Competition Issues in the Non-Life Insurance Market

Final Report and Recommendations Volume I

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Executive Summary

EXECUTIVE SUMMARY - INSURANCE STUDY

Introduction

This Study presents the Competition Authority's analysis of competition in the non-life insurance sector in Ireland. It focuses on motor insurance, employer's liability insurance and public liability insurance and provides the Authority's conclusions and recommendations. These conclusions and recommendations are based on an extensive review of the existing literature, four research papers especially commissioned by the Competition Authority, which are reproduced in Volume II of this Study, 16 submissions in response to the Authority's *Preliminary Report and Consultation Document*, which was released in February 2004 and a substantial number of hearings and meetings with relevant parties. The Appendix lists all those groups that made submissions as well as those groups and individuals that attended informal Authority hearings.

The Competition Authority makes 47 recommendations to industry participants, regulators and the Government. These recommendations are designed to increase the level of competition in the non-life insurance sector so that markets work well for consumers. In several cases these build on and strengthen recommendations made by other bodies such as the Joint Oireachtas Committee on Enterprise and Small Business.

What is Insurance?

Purchasers of an insurance policy pay a premium in return for which, in defined circumstances they receive compensation to meet claims. Cover is likely to include third party indemnity, i.e., liability to a third party for negligently caused injury or property damage. By purchasing insurance, risk is shifted from individuals and businesses to firms that specialise in absorbing risk. By aggregating risks from a large number of customers, insurance firms can diversify many idiosyncratic risks, leading to much less risky stream of losses. As a result, the transfer of risk from consumers and businesses to insurers moves risk to a party better able to manage and absorb it, providing substantial benefits to these consumers and businesses.

Three Types of Insurance

The Authority examines competition in three types of non-life insurance:

- Motor insurance covers the liability an individual might face for injury, damage or other harm caused to a third party. Such third party motor insurance is compulsory in all European Union countries including Ireland. Other forms of motor cover such as insurance against the risk of fire and theft are not compulsory.
- Employer's liability insurance covers the liability an employer might face if an employee is negligently injured in the course of employment. While employer's liability is not compulsory in Ireland it is the norm.
- Public liability insurance covers liability from persons, other than employees, who suffer personal injury or damage to themselves or their property through negligence by the buyer. While public liability is not compulsory in Ireland, it is a practical necessity for many business and other organisations.

Liability refers to employer's liability and public liability together.

These types of insurance may be purchased directly from the insurer, as frequently occurs for motor insurance, or through intermediaries. The intermediary channel is especially important for employer's liability and public liability where the buyer's requirements are often specific to a particular employer or organisation that requires assistance to prepare a risk profile for presentation to the insurer. Intermediaries provide independent assistance and/or advice to buyers in the placement or taking up of motor, employer's liability and public liability insurance in the State.

Size, Premiums and Profits

Motor, employer's liability and public liability each form an important part of the Irish economy. In 2003, for example, gross premium income from motor and liability was equivalent to 1.70% (or €1.90bn) and 0.87% (or €0.97bn) of Gross National Product, respectively.

Insurance premiums increased dramatically between 2000 and 2002. However, over the longer period 1998 to 2004 the rise is much less marked, with considerable variation in motor, employer's liability and public liability. For example, while motor insurance premiums increased no more that the rate of inflation between 1998 and 2004, motorcycle insurance premiums increased by 100% even after taking into account inflation.

The net operating profit of motor insurance has increased dramatically since 2000. Liability insurers in Ireland have begun to break even since 2003. Insurers typically report an underwriting loss but break even or become profitable due

to returns made on invested reserves. These patterns reflect in part the increase in premiums and in part the programme of government reform designed to lower insurance costs.

The total commission paid to intermediaries for motor and liability was €164 million in 2003. Over the period 2001 to 2003 intermediary commissions increased as a percentage of total gross written premium for motor from 3.6% to 4.3%, and for liability from 8.0% to 8.4%.

Regulation of Insurance

Regulation is ubiquitous in insurance. A large part of the regulation is pursuant to European Union Directives designed to create a single European market for non-life insurance. The Directives relate to:

- Improved ability of insurers to sell across Member State boundaries;
- Solvency levels;
- Uninsured motorist fund; and,
- Minimum levels of coverage.

These regulations are particularly important for a small Member State such as Ireland since they increase access by foreign-based insurers which is likely to increase competition and thus provide buyers with better prices and more choice.

Member States retain considerable discretion in the way in which they implement the Directives and often impose additional domestic regulatory requirements on the insurance sector. The manner in which domestic regulatory requirements are implemented has the potential to impact on competition in the insurance sector. While recommendations made in this Study are directed at such implementation, they are also directed at the wider legal and institutional infrastructure within which insurers set premiums.

In addition to domestic regulatory requirements imposed on insurance companies, there is significant regulatory involvement in the insurance intermediary sector. Effective competition among insurance intermediaries is vital to the proper functioning of insurance markets. Recommendations are made in this Study that relate to competition in, and the regulation of, the insurance intermediary sector.

Defining Relevant Markets

The basic building block in conducting a competition analysis is defining the relevant market, both in product and geographic terms. It is the market in which rivalry, new entry and competition takes place. The vigour and efficacy of market processes determine how well markets work for consumers. In motor insurance narrow markets are defined by age, gender and to a lesser extent vehicle use (e.g., taxi). Demand for motor insurance is specific to the risks being insured (e.g., a 25 year old male). As a result customers cannot switch from one type of insurance (e.g., a 25 year old male risk profile) to another type (e.g., a 50 year old male risk profile). This leads to a narrow market definition. Motor insurers may not be able to switch easily between markets because they do not have sufficient risk-related data to determine premia. The Study's recommendations for greater disclosure of risk-related data would make it easier for insurers to quote for customers in these narrow motor insurance markets.

Similarly, employer's and liability insurance relevant product markets are specific to buyer characteristics. Relevant employer's liability and public liability product markets are narrower than all employer's liability insurance and all public liability insurance. Due to a lack of disaggregated data, this Study focuses on overall markets for employer's liability insurance and public liability insurance. The focus on these overall employer's liability insurance and public liability insurance, as opposed to narrower relevant markets, does not impact the competitive analysis or the recommendations made in this Study. At times this Study refers to the overall liability insurance market. This is meant to jointly refer to the overall employer's liability and public liability insurance markets.

Market Concentration

Market concentration is high in some motor insurance markets and overall is moderately concentrated. In 2003, the leading four motor insurers accounted for 70% of all premiums. However, for female driver aged 17 to 20 years on a full license the leading four firms accounted for at least 90% of premiums; for the corresponding market for male drivers the leading four firms accounted for a similar percentage of premiums. This example indicates how concentration in relevant markets may be high, but much lower in overall markets.

As with motor, market concentration in liability markets is moderate overall – the leading four firms accounting for close to 60% of premiums – but in some more narrowly defined liability markets there is a limited number of suppliers.

In contrast, the evidence suggests that market concentration for intermediaries is sufficiently low to be considered unconcentrated, with the four leading intermediaries accounting for less than 15% of all gross premiums written by intermediaries.

Market Power: Rivalry and Entry

The economic analysis of competition is based on the concept of market power. Market power is the ability to maintain prices above competitive levels for significant periods of time.

Market power is usually associated with high barriers to entry. Entry refers to the ability of new suppliers to sell in the market. Equally important is the ability of existing suppliers to expand. Rivalry refers to competition between existing or incumbent suppliers. This maybe limited either because incumbents agree implicitly or explicitly not to compete vigorously with each other and/or because buyers face high costs in switching between one firm and other. Rivalry in price is common, but suppliers may also compete in quality, variety, innovation and other variables.

Market power also tends to be associated with low levels of rivalry. There is little or no evidence of price co-ordination in either motor or liability insurance markets in Ireland. This is not surprising: the characteristics of the insurance markets ensure that price collusion is unlikely. Equally, there is no evidence of price co-ordination in the intermediaries market, a conclusion not altogether surprising given its low level of concentration.

There is evidence that rivalry is not vigorous in motor, employer's liability, public liability insurance or intermediary markets. This evidence centres on what appears to be high profits in the case of motor, employer's liability and public liability combined with slow rates of entry and low levels of cost reduction. For intermediaries it centres on commissions that have increased even faster than premiums.

In a competitive market entry and rivalry should reduce profits to normal levels and curb the increase in commissions. After careful consideration the Authority takes the view that a number of policy changes are necessary to increase competition in the motor, employer's liability, and public liability insurance and intermediary markets. These are divided into several groupings:

- Reduced switching costs for non-life insurance markets;
- Lowering entry barriers for non-life insurance markets;
- Reducing legal barriers to entry for non-life insurance markets; and,
- Reducing switching costs for buyers in the intermediary market.

In each case the recommendation is stated in italics, together with a very brief explanation.

Recommendations to Facilitate Buyers Switching between Motor, Employer's Liability, and Public Liability Insurers so as to Secure a Better Price, Product and/or Service.

Switching costs are real or perceived costs that are incurred when a buyer changes insurer, but are not incurred by remaining with the current insurer. Switching costs can inhibit rivalry and new entry by making it more difficult for buyer to take their business to different insurers. The greater are switching costs the less likely switching will occur and prices will as a result be higher.

The Authority considers that a number of changes concerning the way that the non-life insurance sector functions can reduce switching cost, with no offsetting losses. These changes will make it easier for buyers to search the market, i.e., to shop around, and hence encourage competition amongst insurers.

- **Should policyholders be provided with their claims history?** *IFRSA should modify its code of conduct for insurers to require that: (i) renewal notices include a certified history of claims for the buyer; and, (ii) they provide a certified claims history to any buyer upon request.* In order for an insurer to quote a premium for a consumer the insurer needs to examine the customer's claim history so as to properly evaluate the risk. The "no claims" certificate issued for motor policyholder is an example of a claims history, albeit limited in scope.
- **Should motor insurance quotations provide greater price transparency?** *IFSRA should modify its code of conduct to require insurers to provide initial quotations and renewal notices that break down premiums so as to show the premium charged for different services, such as liability, fire and theft, and comprehensive cover. Discounts (e.g., accident free discounts) and risk class descriptions (e.g., male driver aged 26-30) should be detailed as well.* This recommendation is to facilitate informed decision making and shopping around for alternative buyers.
- **Can I self-insure for motor risks?** *The Department of Transport should establish guidelines, procedures, and reporting requirements that would permit eligible firms to self-insure motor risks.* An alternative in many markets if the buyer does not like the price and quality offered on the market is to self provide the service, provided of course that it is done within the proper regulatory framework
- **Should liability policyholders be given enough time to switch insurers?** *IFSRA should modify its code of conduct for insurers to require that renewal*

notices for liability insurance be sent by insurers so as to reach buyers at least eight weeks prior to the expiration of the existing policy. Such provisions already exist to facilitate shopping around when a motor insurance policy falls due; this extends that provision to liability insurance.

- **Should the IFRSA cost surveys of motor insurance be extended to liability insurance?** *IFSRA should publish cost surveys on liability insurance. These cost surveys should cover both employer's liability and public liability insurance for representative buyers, such as small business from several different industries. These cost surveys should be updated at least annually.* Finding out the cost of insurance can be an expensive and time-consuming exercise. Thus providing such information in a readily accessible, albeit aggregate form should assist buyers in evaluating insurance quotations. This recommendation extends a service already provided by IFRSA for motor to liability insurance.

These recommendations are designed to provide the buyer of insurance in motor, employer's liability and public liability with their risk information/claims history in sufficient time ahead of renewal so that they are in a better position to search efficiently and cheaply. For those buyers that use intermediaries a corresponding set of recommendations are made below.

Recommendations Designed to Increase Competition by Reducing Barriers to Entry to Motor, Employer's Liability and Public Liability Insurance Markets by New Entrants.

Entry or the threat of entry to a market can constrain price rises and induce existing suppliers to behave more competitively. A successful entrant has a positive effect in terms of choice and value for buyers because otherwise buyers would not be able to switch from existing suppliers.

In a number of important instances the Authority is of the view that policy changes by Government can reduce barriers to entry with consequent improvement in consumer welfare. In some cases the changes may also stimulate rivalry between existing insurers in a market. The first two sets of recommendations apply to motor, employer's liability and public liability, while the remainder refer only to motor.

- **Are "high" solvency levels justified for motor and liability insurance?** *To the extent that new entrants are required to meet standards in excess of those for existing suppliers, the IFSRA guidelines should justify these increased standards.* Lack of knowledge of the solvency standards and levels for entrants as well as the higher level for such insurers are likely to deter entry.

- **Should there be compulsory information sharing?** *IFRSA should (i) complete the establishment and on-going implementation of its programme to centralise the gathering and publishing of statistics on motor insurance premium and claims costs by driver profile; and (ii) should establish a system for the on-going collection and publication of data on mass risk employer's liability and public liability policies.* The more information that an insurer has about claims in the market, the more precisely it can calculate its costs and hence more keenly it can price. Furthermore the lack of such information should remove this reported hindrance to new insurers entering the Irish market.

- **Should the Policyholder Protection Fund cover all motor policyholders?** *IFRSA should modify the coverage of the Insurance Compensation Fund so that it covers all Irish mass risk insurance policyholders, independent of the home state for any insurer, so long as the home state has solvency requirements above some minimum standards.* Irish policyholders may be reluctant to switch to an insurer based in another Member State, since if that insurer becomes insolvent they may receive no protection. The recommendation is designed to remove that concern and thus encourage insurers in other Member States to enter the Irish market.

- **How should insurers fund Motor Insurance Bureau of Ireland ("MIBI") costs associated with claims for uninsured drivers?** *MIBI should collect levies to cover the expected costs to manage and settle uninsured claims resulting from accidents in a given year as a per-policy or per-vehicle fee assessed at the time policies are sold to customers in that year.* At the present time when an insurer enters the Irish motor insurance market it must contribute to MIBI costs for the previous year based on their market share in current year. (In other words, a new entrant pays nothing in its year of entry). Thus the new insurer takes on responsibility for all unsettled MIBI claims. Given the uncertainly surrounding the expected cost and its magnitude – about 5% of the average motor policy premium – this discourages entry. The recommendation removes that disincentive.

- **What measures should be introduced to reduce the uncertainty associated with compulsory provision of insurance for high-risk drivers under the Declined Cases Agreement ("DCA")?** *The Department of Transport and the Declined Cases Committee should (i) publish a statement detailing the criteria used in applying the public interest test as*

to when motor insurance may be denied to high risk drivers; and (ii) publish detailed annual statistics on the cases handled under the DCA. Under the DCA insurers are required to provide insurance to drivers if they have approached at least three insurers and have been unsuccessful in obtaining cover. In general the first insurer approached will be required to provide insurance. A difficulty arises if the insurer has to provide insurance outside their area of expertise, on which it may make a loss. This creates uncertainty and hence makes entry less likely. The recommendations are designed to reduce the uncertainty so that the insurer is better informed of the risks.

The purpose of these recommendations is to encourage entry by reducing uncertainty that an entrant might face by the provision of better information on certain important elements of costs and restructuring the liability for uninsured drivers.

Recommendations Designed to Reduce Legal System-Created Barriers to Entry to Motor, Employer's Liability and Public Liability insurance markets

The legal system is an essential part of the infrastructure for insurance and the legal system operates in turn affects, and is affected by, competition in the insurance sector. If parties to an insurance contract cannot agree on the validity and value of a claim then the legal system provides the framework within which theses issues are resolved. Although not all cases go through the legal system, it is nevertheless the case that the legal system sets the benchmark for awards.

The operation of the Irish legal system has resulted in:

- Claims levels that are far in excess of those in other EU Member States, for both small and large claims, across motor, employer's liability and public liability.
- A large overhead in terms of legal costs, which average between 40 and 65% of the amount of compensation, awarded by the legal system, depending on the year and the insurance type – motor, employer's liability and public liability.

Government has introduced a series of measures to reduce legal costs and speed up the settlement of insurance claims. Other reforms include the Personal Injuries Assessment Board ("PIAB") the Civil Liability and Court Act, 2004. Although not their primary objective several of these measures positively impact on competition.

Despite these welcome policy measures to reduce the costs associated with the legal system and to provide guidance to the level of claims through the Book of Quantum, further reform is needed to remove an information deficit that disadvantages entrants and makes it more difficult for incumbents to price insurance products.

- **Should information be collected on the level of claims awarded by the legal system?** *The Courts Service and the Department of Justice, Equality and Law Reform should consider potential reforms to generate and publish information regarding court awards for personal injury cases. Such reforms might include:*

  (a) The Department of Justice, Equality and Law Reform could bring forward legislation to require that all court decisions in personal injury cases be delivered in writing in addition to any oral delivery. Written decisions need not be long and complex. Indeed, transcripts of findings delivered orally may suffice.

  (b) The Courts Service could publish the results of all personal injury cases. This could involve the use of a standardised structure for case reporting. Such a structure could detail the apportionment of liability, the grounds for the finding of negligence, the amount awarded for special damages and the amount awarded for general damages in respect of pain and suffering to date (and into the future, if relevant).

  (c) Cases reported by the Courts Service could be detailed using a standardised classification of injury descriptions consistent with the categorisation in the Book of Quantum released by the PIAB.

  (d) The data published by the Courts Service of personal injury cases could be made public through a searchable database available over the Internet.

  (e) The Courts Service could publish data on legal cost awards, including information on legal costs relative to total damages awarded.

In considering any proposals, the impact on insurer costs and prices, insurer rivalry, and barriers to entry into insurance markets should be included in the cost/benefit analysis.

Only very limited information is available regarding actual court awards. Incumbent insurers have information regarding the outcomes of their own cases. Insurers considering entry into the Irish market do not have similar information. The availability of only limited information regarding court awards places entrants at a disadvantage relative to incumbents and thus serves as a barrier to entry into the Irish motor and liability insurance markets.

The availability of accurate, timely and easily accessible information on claims will assist insurers, including entrants, in assessing the Irish insurance marketplace. It would also make detailed information available to policymakers, including legislators and regulators, to assist in their evaluation of the performance of further reforms to the legal system.

Recommendations to Facilitate Reduced Switching Costs in the Intermediaries Market

The Authority has carefully studied the workings of the intermediaries market and concluded that there are a number of measures that Government should take in order to improve the workings of this market, primarily through reduced switching costs. In some cases the recommendations mirror those made above with respect to motor, employer's liability and public liability.

- **Should intermediaries be required to disclose to the buyer the commission or other payments made by the insurer?** *IFRSA should modify its codes of conduct to require intermediaries to inform buyers of the precise monetary payment that the intermediary receives for placing the buyer's business and on what basis that monetary payment is calculated (e.g., whether the payment is an ad valorem or other payment structure).* Frequently buyers are unaware of the payments received by intermediaries. Price transparency through commission disclosure enables the buyer to evaluate the benefits of having an intermediary and to compare the price/service combination of one intermediary with another. The intermediary is an agent of the buyer and is not just a standard distribution channel.
- **Should certain forms of commission be proscribed?** *IFSRA should not limit the forms of compensation that intermediaries can receive as a result of its current consultation process.* IFSRA is considering whether to eliminate certain forms of compensation as part of its current consultation process. There does not appear to be any reason to do this on a statutory basis. Some intermediaries are opting to eliminate certain forms of compensation in response to what customers want. Transparency is likely to encourage such action, and in an environment of transparency, there does not appear to be any need for regulatory intervention.
- **Should the buyer be informed of the quotations secured by the intermediary?** *IFSRA should modify its code of conduct to require that intermediaries forward to the buyer details of all the quotations secured. These quotations must include information regarding commission and other compensation due or potentially due to the intermediary*. If the buyer knows which insurers the intermediary has approached in its particular case, the buyer can decide whether to look for additional quotes directly or through another intermediary. The buyer can also better assess the service of the intermediary and decide whether to stay with that intermediary or consider using another one. Finally, with full details of the search, including any quotations received, together with the commissions payable on these quotations, the buyer can better evaluate the extent of any conflict of interest with regard to the intermediary's recommendations.
- **Classification of Intermediaries.** *IFSRA should modify the classification system for intermediaries to make it clearer for buyers. The classification system should include standardised definitions of the classes of intermediaries active in the marketplace. Each intermediary should include the IFSRA-approved statement of the functions performed by its type of intermediary in all contracts, quotations, renewal notices, advertisements and electronic communications sent by the intermediary to a buyer.* If buyers are to assess their intermediary, as well as their alternatives, they need to understand the role played by their intermediary, the extent of their intermediary's capabilities, the breadth of their intermediary's search for quotes, and the capabilities of their alternatives.
- **Should enough notice and clear procedures be in place so a buyer can switch intermediaries?** *IFSRA should modify its code of conduct to: (i) require renewal notices be sent both to buyers and any intermediaries that act as their agent; and, (ii) include clear requirements including timescales for changing intermediaries. These requirements should ensure that buyers have sufficient time after the receipt of a renewal notice to consider thoroughly their options regarding switching insurers and switching intermediaries*. The purpose of these recommendations is to allow sufficient time that a buyer can, if they so wish, switch intermediaries and are aware of the procedures for doing so.
- **Free Riders, Risk Profiles and Shopping Around.** *IFSRA should modify its codes of conduct to require that: (i) the intermediary provide the buyer with a copy of the risk presentation sent to each insurer; and, (ii) intermediary contracts with buyers for employer's liability and public liability policy searches include the price to be charged for any risk presentation given to a buyer.* An insurer needs a risk presentation in order to prepare a quotation. Risk presentations require time and effort to prepare by an intermediary on behalf of a buyer. The purpose of the recommendation is to facilitate the shopping around by

a buyer to different intermediaries/insurers, but at the same time ensure that the intermediary is compensated for preparing the risk presentation. If not compensated the intermediary has little incentive to prepare such presentations.

- **Should insurers state their policy on providing a quote when they have already made one?** *IFSRA should: (i) modify its codes of conduct to require that each insurer active in the Irish market publish a statement regarding how it handles buyers of employer's liability, public liability and commercial motor insurance policies who are presented to them separately by different intermediaries. These statements should be made generally available, for example, via posting on insurer websites; and, (ii) publish a table summarising this information from insurers.* Insurers have several different approaches they can take to dealing with a request for an alternative quote for a risk that has already been quoted. They can refuse to provide a quote, refuse to provide a lower quote, refuse to provide a quote without a new risk analysis, or they can offer a new quote. Buyers are typically unaware of the approach insurers take in this regard. Additional information should be made available to assist buyers in testing the market for alternative insurance quotes and for alternative intermediary services.

These recommendations should facilitate greater competition in the intermediary market by empowering buyers in selecting which intermediary to place their insurance.

Conclusion

The Authority believes that its recommendations, taken together with the vigorous and ground-breaking reforms that have already been made by Government, should result in buyers in the non-life insurance sector getting better value for money. Just because there appears to be some lessening, indeed partial reversal, of the upward drift in insurance premiums in 2000-2001 that motivated the Authority's study is no reason for complacency. Just as night follows day we can be sure that insurance premiums will eventually rise again at high rates. By implementing the reforms advocated in this Study we would be that much better prepared.

Chapter 1

INTRODUCTION

INTRODUCTION

Why Study Non-Life Insurance?

1.1 The non-life insurance sector is an important sector, both in its own right and in terms of its relationship as a facilitator of activity, both commercial and non-commercial, in other sectors of the economy. The non-life insurance sector accounted for approximately 3.9% of GNP in 2003. This is equivalent to €4.39bn.

1.2 There are risks associated with all kinds of economic activity. Insurance markets provide a mechanism for businesses and individuals to transfer some of those risks to firms that specialise in absorbing risk. In so doing, businesses and individuals are better able to undertake certain activities and in particular, certain economic activities, than they would otherwise be. In this way, insurance markets facilitate higher levels of economic activity.

1.3 Given the economic significance of the non-life insurance sector, it is vitally important that the sector operate in an efficient manner as possible. Strong competition in the insurance sector will drive efficiency. It is therefore crucial to the wellbeing of the Irish economy that the insurance sector is strongly competitive.

1.4 It is important for business that insurance is provided on a competitive basis. Business in Ireland competes with business in other countries. If insurance costs are determined in an environment of vibrant competition, Irish business will be better equipped to compete internationally because this non-traded input is being supplied on a competitive basis.

