA ("GEC") by way of purchase of shares.

Decision: The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

Allianz IARD SA: Allianz IARD SA is a French subsidiary of Allianz SE. It provides various kinds of non-life and life insurance, asset management and banking operations services.

The Target: The Target is a self-standing insurance portfolio of GEC relating to non-life insurance products provided to individuals, professionals and businesses, as well as the related brokerage businesses and management activities, together with the related non-portfolio items, assets and liabilities.

GEC: GEC is a wholly-owned subsidiary of Groupama, a French insurance company, is active in the market for the provision of non-life insurance products to individuals and businesses, transport insurance and group insurance products.

Product market

Non-life insurance is the only market in which the transaction would lead to horizontal overlaps between the concerned undertakings.

Non-life insurance

Within these categories, insurance products are intended to cover specific risks.

The Commission noted that supply-side considerations may lead to broader product markets in respect of certain types of risk, indicating that different types of insurance may be included in the same product market.

From a demand-side perspective, however, the Commission in previous decisions noted that life and non-life insurance products might be subdivided into as many product markets as there are different kinds of risk covered since the characteristics of individual policies are distinct and the insurance against a given risk is not generally substitutable with insurance against another risk from the consumer’s perspective. Accordingly, the Commission in the past considered the possibility that distinctions might be drawn among non-life policies between the following insurable risks: accident and health, motor vehicle, property, marine, aviation and transport, liability, credit and suretyship and travel.

As regards the further sub-segmentation of the specific non-life insurance market in France, the notifying party notes that the decisional practice at national level under the Code des Assurances suggests that the following categories of insurance products might be distinguished between:

- motor vehicle insurance for individuals – including both two and four-wheeled vehicles;
- home insurance for individuals – including home and real estate property insurance products for individuals, as well as insurance products related to damage caused to products related to the household (e.g. cell-phone damage);
• general liability for individuals – insurance products covering individuals against the risks of liabilities imposed by lawsuits and similar claims, as well as the consequences of the actions of individuals;

• insurance for fleets of motor vehicles for businesses – including insurance for vehicle fleets and groups;

• construction insurance – including general civil liability, site risks, and building and constructors’ liability;

• real estate property insurance for professionals/businesses – covering damage to real estate property owned by professionals/businesses;

• property damage insurance for professionals/businesses – including damage to other professional/business property, as well as other risks (excluding assumption);

• general liability insurance for professionals/businesses – covering liability for the conduct of professional activities;

• other insurance products – covering natural disasters, credit insurance, etc.

In the past, the Commission often carried out its initial analysis on the basis of segmentation by insurance class, following the classification used in the national regulatory framework, which transposes the relevant EU Directive. However, where necessary and, in particular, in relation to large commercial risks, the Commission also looked at more narrow possible markets.

Insurance underwriting and management service

In its previous administrative practice, the Commission distinguished between, a relevant product market for insurance and reinsurance services on the one hand, and, on the other, a downstream relevant product market for the underwriting and management of insurance and reinsurance risks to insurers and reinsurers. In doing so, it concluded that these downstream services constituted a single relevant product market which is distinct from the provision of (re)insurance. Although the Commission considered whether this market should be further segmented according to the types of risks involved, the precise market definition was thus far left open.

The notifying party submits that a separate relevant product market for underwriting and management of insurance products does not exist in France, given that insurance undertakings are characterized by high levels of vertical integration and generally perform all the business-related functions themselves, including underwriting and management services. However, even if the Commission were to consider that a separate relevant product market exists for underwriting and management, which would not change the competitive assessment of the transaction as, according to the Commission’s previous decisional practice, the assessment of the parties’ shares should be based on their gross premiums, thus reflecting the total value of insurance placed by them. In effect, market shares would in the case at hand be the same as for insurance production.

Distribution of insurance products
In its administrative practice, the Commission in the past concluded that a downstream market for insurance distribution involves the procurement of insurance cover for individual and corporate customers through different distribution channels, whether comprised of direct writers, tied agents or intermediaries such as banks and brokers. In doing so, the Commission always left open the possibility of whether the market for insurance distribution comprised exclusively all outward (i.e. non-owned and third-party) insurance distribution channels (e.g. brokers and agents), or whether the sales forces and office networks of insurance undertakings (constituting a direct means of sale to end-customers) should also fall within the market for insurance distribution.

As regards the French market for insurance distribution, Allianz submits that its classification generally corresponds to the classification adopted by the Commission for insurance distribution.

**Assistance Service**

In its previous decisions, the Commission defined a separate market for the provision of assistance services. In this kind of market, it is the assistance provider who organises the assistance to the policyholder (such as sending an ambulance or a car recovery vehicle, organising the repatriation of the policyholder or contacting travel agents, airlines and hotels to make the necessary changes to a trip, etc.) while it is the insurer who covers the costs related to such unexpected events.

**Geographic market**

In its administrative practice, whilst recognising that insurance markets are becoming more open to intra-Community competition, the Commission consistently found that markets for non-life insurance and life insurance products are generally national in scope due to the particular national distribution channels, established market structures, fiscal constraints and different regulatory regimes. This also applies to the assistance market.

As regards the geographic scope of the insurance underwriting and management market, the notifying party notes that the Commission’s previous decisions suggest that the geographic dimension of the insurance underwriting market is at least EEA-wide.

---

**EU Commission 20 September 2012 COMP/M.6485 – EULER HERMES/MAPFRE/MAPFRE CC**

**Transaction:** The subject of the decision is a concentration whereby Euler Hermes SA and Mapfre S.A. create a Joint Venture (JV).

The Parties will contribute their respective del credere businesses in Spain, Chile, Colombia and Mexico to the JV. They will each hold 50% of the shares in the JV. Therefore the JV is jointly controlled by Euler Hermes and Mapfre.

**Decision:** The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

**Euler Hermes:** Euler Hermes is an international French business group, operating in 54 countries worldwide mainly active in the commercialisation of credit insurance products (including delcredere insurance and bonding products), allowing companies to be secured by insurance coverage for the payment of trade receivables. It is ultimately controlled by the Allianz Group.
**Mapfre:** Mapfre is an international Spanish insurance and reinsurance business group.

