

# BILA Lunchtime Lecture

Skadden

## The FCA Wholesale Inquiry and Other Antitrust Hot Topics

20 May 2019

Bill Batchelor



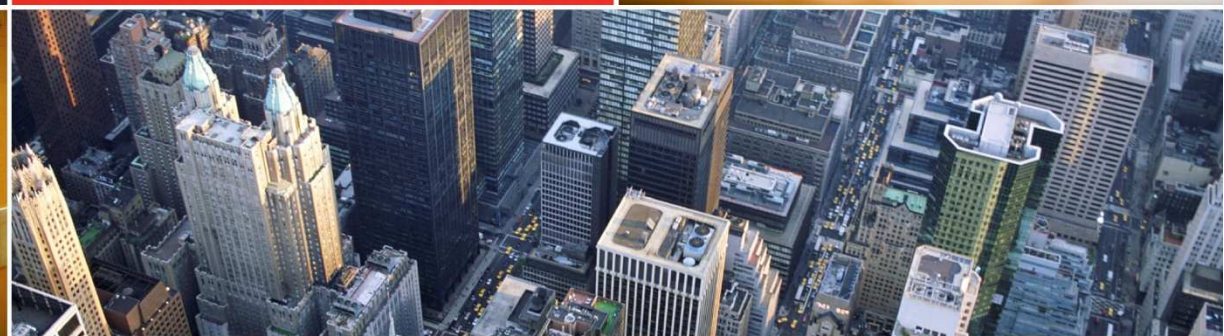
1,700  
attorneys



22  
offices



50+  
practices



Beijing / Boston / Brussels / Chicago / Frankfurt / Hong Kong / Houston / London  
Los Angeles / Moscow / Munich / New York / Palo Alto / Paris / São Paulo / Seoul  
Shanghai / Singapore / Tokyo / Toronto / Washington, D.C. / Wilmington

1

## The FCA Wholesale Insurance Inquiry

Section Description 1

2

## Other Insurance and Antitrust Hot Topics

Section Description 2

3

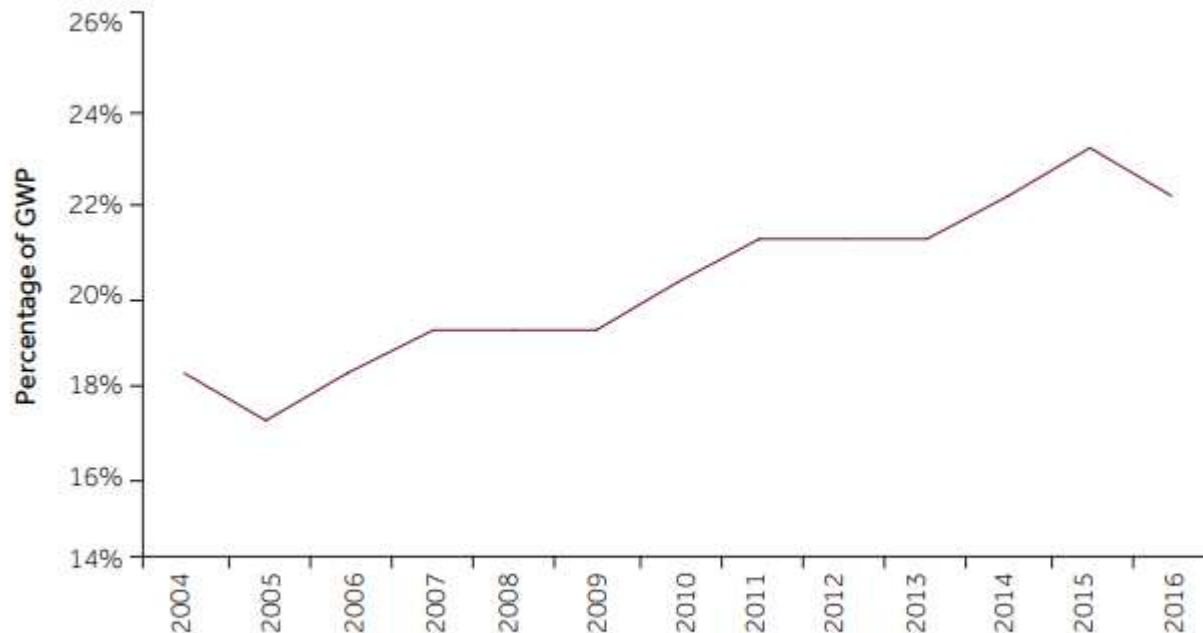
## Takeaways

Section Description 3

# 1 The FCA Wholesale Inquiry

# Why did the FCA decide to launch a market study?

Figure 4: Lloyd's of London acquisition costs (% of GWP) (Whole market)