1.5 Equally consumers will benefit if insurance is provided on a competitive basis. Prices will be lower than they would otherwise be, resulting in consumers being able to spend their income on other items of consumer expenditure. Furthermore, if insurance premiums are kept to a minimum then there is less likelihood of drivers opting to drive without insurance. At the present time approximately 5% of motor insurance premiums reflect payment for the costs incurred by uninsured drivers.

Legal Basis of Study

1.6 Section 30(1)(a) of the Competition Act, 2002, allows the Competition Authority ("the Authority") to study competition in a sector generally. It should be noted that the Authority would not have embarked on a study if it believed that the only problems in this sector related to private restrictions on competition that could be resolved by enforcement of Sections 4 and 5 of the Competition Act, 2002. Indeed the Authority received a large number of complaints concerning insurance and concluded that with rare exceptions that there was no evidence of a breach of the Competition Act, 2002. For this reason, the Study focuses, firstly, on public or regulatory restraints and, secondly, on private practices that, while they may not breach the Act, may inhibit competition.

Procedure and Timing of Study

1.7 This Study was launched in the autumn of 2002 jointly with the Department of Enterprise, Trade and Employment ("the Department"). In 2003 the Authority and the Department commissioned four research papers to assist in the study of insurance. These papers are reproduced in Volume II of this Study.

1.8 The timing of the insurance study reflected concern over the sharp increase in premiums and, in some cases, extreme difficulty in obtaining cover. This raised questions about key underlying causes relating to the number of accidents, the cost of claims, and competition in the market, the last being the central focus of work in this Study.

1.9 In February 2004 the Authority released *Preliminary Report and Consultation Document*[1] that raised a series of questions and issues. Responses and submissions were requested. Sixteen submissions were received from interested parties. These were extremely helpful to the Authority in informing this Study's final conclusions and recommendations.

Context of Study

1.10 While the Authority was conducting its analysis of competition in the non-life insurance sector Government introduced a series of reforms designed to lower the cost of insurance. These included the Personal Injuries Assessment Board and Civil Liability and Courts Act, 2004. At the same time there were also a series of reports pertinent to this Study, especially those of the Motor Insurance Advisory Board and the Joint Oireachtas Committee on Enterprise and Small Business. This Study builds on these reforms and reports. Where appropriate the Authority's recommendations and policy direction comment directly on these.

1 This can be found on the Authority's website, www.tca.ie.

Remit of Study

1.11 The remit or terms of reference of this Study are as follows:

- To identify anti-competitive practices or other constraints on competition in the non-life insurance market in Ireland, with particular reference to motor insurance, employer's liability and public liability insurance;
- To highlight any anti-competitive practices or other constraints that are particular to the Irish market;
- To make recommendations for legislative and other changes to ensure that competition works well for consumers in the Irish markets; and
- To make, in the case of any problems identified at EU level, recommendations for change at that level.

Focus of Study

1.12 Focus of Study:

(a) This report focuses on three non-life market sectors: motor insurance, employer's liability insurance and public liability insurance.

(b) Insurers, the legal system and intermediaries.

(c) Recommendations are directed at regulators, especially the Irish Financial Services Regulatory Authority ("IFSRA"), the Department of Transport, the Department of Justice, Equality and Law Reform and the Courts Service.

Structure of the Study

1.13 The structure of this Study is as follows:

- Chapter 2 examines the nature of insurance;
- Chapter 3 provides an overview of the Irish non-life insurance sector, with particular emphasis on motor, employer's liability and public liability;
- Chapter 4 discusses the regulation of insurance markets, both at European and national level;
- Chapter 5 contains an outline of the methodology used for analysing competition;
- Chapter 6 identifies relevant markets in non-life insurance and the extent to which a small number of firms account for a large percentage of the output of the market;
- Chapter 7 addresses and makes recommendations on the issue of rivalry and switching costs in the motor and liability markets;
- Chapter 8 analyses and makes recommendations on the issue of barriers to entry to insurance markets;
- Chapter 9 deals with the issue of barriers to entry and the legal system;
- Chapter 10 analyses the role played by intermediaries and makes a series of recommendations;
- Chapter 11 brings together the 57 recommendations made in this Study;
- Appendix I provides further details on the mandate for the Study and the consultation; and
- Appendix II furnishes a list of acronyms.

Outcome of Study

1.14 Markets work well when buyers are well-informed and can switch easily between suppliers, firms with new ideas can enter the market if they see opportunities and existing suppliers compete vigorously with one another. The Authority's Study of non-life insurance found that in each of these three areas that policy changes are required in order that markets work well for consumers. Thus the Authority 57 recommendations fall into three broad categories:

- Measures to inform and empower buyers to switch between insurers so that they can shop around for better, more competitive insurance premiums and products.
- Measures designed to facilitate entry into non-life insurance markets by reducing uncertainty, ensuring that various regulatory requirements that treat entrants unfavourably compared to existing insurers are justified and proportionate and increasing transparency so that an entrant is better able to price insurance.
- Measures that encourage existing insurers to compete with one another, such as empowering buyers and the compulsory publication of data on risk profiles, an essential ingredient that is needed to price insurance. The importance of the latter is reflected in the fact that although competition authorities frequently look unfavourably on information sharing, an exception is made in the case of insurance by the European competition authorities.

If all these recommendations are implemented it is the Authority's belief that non-life insurance markets will perform better for buyers of insurance, whether consumers, businesses or the non-profit sector.

Chapter 2

THE NATURE OF INSURANCE

THE NATURE OF INSURANCE

Introduction

2.1 This chapter examines the nature of insurance. It focuses on motor insurance, employer's liability ("EL") insurance and public liability ("PL") insurance. Insurance is a product that shifts risks from individual consumers and businesses to companies that specialise in absorbing risks. Consumers and businesses are generally risk averse, and they gain from the transfer. By aggregating risks from a large number of customers, insurance companies can diversify away many idiosyncratic risks, leading to a much less risky stream of losses.

2.2 This chapter begins by describing motor, EL, and PL insurance, which are the products examined in this Study. It then considers these products more generally from both the demand and supply sides of the market. Demand is considered first. From a buyer's point of view, insurance is one part of an overall risk management strategy. Next, the supply side of the market is studied by considering in detail what insurance companies do, with a focus on aggregating and diversifying risks. The insurance industry is characterised by a boom and bust cycle, and a discussion of this cycle follows. Issues related to buying insurance are discussed next, and international comparisons follow. The chapter ends with a summary and conclusions.

Types of Insurance

2.3 The main function of insurance is to provide compensation to meet claims in defined circumstances. Purchasers of insurance pay a premium into a fund and, in return, have the right to call on that fund in the event that an insured event occurs. Insured events are generally grouped by categories, and these categories define the different types of insurance that are available. These types are life assurance, health insurance and property and casualty insurance (also known as "non-life" insurance). There is also reinsurance. This Study focuses on the non-life insurance, with particular reference to motor, EL and PL insurance. Each of these types of insurance is discussed below.

Motor Insurance

2.4 Third party motor insurance is compulsory in all EU countries, including Ireland. This ensures that, if an individual causes injury, damage or other harm to a third party via a motor vehicle, there are sufficient funds available to compensate the third party. Motor insurance is a particularly important class of business for insurers. In Ireland, it accounted for 52% of non-life insurance premiums in 2001, 48% in 2002 and 45% in 2003.[1]

2.5 Motor insurance policies generally combine different forms of cover. Third party indemnity covers liability to a third party for negligently caused injury or property damage. This is the legally compulsory element of motor insurance. Two other forms of cover are also available on an optional basis. The first covers fire and theft in addition to third party liability (i.e., "third party, fire and theft"). The second is the more wide-ranging "comprehensive" insurance, which includes cover for damage to the driver's own vehicle.

Employer's Liability Insurance

2.6 EL insurance is designed to cover the liability that an employer might face if an employee is negligently injured in the course of employment. EL is not compulsory in Ireland but is a norm for organisations with employees.

Public Liability Insurance

2.7 Organisations or individuals buy PL insurance to cover the possibility of claims for compensation from persons, other than employees, who suffer personal injury or damage to themselves or their property through negligence on the part of the buyer. PL is not compulsory but is a practical necessity for many businesses and other organisations.

Insurance within Risk Management

2.8 Businesses and consumers prefer to avoid risk and uncertainty. As a result, they have formal or informal strategies for managing risk. Insurance is one element of an overall risk management strategy.

2.9 Risk management can be broken down into three parts: reduction, retention and transfer. "Risk

1 Insurance Industry Federation *Factfiles* (www.iif.ie). These percentages are based upon gross premium income of IIF members.

reduction" involves taking measures to identify and minimise risk. Straightforward examples include health and safety policies in the workplace and the wearing of seat belts in motor vehicles.

2.10 The second part of risk management is "risk retention". Risk retention is in effect self-insurance. The "excess" or "deductible" that must be met by the insured individual or business prior to receiving any payments from the insurance policy is a form of risk retention. With motor insurance, the deductible may be, for example, the first €200 of any claim; deductibles in liability insurance may be much larger. A more complete form of self-insurance is where an organisation establishes a fund to meet losses either in-house or through its own "captive" insurer, only requiring insurance from outside sources to cover the potential for very large losses.

2.11 The third part, "risk transfer", involves a shift of risk onto others. Insurance is a means of doing this. It provides a mechanism whereby consumers, both personal and business, can transfer some of the risks arising from their activities to others, namely, insurance companies. In effect, they are transferring an uncertain payment, which could be large and have a significant impact on their future income, wealth, or business prospects, in exchange for a much more certain payment, the insurance premium. Individuals are generally risk averse, meaning that they are willing to pay to avoid risk. As discussed in more detail below, by pooling risks, insurance companies are better able to manage and absorb risk than are individual businesses and consumers. As a result, the transfer of risk from consumers and businesses to insurance companies moves the risk to a party better able to manage and absorb it, providing substantial benefits to these consumers and businesses.

2.12 The existence of insurance markets allows the economy as a whole to be more enterprising and to undertake longer term capital expenditure decisions which otherwise might not be made, or might be delayed. With insurance, decision-makers, faced with less uncertainty, are more willing to undertake adventurous and potentially more profitable activities. When operating in competitive markets, industrial, commercial and trading enterprises have to take "risks" in order to make profit. These risks include normal commercial risk (e.g., whether there will be sufficient demand for a proposed product) and other risks, for example, associated with the production process (e.g., accidents in the workplace). Insurance deals with this latter kind of risk. By being able to transfer some of the risks associated with their commercial and investment decisions, the decision-taking process itself is made less risky and investment is encouraged.

2.13 In the case of non-profit making (e.g., community and voluntary) activities, risk transfer through insurance enables, in some cases, events to take place and services to be provided that might otherwise not be. These events or services, on an individual basis, may be considered too risky in relation to the possibility of a claim being incurred. Thus, the ability to insure these kinds of risks can benefit society in a broader sense.

2.14 In sum, to the extent that a buyer of insurance can reduce and/or retain risk, the need for insurance that transfers risk to others will be lessened. However, most buyers will need some degree of external insurance within an overall risk management strategy. This is because insurers are better able than individuals and businesses to absorb certain risks, and hence transferring these risks to insurers, for a fee, is beneficial to all involved and hence enhances the efficiency of the overall economy.

What do Insurance Companies do?

Risk Transfer Facility

2.15 In supplying insurance, the insurer is accepting risk, often unlimited, for a price. Insurance provides a "risk transfer facility", for which insurers receive payment in the form of premiums.

2.16 The price of such a service depends on the size of the risk and the size of the market. Insurance is predicated on the pooling of a large number of risk exposures where the causes of loss are to a significant degree independent of each other. Such pooling enables the insurer to estimate the expected level of claims to a reasonable degree of certainty via an application of the law of large numbers.[2,3] In principle, a larger group of risks can allow insurers to exploit the law of large numbers more effectively than a smaller group. As a result, insurance exhibits economies of scale, and thus scale facilitates a lowering of the average price of insurance. Where risk exposures are few in number or where there is a high degree of correlation between risk exposures, due to a common cause of loss or to a concurrence of causes, then insurance is more difficult to price accurately.

2.17 Catastrophic losses can arise from the adverse impact of one very large risk exposure or, more commonly, from the simultaneous impact of a large number of smaller risk exposures (e.g., a bad storm). Failure to have an effective pooling of risk exposures does not

2 Pooling risks may also be seen as a portfolio diversification strategy. By assembling a portfolio of insurance contracts, the insurer realises the overall average level of risk and eliminates the idiosyncratic risks inherent in each contract.

3 The law of large numbers says that in repeated, independent trials with the same probability of a particular outcome occurring in each trial, the percentage of such outcomes actually occurring is increasingly likely to be close to the chance of a particular outcome occurring as the number of trials increases.

necessarily mean that insurance cannot be supplied, but it does mean that the cost and price of the insurance will tend to be high because more capital is needed to absorb these greater risk concentrations.

2.18 Insurers use two main methodologies or approaches for pricing risks or setting premiums. The first is "group rating", which is used for most liability insurance risks. Under this methodology, insurers divide the total pool of risks into a number of sub-groups, placing risks with similar characteristics in the same sub-group, thereby allowing similar rates of premium to be calculated. The second is "experience rating". This involves pricing risk on the basis of the buyer's own past claims experience, or rating a risk on its own merits. The use of experience rating depends on the individual risk in question having a statistical base wide enough to predict future loss patterns. Group and experience rating are often used together. For example, a "no claims discount" uses an ex post experience rating to modify a premium set by the group rating method. The final cost of the insurance will then depend on a number of additional factors including the level of deductible, the cost of reinsurance, loadings for contingencies, expenses, investment income, and the cost of capital. Market forces and market behaviour also have an effect on profit margins and ultimately on price.

2.19 Like any other organisation managing its risk, an insurer engages in risk retention, risk reduction and risk transfer. In respect of the risk it retains to itself, it sets up a fund (i.e., reserves) to meet claims for losses as they occur. An insurer can reduce risk in a number of ways, including addressing the issues of moral hazard and adverse selection. It can also transfer risk to others via reinsurance. Moral hazard, adverse selection, and reinsurance are discussed in greater detail below.

Moral Hazard

2.20 Moral hazard occurs where buyers of insurance might be less careful in protecting their insured assets, and more likely to cause financial loss to others, because they know that an insurance company will bear the cost rather than themselves.[4] Moral hazard may be reduced by the use of deductibles (where the policyholder pays the first €x of any claim) and pricing incentives (such as no-claims discounts in motor insurance, where there is a promise of reductions in future premiums to reflect claim free years). In effect, these strategies impact behaviour because they require the buyer to retain some of the risk.

Adverse Selection

2.21 Adverse selection occurs where an insurer's pool is made up of worse-than-average risks.[5] Within a pool, the premiums of the many should generally be expected to pay for the claims of the few. However, in a competitive insurance market, an insurer that does not, or cannot, segregate risks into sub-groups and set premiums according to the risk profile within each sub-group will likely end up with a lot of customers above the "average" risk, and few below. The average price that the insurer must set will be good value for higher-risk buyers and bad value for lower-risk buyers. Adverse selection occurs when the low-risk buyers withdraw, leaving the insurer with only high risks. To combat adverse selection, insurers try to get accurate information about buyers in order to set an appropriate premium. Techniques such as individual assessment may be used, although they entail costs and are therefore more likely in relation to larger premiums.

Reinsurance

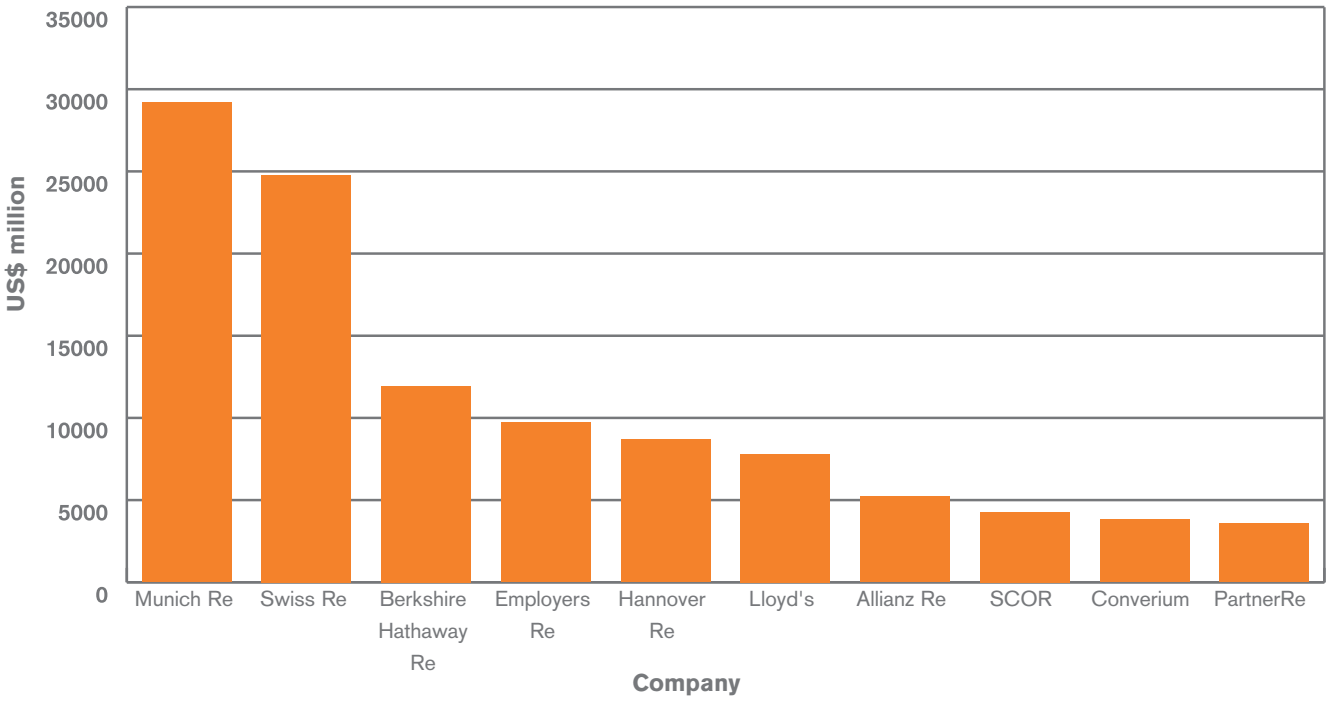
2.22 Like buyers of insurance, insurers do not retain all of their risk - they also *transfer* some of the risk they face onto other insurance companies in the form of reinsurance. Reinsurance is an important part of the operation of the insurance market. It is a contract between two insurers whereby one party insures the other's defined risks to an extent specified in the contract. The reinsurance market is international with very large potential risk exposures being spread so as to exploit the benefits of the law of large numbers. This provides some protection for insurers against large single losses or accumulations of smaller losses from single events.

2.23 There are economies of scale in reinsurance, both in capital and in the ability to acquire the requisite information to price complex risk events with low probabilities of occurrence. The top ten reinsurers in the world in 2003 wrote reinsurance policies worth a total of US$109bn in premiums. The top two individual reinsurers – Munich Re and Swiss Re – wrote almost US$30bn and US$25bn respectively, as shown in Figure 2.1.

4 The concept of moral hazard is well documented in the economics literature. One of the seminal papers is Holmström, B. (1979), "Moral Hazard and Observability", *Bell Journal of Economics*, Vol. 10, pp. 74-91.

5 The seminal papers on the concept of adverse selection are Akerlof, G. (1970), "The Market for "Lemons": Qualitative Uncertainty and the Market Mechanism", *Quarterly Journal of Economics*, Vol. 84, pp. 488 – 500, and Rothschild, M. and Stiglitz, J. (1976), "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information", *Quarterly Journal of Economics*, Vol. 90, pp. 629-650.

Figure 2.1: Top Ten Reinsurers Worldwide based on Net 2003 Reinsurance Premiums Written



Source: Standard & Poor's

2.24 The cost of reinsurance has risen sharply in recent years. The large claims arising from the terrorist attack of 9/11,[6] many of which were borne by the global reinsurance industry, have served to increase the cost and decrease the availability of reinsurance. This has, in turn, impacted on the cost of direct insurance, including liability insurance. There are now some signs that this is abating with fresh capital coming into the market.[7]

Summary

2.25 The principal service provided by insurance companies is risk transfer. For a premium, insurance companies will accept the risk of a particular defined event occurring and pay out if that event occurs. Insurance companies encounter two main problems, moral hazard and adverse selection. Moral hazard occurs when the behaviour of the insured entity changes because it is insured; this problem can be lessened by requiring the insured entity to retain some portion of the risk involved. Adverse selection occurs when an insurer is unable to distinguish between high and low risk category buyers. Insurers attempt to deal with the problem of adverse selection by improving their knowledge of the risks presented by individual buyers. Like individual buyers, insurance companies manage their own risk using a variety of strategies including reinsurance. Reinsurance allows insurance companies to protect themselves against very large exposures by pooling risk on an international basis. Insurers, in addition to their core underwriting activities, may also provide other services in exchange for the insurance premium paid. These might include safety advice, loss settlement advice and legal services when negotiating with aggrieved parties in suits of negligence.

Pricing Insurance

Pricing Risk Accurately

2.26 The ability of an insurer to price risk accurately depends on a number of conditions. First, the events causing or triggering an insured loss must be clearly defined. Second, insurers must have sufficient information to estimate the frequency and severity of accidents from a set of defined causes in order to determine adequate and actuarially accurate prices. Third, buyers should not be allowed to conceal information from insurers, willingly or unwillingly, about their risk propensities, as this will prevent the insurers from charging actuarially accurate prices, potentially leading to adverse selection. Fourth, the frequency, amounts and volatility of compensation awards have an impact on the amounts that need to be set aside for reserves, which feed through to the price of insurance. Fifth, legal and associated claims costs are a significant component of overall cost.

6 Over the period 1970 to 2003, the most costly insurance loss was 9/11, with an insured loss of US$21,062m. (Source: Swiss Re. The loss figures relate to all losses except liability.)

7 Since 9/11 and the fall of stock market values, stock markets have begun to recover, bringing fresh capital into the market. For an explanation of how this impacts on insurance markets see the section on the "insurance cycle" below.

2.27 The rating and underwriting of liability insurance is generally more problematic than that of motor insurance. Liability insurers are liable, usually up to a pre-determined limit, in respect of claims for injury that were caused when they were carrying the risk.[8] Some forms of liability insurance (including PL but especially EL) are characterised by a "long tail" of claims[9], which extends many years beyond the periods of insurance where the claims have their origin (e.g., asbestosis). The potentially long delay between underwriting a risk or group of risks and settling the last claims that arise from the insurance in question creates considerable uncertainty. This uncertainty impacts the final cost of such claims and the level of premium that is necessary to cover them. The uncertain effects of inflation, investment yields and potential increases in the size of court awards over long time periods make pricing inherently difficult. Furthermore, the longer the time span of the insurance transaction, the greater is the risk that changes in legislation, scientific knowledge or accident victims' general propensity to seek compensation will make claims greater in number or value than was anticipated. For example, a failure to predict accurately the level of future claims for asbestos-related illness and environmental damage contributed to the collapse of many insurers in the United States late in the last century and also contributed significantly to the problems of the Lloyd's insurance market in recent years.[10]

2.28 Experience rating may be impractical even for large liability risks if such risks generate long-tail claims. This problem is particularly acute in respect of EL risks that generate a high proportion of claims for latent or gradually developing diseases (e.g., deafness).

2.29 Techniques for calculating the final premium depend on the level of detail and the reliability of the available data. Generalised Linear Modelling techniques are commonly used across the motor market in Ireland. Rating and underwriting of liability insurance is a more complex problem. The potentially long delay between underwriting a risk and settling the last claims that arise from the years of insurance in question (i.e., the "long tail") creates uncertainty as regards the final cost of claims. This makes it difficult to set a premium to cover such potential claims. Motorists often tend to relate the cost of motor insurance to the value of their car. In fact, the greater part of a private motor insurance premium is unrelated to the value of the car and instead covers the third party insurance risk.

Other Factors Influencing the Price of Insurance

2.30 In addition to the conditions required to price risk accurately, the final level of premiums will depend on a number of additional factors. First, the availability and price of reinsurance, as discussed in an earlier section of this chapter, can be crucial to the design and price of the final insurance product. Second, the "insurance cycle", discussed in some detail in the following section, is also important. Third, the competitive conditions that insurers face will affect how they set premiums. Chapters 6 to 10 of this Study are devoted to the analysis of the competitive conditions in the Irish insurance sector, while Chapter 5 provides a framework within which to analyse competition.