<table>
<thead>
<tr>
<th><strong>Product market</strong></th>
<th>Del credere Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>According to the notifying parties, the JV will be active only in the provision of del credere insurance in Spain and in some countries in Latin America.</td>
</tr>
<tr>
<td></td>
<td>In past decisions the Commission has identified Credit insurance consistently as a segment of the non-life insurance branch. Within credit insurance, the Commission has identified five sub-segments, based on their characteristics: &quot;del credere&quot; insurance, capital goods insurance, consumer credit insurance, fidelity insurance and guarantee insurance.</td>
</tr>
<tr>
<td></td>
<td>The Commission considered that del credere policies differ from other credit insurance products as a function of their specific characteristics as well as the requirements that must be met by the entities offering them.</td>
</tr>
<tr>
<td></td>
<td>In particular:</td>
</tr>
<tr>
<td></td>
<td>• the risk of losses and profit margins are in general higher in del credere insurance than in other segments;</td>
</tr>
<tr>
<td></td>
<td>• different (and more complex) statistical information is required to accurately evaluate the risks to be covered (and hence to set appropriate premiums) and</td>
</tr>
<tr>
<td></td>
<td>• the interpretation of the statistical information needs specialist and complex data-processing systems in order to be processed.</td>
</tr>
</tbody>
</table>

| **Geographic market** | The notifying parties note that the Commission has defined the geographic scope of the del credere market as national, since the provision of such services requires companies to set up a local presence in order to both commercialise the products and handle policies and necessitate good knowledge of the local business community. Thus, even though multinational customers conclude global policies at EU/international level, their subsidiaries conclude additional sub-policies with subsidiaries or branches of their credit insurer in each country. |
|                      | Outside the JV no other company of the Euler Hermes (including Allianz) and/or Mapfre groups provides del credere insurance in Spain or in the Latin American countries concerned. Therefore the only transaction-specific overlap occurs in the Spanish del credere insurance segment. |

<table>
<thead>
<tr>
<th><strong>EU Commission 9 November 2012 COMP/M.6694 – Helvetia/Certain Parts of Gan Eurocourtage’s Transport and Marine Insurance Portfolio</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction:</strong> The subject of the decision is a transaction whereby Helvetia Assurances SA indirectly controlled by Helvetia Holding AG acquires control of part of Gan Eurocourtage SA (&quot;The Target&quot;) by way of purchase of assets.</td>
</tr>
<tr>
<td>The transaction consists in the purchase of the portfolio of GEC’s Marine and Transport Insurance contracts and their related assets underwritten in France and the various French overseas territories.</td>
</tr>
<tr>
<td><strong>Decision:</strong> The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.</td>
</tr>
<tr>
<td><strong>Helvetia:</strong> Helvetia is a Pan-European insurance company active both in the life and the non-life insurance sectors.</td>
</tr>
</tbody>
</table>
The Target: The Target is the portfolio of Gan Eurocourtage’s ("GEC") Marine and Transport Insurance Contracts and their related assets underwritten in France and various French overseas territories.

| Product market | In past decisions the Commission identified transport insurance as a segment of the wider non-life insurance branch. Within transport insurance, the Commission envisaged further sub-segments by reference to the applicable national insurance classification. The notifying party does not disagree with such practice and submits that the relevant insurance classification is consistent across those Member States where the combined entity will be active, i.e. Austria, France, Germany, Italy and Spain.

Based on the above, the parties' activities overlap in the following sub-segments: marine hull insurance, cargo insurance and transport liability insurance.

Marine Hull Insurance

Marine hull insurance provides coverage for damage incurred by all floating methods of transport. Within such branch, the Commission also considered further potential product markets, i.e. sea marine hull insurance and inland marine hull insurance. The former segment can be further sub-divided into marine hull insurance for sea-going vessels and insurance for construction risks (which covers damages caused by shipbuilders and repairers) and the latter can be sub-divided into marine hull insurance for inland crafts and insurance against damage to land-based (harbour) materials (such as cranes used in the context of marine transport).

Cargo Insurance and Transport Liability Insurance

According to the notifying party, it would not be appropriate to further sub-divide the product markets for cargo insurance and transport liability insurance by the means of transport involved. In fact, such segmentation would be neither meaningful nor practical, because most insurance contracts cover multimodal transportation within a single voyage. Thus, sub-divisions within the voyage itself, and according to the particular means of transport used for every leg of a journey, would be artificial.

The Commission decided that the exact product market definitions can be left open in this case as the notified transaction does not raise serious doubts as to its compatibility with the internal market under any alternative definition.

| Geographic market | The Commission generally defined the geographic scope of non-life insurance markets as national because of national distribution channels, established market structures, fiscal constraints and differing regulatory systems. However, with respect to the geographic scope of markets related to transport insurance, the Commission indicated that it is likely to be wider than national for large corporate customers and large risk insurance respectively. In two past decisions regarding the marine insurance sector the Commission considered that the market could be at least EEA-wide, but ultimately left the exact scope of the relevant geographic market open.

The notifying party submits that each of the relevant product markets
defined is indeed at least EEA-wide.
In this case the Commission decided that the exact definition can be left open.

**EU Commission 19 November 2012 COMP/M.6743 – Talanx International/Meiji Yasuda Life Insurance Company/HDI Poland**

**Transaction:** The subject of the decision is a proposed concentration whereby Talanx International AG and Meiji Yasuda Life Insurance Company acquire joint control of HDI Asekuracja S.A ("HDI Poland Non-life", Poland) and HDI-Gerling Życie S.A ("HDI Poland Life", Poland) by way of purchase of shares.

**Decision:** The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

**Talanx International:** a fully-owned direct subsidiary of Talanx AG. Talanx provides life and non-life insurance products and is also active in the market for reinsurance. Its activities have a worldwide scope, and it is also active in Poland.

**Meiji Yasuda Life Insurance Company:** a Japanese insurance company, providing both life and non-life insurance products and to a much lesser extent reinsurance. Outside Japan, MY operates through subsidiaries and affiliates in Asia, Europe and North America.

**HDI Poland:** HDI Poland Non-life is a Polish company providing non-life insurance to individual and business customers in Poland and having only marginal reinsurance activities. HDI Poland Life is a Polish company providing life insurance to individual and business customers in Poland. It is not active in the reinsurance market.

<table>
<thead>
<tr>
<th>Product market</th>
<th>Life insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>With respect to life insurance, the Commission has in certain previous decisions looked separately at (i) pure protection products, (ii) pension products and (iii) investment products, but also, on other occasions, considered pension and investment products together, but in a separate class from pure protection products. The Commission has, however, so far left the exact product market definition open.</td>
<td></td>
</tr>
</tbody>
</table>

The Notifying Parties point out that the classification according to the Polish Insurance Act does not strictly distinguish between protection, pension and insurance products. Rather, within some classes of insurance different types of products are grouped. Therefore the Notifying Parties propose a market segmentation by insurance class.