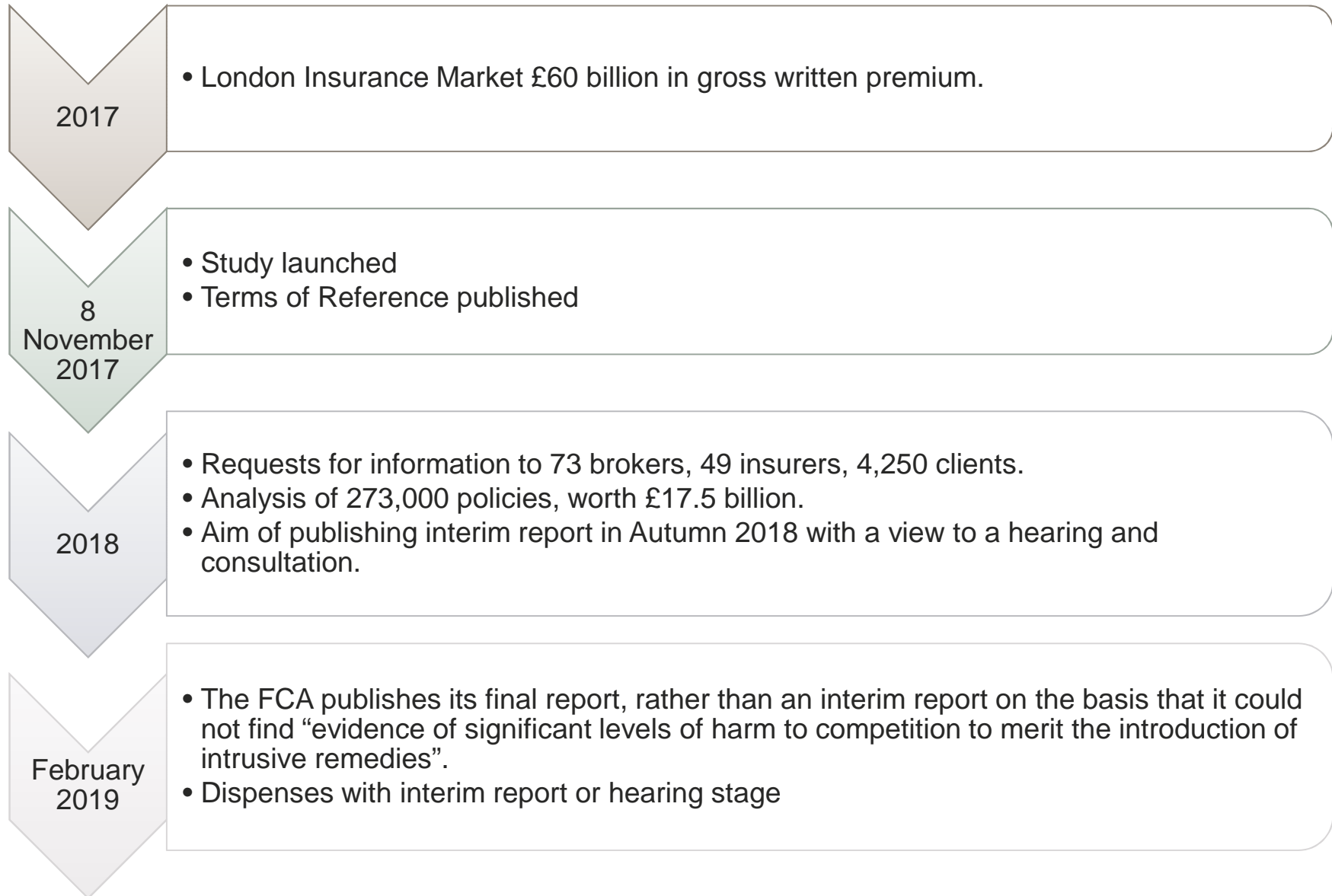


The FCA aims to “ensure that [wholesale] markets demonstrate clear, proportionate and consistent standards of market practice, transparency, open access, integrity and competition on merits”

Source: Lloyd's of London statistics 2017<sup>20</sup>

- Market study launched based on “evidence from practitioners of potential competition concerns as well as our own analysis of this market.”
- Rising costs of distribution
- Focus primarily, but not exclusively, on broker practices

# Timeline



# Market study conclusions

| Focus  | FCA Finding   |
|--|---|
| <b>Market power:</b> are brokers are able to exercise market power?  | No evidence of market power/excessive market concentration.   |
| <b>Pay-to-play:</b> do brokers compel insurers to pay fees for additional services (data, product design or consultancy) as a condition of accessing the broker's client base? | No clear evidence, albeit services to insurers (whether placement or non-placement related) are so prevalent that difficult to assess pay-to-play.                  |
| <b>Additional fees charged by brokers to insurers:</b> whether increased distribution costs are due to inflated fees and higher commissions?                                   | Fees for facility agreements are generally commensurate to the level of service provided. (FCA focus primarily considers client fees).                              |
| <b>Insurance/Reinsurance tying:</b> tying of reinsurance services to insurance placement   | Insurers usually use broker services for facultative reinsurance placement due to efficiency and expertise on risk.   |
| <b>Broker conflicts:</b> the receipt of higher revenue for business that is placed with captive MGA or facility not be in the best interests of the client.                    | Brokers receive higher remuneration rates for business placed via placement facilities than they do for placing the risk in other ways, such as in the open market. |
| <b>Broker collusion:</b> coordination between competitors to limit rivalry and the sharing of commercially sensitive information such as tender information.                   | Industry characteristics mean that tacit coordination between firms is unlikely.  |

## ...But main question unanswered

Why have costs increased over time and is it due to a market failure?

- The FCA found that insurer commission is “*the main revenue stream for brokers*” rather than client fees.
- Client fees account for an increasingly small amount of broker revenue.
- Increasingly revenue from insurers via placement and non-placement service.