The Insurance Cycle

2.31 Insurance markets tend to swing between "hard" and "soft" markets, with periods of (relative) profitability and (relative) unprofitability alternating over a cycle of 6-9 years. This empirical observation is commonly known as the "underwriting" or "insurance" cycle and is a persistent feature of insurance markets. Three theories of the underwriting cycle have some degree of empirical support. These are "cash flow" underwriting, equity capital/cost of equity and claims shock theory.[11]

"Cash Flow" Underwriting

2.32 Insurance companies receive premiums at the outset of the insurance contract and can invest these premiums until claims are eventually paid. If rate of return is expected to rise, insurance companies will seek to reduce insurance prices in order to attract more premiums to invest. In reverse, if rate of return is expected to fall, insurance rates will rise.

Equity Capital/Cost of Equity

2.33 There are two effects related to insurer capital that result when stock markets rise above a normal level. First, the cost of capital falls for existing and new insurance companies. Second, the rise in share price increases the value of the financial asset holdings of insurance companies and brings about an even greater increase in their capital and reserves. This increase in available capital, and a reduction in the cost of capital,

8 Note, however, that motor insurance in Ireland currently provides unlimited indemnity for personal injury liability.
9 See Dowling, D. (2004), *Analysis of the 2002 Statutory Returns in the Irish Insurance Market and Related Matters*. This is reproduced in Volume II of this Study.
10 There have been around 265,000 asbestos-related deaths in the USA. Between 1988 and 1990, 106 US insurers became insolvent, asbestos-related and pollution claims being a major source of failure. Despite the fact that the use of asbestos in Western Europe had more or less ceased by the 1970s, because of the long periods before asbestos exposure illness becomes apparent, it is anticipated that asbestos-related claims in Western Europe will not peak until the year 2020. See C. Parsons et al. (2004), *Report on the Economics and Regulation of Insurance*, London: Cass Business School, City of London, p. 51. This is reproduced in Volume II of this Study.
11 For further information on the "insurance cycle" see C. Parsons et al. (2004), *Report on the Economics and Regulation of Insurance*, London: Cass Business School, City of London, p. 19.

tends to increase supply and hence impart a downward pressure on insurance prices. In reverse, when stock markets fall, the cost of capital rises and the fall in share prices reduces the value of insurers' financial assets and limits underwriting capacity because of restraints imposed by solvency regulation.

Claims Shock Theory

2.34 This theory relates to claims experience. It holds that insurance pricing tends to underestimate the potential for claims during periods when there are no large individual claims or clusters of claims. However, when a very large claim occurs, insurance prices rise sharply, especially if the large loss also depletes capital or causes insurer insolvencies. If there are no major claims in the ensuing period, insurance prices tend to drift downwards until another large loss occurs. This theory is based on the concept of an "economic shock" and assumes that the insurance market has a short memory.

Summary

2.35 Empirical evidence, though inconclusive due to a paucity of data, suggests that each of these theories apply at the same time, but that their relative importance depends on the type of insurance under consideration. In particular, the price of insurance in respect of natural catastrophes appears to be best explained by the claims shock theory while less risky forms of insurance, such as motor insurance, are better explained by the cash flow and capital markets theories. Price cycles for liability insurance are also best explained by the cash flow and capital markets theories. The cash flow cycle is important in liability insurance because of the long time lags between when premiums are paid and claims are settled. Capital market effects are important for liability insurance because this type of insurance tends to tie up suppliers' capital.

2.36 Whether any single theory best explains observed patterns of insurance prices, or whether a combination of theories is required, is not of purely academic interest in the present context. This Study was launched during a period when both liability and motor insurance premiums were rising rapidly (i.e., during a particularly hard phase of the insurance cycle). Rates of return were falling to historical lows (invoking the cash flow theory); stock markets were down (invoking the capital market theory); and the insurance industry had just paid out on the single biggest claim in history following 9/11 (invoking the claims shock theory).

There are now indications that the hard phase is beginning to soften: rates of return are still low but there are tentative signs that a turning point may have been reached; stock markets have recovered somewhat; and the effects of 9/11 have now largely been absorbed. Thus, while insurance prices may not appear at present to be as pressing an issue as had been the case until relatively recently, pricing most likely will be an important issue when the cycle "hardens" again. The implication is that recommendations made in this Study have the potential to hasten the softening of the current hard phase and also to ensure that the Irish insurance sector is flexible and better able to manage future hard phases.

Buying Insurance

Buyer Profiles

2.37 Buyers of insurance include private individuals, small commercial firms, large organisations, public bodies, and community and voluntary groups.

2.38 Usually, the purchase of insurance is an annual event and, in many cases, it is complex. Many buyers choose to use an intermediary instead of buying directly.

2.39 Large enterprises tend to arrange individual policies for their liability exposures, perhaps using different insurers for different risks. For large enterprises and specialised risks, cover is often tailored to the buyer's specific needs. In this case an insurance intermediary may play a major role in negotiating the precise terms of the cover or even propose its own wording for the contract.

2.40 Some Small and Medium Sized Enterprises ("SMEs") are offered combined policies, incorporating liability and some other insurance products such as property insurance. This may involve a limited amount of tailoring to individual requirements. Packages of liability and other insurance may also be offered to smaller organisations. Small organisations and businesses, however, do not typically have contracts tailored to individual requirements. This is especially the case in business sectors, such as small shops, offices, restaurants and public houses, where risks do not vary much and insurance needs are relatively simple. Intermediaries also provide considerable input into policy wording for insurance schemes that cover a range of individuals or organisations of similar type (e.g., members of a trade association).

2.41 In the case of some large organisations, an alternative to buying full insurance is to retain a large part of the

risk in the form of self-insurance. This may involve the organisation having a fund of its own to cover losses/claims, or setting up a "captive" insurer and buying re-insurance in respect of very large, or catastrophic, risks. However, even with a degree of self-insurance, there is usually a role for outside insurance of the residual risk (i.e., the risk that remains beyond self-insurance).

Buyer Switching Behaviour

2.42 Competition only exists if buyers search for the best available product. If buyers demonstrate too much loyalty to insurers (or intermediaries) or inertia, then the full benefits of competition cannot be realised. The incentive for insurers to lure customers from other suppliers via lower prices, to realise cost savings or to develop new products is reduced if buyers are unlikely to change from their existing insurer.

2.43 As with many financial products, buyers may not be aware of all the product attributes that they should consider in choosing between competing products. Indeed, even after a year with an insurer, the buyer may not have learned whether its policy meets all of its needs because often policyholders do not make a claim in a given year. This implies that there may be an information asymmetry between the buyer and the insurer with regard to the overall "quality" of the insurance.[12] One response to this asymmetry is to use an intermediary that can provide advice to, and act in the interest of, the buyer.

2.44 Intermediaries can help reduce search and switching costs by researching the various alternatives available. In addition, publications, such as the Irish Financial Services Regulatory Authority ("IFSRA") motor insurance cost surveys, have produced information that assist in making price comparisons. This sort of information is of value to buyers and can reduce search costs. Even if search costs are low, competition will still be hindered if there are obstacles to switching. Such obstacles can potentially include the effect of regulations and lack of market information (e.g., buyers not knowing that in some cases they can negotiate a lower price).

2.45 The ability of buyers to observe price variations in the market and to switch supplier in response to a lower price is key to driving competition. Not only does buyer responsiveness to price cuts stimulate rivalry among existing players, it also makes it easier for efficient new entrants to win business quickly. This serves to encourage entry because a new supplier may reach profitable scale more rapidly.

2.46 Very often the reasons that buyers do not shop around more relate to lack of buyer-specific information. For example, commercial risks need hard data about their own claims and accident history to market their risk in advance of policy renewal. Government policies that improve the information available to customers and avoid unnecessary lock-in will promote choice and enable informed decision-making that in turn can improve competition.

2.47 Switching costs may be lower when buyers are businesses rather than when they are individuals. This is because in some cases businesses are larger buyers. For many such firms, purchasing insurance cover is part of business operations, and as such they will employ staff or external consultants for their expertise. It may also be because intense competitive pressure in their own market forces them to seek cost reductions aggressively, or because businesses are generally better organised together (e.g., buyer groups) than consumers.

Summary

2.48 Insurance products are often complex and/or are purchased infrequently and hence difficult to compare. The implication is that buyers often face high search costs. This tends to inhibit switching behaviour, which in turn inhibits competition. Further, buyers differ in their degree of sophistication, with individuals and small businesses facing relatively higher search costs. Intermediaries can help to reduce search costs, and therefore enhance competition, by performing the "shopping around" function on behalf of their clients. Larger buyers often find it optimal to internalise the shopping around function and invest in developing buyer expertise.

Insurance in Other Countries

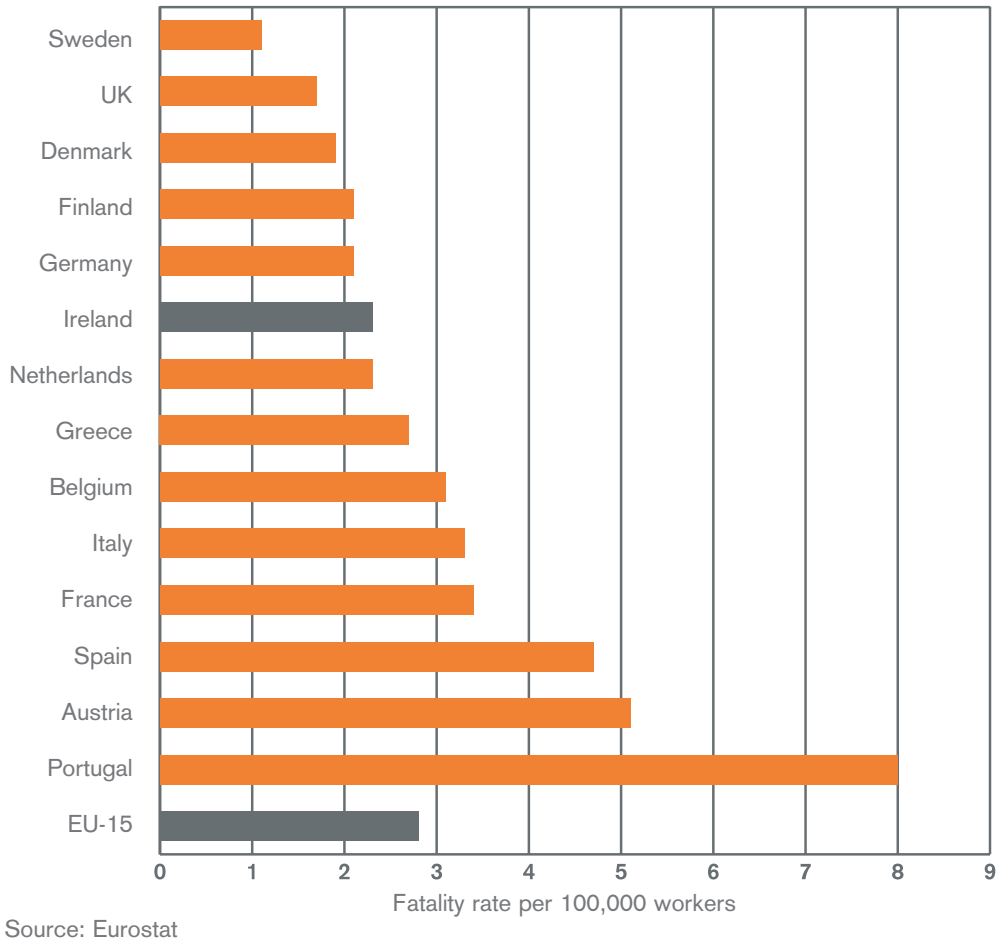
Liability

2.49 Comparisons of insurance across countries are not straightforward, especially for liability insurance, owing to general or fundamental differences between legal systems, including different risk exposures due to more limited rights to sue employers than exist in Ireland. In the case of EL, there are variations in industrial composition and speed of development, and there are different proportions of workers in hazardous occupations.

2.50 There are also various technical hindrances to international comparison. Eurostat collates work-related fatality and injury statistics from the EU Member States

12 Note that quality may have many attributes in this context, including the ease of making claims, the time taken to resolve claims, the extent of cover, the size of deductibles, etc.

Figure 2.2: Standardised EU Member State Workplace Fatality Rates, 2000



Source: Eurostat

and calculates standardised rates taking the differences in sector distribution into account. However, the criteria used to define industrial accidents and diseases may differ from one country to another. There are also variations in the collection of data, reporting systems and under-reporting, with gaps and deficiencies existing in national statistics. However, the Health and Safety Authority estimates that Ireland has the lowest rate of workplace accidents in the EU.[13]

2.51 Figure 2.2 above provides Eurostat data on the standardised incidence rate of fatal accidents at work in nine sectors.[14] The EU average for 2000 was 2.8 fatal accidents per 100,000 workers. Ireland was below the average at 2.3 fatal accidents per 100,000 workers.

2.52 Figure 2.3 on the following page presents Eurostat data on non-fatal accidents leading to an absence of more than three days from work.[15] These data are for 2000 and cover the same nine sectors as Figure 2.2. Ireland has the lowest non-fatal accident rate in the EU. The EU average was 40.16 non-fatal accidents per 1000 workers. Ireland's figure was well below the average at 10.27 per 1000 workers.

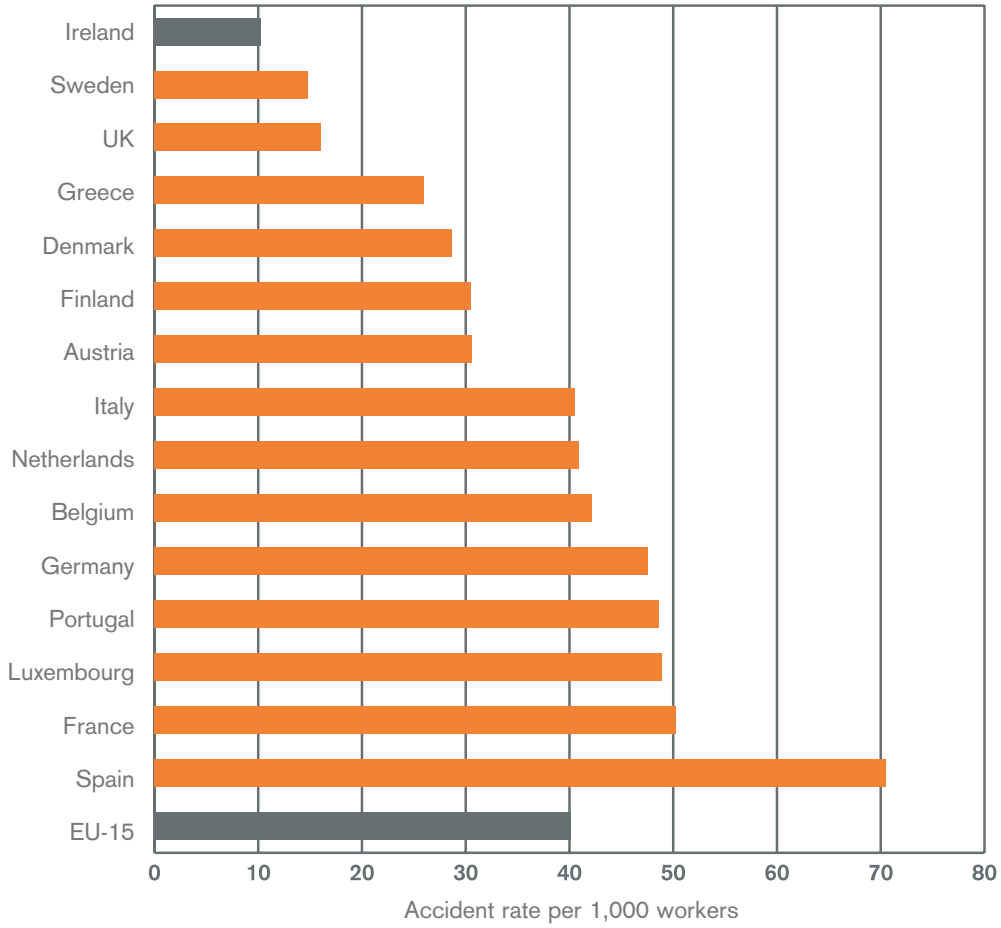
2.53 Comparison of occupational disease rates across Europe is problematic, with countries using different practices for monitoring, reporting and recording occupational illness.

2.54 Comparisons can be made across several characteristics with regard to occupational injuries. The first characteristic is the degree of integration (i.e., the extent to which arrangements for work injuries are integrated with compensation for other injuries). Most countries give broader rights to compensation in respect of occupational injuries than to other types of injuries.

2.55 Second, there is a distinction between tort and non-tort-based systems. In a tort-based system, the injured employee must establish legal responsibility on the part of the employer in order to receive compensation, although the employer's obligation to pay may be transferred to an insurer. The successful claimant may be entitled to all losses, both economic and non-economic. Although some countries, including Ireland and the UK, have a system of tort-based rights in respect of work injuries, they do not rely on it exclusively, and neither do other countries.

13 Health and Safety Authority (2004), *Annual Report* 2003.
14 The nine NACE sectors are Agriculture; Manufacturing; Electricity, Gas & Water; Construction, Wholesale & Retail Repairs, Hotels and Restaurants, Transports & Communications; Financial Intermediation; and Real Estate Business Activities. These data exclude road traffic accidents.
15 These data exclude road traffic accidents.

Figure 2.3: Standardised EU Member State Workplace Accident Rates, 2000



Source: Eurostat[16]

2.56 Non-tort based compensation (workers' compensation) schemes have a "no-fault" basis, meaning that the employee is not required to prove an employer's negligence or breach of legal duty. The aim is generally to provide reasonable redress for economic loss rather than "full" compensation. Benefits typically include the cost of medical care and rehabilitation, replacement of lost earnings (generally up to 70% of income, subject to a maximum figure) and some other expenses. Germany provides an example of what is virtually a pure workers' compensation system. Other systems of this sort exist in France, Austria, Switzerland and most US states. Rights for legal action against persons other than the employer (e.g., safety consultants or engineers that designed the workplace) are, however, often preserved. This gives an incentive for legal arbitrage, which is recognised as a weakness of providing for workers' compensations as an exclusive remedy. In practice, many European countries use both EL and workers' compensation schemes, but the balance between these sources of compensation varies considerably. EL is of marginal importance in most European countries because workers' compensation benefits may be generous enough to make a tort claim not worth the costs. Furthermore, tort claims may require proof of intent or gross negligence, which may be difficult to prove, or may be restricted to particular types of accidents.

2.57 Third, arrangements for workers' compensation insurance vary quite widely in Europe. It can be part of a fully integrated social insurance programme (e.g., Netherlands) or can be a distinct component of a social insurance programme (e.g., Occupational Injuries Benefit in Ireland). Between the two extremes of state and private provision, there are various public and semi-public risk carriers. EL is rarely a separate line of business in Europe (Ireland, UK and Cyprus being exceptions), and EL claims in other European countries are often included in the figures for general (public) liability. Virtually all work injury compensation systems in Europe make a distinction between accidents and occupational diseases. Typically, workers' compensation insurance operates in respect of all occupational accidents but only some

16 Covers accidents, excluding road traffic accidents, leading to absences of more than three days in nine NACE industries.

("scheduled" or "prescribed") diseases. Some countries (e.g., Belgium and Portugal) have different systems for compensation in respect of accidents (the employer retains the risk and insures against it) and occupational diseases (which are underwritten by a recognised private insurer).

2.58 The operation of workers' compensation systems is likely to be less costly in purely financial terms in their operation than tort-based regimes. However, to completely abolish tort-based rights against employers could have the effect of increasing tort claims elsewhere (e.g.,against manufacturers of products that cause work-related injuries).

2.59 Workers' compensation systems have been more effective than tort-based systems in promoting rehabilitation of injured workers. The non-contentious nature of the system allows the insurer to have early access to the victim, making for more effective case management. By contrast, the more adversarial tort-based employers' liability systems tend to result in later access to work victims. Furthermore, if a number of insurers have a limited claims portfolio, they may not think it worthwhile to invest heavily in rehabilitation services.

2.60 State social insurance schemes are generally not risk-related, which can have important economic consequences (e.g., through reduced incentives to behave safely). Also, low-risk industries are loaded with costs unrelated to their activities and high-risk industries are sheltered from the true social costs they cause. However, in EL systems, premiums may not accurately reflect the safety record of individual firms because experience rating is usually practical only in the case of larger organisations. Furthermore, "long tail" claims in respect of diseases partly undermine the effectiveness of experience rating.

2.61 Despite problems in EL systems, there would be difficulties in shifting to a workers' compensation system in Ireland, especially in relation to transitional problems in handling the long tail. In the UK, no concrete reform measures have been put forward as yet, but there is support for a system that would separate accidents and short-tail diseases from long-tail occupational diseases.

2.62 In the case of PL, comparative study is difficult because it is a "residual" class dealing with elements of liability insurance not covered by other specific classes. In Ireland and the UK, the other specific classes would include EL, motor, product liability, professional indemnity, etc. However, in other countries, PL policies may be structured differently. There are no statistics, from Ireland or elsewhere, on the incidence of accidents covered by public liability policies.

Motor

2.63 In motor insurance, data on road accidents show that Ireland is close to the European average on most measures but the cost of motor insurance is higher than in any other European country except Luxembourg. However, international comparisons can be misleading. There are differences in the relative volume and cost of claims for vehicle damage, even in countries with similar accident rates. Also, there are variations across Europe in the level and cost of claims for personal injury – they are particularly high in Ireland (especially for minor injuries) and low in Greece and Portugal.

Summary

2.64 Significant differences in the structure and purpose of insurance systems, as well as the manner in which data are collected and reported, make it difficult to make international comparisons of incidence rates, costs of claims and other relevant variables across EU Member States. For example, in the case of EL, the degree to which arrangements for occupation related injuries are integrated with arrangements for other injuries makes comparison difficult. Similarly, reliable comparisons between tort and non-tort based systems are difficult to make as are comparisons between systems where compensation systems are to some degree integrated with wider social insurance. The implication is that international comparisons can tell us little about competition.

Summary and Conclusions

2.65 This Study examines three types of insurance - motor, EL and PL. Motor insurance is compulsory in all EU countries including Ireland. EL and PL are not compulsory in Ireland. However, EL is a practical necessity for organisations with employees. PL is necessary to cover against exposure to claims from persons other than employees who suffer personal injury or property damage as a result of negligence.

2.66 Insurance is a mechanism for risk transfer. Risk management incorporates not only the transfer of risk but also risk reduction and risk retention. It follows that measures to reduce risk (including all relevant safety procedures) and retain an appropriate level of risk (such as a deductible) should reduce the amount of risk to be transferred to an insurer, thereby reducing the price of the insurance premium from what it would otherwise be.

2.67 Insurers aggregate and absorb the risks of a number of buyers, converting individual, idiosyncratic risks into a much more predictable pool. Insurers use two main methods to price risk. These are "group rating" and "experience rating", and these two methods can be combined with the use of systems such as the "no claims discount". The final cost of the insurance depends on a number of additional factors including the level of deductible, the cost of reinsurance, loadings for contingencies, expenses, investment income, and the cost of capital. Competition, market forces and market behaviour also have an effect on profit margins and ultimately on price. Therefore, many of the factors that help to determine the price of insurance are external to the characteristics of individual buyers.

2.68 Two of the risks that insurers face when selling insurance are moral hazard and adverse selection. Moral hazard occurs where buyers might be less careful than if they were not insured on the basis that the risk of a claim has been transferred to an insurer. The use of such features as deductibles and no-claims discounts help to reduce moral hazard. Adverse selection occurs where an insurer's pool is made up of worse-than-average risks. To combat adverse selection, insurers try to get accurate information about buyers in order to set an appropriate premium.

