BUSINESS INSURANCE SECTOR INQUIRY

COMMENTS TO THE INTERIM REPORT

SUBMISSION OF THE ALLIANZ GROUP

I. Introduction

The Allianz Group ("**Allianz**") is a global, integrated financial service provider. It offers a comprehensive product portfolio including life and non-life insurance, banking and asset management to more than 65 million customers in more than 70 countries. In Europe alone, Allianz has a presence in 29 countries, including many of the new Member States, and serves more than 45 million private and business customers.

Allianz has long considered Europe to be its home market. In fact, Allianz was the first German blue chip company that changed its corporate form into a *Societas Europaea*, thereby emphasizing its international strategy. Allianz knows that well functioning insurance markets are essential for efficient and dynamic development of the European Union's economy – and for the Allianz business. They are indispensable for its performance in the interests of its shareholders and its customers.

Therefore, Allianz welcomes the objective of the Commission's inquiry into the business insurance sector ("**Sector Inquiry**"), *viz.* to get a better understanding of the insurance industry. Allianz has devoted considerable efforts to answer the Commission's questionnaires and, thereby, supported its investigation. It has carefully, and with great interest, studied the interim report that was published on January 24, 2007 ("**Interim Report**") and welcomes the opportunity to comment on the Commission's preliminary findings.

The Interim Report addresses a broad range of aspects relevant to the business insurance industry. All of these aspects deserve attention. However, given the Commission's request to limit submissions to no more than 20 pages, Allianz has limited its comments to those aspects on which it hopes its input, as a (predominately) direct insurer, to be particularly valuable to the Commission.

II. MARKET INTEGRATION

Cross-border mergers and acquisitions have helped, and will likely continue to help, insurance companies to extend their business activities beyond the borders of their Member States. Allianz does not believe them to be less favourable than e.g. direct cross-border sales in terms of their capability to integrate the European insurance industry.

According to the Interim Report, cross-border mergers and acquisitions ("**M&A**"), i.e. the acquisition of a local insurance company by another insurance company that is currently not active in the target's Member State, is the most commonly pursued way to enter a foreign market (page 48). While it acknowledges some of the significant advantages of cross-border M&A, the Interim Report clearly seems to believe that direct cross-border sales are a more favourable means of market integration. Allianz tends to disagree.

Once an insurance company has taken the strategic decision to enter another Member State, it will consider and, in fact, it is that insurance company's very responsibility vis-à-vis its shareholders and employees to consider, alternative plans to implement that strategic decision. Eventually, it will choose the most feasible and sustainable one of them. Quite often, this plan will involve, at least as a starting point, some type of cross-border M&A activity.

There are a number of obvious factors that may favour entering another Member State via cross-border M&A from the perspective of the *acquiring company*. In fact, the Interim Report mentions various of these benefits, including (page 48):

- ❒ An instant gain of market share.
- ❒ Access to the target's know-how and expertise in dealing with local market conditions and customer preferences.

However, there are also significant benefits to the *acquired company*, ultimate consumers (i.e. insured companies) and market integration in general – none of which are being addressed in the Interim Report:

- ❒ As to the acquired company, obvious benefits include the instant access to fresh capital, know-how and reinsurance capacities. Indeed, the acquired company may have been short of these resources and, therefore, unable to significantly extend its business, *e.g.* for regulatory reasons. In that scenario, the transaction may help the acquired company to significantly strengthen its capital base, increase its scope to underwrite new risks and, thereby, eventually establish a more competitive player in the market. That will eventually benefit *consumers*. Some of the M&A activities in Eastern and South-eastern Europe provide good examples.
- ❒ Also, where the target becomes part of an international network, the purchasing insurer and, indeed, the overall network will generally benefit from a mutual exchange of know-how. This may help to develop, or improve existing, best practice guidelines to further improve efficiency and services to clients.
- ❒ Finally, cross-border M&A clearly brings about some of the other benefits that the Commission attributes to *market integration*, most importantly regional diversification of risks.

Although these are only some of the more important benefits of cross-border M&A activity, they clearly demonstrate its significant potential to enhance market integration. In fact, the Commission – along with the other institutions involved in the legislative process – has actively been promoting the emergence of truly pan-European corporate groups. Beyond merely enforcing the free movement of capital (Article 56 EC), this policy has also brought about very specific legislation. For example:

- Directive 2005/56/EC of the European Parliament and of the Council explicitly allows for, and harmonizes the implementation of, cross-border mergers of limited liability companies.

- Council Regulation (EC) No. 2157/2001 establishes, and provides the framework for, a European public limited liability company (*Societas Europaea*), in particular by merging two companies incorporated in different Member States.

- Directive 2004/25/EC of the European Parliament and of the Council harmonizes the rules for takeover bids, also with a view to removing disadvantages of foreign investors.

- Finally, Council Regulation (EC) No. 139/2004 has harmonized the merger control rules governing transactions with a Community dimension.

Against this track record and the evidence provided above, there is certainly no difference between direct cross-border sales and cross-border M&A activity in terms of their respective capability to further enhance the integration of the European business insurance industry.

