



ERNST & YOUNG REPORT FOR EUROPEAN COMMISSION ON POOLS AND LINE SLIPS AND THE SUBSCRIPTION MARKET

European Commission study repeats competition concerns on pools and line slips, and questions the need for related block exemption, but endorses subscription market.

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On 11 February 2013, the European Commission (the Commission) published a study conducted on its behalf by Ernst & Young on co-(re) insurance pools (including line slips) and ad hoc co-(re)insurance agreements on the subscription market.

The Commission held a workshop on the study in Brussels on 12 March 2013, and introduced its new team covering competition in insurance. Although the Commission has previously expressed concerns about the subscription market, particularly around automatic upward premium alignment, the study concludes that the

subscription market is competitive and that there are no immediate grounds for concern.

However, the study criticises a number of co-(re)insurance pools and line slips for failing to conduct adequate competition law assessments of their activities. This echoes previous strong concerns expressed by the Commission that pools (including line slips) are entered into without appropriate due diligence or due regard to the limitations on what is permitted under the EU block exemption on insurance agreements (IBER), for example, market share restrictions. The study also points out that the industry may not fully understand the scope of a “pool” as defined by the Commission, and flags a potential need for clarification.

The Commission will no doubt use the findings of the study in its review of the current block exemption before it expires in March 2017. Indeed, at the workshop the Commission questioned whether there is a need for a block exemption covering pools and line slips. Industry participants thought that the continuation of the

block exemption in this respect was important for legal certainty, without which such arrangements would not be viable.

Meanwhile, it is possible that the Commission will carry out a separate review or investigation of pools and line slips, to check that the competition rules are being complied with. Market participants and brokers should therefore ensure that they are compliant by undertaking appropriate competition assessments.

Overview of co-(re)insurance pools and line slips

The study identified only 51 pools, for 43 of which it had been possible to gather information on their characteristics. As line slips are included within the Commission's definition of a "pool", it would appear that this number is very low.

The study detected two factors as main drivers for the creation of pools. First, the presence of nuclear power plants is often accompanied by the presence of pools to cover the associated risk. Secondly, small domestic markets for national non-life insurance show greater usage of pools as opposed to other co-(re) insurance arrangements compared to larger markets.

The study found that many pools are established to cover catastrophic risk (nuclear, environment, terrorism) but are not the only option for such risks, as insurance markets and other mechanisms, such as state-guaranteed insurers, also cover some of these risks. As well as such pools for major risks, other arrangements between insurers exist to deal with new risks or risks that the insurance

market does not want, or to take advantage of a market niche where insurers combine to provide capacity in the subscription market. At the workshop, the Commission indicated that it may need to clarify the definition of "new risk", which is perceived as too narrow.

Concerning the rationale of pools, the study found that the two main reasons provided by pool members were that pooling risk gave access to cheaper/more efficient cover for pool members and that individual pool members would not have the capacity to cover risks insured in pools. Brokers considered that a pool is often not the cheapest and most efficient option, but may be often the only available choice to place certain types of risks if cover is not available in the market.

The study established that the functioning of each pool requires competition assessment on its individual merits. The study found that the majority of the pools have standard membership conditions such as financial strength, willingness to commit to premiums as prescribed by the pool, and establishment in certain EU Member States. However, the study found that there is usually no requirement for adoption of a standard method of determining premiums for their clients. The study found that awareness of the IBER appeared mixed. It found that there are uncertainties as to definition, with a risk of mismatch between industry perceptions of pools and the intentions of the IBER, which may indicate a need for clarification.

Therefore, this remains an area of concern for the Commission. It has previously warned against insurers entering into co-operative

arrangements without undertaking competition due diligence. For example, the IBER permits pools (including line slips) subject to various conditions, such as market share thresholds. In the case of co-insurance pools, the permitted limit is 20% of any relevant market, and for co-reinsurance pools, the limit is 25% of any relevant market. The IBER provides that in calculating the market share of a participating undertaking on the relevant market, account must be taken of:

- The market share of the participating undertaking within the pool in question.
- The market share of the participating undertaking within another pool in the same relevant market as the pool in question, to which the participating undertaking is a party.
- The market share of the participating undertaking in the same relevant market as the pool in question, outside any pool.

The IBER also provides that the market share shall be calculated on the basis of gross premium income. If gross premium income data are not available, estimates based on other reliable market information, including insurance cover provided or insured risk value, may be used to establish the market share of the undertaking concerned. The IBER states that the market share shall be calculated on the basis of data relating to the preceding calendar year.

The question arises as to who should be responsible for undertaking the competition review, and who would have access to the relevant information. It may be possible for the



broker or other professional adviser to undertake this analysis, having received relevant market share information from insurers on a confidential basis. However, reliable information on the size of a particular market may not always be available, and there may also be uncertainties around how a market should be defined, for example its geographic scope.

The study found that in the UK, solutions developed by intermediaries for particular types of business or groups of customers might be offered to a panel of insurers under a line slip or to a single insurer. Respondents indicated that such arrangements were formed by intermediaries not by insurers, and were not considered by the industry to be pools for that reason. However, such arrangements set up by intermediaries may well come within the definition of a pool, as perceived by the Commission for the purpose of the EU competition law rules. The study also indicated that such arrangements have come to the attention of the Dutch Competition Directorate as potentially restrictive of competition, resulting in the development of a market protocol for high-level self assessment by each such intermediary led pool or line slip in the Netherlands. This is one example of how competition self-assessment may be addressed.