<table>
<thead>
<tr>
<th>Product market</th>
<th>Non-life insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accident and sickness insurance</strong></td>
<td></td>
</tr>
<tr>
<td>Whilst the Commission has in the past considered accident and sickness products as part of a single market, the Notifying Parties note that, according to the Polish Insurance Act two separated classes of insurance are identified, i.e. Class 1 – Accident and Class 2 – Sickness. The Notifying Parties therefore provided the market shares also on this narrower basis.</td>
<td></td>
</tr>
</tbody>
</table>

In any event, the exact product market definition for accident and sickness insurance products can be left open in this case as the proposed transaction does not raise serious doubts as to its compatibility with the internal market irrespective of the precise market definition.
**Property insurance**

In previous cases, the Commission has generally not distinguished between property insurance on the basis of the origin of the risk. The Notifying Parties note that, according to the Polish Insurance Act, two classes of insurance are identified within the broader category "property insurance", i.e. Class 8 – Natural disasters and Class 9 – Other property losses if the causes are not included in class 8. Although the Notifying Parties agree with the Commission's previous practice which tended to find that a single, overall market existed for property insurance, the Notifying Parties provide the market shares also on the basis of a breakdown between classes 8 and 9.

In any event, the exact product market definition for property insurance can be left open in this case as the proposed transaction does not raise serious doubts as to its compatibility with the internal market irrespective of the precise market definition.

**MAT insurance**

In previous decisions, the Commission has considered MAT insurance as a separate segment within non-life insurance, but it has also considered whether a further segmentation was necessary on the basis of the means of transport.

The Notifying Parties agree with the latter segmentation and note that a distinction by means of transport would also be in line with a number of other cases in which the Commission specifically investigated aviation and aerospace risks, or even sub-segments thereof, such as airline risks, product and airport risks, general aviation risks, banks/non-ownership risks (insurance of legal owners of aircrafts when these are not their users, e.g., banks and leasing companies), satellite and space risks. Moreover, in support of this segmentation, the Notifying Parties argue that insurance companies that seek to offer coverage for insurance of marine and aviation risks tend to require specific know-how.

In this respect, the Notifying Parties provided market shares according to the classes of the Polish Insurance Act, which identifies different classes according to the means of transport (Class 4 – Railway hull insurance; Class 5 – Aviation hull insurance; Class 6 - Marine and inland navigation hull insurance; Class 11 – Aircraft third party liability insurance; and Class 12 Marine and inland third party liability insurance).

In the most recent cases where the Commission examined whether segmentation by means of transport would be appropriate, the results of the market investigation were inconclusive as regards the pertinence or otherwise of supply side substitution to the definition of the relevant product market.

In any case, the market definition for the purposes of the present case can be left open since, regardless of the exact definition, the proposed transaction does not raise serious doubts as to its compatibility with the internal market.

**Cargo insurance**

The Notifying Parties also considered cargo insurance as a possible separate segment, and provided market shares for insurance Class 7 named "Cargo in transit insurance". The Notifying Parties note that while cargo insurance is frequently referred to in publications of the Polish...
Financial Supervision Authority and the Polish Insurance Chamber as “goods-in-transit insurance”, the risks covered under Class 7 relate to all cargo shipped into, from or within Poland, not just transit cargo in a strict sense, i.e. cargo neither the origin nor the destination of which is located in Poland. Therefore, the Notifying Parties refer to Class 7 in general as “cargo insurance” and not as “goods-in-transit insurance”.

In the Warta Decision, the Commission investigated cargo insurance in Poland and whether, within it, it was possible to identify any relevant segmentation. In that case, the market investigation revealed that a distinction could be made based on different types of risks and also between international and domestic shipments. Nonetheless, type of cargo and means of transport were not significant factors impeding supply-side substitutability.

However, the market definition can be left open for the purposes of the present decision since, regardless of the exact market definition considered, serious doubts do not arise as to the compatibility of the notified transaction with the internal market.

Reinsurance
The Notifying Parties, in the present case, argue for a broad product market definition of reinsurance, distinct from life and non-life insurance, but not itself further subdivided.

In any event, the precise product market definition for reinsurance can be left open in this case, since the transaction does not raise serious doubts as to its compatibility with the internal market regardless of the exact market definition.

<table>
<thead>
<tr>
<th>Geographic market</th>
<th>Non-life insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Parties agree with the Commission's previous findings as regards the geographic market definition and consider that the geographic scope of the affected markets for non-life insurance is national, with the exception of MAT insurance, including cargo insurance, which in their view would be at least EEA-wide, if not international.</td>
<td></td>
</tr>
<tr>
<td>The market investigation in the Warta Decision suggested that the geographic scope of the market(s) for MAT insurance and cargo insurance was at least EEA-wide in case of large risks, but nonetheless remained national for smaller risks and, in case of cargo insurance, for most purely domestic shipments.</td>
<td></td>
</tr>
<tr>
<td>In any event, the exact scope of the relevant geographic market for each of the classes of non-life insurance considered can be left open for the purposes of the present decision since the notified transaction does not lead to serious doubts as to its compatibility with the internal market, whether or not each of the markets is national or EEA-wide (or wider) in scope.</td>
<td></td>
</tr>
</tbody>
</table>

EU Commission 7 March 2013 COMP/M.6739 – Allianz/VW Financial Services/JV

Transaction: Subject to the decision is a transaction whereby Allianz SE and VW Financial Services AG, a subsidiary of Volkswagen AG acquire joint control of the newly founded Joint Venture Volkswagen Autoversicherung AG.

The planned joint venture is intended to develop, position and distribute insurance products.
The joint venture will be in possession of its own license to provide insurance products and bear the economic risk for all transactions.

**Decision:** The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

**Allianz:** Allianz SE is the parent company of a group of companies operating *inter alia* in the insurance sector. It operates in Germany but offers its insurance products and services also worldwide. In Germany, the insurance business of Allianz operates through its wholly-owned subsidiary Allianz Deutschland AG.

**VW Financial Services:** VW Financial Services is a wholly owned subsidiary of Volkswagen AG. The company provides car warranty insurance for end customers in Germany. As an intermediary, VW FS offers buyers of Volkswagen vehicles insurance policies of third party providers.

