

INTERIM REPORT ON EU COMPETITION INQUIRY INTO COMMERCIAL INSURANCE

January 25, 2007

On 24 January 2007 the European Commission (“Commission”) published its Interim Report on the effectiveness of competition in commercial insurance in the EU¹. The Report suggests that the Commission has found competitive distortions in the EU commercial insurance industry.

In contrast to its investigation of the energy sector however, the Commission has not indicated an intention to take immediate — or at least public — action against particular market participants before finalisation of the inquiry. The Commission has instead opened a public consultation on its findings and, importantly, has said that it will conduct supplementary targeted investigations where potential competition issues have been identified. The major issues are summarised below.

Insurers and other stakeholders should welcome the publication of the Interim Report and the invitation to comment. They should, however, also prepare now to address a new round of detailed questions on particular business practices.

The Commission’s preliminary findings

The main findings of the Commission’s interim report are:

¹. See Business Insurance Sector Inquiry Interim Report.

- **High and sustained profitability in some Member States and business segments.** Insurers’ underwriting profitability is markedly different between Member States. The Commission is concerned that this may reflect market power in some Member States, entrenched by market fragmentation along national lines. Furthermore, profitability analysis indicates less competition for the business of small and medium-sized enterprises (“SMEs”) than for large corporate customers. Presumably, this may represent an opportunity for some insurers.
- **Long term contracts and distribution as barriers to entry.** In some Member States, long-term insurance contracts and certain distribution structures (e.g. networks of exclusive agents) may reduce the scope for competition by foreclosing the market for new insurers. These issues are particularly important as, according to the Commission’s survey, insurers consider access to customers and to distribution infrastructures as one of the most important factors influencing their decision to enter a new market.
- **Best terms and conditions clauses in reinsurance.** According to the Commission, “best terms and conditions” clauses in reinsurance and certain co-insurance contracts lead to a harmonisation of terms and conditions at the most favourable level for the reinsurers, to the detriment of the cedant and, ultimately, of the final business insurance customer.
- **Intermediaries’ conflicts of interest.** The dual role of certain intermediaries, typically brokers, who act both as a distribution

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This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your LeBoeuf Lamb relationship partner.

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channel for the insurer and as an advisor to their clients, is a potential source of conflicts of interest. According to the Commission's survey, while contingent commissions have historically been widespread in the E.U., the Spitzer investigation in the U.S. and the increased public attention have led some market participants to change their policy, and more generally to increase transparency.

- **Cooperation Among Insurers.** The Commission has found that significant differences exist in the degree of horizontal cooperation among insurers in different Member States, raising questions as to the rationale and need for such cooperation. This in turn has possible implications for the scope of the 2003 Insurance Block Exemption from the competition rules, on which large parts of the industry have relied.

All these areas will be the subject of more detailed analysis in the coming months.

Next Steps: Public Hearing, Consultation and Second Round of Investigation

The Commission is still in the process of understanding the structure of commercial insurance across the E.U. Therefore, before reaching its final conclusions (due to be published in September 2007), the Commission will conduct an additional, more focused, round of questionnaires and/or interviews with various stakeholders with the stated aim to obtain "clear, accurate

and exhaustive" responses. In particular, the Commission will seek additional input from risk managers and commercial insurance buyers in order to obtain a more "balanced" illustration of the relevant issues.

The Commission is also inviting all interested parties to submit their views on the preliminary findings through a public consultation process lasting until 10 April 2007, which will highlight the issues arising from the Interim Report. Distribution networks and horizontal cooperation will be the subject of a public hearing, to take place in Brussels on 9 February 2007.

The Interim Report suggests that the Commission will only decide on whether specific measures are necessary upon the publication of the Final Report. Despite this indication, the Commission is free to take action against individual companies and/or pools on the basis of the information it has already gathered, if it believes such information evidences competition law infringements.

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