Reconciling cooperation and competition in the insurance sector

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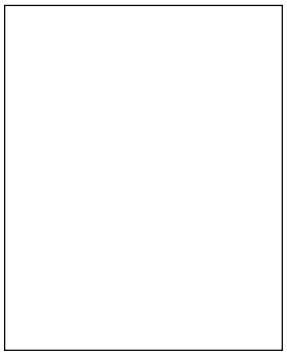
A draft of the block exemption on the application of the competition rules of the Treaty of Rome in the insurance sector was published in the Official Journal of the Communities in August.

This text does not exactly provide for new rules. To a large extent it confirms the principles which the Commission, and the Court of Justice in certain cases, have developed in the past when applying the competition rules in the field of insurance.



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Contents of the rules

The principle of undistorted competition on the part of operators in the market rests on two provisions:

- Art. 85 prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition.
- Art. 86 prohibits any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it, which may affect trade between Member States.

Examples of infringement are given in the text of these Articles, however the list is by no means exhaustive. Both provisions apply where there is an existing or potential effect on trade between Member States. The Commission and the Court of Justice have given abroad interpretation of this requirement. No doubt in an increasingly integrated market many more agreements are likely to have an impact on interstate trade.

However, the restriction must be significant for the rules to be applied. The Commission has published a notice on agreements of minor importance. It sets out those agreements whose effects on trade between Member States or on competition are negligible and do not, in its opinion, fall under the ban on restrictive agreements contained in Article 85. This would generally be the case where the goods or services subject to the agreements, together with similar goods or services provided by the participating undertakings, do not represent more than 5 % of the relevant market and where the aggregate annual turnover of the participants does not exceed 200 million ECU.

Where an agreement or practice is caught by Article 85, it is automatically void, unless

the prohibition has been declared inapplicable, in other words, unless the Commission has granted an exemption. For the exemption procedure to apply, the undertakings must give prior notification of their agreement. The agreement must also fulfill the criteria laid down in Art. 85 para 3, that is to say,

- it must contribute to an improvement in the production or distribution of goods or to the promotion of technical or economical progress;
- it must allow the consumers a fair share of the benefit;
- it must not impose restrictions which are disproportionate to the objective of the agreement;
- it must not eliminate competition in respect of a substantial part of the products in question.

Position of the rules in the Treaty

One of the first articles of the Treaty sets out the activities that the Community should pursue in order to achieve its final aim. Included among these is the institution of a system ensuring that competition in the common market is not distorted. This is not an abstract goal, it is a means of achieving the purpose of the Community. This provision (Art. 3 g) is unaffected by the Maastricht Treaty and remains a fundamental element of the Community's development.

According to Article 5, it is also the responsibility of the Member States to make sure that these principles are respected in the application of domestic legislation. Not only are Member States prevented from thwarting the effect of the rules or breaking the rules themselves, but the national authorities are also competent to condemn an agreement, a restrictive practice, or an abuse of a dominant position, on the basis of the Treaty competition rules since they are of direct application.

This gives plaintiffs an additional advantage because national courts have the power to order compensation for the victims of an infringement, whereas the Commission is only able to declare the breach and impose fines on the undertakings or association at fault.

Application of the rules to the insurance sector

The rules laid down in Art. 85 of the Treaty are necessarily of general application and establish broad principles. Their practical application to the various sectors of the industry, and to specific forms of arrangements, requires a deeper analysis of the peculiarities of these markets, and has, over the years, led the Commission, under the control of the Court, to interpret the rules and clarify their content.

In effect, the Commission has always recognised that the specific characteristics of the insurance sector, such as uncertainty and the mutualisation of risks, justified certain kinds of co-operation. Therefore, in response to the wishes of the industry, the Commission proposes to establish a set of rules in the form of a block exemption regulation. These would codify the conditions which the most common agreements must fulfill in order to benefit from automatic exemption, without prior notification. Futhermore, and this point is important, an exemption regulation can be used to effect a certain degree of decentralisation since national courts, although not competent to grant individual exemptions, can assess whether the conditions set out in the regulation are fulfilled in an individual case.

Timetable for the insurance block exemption

After the publication of the draft in August, a number of suggested amendments were received from various sources. Some of these were included in a new draft, which will be discussed with the Advisory Committee on Restrictive Practices.

In the meantime, representatives of the insurance industry, private and corporate policyholders as well as brokers, will have a chance to put their views orally.

In the light of these consultations, a final version will be submitted to the commission for approval, hopefully by the end of the year.

Once the regulation comes into force, all agreements meeting the new criteria will be automatically exempted. Any agreements previously notified may be exempted even before the new regulation is formally approved provided, of course, they fulfill the same criteria.