### Broker revenue 2016

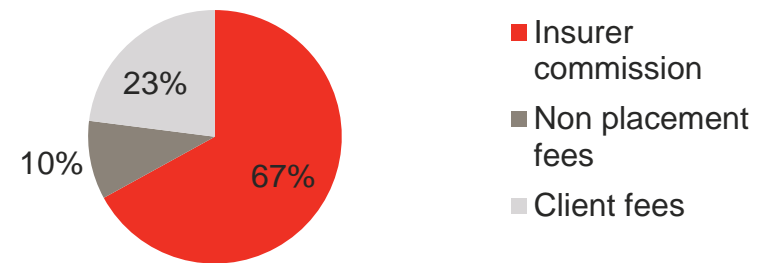
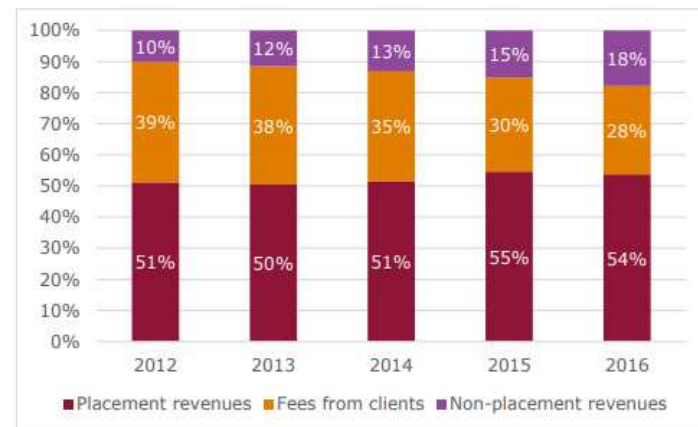


Figure 4: Sources of revenues (2012-2016) for the 3 largest brokers



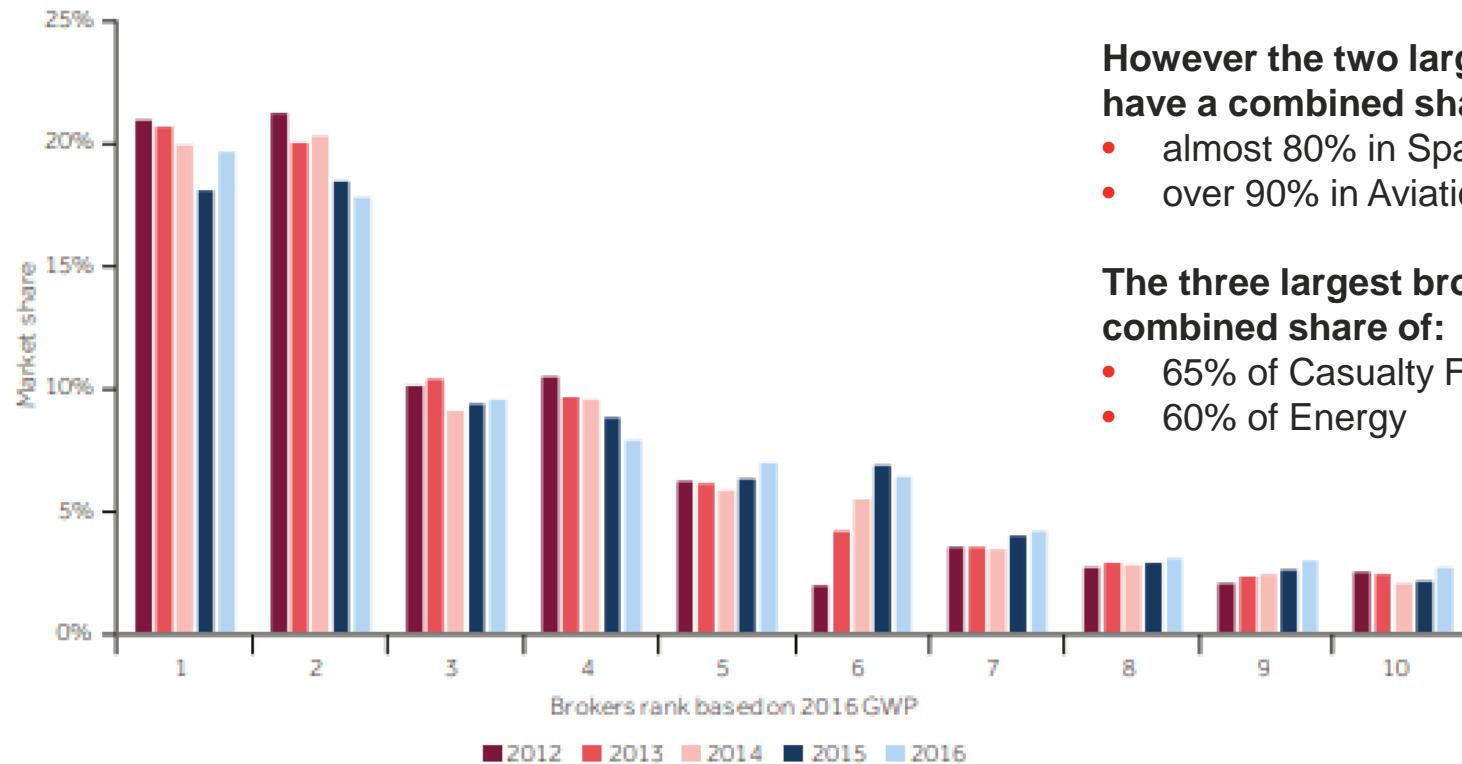
# 1.1 Broker Power?

