

# EU's inquiry reveals the complexity of insurance

This article first appeared in Insurance Day and can also be found at [www.IDnewscentre.com](http://www.IDnewscentre.com)



With the public hearing on the European Commission's inquiry into business insurance being held today in Brussels, **GUY SOUSSAN** (*far left*) and **PHILIP WOOLFSON** (*left*), of Steptoe & Johnson, take a look at the current state of play

Two weeks ago, the European Commission (EC) published an interim report on its inquiry into competition in business insurance. At 164 pages, the report is worthy of the sector's importance: the EC cites gross premiums in 2004 of €345bn (\$448bn), 3% of European Union (EU) gross domestic product. This article comments on some of the principal findings of the report.

First, it must be seen in context: it is in an interim report only and the first step in the EC's consultation (today there is a public hearing with a review of submissions to follow and adoption of a final report in autumn 2007).

Second, the report recognises the size and complexity of the EU insurance sector: much of the report describes the nature and function of business insurance, the market and its integration within the EU.

The balance of the report sets out the EC's initial findings for a limited number of topics: variations in profitability in geographical and product markets; duration of contracts; reinsurance terms and conditions; distribution post-Spitzer and insurer co-operation.

## Five areas of concern

A close reading of these sections suggests the EC maintains an open mind on how to tackle behavioural or structural obstacles to competition in the market. The report adopts a less aggressive and prescriptive tone than the results of the parallel inquiries into the energy and banking sectors (DG Competition of the Commission has long experience in investigating and fining anti-competitive behaviour in these sectors – for example, the €124m fine recently confirmed by the European Court against the Austrian "Lombard Club" banking cartel).

This tentative approach no doubt stems from the diversity and complexity of the sector and the absence (unlike in the banking sector) of pressure to react to public dissatisfaction.

With regard to variations in profitability, the report provides a descriptive comparison, using the combined ratio. The EC concludes that the sector is

generally profitable, but with significant disparities, in particular between the original 15 member states and the 10 new states which acceded in 2004, between product lines and between small and medium-sized enterprises (SMEs) and large corporate clients (LCCs). These disparities could suggest, for example, market fragmentation and exercise of market power.

The EC will further investigate "... a possible causality between financial performance and possible barriers to competition ...". Given the acknowledged and well-documented shortcomings in the creation of a single market in insurance, these barriers might well be historical, cultural, regulatory and legal and, consequently, have no relation to any breach of EC competition rules: an insurer that benefits from demand-side inertia is not breaching competition rules.

In the second topic identified, long-term insurance, the EC notes that long-term insurance contracts tend to be limited to certain jurisdictions (eg, Italy); they are not inherently unlawful and may, despite the risk of foreclosure of markets, be justifiable on consumer benefit or other grounds.

The EC concludes that its analysis indicates "... issues that should be taken into account when assessing the competition concerns" raised by such agreements. Although this is not a clarion call for change, parties to such agreements should be ready to defend them on the ground that there is no restriction of competition or that a restriction is justifiable in the light of the relevant competition rules.

The third concern, reinsurance, focuses on two issues, demand substitutability – ie, the ability, dependent on ratings, of a cedant to substitute one reinsurer for another and "best terms and conditions".

In the latter case, the EC concludes that, by excluding price differences based on solvency and other differences between reinsurers, by increasing price transparency and, potentially, fixing prices, such clauses can operate to the detriment of direct insurers and,

ultimately, the final customer.

Reinsurers may have to advance arguments to justify the practice (if, in fact, it is widespread) and the allegedly higher prices it generates. Similar concerns and justifications may arise in co-insurance.

Rather more sensitive is the analysis of distribution of insurance, where the "Spitzer effect" has clearly changed market behaviour in the EU. DG Comp has carried out a traditional competition law analysis of distribution agreements between insurers and intermediaries, including the now notorious contingency commission agreements.

While the report makes it clear that barriers can exist (eg, exclusivity), that retail price maintenance (eg, through no rebating) is challengeable and that contingency commissions will be scrutinised further, the EC has not (yet) recommended specific prohibitions or changes in the current rules.

By way of example, non-disclosure of an intermediary's remuneration (especially when the commission is "bundled" with the cover) not only "... reduces the potential for price competition in relation to mediation services ...", it also creates a conflict of interest, which can be (and has been) more easily remedied by self regulation and a more robust attitude by, in particular, SMEs.

Having just digested the Insurance Mediation Directive, the sector needs to resist any legislative zeal regarding commission, contingency or otherwise, by encouraging voluntary disclosure of all remuneration.

The last concern is co-operation among insurers – for example, pooling arrangements, exchanges of data and standard policy conditions. The EC's conclusion is rather a *mea culpa*: having noted extensive differences among member states and insurance classes, the EC casts doubt on the effectiveness of the exemption provided by the 2003 block exemption regulation and questions whether existing co-operation between insurers is justifiable at all.

This is potentially serious, given that the 2003 regulation,

which expires in 2010, replaced a previous text dating back to 1992 and provoked extensive debate at the time. It could mean loss of access to data, expertise and networks essential to proper pricing, appropriate wordings and sharing of insurance risks.

The sector will need to reflect on how to promote open and transparent co-operation (for example, non-binding clauses and access to data for all interested parties) and whether it would accept the general self-assessment regime.

## Industry input

The report concludes by announcing further investigations and by inviting interested parties to respond to 13 questions focusing on the five topics above. These questions illustrate the EC's need for basic market feedback and so represent an excellent opportunity for the sector to explain its structure and practices, to promote change where needed and to maintain its prominent international position. A sector inquiry can only provide background information to a separate individual investigation. Thus, the report cannot be used against an economic operator in individual proceedings.

In sum, the report echoes the EC's cautious approach in the past to competition in the insurance sector: over the past 15 years, the EC has periodically negotiated changes in the market – for example, the 1992 block exemption regulation, the 1998 renewal of the P&I clubs' exemption and the 2003 block exemption.

The history, size and diversity of the market preclude a "one-size-fits-all" competition solution to perceived obstacles. As the EC regularly notes in its merger decisions, "insurance can be divided into as many product markets as there are different kinds of risks covered". The sector should state its case, starting with the 13 questions set out in the report.

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