2.69 Insurance markets tend to swing between periods of (relative) profitability and (relative) unprofitability in a phenomenon known as the "insurance" or "underwriting" cycle. There are a number of plausible theories of the "insurance cycle", the relative importance of which depends on the particular type of insurance in question. Each of liability and motor insurance are likely to be most influenced by the capital markets and cash flow theories of the insurance cycle. However, since the cost of reinsurance is influenced by claims shocks, the claims shock theory is also likely to influence motor and liability insurance. The competitive conditions that insurers face are the subject of analysis of Chapters 6 to 10.

2.70 There is a natural role for market intermediaries. Intermediaries play a significant role in distributing insurance products. From the buyer's perspective, intermediaries can help reduce search and switching costs. For unsophisticated buyers such as individuals and small business, the intermediary plays a very important role. For larger buyers who often find it worthwhile to develop internal expertise, the intermediary is less important. A properly functioning intermediary market enhances competition in the insurance industry and benefits all consumers of insurance.

2.71 Comparisons of insurance market variables such as incidence rates and cost of claims with other countries are not straightforward because of fundamental differences in systems of coverage and the manner in which data is collected and reported. For instance, the degree to which state compensation schemes are integrated with insurance differs across EU Member States. Distinctions between tort and non-tort based legal systems are important. The implication is that international comparisons of levels of insurance tell us little about relative competitive conditions across states.

Chapter 3

MOTOR AND LIABILITY INSURANCE IN IRELAND

MOTOR AND LIABILITY INSURANCE IN IRELAND

Introduction

3.1 This chapter presents a brief overview of the non-life insurance sector in Ireland, looking at its size, profitability, premiums and the existence of various segments. The chapter also includes a discussion of insurance providers and buyers. It concludes with a discussion of the ownership of the insurers supplying products in Ireland.

Overview of Market

Market Size

3.2 This section provides estimates of size of the non-life insurance sector. The data provided underestimate true values because data are missing on certain suppliers. However, the data are sufficient for present purposes, which is to provide a sense of the size of the overall non-life sector and a breakdown of this into motor and liability.[1]

3.3 Total gross premium income for non-life insurance received by Head Offices and Branches located in Ireland in respect of Irish risk is provided in Table 3.1 below. This table also provides data on annual growth rates, GNP and growth in GNP in Ireland, and the fraction of GNP represented by non-life insurance.[2]

3.4 The data in Table 3.1 show that the Irish non-life sector is valued in excess of €4 bn annually and represents just under 4% of GNP in Ireland. The sector grew rapidly in 2002, and this growth far outstripped GNP growth. As a result, the fraction of GNP represented by non-life insurance increased during 2002.

3.5 Table 3.2 provides a breakdown of non-life insurance by motor and liability. It also provides data on the percentages of GNP represented by these categories.

Table 3.1: Gross Premium Income and the Fraction of GNP Represented by Non-Life Insurance, Ireland, 2001 - 2003

Year	Gross Premium Income ("GPI")	Annual GPI Growth Rate	GNP	Annual GNP Growth Rate	GPI as a % of GNP
2001	€3.43bn	—	€97.11bn	—	3.5%
2002	€4.12bn	20.1%	€104.47bn	7.6%	3.9%
2003	€4.39bn	6.5%	€111.67bn	6.9%	3.9%

Source: *Blue Books, Insurance Statistical Review 2003* and CSO data available at www.cso.ie

Table 3.2: Gross Premium Income and the Fraction of GNP Represented by Motor and Liability Insurance, Ireland, 2001 - 2003

Year	Motor GPI	Motor GPI as a % of GNP	Liability GPI	Liability GPI as a % of GNP
2001	€1.68bn	1.73%	€0.58bn	0.59%
2002	€1.91bn	1.83%	€0.85bn	0.81%
2003	€1.90bn	1.70%	€0.97bn	0.87%

Source: *Blue Books, Insurance Statistical Review 2003* and Table 3.1 above

1 Data in this section are drawn from a number of sources including: (1) The *Insurance Statistical Review 2003*, published by the IFSRA in October 2004, which contains detailed statistical information on the insurance industry in Ireland for 2003 and is based on insurers' statutory returns; (2) statistics for years previous are drawn from the Insurance Annual Reports (known as the "*Blue Books*"), which were published by the Department of Enterprise, Trade and Employment and are also based on insurers' statutory returns; and (3) the Insurance Industry Federation *Factfile*, published annually by the IIF. *The Insurance Statistical Review 2003* provides figures in respect of companies regulated in Ireland, while the IIF *Factfile* provides figures relating to members of the IIF. In neither case do figures include how much Irish buyers spend on insurance that Lloyd's, or others who are not members of the IIF, provide on a "freedom of service" basis (i.e., cross-border). The IIF estimates that its 20 non-life members wrote in excess of 95% of domestic (ie., establishment business) non-life premiums in 2003 with similar percentages in other recent years.

2 The data in Table 3.1 exclude Lloyd's because it does not have a Head Office or Branch in Ireland but instead provides insurance on a "freedom of service" basis. Lloyd's is largest provider of non-life insurance on a "freedom of services" basis in Ireland. In 2003, it is estimated that Lloyd's gross premium income, including business written on a "freedom of services" basis was €298m. In respect of the Irish market, it is estimated that, in 2003, Lloyd's had a market share of 8% in the non-life insurance market. (Source: Ray McGovern, Lloyd's Underwriter's Sole Representative in Ireland.)

3.6 In the case of motor insurance, gross written premium income increased in 2002 and fell slightly in 2003.[3] The increases in the value of the motor insurance market as compared to 2001 reflect, to some degree, the increase in the numbers and value of vehicles registered. The level of indemnity may also change over time. For example, buyers with newer cars might buy comprehensive cover whereas they might previously have been satisfied with Third Party, Fire & Theft. Between 1997 and 2001 Third Party Fire & Theft cover fell from 38% to 25% of all cover whereas comprehensive cover increased from 56% to 72% during this period.[4,5]

3.7 In the case of liability insurance, gross written premium income increased steadily in 2002 and 2003, both in value and as a fraction of GNP.[6,7] The trends in expenditure on liability insurance are more difficult to explain. The market has grown in value. More people at work and higher economic activity could increase the demand for liability insurance and add to insurers' revenue even without an increase in the underlying rate of premium charges. Anecdotal evidence suggests that premiums have risen sharply since 2001. This is likely to lead to a decline in the quantity of insurance demanded. Thus, the data showing growth in the value of the liability marketplace may mask trends toward risk retention. Businesses often do not insure all their liability exposure "from ground up". Larger companies may be moving toward self-insurance with or without "stop-loss" reinsurance to limit their exposure. Smaller businesses may be taking a higher excess or liability retention.[8]

3.8 Table 3.3 disaggregates the liability data into EL and PL. It also provides the fraction of non-life gross premium income represented by each.

3.9 The growth in both of these categories has been substantial recently. The values of EL and PL grew by 90.7% and 81.8%, respectively, between 2001 and 2003, or 73.7% and 65.7% after adjusting for inflation.[9]

Profitability

3.10 In describing the profitability of insurance, there are two levels of performance. The first is the underwriting result. This is the difference between the amount received in premium for the risk period and the amount incurred on claims plus management expenses and commission. If the amount incurred is greater than the premium received, there is an "underwriting loss". The second level of performance takes the underwriting result and then adds any investment income earned on assets that are held to meet future liabilities. This is the "operating" or "technical" result.

Table 3.3: EL and PL Gross Premium Income, Ireland, 2001 - 2003

Year	EL GPI	EL GPI as a % of Non-life GPI	PL GPI	PL GPI as a % of Non-life GPI
2001	€226.1m	7.0%	€235.8m	8.9%
2002	€348.4m	8.8%	€376.8m	9.5%
2003	€431.2m	10.0%	€428.7m	10.0%

Source: IIF *Factfile*

3 The data in Table 3.2 do not include Lloyd's "establishment business" in Ireland, which is recorded in the Insurance Statistical Review 2003 and Blue Books. In the case of motor, this was €46.44m in 2001, €32.75m in 2002 and €38.63m in 2003. Neither do these data include motor insurance purchased on a "freedom of service" basis from Lloyd's or other providers. It is estimated that Lloyd's had approximately a 1.5-2% market share for motor insurance in 2003 (Source: Ray McGovern, Lloyd's Underwriters' Sole Representative in Ireland). This is a decline from 3.25% in 2001.

4 Source: MIAB *Report 2004*.

5 The increase in levels of comprehensive cover may be partially explained by a decrease in the average age and an increase in the average quality of the stock of Irish vehicles. This is most likely due to a combination of factors including increased affluence of the population. The vehicle scrappage scheme, which was first introduced in 1995, and the introduction of the National Car Test in 2000 are also likely to be important factors.

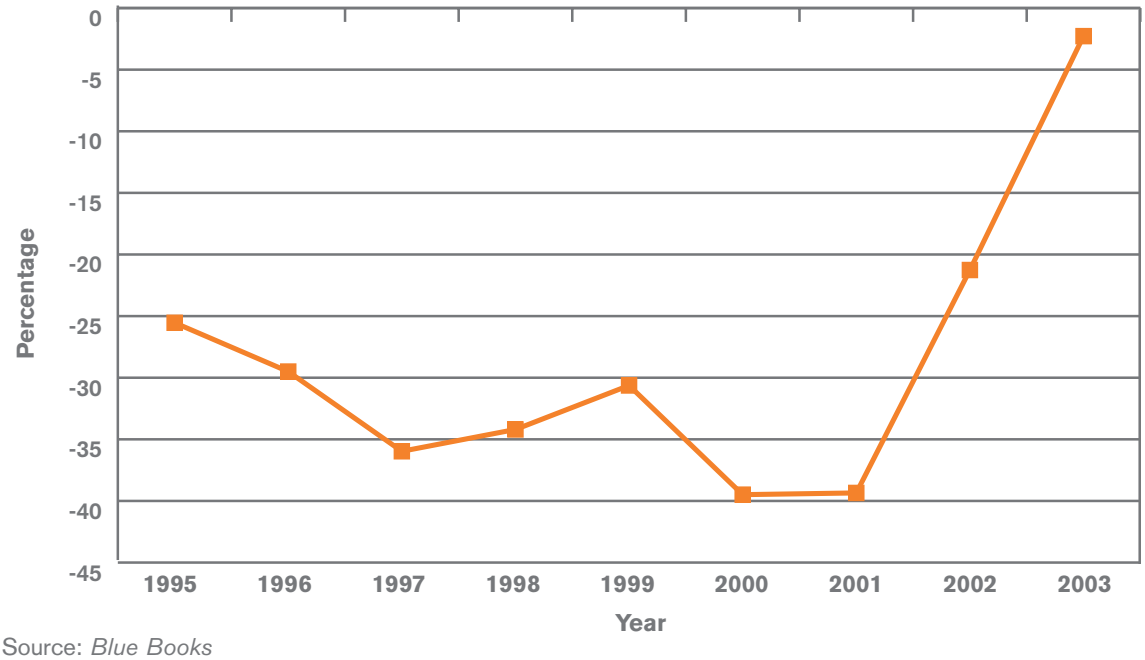
6 The data in Table 3.2 do not include Lloyd's "establishment business" in Ireland, which is recorded in the *Insurance Statistical Review 2003* and the *Blue Books*. In the case of liability it was €33.14m in 2001, nil in 2002 and €41.29m in 2003. Neither do these data include insurance provided on a "freedom of services" basis by Lloyd's or other suppliers. In the liability market, it is estimated that Lloyd's had approximately a 20% share in 2003, concentrating on larger premium categories. (Source: Ray McGovern, Lloyd's Underwriters' Sole Representative in Ireland).

7 Liability insurance figures include EL insurance, PL insurance, product liability insurance, professional indemnity insurance and directors' and officers' liability insurance. EL insurance accounts for approximately 50% of total liability insurance while public/product liability accounts for approximately 35% (product liability and public liability are typically covered within the same policy) - C Parsons et al (2004), *Report on the Economics and Regulation of Insurance*, London: Cass Business School, City of London.

8 While there are no official figures on the level of self-insurance, sources within the industry confirmed during informal meetings with the Authority that the level of self-insurance has increased over the last number of years. Furthermore, the OFT has observed a similar trend in the UK – See OFT (2003), *The UK Liability Insurance Market: Summary of Key Findings*, London: OFT.

9 Figures are adjusted for inflation using the Consumer Price Index.

Figure 3. 1: Liability Underwriting Result as a % of EPI, Ireland, 1995 - 2003



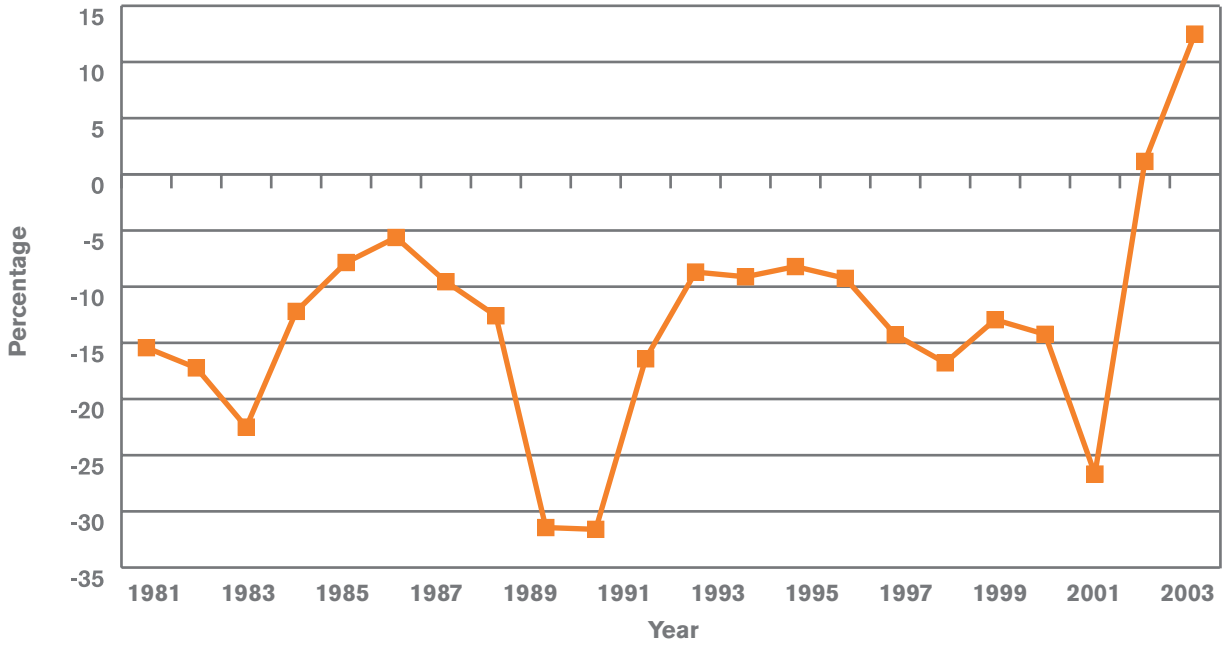
Source: *Blue Books*

3.11 Figure 3.1 above shows the underwriting result as a percentage of net Earned Premium Income ("EPI") between 1995 and 2003.

3.12 These figures indicate that for every euro of premium, insurers incurred an outlay of an additional 26% in 1995 rising to 40% in 2000 and 2001 before falling to 2% in 2003. It is not unusual throughout Europe for incurred costs to exceed premium income because investment returns are added in arriving at the overall operating result.

3.13 The underwriting results of motor insurers in Ireland over a much longer period, 1981 - 2003, are shown in Figure 3.2 below. There was a significant deterioration in 2000 when the underwriting loss represented over 26% of EPI compared to just under 15% in 1999 and just under 13% in 2001. This loss trend has altered significantly recently with an underwriting profit shown for the first time in 2002 of 1.15% of net EPI.

Figure 3.2: Motor Underwriting Result as a % of EPI, Ireland, 1981 - 2003



Source: *Blue Books* and *Insurance Statistical Review 2003*

3.14 The years 1989 and 1990 saw particularly significant underwriting losses. Pricing of premiums appears to have reflected an expectation that claims costs would fall as a result of the abolition in 1988 of juries hearing personal injury cases. However, those expectations did not materialise. Premiums then increased during 1991 and 1992. The recent dramatic improvement in motor underwriting results may in part reflect recent reforms in the insurance sector.[10] The introduction of the penalty points system may also have had an impact. However, the observed cyclical pattern of motor underwriting results is also likely partially explained by the "insurance cycle".[11]

3.15 The comparison between underwriting results as a percentage of net EPI for motor and liability for the years since 1995 is set out in Table 3.4.

3.16 Like motor insurance, there has been an improving trend in liability underwriting results. Unlike motor insurance however, liability underwriting results have not become positive. Obviously, this improvement in the profitability of liability insurance cannot be attributed to the introduction of penalty points, which related to road accidents only, though other reforms in the insurance sector may have had an impact. The improvement in national statistics for workplace accidents long pre-dates 2002. The observed pattern is, however, somewhat cyclical, suggesting that the "insurance cycle" is a factor here also.

3.17 It takes time before money received in premiums must be paid out in claims, and insurers therefore have funds to invest. Information on insurers' earnings from investments only became available from the Statutory Returns of 1995 onwards, although the Deloitte & Touche Report of 1996 provides some estimates for previous years.[12] Table 3.5 below shows investment income per year of account for motor and liability in Ireland from 1995 to 2003.

3.18 The net operating/technical result is profitable in all but three years for motor and four for liability, as represented in the Figure 3.3. For liability three years are close to zero with only one year showing a significantly positive result. The motor market experienced a significant change between 2000 and 2002, turning from a loss making market to a profitable market between 2001 and 2002. The liability market was experiencing losses; however the *Insurance Statistical Review 2003* shows a profitable technical result. The overall non-life net operating profit increased significantly after 2001. In 2001 the overall loss was €73.3m, but this changed to a profit in 2002 of €226.3m and continued to increase in 2003 to €757m.

Table 3.4: Underwriting Result as % of EPI per Year of Account, Motor and Liability, Ireland, 1995 - 2003

Class	1995	1996	1997	1998	1999	2000	2001	2002	2003
Motor	-9%	-14%	-17%	-13%	-15%	-26%	-13%	+1%	+12%
Liability	-26%	-30%	-36%	-34%	-31%	-40%	-39%	-21%	-2%

Source: *Blue Books* and *Insurance Statistical Review 2003*

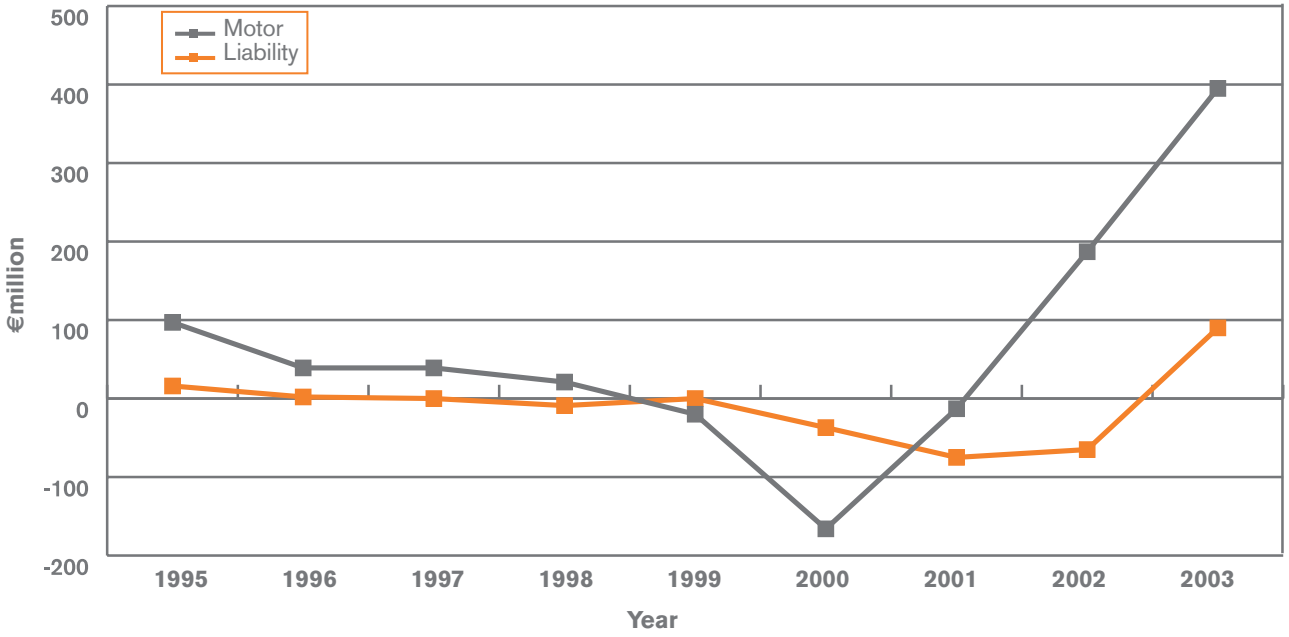
Table 3.5: Investment Income per Year of Account (€m), Motor and Liability, Ireland, 1995 - 2003

Class	1995	1996	1997	1998	1999	2000	2001	2002	2003
Motor	162	154	184	145	140	156	173	169	182
Liability	83	83	101	94	97	95	90	60	106

Source: *Blue Books* and *Insurance Statistical Review 2003*

10 Recent reforms in the insurance sector and particularly reforms relating to the legal system and how claims are settled are discussed in Chapter 9.
11 The "insurance cycle" is discussed in Chapter 2.
12 Deloitte & Touche (1995), *Economic Consequences of the Cost of Insurance in Ireland*.

Figure 3.3: Net Operating Profit (€m), Motor & Liability, Ireland, 1995-2003



Source: *Blue Books* and the *Insurance Statistical Review 2003*

3.19 The five largest insurance companies supplied their profits to the Joint Oireachtas Committee on Enterprise and Small Business in July 2004. The change in their profits between 2002 and 2003 can be seen in Table 3.6 below. In total the profits of the five largest insurance companies operating in Ireland - Allianz, AXA, FBD, Hibernian and Quinn-direct - increased by €417m between 2002 and 2003; this represents an increase of 367%.

3.20 Overall, therefore, profits have increased significantly in recent years. On the cost side, improved profitability may be in part due to ongoing reform in the sector. However, as the next section shows, improved profitability in the sector may also be partially attributed to increased levels of premiums. Profitability patterns show a degree of cyclicality which is to be expected given the "insurance cycle" phenomenon.

Premiums

3.21 In considering the development of the price of motor insurance in Ireland it is necessary to have regard to the Consumer Price Index (CPI). General inflation, as measured by the CPI, has varied between 2.4% and 5.6% annually over the seven-year period 1998 to 2004, although the rate of inflation had decreased in 2002 to 4.6% and 2.5% in 2004.[13] Over the full seven years to the end of 2004, the CPI increased by 24.3%.