**Volkswagen Autoversicherung AG:** It is intended that the joint venture will in particular operate in the automotive comprehensive insurance, third-party liability insurance, guaranteed asset protection, warranty insurance for used cars sold by Volkswagen car dealers, private motor vehicle passenger accident insurance and driver protection insurance markets. The joint venture will sell car warranty insurance only to Volkswagen dealers but not to end customers.

<table>
<thead>
<tr>
<th>Product market</th>
<th>In the context of this decision, the Commission in particular dealt with market definition in terms of car warranty insurance.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Car warranty insurance</strong></td>
<td>Car warranty insurance covers the risk of repair costs of both new and used cars. The demand arises from either car dealers wishing to have their warranty commitment covered, or end consumers wishing to have the cost of possible repairs covered.</td>
</tr>
<tr>
<td></td>
<td>Car warranty insurance offered for new or used cars covers repair costs and applies irrespective of any statutory guarantee by the manufacturer. For new cars, it applies only to the extent these costs exceed the manufacturer's warranty. To date, the Commission has not reviewed whether the market for car warranty insurance constitutes a separate market.</td>
</tr>
<tr>
<td></td>
<td>Car warranty insurance is not the only means of responding to the request of extended warranty for a vehicle. Some automotive manufacturers give a warranty extending the warranty period without using any kind of insurance. Similarly, also automotive dealers give warranties without resorting to insurance contracts. The automotive dealers can purchase special IT risk management products from insurance companies to accordingly enter the risk positions in their books.</td>
</tr>
<tr>
<td></td>
<td>In this respect, the Commission holds the view that car warranty insurance is probably a separate product market and not part of another car insurance market or property insurance market because in terms of supply-side substitutability, insurers need specific know how and qualified staff for marketing and loss adjustment and for this purpose therefore often employ trained master automotive mechanics, automotive mechanics or former automotive dealers.</td>
</tr>
<tr>
<td></td>
<td>Despite the indications that car warranty insurance could possibly constitute a separate product market, the Commission decided that the product market definition can be left open since there are no competition...</td>
</tr>
</tbody>
</table>
Different forms of cooperation between insurance companies and their respective impact on competition

| Geographic market | The Commission regards the relevant geographic market for insurance products as national market owing to national distribution channels, well-established market structures, fiscal legislation and differences in statutory provisions. In the present case, the Commission decided that there was no reason to deviate from the former practice of the Commission because the joint venture will offer insurance only on the German market. |

**ECJ 14 March 2013 – C-32/11 Margin No. 51 – Allianz Hungaria Biszosito et al**

**Subject of Decision:** The subject of the decision is a dispute between the companies Allianz Hungária Biztosító Zrt (‘Allianz’), Generali-Providencia Biztosító Zrt (‘Generali’), Magyar Peugeot Márkakereskedők Biztosítási Alkusz Kft (‘Peugeot Márkakereskedők’) and Paragon-Alkusz Zrt and the association Gépjármű Márkakereskedők Országos Szövetsége (‘GÉMOSZ’), on the one hand, and the Gazdasági Versenyhivatal (the competition authority) (‘the GVH’), on the other hand, concerning a decision taken by the latter imposing fines on those undertakings and on Porsche Biztosítási Alkusz Kft (‘Porsche Biztosítási’) for having concluded a series of agreements with an anti-competitive object.

**The Circumstances:** Once a year, the Hungarian insurers, and in particular Allianz and Generali, agree with the dealers conditions and rates applicable to repair services payable by the insurer in the case of accidents involving insured vehicles. Those dealers are connected with the insurers in two ways. First, they repair, in the event of accidents, cars insured by the insurers and, secondly, they act as intermediaries for the insurers by offering, as agents of their own insurance brokers or associated brokers, car insurance to their customers on the occasion of the sale or repair of vehicles. During 2004 and 2005, framework agreements were concluded. Those agreements provided that the dealers would receive higher remuneration for car repairs where Allianz car insurance made up a certain percentage of the insurance sold by the dealer.

**Ruling:** Article 101(1) of the TFEU must be interpreted as meaning that agreements whereby car insurance companies come to bilateral arrangements, either with car dealers acting as car repair shops or with an association representing those dealers, concerning the hourly charge to be paid by the insurance company for repairs to vehicles insured by it, stipulating that that charge depends, inter alia, on the number and percentage of insurance contracts that the dealer has sold as intermediary for that company, can be considered to be a restriction of competition ‘by object’ within the meaning of that provision, where, following a concrete and individual examination of the wording and aim of those agreements and of the economic and legal context of which they form a part, it is apparent that they are, by their very nature, injurious to the proper functioning of normal competition on one of the two markets concerned.

**EU Commission 29 April 2013 COMP/M. 6848 – Aegon/Santander/Santander Vida/Santander Generales.**

**Transaction:** The subject of the decision was an agreement whereby Aegon Spain Holding B.V. and Santander Seguros y Reaseguros acquire joint control over Santander Vida and Santander Generales by way of purchase of shares.
**Decision:** The transaction does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

**Aegon:** Aegon is active in the life insurance and non-life insurance (including accident and health insurance) sectors in Spain. The Aegon Group’s activities include asset management, insurance, pension and related products. Aegon Group is active worldwide, mainly in the US, the Netherlands and the UK.

**Santander:** Santander is active in the life and non-life insurance markets and insurance distribution in Spain. The Santander Group is active in commercial banking, retail banking, corporate banking, investment banking, asset management and treasury in Spain, the UK, some other European countries as well as in North and South America.

**Santander Vida/ Santander Generales:** Santander Vida and Santander Generales will be active in the Spanish life and non-life insurance markets respectively.

<table>
<thead>
<tr>
<th>Product</th>
<th>The parties activities overlap mainly horizontally on several market segments of life and non-life insurance. However, the proposed transaction gives rise to only two horizontally affected market segments in relation to the life insurance market: investment products market in Spain and life insurance for individuals in Spain. The Commission acknowledged the distinctions the Commission has generally considered in the past:</th>
</tr>
</thead>
<tbody>
<tr>
<td>market</td>
<td>• As regards the life insurance market, the Commission has considered in the past the following subsegmentations, namely (i) pure protection products, (ii) pension products and (iii) investments products. It has further considered the distinction based on category of customers between life insurance products addressed to individuals and to groups</td>
</tr>
<tr>
<td></td>
<td>• Regarding non-life insurance products, the Commission has in the past generally considered a distinction between the following segments: (i) accident and sickness; (ii) motor vehicle; (iii) property; (iv) marine, aviation and transport (&quot;MAT&quot;); (v) liability; (vi) credit and suretyship; and (vii) travel.</td>
</tr>
<tr>
<td></td>
<td>• The Commission has in a number of decisions acknowledged that there is a degree of supply-side substitutability in the non-life insurance segment as the conditions for insurance of different types of risks are similar and most large insurance companies are active in multiple risk types of policies.</td>
</tr>
<tr>
<td></td>
<td>• However, as the non-life insurance products are not necessarily substitutable from the demand-side, the market could potentially be divided into as many products as there are different risks.</td>
</tr>
<tr>
<td></td>
<td>• The Commission has in the past distinguished the market for reinsurance from those for life and non-life insurance and has so far left open the question whether reinsurance constitutes a single relevant product market or whether it should be further subdivided into life and non-life segments.</td>
</tr>
</tbody>
</table>