“At an aggregate level, combining all risk classes, the wholesale insurance broking sector does not appear to be highly concentrated” ¶3.100



# FCA find no broker-to-client market power...

**Figure 3: 2012-2016 trend in relative market shares based on GWP for the largest 10 brokers<sup>23</sup>**



**However the two largest brokers have a combined share of:**

- almost 80% in Space risk class
- over 90% in Aviation excess of Loss

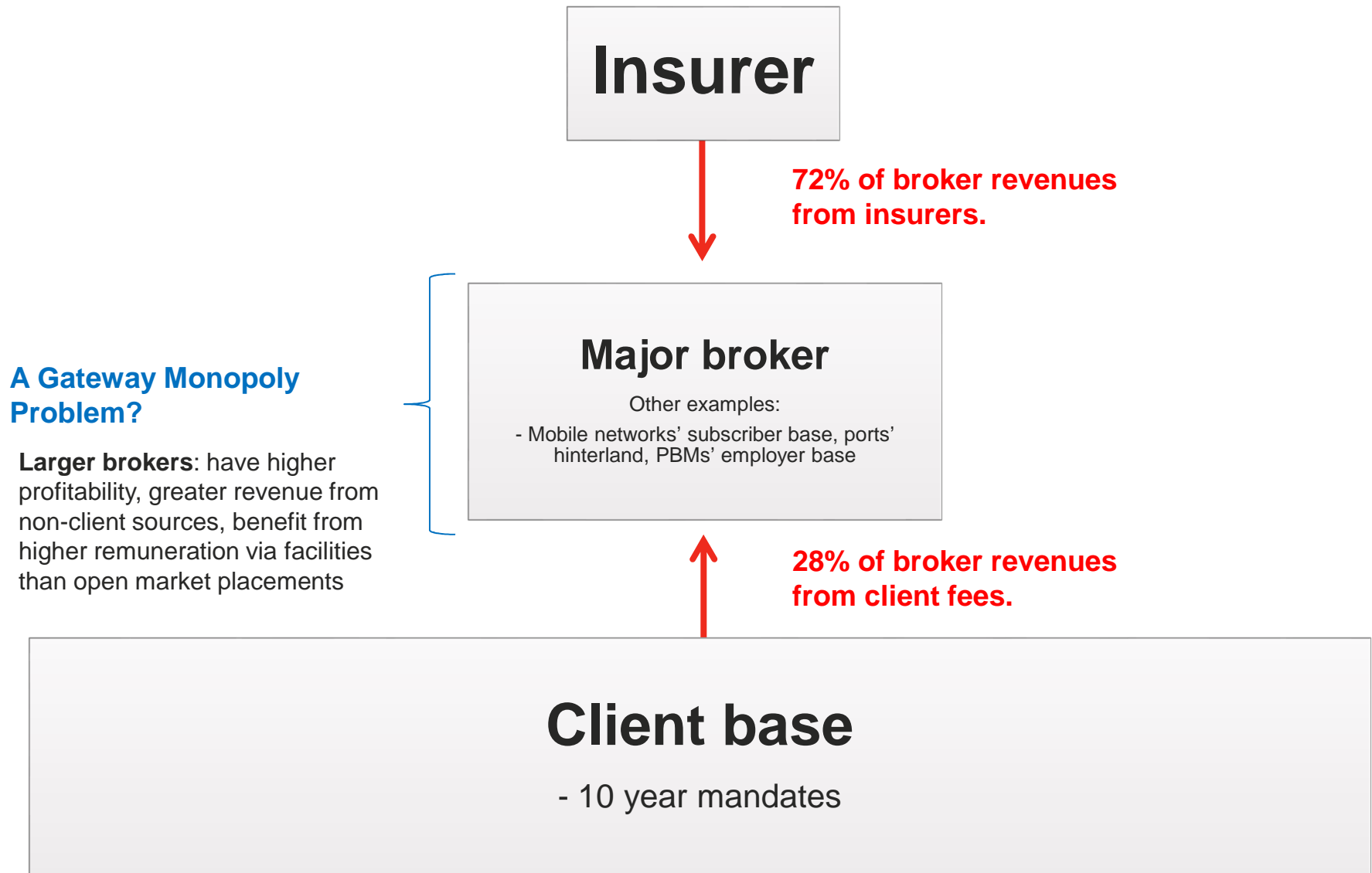
**The three largest brokers have a combined share of:**

- 65% of Casualty FinPro
- 60% of Energy

Source: FCA analysis of broker data request.

**Conclusion: no finding of market power on provision of broking services to insureds**

# ....But consider broker-to-insurer power



## 1.2 Pay-to-Play

“There is widespread use of agreements and MGAs by insurers and brokers.

This means that there is insufficient variation in the data for a quantitative analysis to find robust evidence, even if there is pay-to-play.” ¶4.17

# Is there evidence of “pay-to-play”?

- **Considers whether there is evidence of pay-to-play:**
  - Additional services
  - Placement facilities
  - Tying reinsurance broking services to placement of direct insurance
- **Concludes:**
  - No strong statistical correlation between volume of insurers' business and commissions paid to brokers.
  - Services to insurers (whether placement or non-placement related) are so prevalent in cannot reach a conclusion as to whether they are entered into under pay-to-play coercion
  - No respondents provided concrete evidence of existence of pay-to-play

- What services were provided?
  - “greater understanding of the broker’s positioning”
  - “streamlined underwriting and claims processes”
  - “increased support for business development” and
  - “greater understanding of client’s needs.” ¶4.8
- “We also asked the participating insurers whether they would be at a competitive disadvantage if they had not signed these agreements. A large proportion of respondents stated that they would not, *other than the loss of value that these services provide in terms of improving their businesses.*” ¶4.9
- But query how these differ from the services expected by clients of their broker.