Allianz strongly supports further integration of the European insurance industry. However, in its day-to-day business, it experiences various aspects (mostly related to customer preferences), all of which continue to be obstacles to direct cross-border sales, although they are totally unrelated to the behaviour of market participants that is relevant under the antitrust laws.

According to the Interim Report, the level of direct cross-border sales in the European business insurance industry is low (page 45). However, that statement is not entirely true and, more importantly, fails to recognize the industry's efforts to develop cross-border business. Insurance companies are prepared to sell their products cross-border and international brokers provide both a suitable and promising way to do so. Unfortunately, being able to sell cross-border is only part of the story, overcoming businesses' practice to favour domestic insurance companies is another, more difficult issue. Nonetheless, some lines of business are already truly international. For example, in *Berkshire Hathaway/Converium/Gaum JV*, the Commission explicitly held that the aviation and aerospace insurance markets were at least EEA-wide in scope.[1] Likewise, in *Axa/Winterhtur* and *Sampo/Varma Sampo/IF Holdings/JV*, the Commission found evidence suggesting that the marine and transport insurance business was predominately international, at least for larger clients and/or risks.[2]

Based on our experience, there are various factors that help to explain why businesses often choose to place their risks rather with a domestic insurance company than with a foreign competitor selling cross-border, the most important of which we have listed below.

1 Commission decision of February 28, 2003, Case No. COMP/M.3035 – *Berkshire Hathaway/ Converium/Gaum JV*, para. 29-32.

2 Commission decision of August 28, 2006, Case No. COMP/M.4284 – *Axa/Winterthur*, para. 17-20; Commission decision of December 18, 2001, Case No. COMP/M.2676 – *Sampo/Varma Sampo/IF Holding/JV*, para. 19.

- The serviceability of insurance contracts, including underwriting, claims settlement and customer care often requires the insurance company to have a presence in the client's vicinity or, at least, Member State: customers prefer to have local staff being on-site.

- Insurance products that are designed for sale in several Member States will almost necessarily contain provisions (*e.g.* on termination rights, arrears with premiums) that will not fully reflect each Member State's (non-mandatory) substantive law. Also, choice of forum might be an issue. If the policy' terms and conditions provide for litigation in the insurance company's Member State, the client might be confronted with foreign courts and procedural rules (*e.g.* on the enforcement of judgments). Clients generally prefer to deal with familiar, i.e. domestic rules and institutions.

- Finally, most clients, businesses and private individuals alike, consider insurance coverage as a rather sensitive issue that requires an exceptional degree of mutual trust between the client and the insurance company. This is because the client will generally pre-pay for an intangible service, i.e. insurance coverage and the "mere" promise to settle future losses. Therefore, insurance clients often prefer to deal with local companies which they know and which speak their language.

III. FINANCIAL ASPECTS OF THE BUSINESS INSURANCE SECTOR

The Commission's market investigation has produced a considerable data base as far as the European business insurance industry's financial performance is concerned. Allianz supports the Commission's efforts to get a firm understanding of the financial aspects that drive competition in the business insurance sector. However, there are limitations as to which conclusions can, and cannot, be derived from the Commission's data base. Three of the more important limitations will be addressed later in this section. In addition, there is also a more general point to the Interim Report's analysis of the financial conditions prevailing in the business insurance industry, *viz.* the Commission's approach to, and interpretation of, profitability as nothing but an indicator of market power.

Unlike other industries, the insurance sector is subject to financial supervision which needs to be given due consideration when analyzing profitability in the insurance industry. Therefore, Allianz strongly recommends that the Commission liaises closely with national financial supervisory agencies before finalising the financial aspects section of the report.

The Commission's approach to focus on profitability as an indicator for market power might seem self-evident to an antitrust agency conducting a market investigation under antitrust rules. However, Allianz believes this approach to be too one-sided in an industry that is as heavily regulated as the insurance industry.

In particular, analysing profitability in the insurance industry has to give due consideration to the regulatory framework and the objectives thereof. Ensuring the profitability and solvency of insurance companies is at the very heart of the financial agencies supervising the industry: insurance companies need, and are required, to have sufficient resources to honour their obligations vis-à-vis their clients. At times, there may be tensions between the objectives of prudential financial supervision and competition. However, when solving these tensions, it is important to understand that both, the regulatory framework and the antitrust laws, are ultimately designed to benefit consumers. Thus, analysing the insurance industry's profitability and what it means – and, even more importantly, what it does not mean – in terms of competitiveness and market power certainly requires that due weight be given to regulatory solvency and capital requirements.

The combined ratio is a rather poor indicator in terms of its ability to measure the competitiveness of the business insurance industry and, in particular, to compare the degree of competitiveness prevailing in various Member States.

