

BUSINESS INSURANCE SECTOR INQUIRY INTERIM REPORT

RESPONSE FROM AON

1. Introduction

- 1.1 Aon welcomes the opportunity to comment on the Business Insurance Sector Inquiry Interim Report. Set out below is Aon's response to a number of questions and issues raised in the Interim Report.
- 1.2 This response focuses on those issues and questions raised in the Interim Report that are of most relevance to Aon. Accordingly, the first and largest section of this response deals with distribution issues. The second section deals with two non-distribution issues: long term agreements and horizontal co-operation.
- 1.3 Aon notes that separate questionnaires have been sent dealing with best terms and conditions clauses in co-insurance and reinsurance and commission rebates. These issues will therefore be dealt with in Aon's response to those questionnaires rather than here.

A. DISTRIBUTION ISSUES

2. Benefits of broker channel

- 2.1 Aon considers that the insurance broker channel has had a hugely pro-competitive effect on the development of the business insurance market to the benefit of customers.
- 2.2 Aon notes with agreement the points made by the Commission in this respect, i.e. that:
 - (a) The broker channel stimulates competition by allowing clients access to a wider choice of possible insurers (also facilitating market entry for foreign insurers that do not have their own or a sufficiently developed distribution network). It is Aon's experience across Member States that brokers have helped to open up the insurance market in this way. This is true both:
 - (i) specifically in terms of bringing access to foreign insurers in national markets which have traditionally relied upon large national insurers; and
 - (ii) more generally in terms of giving clients access to multiple insurers – in circumstances where those clients also have access to multiple brokers each of which can fulfil this function.
 - (b) The broker channel stimulates competition by increasing the bargaining power of clients.
 - (c) Brokers help to reduce search costs and provide a channel for information flows, thereby facilitating transactions.
 - (d) In addition Aon would add that it is, in particular, brokers' specialised, up to date knowledge of the market and experience of understanding clients' needs and advising them on the pricing and terms of risk management programmes that is so valued by clients.

2.3 The benefits outlined at paragraph 2.2 (a) to (d) above work in favour of clients in a number of ways:

- (i) By improving the pricing and contract terms packages available to clients, as well as the breadth of different offerings from the market, including offering products from insurers outside of the Member State in which the client is based.
- (ii) By improving clients' risk management programmes.
- (iii) By enabling innovative risk transfer solutions provided by a choice of insurers, including insurers outside of the Member State in which the client is based, and, where appropriate, by enabling them to decide to manage certain risks without purchasing insurers' products.

2.4 Indeed, over the years, the net result of all of these benefits is that the insurance spend of many clients is less than it would have been had a broker not been involved.

3. Disclosure of remuneration

3.1 Aon believes that in the EU, automatic disclosure is not common practice, although this varies to some extent between Member States. As far as Aon is concerned, its transparency policy (applicable across all Member States) requires it to: (1) comply with national law; (2) make automatic disclosure where required under regulatory settlements; and (3) in any case, disclose its remuneration on request of the client.

3.2 From Aon's experience, only certain clients are interested in disclosure of remuneration. These are typically large clients, and they receive disclosure on request. In addition, they often pay for services on a fee basis. The majority of commercial clients (predominantly SMEs) do not consider brokers' commission to be a separate or additional cost item. This is because the client is interested in the total cost of the insurance and part of the broker's value is to improve the overall cost of insurance. Further, price is but one of the factors which determine a client's choice. Other factors include the breadth of coverage available, the insurer's financial security, the client's claims history, etc.

3.3 That many other factors apart from price determine a client's choice is also reflected in the Insurance Mediation Directive (**IMD**), which lays down precise rules on disclosure and the advice to be given by intermediaries. These rules enable clients to make informed decisions.

4. Contingent Commissions

4.1 Contingent commissions are still common in the insurance broking industry. Aon however, as from 22 October 2004, has stopped accepting contingent commissions on any new policy placed, renewed, consulted or serviced after that date. The fact that many brokers continue to operate contingent commissions places those, such as Aon, who have abandoned them, at a competitive disadvantage in the market.