3.22 Private motor insurance prices are tracked by the Central Statistics Office and form part of the "Services" element of the CPI calculation. Over the five years 1998 to 2002, the price of motor insurance increased by 53.8% in nominal terms. Premiums for motor car insurance actually fell over the past two years. Due to this decline, the increase in the nominal

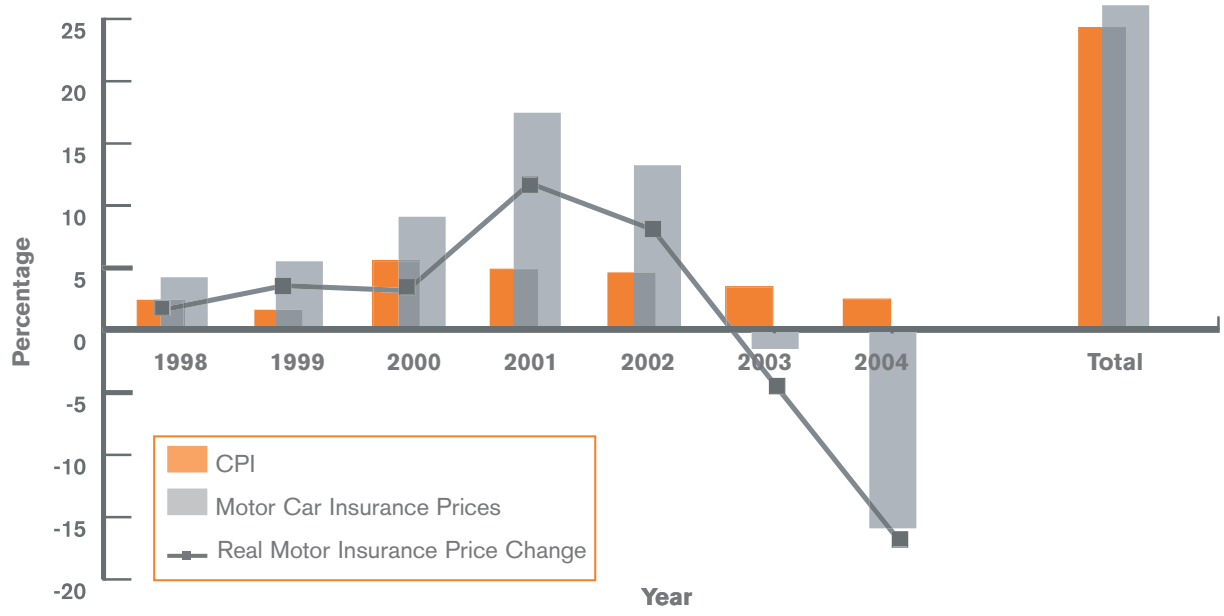
Table 3.6: Five Largest Insurance Companies' Profits, Ireland, 2002-2003

	2003 Profit (€m)	2002 Profit (€m)	% Increase from 2002
Allianz	118	(22)	
AXA	123	52	237%
FBD	89	21	257%
Hibernian	130	71	183%
Quinn-direct	113	34	332%
Total	**573**	**156**	**367%**

Source: Joint Oireachtas Committee on Enterprise and Small Business, July 2004

13 The 2004 inflation figures in this section are calculated from the change in prices between September 2003 and September 2004.

Figure 3.4: Motor Insurance Price Index and Consumer Price Index, Ireland, 1998-2004



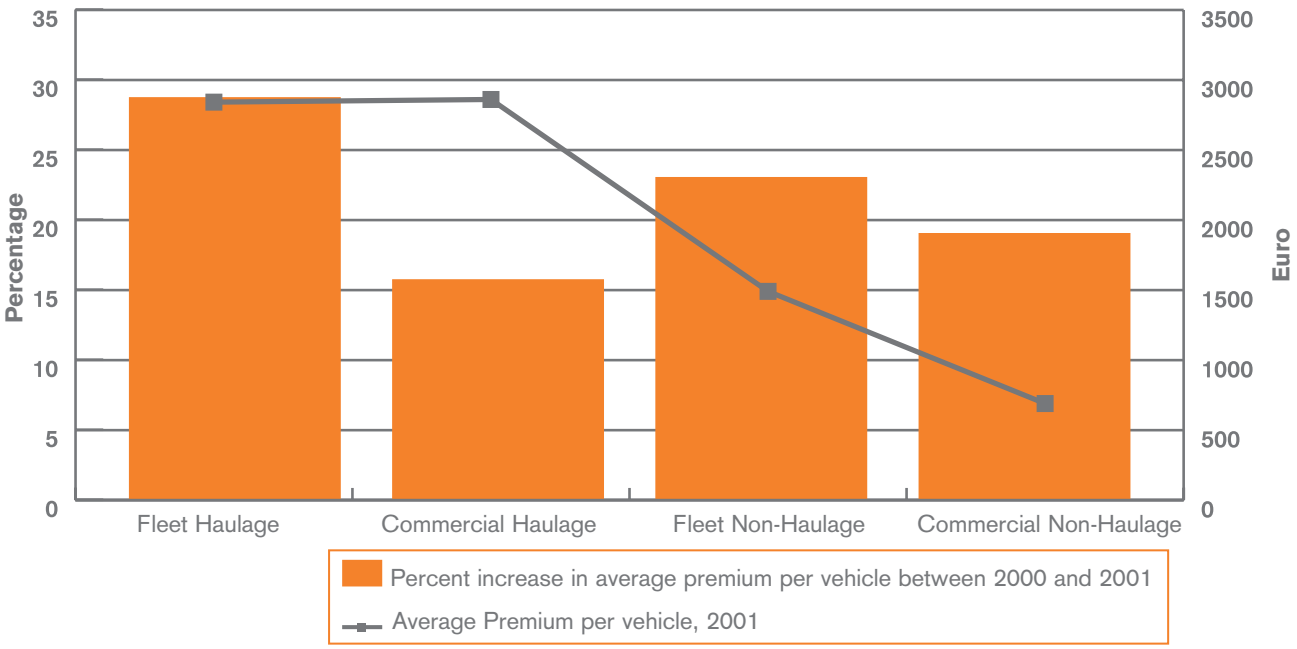
Source: Central Statistics Office

price of motor insurance over the full period 1998 to 2004 was only 26%. This is shown in Figure 3.4 above. Thus, taking the level of inflation into consideration, the real price of motor insurance increased 1.71% between 1998 and 2004.

3.23 The CPI also tracks motorcycle insurance. In the period 1998-2004, while the CPI increased by 24.3%, motorcycle insurance prices rose by 140%. As a result, real motorcycle insurance premiums rose by over 100%.

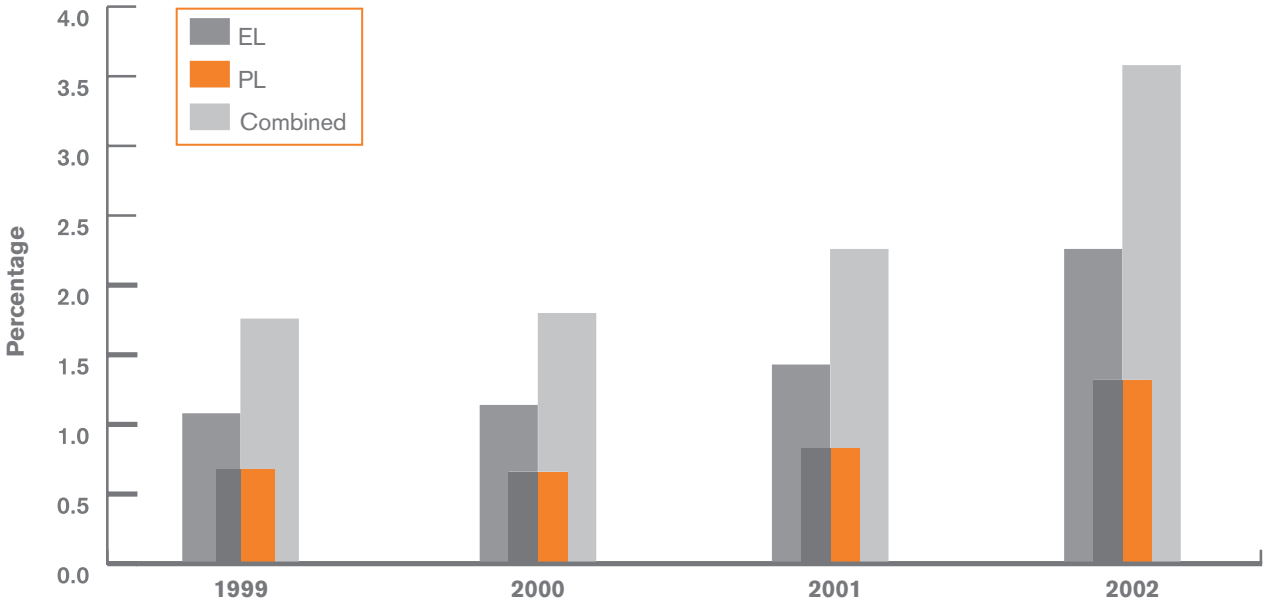
3.24 The Motor Insurance Advisory Board ("MIAB") Report 2004 details the increase in average premiums per risk category for commercial motor insurance. Commercial non-haulage vehicles accounted for 80% (323,000 vehicle years) of the overall exposure in commercial motor in 2001. Fleet non-haulage, fleet haulage and commercial haulage accounted for 16%, 3% and 2% respectively. Figure 3.5 shows large increases in average premiums between 2000 and 2001; the fleet and commercial haulage average premiums are virtually the same in value. However for non-haulage vehicles, fleet premiums are over twice the average premium of commercial vehicles.

Figure 3.5: Percentage increase and value per commercial risk category, Ireland, 2000 - 2001



Source: MIAB (2004) *Report 2004*

Figure 3.6: Average EL and PL Premium as a Percentage of Payroll, Ireland, 1999-2002



Source: IBEC

3.25 The MIAB analysis deals with data up to and including 2001. There is no equivalent analysis available for 2002. However, a survey by the Irish Business and Employers Confederation ("IBEC") indicated that insurance premiums had increased by an average of 42% between 1999 and 2002.[14]

3.26 The CSO does not track the price of liability insurance. However, the 2002 survey by IBEC in 2002 indicated that the combined cost of EL and PL doubled as a percentage of payrolls, increasing from 1.8% in 1999 to 3.6% in 2002. As shown in Figure 3.6, the biggest year-on-year increase was between 2001 and 2002.

3.27 An Alliance for Insurance Reform survey from 2003 of 173 companies employing 16,000 people also reported increases in premiums. This survey found that almost 18% of companies had premium increases of over 100% in 2002, compared to 9% of firms the previous year.

3.28 Some sectors have indicated that their costs rose far in excess of the average. Examples include many of the construction trades, as well as hotels, leisure, and community and voluntary groups. The Irish Hotels Federation carried out a survey of its members showing that the mean increase in insurance premiums in the hotel and guesthouse sector over the period 2000 to 2003 was 351%. However, there are reports of reductions in 2004.

Segmentation

3.29 The above overview, with reference to size, profitability and premium income, in the non-life insurance sector provides an indication of the trends in the motor and liability markets. It also indicates some examples of types of risks - or segments of the market - that have experienced much greater premium increases than the market as a whole. One difficulty in exploring this issue is the lack of publicly available, market-wide data on the loss statistics of particular segments of the market.

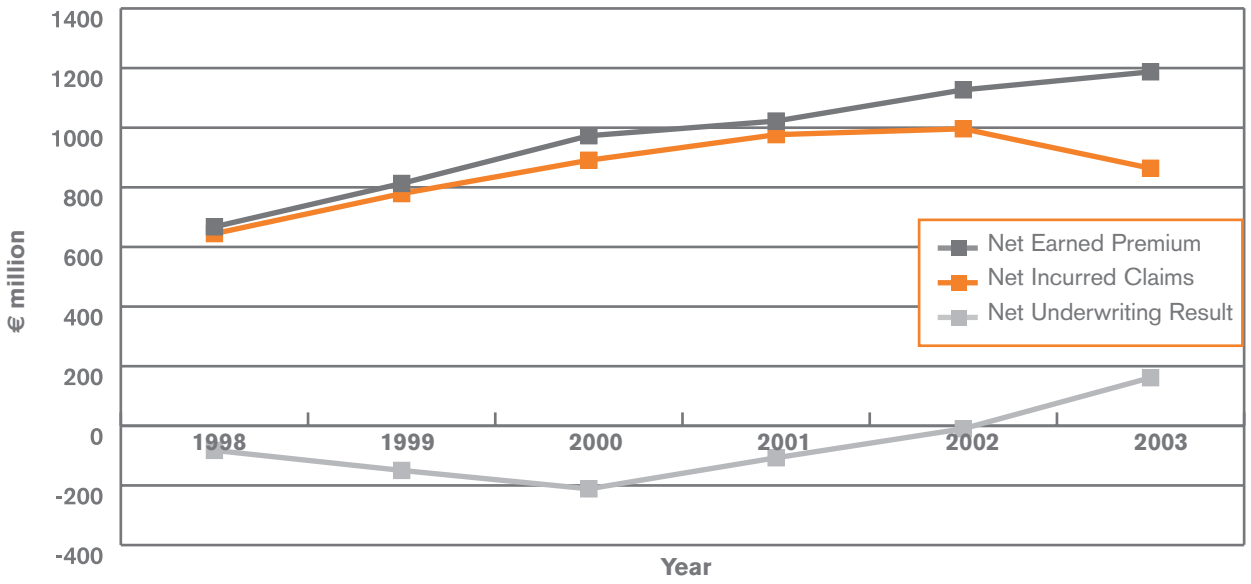
3.30 The IIF *Factfile* provides a slightly more disaggregated picture than that presented in the *Insurance Statistical Review 2003* and the *Blue Books*. It should be borne in mind when interpreting the data in this section that even if premiums exceed claims, there can still be an underwriting loss because commissions and administration costs must still be deducted.

3.31 In the case of "private motor", the net EPI has increased by 78% over the six-year period 1998 to 2003, from €668m in 1998 to €1187.4m in 2003. See Figure 3.7.[15] The net underwriting loss of €9m in 2002 was a significant improvement on the €107m loss in 2001. This further improved to an underwriting profit of €161.4m in 2003.

14 IBEC (2002), *IBEC Survey of Insurance Costs 2002*. The survey examines the experience of 207 companies, employing over 78,000 employees, obtained from questionnaires sent to a random sample of companies. The survey covers the period 1999 to 2002.

15 The IIF *Factfile* separates motor insurance into "private motor" and "commercial motor". Private motor constitutes just under 70% of gross premiums. See IIF *Factfile* (www.iif.ie).

Figure 3.7: Private Motor Premiums, Claims and Underwriting, Ireland, 1998-2003

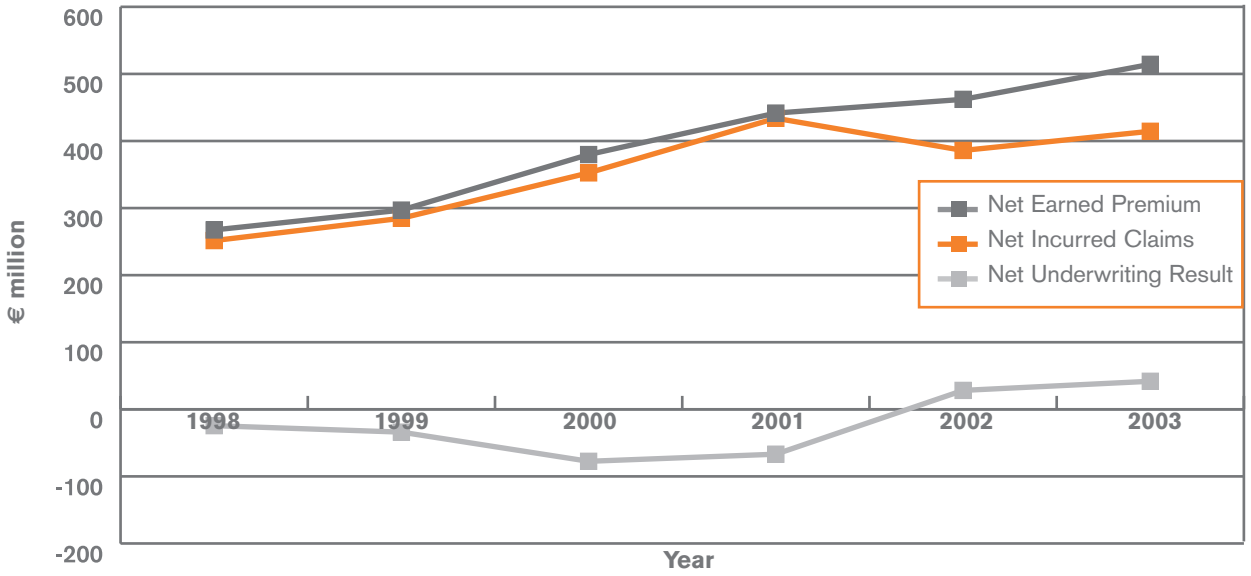


Source: IIF *Factfiles*

3.32 The value of the commercial motor insurance market, in terms of net EPI, has increased by 92.3% in the six-year period 1998 to 2003. The underwriting result improved from a loss of €77.5m in 2000 to a profit of €42m in 2003 as shown in Figure 3.8.

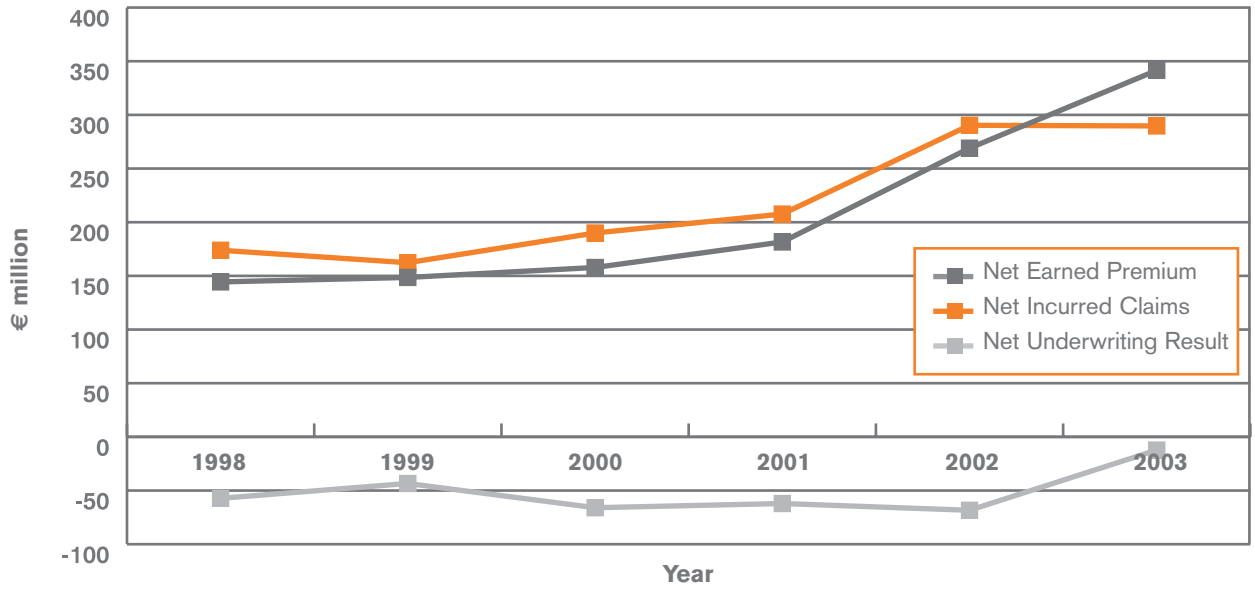
3.33 In EL net claims costs exceeded net EPI each year from 1998 up to and including 2002 as shown in Figure 3.9 (on the following page). However, in 2003 EPI exceeded Net Incurred Costs. The underwriting loss reduced from €68m in 2002 to €12m in 2003.

Figure 3.8: Commercial Motor Premiums, Claims and Underwriting, Ireland, 1998-2003



Source: IIF *Factfiles*

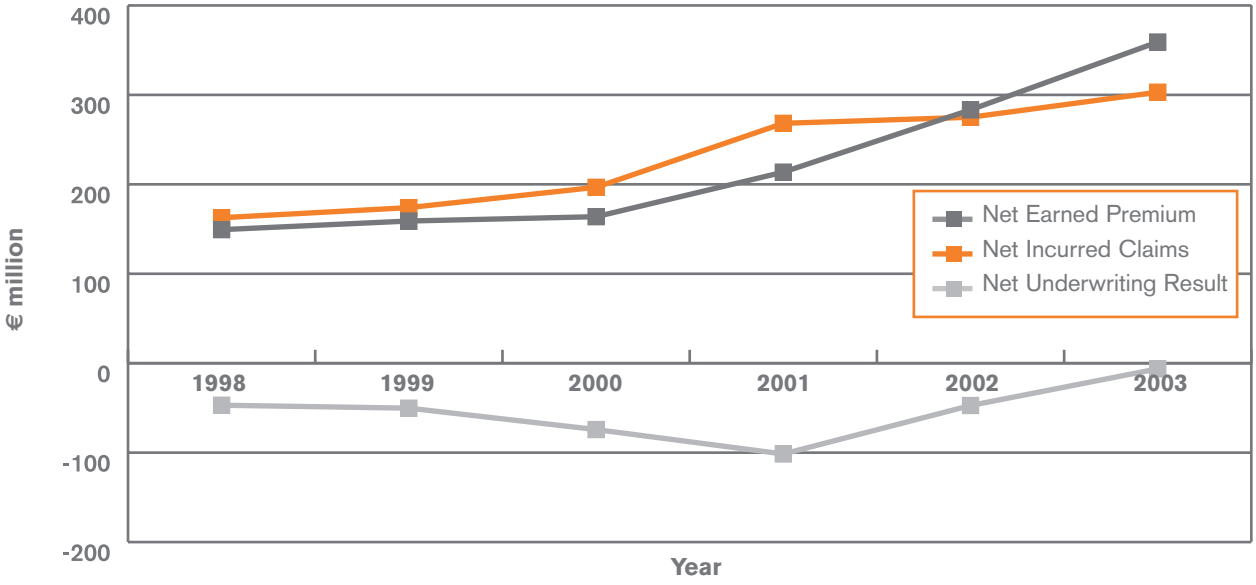
Figure 3.9: Employers Liability Premiums, Claims and Underwriting, Ireland, 1998-2003



Source: IIF *Factfiles*

3.34 In the case of PL, underwriting losses were at €50m in 1998, went to €102m in 2001 but have recovered to €6.3m in 2003 as shown in Figure 3.10.

Figure 3.10: Public Liability Premiums, Claims and Underwriting, Ireland, 1998-2003



Source: IIF *Factfiles*

Table 3.7: Numbers of Non-life Insurance Undertakings in Ireland Covering Irish Risk Business, 2001 - 2003

Insurance Undertakings in Ireland having	2001	2002	2004[17]
Head Offices	35	42	47
Branches	20	21	19
Head Office outside EEA	1	1	1

Source: *Blue Books* and *Insurance Statistical Review 2003*

Market Players and Distribution

3.35 The *Insurance Statistical Review 2003* and the *Blue Books* for previous years show the numbers of insurers with establishments in Ireland. These insurers include those with head offices in Ireland; branches of insurers that have their head offices in other EU Member States and other European Economic Area ("EEA") states[16] and branches of insurers that have their head offices outside the EEA. The number of undertakings in the non-life sector are as follows are shown in Table 3.7 above.

3.36 In addition, as of 24th September 2004, 463 insurers had authority to write non-life business in Ireland on a "freedom of services" basis. The corresponding figure in 2002 was 433.[18]

3.37 29 motor and 43 liability underwriters have either a head office or a branch in Ireland; of these only 15 and 16 companies, for motor and liability, respectively, have an EPI, net of reinsurance, exceeding €1m. Of the 463 companies who have notified IFSRA of their intention to provide motor and liability insurance on a "freedom of services" basis, many are not currently active on the Irish market.

3.38 There are 20 non-life IIF members. The IIF estimates that its members account for over 95% of the general insurance business in Ireland.[19] Fourteen IIF Members provide liability insurance and fifteen provide motor insurance.

3.39 The IIF, in its submission to the Joint Oireachtas Committee on Enterprise and Small Business on motor insurance for young drivers, stated the following:

"Eight insurers established in Ireland ... are actively writing private motor insurance business (and a ninth writes "scheme" business only.)... There are, however, a number of other companies already authorised to write motor insurance business in Ireland, and no further access conditions are imposed on them if they wish to enter the market or any particular sector of the market."[20]

3.40 Some insurers sell insurance directly to buyers, others distribute exclusively through brokers, and other underwriters use both channels.

3.41 Brokers are an important distribution channel. The Irish Brokers Association ("IBA") has indicated that its members provide services for approximately 80% of general insurance polices sold in Ireland.[21] AXCO reported that brokers and other agents were the main distribution channel for 95% of liability insurance in Ireland and 40% of motor. Direct writers earn 50% of the motor insurance premium income. By comparison, little liability business is done directly, mainly due to the complexity of liability insurance.[22]

3.42 The vast majority of buyers of commercial liability insurance access the market via an intermediary of some sort. Small firms with relatively simple insurance needs are more likely to use an agent or a small local broker or, in some cases, to buy their insurance directly. Large firms with complex insurance needs are more likely to use the services of one of the major international or large national insurances brokers. Firms with very specialised insurance needs, including those in high-risk sectors, are more likely to use specialist intermediaries.

3.43 While insurance brokers dominate the distribution systems for commercial insurance, the marketing of motor insurance (and "personal lines" generally) has undergone major change in recent years. Direct marketing accounts for between 10% and 30% of motor insurance across the overall European insurance market. The success of direct marketing of motor insurance arises from the fact that motor insurances are simpler and more homogenous products than commercial insurance products and do not require the same level of risk management services and capital support.