However, the Commission did not define the relevant market in the present case, as the proposed transaction did not raise competition concerns irrespective of the precise product market definition.

| Geographic | The Commission in its previous decisions has considered the geographic market for life insurance and its segments to be national in scope due to differing regulatory frameworks, differing distribution structures and |
| market     |                                                                                                                                                                       |
Different forms of cooperation between insurance companies and their respective impact on competition

| life insurance | established brands. However, the exact product market definition has been left open. The Notifying Parties agree that the life insurance has a national dimension but submit that the consolidation of the freedom to provide services in the European Union and the harmonization of the legislation between Member States could ultimately even lead to a market definition wider than national. With regard to the geographic scope of non-life insurance market and its various subsegments, the Commission has generally considered these markets as national, with the exception (i) of large commercial risks, such as the insurance of aerospace risks, which is most likely to be at least EEA-wide in scope and, (ii) with respect to MAT insurance, which is likely to be wider than national for large/multinational corporate customers and large risks respectively. However, the Commission finally left the exact scope of the geographic market open. As regards reinsurance, the Commission has previously defined this market to be global due to the need to pool risks on a worldwide basis. |
| non-life insurance |
| reinsurance |

EU Commission 31 May 2013 COMP/M.6883 – Canada Life/Irish Life

**Transaction:** The subject of the decision is a transaction whereby Canada Life, ultimately controlled by Power Corporation of Canada, acquires sole control over Irish Life Group Limited ("Irish Life") currently owned by the Minister for Finance of Ireland.

**Decision:** The agreement does not raise any concerns as to its compatibility with the Common Market.

The Commission considered whether the life insurance market shall be segmented taking into account the different risks covered (pure risk protection products, pension products or savings and investment products) and/or the nature of the customer (individual or group).

However, without further examinations, the Commission left the final decision open in this case in view that the transaction does not give rise to serious doubts as to its compatibility with the internal market in any market segment.

EU Commission 10 June 2014 COMP/M.7233 – Allianz/Going concern of UnipolSai Assicurazioni

**Transaction:** The subject of the decision is a transaction whereby Allianz S.p.A. acquires sole control of a non-life insurance going concern ("The Target") currently owned by UnipolSai Assicurazioni S.p.A. by way of purchase of assets.

**Decision:** The European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement.

**Allianz Group:** Allianz Group is a worldwide provider of financial services, active in the provision of life and non-life insurance, reinsurance and asset management. Allianz is a...
The Target: The Target is a going concern consisting of a portion of UnipolSai’s non-life insurance business and includes certain assets and liabilities of the former Milano Assicurazioni S.p.A. The Target is active in all the Italian non-life insurance market segments in Italy, with the exception of the credit and suretyship insurance business.

<table>
<thead>
<tr>
<th>Product market</th>
<th>Non-life insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Commission has in the past considered a distinction between the following segments: accident and health, motor vehicle, property, marine, aviation and transport (&quot;MAT&quot;), liability, credit and suretyship and travel.</td>
<td></td>
</tr>
<tr>
<td>In some of its previous decisions, the Commission has also made reference to the applicable national insurance classification, as well as to the case practice of the national regulatory agencies.</td>
<td></td>
</tr>
<tr>
<td>The 18 classes are as follows: (1) accident; (2) health; (3) land vehicles; (4) railway rolling stock; (5) aircraft; (6) ships; (7) goods in transit; (8) fire and natural forces; (9) other damage to property; (10) motor vehicle liability; (11) aircraft liability; (12) liability for ships; (13) general liability; (14) credit; (15) suretyship; (16) miscellaneous financial loss; (17) legal expenses; and (18) assistance.</td>
<td></td>
</tr>
<tr>
<td>The party argues that the 18 classes may, however, be reconciled with the Commission's case practice through the following groupings: (i) accident and illness (No. 1 and No. 2); (ii) motor insurance (No. 3 and No. 10); (iii) fire and other damage to property (No. 8 and No. 9); (iv) MAT (No. 4, No. 5, No. 6, No. 7, No. 11 and No. 12); (v) liability (No. 13); (vi) credit and suretyship (No. 14 and No. 15); (vii) travel (No. 18); and (viii) residual categories (No. 16 and No. 17).</td>
<td></td>
</tr>
<tr>
<td>In this case the Commission decided that the exact product market definition for the provision of non-life insurance products can be left open, as the Transaction does not raise any serious doubts as to its compatibility with the internal market under every market definition considered.</td>
<td></td>
</tr>
</tbody>
</table>

Insurance distribution

The Commission has identified a downstream market for the distribution of insurance products, which involves the procurement of insurance cover for individual and corporate customers through different distribution channels, whether comprised of direct writers, tied agents or intermediaries such as banks and brokers in its previous decisions. |

However, the Commission has left open the question as to whether the market for insurance distribution comprises exclusively all outward (i.e. non-owned and third-party) insurance distribution channels (e.g. brokers and agents), or if the sales forces and office networks of insurance undertakings should also fall within the market for insurance distribution. |

Additionally, the Commission has also considered that a distinction could be made between the distribution of non-life and life insurance products due to differences in the applicable regulatory regime and the fact that different providers are involved in the distribution of life and non-life insurance products. |

The Commission decided that in any event, the exact product market definition for the distribution of insurance products can be left open, as
Different forms of cooperation between insurance companies and their respective impact on competition

<table>
<thead>
<tr>
<th>Geographic market</th>
<th>Non-life insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>In previous decisions, the Commission has generally considered the market for the provision of non-life insurance products and its various sub-segments as national, with the exception of large commercial risks, such as the insurance of aerospace risks, which is most likely to be at least EEA-wide in scope and the MAT insurance market, which is likely to be wider than national for large/multinational corporate customers and large risk insurance respectively. However, the Commission ultimately left the exact scope of the geographic market open.</td>
<td></td>
</tr>
</tbody>
</table>

The notifying party agrees with the Commission’s case practice and also points out such approach is in line with the approach adopted by the AGCM, which considers the market for non-life insurance products and its sub-segments to be national in scope.