# 1.3 Tying Reinsurance Broking

# Whether there is insurance/reinsurance tying

- Concern that when placing a risk with an insurer brokers may require the insurer to use them for any subsequent reinsurance of the same risk.
- Conclusions ¶4.32-4.38:
  - Reviewed 6,200 reinsurance placements from 2016.
  - 61% of placements were with the original broker representing 65% of total net ceded premium.
  - 76% of net ceded premium in the property class was reinsured with the original broker c.f. 29% in accident and health.
- Findings show that:
  - The original placing broker is not always used to place facultative reinsurance.
  - 35% of total net ceded premium, the insurer chooses a third-party broker to arrange reinsurance.
  - Reason for placing via originating broker may be due to efficiency or confidentiality considerations.
- Query whether 65% is inherently a high proportion of reinsurance placement; potential for understanding on reinsurance placement if broker acts as gateway to opportunity.

# 1.4 Compliance Issues

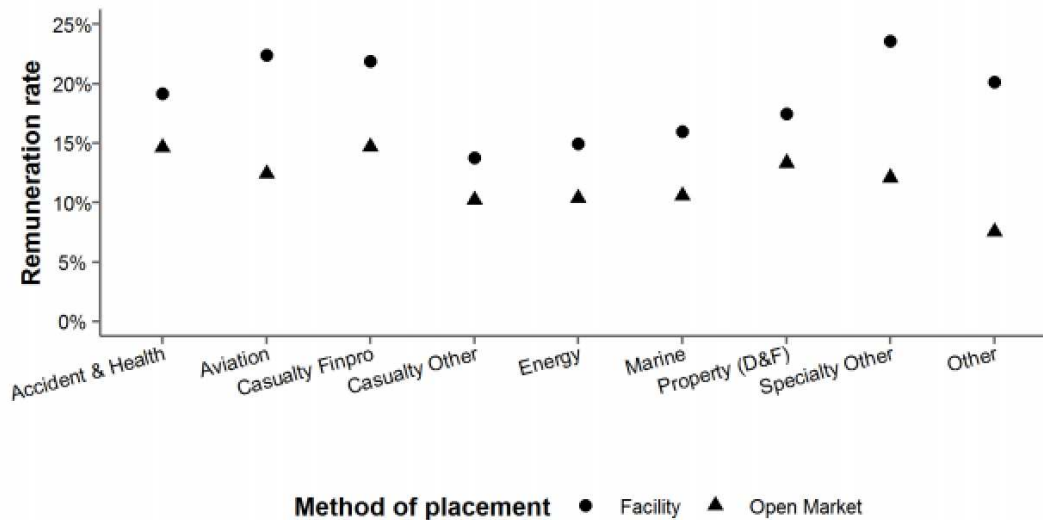


- Facilities - general rule:
  - Check market share of participating insurers (generally <20%)
  - Check for restrictive terms: non-competes, long notice periods, disadvantaging non-facility business
    - » See [EU BER Impact Assessment](#) (p68)
- FCA identifies problem clauses in facilities ¶4.27-4.30:
  - Most-favoured-nation clauses require insurers not to offer better open market terms.
  - Exclusivity requiring insurers not to deal with facility clients outside the facility.
    - » NB confidentiality and IP clauses also common
  - FCA puts participants on notice (note: issues 11 “advisory letters” in 2018)

# Compliance issues (2): conflicts of interest

- The FCA found that:
  - brokers receive higher remuneration rates for business placed via placement facilities than they do for placing the risk in other ways, such as in the open market.
  - Upward trend in remuneration of broker-owned MGAs since 2012.

**Figure 2: Average remuneration rates on policies placed in facilities and open market across different business class**



- The **FCA's supervisory focus** is on the need to manage conflicts of interest and ensure that brokers must broker client's better disclosure.
- Brokers are incentivised to refer business as they can earn higher revenues from facilities than in the open market
- Does the increasing use of facilities is producing real efficiencies and economies?

# FCA Wholesale Inquiry: Conclusions

- Second review of broker practices in the London market. First *Post-Spitzer* review of remuneration and disclosure ended with no material changes (FSA Transparency and Remuneration Study (March 2008))
- Potentially a missed opportunity to dig deeper into wholesale insurance market practices.
  - Not an obvious candidate for market failure given sophisticated insurers, intermediaries and large corporated insureds involved.
  - BUT choice not to proceed to interim report and consultation highly surprising given anecdotal evidence of market power and ambiguous outcomes on pay-to-play, tying and conflicts of interest.
- Takeaways:
  - Continued focus on compliance issues with facilities
  - Conflicts of interest likely to be subject to further review
  - More intrusive regulation of unrelated fees, disclosures, “paper” services agreements unlikely



“A very small minority of insurers who responded to our survey expressed some concerns in relation to pay-to-play.” ¶4.11

# 2 Hot Topics in Antitrust and Insurance

# Insurance under the spotlight

## UK:

- Competition Commission published preliminary findings in the UK private healthcare market (2013).
- Private motor insurance market investigation (2015).
- FCA broker aviation investigation (2017).
- FCA asset management market study (2017).
- CMA issued Statement of Objection in investigations against BISL Ltd and its digital comparison tools for the use of most favoured nation clauses (2018).