The Dutch protocol for line slips/ intermediary led pools

The Dutch protocol (developed by the Association of Insurers together with the insurers) is not formally endorsed by the Dutch Competition Directorate, but is recognised as a market solution. The protocol prescribes that a self-assessment under EU competition law is necessary if the pool or line slip

has a share in the relevant market of 5% or more, and/or if the pool covers non-regular risks. Regular risks are those that can easily be placed by an “average intermediary” at another insurer, other than one of the member insurers, without the need of co-insurance. The protocol prescribes that all communication about terms and pricing is between the broker/ authorised agent and the individual insurers. Participating insurers are not allowed to consult each other. A pool agreement has a maximum duration of one year and can only be renewed expressly - it cannot simply continue by tacit agreement. Compliance with the protocol must be recorded in the pool agreement and the agreement between intermediary and insurer. To assess the market share in the relevant market, the Association of Insurers issues figures on a yearly basis.

Overview of ad hoc arrangements on the subscription market

The Commission’s traditional concern with the ad hoc subscription market has been automatic upward alignment of premiums.


The study found that alignment of terms and conditions between participants is very common, and is usually described as being for the benefit of customers who seek to avoid inconsistent terms and conditions in their insurance cover. The study found that pricing is also typically aligned, although respondents described how some large contracts might be placed on a verticalised or partially verticalised basis to benefit from different terms and prices.

The study did not identify any anti-competitive agreements or arrangements between insurers to align premiums.

To address the European Commission’s concerns, the European Federation of Insurance Intermediaries (BIPAR) developed and in 2008 issued high-level principles for the placement of a risk with multiple insurers. The study found that the BIPAR principles are generally respected.

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premium of the leader, although BIPAR principle four protects the rights of parties to negotiate individual premiums. But the study found that, based on respondents' views, the alignment reflects intensive competition in the market for the selection of the leader and so for the corresponding initial determination of premiums. Therefore, the study found that there is no further efficiency to be squeezed out of the following market. There is also currently much capacity, so that it is a buyers' market. On this analysis, even though there is no constraint on seeking further reduction from individual (re)insurers in the following market, the marginal benefits that might be achieved are perceived to be less than the frictional costs of seeking them. Accordingly, alignment of premiums reflects an equilibrium. Respondents emphasised that the market for large and complex risks is a global market with high capacity and that brokers and customers have strong negotiating power. The adoption of the BIPAR principles provides a framework for the future even if market conditions change and buyer negotiating power is reduced.

The Commission previously had particular concern on "best terms and conditions" clauses to make an underwriter's offer conditional on the sharing in more favourable terms and conditions negotiated by another insurer taking a share of the same risk. Respondents to the study confirmed that attempts by underwriters to impose such clauses are not an acceptable practice and had been only rarely seen in the main four European markets (London, Germany, France, Netherlands) in the past five years. The practice is explicitly forbidden by the BIPAR principles, and the ban has been written into the

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standard market form for the London market.

The rationale for using ad hoc co-(re) insurance agreements was most often stated to be service and cost efficiency. Other reasons included that it helped to satisfy the needs of both customers and underwriters for risk diversification.

Similarities and differences between pools and the subscription market

The study found that pools are created and the subscription market is used to provide access to insurance or reinsurance for customers and insurers. Co-(re)insurance allows for better diversification for both customers and (re)insurers, spreading risks over a larger population. Both co-(re) insurance pools and the subscription market ease access for clients, but the pools are often seen as more suitable for clients seeking to cover new risks for which it is difficult to assess the risk and the potential claims, where the market might be unable to provide a solution. Pools are seen as a “bulk” solution. The subscription market is seen as better able to satisfy bespoke needs of clients wishing to cover a specific risk. Ad hoc subscription arrangements are led by the broker/customer and must feature bilateral negotiations.

The future

Brokers and participants in line slips should review the compatibility of their arrangements with the competition rules. The Commission continues to have concerns in this area. The IBER lays down conditions for automatic exemption under the competition rules. If these conditions are not satisfied, for example because the market share threshold is exceeded, this does not mean that the arrangement will necessarily infringe the competition rules. But parties should then conduct an assessment on whether the competition rules are infringed. It may for example be the case that there is sufficient external competition or that the pool or line slip enables coverage of a risk which could not be insured in any other way. In such circumstances, the pool or line slip would not infringe the competition rules even if the conditions of the automatic block exemption are not satisfied.

As the Commission has the power to impose heavy fines for infringement of the competition rules, as well as the ability to launch dawn raids in order to monitor compliance, we recommend that those participants in line slips and pools (including brokers) who have not undertaken appropriate competitive law due diligence, should ensure that this is undertaken at their earliest convenience.



As well as reviewing the market for pools and line slips, it seems likely that the Commission will consider clarifying the definition of pools, to include line slips and consortia specifically, when it reviews the IBER and reports to the European Parliament in 2016 before the expiry of the IBER in 2017. But it appears from the Commission's workshop that the Commission is not currently certain that the continuation of the block exemption for pools or line slips beyond March 2017 is necessary. The Commission appreciates that the IBER provides a safe harbour of legal certainty and stability. It understands that pools may be necessary for catastrophe risks at least in some Member States, and that small and medium-sized insurers in particular may benefit from the safe harbour for other risks. But the Commission is not convinced that the benefit of the IBER has resulted in significant market entry. So, industry participants who are concerned about potential loss of the IBER and related legal certainty

should consider making appropriate representations to the Commission. There is due to be a public consultation in 2015, but views may be submitted informally in advance.

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