Insurance distribution

The Commission, while recognising the national nature of insurance distribution channels, has left the exact geographic market definition open, in particular with respect to the question as to whether the relevant geographic market could be wider than national.

With regard to the Italian market, in some of its previous decisions the Commission has also assessed whether a narrower segmentation at a local level would be appropriate.

The notifying party supports the Commission’s practice with respect to the geographic dimension of the market for the distribution of insurance products but explains that in its case practice the AGCM has regarded this as narrower than national at the level of administrative provinces due to the perceived lack of mobility of customers. In this regard, the notifying party submits that such granular approach is inappropriate due to the homogeneity of legislative and regulatory environments at national level, the competitive conditions and the type of services provided.

Moreover, the notifying party argues that the Italian market for the distribution of insurance products was characterised by a chain of substitutability between the various retail spots located outside of the administrative borders of a given province similar to the one found by the Commission in Case COMP/M.5960 Crédit Agricole/Cassa di Risparmio della Spezia/Agences Intesa San Paolo with respect to the market for retail banking.

In this respect, the Commission decided that the exact geographic market definition for the distribution of insurance products can be left open, as the Transaction does not raise any serious doubts as to its compatibility with the internal market under every market definition considered.

9.3.2 US Case Law

| United States Court of Appeals for the seventh circuit 4 March 1986 784 F.2d 1325; 1986 U.S. App. LEXIS 22737; 1986-1 Trade Cas. (CCH) |
| Cause of Action: Plaintiff hospitals sought to enjoin defendant insurance companies from |
implementing their proposed preferred provider organization (PPO).

Decision: The court affirmed the denial of plaintiff hospitals' motion for an order for enjoining defendant insurance companies from implementing the PPO plans and affirmed the dismissal of plaintiffs' state law claims.

<table>
<thead>
<tr>
<th>Product market</th>
<th>Health Care Financing</th>
</tr>
</thead>
</table>
| The district court treated the product as "health care financing". Insurance companies and hospitals offering preferred provider organisations (PPOs), health maintenance organisations (HMOs), and self-insuring employers all offer methods of financing health care.
| The demand is highly elastic:
| • Customers will quickly switch if any one supplier raises price, which makes the increase unprofitable; nothing binds an employer or patient to one plan.
| • Consequently, no competitor has the power to control prizes. |

<table>
<thead>
<tr>
<th>Competitive Effects</th>
<th>Market Entry</th>
</tr>
</thead>
</table>
| The market in health care is competitive also because new suppliers can enter quickly and existing ones can expand their sales quickly:
| • The "productive asset" of the insurance business is money, which may be supplied on a moment's notice, plus the ability to spread risk, which may firms possess and which has no geographic boundary.
| The lower the barriers to entry, and the shorter the lags of new entry, the less power existing firms have. When the supply is highly elastic, existing market share does not signify power. |

**United States Court of Appeals for the seventh circuit 18 September 1995 (decided) 65 F.3d 1406; 1995 U.S. App. LEXIS 26339; 1995-2 Trade Cas. (CCH) P71,120**

**Cause of Action:** Plaintiffs, an insurance company and its health maintenance organisation (HMO) subsidiary, argued that defendants had improperly monopolized the "HMO market" in the area and that they had engaged in improper price-fixing and division of markets.

**Decision:** The court affirmed the judgment in part and reversed it in part, holding that there was sufficient evidence for the verdict on the division-of-markets charge but that the verdict on the monopolization and price fixing charges could not stand because defendants' natural monopoly did not violate the law.

<table>
<thead>
<tr>
<th>Product market</th>
<th>The court states that in defining a market, one must consider substitution both by buyers and by sellers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Substitution by buyers:</td>
<td></td>
</tr>
<tr>
<td>Individuals, and their employers, and medical insurers regard HMOs as competitive not only with each other but also with the various types of fee-for-service provider, including preferred provider plans (PPOs) under which the insurer offers more generous reimbursement if the insured patronizes physicians who have contracts with the insurer to provide service at low cost to its insureds.</td>
<td></td>
</tr>
<tr>
<td>Substitution by sellers:</td>
<td></td>
</tr>
</tbody>
</table>
Even if two products are completely different from the consumer’s standpoint, if they are made by the same producers an increase in the price of one that is not cost-justified will induce producers to shift production from the other product to its own in order to increase their profits by selling at a supra-competitive price.

The services offered by HMOs and by various fee-for-services plans are both provided by the same physicians, who can easily shift from one type of service to another if a change in relative prices makes one type more lucrative than others.


**Cause of Action:** The court affirmed an order granting defendant insurance company’s motion for summary judgement in an antitrust class action alleging that defendant illegally tied access to policy information to the purchase of computers from defendant. The court held that electronic access to policy information was merely a component of defendant’s insurance product and the relevant market for antitrust purposes was the insurance sales market.

**Decision:** The court held that plaintiffs failed to raise a question of material fact as to whether defendant violated the antitrust laws.

| Product market | The relevant market in an antitrust inquiry is defined by the cross-elasticity of demand between a given product and its substitutes. The plaintiffs allege that defendant illegally tied electronic access to policy information to the purchase of computers from defendant and that the relevant market is the market for electronic access to policy information. The court, however, states that the relevant market is the market for insurance sales as the defendant does not sell electronic access or computers to consumers. This shows, that only demand-side aspects were considered as relevant. |

**United States District Court for the Northern District of Texas (Dallas Division) 3 August 1999 Civil Action No.: 3-99CV1398-H – Competitive Impact Statement**

**Transaction:** The subject of this Competitive Impact Statement is an agreement whereby Aetna acquires substantially all of Prudential’s assets related to issuing, selling, and administering group medical, dental indemnity, and managed care plans, including HMO and HMO-based POS plans.

**Aetna:** Aetna is a Connecticut corporation providing health and retirement benefits and financial services. Through its wholly owned subsidiary, Aetna U.S. Healthcare, Aetna offers an array of health insurance products, including indemnity (“fee-for-service”), preferred provider organization (“PPO”), point-of-service (“POS”), and health maintenance organization (“HMO”) plans.

**Prudential:** Prudential is a New Jersey mutual life insurance company with its principal place of business in Newark, New Jersey and offers indemnity, PPO, POS, and HMO plans.

