

Co(re)insurance and Antitrust Compliance: Choppy Waters Ahead?

On 8 February 2013, DG Competition of the European Commission (Commission) published a long awaited study commissioned to Ernst & Young on co(re)insurance pools and ad-hoc co(re)insurance agreements on the subscription market (the Study). The main objective of the Study was to provide an in-depth view of both forms of co(re)insurance across each of the 27 EU Member States.

Not binding, but influential

The Study is descriptive only, and makes no recommendation for action, but is expected to provide input for the Commission's next review of the Insurance Block Exemption Regulation (BER) ahead of its expiry in March 2017.

The study also considers the similarities and differences between the two types of co(re)insurance arrangements, so as to assist the Commission in determining whether they merit different treatment under competition law. This includes a review of market practices in relation to ad-hoc co(re)insurance agreements following concerns about the potential alignment of terms initially raised in the Commission's 2007 report on the Business Insurance Sector Inquiry (BISI).



Main conclusions of the Study

Co(re)insurance pools

At present, certain co(re)insurance pools fall within the terms of the BER and therefore benefit from a safe harbour from the application of the general prohibition on anti-competitive agreements set out in Article 101 of the Treaty on the Functioning of the European Union (TFEU). However, not all pools are covered. The BER applies only to pools which do not include so called "black listed" restrictions and is only available (a) for the first three years of their existence if they cover "new risks" (regardless of the market share of the pool); or (b) indefinitely if they cover risks which are not new, provided the market share of the pool falls below

Key issues

- Why has the European Commission commissioned a study on the application of competition law to co(re)insurance arrangements?
- How might the study's conclusions influence:
 - the Commission's review of the Insurance Block Exemption, and
 - the Commission's approach to ad-hoc arrangements on the subscription market?

certain revised market share thresholds (20% for co-insurance pools and 25% for co-reinsurance pools).

When renewing the BER in 2010, the Commission expressed concern that many insurers mistakenly concluded that their pools fell within the BER, for example as a result of a misinterpretation of its terms (in particular, the definition of a "new risk", the coinsurance of which is not subject to a market share threshold)

or due to defining incorrectly the scope of the relevant market when calculating market shares. With this in mind, the latest Study was intended to assess the degree of compliance. As Commissioner Joaquín Almunia stated, the Commission and national competition authorities *"will see to it that the industry does not use the exemption as a blanket protection and will enforce competition rules where and whenever necessary"*.

The Study gathered evidence from 44 pools by way of interviews supported by questionnaires tailored to the type of market participant. As summarised below, its main conclusions broadly supported the Commission's unease:

- The Study concluded that the definition of "pool" is not widely understood. In particular, schemes set up by intermediaries that involve more than one insurer to enable the efficient placement of risks are often not identified as "pools" by their participants. This may indicate a need for clarification and further study on pool-like arrangements that are set up by parties other than insurers, particularly intermediaries.
- Insurance pools found it difficult to determine the market in which they operate and, as a result, their market shares. The main problems identified were the definition of the relevant market and measuring the premiums for this relevant market.
- The response rate for questions in the survey relating to awareness of BER and self-assessment of pools was low. Of those pools that did respond, there was awareness of the presence of the BER, although only a minority of pools had engaged in self-assessment.



Ad-hoc agreements on the subscription market

As with pools, the information on ad-hoc agreements was gathered by way of interviews, supported by a set of questionnaires to participants in each of the 27 Member States. Examples of typical agreements were requested during the interviews and the most active participants were targeted to minimise the risk of the Study failing to identify any significant market practice. As a result, 179 ad-hoc agreements were reviewed.

The Study's main conclusions in relation to ad-hoc co(re)insurance agreements on the subscription market are set out below.

Ad-hoc agreements

Ad-hoc agreements are specifically excluded from the BER. Moreover, the Commission indicated in its BISI some concern about a possible distortion of competition arising from the alignment of premiums of lead and follow insurers in the subscription market, resulting in the insured being charged the highest level of premium. The Commission's concerns related

exclusively to the procedure in two stages; this involves the selection of a lead insurer in the first round and then the attribution of the remaining risk to insurers who do not reassess it but simply conclude agreements on identical terms to those of the lead insurer.

In order to address this concern, BIPAR (European Federation of Insurance Intermediaries) developed and issued high-level principles on the placement of risk with multiple insurers in April 2008. Principle 4 protects the right of parties to negotiate individual premiums and recommends that brokers decline conditions whereby insurers reserve the right to align their premiums upwards in the event that a follower requires a higher premium to complete the coverage.

The Study found no evidence of agreements or concerted practices between undertakings to align premiums. It notes, however that, in practice, premiums typically continue to be aligned with the premium of the leader. This is stated by respondents to be attributable to the intense competition for the selection of the

leader (and corresponding initial determination of premiums), after which there is no further efficiency to be squeezed out of the following market.

"Best terms" clauses

The Commission also raised the concern in the BISI report that the common use of "best terms and conditions" clauses by co(re)insurers, giving them the benefit of any more favourable terms negotiated by another insurer taking a share of the same risk, may be anti-competitive.

Respondents to the Study stated that this was no longer an acceptable practice and is now forbidden by the BIPAR principles, the ban also being written into standard market form for the London market, reinforcing local regulatory initiatives on contract certainty.

Similarities and differences between co(re)insurance pools and ad-hoc agreements

The main similarities relate to the willingness of members to take part, their expertise record and knowledge of risks and capacity of the (re)insurer. The rationale of both pools and ad-hoc agreements also tends to be similar.

However, whereas pools are typically formed in circumstances where it is perceived that the commercial market is not in a position to provide cover (or for reasons of public policy the state does not wish it to be left to the market), ad-hoc agreements exist to extend the capacity of the insurance market to provide coverage for large and complex risks. As a result, the process leading to the formation tends to be different.



Comment

While the Study does not attempt to offer recommendations or a view as to compliance with competition law, it does appear to validate the Commission's anxiety about the perceived application of the BER to insurance pools (as expressed in its tender for the Study), namely, that insurers were viewing the BER as a blanket exemption covering all their agreements, rather than properly assessing compatibility with the BER's specific conditions (or engaging in rigorous self-assessment).

The Study is intended to provide input for the Commission in its review of the insurance BER, for which the Commission is required to prepare a report on its functioning to the European Parliament and Council by 31 March 2016, a year in advance of the expiry of the BER.

Further guidance from the Commission on the points of greatest uncertainty, such as the appropriate identification of pools and market concentration analysis may remedy some of the concern and enhance the efficacy of the BER. This could possibly take the form of supplementary guidance or even Frequently Asked Questions (FAQs) such as those published in 2012 in relation to the Motor Vehicle

Block Exemption Regulation.

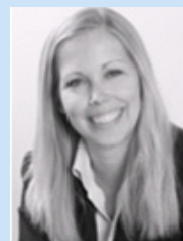
In relation to ad-hoc agreements on the subscription market, the Study did not identify any agreements to align premiums. The BIPAR principles on the placement of risk were generally reported as respected. However, notwithstanding the BIPAR principle preserving the right of parties to negotiate individual premiums, in practice, premiums continue typically to align to the premium of the leader. Given this finding and the view from respondents that alignment is the most efficient approach as a result of the market dynamics, it will be interesting to see what, if any, the Commission's next steps in this area may be.

The Commission is holding a workshop on 12 March at which the main findings of the Study will be presented by its authors and discussed with attendees. How the Study is then used by the Commission, both in terms of adjusting the BER and influencing enforcement action, will be closely observed by the industry.

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