16 The EEA consists of the EU Member States along with Iceland, Liechtenstein and Norway.
17 As of 24th of September 2004.
18 *Insurance Statistical Review 2003* and *Blue Books*.
19 See www.iif.ie.
20 IBA (2001), Submission to the Joint Oireachtas Committee, 8th May.
21 Presentation to the Joint Oireachtas Committee on Enterprise and Small Business, 23rd July 2003.
22 C Parsons et al (2004) *Report on the Economics and Regulation of Insurance with particular reference to Motor, Employers' Liability Insurance and Public Liability Insurance*, London: Cass Business School, City of London.

Buyers

3.44 Private individuals play a very significant role in the Irish motor market. There are approximately 1.5 million cars in Ireland, 35,000 motorcycles and 250,000 commercial vehicles.[23] By contrast, the main buyers of EL and PL are organisations such as business firms, public agencies and community and voluntary groups. Apart from third party motor, the only form of liability insurance of any significance bought by private individuals is the cover provided under home insurance policies. These policies indemnify for accidents arising in connection with the ownership and occupation of domestic property or other non-business activity (sometimes referred to "personal liability" cover).

3.45 Some small firms or individuals find it difficult to get insurance. In order to take advantage of scale economies and the benefits of data pooling, individuals or small firms with similar risk profiles, usually with the help of a broker, can group together. This enables the broker to collate and maintain relevant data and to manage the interface with the affinity/group. This information can then be presented to the underwriter who offers the best price. These may be referred to as "group schemes". For example an insurer may be unwilling to accept a single client from a particular area of economic or voluntary activity due to the insurer's lack of a risk profile in that particular area. However, due to a relevant association and/or a broker pooling together a group of similar organisations, the risk of the group as a whole is measurable and the risk is easier to manage (i.e., the insurer may impose restrictions on the activities of the organisations in the scheme in order to reduce risk). Such a scheme creates a critical mass of customers for the insurer. Schemes allow groups to differentiate themselves on the basis of their membership standards. Group schemes for trades are often used as a means for attracting members to unions or associations.

Ownership

3.46 One of the key drivers of market change in insurance has been the continuing globalisation of business and commerce. In insurance, international companies have been gaining greater shares of national insurance markets, sometimes by new market entry but mainly through mergers and acquisitions. The mergers and acquisitions that have occurred were cleared at EU level. The buoyant stock markets of the second half of the 1990s were a major factor in this, because listed insurance companies with a good stock market rating were able to acquire smaller insurance companies or insurance companies of similar size with lower stock market valuations. There was increased activity, regionally and globally, as some of the largest international companies, including a number of European-based firms, sought to develop operations with a wider geographical reach. A major reason for this policy lay in the fact that insurers' corporate customers were themselves "going global" and, in a service industry such as insurance, there is a commercial imperative to have a global network to service these multinational clients.[24]

3.47 In addition to the few indigenous companies, most of the main players in the Irish insurance market are subsidiaries of international groups. The level of international ownership in Ireland indicates that international insurance developments will have a significant, direct impact on the Irish insurance market.

3.48 The introduction of various EU Insurance Directives was designed to stimulate the creation of a more integrated European insurance market.[25] This has seen many European insurance companies setting up operations in other European countries, especially in countries that are geographically contiguous. However, the main driver of European insurance market integration has been mergers and acquisitions, and it has been the larger insurance companies that have been the most active in this regard. By 2003 foreign penetration of national markets was much higher than it had been ten years earlier, except for countries such as Ireland, Belgium and Austria, where foreign ownership had historically been high. In these countries foreign owned companies often changed hands as a result of mergers and agreed acquisitions between insurance companies in other countries, usually in the larger European countries and, in particular, France, Germany, UK, Switzerland and the Netherlands.

Summary and Conclusion

3.49 The non-life insurance sector is a substantial and growing part of the Irish economy. It was excess of 3.9% of national income or more that €4.39bn in 2003.

3.50 The profitability of the non-life insurance sector has improved over the last few years. This may be due in part to ongoing reform in the sector, but also because of large increases levels of premiums. Profitability of non-life insurance providers shows a degree of cyclicality, which is consistent with the "insurance cycle" phenomenon.

3.51 Non-life insurance premiums have risen sharply over the last number of years. Certain market segments have experienced much higher levels of increase than others.

23 *Department of Environment 2003 Bulletin.*
24 C Parsons et al (2004) *Report on the Economics and Regulation of Insurance with particular reference to Motor, Employers' Liability Insurance and Public Liability Insurance*, London: Cass Business School, City of London.
25 For a discussion of the relevant EU Directives, see Chapter 4, below.

3.52 There are in excess of 40 non-life insurance providers with head offices in Ireland supplying the market and almost 20 providers with branches in the State, but head offices outside the State. Brokers and other market intermediaries play a significant role in distribution, especially for liability insurance and where buyer requirements are non-standard and specialist intermediaries are required. Approximately 80% of general insurance is sold through market intermediaries. For motor, buyers are typically individuals. However, for liability, buyers tend to be businesses, public bodies and voluntary groups.

3.53 Individuals and small businesses often find it difficult to get insurance. As a consequence, group schemes have become an increasingly prominent feature of the market.

3.54 The Irish insurance market is characterised, to a significant degree, by a high level of foreign ownership, particularly by global insurance entities. The implication is that Irish non-life insurance markets are influenced heavily by developments in the global insurance market conditions.

Chapter 4

REGULATION OF INSURANCE

REGULATION OF INSURANCE

Introduction

4.1 In general, suppliers in a market competing against one another for customers can be expected to drive down price and drive up quality and innovation. In this way, market forces work in the interest of buyers. However, where there is "market failure", there is a case for considering some form of intervention in the marketplace.

4.2 Regulation by the state is not necessarily the optimum response in all cases of market failure, however, because there may be other, simpler remedies.[1] These include voluntary codes of conduct, self-regulation and the use of contracts between the parties concerned. Even so, there is some degree of statutory regulation in insurance markets in most developed economies. This regulation typically focuses on solvency and consumer protection.

4.3 This chapter describes general reasons for regulating insurance. It also looks at the nature of regulation in the Single European Market, which provides the basis for regulation in Ireland. Finally, regulation in Ireland is studied more closely.

Reasons for Regulation in the Insurance Sector

4.4 Market failure can arise from three main sources, each of which is described below. First, there is information failure, especially asymmetric information. Second, there is the occurrence of externalities in consumption or production. Third, there is market power.

Information Failure

4.5 When buyers and sellers in a market do not have the same information (i.e., there is "asymmetric information"), the competitive market may fail to produce a socially optimal outcome. Information asymmetries exist in many forms. For example, in the case of complex products, a buyer might not know how to judge the quality of the product. This leads to a role for consumer protection measures. There are consumer protection laws that operate across the economy as a whole. However, in many cases, specific rules are designed for individual sectors or types of products, including insurance.[2]

4.6 It is widely accepted that buyers of insurance are usually relatively less well informed than suppliers about the detail of the coverage of an insurance product. The "small print" provides information but this may take considerable time for buyers to absorb, and many find it difficult to understand. In addition, insurance is usually an annual purchase, so there is often little opportunity for the buyer to develop expertise. Furthermore, insurance is in many ways an experience good. Consumers typically cannot assess the quality of the product they have purchased until they submit a claim. For example, how easy is it to file a claim? How promptly are claims handled? In addition, it may be a claim from a third party that tests the quality of a particular insurance policy. These factors add to the difficulty consumers have in developing expertise and determining the quality of the insurance products they purchase or can purchase from other insurers.

4.7 Claims can be filed years after insurance is purchased. Thus, a central aspect of the quality of an insurance policy is the insurer's ability to honour claims both now and in the future. This ability relates to the solvency of the insurer. Given the importance of solvency, buyers, *ex ante*, seek reassurance that their insurer is solvent in order to ensure valid claims will be honoured, both now and in the future. Against this background, the regulation of insurance aims to protect buyers by checking regularly that insurers have enough money to pay expected future claims.

4.8 In some markets, including insurance, there are cases of consumer inertia. One cause of inertia may be a lack of information on the part of the consumer. In the case of complex services such as insurance, it may be difficult for consumers to make "value for money" comparisons. Rules that cover disclosure of information, levels of competence, etc. can help to reduce information asymmetry to the benefit of the buyer. There is also a role within markets for intermediaries in explaining issues to buyers. There are, at the same time, information asymmetry issues in intermediary markets, which give rise to rules on competency and disclosure in the intermediary market as well.

4.9 Another type of information asymmetry in insurance markets relates to buyers knowing more than an insurer about their own individual risk. If buyers do not reveal information that would affect how their risk is rated, they might wrongly be charged a premium lower than

1 Furthermore, any market failure needs to be considered in the context of government failure. For a discussion of this issue see Wolf, C. (1988), *Markets or Governments: Choosing between Imperfect Alternatives*, 2nd Edition, Cambridge, Mass: The MIT Press.

2 For a more detailed discussion of the economics of market failure and regulation, see Church, J., and R. Ware (2000), *Industrial Organization: A Strategic Approach*, San Francisco: McGraw-Hill.

their real risk profile would demand. Hidden information may also lead to the insurance being invalid, which might be discovered when a claim is lodged. For this reason, a buyer is required to disclose all relevant facts fully and truthfully before purchasing insurance.[3]

Externalities

4.10 Externalities occur when the consumption or production of goods or services have positive or negative "spill-over" effects on third parties.[4] Insurance can give rise to positive externalities. In particular, if an insured person or company negligently causes harm to a third party, the third party is likely to have a greater chance of compensation if the person or company causing the accident has valid insurance.

4.11 On the other hand, a negative externality of insurance is "moral hazard". Moral hazard results when a buyer of insurance relies on the insurance to cover risky behaviour, rather than taking steps to reduce risk. In this case, the purchase of insurance might lead to there being more accidents.[5] This can be addressed by measures such as risk sharing through higher deductibles, or insistence on relevant training or safety measures. It can also be addressed by enforcement of relevant laws to discourage illegal, risky behaviour.

Market Power

4.12 Market power is the ability of firms to raise prices above the competitive level. This can occur where firms achieve a monopoly or dominant position, which can happen, for example, when economies of scale are significant or rivals are excluded from the marketplace.

4.13 In cases where there is easy entry and a large number of sellers, the firms in the industry are not likely to have market power, and there is not likely to be a market power rationale for government intervention in the marketplace. However, if there are restrictions on entry and a small number of suppliers, there may be a case for sector-specific regulation to protect buyers from an exercise of market power.

4.14 In addition to sector-specific regulation, competition policy and law are a general set of requirements, applicable to all sectors of the economy (including insurance), related to the development and exercise of market power. Competition law and policy have several components.[6] One is the investigation of cartels and abuses of dominant positions in the market. These functions are carried out ex post, i.e., after an alleged breach of competition rules has begun. Financial penalties and behavioural remedies may be imposed, and the threat of investigation acts as a deterrent to anticompetitive behaviour. Merger analysis is another component of competition policy. In contrast to cartel and abuse of dominance cases, the assessment of a merger typically takes place ex ante, i.e., before a merger is put into effect. The focus of such an assessment is on whether the merger would be likely to lead to a substantial lessening of competition. If so, the merger will either be blocked or conditions attached to it in order to alleviate competitive concerns. The final component of competition policy involves the study of markets. Market studies may lead to recommendations aimed at improving how the markets function.

Insurance Regulation in the Single European Market

4.15 Within the EU/EEA, regulation of insurance takes place at national level. However, there is a framework for mutual recognition and cooperation among national supervisory authorities. The legislative measures that have been designed to create a single market in insurance include three "generations" of directives.

First Generation of Directives

4.16 The first generation incorporates the First Non-Life Insurance Directive, which was introduced in 1973.[7] This made provision for a harmonised insurance supervision law, paving the way, along with the so-called "liberalisation directive"[8], for insurers to open agencies or branches in other Member States ("freedom of establishment"). This constituted a step towards an integrated market. However, it still required insurers seeking to do business in another Member State to get prior authorisation from the host state regulator for each class of insurance business, notwithstanding the fact that they were already regulated in their home state.

3 This is often referred to as "adverse selection". Adverse selection is also discussed in Chapter 2 of this Study.
4 An example of a positive externality is the beneficial effect on public health when individuals obtain innoculation against disease. An example of a negative externality is pollution arising from production or consumption.
5 Moral hazard is also discussed in Chapter 2 of this Study.
6 For more details see the Authority's website, www.tca.ie.
7 Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life assurance, OJ [1973] L 228/3.
8 Council Directive 73/240/EEC of 24 July 1973 abolishing restrictions on freedom of establishment in the business of direct insurance other than life assurance, OJ [1973] L 228/20.

Second Generation of Directives

4.17 The second generation of directives incorporates the Second Non-Life Insurance Directive.[9]

4.18 This Directive drew a distinction between "large" risks and "mass" risks. Large risks include, for example, commerical risks where buyers who, by virtue of their size, status or the nature of the risk, did not require special protection in the Member State in which the risk was insured. The Directive provided for complete freedom so that buyers could "... avail themselves of the widest possible insurance market".[10] Accordingly, an insurer's authorisation in its home state was also a licence to cover such risks in all other Member States. The insurer is only required to inform the host state's regulator that it intends to provide services in the Member State in question.

4.19 Mass risks involve insurance cover for private individuals and commercial organisations that do not qualify as a "large" risk. The Directive considered that buyers in this category would still require special protection. Therefore, if an insurer wanted to cover mass risks in another Member State, it would still have to seek formal authorisation from the home state regulator.

4.20 The Second Non-Life Insurance Directive also contains rules about the law applicable to insurance contracts. In the case of large risks, it indicates freedom to choose whether the law of the home state or host state would apply. In the case of mass risks, the applicable law is generally that of the host state.

Third Generation of Directives

4.21 The third generation of directives includes the Third Non-Life Insurance Directive.[11] Under this Directive, an insurer that is established and authorised in one Member State can provide services in any other Member State under both freedom of establishment or freedom of services provisions without having to fulfil any further requirements. However, "general good" requirements must be fulfilled.[12] Supervisory control remains with the regulator in the home state.

4.22 This means that there is now a single system for the authorisation and financial supervision of an insurer by the Member State in which it has its head office (i.e., "home country control"). An authorisation issued by the home Member State enables the insurer to provide services anywhere in the EEA. This can be done either by opening agencies or branches in other Member States (i.e., "establishment"), or by providing services directly from its home state or another Member State (i.e., "freedom of services"), for example, via telephone or the Internet. This single-licence supervisory system is made possible by the level of harmonisation achieved by EU/EEA legislation on insurance, especially in the prudential field.

Solvency Supervision

4.23 This "single passport" system relies on mutual recognition of the supervision exercised by different national regulators according to rules harmonised to the extent necessary at the EU/EEA level. The minimum levels of capital required by insurers are dealt with in Council Directives[13] and there is provision to index the required amounts to inflation. The solvency thresholds are based on the levels of premiums and claims.

4.24 In order to take account of specific local risks, Member States may lay down stricter rules for insurers that they regulate than those contained in the Directive. For example, they can set the solvency margin (the additional minimum capital that must be available to an insurer in the event of unforeseen difficulties) at a higher level than the minumum required. They can also intervene early to take remedial action where buyers' interests are threatened (e.g., an insurer satisfying the solvency margin requirements, but experiencing a rapid deterioration in its financial position).

4.25 Work is now taking place at EU/EEA level on developing a "risk-based" solvency regime in a "Solvency II" project. This is a wide ranging review involving more sophisticated approaches to solvency. The objective is to match solvency requirements better to the true risk encountered by an insurer and to encourage insurers to improve their measurement and monitoring of the risks they incur.

Winding Up of Insurance Undertakings

4.26 In accordance with Directive 2001/17/EC on the reorganisation and winding up of insurance undertakings, when an insurer with branches in other Member States fails, the winding up process is subject to a single bankruptcy proceeding in, and subject to the bankruptcy law of, the home state. Creditors in this proceeding have to be treated without discrimination regardless of the Member State in which they are resident.

9 Second Council Directive 88/357/EEC of 22 June 1988 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC, OJ [1988] L 172/1.

10 Ibid– preamble.

11 Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and adminstrative provisions relating to direct insurance other than life assurance and amending Directive 73/239/EEC (First Non-Life Insurance Directive), OJ [1992] L 228/1.

12 The concept of the "general good" is discussed below.

13 For example, Directives 2002/12/EC and 2002/13/EC ("Solvency 1") deal with setting the amounts of capital required. Solvency 1 applies to all insurers by 2006.

4.27 However, the extent to which policyholders are compensated in such circumstances depends on a number of factors. One factor is the extent of assets available for distribution to creditors. A second is the degree of priority the law of the home state assigns to policyholders as creditors. A third is the existence of permanent or ad hoc policyholder protection fund arrangements for compensation of policyholders and the extent to which these arrangements are available to all EEA policyholders.

Policyholder Protection Fund

4.28 The failure of an insurer in the EU with significant cross-border business has highlighted the difficulties that can arise in relation to policyholders outside the home state. In the UK, a policyholder protection fund was invoked after the collapse of Independent Insurance Company. Independent Insurance Company had customers in both the UK and Ireland. Private Irish policyholders were protected by the fund. However commercial Irish policyholders were not protected by the UK fund. This fund is collected via a levy on insurance premiums. It covers 100% of the claim for the first £2000 and 90% of the remainder of the claim. There is no ceiling on the value of claims. Both outstanding claims and unearned premiums are covered.[14]

4.29 Member States of the EU and EEA are currently considering the possibility of introducing some minimum harmonisation of guarantee schemes at EU/EEA level in order to ensure protection to buyers of insurance (and third party claimants) in the event of the collapse of an insurer. One objective of a guarantee scheme would be to ensure that there would be at least a minimum level of prompt compensation in cases where not enough assets are left to pay outstanding claims within the winding-up proceedings. The issue is being discussed in a working group within the European Commission's (the "Commission") "Insurance Committee", which includes representatives of all member states, with Ireland being represented by IFSRA and the Department of Finance.

The "General Good" in the Insurance Sector

4.30 A Member State may have recourse to the concept of the general good in order to enforce compliance with its own laws by an insurer wishing to carry on business within its territory under the right of freedom of establishment or freedom of services.

4.31 An insurer must comply with the rules of the host country, even if they entail a restriction. For such a measure to be justified as being in the general good, it must not have been harmonised at EU level and must not duplicate rules of the country of origin. It must be:

(a) non-discriminatory;

(b) justified by imperative requirements in the general interest;

(c) objectively necessary; and

(d) proportionate to the objective pursued.

4.32 If an insurer is faced with a national rule that constitutes an unjustified restriction of the freedom of establishment or the freedom to provide services, it may resort to the courts or lodge a complaint with the Commission.[15]

Motor Insurance

4.33 Liberalisation of international road travel in the EU/EEA has been a major factor in efforts to harmonise the widely varying motor insurance regimes of Member States. This process is by no means complete, but there have been four Council Directives on motor insurance.[16]

4.34 The First Council Directive on Motor Insurance (1972) stipulated that motor insurance policies in a Member State had to provide the minimum cover for each of the other Member States. This allowed any vehicle in the EU to travel legally to other Member States on the basis of its own insurance policy. This did not address the disparity in the minimum indemnity requirements prescribed by the laws of the various Member States.

4.35 The Second Directive (1984) introduced minimum indemnity. In addition, it required an insurance policy covering any motor vehicle to accept liability for all drivers whether or not they were named on the policy. It also required a compensation fund to be set up to compensate victims of road accidents where there was no insurance, defective insurance or where the culpable vehicle was untraced - although motor insurance bureaux were already providing that service in practice.

4.36 The Third Directive (1992) required that, in the case of vehicles insured in one Member State but visiting another, the minimum legal cover would be the higher of the two Member States. In addition, a single

14 Commission (2003), *Insurance guarantee schemes discussion paper for the III meeting of the Working Group, Commission*, January.
15 Chapters 7 and 8 contain analyses of a number of "national rules" which may constitute unjustified restrictions of competition.
16 Directive 72/166/EEC, OJ [1972] L 103, 2.5.1972, p. 1 (First Motor Directive); Directive 84/5/EEC, OJ [1984] L 8, 11.1.1984, p. 17 (Second Motor Directive); Directive 90/232/EEC, OJ [1990] L 129, 19.5.1990, p. 33 (Third Motor Directive); Directive 2000/26/EC, OJ [2000] L 181, 20.7.2000, p. 65 (Fourth Motor Directive).

premium would have to cover use of the vehicle throughout the EU. Passenger liability would have to be included in the policy. Compensation would have to be paid as soon as liability was established. Where there was a dispute, the insurer, or motor insurance bureau if applicable, would have to pay compensation as soon as liability was established and then sort details between themselves afterwards.

4.37 The Fourth Directive (2000) established a mechanism for quick settlement of claims where the accident takes place outside the victim's Member State of residence. It required insurers to have claims representatives in all Member States. It also established an information and assistance service for claimants in respect of accidents that took place outside their own Member State. Towards this end, it required each Member State to set up a register of insured vehicles.

4.38 There is now a proposal from the Commission for a Fifth Directive on motor insurance. The main objectives in this regard are to (1) update and improve the protection of victims of motor vehicle accidents through compulsory insurance; (2) fill gaps and clarify certain provisions of the earlier Directives, thereby ensuring increased convergence as regards their interpretation and application by the Member States; and (3) provide solutions to problems that arise frequently in order to create a more efficient single market in motor insurance.

4.39 In some Member States, including Ireland, liability for personal injuries in motor insurance contracts is unlimited. Insurers have the option of drawing upon reinsurance in the event of very high-cost settlements. There is a debate as to whether liability should continue to be unlimited, but there is no consensus at this stage on whether changes to the existing system would be appropriate.

Block Exemption Regulation

4.40 The Insurance Block Exemption Regulation[17] conditionally authorises certain types of co-operation agreements between insurance companies which would otherwise be illegal and void under EU competition law. Agreements covered include joint calculations of risks and joint studies on future risks; the establishment of non-binding standard policy conditions; the establishment and management of insurance pools; and the testing and acceptance of security equipment.

Insurance Mediation

4.41 With the objective of achieving an internal market for insurance intermediaries, the Insurance Mediation Directive ("IMD")[18] was adopted in 2002 and came into effect on the 14th January 2005.[19] It will provide for a European passport for insurance intermediaries, based on registration in their home state on the basis of professionalism and competence (as determined by the regulations applicable in that Member State). This will require individuals engaged in the sale of insurance products to possess appropriate knowledge and ability[20] on an ongoing basis. It will also require professional indemnity insurance.

4.42 The IMD will require an intermediary to inform a client, before the conclusion of an insurance contract, whether "broad based advice"[21] is being offered, or whether the service is limited to placing business with one or more insurers. The reasons why particular products are considered suited to a buyer's requirements must be provided to the buyer in writing. The IMD information requirements are applicable to mass risks but not to "large" risks.

4.43 Under the IMD, Member States will be committed to providing easy public access, through a single information point, to details of registered insurance and reinsurance intermediaries, the competent authorities with which they are registered and regulated and the Member States in which they conduct business. The IMD also encourages Member States to set up appropriate and effective Alternative Dispute Resolution procedures for out-of-court redress for dissatisfied customers.

Proposed Directive on Equal Treatment between Men and Women

4.44 The Commission has proposed a Directive on equal treatment of men and women outside the workplace. This is still under negotiation. A concern with disallowing any differentiation between men and women in relation to motor insurance would be the impact on risk-related calculation of premiums. For example, in the case of motor insurance, there is evidence that, as a group, young male drivers are a higher risk than their female counterparts.[22] It follows that gender may be relevant in the setting of risk-related premiums. Against the background of a general requirement to treat men and women equally,

17 Commission Regulation 358/2003.
18 Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.
19 S.I. 13 of 2005 brought the IMD into effect in Ireland.
20 In the case of corporate intermediaries, the requirement will be applied to a "reasonable proportion" of the persons within the management structure of such entities who are responsible for insurance mediation activities, and all others directly involved in insurance mediation.
21 This requires "… analysis of a sufficiently large number of insurance contracts available on the market, to enable … a recommendation in accordance with professional criteria, regarding which insurance contract would be adequate to meet the customer's needs". The phrase "adequate to meet" includes the extent of coverage as well as best price. The specific requirements are laid out in the IFSRA Handbooks for Authorised Advisors and Multi Agency Intermediaries.
22 Accident data from the National Roads Authority show that 15-24 year old males represent 8% of the population but account for 16% of drivers involved in fatal and injury accidents.

the burden of proof that differentiation on the basis of gender is actuarially sound would rest with insurers, and would require the use of sound data.