<table>
<thead>
<tr>
<th>Product market</th>
<th>HMO and HMO-POS</th>
</tr>
</thead>
<tbody>
<tr>
<td>As the Complaint alleges, HMO and HMO-POS products differ from PPO</td>
<td></td>
</tr>
</tbody>
</table>
or indemnity plans in terms of benefit design, cost, and other factors:

- HMO and HMO-based POS options are generally less expensive, provide better benefits with respect to health maintenance or preventative care, place greater limits on treatment, and restrict access to providers (generally require use of a primary care physician “gatekeeper”).
- PPO plans, which allow greater access to providers (do not require enrollees to go through a “gatekeeper”) and do not emphasize preventative care, are generally more expensive than HMOs and provide better benefits with respect of coverage when ill.

The Court stated on these grounds that the health plans are perceived as different by purchasers; neither employers nor employees view PPO plans as adequate substitutes for HMO or HMO-POS plans. According to the Court’s examination other health plan providers, along with many brokers and consultants, agree, noting the difference in networks, benefits, regulatory requirements, administrative systems, medical management requirements, and costs of HMO and HMO-POS plans as opposed to PPO plans.

Indeed, enrollees who leave an HMO or HMO-POS disproportionately select another HMO of HMO-POS, not a PPO, for their next health care benefit plan. Analyses demonstrate that the elasticity of demand for HMO and HMO-POS plans is sufficiently low that a small but significant price increase for all HMO and HMO-POS plans would be profitable because consumers would not shift to PPO in sufficient numbers to render such an increase unprofitable. Therefore the Court concluded that HMO and HMO-POS plans constitute the relevant product for analysis of the proposed transaction.

### Geographical market

The Court concluded that the health plan providers usually establish provider networks in the areas where employees live and work and that they compete on the basis of these local provider networks. The relevant geographic markets in which HMO and HMO-POS plans compete are thus generally no larger than the local areas within which HMO and HMO-POS enrollees demand access to providers.

More specifically, a small but significant increase in the price of HMO and HMO-POS plans would not induce a sufficient number of customers to switch to health plans outside of these regions to make such a price increase unprofitable. For this reason, the Court focused on Metropolitan Statistical Areas in and around Houston and Dallas as the relevant geographic markets.

### Competitive Effects

#### Market Entry

The Court concluded that, regarding HMO and HMO-POS plans in Houston or Dallas it is unlikely that either new entry or expansion by competitors could counteract a post-merger price increase. Effective new entry for a HMO plan in Houston or Dallas typically takes two to three years and costs approx. $50 million. In such an environment, de novo entry is unlikely to defeat a price increase over the short term.

Furthermore, companies currently offering PPO plans are unlikely to shift their resources to provide HMO or HMO-POS plans in Houston or Dallas in the event of a small but significant price increase. A number of
managed care providers have stated during interviews that this kind of shift would be difficult, expensive, and time-consuming and that they would not enter the HMO or HMO-POS markets even if the prices were raised by a small but significant amount.

**People of N.Y. vs. Marsh & McLennan C.; Sup. Ct. N.Y., filed October 14, 2004 No. 04/403342 (N.Y. Sup. Ct., Oct. 14, 2004); see also 2006 U.S. Dist. LEXIS 73055**

**Cause of Action:** New York State Attorney filed a civil complaint in New York State Supreme Court against Marsh & McLennan ("Marsh") alleging, among other things, that Marsh had solicited rigged bids for insurance contracts, and had received improper contingent commission payments in exchange for steering its clients to a select group of insurers.

**United States Court of Appeals for the eighth circuit 29 December 2009 (filed) 591 F.3d 591; 2009 U.S. App. LEXIS 28498; 2009-2 Trade Cas. (CCH) P76,849**

**Cause of Action:** An association of cardiologists developed a hospital that specialized in cardiology services. The association alleged that a hospital company conspired with an insurer to restrain trade in and monopolize the market for cardiology services for privately insured patients.

**Product market**

A court's determination of the limits of a relevant product market requires inquiry into the choices available to consumers. The focus is on how consumers will shift from one product to the other in response to changes in their relative costs. The relevant product market should include products that have reasonable interchangeability for the purpose for which they are produced.

The product market alleged by the association was limited to patients covered by private insurance.

However, in this case, the relevant inquiry is whether there are alternative patients available to the cardiologists. Therefore, according to the court, patients who were able to pay their medical bills, regardless of the method of payment, were reasonably interchangeable from the cardiologists’ perspective.

**United States District Court for the Southern district of New York 11 May 2010 2010 U.S. Dist. LEXIS 60196; 2010-1 Trade Cas. (CCH) P77,053**

**Cause of action:** Current and former employees of the City of New York, as well as their dependents, receive health benefits the City’s Health Benefits Programme, including plans offered by GHI and HIP. The City has agreed to pay for participants' benefits up to the rate charged by HIP for its health maintenance organisation (HMO) product; where an employee chooses a plan with a higher premium, he or she is responsible for the difference in the form of either a payroll or pension deduction. The City has also created a "Stabilization Fund" to cover the difference between the GHI preferred provider organisation (PPO) rate and the HIP HMO rate. On 29 September 2005, GHI and HIP announced their intention to affiliate under a common holding company, which was consummated on 15 November 2006.

**Product market**

The relevant market is defined as all products reasonably interchangeable by consumers for the same purposes, because the
ability of consumers to switch to a substitute restrains a firm's ability to raise prices above the competitive level.
10 Appendix: Cross-country comparison of State involvement in co(re)insurance schemes

We have reviewed literature on four key types of risk that, based on evidence from literature, are likely to be unconventional (i.e. cyber, nuclear, terrorism and natural catastrophe) in order to understand the types of cooperation schemes operating in these insurance markets.

Cooperation schemes, and hence the mutualisation of risk, are not always present in insurance markets for unconventional risks. In this annex we provide examples from the literature of the roles played by the state in co(re)insurance schemes. However, before turning our attention to state intervention in co(re)insurance schemes, it is worth noting that state involvement in unconventional risk insurance is not exclusively though the development of such schemes. We briefly provide examples of such other cases:

- In some cases, some governments may directly back up the liabilities of each individual insurer. This is the case, for example, with the insurance of terrorism risk in the USA, where there is no risk mutualisation across different insurers, but rather the government has committed to paying 90 per cent of each insurer’s property-casualty losses which exceed a pre-determined insurer deductible (which is based on the premiums the insurer earns in the previous year). This means that losses caused by a future terrorist attack would only be covered by the insurers whose policyholders are actually affected (and, of course, the government through its support to each individual insurer).132

- In other cases, the state may not support the insurance market as an ‘insurer of last resort’, but rather provide ad hoc relief as and when needed.133 In Germany, natural catastrophe (re)insurance is provided solely by the private sector and is not a compulsory purchase requirement. This means that penetration rates in this German insurance market are extremely low (only about 5 per cent for building insurance and 10 per cent for contents insurance), as there is an implicit guarantee that the state will provide ad hoc disaster relief when needed.

