



European Commission
Competition GD
Directorate D
Unit D 1 Financial services

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COMMISSION INTERIM REPORT ON BUSINESS INSURANCE MARKET

The Federation of Finnish Financial Services (the Federation) is a newly formed organisation that represents insurers and financial institutions operating in Finland. The body was formed by combining the operations of the Federation of Finnish Insurance Companies, the Finnish Bankers' Association, the Employers' Association of Finnish Financial Institutions and the Finnish Finance Houses Association under one roof starting from on 1 January 2007.

Like the relevant trade bodies in the other EU countries, the Federation of Finnish Insurance Companies was involved in the Commission inquiry into the business insurance sector by answering to the Commission questionnaires. Therefore the Federation, which continues the operations of the Federation of Finnish Insurance Companies, would like to make the following statement on the interim report.

I DISTRIBUTION CHANNELS

The Commission interim report on distribution channels refers in section 1.1.2 to Finnish, Danish and Swedish legislation on insurance intermediaries and reports on some insurance brokers' critical views of the net quoting system adopted in the Nordic countries. As this section of the report contains both a number of mistakes and biased claims, we would like to bring the following to the Commission's attention.

Net quoting in non-life insurance

It is true the Finnish Insurance Mediation Act (570/2005) prohibits payment of commissions by insurers to brokers. This prohibition on broker commission will not, however, take effect until 1 September 2008 at the



expiry of a three-year transition period from the effective date of the law. Until then, Finnish insurers may continue to pay commissions to brokers.

Despite the transition period, a significant number of non-life insurers operating in the Finnish market changed over to net quoting in 2003-2005. This changeover resulted from the Federation of Finnish Insurance Companies recommendation in late 2002 to the effect that broker commission not be charged to customers as part of the insurance premium but that non-life insurers change over to quoting net premiums.¹ The reason why the recommendation was issued was a decision made by the Helsinki administrative court on insurance premium tax, according to which customers would have had to pay insurance premium tax at 22% on not only the insurance premium but also on broker's commission in cases where the insurer collects the broker remuneration as part of the insurance premium. But if the broker charges its fee direct to the customer, no insurance premium tax need be paid on the fee, because insurance premium tax is not imposed on broker fee.

In practice, the proportion of work put in by the broker for the benefit of the insurer was taken into account in the changeover to the net quoting system in such a manner that the insurer lowered the premium charged to policyholders using brokers by an amount that equalled the amount of the commission paid earlier to the broker.

Legislation draws a line between agents' and brokers' roles in the market

According to Finnish legislation, insurance intermediaries have been divided into two groups, agents and brokers, since 1994. The key difference between the two is that an agent is a representative of the insurer working for the account of the insurer at the insurer's risk. An insurance broker, instead, is a representative of the customer, or the policyholder, whose role is to compare and analyse insurance products available in the market, shop around for insurance cover that best meets the customer's needs and serve the customer also otherwise in insurance-related matters. Some of the core characteristics of a broker is impartiality and independence from insurers. A broker may not be financially dependent on the insurer either as an employee, agent or in any other capacity.

One of the reasons behind Finland's new legislation on insurance mediation, effective since 1 September 2005, was that practices in the insurance market had gradually changed in a direction that was not only contrary to the purpose of the existing law, enacted in 1994, but also partly

¹ BIPAR, the International Federation of Insurance Intermediaries, complained about the recommendation of the Federation of Finnish Insurance Companies to the Commission, which informed the Federation in September 2005 (CASE COMP/01/38.748), however, that the case would be closed because BIPAR had withdrawn its complaint.



misleading to customers. Supervision of the independence and impartiality of insurance brokers failed to work in the desired manner in a setting where some brokers were in effect working as agents to a number of insurers, although the brokers were marketing their services as independent and impartial players. The problem thus was that the roles of agents and brokers blended, brokers' impartiality was jeopardised and the pricing of broker services became non-transparent. A case in point is a survey made in 2003 in Finland which disclosed that 69% of the small and medium-sized businesses that used insurance brokers did not know how much of the premiums paid by them went to the broker in compensation for the service provided.

As a result, the most vital objective of the new insurance mediation law was to clarify the roles of insurance brokers and agents. To improve customer protection and prevent conflicts of interest, the law was written to include a provision to the effect that a broker may accept remuneration from the customer only, ie the party whom the broker represents and in whose interest the broker is obliged to work.

Net quoting system improves both transparency and competition

According to what has been told in both Finland and the Commission interim report on the inquiry, some brokers have voiced views that the net quoting system has adverse effects on brokers' operations and puts brokers in a less favourable competitive position than insurers' agents. This has been claimed to lead in the long run to brokers' departure from the market, which in turn would reduce customers' chances of getting impartial and independent advice and specialist service.