## Europe:

- EY Subscription Market Review (2012).
- Block Exemption review (2017).
- Dawn raids in motor insurance industry in Ireland (2017).
- Aviation brokers investigation (taken over from the FCA) (2017).

## South Korea:

- Investigation launched into General Insurance Association of Korea and four insurance companies over alleged price fixing (2016).

## North America:

- \$850 million settlement following Spitzer investigation of contingent commissions (2005).
- Health Insurance Industry Antitrust Enforcement Act of 2013 (Jan 2013).
- Settlement in DOJ antitrust lawsuit against Carolinas HealthCare System, challenging its practice of imposing steering restrictions in its contracts with commercial health insurers (2019)

## France:

- Investigation into provision of borrowers insurance (2010).
- Recommendations by Competition Authority to ensure effective competition in complementary and collective health sector (March 2013).

## Turkey

- NCA opened investigation into 33 undertakings operating in the market for compulsory automobile financial liability insurance for suspected joint implementation of excessive pricing (March 2017).

## Italy:

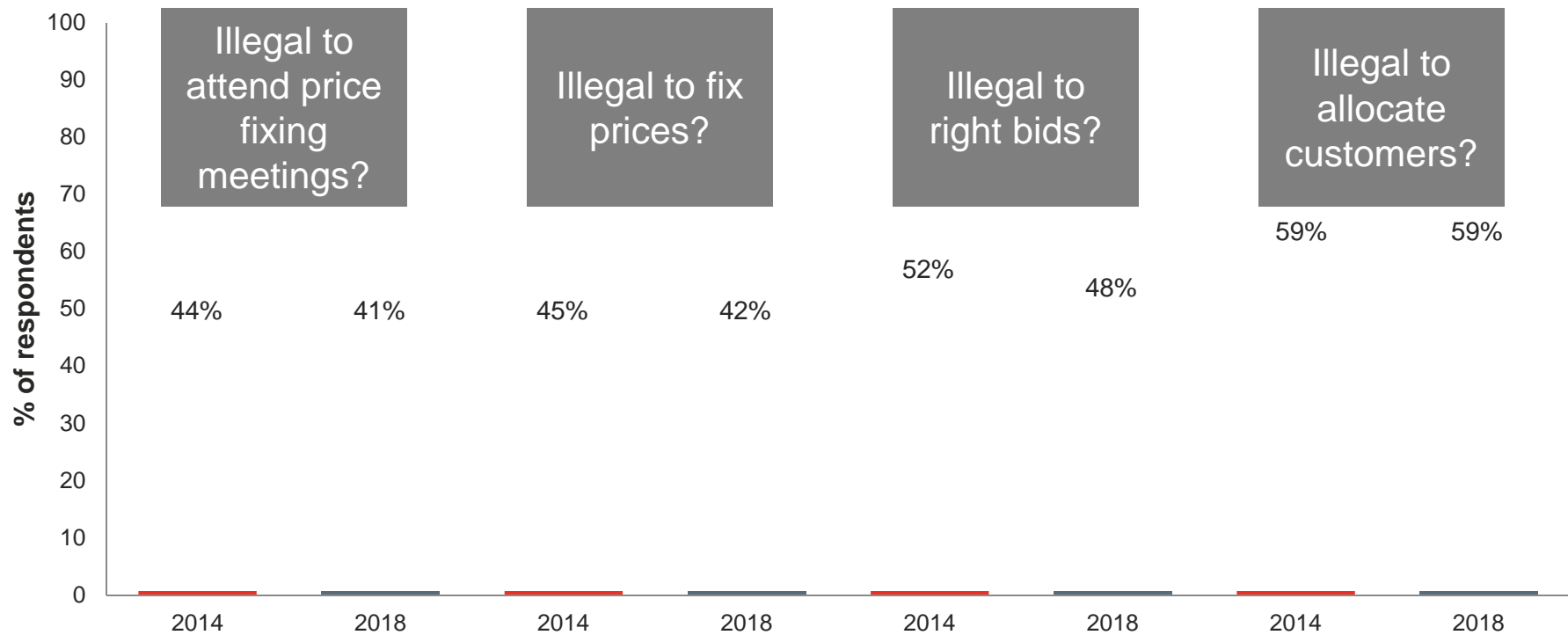
- Investigations into health insurance (2010).
- Investigation into the clauses that eight automobile insurers impose upon agents (June 2013).
- Investigation against auto insurers for alleged price-fixing (2012).
- Investigation into the country's leading car insurers over possible anti-competitive practices (unveiling their respective pricing strategies related to expected insurance premium increases) (2016).

## China:

- NDRC and provincial authorities launched investigations into price-fixing by car insurers in China – combined fines of \$18m (2014).
- €810,012 on the Insurance Association of Xinjiang and six local insurance companies for price-fixing (2014).
- €271,676.16 fine on insurance association and member companies for price fixing and market sharing (2017).

# Anti-trust awareness remains alarmingly low

Awareness of anti-competitive behaviours  
2014 vs. 2018



It can be illegal to attend a meeting at which competitors agree prices with each other. It's OK for competitors to agree prices in order to avoid losing money.

