



The European Commission's business insurance sector inquiry

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The European Commission intends to investigate further areas such as long-term insurance contracts, 'best terms and conditions' clauses in reinsurance, and various aspects of intermediaries' remuneration. It will also review the operation of the block exemption. These are the main conclusions of the Commission's 24 January 2007 interim report of its business insurance sector inquiry (Report). It finds indications that competition in the business insurance market is not working as well as it might, and identifies the practices noted above as particular examples.

The European Commission published the interim report of its business insurance sector inquiry (Report) on 24 January 2007. The Report analyses the market in depth, covering market integration, the insurance and reinsurance markets, distribution of insurance and horizontal co-operation. It flags up some signs that the market is not operating as competitively as it might – with a particular concern that separate national markets are not integrating into a pan-European market. Some specific concerns are identified – mostly in particular member states rather than across the Community as a whole – which we outline below. However, the Report perhaps does not convey the same sense of serious pan-European concern that was evident, for example, in the report following the energy sector inquiry. For the moment, the Commission's goal is to collect more information in particular areas.

Background

The European Commission announced its decision to undertake an inquiry into the business insurance sector in June 2005. It cited concerns arising from:

- insurers' associations jointly setting standard policy conditions;
- co-operation within the framework of those associations and in the context of coinsurance arrangements; and
- the mechanisms for distribution of insurance.

The sector inquiry was initiated in the context of action in the US (precipitated by New York Attorney General, Eliot Spitzer) regarding 'contingent commissions' paid to brokers, and in the context of wider scrutiny by the Commission of the financial services sector, such as its retail banking sector inquiry.

Overview of the market

The Report sets out a detailed overview of the insurance market in the Community. Perhaps its most important observation is that levels of profitability vary sharply between member states and between lines of business. The Commission also notes that levels of cross-border business are generally relatively low.

These observations are taken to suggest that national insurance markets are not integrating into a pan-European market as well as the Commission would wish.

Furthermore, the Commission notes that cost/efficiency levels also vary from one member state to another, and that efficiency levels seem to be lower in countries where profitability is higher. This, the Commission states, suggests that there are barriers in some countries that are preventing wholehearted competition and market integration.

The Report also analyses profitability levels for insurance business for SMEs and large companies. It concludes that, in some member states, there is evidence that SMEs get a worse deal than their larger counterparts.

Long term insurance contracts

The Report goes on to examine the prevalence of long-term insurance contracts. In most member states, contracts are of a relatively short duration, around a year. However, in some member states – Austria, Italy, the Netherlands, Slovenia and Spain – they are longer (up to eight years on average in Austria). The Commission suggests that, in some cases, long contracts could shut out potential new entrants from the national insurance market.

The prevalence of clauses providing for automatic renewal or extension of insurance contracts is also examined. Again, practice varies dramatically between countries. The Commission concludes that, where a network of these clauses is present across a market, there may sometimes be a harmful effect on competition.

Reinsurance

The Commission identifies one practice in the reinsurance market which it believes may be anticompetitive. It finds that certain reinsurance companies habitually insert a ‘best terms and conditions’ clause in their contracts with insurers. This clause allows them to benefit from the most generous terms offered to any reinsurer on the contract in question. This will tend to align premium levels, in an upward direction. The Commission also points out that it will tend to increase levels of transparency in the market.

For both of these reasons, the Commission indicates that such clauses may in certain circumstances breach the Article 81 prohibition on anticompetitive agreements, and they indicate that they will be seeking further information on the prevalence and effect of this type of clause.

Insurance distribution

Insurance distribution has been the subject of a great deal of controversy in recent years, particularly in the light of Eliot Spitzer’s US investigation. It is widely thought that this investigation was one of the reasons that the European Commission was drawn to investigate this sector.

The Report addresses directly one of the key Spitzer issues – contingent commissions (ie commissions payable by the insurer to the broker for reaching agreed targets, for example on the volume or profitability of business placed by the broker with the insurer). The Report finds that use of contingent commissions again varies from country to country in Europe, with a general downward trend in their use since the Spitzer investigation. However, they are far from being eliminated and the Commission is seeking further information on their use and disclosure. Indeed, it views disclosure of intermediary remuneration generally as an issue that requires further investigation.

It also expresses concerns about restrictions on the ability of intermediaries to pay part of their commission over to their client as a rebate. The Report remarks that these payments are illegal in Germany. However, the Commission notes that the practice of making the payments is actually pro-competitive. The Commission says that it will seek further information on any agreements or practices that may restrict the ability of intermediaries to provide these rebates to their clients.

Horizontal co-operation between insurers

The Report notes that ‘horizontal co-operation among companies is significant in the insurance sector’, with mechanisms such as pooling playing a key part in the market.

A number of forms of horizontal co-operation in this market are permitted by the insurance block exemption, originally introduced in 1993 and revised in 2003. The Report examines the various forms of co-operation that are permitted under the block exemption – for example, co-operation on the preparation of studies and standard terms, and the joint establishment of technical specifications and codes of practice for security devices.

It finds, once again, that practice varies significantly across the Community. In some member states there is quite a high level of co-operation within the various categories set out in the block exemption. In others the market appears to operate without any such co-operation.

The Commission is therefore drawn to consider whether or not there is a case for retaining these exemptions. This is perhaps no surprise, as there has been some scepticism for some time as to the usefulness of this block exemption. The Commission is now seeking further information on why the differences in practice exist and how much use market participants make of the exemptions.

Next steps

The Report concludes with a list of questions for consultation reflecting the issues identified above. The consultation period runs until 10 April 2007.

The Commission is also holding a public hearing on the issues raised in the Report on 9 February 2007 in Brussels. The final report is said to be scheduled for September this year.

Comment

The Report perhaps lacks the fireworks that were seen in the energy sector inquiry report, but it does identify a number of specific, targeted concerns. Many of these seem to be specific to groups of member states rather than pan-European, or specific to certain lines of business in those member states. It seems possible, therefore, that any enforcement action that takes place will be by appropriate national competition authorities rather than by the European Commission.

All of the stakeholders in the insurance industry will wish to consider carefully the potential impact of the Commission's concerns and any action that might be taken to remedy them. They will therefore want to give some thought to the Commission's questions for further investigation and the best way to contribute to the ongoing consultation exercise.

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