Financial Services Action Plan

4.45 The Financial Services Action Plan ("FSAP") was adopted in 1999 with the objective of ensuring an integrated financial market in the Single European Market. It has three strategic objectives. The first is to complete a single wholesale market by the progressive removal of outstanding barriers to an integrated capital market. The second is to develop open and secure markets for retail financial services. The third is to ensure that supervisory practices can contain systemic or institutional risk (including, inter alia, solvency margins for insurers) and take account of changing market realities (incorporating, for example, pan-European, cross-sectoral organisations).

4.46 Progress is being made across a range of measures under the FSAP. However, cross-border purchasing of financial services, including insurance, in the Single European Market remains relatively limited, especially for motor insurance. In Ireland, only a very small amount of motor insurance is written from abroad. In liability insurance, the proportion written from abroad is higher. Lloyd's estimate that they write approximately 20% of liability insurance in Ireland, by premium volumes, but much less in terms of number of contracts.[23]

Regulation in Ireland

4.47 Insurance legislation in Ireland is largely derived from EU directives. Insurers with their head office in Ireland submit statistical returns to, and are supervised by, the Irish regulatory authority. Currently, the Irish regulatory is IFSRA. Insurers with their head office outside the EEA, but with a branch in Ireland, submit statutorily prescribed annual returns to, and are supervised in respect of their Irish branch by, the Irish regulatory authority. Insurers with a branch in Ireland, but with their head office in another Member State of the EEA, submit statistical returns to the Irish regulatory authority but are supervised in their home Member State. In addition to the entities that are established in Ireland, there are insurers based in other EEA countries with authorisation to write business into Ireland on a "freedom of services" basis. These insurers are supervised in their home state.

Irish Financial Services Regulatory Authority

4.48 Since 1st May 2003 the regulation and supervision of insurance companies in Ireland is the responsibility of IFSRA, which deals, *inter alia*, with issues relating to the financial stability of the insurance sector. It aims to help customers to make informed and responsible decisions on their financial affairs in a safe and fair marketplace. It also aims to foster sound and solvent financial institutions.

4.49 IFSRA supervises non-life insurers only if they have head offices in Ireland, but that supervisory role extends to all the business that such insurers do in other member states of the EEA - whether such business is done by establishing a branch in another Member State or on a cross-border basis by "freedom of services".

4.50 While IFSRA does not have responsibilty for supervising insurers that have their head offices in other EEA Member States, it receives statistical returns from the Irish branches of those insurers in respect of the business those branches do in Ireland.

4.51 The *Insurance Statistical Review 2003*, published by IFSRA in October 2004, shows that IFSRA supervised 127 non-life insurers that had head offices located in Ireland as of 24 September 2004. In addition there were 32 branches in Ireland of non-life insurers that have head offices located in other member states of the EEA. There was also one branch in Ireland of a non-life insurer with its head office outside the EEA. As of 24 September 2004, 463 non-life insurers had notified IFSRA of their intention to write business into the Irish market on a "freedom of services" basis.

Solvency

4.52 In accordance with the EU Insurance Directives, national regulators can set the solvency requirements above the minimum level. The solvency ratio set by IFSRA is approximately double the European minimum level and higher for new entrants for as long as the regulator considers necessary - usually three years. This is because there is considered to be a greater likelihood of an insurer failing in its first three years of operation than later on.[24]

4.53 In the event of an insurer failing to maintain adequate technical reserves or solvency, IFSRA has the power to take action. Such action could include prohibiting the free disposal of assets, suspending the taking on of new business, and requiring deposits to be

23 For a more detailed discussion of this issue see Chapter 6.
24 This is discussed in greater detail in Chapter 6.

furnished or information to be supplied. In the case of failure to meet the solvency margin requirements, an insurer may also be directed to submit a plan for restoration to a sound financial position; a short-term finance scheme must be submitted for approval in the event of a severe shortfall in the solvency margin. The ultimate sanction is revocation of an insurer's authorisation. This may occur if an insurance undertaking seriously fails in its statutory obligations, fails to comply with the regulations or is unable to restore its solvency margin within the time allowed.[25]

4.54 In order for the regulator to assess whether a company is complying with solvency requirements, insurers must submit their annual returns to their regulator. In Ireland's case, these returns were used in compiling the *Insurance Annual Report* (known as the "*Blue Book*") up to 2002 and are now used in the newly formatted *Insurance Statistical Review*; first published in 2004 based on 2003 data.

Data Sharing

4.55 Insurance is a special case where certain forms of data sharing can promote competition. An unusual feature of insurance is that sellers only discover their costs after they set prices, sometimes years later. The more information that an insurer has about claims in the market, the more precisely it can calculate its expected costs and hence the more keenly it can price. The wider publication of such data can also reduce the costs of new entry, an additional stimulus to competition.

4.56 This is especially important for smaller markets, where even a specialist may not have many observations in a year. For this reason, data sharing may be more important in a small economy like Ireland's. Indeed, many industry participants have cited the scale of the Irish market as a disincentive to entry.[26]

4.57 When there is inadequate information about a specific risk, different types of risk may be lumped together into a common grouping. This will seem unfair to what might be termed "lower-risk" clients, because they are grouped with other somewhat similar but in fact higher risks. This leads to lower-risk clients paying higher premiums than their individual risks would have ultimately required. Better information about risk, at a useful level of detail, helps in tackling this.

4.58 The fact that data sharing can have a positive effect on competition in insurance is recognised in EC law in a "block exemption" regulation.[27] This regulation provides for certain specified forms of co-operation, subject to strict conditions. In particular, the collective creation of reliable statistical data on the intensity and frequency of claims in respect of a risk in the past is allowed. No individual insurance undertakings, nor any insured parties, may be identified. Nor should any insurer be obliged to make use of the data. The results should be made available on reasonable and non-discriminatory terms, e.g., publication.

4.59 The work done by MIAB, which analysed raw data from insurers, is a good example of how the creation of reliable statistical data at a market-wide level can comply with competition law. MIAB recommended[28] that the central gathering of statistics on motor insurance premiums and claims costs by driver profile be formalised by IFSRA. It also recommended that IFSRA monitor data quality to ensure that reliable information is available to inform public policy in future years and to improve market intelligence. IFSRA is carrying on the work done by MIAB in this regard and is currently in consultation with the insurance industry on how to further develop the collection of reliable data.

Price Surveys

4.60 In the case of motor insurance, IFSRA carries out regular price surveys and publishes the results. It picks a range of buyers in each survey and shows the prices available from various insurers. An effect of this exercise is to highlight the consumer benefits of shopping around.

Intermediaries

4.61 The statutory regulation of intermediaries covers both the life and non-life sectors. The are two categories of intermediaries - multi-agency intermediaries ("MAI") (which, for regulatory purposes include tied agents and single agency intermediaries) - and authorised advisors ("AA").[29] Both categories require authorisation by IFSRA under section 10(5) of the Investment Intermediaries Act 1995.

4.62 An AA must demonstrate to IFSRA that it has sufficient skills, competence and knowledge to provide stand-alone advice in relation to a potentially wide range of investment products and services. AAs must, taking all relevant factors into account, recommend for each client the most suitable product available, regardless of whether it holds an appointment in writing from the relevant insurer or product producer.

25 Department of Enterprise, Trade and Employment (2003), *Insurance Annual Report 2002*, p. 15.
26 A Datamonitor Survey from 1995 ranked the Irish liability insurance markets last of 16 European Countries in terms of attractiveness (See C Parsons et al (2004), *Report on the Economics and Regulation of Insurance*, London: Cass Business School, City of London.) One of the factors considered in the ranking was market size. Ireland ranked low in this category. A number of insurers and intermediaries also referred to the small size of the Irish insurance market as a disincentive to entry at the Joint Oireachtas Committee on Enterprise and Small Business hearings during 2004.
27 Commission Regulation 358/2003 - see section on Single European Market above.
28 MIAB (2002), *Report*, Recommendation No. 5.
29 For a complete description of Multi-Agency Intermediaries and Authorised Advisors see http://www.ifsra.ie/industry/data/categories_of_intermediaries.doc

4.63 Unlike an AA, an MAI is not obliged to recommend a product from an insurer with which it does not hold an appointment. Indeed, an MAI is not allowed to recommend or sell such a product. However, it must act in the best interest of the buyer in respect of the products available to it. It has to demonstrate to IFSRA that it has sufficient skills, competence and knowledge to provide the relevant services.

4.64 IFSRA maintains a register of intermediaries authorised to provide investment and insurance services. This register provides the status of each intermediary and a list of product producers from whom it holds an appointment.

4.65 Firms are authorised and included in the register only when they satisfy IFSRA that they meet the necessary criteria for authorisation. These criteria include organisational structure, conduct of business, fitness and probity of individuals and financial resources.

4.66 Investment and insurance intermediaries are required to comply with the relevant statutory provisions and also with the requirements set out in the relevant Handbook.[30] There are separate Handbooks for AAs and MAIs. Both categories of intermediary are required to submit financial information and any additional information that may be required by IFSRA. IFSRA also has the right to carry out on-site inspections of intermediaries to ensure that they are complying with their obligations under the legislation and the relevant Handbook. In particular intermediaries must:

(a) Be solvent;

(b) Maintain, if an AA, a minimum level of shareholders' funds (or, in the case of sole-traders and partnerships, a capital account for sole traders and partnerships) of €10,000;

(c) Maintain a minimum level of shareholders' funds (or in the case of sole traders and partnerships a capital account) of €50,000 when acting as a product producer;

(d) Submit annual audited accounts to IFSRA within six months of the firm's financial year-end (unincorporated entities such as sole traders and partnerships must have their accounts audited);

(e) Accept cash from a client only in certain circumstances, or where an express agency agreement exists whereby the intermediary acts as agent of a product producer in transferring premium rebates to a client; and

(f) Transmit orders for insurance policies to Lloyd's or other non-resident intermediaries only if in possession of an agreement and authorised by IFSRA to do so.

4.67 IFSRA is carrying out consultation on the implementation of the IMD in Ireland.

Policyholder Protection

4.68 The protection of policyholders against insolvency of insurance companies is one of the primary objectives of insurance regulation. When an insurance company becomes insolvent, policyholders face potential financial loss because they will not be fully indemnified for claims made against them or for their own insured losses. The objective of policyholder protection funds is to provide some assistance in such situations.

4.69 In Ireland, an Insurance Compensation Fund has been in place since the enactment of the Insurance Act 1964 and can be used if a non-life insurance company goes into liquidation or experiences financial difficulty. There are no ongoing contributions to the fund but levies have been imposed on non-life insurance policies in the past following the collapse of an insurer. In this sense, contributions to the fund are *ex post*, (i.e., they have been imposed and collected after a collapse), rather than *ex ante*, (i.e., collected in advance of any collapse).

4.70 An Insurance Compensation Fund levy on non-life insurance policies was imposed on 1 January 1984 to provide funding following the collapse of PMPA. Levies were paid by all non-life insurers at a rate of 2% of gross premium income until the end of 1991. The rate was reduced to 1% for 1992 and then ceased to apply from 1993 as it was felt that sufficient funds had been collected to enable the successful completion of the administration of Primor plc (formerly known as PMPA Insurance plc). Some £148 million was collected by way of the levy. The process of compensation for PMPA policyholders is now considered to be almost complete. The resources remaining in the fund - i.e., the surplus from the proceeds of the levy - is estimated to be of the order of €20m. There is an ongoing Government levy of 2% on non-life insurance premium income. However, this is a general stamp duty, the proceeds of which go to the Exchequer and not to the Insurance Compensation Fund.

4.71 Following a proposal from the Irish regulatory authority in 2001 (then the Department of Enterprise, Trade and Employment) the Commission has fostered discussion among national regulators on the possibility of introducing some harmonisation of policyholder protection measures at EU/EEA level. IFSRA and the Department of Finance are actively participating in those discussions on Ireland's behalf.

30 See http://www.ifsra.ie.

Compulsory Insurance

4.72 In Ireland third party motor insurance is the only compulsory insurance. EL and PL are not a legal requirement. However EL and/or PL are considered an essential purchase for many organisations that face even a small exposure to the risk of a claim from an employee and/or a person from outside the organisation.

4.73 Many contracts for public works as well as other commercial projects require the successful bidders to show that they hold such cover before work begins. In this way, purchasing organisations can minimise their own risk and ensure that those working on their behalf are, at a minimum, able to meet claims that arise from any negligence on their own part. Local authorities, and some other organisations conscious of risk management, frequently require not only their contractors, but also their subcontractors, to carry liability insurance for large levels of coverage. In some industries and professions, licensing arrangements include a requirement to have liability insurance.

Special Regulation of Motor Insurance

4.74 In many countries certain types of insurance have been made compulsory by law. This reflects the wider public interest overriding personal freedom of choice in the buying of insurance. Compulsion can arise from a variety of public interest concerns.

4.75 The first and most widespread public concern relates to third party liability. If an individual negligently causes loss to a third party, then an obligation on the part of the former to possess adequate, valid insurance will help to ensure that funds will be available to satisfy compensation entitlements of the latter. Compulsion tends to be applied where there is non-negligible probability of loss and where the severity of loss would have a significant impact on the party affected. Clearly, what is non-negligible and of sufficient severity will depend on value judgements but, in most societies, there is an obligation to insure liability from vehicle use in a public place.

4.76 Third party motor insurance has been compulsory in Ireland since the Road Traffic Act, 1933 came into force. Regulations under this Act set out specific obligations, including a requirement that a certificate of insurance and windscreen disc must be drawn up in a specific format.

4.77 A system that makes insurance compulsory will generally create a larger demand than one where insurance is voluntary. The demand is relatively inelastic because the only alternatives are to give up driving or to break the law and drive without insurance. At the same time, given the risk exposure arising from the use of a motor vehicle, it is reasonable to assume that demand for at least third party motor insurance would be high even without legal compulsion.

4.78 The extent to which the compulsory system is enforced is important. If the mechanisms of compulsion are not effective, demand will be reduced. In most developed economies, compulsion is likely to increase the demand for insurance, but not necessarily to 100% of the target market. In principle, a larger market can allow insurers to exploit the law of large numbers more effectively, facilitating a lowering of the average price of insurance.

4.79 On the supply side, compulsion might allow a small saving on marketing costs and some economies of scale in production costs, but it also creates some problems. The principal difficulty is that insurers collectively must be willing to offer insurance up to the level that is legally required to all who are obliged to purchase it. Sometimes individuals find it difficult to obtain insurance cover, usually because they are perceived to have a high claim propensity. In response to such demand, some suppliers may be induced to take on hard-to-place risks, albeit at a relatively high price. However, in certain cases legislation is required to compel insurers to offer the insurance that is required by law. This is to ensure that insurance is available to high-risk drivers and drivers that come under the "aggravated risks" category provided for in the Non-Life Directives.

Declined Cases Agreement

4.80 The "general good" requirements in Ireland for motor insurers include participation in the Declined Cases Agreement ("DCA").[31] The purpose of the DCA is to ensure all licensed drivers can obtain minimum compulsory motor insurance, even when no insurer would otherwise be willing to underwrite the risk.

4.81 An individual unable to secure motor insurance after approaching three companies is able to secure cover under the DCA. The DCA and a Declined Cases Supplemental Agreement between the insurers contain rules on allocating declined risks to the various insurance companies.[32] It is for a Committee, made up of representatives of the insurers that are party to the Agreement, to decide which firm should make a quote under the agreement. If the individual held a policy within the last three years, the company that most recently insured the individual must provide a quote.

31 The Declined Cases Agreement is not a legislative obligation. It is an Agreement between the relevant Minister and insurers.
32 The Declined Cases Supplemental Agreement is an supplemental to the Principal Agreement, i.e., the DCA, between insurers. It enables them to discharge their obligations under the DCA.

Table 4.1: Number of Instances of Declined Cases, Ireland, 1997 - 2003

Year of Referral	1997	1998	1999	2000	2001	2002	2003
Category by main factor							
Hackney/Taxi	36	31	64	39	175	120	96
Convictions	67	54	41	63	58	76	59
Young Driver	79	67	90	110	116	70	35
First Insurance	-	2	11	3	2	7	53
Overseas	18	18	20	27	22	16	18
Health Impaired	11	10	7	10	4	1	13
Occupation	40	38	28	33	41	34	29
Claims Experience	-	-	-	16	31	34	29
Other	55	77	68	27	29	32	43
Total	**306**	**297**	**329**	**328**	**478**	**393**	**379**

Source: MIAB (2004) *Report 2004*

If the individual has not had a policy in the last three years, then the first company approached must provide a quote. Where this is in doubt, as can be the case when intermediaries send out requests for quotes to a number of underwriters simultaneously, the insurer is selected based on a rota system which takes account of the market shares of the firms on the rota.

4.82 The committee can judge whether the quote is too high or the terms so excessive as to be tantamount to a refusal to supply. The rota has been used in the past but has not been used for at least a year because all applicants have been placed with an insurer. These placements are either based on coverage with an insurer in the previous three years or being the first insurer approached and so being obliged to take on the risk. There are now two external observers on the Declined Cases Committee - one from the Insurance Ombudsman's Office and one from the Consumers Association of Ireland. Table 4.1 above provides an indication the number and reasons why coverage was declined and so handled by the DCA between 1997 and 2003.

Motor Insurers' Bureau of Ireland

4.83 Alongside compulsory motor insurance, governments seek to ensure that funds are available to pay injured third parties in the event of insurer insolvency, or in the case of accidents caused by drivers who are uninsured or who cannot be traced. The costs of such funds are usually passed on to the insurance industry and hence to policyholders.

4.84 The Second Council Directive on Motor Insurance (1988) required a compensation fund to be set up to compensate victims in such cases. In Ireland this obligation is implemented by the Motor Insurers' Bureau of Ireland ("MIBI"). The MIBI collects monies from motor insurers, based on their gross premium income, to make payments as necessary to third parties.

4.85 The MIBI is a private, non-profit body set up under an agreement between the Minister for Transport and the motor insurance industry. All firms offering motor insurance in Ireland, including those headquartered outside the State and supplying insurance on a freedom of service basis, must belong to the MIBI. The MIBI is responsible for handling claims arising from uninsured or untraced vehicles. In 2003 a total of €52m was paid out in respect of MIBI-related claims. As at the end of 2003, the provisions for all unsettled claims, notified and to-be-notified, was €407m.

4.86 There are currently 31 members of the MIBI, each contributing levies according to their share of the market in the last year for which records are available. Consequently, new entrants to the Irish motor insurance market are not required to contribute in the first year. However, since 1st January 2004, each new entrant pays an entry fee of €5,000, and there is an annual membership fee of €5,000.

4.87 The insurance firms are represented on the Board of the MIBI. The largest five firms, by motor insurance premium income, and two others elected by insurers, provide representatives to serve on the Board. Currently the five largest firms are AXA, Hibernian, Allianz, Quinn-direct and Royal & Sun Alliance, while St. Paul and FBD have been elected to, and currently serve on, the Board.

4.88 Claims are handled by six insurers - AXA, Allianz, Eagle Star, FBD, Hibernian, and Royal & SunAlliance. MIBI reimburses these insurers for the costs of meeting MIBI claims plus a handling fee. The claims are allocated to the six insurers in rough proportion to the relative size of the firms in the motor-insurance market. The firms must report on the progress of claims every quarter, and for claims in excess of €0.5 million the firm must seek discretion from the MIBI before proceeding. The six insurers handling claims have these roles because of historical precedent.

4.89 In March 2004, MIBI introduced service-level agreements for handling claims. A significant change from previous procedures is a requirement for handling offices to treat MIBI claims in the same way as they handle their own cases. MIBI officials now carry out audits to ensure that the required service is being provided to MIBI cases.

Conclusion

4.90 As can be readily inferred from this chapter, non-life insurance is subject to extensive sector-specific regulation. While much of this emanates from the EU, there is still a considerable degree of discretion at Member State level as to how EU regulations are implemented. For example, the EU sets down minimum solvency levels which, Ireland has chosen to double, except for new entrants for which the solvency levels are even higher.

4.91 Much if not all of the regulation set out in this chapter can be justified in terms of the information failure and externalities rationales set out at the beginning of the chapter. For example, solvency requirements can be justified on the grounds of preventing a negative externality, i.e., an insurance firm becoming insolvent. However, there may be trade offs between the various rationales. Again this can be illustrated with the solvency requirements. The IFSRA requirements arguably lean much more towards preventing the occurrence of a negative externality and less towards encouraging competition, since a new entrant has to have a higher solvency level which is likely to deter entry and thus lessen competition. The issue of insolvency levels is something we return to in chapter 8.

Chapter 5

METHODOLOGY OF ANALYSING COMPETITION

METHODOLOGY OF ANALYSING COMPETITION

Introduction

5.1 This chapter outlines the method of competition analysis used in this Study. It starts with a discussion of market power and how relevant markets are defined, goes on to look at the role and measurement of market concentration, and then discusses the main sources of competition - new entry and rivalry among existing competitors. The final section discusses the analysis of competition where markets are "vertically" related.[1]

Market Power

5.2 The economic analysis of competition is based on the concept of market power. Market power is the ability, absent effective regulation, profitably to maintain prices above competitive levels for a significant period of time. The exercise of market power results in prices that fail to reflect the social costs of production, and this leads to resource misallocation and economic inefficiency. In addition to the ability profitably to elevate prices, a firm with market power may also be able to increase its profits by manipulating the quality of the goods or services it provides. By reducing quality, a producer can lower its costs so that even in the absence of a price increase, greater profits are earned per unit sold. In practice, when assessing whether market power has been exercised, analysts consider quality adjusted price levels to the extent possible.

5.3 The analysis of competition and the exercise of market power for a competition review typically involves several separate analytical steps. These steps include the definition of relevant markets, the analysis of market structure, the analysis of rivalry, and the analysis of the magnitude of any barriers to entry for new participants or to expansion by existing participants.

Market Definition

5.4 The analysis of competition and the exercise of market power typically begins with market definition. Market definition provides a conceptual framework for organising information relevant for the overall analysis. It involves identifying the product or group of products comprising a relevant market, as well as the geographical scope of the relevant market, based on an analysis of substitutability. The relevant market includes those products that are close substitutes for each other. As close substitutes, the products within a market are prime sources of competition for one another. Those outside a market may provide competition in future by new entry or product repositioning.

5.5 Relevant markets have both product and geographic components. With regard to the product component, substitutability is looked at first from the standpoint of buyers (demand-side). This is often done by examining the characteristics of the product, but can also be done using econometric (statistical) analysis where suitable data are available. A useful conceptual approach to measuring substitutability is to ask how buyers would respond to a **S**mall but **S**ignificant **N**on-transitory **I**ncrease in **P**rice ("SSNIP"). If a SSNIP of 5 or 10% for one product would result in many consumers switching to a different product, then both products would be in the relevant market and the producers of each would be viewed as direct competitors. Conversely, if very few consumers would switch to the second product, it would not be in the same market, and the producers of each would not be direct competitors with regard to those products.

5.6 Supply side substitutability measures the extent to which an existing product that is not currently a good substitute for consumers could be made a close substitute with only relatively minor modifications. For example, suppose A4 and A3 paper are not close substitutes for buyers. However, if a producer of A3 paper could easily cut its paper to a smaller size, then both should be considered to be in the same market.[2] Products should only be included as supply substitutes if producers are capable of switching production quickly between them and would actually do so. Otherwise, their impact can be considered under entry or product repositioning.

5.7 A market definition generally refers to a geographic area. A similar methodology is used to define this relevant geographic area. On the demand side, the analysis asks whether products in another area are close substitutes for buyers in the area of interest. For example, if there were a price increase of 5% in area 1, would buyers switch to products in area 2? If so, the second area is in the relevant market. On the supply side, the question is whether a supplier outside the area could quickly begin to supply within the area. If so, the area would also be included. Here the question is not whether the buyers would switch but whether sellers from other regions would begin to sell in the geographic area of interest.