The Interim Report largely resorts to combined ratios as a proxy for the competitiveness or market power prevailing in the European business insurance industry. While the Commission does acknowledge that there are a number of drawbacks associated with that approach, it nonetheless holds that annual combined ratios, which are regularly and significantly lower than 100% may be a strong indication that insurance companies are exerting market power (pages 52-53). Allianz disagrees with any broad statement to that effect. The degree of competition and/or market power may be one, but not certainly the only one, factor that determines the level of the combined ratio in a given business line and/or Member State. Indeed, the Commission tends to understate the various drawbacks to using combined ratios as a proxy for the competitiveness of the insurance industry – those identified in the Interim Report and others.

As noted by the Commission, there is usually a time lag between the date that an insurance company writes premiums for a certain risk, on the one hand, and the date that the risk covered materialises, claims are made and settled, on the other hand. The impact of this effect on combined ratios depends on the volatility of the risks covered. Where volatility is high, combined ratios may be exceptionally low as long as no major claims are made and exceptionally high in other years. This effect amplifies the "usual" up-and-down of combined ratios alongside underwriting cycles and differs significantly amongst business lines. For example, from 2002 through 2004, the German insurance industry's expenses for major claims brought under fire insurance and fire consequential loss policies was remarkably low which suggests that this effect had a real impact on the Commission's analysis.

The Commission also tends to understate the significance of an insurance company's investment income and its impact on combined ratios. According to the Interim Report, "[s]takeholders seem to agree widely that underlying profits shouldn't magnify significantly the investment profits." Allianz disagrees. With investment income going down, it is no longer sufficient for insurance companies to make no or small losses in their core business. That business has to be profitable on a stand-alone basis. This finding has two important and interrelated implications.

First, unlike the investment capital available to other financial institutions, insurance companies are subject to stricter solvency requirements and, therefore, have to invest in a more conservative (i.e. usually less profitable) manner. This is a cost which is inextricably linked to the insurance business and which, in fact, varies significantly across business lines, between long-tail and short-tail business and across Member States. In order to survive as an independent player on the financial markets, insurance companies cannot exclusively rely on their investment income; they also need income (and profits!) from their core activity, *viz.* underwriting insurance policies. A long-term combined ratio of, or just below, 100% is insufficient.

Therefore, secondly, there is a strong incentive for insurance companies to increase efficiency of their underwriting businesses, thereby lowering the combined ratios – without exerting any market power but rather to the long-term benefit of consumers.

The result of analysing combined ratios as a proxy for the existence, or the absence, of market power is particularly ambiguous if used to compare the degree of competition prevailing across different business lines and/or Member States. Some of the inherent problems relate to definitional issues: The comparison of combined ratio levels – and, in fact, their analysis in general – is meaningful only if the various elements that are factored into the calculation are defined in the same way. This requires, for example, a common understanding of which underwriting expenses are relevant and how certain (overhead) costs should be allocated to business lines and Member States.

The Interim Report notes some of these difficulties but holds that they can be mitigated by resorting to broader business categories such as "all commercial non-life activities" (page 53). However, that approach disregards one core aspect of combined ratio analysis: profitability requirements do differ amongst business lines and Member States, reflecting different reserve setting approaches, underwriting cycles, degrees and types of reinsurance coverage, risk volatilities, cost of capital, legal/regulatory frameworks and/or solvency requirements. Hence, while resorting to broader categories of business lines might mitigate drawbacks from definitional problems, it will distort the analysis even more.

Even if combined ratios were a good measure of the competitiveness of the insurance industry (which they are not), any meaningful analysis would require, at the very least, to define specific combined ratio thresholds indicating market power for each business line in each Member State.

The time period covered by the Interim Report (2000-2005) does not support the finding of "sustained" high profitability in the European business insurance industry and, based thereon, a potential scale for price reduction in parts of the European Union. This is because the Commission's analysis of combined ratios does not consider data from a complete underwriting cycle but only part thereof, the time period covered showing combined ratios above the entire cycle's average values.

The business insurance industry is characterized by cyclical patterns, i.e. alternating periods of increasing premium levels and underwriting profitability (so-called "hard market") and decreasing premium levels and underwriting profitability (so-called "soft market"). Therefore, a static analysis of the combined ratio(s) prevailing in any given year will not adequately reflect the industry's long-term profitability. Instead, if the analysis of combined ratios is to yield any meaningful results, it needs to cover at the very least one complete underwriting cycle for each business line and/or Member State. Where risks or large claims are highly volatile, only an even longer-term analysis including several underwriting cycles stands a chance of producing reliable statistical data.

The Interim Report acknowledges both the cyclical nature of the business insurance industry and the need to extend the analysis of combined ratios beyond a single year. However, by looking only at the combined ratios from 2000 through 2005 instead, the Interim Report still falls short of covering one complete underwriting cycle. This shortcoming significantly distorts the analysis' results. While the Interim Report finds that "profitability is high in business insurance […] and has also been sustained over time" (page 65) and that "the magnitude of combined ratios is not very volatile over the medium-term trend" (page 61), a longer term analysis would have produced ample evidence that, prior to 2001, the business insurance industry suffered from an extended period of low profitability and that the time period covered by the Interim

Report (2000 through 2005) resembled, on average, the more profitable part, i.e. the hard market phase of the current underwriting cycle. Put into perspective, the most recent profits are anything but an indicator of market power or of “a potential scale for price reduction in parts of the European Union”. In fact, they have been hardly sufficient to compensate for the significant losses that the industry incurred prior to 2001.

