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Review: EU antitrust report

Insurance lawyers at Steptoe & Johnson explain that the new Europeam Commission report on the business insurance sector requires review of practices and does not rule out enforcement action

In June 2005, the European Commission (EC) launched a sector inquiry into business insurance. The final report was issued this Tuesday. It is surprisingly shy of reaching final conclusions, but it makes strong assertions in relation to three key areas and it is clear that the EC is looking for improvements in industry practice.

In its interim report, the EC found the insurance industry is generally highly profitable but has some "striking" geographic variations and discrepancies. Some insurers have criticised the methodology used by the EC to reach this conclusion. The EC accepts some of those criticisms, but states that the "general picture painted by the interim report remains unchanged". The profitability of reinsurance companies is still under review and will be the subject of an addendum to the final report.

Co-insurance

The first substantive issue covered in the report relates to co-insurance (and co-reinsurance) and is of great relevance to the London market. The EC acknowledges the benefits of co-insurance in general, but it "has found evidence which suggests that some practices prevalent in parts of the market might fall within the scope of Article 81(1)". This provision prohibits anti-competitive agreements between competitors and breach of it can give rise to massive fines.

The interim report questioned the legality of "best terms and conditions" (BTC) agreements and that concern is repeated in the final report. As most insurers and reinsurers have stopped using such agreements, this may be of relatively little practical concern.

However, the EC has now dug further. The final report alleges that in co-insurance and reinsurance markets there is "almost always" "a *de facto* alignment of premiums and other conditions of coverage independently of the use or otherwise of BTC clauses".

The main concern appears to be the sharing of pricing information, which the EC believes may amount to an unlawful exchange of information and price fixing. To escape liability, co-insurers would have to demonstrate that such an exchange of information was both objectively justified and was indispensable.

This has particular ramifications for the London market, in which complex insurance programmes are underwritten using a subscription market to provide large amounts of capacity quickly.

Price information

Until now, some following insurers have taken into account the pricing of the leading insurer when setting their own premium. However, brokers and insurers are now effectively on notice that if they share pricing information in this way, they may find themselves at risk of allegations of price-fixing. The inference is each insurer should make its own independent evaluation of the appropriate premium for any given risk, even if being asked to take only a very small line. One possible result could be a contraction of capacity, with some insurers being less willing to take lines in areas in which they have limited expertise. Alternatively, insurers may choose to write business outside their core areas of expertise, but with a less sophisticated understanding of pricing than the leading insurer, giving rise to under-charging or over-charging, neither of which is likely to be in the long-term interest of insureds.

A third possible result is that large amounts of underwriting information will have to be distributed to more insurers than at present, which could potentially slow down the placing process.

Although insurers are urged to review their current practices, they can at least breathe easy that the EC will not be bringing action in relation to "legacy" practices.

Brokers

The final report also raises serious concerns regarding brokers.

In this regard, most attention is given to remuneration. The EC suggests remuneration is often structured in a way which encourages the broker to direct business to insurers based on the broker's own interest, rather than providing the best deal to the insured.

Previous efforts of the Financial Services Authority (FSA) and other regulators in this area have tended to focus on a duty to disclose the amount of the remuneration received by the broker. However, the final report states it is "questionable" whether disclosure alone gives enough protection.

It notes insureds have "seemingly low concern" about brokers' remuneration, but suggests this may be because they do not realise how much brokers are paid. The final report makes no definitive recommendations, but the implicit preference of the EC would seem to be that brokers' fees would be agreed between the broker and the insured, without involvement of the insurer.

The final report also raises a much broader concern, that brokers have actual or potential conflicts of interest when they act on behalf of insurers as well as insureds. This has given rise to some tricky legal questions in the past and no doubt poses problems for brokers in practice. Again, no specific recommendations are made. However, the final report flags these issues for consideration in the forthcoming review of the Insurance Mediation Directive and it is clear the EC will return to them. Brokers therefore have a "heads up" that these issues will surface again and it would be prudent to consider what commercial steps can be taken to pre-empt them.

Block exemption regulation

A third issue attracting the EC's attention is the block exemption regulation (BER). Article 81(1) of the EC Treaty prohibits anticompetitive agreements, but the BER exempts certain forms of insurance and reinsurance co-operation agreements such as the sharing of certain historical claims data.

The EC notes the vast majority of respondents support the BER and regard the forms of co-operation exempted by it as competitive. However, its response to these submissions is even if co-operation arrangements are desirable and competitive, this would not mean the legal instrument of a block exemption is required.

The EC implies insurers should have to assess the merits of each arrangement for themselves and be prepared to defend their view. The EC considers the inquiry has shown business insurers do not seem to need a tailored BER and are perfectly capable of self-assessing the legality of their agreements. Despite expressing these views, the EC will review the matter by March 2009.

The BER will expire on March 31, 2010 unless it is renewed. Given the general trend of Community competition policy, insurers will have an uphill struggle to maintain the BER. The EC states it sees no "compelling reasons to prolong it beyond 2010".

Conclusion

The final report discusses three important areas, namely pricing by leading/following insurers, the role of intermediaries and the BER. It "invites the parties concerned … to carry out their own assessment and to engage in a dialogue with a view either to clarifying whether these practices are compatible with competition law, and/or to reviewing the practices in question." That invitation is backed up with the message that the Ec "will not hesitate to make use of its enforcement powers" if needed. In other words, the EC is using the approach of an iron fist in a velvet glove. Experience in parallel sectors, such as banking, shows the Ec is willing to take those enforcement measures.

That approach is remarkably similar to the one taken by the FSA in relation to contract certainty. On that issue, the market was able to take action to the regulator's satisfaction. It appears the gauntlet has been thrown down once again.

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