These are incorrect claims. What the net quoting system means is only and exclusively that broker compensation is no longer added as a non-transparent part to insurance premium; it does not mean anything like imposing adverse effects on the broker distribution channel. In the net quoting system, a broker negotiates and agrees with its customer, ie the policyholder, about the price of the broker service. This is a normal practice and business convention in any industry: the purchaser of the service pays for the service purchased. The insurer on its part sets its net insurance premiums by taking account of the fact that part of the work done by the broker reduces the amount of work needed on the part of the insurer.

Insurers operate in the insurance services market, providing various insurance products to policyholders. Insurance brokers, instead, operate in the intermediary services market, providing advisory and intermediary services to policyholders, independently from insurers. These are two separate markets and two separate services. Sound and effective competition requires that advisory services marketed as independent and impartial services really are independent and impartial also in practice and that both insurance premiums and broker fees are transparent. This is



possible only through a clear division between the prices of services traded in two separate markets. Impartiality and transparency can be ensured best by having the customer negotiate the price of the broker service and pay the fee agreed.

Brokers' views of how the net quoting system puts brokers in a less favourable competitive situation than agents are not correct either. The net quoting system does not mean that broker remuneration and thus brokers' chances of carrying on the business would be abolished; instead, it means that broker remuneration is to be negotiated between the proper parties concerned, the parties to the transaction, ie the customer and the customer's broker, and not between the broker and the insurer competing for the deal.

Second, it is worth pointing out that agents and brokers are not competitors, because they do not provide the same services and they play different roles in the market: an agent is a representative of the provider of insurance, ie the insurer, whereas an insurance broker is a representative of the buyer, the policyholder.

In our view the transition to the net quoting system has not removed the need for independent and impartial advisory services in the insurance market. On the contrary, the need for such service is likely to increase in the future, notably in the present setting where insurance products are increasingly sophisticated, policies are more and more difficult to compare and the internal market is developing and becoming increasingly international. This, however, is the case only if the specialist and advisory services which are marketed as impartial and independent services really are what the words imply and add value to the customer.

The changeover to a net quoting system has increased competition in the Finnish insurance brokerage market too. It has proved to be in the interest of the customer to gain control of not only insurers but also insurance brokers choosing insurance coverage on behalf of the customer.

The experience gained from the Finnish insurance market may lead to a situation where a small number of insurance brokers convert their brokerage business into an agent's business. This is not a bad alternative in circumstances where operations are in effect merely reshaped to fit the true character of the business. Even so, most insurance brokers operating in Finland have continued to work as brokers in spite of the adoption of the net quoting system and thus proved to add value to their customers in the market for independent and impartial intermediary services.

On the basis of the above the Federation considers that, in order to avoid the conflicts of interest described in the Commission interim report, it is important to clarify the role of insurance brokers and to improve the transparency of insurance broker's compensation.



II HORIZONTAL COOPERATION AND BLOCK EXEMPTION REGULATION APPLIED TO INSURANCE INDUSTRY

The Federation agrees with the CEA statement on the necessity of the block exemption regulation and considers that although different member states have made use of the regulation in different ways the situation can hardly lead to the conclusion that the regulation is needless. How individual states cooperate under the block exemption depends on the market structure, legislation and authorities' responsibilities, which all differ from state to state.

Standard policy conditions

The Federation considers that cooperation in the preparation of standard policy conditions should be allowed in the present scope also in the future. The benefits of this cooperation are discussed widely in a statement issued by the former Federation of Finnish Insurance Companies, the Finnish Consumer Ombudsman, the Finnish Insurance Ombudsman and Kuluttajat ry (The Consumers) on 24 September 2002 (Enclosure 1). It appears from the statement that both the insurance industry and insurance consumer organisations unanimously agree that cooperation in the preparation of policy conditions is necessary and useful from the perspective of insurers, insurance consumers and supervisory authorities.

Approval procedures for safety equipment

The Federation considers that the approval scheme for safety devices now allowed under the block exemption regulation should be allowed also in the future. Insurers' standards, guidelines and assessment criteria possess many benefits compared to the procedures of European standardisation organisations.

Broadly speaking, the insurance industry rests on the European standards, if they exist. Gaining market access through the European standards scheme has, however, proved to be a very slow process for new technology products, owing to commercial interests. The insurance industry, being a neutral player on the scene, is far more flexible and quicker to create fair safety requirements for the safety equipment market. In this setting, the approval system operated by the insurance industry advances the entry to the market of new safety devices and increases competition in the safety equipment market, because it is an effective and quick way financially independent from safety equipment suppliers.