As noted earlier, any meaningful attempt to measure profitability based on combined ratios would have to use, at the very least, benchmarks that properly reflect the specific characteristics of each business line and Member State. Likewise, in order to produce data that properly reflects a business line’s profitability, one would have to consider a time period sufficient to cover that business line’s specific underwriting cycle. However, irrespective of specific underwriting cycles, there was a general trend that characterized the overall business insurance industry over the last decade.

Generally speaking, prior to 2001, the European business insurance industry had been suffering from weak profitability for some years. During 2001, premiums began to “harden”. Profitability increased and remained above average for the remainder of the time period covered by the Interim Report, including 2004 and 2005. There are various factors that added to, or facilitated, the hardening of the European insurance business from 2001 onwards, including any of the following: decreasing insurance capacities, significant actuarial losses, poorly performing capital markets, a substantial increase in reinsurance premiums and the fact that the levels of risk exposure kept increasing faster than insurers’ capital bases. There were also developments which had a particular impact on specific business lines, *e.g.* 9/11 (especially in the marine, aviation and transport business lines – “**MAT**”) and the use of improved pricing, risk and emergency models (especially for environmental risks such as floods).

The Commission’s data clearly reflects this general trend, most notably the data contained in Table VI.1 of the Interim Report (page 56). On average, 2000 showed the highest combined ratio for the overall commercial non-life business (111%), while 2005 showed the lowest (91%). In fact, for a large number of business lines, including the categories “MAT total” and “liability total”, the lowest combined ratio was reported in 2005, in most of the remaining cases, including the property and business interruption business lines, in 2004. Also, starting in 2002, a majority of business lines showed combined ratios below the 2000-2005 average; in 2004 and 2005, that was true for almost all business lines. Indeed, as we have just demonstrated, there is ample evidence in the Commission’s data itself that, on average, profitability increased significantly starting in 2001 and that the insurance business continued to be “hard” throughout 2004 and 2005 – there is no evidence in Table VI.1 suggesting that the business began to soften in 2003 through 2005, as the Interim Reports does (*see* page 56).

Volatility of risks is another factor that can have a significant impact on combined ratios and that, therefore, requires to extend the analysis to a period of time long enough to provide statistically reliable data (irrespective of, and possibly longer than, individual underwriting cycles). Where the risk is both high and volatile, combined ratios will be extremely high in years in which the risk materializes. In other years, possibly for an extended period, the combined ratios may be very low, falsely suggesting that the business line was particularly profitable.

This feature may be particularly prominent with respect to MAT, terrorist and environmental risks. However, the frequency of large losses may also vary significantly in other business lines. It may have had – and, in fact, did have – an impact on the Commission’s data base. For example, in Germany, the expenses for major claims in the fire insurance and fire consequential loss business lines were extremely low, in fact far below a 15-year average, in 2002 and 2003. At the time, the combined ratios for these business lines dropped significantly in 2002 (as compared to 2001) and again in 2003 (as compared to 2002).

The results of the Commission's investigation into the profitability of insurance services provided to large corporate clients, on the one hand, and small and medium-sized enterprises, on the other hand, are largely ambiguous and do not support any broad finding to the effect that insurance companies generally, or even consistently, display higher underwriting profitability with respect to services offered to small and medium-sized enterprises. Combined ratio differentials, which may "favour" either group depending on the Member State and/or lines of business, do not indicate discriminatory treatment.

Reading the Interim Report and some of the statements made by Commissioner *Kroes* in the wake of its publication, allegations of unequal treatment of, and allegedly unacceptable cross-subsidization between, large corporate clients ("**LCC**") and small and medium sized enterprises ("**SME**") seem to be one of the major themes that the Commission will follow up on. In order to put this issue into perspective, in particular as far as the Commission's profitability analysis is concerned, the following comments are required:

Firstly, from the very outset, the criteria chosen by the Commission to distinguish LCC from SME were both artificial and largely arbitrary. They never reflected insurance companies' practice and squarely failed to note that there is no definition of LCC and/or SME commonly or even predominately used in the insurance industry. Therefore, the Commission's criteria were destined to produce a data base the quality of which on this account (i.e. LCC vs. SME comparison) is questionable at best, inviting insurance companies to either outright ignore the Commission's definition or provide rough and hardly more meaningful estimates.

Secondly, it is important to recall what, according to the Interim Report, the investigation found and what it did not find. In a recent speech, Commissioner *Kroes* noted that "[a]n area of particular concern [was] that insurance companies tend[ed] to display *consistently* higher underwriting profitability in the services to SME, compared to the services they offer to large corporate clients".[3] The Commission's investigation has not produced any conclusive evidence to that effect. In fact, the evidence is much more ambiguous (*see* Interim Report, page 65):

- ❒ As the Interim Report notes, the pattern of the combined ratios applied to SMEs and LCCs varies significantly across the European Union, i.e. while in some countries the combined ratios for SMEs are lower than those for LCCs, they are higher in others.