It's OK to discuss prospective bids with competing bidders so that everyone has a chance to get tenders from time to time.

Businesses can agree not to sell to the same customers as each other.

## Information Exchange (1): A single email engages personal liability

- FCA *Hargreave Hale; River & Mercantile* Decision (February 2019)
- UK FCA fines asset management firms £400,000 for sharing price information on IPOs and placements
- No action in relation to exchanging views on valuation well before placement date
- Asset manager searches internet for potential compliance risks, but does not escalate internally (until after sending email) or consult firm's compliance policy
- £32,500 Individual penalty notice to asset manager for breach of principle 3 (failure to observe proper standards of conduct) and 2 (failure to exercise proper diligence in assessing compliance risks) *Stephany Final Notice*

### RE Urgent - on the beach IPO

“Sorry for the out of the blue email but I wanted to urge those considering or in for the OTB IPO to think about moving to a 260m pre money valuation limit. I have done that first thing this morning with my GBP17m order. ... I haven't received any indication that the books are well covered or even covered so suspect this one is still very much open to price movement. Please have a think and mention to any colleagues or have put orders in.”

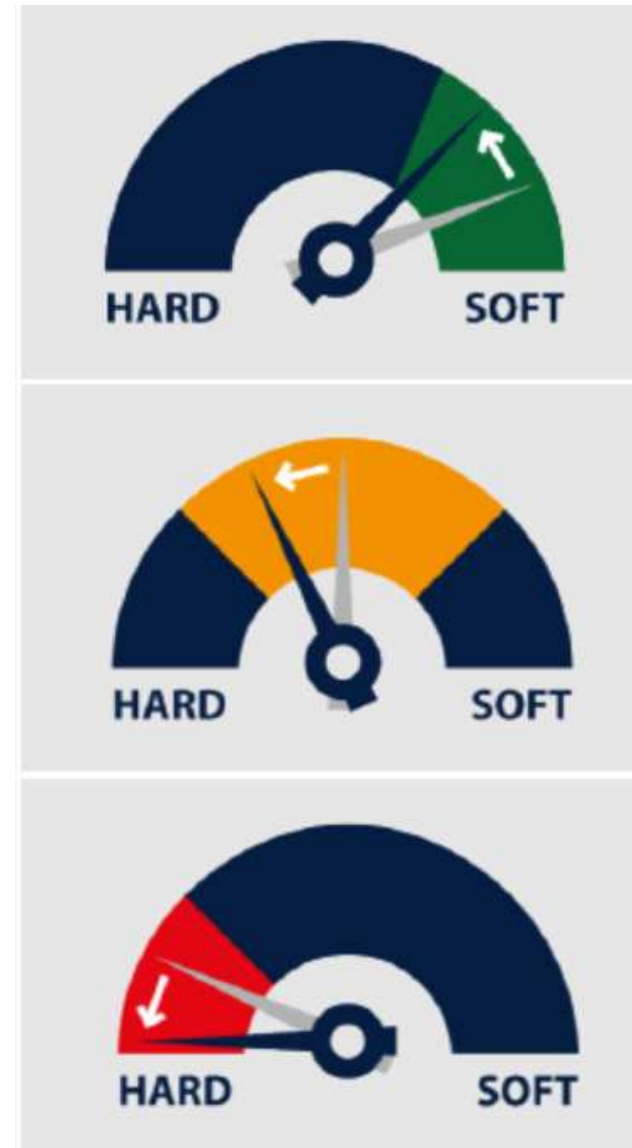
- December 2016: CMA fine of £130,000 against Balmoral for taking part in the exchange of commercially sensitive information on prices and pricing intentions.
  - » Information exchanged at meeting in which Balmoral was invited to join a cartel. Importantly, Balmoral **refused** to join the cartel or engage in price fixing.
  - » However, it did share competitively sensitive information on pricing.
  - » Meeting was secretly recorded by the CMA.
- Fine upheld by Competition Appeals Tribunal in 2017.
- 15 February 2019: Court of Appeal dismissal of Balmoral's appeal against the CAT





# Information Exchange (3): Aviation Brokers

- In 2017, the Commission took over a FCA investigation to launch a probe into aviation brokers for allegedly sharing competitively sensitive information.
- Aviation and aerospace insurance and reinsurance broking products and services.
- Companies:
  - Jardine Lloyd Thompson Group
  - UIB Group
  - Marsh Ltd
  - Aon PLC
  - Willis Tower Watson
- Despite handing the investigation over to the Commission, the FCA retains conduct investigation into alleged sharing of client confidential information.
- NB FCA wholesale insurance inquiry finds that the broking sector not prone to collusion on price because of substantial pricing disparities.



- On 14 May 2019, the Commission opened an investigation into whether the conditions of access to Insurance Ireland's data pooling system is restrictive to competition.
- The data pool (Insurance Link) is managed by Insurance Ireland:
  - » Claim to detect fraudulent behaviour and ensure accuracy of information.
- Data-pooling arrangements are usually regarded as pro-competitive as they increase choice and service providers may offer better prices and services.
- Commission investigation into conditions of access to and participation in the data pool could result in a competitive disadvantage to some market operators and limited choice for consumer.