- The UK situation prior to the imminent launch of Flood Re was similar to the German case, in that there was no government backing of the insurance market, but rather the government committed to providing flood protection, on the grounds that insurers provide flood risk insurance as part of standard home insurance packages. Unlike Germany, however, the UK market achieved much higher penetration rates by the requirement to have flood risk insurance when applying for a mortgage.

With the above exceptions in mind, however, in the majority of markets for unconventional risk insurance where state intervention does occur in field of unconventional risk insurance, this is usually in the form of state participation in we do see the presence of cooperation co(re)insurance schemes with state involvement. However, the range of cooperation schemes found in the unconventional risk space is


very diverse, in particular, the precise role of the state in these cooperation co(re)insurance schemes can vary.

The market for terrorism risk coverage exemplifies such variation. Following the terrorist attacks in the USA on 11th September 2001, existing insurance and reinsurance markets for terrorism risk broke down. In many countries, this led to the establishment of collective agreement pools backed by state support, such that terrorism risk coverage could continue to be offered. However, although there was this common strategy of risk mutualisation coupled with state support (with the exception of the US discussed above), there were nevertheless some key variations in the exact approaches taken by different national governments. We proceed by describing the cooperation scheme structures in three of the key European insurance markets — France, Germany and the UK— in order to highlight different approaches.134

The French model. The French government developed a national public-private co-reinsurance pool called the GAREAT, which has a four-tier structure for risk sharing as follows:

- **First layer**: this pool consists of around 100 insurance companies, with co-reinsurance across all members based on their share of the underwritten business, up to a total annual capacity of €400million. It keeps 30 per cent of the insurance premiums collected.

- **Second layer**: this pool consists of around 30 reinsurance companies led by Swiss Re and has a total annual capacity of €1,250million. It keeps 50 per cent of the insurance premiums collected.

- **Third layer**: this is a pool of international reinsurers led by Hannover Re, which provides an additional €350million of coverage. It keeps 10 per cent of the insurance premiums collected.

- **Fourth layer**: this is an unlimited guarantee offered by the French government, which is administered through a state-owned reinsurance company called Caisse Centrale de Réassurance (CCR). It keeps 10 per cent of the insurance premiums collected.

The German model. The German government also developed a collective co-reinsurance agreement, but their approach relied on the following specificities:

- A new property insurance corporation called Extremus AG was established to directly provide terrorism cover to prospective customers.

- The risks of Extremus AG are fully reinsured by a three tier co-reinsurance structure, consisting of:
  - **First layer**: the shareholders of Extremus, a series of private insurance and reinsurance companies, who collectively reinsurance all of Extremus AG’s terrorism risk and cover losses up to €1,500million.
  - **Second layer**: this covers up to a further €500million in losses through a co-reinsurance pool of mainly international reinsurance companies.

---

Third layer: the federal government as an insurer of last resort up to an additional €8,000 million.

The UK model. The UK government helped establish a collective mutual co-reinsurance agreement, called Pool Re, with the following features:

- Pool Re is backed by the government, through HM Treasury, in the case that it has insufficient funds to cover a legitimate claim.
- In exchange for this retrocession agreement with HM Treasury, Pool Re pays a premium to HM Treasury which is financed through the premiums it charges its members.
- Up until 2015 Pool Re was only reinsured by the state, but since then it has bought £1.8 billion in retrocession from the open market and thus is both privately and publicly reinsured.

Aside from terrorism risk coverage, there are other examples of cooperation schemes operating in markets for likely unconventional risks. More specifically:

- Nuclear. Until recently, nuclear insurance in Europe was provided exclusively through a series of national coinsurance pools which operated on a non-competitive basis. This meant a nuclear operator had no choice but to use their national insurance pool. The insurers participating in the pool would determine how much coverage they are willing to provide to the pool, and thus the aggregation of all the insurers’ proposed contributions would constitute the total capacity of the pool. Alongside these national insurance pools operate international mutual insurance associations (or captives), such as the European Mutual Association for Nuclear Insurance (EMANI) and the European Liability Insurance for the Nuclear Industry (ELINI). These captives supplement the insurance coverage provided by national pools.

- Natural catastrophe. A good example in the area of natural catastrophe risk is the recently developed Flood Re scheme in the UK, which comes into operation in April 2016. In this model, flood cover will continue to be provided to policyholders as part of their home insurance package, but then the insurance providers will be able to reinsure the flood risk part of the home insurance package to Flood Re. All reinsurance to Flood Re will be done at a fixed premium based on the council tax band of the property being reinsured. The scheme will also be funded by a levy on UK home insurance companies. There is no floor or ceiling on the amount of risk that the insurer directs to Flood Re, but rather this is at each insurer’s own discretion. Within a similar context, the French law imposes a mandatory catastrophe insurance cover for all owners of property with fixed premiums and State-funded reinsurance.

---


136 EMANI and ELINI members consist of operators of nuclear facilities and other companies in the nuclear industry seeking additional cover outside that provided by the national pools. No reinsurers are members of these organisations. ELINI currently covers 38 members across 15 countries, and EMANI 60 members across 15 countries.

• **Cyber.** At present the market for cyber risk is still a fairly nascent market and so the development of cooperation schemes in this area appears to be a work in progress. One study looking into the UK market, has suggested a public-private cyber-catastrophe reinsurance programme akin to those found for flooding (Flood Re) and terrorism (Pool Re).\(^{138}\)

Different forms of cooperation between insurance companies and their respective impact on competition

European Commission

Studies on issues pertaining to the insurance production process with regard to the application of the Insurance Block Exemption Regulation (IBER)

Different forms of cooperation between insurance companies and their respective impact on competition

Europe Economics

Luxembourg: Publications Office of the European Union

2016 – 99 pages pp. – 21.0 x 29.7 cm

ISBN [ISBN – will be filled in by DG Competition]

doi: [DOI – will be filled in by DG Competition]

Abstract

[Abstract text – around 200 words]