- ❒ Also, differentials between SMEs and LCCs are not always consistent over time; while they are in some Member States, they are quite divergent in others.

---

3 *Neelie Kroes*, Getting more from financial services markets: greater competition for a better deal for consumers, speech given before the London School of Economics on February 19, 2007 (emphasis added). *See also Neelie Kroes*, Developments in competition policy since October 2006 – a look forward into 2007, speech given before the European Parliament's Economic and Monetary Affairs Committee on March 20, 2007 ("high underwriting profitability in the SME segment").

- Therefore, if anything, the investigation merely shows that there happened to be a limited number of Member States displaying lower combined ratios and higher underwriting profitability in the SME segment from 2000 through 2005. This finding is much narrower than the one cited earlier and, given that the data does not even cover an entire underwriting cycle, hardly supports the conclusion that, even in these Member States, insurance companies enjoyed a consistently higher underwriting profitability for services provided to SME.

Finally, as also noted in the Interim Report, the mere fact of different combined ratios in the SME and LCC business segments of itself does not evidence discrimination. There are good and perfectly justifiable reasons as to why, at times, insurance companies display lower combined ratios in their SME business. The Interim Report mentions client specific characteristics and more accurate risk rating for LCC policies (page 63).

SME and LCC also differ in terms of the types of coverage purchased: SME typically purchase lower limits, package policies and multiple-peril standard products, whereas LCC often purchase higher limits and excess policies. SME and LCC also differ in terms of risk consciousness and the risk volatility.

IV. DURATION OF BUSINESS INSURANCE CONTRACTS

The duration of business insurance contracts does not raise any concerns under the European antitrust laws.

In the Interim Report, the Commission develops a legal framework for analysing whether exceptionally long-term contracts might have an anti-competitive effect. As a conclusive remark on the issue, the Commission notes that "[t]he analysis developed [in this section of the Interim Report] does not pretend to already identify the existence of restrictions to competition in a specific insurance market" (page 73). Allianz endorses that conclusion. However, it does not share the Commission's underlying anti-competitive concerns allegedly associated with long-term insurance contracts – and that is for legal and factual reasons.

- As a matter of law, the duration of an agreement in and of itself is not anti-competitive and does not violate Article 81(1) EC, irrespective of the prevailing market conditions and irrespective of whether there is merely a single long-term agreement or a "bundle" of them. In order for a long-term agreement to raise any foreclosure concerns, there has to be a specific obligation on behalf of either party that is capable of restraining competition. Most notably, both *Brasserie De Haecht v. Wilkin*[4] and *Stergio Delimitis v. Henninger Bräu AG*[5], which are the two European Court of Justice cases cited in the Interim Report (*see* page 72), concerned exclusive purchasing obligations, i.e. explicit – or, at least, implicit – contractual obligations on behalf of the purchaser to source its entire demand from a given supplier. Insurance policies provide for no such (or similar) exclusivity/non-compete clauses.

- Turning to the facts, assuming that long-term insurance contracts could foreclose competition (again, as a matter of law, they cannot), their capability to do so would seem to critically depend on the client's ability to switch

4 European Court of Justice, judgment of December 12, 1967, case 23/67, [1967] ECR 407, *De Haecht v. Wilkin*.

5 European Court of Justice, judgment of February 28, 1991, case C-234/89, [1991] ECR I-935, *Stergio Delimitis v. Henninger Bräu AG.*

insurance companies. The written (explicit) terms of the agreement are one factor determining that ability but not the only one. Most importantly, statutory termination rights may significantly enhance the client's ability to switch their insurance company. Even if the client might choose not to use them, the mere existence of termination rights acts both as a competitive constraint on the client's current insurance company and signals to competing insurers that the client is not "tied-in". A number of Member States rely on statutory termination rights as a tool to strengthen the client's leverage vis-à-vis insurance companies – and, in fact, they increasingly do so. For example:

- Under Belgian law, clients may cancel their policy anytime they have made a claim thereunder.

- Italy has recently (in 2007) introduced a new statute grating clients the right to cancel their policies each year upon two months notice.

❒ Furthermore, current market developments and ongoing liberalisation efforts have already had an impact on the average duration of insurance contracts, and they continue to do so.[6] For example:

- There is evidence that the Dutch insurance industry is currently moving towards shorter terms, especially in the SME segment. Today, at least according to our business experience, new contracts often provide for 1-3 year terms, as opposed to the 79 months average referred to in the Interim Report (*see* page 67-68). The move has largely been the result of recommendations by consumer and other organizations, which demonstrates that market forces do work. For LCC, annual contracts have long (since the 1990s) been standard practice in the Netherlands – just as they are in most Member States.

- Austria provides an example as to how ongoing liberalisation is beginning to bring down contract duration. As compared to other Member States, deregulation is a rather new concept for the Austrian insurance industry; first steps were introduced only in the mid 1990s. This helps to explain why longer-term contracts are (still) relatively widespread in Austria. However, with deregulation starting to have a real impact on the industry, Allianz expects Austria to move towards the European average. Similar reasons may help to explain the situation in Slovenia.