The Commission would expect those agreements failing to meet the new requirements to be adapted within a given period. Alternatively and, in exceptional circumstances, the parties can ask for an individual exemption.

As in the case of individual exemptions, a block exemption is always subject to a time limit : the regulation will specify its period of validity which will probably not exceed 10 years.

At the end of this period, the block exemption can be renewed as it stands, and some have been extended in this way already, or it may be amended in the light of any experience gained during its application. It is worth noting that the Council, in its Regulation authorising the insurance block exemption, expressly asked the Commission to submit a report 6 years after the implementation of the block exemption.

Contents of the block exemption

The Commission cannot adopt a block exemption unless it falls within a framework defined by the Council beforehand. On the 31st May 1991, a Council Regulation established such a framework. It gave the Commission the power to exempt six categories of agreements by regulation as follows,

a) the joint establishment of risk premium tariffs;
b) the establishment of standard conditions of insurance;
c) the joint coverage of certain types of risks;
d) the settlement of claims;
e) the testing and acceptance of security devices;
f) registers of, and information on aggravated risks.

As yet, the Commission does not have enough information to carry out a legal assessment of the restrictions raised in agreements under categories (d) and (f), that is, agreements concerned with the settlement of claims, and those covering aggravated risks. For this reason, it did not appear appropriate to us to include them in the application of the Regulation at this stage. This does not mean that such agreements are not allowed: some of them may not be restrictive at all and will not, therefore, be caught by Article 85.

Calculation of premium

Article 2 of the Regulation covers the calculation of the premium. In this area, the block exemption will cover agreements between insurance companies or among associations of companies which relate to the use of statistics to calculate the average cost of risk cover.

In previous decisions, the Commission has stated that only cooperation on pure premiums was acceptable, but that cooperation on commercial tariffs was not. An example of such a decision is the Concordato Incendio case, in December 1989 where the Commission exempted recommended pure premiums tariffs and conditions in industrial fire insurance in Italy.

On the other hand, three years earlier, in December 1985, the Commission had found that a recommendation for an across-the-board increase in gross premiums by the German Association of property insurers (VdS) infringed Article 85 and could not be exempted. The decision was later confirmed by the Court

of Justice in an important ruling in January 1987.

However, a full definition of pure premiums was never given in these decisions. The Commission said that recommended tariffs which included overheads, administrative costs, profits and commissions paid to intermediaries were unacceptable but went no further.

The draft block exemption will clarify the position. In future, agreements concerned with the calculation and recommendation of average cost will be exempt if they are based on the grouping together of past data, spread over a number of risk years and related to identical or comparable risks.

Estimated projections as to the likely impact of future developments, such as for instance, a change in the law applicable to the liability insured, may well be the subject of a joint study. These estimates should not, however, be included in recommended pure premiums in the form of loadings for contingencies or otherwise.

Standard policy conditions

The second category of agreements included in the block exemption covers the establishment of standard policy conditions.

The establishment of standard insurance conditions has improved the comparability of cover for the consumer and allowed risks to be classified more uniformly. This makes the compilation of statistics and the spreading of risk via co-insurance easier. It should not however lead either to the standardization of the products, or to the creation of an unduly captive customer base. Accordingly, the development of standard contracts or clauses should be exempted provided that they are only models or references, the use of which is not made compulsory.

Therefore, the exemption should not apply if participating undertakings agree among themselves not to deviate from the commended conditions or if other companies are forced to apply the same conditions. Article 7 of the draft lists a number of clauses which should not appear in recommended standard conditions.

Furthermore, these standard conditions should not provide for systematic risk exclusion, nor should they make cover subject to specific conditions or warranties without stating clearly that the extension of the cover to include these risks or the exemption from the warranty is an option which an individual insurer might offer, systematically or occasionally.

It is worth noting that the purpose of the regulation is neither to harmonise contract law nor to forbid individual insurers from using a particular clause. Neither is its aim to oblige them to grant cover for risks excluded in recommended standard conditions. The regulation only covers collusion between insurance companies or recommendations by their associations. This means that each insurer can, if he is acting independently, and in as far as the law permits, refuse or limit cover.

Similarly, insurance companies and their associations should not standardise maximum cover or deductibles. They should not impose comprehensive cover which includes risks to which a significant number of policyholders is not simultaneously exposed. Nor should they provide for the continuation of the contract with the person insured for an excessive period, or beyond the initial object of the contract.

One of the justifications for establishing a set of standard policy conditions in the market, is to improve transparency and comparability. It is very important that users have access to these conditions. Therefore, the text provides that any interested party must receive them upon request. It has also been suggested that at least for mass risks (in the

sense of the 2nd directive) policyholders should receive the conditions before the conclusion of a contract with one of the participating companies.