5. Conflicts of interest

5.1 Aon considers that to the extent potential conflicts of interest arise, they can be managed. Aon has robust systems and policies in place to identify and deal with potential conflicts of interest and also to ensure that its clients are provided with sufficient information to make informed decisions about the purchase of insurance products. Further, conflicts of interest are avoided as a result of the highly competitive

environment in which Aon operates. If Aon does not act in the best interests of its clients, this could result in reputational damage and loss of business. Finally, potential conflicts of interest are also managed through the IMD. Under the IMD, insurance intermediaries must disclose, inter alia, whether they have a relationship with particular insurance companies, whether they are giving advice based on a fair analysis and the reasons for advice given on a particular insurance product. Such information must be provided on a contract by contract basis and must be consistent with the complexity of the insurance contract being proposed. Aon considers that the combination of these factors results in a strong alignment of the interests of the intermediary with the best interests of the client, thereby avoiding conflicts of interest.

6. Country specific issues

(i) Scandinavia – Net quoting

6.1 In Sweden, Finland, Norway and Denmark, insurers have stopped paying commissions to brokers and statutory prohibitions on the payment of commission are being introduced or considered. The prohibitions do not apply to all intermediaries: agents and multiple agents are permitted to accept all kinds of commission, including contingent commissions. Aon believes this has an adverse effect on the broker distribution channel and acts as a barrier to entry for foreign insurance companies wishing to enter the Scandinavian markets via brokers. In addition, Aon observes that net pricing has not benefited clients: insurers have not reduced prices proportionately in the broker channel, so that brokers' fees to clients are an additional client cost. Further, net pricing is leading to a concentration in the brokers' market (as smaller brokers whose income is largely dependent on commission are being forced out). Accordingly, Aon's view is that neither net quoting nor any legislation designed to achieve this practice is in the interests of clients.

6.2 In relation to Finland, Aon would like to comment on some of the statements made in the interim report. The prohibition on payment of commissions by insurers to brokers, introduced by the new Insurance Mediation Act (which entered into force on 1 September 2005) does not come into effect until 1 September 2008. However, insurers have currently already collectively decided to stop paying commissions to brokers. This would also suggest that data shown in Figure IX.29 (p. 121 of the Interim Report) and in Figure IX.32 (p. 120 of the Interim Report) does not reflect the true position in Finland following the imposition of the Insurance Mediation Act: the report indicates that over 30 per cent of brokers operate on contingent commissions whereas to the best of Aon's knowledge no brokers operate on this basis in Finland.

(ii) Germany

6.3 Regarding Germany, two points were highlighted in Aon's response to the sector inquiry questionnaire:

- (a) The lack of sufficient application of the public procurement services directive in the insurance sector (which has been raised repeatedly in Germany and with the European Commission); and
- (b) The bar on brokers providing legal consulting/advisory services which are not targeted at an insurance contract for which they act as an intermediary. With the implementation of the IMD in Germany, insurance intermediaries will be allowed to give legal advice to business clients independently of any broking activity. However, in the public sector, court decisions which prohibit broker involvement will continue to hinder brokers' activities.

B. NON-DISTRIBUTION ISSUES

7. Long-term agreements and risks of foreclosure

7.1 Aon believes that the key issue is client choice, and that long term agreements should remain available to clients where this is the client's preference. Indeed long term agreements might for some clients in some circumstances be a desirable option.

8. Horizontal cooperation

8.1 The inquiry's data concerning the various forms of cooperation among insurers shows substantial differences among Member States. Aon considers that these differences can be explained by (i) market practice over time and (ii) changes brought about by legislation. Market practice has led to specific customs and relationships within markets. Where governments have intervened to introduce legislation (such as the legislation bringing about the GAREAT pool for Terrorism in France and Pool Re in the UK) it has resulted in country specific statutory frameworks.

8.2 Aon considers that horizontal cooperation among insurers can give rise to both benefits and competition concerns. Benefits from cooperation among insurers observed by Aon include the following:

- (a) In the UK: anti-fraud measures, the fire brigade levy, the Policy Holders Protection Act, acting together to lobby government, obtaining cooperation with government (e.g. MIB), and electronic trading (e.g. ABC, ECF and market platforms).
- (b) In Italy, environmental pollution insurance via the Italian Pool.
- (c) In Belgium, co-insurance pools and claims settlement agreements.
- (d) In the Netherlands, co-insurance pools (e.g. the Milieupool, Atoompool, BAVAM-pool and Nederlandse Herverzekeringsmaatschappij voor Terrorisemeschaden N.V. (NHT)).

8.3 One instance where Aon believes cooperation among insurers may hinder competition is the Finnish insurers' influence on the introduction of net pricing legislation in Finland that has prevented brokers from accepting commissions. Brokers initiated a complaint against domestic insurers on this issue which has been before the Finnish Competition Authority and Market Court and is now pending before the Supreme Administrative Court.

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