# Most Favoured Nation (MFN) Clauses

- BISL (ComparetheMarket) Statement of Objections (2018)
  - ComparetheMarket’s contracts with home insurers break competition law and could lead to higher premiums.
  - Prevent home insurers from quoting lower prices on rival sites and therefore reducing availability of cheaper premiums to consumers
- ‘MFN clauses’:
  - ‘broad’: insurer agrees not to quote a better price on its own or rival sites
  - ‘narrow’: insurer agrees not to quote a better price on its own site, but can quote a better price on third party sites.
- Questionable legal theory given BISL brand investments and best price guarantees.

| Beitrag   | Versicherer   | Tarifnote                        | Weitere Informationen      |
|---|---|----------------------------------|----------------------------|
| <input checked="" type="checkbox"/> <b>203,39 €</b><br>jährlich | <b>DirektVersicherung</b><br>Tarif: AutoStart                                   | <b>Tarifnote 2,4</b><br>gut      | Wechselservice<br>weiter » |
| Tarifleistungen   | Testberichte  | Kundenmeinungen (7.845) ★★★★★    |                            |
| <input checked="" type="checkbox"/> <b>205,20 €</b><br>jährlich | <b>Confidon</b><br>Tarif: Klassik Kasko Clever                                  | <b>Tarifnote 1,4</b><br>sehr gut | Wechselservice<br>weiter » |
| Tarifleistungen   | Testberichte  | Kundenmeinungen (12.270) ★★★★★   |                            |
| <input checked="" type="checkbox"/> <b>205,63 €</b><br>jährlich | <b>C</b><br>Tarif: Basis Sorglos Kasko  | <b>Tarifnote 2,9</b><br>gut      | Wechselservice<br>weiter » |
| Tarifleistungen   | Testberichte  | Kundenmeinungen (1.631) ★★★★★    |                            |
| <input checked="" type="checkbox"/> <b>205,71 €</b><br>jährlich | <b>DirektVersicherung</b><br>Tarif: AutoBasis                                   | <b>Tarifnote 2,4</b><br>gut      | Wechselservice<br>weiter » |
| Tarifleistungen   | Testberichte  | Kundenmeinungen (7.845) ★★★★★    |                            |
| <input checked="" type="checkbox"/> <b>206,26 €</b><br>jährlich | <b>Barmenia</b><br>Versicherungen<br>Tarif: Europa-Deckung mit Werkstattservice | <b>Tarifnote 1,5</b><br>sehr gut | Wechselservice<br>weiter » |
| Tarifleistungen   | Testberichte  | Kundenmeinungen (145) ★★★★★      |                            |
| <input type="checkbox"/> <b>206,26 €</b><br>jährlich            | <b>ADCURI.DE</b><br>Tarif: Kfz-Spezialtarif mit Werkstattservice                | <b>Tarifnote 1,6</b><br>sehr gut | Wechselservice<br>weiter » |
| Tarifleistungen   | Testberichte  | Kundenmeinungen (1.306) ★★★★★    |                            |
| <input type="checkbox"/> <b>207,20 €</b><br>jährlich            | <b>direct fire</b><br>Tarif: Basis  | <b>Tarifnote 2,4</b><br>gut      | Wechselservice<br>weiter » |

# Horizon (1): FCA ramping competition law activity

- **2018:** issuance of 11 ‘advisory’ letters
- **October 2018:** Market study into home and motor insurance pricing in response to concerns about ‘inertia pricing’ where longstanding customers pay more than new customers with equivalent risk. Focus on:
  - > Consumer harm from pricing practices
  - > Fairness of pricing practices
  - > Impact of pricing on competition
- **November 2018:** FCA publishes its results on its supervisory work on general insurance pricing practices. Resultantly, the FCA has initiated:
  - » A market study on general insurance pricing practices addressing conduct by firms
  - » A wider discussion paper on fairness of pricing in financial services
  - » An evaluation of the FCA’s prior actions on general insurance pricing.
- **March 2019:** the FCA opened an investigation into “suspected anti-competitive arrangements in the financial services sector.”

# Horizon (2): that Brexit question

Fines imposed in 2017 across selected EEA/EFTA states (before adjustments by court judgments)

## Cartel fines in thousands of euros



**FINANCIAL TIMES**

FCA launches antitrust investigation into aviation brokers

**RISK MANAGEMENT**

European Commission takes over aviation broking probe

Rob Lenihan  
10/27/2017 1:20:00 PM

on into the  
art of a probe

Willis Towers Watson

**GOV.UK**

**Financial services sector: suspected anti-competitive practices**

16 November 2018

The CMA is investigating suspected anti-competitive arrangements in the financial services sector under the Competition Act 1998.



\* Source: GCR Rating Enforcement 2018 – GCR figures take into account all anti-competitive agreements (horizontal and vertical conducts) - UK civil penalties for cartel conduct specifically (i.e. horizontal agreements and/or hub & spoke) amounted to £4,880,000 for the year 2017

# 3 Takeaways

# Takeaways & Key Risk Areas

- Key risk: contacts with competitors
  - Cheap talk – slippery slope from general market conditions to price intentions
  - Spill-over in subscription market/consortia, renewals, unrelated business
  - Ensure statistics programmes escalated to legal for review
- Competitor facilities (lineslips, consortia, joint binders): ensure legal appraisal/sign off:
  - Need to self assess based on market share and other restrictive clauses
  - Bad practices creeping back in
- Broker remuneration:
  - Robust policy on acceptable remuneration
  - MSAs/PSAs with substance, not paper-only services
  - Raise business awareness of potential conflicts – reinsurance tying, use of facilities/MGAs where not in client's best interest





Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates