

INSURANCE DAY



London faces up to new countdown over market

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GUY SOUSSAN, PHILIP WOOLFSON and ANGUS RODGER investigate the recent anti-trust inquiry by the European Commission and the effect that it has had on the subscription market in London

Having only recently implemented new process reforms to achieve contract certainty, it seems that a new countdown has begun in earnest for the London subscription market, this time at the instigation of the European Commission (EC) in Brussels.

In its recent final report on competition in the business insurance sector (*IDnewscentre*, Sept 28, 2007), the EC raised serious doubts in respect of "certain practices leading to premium alignment when co-insurance is purchased through a two-step process involving a lead and following re-insurers". The commission had in mind the market practice of following insurers taking a share of the risk at a premium and on terms set by the lead underwriter.

Need for action

The final report urged the market to review its practices, but did not give a specific timeframe for doing so. The pressure for change has become more apparent as a result of recent statements by EC officials (speaking in a personal capacity at a web-seminar arranged by Steptoe & Johnson LLP) that the subscription market has "two to three months", not years, to review and amend its current practices.

The message from the commission was clear: enforcement action may follow if there is no movement in the right direction. It is now clear that time is of the essence, and the market needs to identify the practices which are in issue.

Limits of defences

It is true that the final report seemed to provide some comfort at least in respect of "the practices of revealing the price of a lead insurer in the subscription phase, guaranteeing the lead insurer's share and aligning the terms of cover other than the premium". For the commission, these practices would raise fewer competition concerns if they can be justified.

In contrast, the final report – echoed in the statements made during the seminar – makes it clear that the EC is



not willing to accept, "as a general matter", efficiency justifications advanced to explain a *de facto* alignment of premiums.

Although the commission recognised that it has found no evidence of actual collusion in the subscription market, it saw no valid reasons for premium alignment. In its own words: "It should normally be possible for the risk to be priced individually by each of the participants, as it depends on the terms and assessment of the risks which are specific to every insurer." In its final report, the EC indicated that, in general, efficiency defences are not sufficient to justify all alignments of premiums. It specifically refers to, and discounts, generic defences such as increased capacity, better spreading of risk, administrative efficiency and lower premiums for customers.

During the seminar, Steptoe lawyers developed those arguments and suggested that part of the London market's ability to provide capacity derives from the fact that following carriers are able to place small lines of business without being experts in the relevant area, relying partly on the lead insurer's underwriting expertise.

The commission's representatives responded that they were still not convinced that premium alignment would be necessary in all situations and that even if customers are satisfied with the status quo that does not mean that it complies with competition rules.

The EC concluded that, since the practice is not justified as a general matter, "whether there are efficiencies which meet the criteria

of Article 81 (3) [ie, enjoy exemption] is a matter of factual circumstances which can only be fully determined on a case-by-case basis".

Call for change

The commission therefore calls for a critical reappraisal of current practices in the subscription phase. However, it does not want to be prescriptive and falls short of giving real guidance on the extent of change needed.

An immediate inference is that each insurer, including each follower, will need to make its own independent evaluation of the appropriate premium to charge for any given risk, even if it accepts only a very small line.

At the same time, the follower might still be able to receive information on the premium charged by the leader as well as on the leader's risk analysis, as long as this exchange of information gives rise to real efficiencies, is essential and leaves open the possibility of quoting different premiums.

The EC called for a change in the role of brokers who (it says) should no longer simply pass on the premium proposed by the lead insurer as the reference level to be used by the followers. Their role should be to obtain more advantageous terms and to stimulate more competition from the followers.

Also, the commission wished to see more involvement of customers in the placing of the risk. The commission reiterated that it will not be a defence to breach of anti-trust rules that the insured/cedant consents to all co-insurers or co-reinsurers having the same premium rate.

The London market will

probably remember the EC's action in the mid-1990s to secure competition between lead underwriters in marine hull insurance. At that time, there was a general acceptance that lead underwriters were by definition those who have critical expertise to assess the risk at hand and whose assessment of the risks would be accepted by following insurers.

The current inquiry turned its attention to followers rather than lead underwriters and aspires to a situation where followers will undercut the premiums charged by the lead underwriter. Even if individual assessment leads to greater competition between co-insurers, it is not self evident that this will have an impact on the lead underwriter's premium. This might well not happen despite the strong call for change.

For insurers, the good news is that the commission is not pursuing legacy breaches and any enforcement action would relate only to future practice. Despite apparently firm views expressed in the report, the EC said that the door is still open to justify these practices.

Participants in the London market should consider taking this opportunity. If it is not taken, or if it does not succeed, then the industry is likely to have to change its practices rapidly or face the serious threat of enforcement actions.

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