V. DISTRIBUTION OF BUSINESS INSURANCE

A number of the distribution issues addressed in the Interim Report, particularly those relating to remuneration of intermediaries, are currently the subject of controversial discussions in the industry and legislators have taken, or are taking, various approaches to deal with them. Allianz believes that, for the most part, intermediaries (particularly brokers) will be best placed to comment on these issues. Therefore, it has decided to limit its submission to the following two points.

---

6 As a side note, we would like to remind the Commission that longer-term insurance contracts may often be advantageous to the client. For example, fixing terms and conditions for a certain period of time gives the client the benefit of a longer-term cost calculation base and, more generally, a better "sense of security" – while the risks associated with future cost increases will be born by the insurance company.

In most Member States, the Insurance Mediation Directive has only been implemented recently (in some not yet at all). Therefore, the data base available to the Commission on the degree of transparency in the insurer-intermediary-client relationship reflect a merely preliminary status on the Insurance Mediation Directive's effects. More practical experience is required before considering any further measures in that area.

The interaction between the type and amount of information passed on by brokers to their clients, on the one hand, and the competitiveness of the broker markets, the business insurance industry as a whole and, ultimately, on the price for insurance coverage, on the other hand, is rather complex. Based on our experience, premium levels are much more likely to be driven by other factors such as availability and price of reinsurance capacity. Increased transparency on broker remuneration may give clients more leverage vis-à-vis their brokers but may also lead to further market concentration at the broker level and, eventually, increase rather than lower barriers to entry and market integration. In any case, there seems to be no (at least not yet) evidence clearly and unambiguously demonstrating the pro-competitive benefits of increased transparency but, in fact, even some disagreement amongst Member States as to what might be the best way forward. Therefore, Alllianz kindly recommends that the Commission take a step back and allow itself to compile a more comprehensive data base on the issue.

Directive 2002/92/EC (the "**Intermediation Directive**"), which introduced substantial disclosure obligations for intermediaries, only came into force in January 2003 and afforded Member States a two-year time-frame for transposition. At the time of the Commission's survey, the Intermediation Directive had only recently been implemented. In fact, as the Interim Report notes, implementation was still outstanding in Germany and France (page 113). As to other Member States, there seems to have been at least some need for clarification.[7] Irrespective of the Intermediation Directive's transposition into national law, the newly introduced disclosure obligations will require some time to have a real impact in the industry. As Internal Markets and Services Commissioner *McCreevy* has recently noted while discussing the status of the Intermediation Directives' implementation:

> "[T]he Commission cannot carry out an evaluation that makes real sense unless all Member States have implemented the [Intermediation Directive] and we have *allowed some time for practical experience to be acquired*."[8]

Allianz agrees. As the Interim Report notes, frequency and scope of disclosure will change once the Intermediation Directive has been fully implemented, also in daily business practice (page 113). By allowing itself more time to build a comprehensive data base on the extended disclosure obligation's effects, the Commission might also be able to draw on the experience from various Member States that have recently adopted even stricter transparency rules than those laid down in the Intermediation Directive. For example, Italy now requires intermediaries to generally disclose their commissions to clients in the motor third party liability business. Other Member States have recently adopted rules obliging intermediaries to disclose commissions upon their client's request, *e.g.* Portugal and France (which has limited the disclosure obligation to business insurance policies where annual premiums exceed 20.000 € p.a.). Also, the Nordic countries' experience with net quoting may provide helpful insights.

7 *See Charlie McCreevy*, Harmonisation and Better Regulation, speech given at the Irish Brokers Association Lunch on October 20, 2006.

8 *Ibid.* (emphasis added).

Allianz recommends that the Commission take advantage of the Member States different approaches as they may help it to get a better understanding of how competition in and through the broker channel can best be promoted – before new legislation is being proposed at the European Union level.

Exclusive agents are an important and efficient distribution channel for the insurance industry. Therefore, Allianz welcomes the Interim Report's finding that the existence of exclusive agent networks, in and of themselves, do not result in anticompetitive foreclosure. Allianz particularly welcomes the Interim Report's language confirming, once again, that there are no antitrust concerns associated with networks of exclusive agents in Germany.

As noted by the Interim Report, exclusive agents are, on average, the second most important distribution channel for business insurance products (page 90). From a business perspective, and in terms of their impact on competition, there are various benefits to distribution through exclusive agents:

As compared to direct marketing, the major advantage of exclusive agents networks is widespread local presence which allows clients to benefit from a closer (face-to-face) relationship and more personal advice. At the same time, exclusive agents are closely integrated into the insurance company's organisation and, therefore, can take advantage of that organisation's resources. For example, agents will usually benefit from training sessions, IT support and, more generally, the insurance company's know-how. Insurance companies may also provide financial assistance in setting up the agency, pay the costs of advertising and other market specific investments and bear the risks resulting from the business written by the agents. After all, this is why the underlying agreements qualify as genuine agency agreements within the meaning of the Commission's guidelines on vertical restraints and, therefore, are outside the scope of Article 81(1) EC.