The approval system applied in the insurance industry has a wider coverage than the European approval system. The standards, guidelines and



assessment criteria applied in the insurance industry often relate to entire systems such as extinguishing systems, access control systems and intruder alarm systems, whereas the European standards are generally equipment standards. It may be worth pointing out here that the European equipment standards are often based on the assessment criteria crafted by the insurance industry.

The requirement on safety equipment imposed by the insurance industry also improves the position of consumers. The approval system helps insurance consumers and small businesses to select safety equipment and safety systems that meet the requirements imposed by insurers and which provide the best protection to property. If the present system were not allowed, it would be far more difficult for insurance consumers to compare products and make the right choices when shopping for safety equipment. Moreover, it is easier for consumers to switch to another insurer when the safety equipment and safety systems are covered by the same approval system. In this respect, the approval system also serves to improve the efficiency of the insurance market.

Looking from a wider perspective, it is useful to have the approval process operated in the insurance industry because then all information on loss prevention, risk reduction and consumer education is stored under one roof. This improves collection of reliable data, which in turn is used for drafting legislation and guidance to consumers and households on questions relating to protection of property and overall security. The data accumulated in the industry also reveals the latest phenomena on the loss front. Then the problems can be tackled without delay by issuing safety guidelines and criteria made available to everybody.

In view of the above, the Federation is of the opinion that the validity of the block exemption regulation should be extended beyond 31 March 2010.

Yours sincerely,

Federation of Finnish Financial Services
Lea Mäntyniemi

Helsinki 24 September 2002

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Directorate-General for Competition
Unit D1, Office J 70 2/56
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REVISION OF GROUP EXEMPTION REGULATION APPLICABLE TO INSURANCE COMPANIES

Dear Sirs,

As part of its work done to revise the group exemption regulation in respect of insurance companies, the Commission has asked a number of interested parties to express their views on its proposal for a new regulation. In Finland, the Commission proposal has given rise to comments on the proposed standard policy conditions from not only authorities and insurance companies but also consumers' representatives. Given that the views of many of the parties are uniform as regards standard policy conditions, the Finnish Consumer Ombudsman, the Finnish Insurance Ombudsman Bureau, the Finnish Consumers' Association and the Federation of Finnish Insurance Companies (below referred to as the opinion givers) have decided to give this joint opinion to the Commission.

The opinion givers consider that cooperation aimed at drafting standard policy conditions should also in the future be allowed in the scope provided in the current group exemption regulation. This cooperation should not be tied to cooperation in the establishment of risk premiums and pure premiums. The opinion givers support their joint view with the following arguments.

Non-binding standard policy conditions facilitate comparison of policies

It is important for healthy competition that consumers can compare the various products available in the market. As insurance products are more difficult to compare than others, there is the danger that products are not compared at all or that the only criterion used for the comparison is price, although the content of the product, ie policy conditions, would be equally vital.

But comparison can be made easier. One way to make comparison easier is to draft specimen policy wordings which help consumers compare the cover provided by different insurers. Non-binding standard policy conditions would thus serve as a kind of benchmark and help customers not only compare the different products but also shop around.

Besides helping comparison by consumers, non-binding standard policy conditions would also help many other parties who compare or otherwise deal with insurance in their work, such as authorities, insurance intermediaries, news reporters, consumer advisory services and out-of-court settlement bodies. All this would serve to improve transparency and enhance competition.

Seen from the consumer perspective, standard policy conditions would bring another benefit, viz improved legal security, because jointly drafted policy conditions are usually crafted in cooperation with specialists from several insurance companies, which ensures that the conditions comply with the law and established jurisprudence.

In their present form, jointly drafted standard policy conditions have not led to standardisation of insurance products in Finland. Instead, joint conditions have improved comparability of the products and thereby enhanced genuine competition. Against this background, it does not seem justified to impose restrictions any stricter than the present on this cooperation.

Market entry made easier for newcomers

A single insurance market has not made the progress hoped for. Cross-border supply of insurance products has so far been insignificant. One major reason for the scant supply is that the member states have not harmonised their insurance contract laws. As a result, insurance companies cannot offer the same product across the European Economic Area; they have to tailor the products to meet the requirements of national legislation. This is often costly and laborious and sometimes results in unsuccessful launches. There are even cases where a new product launched in the market is governed by conditions which are contrary to the law.

Non-binding standard policy conditions lower the threshold for entry to the market, because they make it easier for newcomers to adjust their policy conditions to conform to local legislation. The entrant may use the standard policy conditions to ensure that the contract terms are in accordance with the legislation, jurisprudence and authority views of the member state concerned. Another aspect worth noting is that standard conditions make it easier for authorities supervising insurance companies to verify the legality of the terms and conditions applied by individual insurers.