Co-insurance or co-reinsurance groups

The third category of agreements deals with the common coverage of certain types of risk. There is of course no question of including in the Regulation single co-insurance contracts. The regulation only covers pools or, to quote the regulation "co-insurance or co-reinsurance groups", that is organizations created to carry out joint insurance operations, in a permanent or at least regular way, in a given sector. The legal form this agreement takes is immaterial.

A valuable aim in the construction of pools is to enable more companies to enter the market, increasing the capacity for accepting risks which are difficult to cover due to their breadth, scarcity, or novelty. In other words, pools should be created in response to a practical need. If, on the other hand, a pool limited the range of independent offers or partitioned the market, it would not deserve an exemption, and the benefit of the regulation would be withdrawn accordingly.

One of the exemption conditions under Article 85 para 3 is that effective competition remains in the markets concerned. The question is where to fix the limits, in terms of market share, for a pool in a given market. If a pool has a monopoly, there is obviously no competition and one of the exemption criteria is not met. Only in exceptional circumstances will cases be looked at individually as the purpose of the block exemption is to grant an a priori exemption to cases unlikely to cause problems.

The draft regulation, as it stands, provides that the members of the pool do not hold, in total, a share of the market exceeding a certain percentage. In the case of co-reinsurance groups it is 15 %. In the case of co-insurance groups it is 10 %. The reason for the difference is that the mechanism of co-insurance requires uniformity in the conditions of insurance and of commercial tariffs. As a result, residual competition between members of a co-insurance group is particularly reduced.

As regards the conditions under which the pools operate, the block exemption is the result of a Commission policy which has developed over the years and through several decisions including the cases of Nuovo Cegam — March 1984, P. & I. Clubs — December 1985 and Teko — December 1989.

The most recent case was adopted in January 1992. It concerned Assurpol, a co-reinsurance pool for environmental damage risks in France. The pool covers accidental and gradual pollution risks originating in certain industrial and commercial installations which may cause health and environmental hazards.

In this case, the co-reinsurance tariff was established in a new way at the request of the Commission. The risk had to be calculated according to the probable cost of a claim plus the operating cost of the pool. The pool was not allowed to include either the overheads of the member who brings the case to the pool, or the commission it pays to the intermediary. This arrangement allows the members to retain their commercial autonomy and shows that such autonomy is not incompatible with the operation of the co-reinsurance pool.

This principle appears in the draft regulation. Furthermore, the regulation does not permit the requirement that all risks within the scope of the pool be brought within it. The Commission considers that this would be an unduly restrictive obligation imposed on the participants.

Approval of safety devices

In article 14, the block exemption covers agree-

ments relating to security devices. Insurance companies may establish technical specifications for the evaluation of security equipment, including both components and complete systems (for example, a sprinkler installation in a refinery) as well as the system's installation and maintenance. As to these last two points, the block exemption also covers rules for the evaluation of instalment and maintenance undertakings.

Once the specifications and rules have been established by insurance companies or their European or national associations, they can be recommended by them to their members for application.

Whether the cover may be made subject to the installation or maintenance of safety devices is to be decided in the light of Article 7 concerning standard conditions, and not in Article 14, which deals with approval criteria for security devices and testing procedures.

The block exemption lists criteria which have to be met if agreements on security devices are to be exempt.

The technical specifications and procedures of evaluation of the equipment have to be precise and technically justified but also appropriate to the expected performance of the security device. These criteria have, among others, been fixed in order to avoid specifications which discriminate against technically new equipment, such as radio-linked alarm systems in case of an anti-theft alarm system.

As regards instalment and maintenance companies, the rules must be objective, appropriate and not discriminatory. To take an example, under the new group exemption, welders working on security devices could not be requested to provide a specific national professional certificate. This would exclude foreign operators with equally qualified personel in possession of an equally recognised certificate operating in another national market.

The evaluation of the devices and undertakings has to be done in a reasonable time, involving no excessive cost, and in case of non-conformity has to be justified in writing.

The establishment of such specifications and rules is possible at a community and national level. It is likely that the insurance sector will attempt to establish common standards applicable throughout the Community in the future. This would in turn encourage production of a wider range of such devices at lower costs and prices.

Cooperation agreements outside the scope of the regulation

Many other forms of cooperation do not fall within the scope of the current draft, including the agreements on claims settlement procedures and those on registers of aggravated risks, already referred to and which are included within the Council enabling regulation of May 1991 but not yet the subject of a draft group exemption.