According to the Interim Report, "the mere existence of a network of tied agents is not sufficient to characterise a finding of foreclosure" (page 101). Allianz agrees. In fact, in most (if not all) cases, networks of exclusive agents will actually enhance both efficiency and competition. The pro-competitive benefits of exclusive purchasing obligations are well-known and have been acknowledged by the Commission. They particularly apply in the present context. Essentially, without the agent's commitment to exclusivity, insurance companies may be more hesitant to make the investment in setting up an agency network in the first place. Insurance companies may not want to train agents, share their know-how and provide finance if competitors would get a free ride from what they had done.

In fact, Germany provides an excellent example of how exclusive agent networks do not harm or foreclose competition but can actually help to establish and to preserve a competitive insurance industry. As noted in the Interim Report, Germany's networks of exclusive agents do not raise any antitrust concerns (page 101).

VI. HORIZONTAL COOPERATION AND BLOCK EXEMPTION REGULATION

Allianz welcomes the Commission's efforts to initiate an open-minded dialogue on the extension of the Commission Regulation (EC) No. 358/2003 (the "**Block Exemption Regulation**") and to involve the industry at an early stage in the process. However, while offering a forum for discussion, the Sector Inquiry should not prejudice the outcome of that discussion even before it has begun. The Interim Report's findings raise interesting issues. However, to put them into perspective, it is important to remember that the Sector Inquiry covers merely *part* of the insurance industry (i.e. non-life business insurance), whereas the Block Exemption Regulation's scope is much broader: it applies to the *entire* insurance industry also including *e.g.* the life/health and private non-life business lines. Hence, irrespective of what the Sector Inquiry's findings prove or do not prove, they form only part of the picture. Having made this general but nonetheless important point, we now turn to some more specific comments.

Allianz strongly favours an extension of the current Block Exemption Regulation beyond March 2010. The economic benefits that the Block Exemption Regulation attributes to the categories of cooperation covered in it continue to apply.

According to the Interim Report, the different levels of cooperation amongst insurers prevailing across business lines and Member States "could raise doubts about the justification of such cooperation and about the scope of the exemption granted by the present Block Exemption Regulation" (page 144). Allianz disagrees.

The pro-competitive effects of joint calculations, tables and studies, standard policy conditions and models, co-insurance and co-reinsurance schemes and of joint technical specifications for security devices are well-known. In the past, the Commission has acknowledged these benefits on numerous occasions, most prominently in the Block Exemption Regulation's recitals themselves.

The pro-competitive effects of the various types of cooperation are largely undisputed. Today, they apply no less than they did in 2003 when the Commission adopted the current Block Exemption Regulation. Therefore, Allianz refrains from repeating those benefits. Instead, it would like to pick up, and focus on, the two following, more general, however, very important, points:

❒ Firstly, some of the pro-competitive effects associated with the forms of cooperation exempted under the Block Exemption Regulation are directly linked to the very nature of insurance business. As to co-insurance schemes, these have particularly been recognized by financial supervisory agencies, most recently by *Thomas Steffen,* Chairman of the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS) and a chief executive director of insurance supervision with the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*):

> "It may not be obvious, but the sharing of certain risks or certain functions, might be highly responsible and prudent risk-mitigation practice by insurers. Supervisors could be pleased to see it. The very nature of insurance business is that risks are pooled. This pooling may be by one insurer or by it with others. That is at the heart of a healthy

market, able to offer cover for risks which might be impossible to cover if not shared."[9]

Allianz fully agrees. However, it still tends to observe that antitrust authorities are reluctant to accept this principle. Given that the regulatory framework is of particular importance in the insurance sector, Allianz believes that the Commission should closely involve financial supervisory agencies in the consultation on the scope of the future Block Exemption Regulation.

- Secondly, the assessment of the Commission that insurance companies resort to certain forms of cooperation more often in some business lines and/or Member States than in others does not cast any doubts on the pro-competitive effects of that cooperation. There are numerous factors which determine how likely insurance companies will cooperate and what forms of cooperation they will choose.

Maybe the most important reasons relate to market maturity and concentration. In fact, there is ample data, even in the Interim Report, evidencing an inverse correlation between the level of cooperation prevailing in a given market and market concentration. Indeed, the new Member States provide good examples. According to the Interim Report, most forms of cooperation will rarely be found in the new Member States. At the same time, they show some of the highest concentration ratios in the European Union. In the past, most of these Member States' insurance industries were dominated by state-owned monopolies with no need for cooperation with anybody. Insurance associations have only recently begun to form and gather experience and data. In our opinion, the more experienced these associations get, the more likely they will be to introduce some of the forms of cooperation already prevailing elsewhere – thereby enhancing competition.

Other reasons relate to market size, culture and the degree of government intervention. For example, in Portugal standard policy conditions are being published by the government agency which also supervises the insurance industry. Government or other public and/or private institutions may also be involved in standard setting for security devices, sometimes in cooperation with the manufacturers of these devices rather than with insurance associations, *e.g.* in France and Spain.