Stakeholder views taken into account

Non-binding standard policy conditions are usually drafted in organisations representing the insurance industry. In Finland, this work is done at the Federation of Finnish Insurance Companies in situations where either insurance companies or their products attract the attention of stakeholders who may have wishes or criticism about the issue at hand. Stakeholders in this context mean, for example, authorities or bodies representing policyholders. Such stakeholders approach the insurance organisation presenting wishes about how policy conditions should be altered or improved or what new risks should be insured. The issue at hand may concern cover against new risks, revision of policy conditions or rewording of existing clauses to better meet the requirements of the stakeholders concerned. In such situations, it is the most appropriate solution for all parties that the issue or problem is discussed together and that the outcome of the negotiations is a joint view of the stakeholders and insurance companies which can be recorded, where desired, in the form of a non-binding standard condition.

Yet another point that deserves a mention is that while neither authorities nor bodies representing policyholders consider themselves able to take part in or give advice for the benefit of individual insurers' product development work, they may well be available for cooperation aimed at creating non-binding policy conditions within an insurance organisation representing the whole industry.

The Finnish experience is that non-binding standard policy conditions do not usually lead to any major imbalance between the rights and obligations arising from insurance contracts. Cooperation between authorities and insurers' joint body on this front is a well functioning way to distribute fair non-binding specimen conditions across the industry. This working pattern serves to improve distribution of information about the content of what are seen as fair policy conditions and to prevent the need to have disputes settled in court.

Attention should also be paid to what is provided in Article 7 of the Council Directive 93/13/EEC on unfair terms in consumer contracts, viz that the member states are required to ensure that in the interest of consumers and competing businesses there are sufficient and effective remedies available to stop the use of unfair terms in contracts concluded between businesses and consumers.

The remedies referred to above include provisions under which persons and organisations who under national legislation have a legal interest in protecting consumers are entitled under national legislation to refer a case to be solved by court or by competent authorities who may decide whether any contract terms intended for general use are unfair by nature and to use sufficient and effective remedies to stop the use of such terms. In compliance with national legislation, the abovementioned legal

remedies may be directed singly or jointly to several businesses engaging in the same industry or to organisations of such businesses which use the same or similar general contract terms or recommend use thereof.

Standard conditions facilitate insurance of new risks

According to the Commission proposal for a regulation, a pool arrangement set up to cover new risks could be allowed for a period of three years. Against this background, we feel that non-binding standard policy conditions, which restrict competition even less than a pool arrangement, should be allowed. This is because not all new risks need pool arrangements to be covered, whereas industry-wide cooperation for the benefit of joint policy conditions may be a precondition for the introduction of new products launched to cover new risks. When new risks are insured, it is often necessary to join the expertise of several insurers, perhaps even stakeholders, to draft the wording of policy conditions. Once non-binding standard policy conditions have been agreed for new risks, even small insurers can include the new product in their product range from the very start and start competing over it in the market.

Finnish examples of industry-wide cooperation efforts launched to establish non-binding standard policy conditions for new risks include environmental insurance and animal disease insurance. The latest case in point is recycling insurance, which is being explored as a way to meet the requirements imposed on car importers by the EU directive on end-of-life vehicles.

Standard policy terms facilitate authorities' work

The legislation of both the member states and the EU impose an obligation on some businesses to take out compulsory insurance. A case in point is the directive on insurance intermediaries, which provides that business can only be started if covered by an in-force liability insurance. The directive – like national legislation in similar situations very often – only defines the minimum sum insured without setting any other requirements for the insurance that is a condition for the business.

However, the main content of the insurance is made up of not only the sum insured but also the applicable policy conditions. Therefore it would be expedient for the supervisory authority, the businesses liable to take out insurance and insurance companies to have non-binding standard policy conditions, drafted in cooperation between insurance companies, various stakeholder groups and possibly also supervisory authorities to meet the authority's requirements, as such standard conditions would ensure legal security, avoid expenses and reduce unnecessary work.

Further information is available from any of the following:

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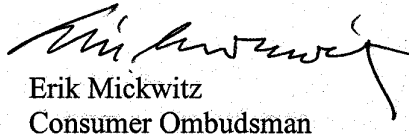
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Yours faithfully,

THE FINNISH CONSUMER OMBUDSMAN



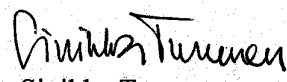
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THE FINNISH INSURANCE OMBUDSMAN BUREAU

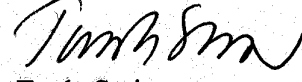


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