Indeed, the Commission has already taken a position on other restrictions, which are outside the scope of the Council regulation altogether, as for example in the case of procedures to be followed in order to move from one set of insurers to another. Such a system was one of the arrangements which was the subject of the P. & I. Clubs Decision.

The Commission is also expected in the near future to take a favourable decision in the London hull insurance market after fundamental changes have been brought to the respect of lead agreement.

Another area which is not covered by the block exemption concerns the relations between insurance companies and their brokers or agents. In May 1992, the Commission published a notice in the Official Journal announcing its intention to take a favourable view on the contract between Standard Life and the Halifax under which the Halifax building society becomes the appointed representative of Standard Life. Under the cur-

rent legislation rules in the United Kingdom, intermediaries must either be fully independent financial advisers or alternatively represent exclusively a single life office.

However, the existence of important networks of exclusive agents might be a cause of concern if they operated as a barrier to entry in certain markets. If necessary, such a network could be apprehended under Art. 85 in view of its cumulative effect. A situation of this kind is currently under investigation in another market.

Mergers and strategic alliances

Of course, the regulation does not deal with mergers and acquisitions or concentrative joint ventures. As you no doubt all know, a specific regulation came into force in September 1990, which gave the Commission new powers to assess, before they can proceed, mergers between companies whose turnover exceeds 5 billion ECU worldwide and 250 million ECU in the Community, unless at least 2/3 of their activity takes place in one Member State. The test is whether the operation creates or strengthens a dominant position in the Community or a substantial part of it. For insurance companies gross premium income rather than turnover is measured. This tends to be the criterion used in the context of the other competition rules too, when applied to the insurance sector.

The number of decisions concerning mergers in the banking and in the insurance field in the last two years is approximately the same. Up to now, none of these deals has been blocked. So far, five decisions have been taken in the insurance sector stating that the operations concerned did not raise serious doubts as to their compatibility with the common market, two others concluded that the concentration did not fall within the scope of the Merger Regulation. One of these related to the Eureko joint venture, which is no doubt familiar to you since it involves Wasa, a well known Swedish company. The case was considered to be cooperative rather than concentrative and therefore assessed under Article 85. A clearance was given in the form of a comfort letter. However, it is conditional on the agreements being amended in one respect. The agreements provide that the parties will not compete with each other in their respective home markets. At the EC Commission's request, however, the parties have agreed to limit this restriction to a period of five years.

The development of the single market not only leads to mergers. It also gives rise to strategic alliances involving many forms of cooperation and the Eureko case is just one example. This type of arrangement is probably even more attractive because it is flexible and presents fewer risks in the event of failure, particularly in terms of investment and employment.

By pooling skills and sharing expertise, these arrangements may help in the penetration of new markets and encourage integration. They may however also serve other purposes which are anti-competitive if they act with what could be described as "non agression understandings". We must take care that the implementation of a single market is not held up by comfortable market partitioning arrangements.

"Bancassurance"

In my view, the phenomenon of bancassurance can also be seen in this way.

It is often argued that the distinction between insurance and banking products is increasingly unclear. Management of risk is the core of the insurance business, but it is certainly a central feature in the banking sector too. Conceivably, the two sectors might be direct competitors in some markets. Indeed, very similar services are provided by opera-

tors in both sectors, in the areas of long term investment and credit protection, for example.

However, included in the term "bancassurance", are some more promising forms of cooperation in the context of distribution. Banks have generally developed comprehensive networks, which are close to the customers, but very expensive. It is therefore reasonable to try to raise further revenue by selling other, complementary products, which might be adjusted to the clients needs and possibilities. Indeed the banks have an in depth view of their customers financial position. For the insurance companies, on the other hand, banks may offer a ready made and possibly cheaper channel to penetrate new markets, not only new geographical markets but also less insurance orientated categories of population.

There are nevertheless limits to the possibilities of cooperation in terms of distribution. Cooperation can only be successful if the insurance product sold does not require a sophisticated risk assessment, for which bank employees have no expertise, secondly, if it does not need a real negociation with the client, and thirdly, if it does not involve the settling of regular insurance claims in which bank agencies may not be prepared to assist. One also has to be aware of the risk of conflicts of interest. A good client of the bank may be a very bad risk in relation to certain covers, such as motor liability. This explains why bancassurance is generally limited to the life sector.

Bancassurance is a development which deserves the full consideration of the Commission when it is confronted with cooperation agreements as well as when assessing mergers or concentrative joint ventures. It might be used as a way to further cross market penetration, but it might also form part of a global defensive strategy.

In an increasingly competitive industry there can be no refuge in traditional markets. Progress will require innovation and the promotion of up-to-date products.