Against the background of its particular features, the European insurance industry requires adequate legal certainty regarding the categories of cooperation that are admissible under the antitrust laws. In terms of its need for legal certainty, the insurance sector differs significantly from other industries and, therefore, should be afforded the benefits of a Block Exemption Regulation.

Under Council Regulation (EEC) No. 1534/91, the Commission's power to exempt certain forms of cooperation from Article 81(1) EC is founded in the firm understanding that "cooperation between undertakings in the insurance sector is, to a certain extent, desirable to ensure its proper functioning and may, at the same time, promote consumers' interests."[10] The Block Exemption Regulation implements the

9 *Thomas Steffen*, Insurance Supervision: interaction between regulation and competition policy, speech given during the Commission's public hearings on the Interim Report on February 9, 2007.

10 Council Regulation (EEC) No. 1534/91, recital no. 3.

Commission's mandate acknowledging two fundamental requirements of competition policy in the insurance sector, which are the "requirements of ensuring effective protection of competition and providing *adequate legal certainty* for undertakings."[11]

The non-renewal of the Block Exemption Regulation may not affect the substantive assessment of the currently block-exempted forms of cooperation. Given their significant pro-competitive benefits (explicitly acknowledged by the Commission on several occasions), they would clearly seem to qualify for an exemption under Article 81(3) EC.

However, there will no longer be that "adequate legal certainty" which the Block Exemption Regulation itself deems to be a fundamental requirement of competition policy in the insurance sector. As a result, cooperation will likely drop below the desirable level, denying benefits to consumers and even thwarting the Commission's efforts to create more integrated insurance industry throughout the European Union.

In terms of its need for legal certainty, the insurance sector differs significantly from other industries. Most of these differences deserve particular emphasis:

- Obviously, the insurance sector is unique in terms of its social functions, its size and importance for the entire economy.

- More importantly, however, insurance companies are subject to various regulatory constraints. For example, the amount of business that an insurance company may underwrite is closely related to its available solvency. Therefore, insurance companies have to develop their business in a rather conservative, risk-averse manner. A low degree of legal certainty *e.g.* on the scope of admissible risk pooling may result in undersupply of capacity in some segments because insurance companies, unlike non-regulated companies, may not be willing to take the chance that a co-insurance scheme will be challenged by the antitrust agencies. This is, of course, notwithstanding the companies' best efforts to assess the scheme's admissibility under Article 81(1) or (3) EC up front. Also, this assessment will likely cause considerably more costs than under the Block Exemption Regulation – and thus further limit the amount of the companies' resources that it can directly invest into providing insurance capacity.

- The importance of cooperation, and adequate legal certainty as to what is admissible, will likely increase under Solvency II. Under Solvency II, the insurance companies' required solvency will no longer be determined by their premium income but, *inter alia*, by complex models evaluating the risks associated with their portfolios. Current drafts require the use of risk data covering at least 10-20 years. Many insurance companies, especially potential entrants, will not have such extensive data available and, thus, will not be able to meet the solvency requirements – that is, unless they have access to joint risk data bases. In fact, national insurance associations are currently developing standard formulas that will help insurance companies – in particular smaller ones – to determine their solvency requirements under Solvency II. Lack of adequate legal certainty may hinder these efforts and, more generally, be a significant disincentive to share risk data.

  The shift from a premium-based approach to direct risk analysis under Solvency II may also be relevant for co-insurance schemes. By allowing insurance companies to share risks and diversify their portfolio, co-insurance

[11] Block Exemption Regulation, recital no. 5 (emphasis added).

schemes may have an even more direct effect on solvency requirements and, thus, insurance capacities available to consumers. Here again, withdrawing the preferential treatment to co-insurance schemes under the Block Exemption Regulation may be at odds with the objectives of Solvency II.

- According to the Interim Report, integration of the European insurance industry has not yet been fully achieved (*see* Interim Report, Chapter V.). It is well-known and has been recognised by the Commission, that the forms of cooperation currently covered by the Block Exemption Regulation lower barriers to entry. Therefore, if the lack of adequate legal certainty were to result in an inefficient, i.e. too low a degree of cooperation (as it likely will), there may even be a negative effect on the Commission's efforts to create a more integrated insurance industry throughout the European Union.

  If further integration of the insurance industry throughout the European Union is indeed one of the major objectives of both competition and internal markets policy, not renewing, or even limiting the scope of, the Block Exemption Regulation will certainly convey the wrong message – and in more ways than one. Prevailing differences between national legal frameworks are one of the obstacles to market integration. The antitrust laws are, broadly speaking, part of that framework. There, the Block Exemption Regulation currently the level playing field for insurance companies throughout the European Union, while the application of Article 81(3) EC on a case-by-case basis will necessarily create different enforcement policies in different Member States, unless and until legal issues have ultimately been resolved by the European Court of Justice.

  Therefore: Where greater regulatory harmonization is one of the major objectives of the European Union's policy, as it is in the insurance sector, harmonization that has already been achieved should not easily be dismissed.

Munich, 10 April 2007