1 Markets are said to be vertically related when the product or service supplied in one market is used in the production process for the product or service supplied in the second market.

2 This example is taken from the Commission, *Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law*. OJ [1997] C 372/5.

5.8 Evidence used in defining the relevant geographic market includes:

(a) Whether buyers have previously bought, or would consider buying, substitute products, or would buy the original products from a new area;

(b) Whether sellers base business decisions on the prospect of buyer substitution between products, or whether suppliers in alternative locations are willing and able to meet demand;

(c) The costs and timing of switching products and how quickly buyers could react to a price increase; and

(d) The level of transport costs relative to the price of the product.

5.9 The definition of the market indicates the product or group of products and the geographical scope of the relevant market. When this exercise is being carried out for a particular purpose, e.g., a merger analysis, a competition case or a study of the market, some market definition questions may be left open if the competitive analysis does not depend upon these questions. However, the market definition exercise provides a basis for a detailed competition analysis.

Market Structure

5.10 The next stage in the analysis of competition involves a description of the structure of supply on the relevant market. This may include:

(a) Market concentration, including the number of firms, and their market shares;

(b) The stability of market shares over time and level of entry and exit;

(c) The level of vertical integration (i.e., the extent to which suppliers are involved in several levels of the chain of supply, such as underwriting and retail brokerage in the case of insurance);

(d) Cost and technology factors such as innovation and research and development intensity; and

(e) Product differentiation.

5.11 A concentrated market has a small number of firms with large market shares, while an unconcentrated market has a large number of firms, each with a small market share. Market concentration may be measured, for example, by the number of firms in the market or by concentration ratios. A concentration ratio is the total market share held by the firms with the largest market shares. For example, the 4-firm concentration ratio is the sum of the market shares of the largest four firms.

5.12 A widely used measure of market concentration is the Herfindahl Hirschman Index ("HHI"). The HHI takes account of both the number and relative sizes of firms in the market. The HHI is calculated by adding the sum of the squares of the market shares of each current competitor. This measure gives proportionately greater weight to the market shares of the larger firms. It will vary between 10,000 (one firm) and 0 (very large number of firms, each with a very low market share). The HHI and other measures of concentration are commonly calculated on three different bases:

(a) Volume as measured by the number of units supplied;

(b) Capacity as measured by the maximum possible volume; or

(c) Value as measured by revenue.

In insurance markets, the usual measure is (c) above, as shown by premium income. The most recent data available are used to calculate market shares. Historic data may also be used, especially if there is volatility in market shares.

5.13 A high market share is generally correlated with market power in the sense that the two often appear together, but inference cannot be drawn. A firm might have a high market share because it is efficient and customer focussed and has succeeded at winning customer demand by competition on the merits in the market. Conversely, a company with much lower market share might have considerable market power if its rivals are unable to expand sales due to capacity constraints. Each case must be considered on its merits when determining whether suppliers have market power.

5.14 For this reason, concentration in a market is at best indicative of a potential problem with competition. The HHI is used in this Study simply to describe the level of concentration, with markets described as follows:

(a) If the HHI is less than 1000, the market is unconcentrated;

(b) If the HHI is between 1000 and 1800, the market is moderately concentrated; and

(c) If the HHI is above 1800, the market is highly concentrated.

These are commonly used categories for the HHI in competition analysis.

Competition: Entry and Rivalry

5.15 Entry and rivalry are the drivers of competition in markets. Entry refers to the ability of new suppliers to sell in the market. Equally important is the ability of existing suppliers to expand. Rivalry refers to competition between existing or incumbent suppliers. Rivalry in price is common, but suppliers may also compete in quality, variety, innovation and other variables.

5.16 Entry to a sector can constrain price rises and induce existing suppliers to behave more competitively. A successful entrant has a positive effect in terms of choice and value for buyers because otherwise buyers would not be able to switch from the existing suppliers.[3]

5.17 Barriers to entry arise from various sources. Regulation that imposes costs or conditions on entrants that are not imposed on existing suppliers can be an insurmountable barrier to entry. Regulation that delays entry can diminish the competitive threat posed by an entrant. Action by existing suppliers that raises the costs of entry or delays entry also dampens its impact. This can happen if incumbents control the inputs, assets or technology necessary for the production or supply of relevant products, can set market standards, or can increase customer switching costs (discussed further below). For example, exclusive distribution agreements may foreclose the market to rivals by cutting off their options to gain distribution for their goods. Other barriers to entry can arise naturally in a market. For example, first mover advantage could in certain circumstances be a barrier to entry. Similarly, some customer searching or switching costs may arise naturally, and not because of action by existing suppliers.

5.18 High fixed costs can be but are not necessarily, a barrier to entry.[4] There are two important scenarios, however, in which fixed costs can constitute a barrier to entry, namely:

(a) Where the entrant must bear fixed costs that the incumbent(s) did not have to bear; and

(b) Where fixed costs are sunk (i.e., committed to the market and irrecoverable if the entrant subsequently leaves) and the incumbents have first mover advantages.

5.19 Consumer search or switching costs can be barriers to entry because they make it more difficult for a new supplier to attract customers away from existing suppliers. These can arise naturally, or because of actions of existing suppliers. An example of a natural barrier to entry would be supply that involves a personal relationship. In contrast, some customer switching costs arise from the behaviour of suppliers in the market. Examples include long-term contracts, exclusive supply distribution, lack of information provision by existing suppliers, or loyalty programmes.

5.20 A critical feature is whether barriers to entry or switching costs result from or are increased by the actions of the incumbent firms, or whether they are natural in the sense of arising regardless of incumbent behaviour. If they arise in part or in whole from incumbent behaviour, then they need to be analysed more carefully. In many cases, practices that have the effect of increasing barriers to entry or switching costs can at the same time have advantages for consumers. For example, long-term contracts may offer customers greater security. Any recommendations targeted against such behaviour should be based on a balanced weighing of the pros and cons in terms of consumer benefit.

5.21 As discussed above, rivalry in a market involves incumbent suppliers actively seeking business, including trying to take customers from each other. Suppliers may use any or all of price, quality, service, innovation or other attractions to win customers from rivals.

5.22 Rivalry can be weak for several reasons.

(a) Regulation may prevent rivalry, as with price controls or restrictions that prevent truthful advertising;

(b) A high level of product differentiation means that the different products or services in the market are not very close substitutes;

(c) High customer switching/search costs mean that buyers will not be willing or able to switch to suppliers that offer a better deal, even for an identical service;

(d) If rivals are capacity constrained, then a supplier will have more incentive to keep prices high because it knows that its rivals are less well placed to sell to its dissatisfied customers; or

(e) Collusion among competitors means that they do not compete. An explicit agreement to fix prices or bids or to limit production, known as a cartel, is the most extreme form of collusion. Collusion can arise without an explicit agreement when firms in the market recognise that it is in each other's interests not to cut prices.

This list is exemplary, not exhaustive. Each of these barriers to rivalry has the feature that it reduces the incentive for existing suppliers to cut prices. In extreme cases, competition may be non-existent. Some of these restrictions (e.g., collusion) tend to be undermined if entry is possible but others (e.g., switching costs) increase barriers to entry.

3 Even the threat of entry, provided it is credible, may have a positive effect on competition. How credible the entry threat is will depend on how quickly the entrant could succeed in the market, and the efficiency of the entrant relative to existing suppliers. The competitive effect of entry will vary, or even be non-existent, depending on the magnitude of barriers to entry.

4 The Competition Authority (2002), *Notice in Respect of Guidelines for Merger Analysis*, Decision No. N.02/004, in Section 5 give some examples of where barriers to entry might be considered high. These Guidelines can be accessed on the Authority's website, www.tca.ie.

5.23 Other market features can increase competition and limit the ability of firms to exploit market power. Two[5] that may be relevant for this Study are:

(a) Countervailing buyer power which, to be effective, requires that buyers are capable of credibly threatening to set up alternative supply arrangements; and

(b) The presence of a "maverick" supplier that has different characteristics or strategies than other suppliers in the market. Low cost mavericks can be especially pro-competitive.

5.24 The analysis of competition generally involves examining all of the above factors, and balancing the pro-competitive and anti-competitive aspects. Not all impediments to competition can be addressed. Some may have strong efficiency rationales so that prohibiting the underlying conduct could do more harm than good. Others may simply be natural features of the market that cannot be removed. Conversely, certain impediments can be shown to be clearly anti-competitive. This is particularly true of regulation or concerted industry action that makes entry or rivalry more difficult.

Vertical Relationships

5.25 The production of goods and services often involves the use of multiple processes or steps. In many instances, the same firm carries out these processes or steps. In other cases, different firms are involved. With multiple firms active at different points in the production or distribution chain, the output of one firm (the "upstream" firm) becomes the input for another (the "downstream" firm). The upstream and downstream firms are said to be vertically related.

5.26 In general, it is not in the interests of a party at one level of the supply chain to have firms at another level gain market power. Instead, parties at one level prefer to see competition at the other levels. This is because the development of market power at another level of the supply chain leads the supplier or suppliers at that level to set a price for their goods or services that is above the competitive level. This leads to a restriction in supply. This restriction in supply adversely impacts the demand for the products or services supplied at other levels of the production chain. With regard to insurance, the implication is that it is not in the interest of upstream insurers to see market power develop at the downstream intermediary level.

5.27 Upstream and downstream firms may have many different types of relationships with each other. The simplest relationship is that of a supplier and its customer where the manufacturer sells its goods without restrictions. It is common, however, for additional contractual arrangements to be agreed between the upstream and downstream firms. This is because the success of one often depends upon the other. A retailer that works hard to promote a manufacturer's products increases both its own unit sales and the sales of the manufacturer. As a result of this interdependence, both parties may gain if they agree to certain restrictions on their behaviour.

5.28 For example, suppose that both an upstream manufacturer and a downstream retailer possess market power. If the manufacturer acts to restrict supply below, and increase prices above, the competitive level upstream, then the retailer will pay a price for the goods it purchases from the manufacturer that is elevated and reflects the manufacturer's market power. The downstream retailer takes this elevated price, along with all of its other input costs, into consideration when determining its own output levels and prices. In exercising its market power downstream, the retailer will also restrict output below the competitive level that would otherwise prevail downstream, given the prices for all of its inputs. This further attempt to increase prices and restrict the volume of goods in the marketplace is harmful to the upstream manufacturer, which sees the demand for its product fall below the level it desires. Both firms would benefit if they could jointly determine their end price to consumers. Consumers would gain as well because this end price would be below the price that would prevail if both firms separately attempted to exercise market power. The dual attempts to earn a mark-up leave consumers worse off.[6]

5.29 There are many other examples of situations where agreed restrictions or limitations on behaviour involving vertically-related firms improve market performance. In markets for which point-of-sale services are important to customers, for example, upstream manufacturers may set up exclusive service territories for their downstream retailers so that each retailer has incentives to provide these services. These exclusive territories restrict the behaviour of downstream retailers by limiting the geographic area in which they may make sales. Without exclusive territories, downstream sellers of the same product may locate close to one another and each may try to undercut the prices charged by the other. This may lead to very low prices, which may make it difficult for retailers to support or fund retailer services. Since these services are important to consumers, consumers benefit from the exclusive territories because they support the provision of these services.

5 A fuller account of other possible sources of competitive pressure is given in the Authority's *Notice on Guidelines for Merger Analysis, op. cit.*

6 For a more detailed exposition of the successive monopoly problem, see Roger D. Blair and David L Kaserman (1983), *Law and Economics of Vertical Integration and Control*, New York: Academic Press, pp. 31 – 36. See also Jean Tirole (1988), *The Theory of Industrial Organization*, Cambridge, Mass: The MIT Press, pp. 173-175.

5.30 Where there is sufficient competition between different "brands" upstream, vertical restraints are generally not viewed as harming competition.[7] Instead, they are viewed as being efficiency enhancing and pro-competitive. As with the exclusive territories example detailed above, vertical restraints provide a means of aligning interests between the upstream and downstream firm.

5.31 In certain settings, the upstream and downstream firms cannot directly contract in a way that aligns their incentives. Upstream and downstream firms can contract over the exclusive territories discussed previously because territories are observable and the resulting sales limitations are enforceable. Suppose that the upstream firm wants the downstream firm to engage in a certain level of "sales effort". Effort itself may not be observable, and a contract that attempts directly to set effort levels would be unenforceable. Instead, the upstream firm may need to provide incentives to the downstream firm, such as sales targets.

5.32 In sum, the analysis of the impact of vertical relationships or restraints on competition has several components. These are:

(a) Define the relevant upstream and downstream markets;

(b) Calculate market shares and determine the extent of market concentration in each market;

(c) Determine whether there is market power in either or both markets;

(d) If there is a finding of market power, then analyse whether the vertical restraint restricts competition; and

(e) If there is a restriction in competition, then analyse whether there are efficiency benefits that flow from the restriction[8] and whether, on balance, the restriction is harmful.[9]

7 See, for example, Commission *Notice: Guidelines on Vertical Restraints*, OJ [2000] C 291/1 (the "Vertical Restraint Guidelines") at paras. 6 and 119.
8 A list of such benefits is provided by the Vertical Restraint Guidelines at para. 116.
9 See Vertical Restraint Guidelines at paras. 120 – 136.

Chapter 6

INSURANCE MARKET DEFINITION AND CONCENTRATION

INSURANCE MARKET DEFINITION AND CONCENTRATION

Introduction

6.1 This chapter considers the markets for motor, EL and PL insurance. Defining the relevant markets and considering the levels of concentration in these markets is typically the starting point in a competition analysis. Market definition for this Study seeks to answer the question of what products compete with motor, EL and PL insurance? To what extent can buyers substitute between insurance products, or between insurance and other products? How closely substitutable are any alternative products?

6.2 The chapter begins by considering the definition of the relevant product markets for motor, EL and PL policies. The relevant geographic markets for each of these products are analysed next. Both demand and supply substitution are considered when defining the relevant markets for motor, EL and PL policies. Information regarding the level of concentration in the relevant markets is provided next. Concluding comments follow.

Market Definition

6.3 Market definition has both product and geographic dimensions. This section begins with a discussion of the definition of the relevant product market. The definition of the relevant market focuses on substitution possibilities. As detailed in Chapter 5, the relevant product market is defined to be the set of products or services that buyers consider to be close substitutes for each other. Motor, EL and PL insurance are considered separately. General considerations are addressed first, and motor insurance is considered next. This is followed by EL and PL insurance. Next, the definition of the relevant geographic market for each of the relevant product markets is discussed.

General Product Market Considerations

6.4 Relevant product markets are defined according to the ability and willingness of customers to switch among products in response to changes in relative prices. Insurance is a specialised product; insurance contracts are designed to mitigate specific risks. A buyer needing to manage one or more specific risks cannot do so via insurance written for other purposes. For example, a motor insurance policy cannot be substituted for a PL policy should the price of a PL policy increase. A PL policy would mitigate different risks. Thus, from a demand perspective, motor, EL and PL insurance are not substitutable. Furthermore, there are no other products that can provide the indemnity offered by insurance. In addition, although self-insurance is an option for some consumers, the purchase of some forms of insurance is mandatory; this is case, for example, with third party motor insurance. Thus, relevant markets are likely to be no broader than motor, EL and PL cover.

6.5 There are narrower niches within these three categories of insurance. The requirements and risk profiles of buyers within individual niches are specific to those niches. This limits the ability of buyers to substitute insurance products between niches. For example, a young motorist cannot substitute to an insurance policy written for an older driver. With only limited demand-side substitutability, it is possible that there are narrower relevant markets than motor, EL, and PL. Whether markets are narrower is discussed separately with regard to the motor and liability insurance categories below.

Product Markets for Motor Insurance

6.6 As explained below, the relevant product market defined for the purpose of this Study is motor insurance. There are narrower product markets as well but it is not necessary to define narrower markets for the purposes of this Study. The definition of narrower markets would not impact the analysis of rivalry or barriers to entry, nor would it impact the recommendations that follow.

6.7 This section begins by considering demand side substitution possibilities across different types of motor insurance. It then considers supply side factors related to motor insurance.

Demand-side Substitution

6.8 As discussed in Chapter 4, a certain level of motor insurance for vehicle users is required by law. If a person owns a mechanically propelled vehicle, or if a firm needs to operate vehicles in the ordinary course of business, then the law requires the person or business to have certain minimum levels of indemnity in respect of third party claims with an authorised insurer. This legal requirement indicates that the

relevant product market is no wider than motor insurance because other types of insurance will not meet this legal requirement. Optional motor cover is also available, such as cover for loss of, or damage to, the insured's own vehicle.

6.9 On the demand side, buyers' motor insurance requirements - and the policies sold to them - are related to their individual risk profiles. Risk profiles are often grouped by observable characteristics such as age, gender and driving experience. Insurers price policies differently based upon these characteristics.[1] The ability of insurers to target policies and pricing to different risk groups limits the range of possibilities for substitutability between motor insurance policies. For example, a 17-20 year old driver on a provisional licence seeking third party insurance cover cannot take advantage of lower prices for policies offered for older drivers or drivers with full licences. In the event of a price increase on 17-20 year old coverage, the young driver cannot substitute the policy targeted at older drivers for his or her existing policy. Similarly, a taxi driver facing increasing insurance costs cannot switch to a cheaper private car policy, and a motorcyclist cannot take advantage of cheaper policies available for other types of vehicles. Thus, insurers price discriminate across individuals based on certain characteristics, and defining narrower markets according to these characteristics is appropriate where sellers can and do price discriminate.

6.10 The ability to arbitrage markets may undermine price discrimination by sellers. Insurance policies are specific to individual consumers or businesses and buyers cannot purchase low-priced insurance and then resell their policies to others facing higher prices. Arbitrage is not possible. Insurers can and do charge different prices to different customers and demand side substitution is strictly limited across types of policies and groups of customers.

6.11 There have been several economic studies of the elasticity of demand for motor insurance.[2] These studies have found that the demand for motor insurance is highly inelastic. These results indicate that few consumers substitute from purchasing motor insurance in response to an increase in its price.[3]

6.12 There are two different classes of customers for motor insurance: "mass" risks and "large" risks.[4] Mass risks include standard motor policies for individual consumers. By comparison, large organisations - as defined by assets, turnover and numbers of employees - are buyers of insurance for large risks.[5] With regard to motor insurance, large risks may involve, for example, a business insuring a fleet of vehicles. Because of the specialised nature of insurance contracts for large customers, mass risk consumers cannot substitute from mass risk policies to large risk policies, nor can large risks shift to mass risk policies for their cover.

6.13 This finding with regard to demand-side substitution is consistent with the approach used by the Commission. For example, in CGU/Norwich Union, it stated:

"On the demand side, life and non-life insurance can be divided into as many product markets as there are insurances covering different kinds of risk. Their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer between the different risks insured ..."[6]

6.14 In sum, there are a number of relevant product markets for motor insurance. These markets are distinguished by the characteristics of buyers, including whether the buyers are large or mass risks, and for mass risks, by the profile of the customer. Profiles include identifiable characteristics such as age, gender, and driving history. Each of the narrow relevant motor insurance product markets is comprised of groups of buyers, where the individuals in a group share some common characteristics.

6.15 The analyses of competition in these individual motor insurance product markets share many common elements. This Study generally refers broadly to the motor insurance product market; unless otherwise indicated, this is meant to refer, collectively, to all of

1 Policies may also differ in non-price terms based upon buyer characteristics. For example, AXA now offers policies solely for young drivers with reduced rates if they have a speed tracking system installed in their automobile. See "Traksure", available from the AXA's website at http://www.axa.ie/car/traksure.html

2 Elasticity of demand measures the responsiveness of consumers in terms of quantity demanded to changes in prices.

3 Jaffee, D. M. and T. Russell (1995), "The Causes and Consequences of Rate Regulation in the Auto Insurance Industry", NBER Working Paper 5245, September, p. 1-54 (estimated demand elasticity of -0.63 for California); Blackmon, B.G., Jr., and R. Zeckhauser (1991), "Mispriced Equity: Regulated Rates for Auto Insurance in Massachusetts", *American Economic Review*, Vol. 81, May, pp. 65-69 (estimated demand elasticity of -0.57 for Massachusetts); Sherden, W. A. (1984), "An Analysis of the Determinants of the Demand for Automobile Insurance", *The Journal of Risk and Insurance,* Vol. 51, No. 1, March, pp., 49-62 (found demand for bodily injury cover in Massachusetts to be highly inelastic, even at pricing levels twice the state average; also found comprehensive and collision cover to be inelastic at pricing levels 1.6 times the state average); Barone, G. and M. Bella (2004), "Price-elasticity based customer segmentation in the Italian auto insurance market", *Journal of Targeting, Measurement and Analysis for Marketing*, October, pp. 21-31 (estimated demand elasticities by customer segments for one insurer, about 57% of which were at or below -1.1, the demand elasticity for a segment looking across insurers would be lower than the elasticity for an individual firm).

4 The distinction between mass and large risks is detailed in Chapter 4.

5 An indication of what constitutes a large risk is contained in section 4 of S.I. 244 of 1992 - European Communities (Non-life Insurance) (Amendment) Regulations available from The Office of the Attorney General website at http://www.irishstatutebook.ie/ZZSI244Y1992.html. In the case of buyers of motor and liability insurance, a large risk fulfils at least two of these three criteria: (1) balance sheet total of €6.2m assets; (2) net turnover of €12.8m; and (3) average of at least 250 employees during the financial year.

6 European Commission, Case No COMP/M.1886 - CGU/Norwich Union, p. 3, available from the European Competition Commission website at http://europa.eu.int/comm/competition/mergers/cases/decisions/m1886_en.pdf

these individual motor insurance product markets. It is not necessary for the purposes of this Study to define each and every specific motor insurance product market. Due to the ability of insurers to price discriminate among customers, these markets may be quite narrow. In any event, the precise boundaries between individual motor insurance product markets do not impact the competitive analysis or recommendations set out below. At times, this Study discusses specific, narrow motor insurance product markets in addition to the broader motor insurance market.

Supply-side Substitution

6.16 If an insurer is authorised to write motor insurance, the authorisation covers all types of buyers and motor policies. Thus, there are no regulatory barriers preventing entry into individual types of motor insurance for insurers that already sell other types of motor insurance. Furthermore, many of the assets and capabilities required to provide motor insurance to one group can be used to provide insurance to other groups. Claims adjusters and billing systems, for example, can be used to support motor policies to many separate types of policyholders.[7]

6.17 There can be practical difficulties in entering new motor insurance markets, however, even for an insurer that already has regulatory authorisation and is actually supplying motor insurance to one or more types of policyholders. These difficulties relate to the availability of sufficient information to evaluate risk profiles, determine expected costs and price policies in the new market. If there are significantly different accident rates for drivers under the age of 25 as compared to drivers in their mid-40s, then data on accident rates and the expected cost of claims for drivers in their mid-40s cannot help an insurer evaluate the risks presented by drivers in the under 25 category. Without such information, the insurer may be unable to price the risk of under-25 drivers and thus may not supply insurance to customers of this type. These issues are discussed in greater detail in Chapter 8. In short, risk experience and pricing data in one market, such as mass risk policies for 50-54 year old males, may not assist with the supply of mass risk policies to other groups, such as for 25-29 year old females. The supply side of the market is not sufficiently flexible to justify defining one wide relevant market for motor insurance.

Summary of Motor Insurance Product Markets

6.18 Relevant market definition is based upon substitution possibilities. The demand for insurance is specific to the risks and policyholders being insured. As a result, buyers cannot easily switch from one type of cover to another. This leads to the definition of relatively narrow relevant product markets. Even so, it may be appropriate at times to define broader markets if supply is readily substitutable between different insurance products. Given the importance of risk-related data, an insurer may not easily switch from the provision of one type of motor insurance to another if the insurer lacks sufficient data. It is the lack of accurate and detailed data regarding risks that makes it difficult for providers to move from one niche in the motor insurance business to others.

6.19 This Study makes recommendations designed to facilitate the collection and publication of detailed market-level data on motor insurance. These data are intended to make it easier for insurers to enter the Irish market or to expand from one area of motor insurance to others. Thus, relevant motor insurance product markets may be broader in the future.

6.20 This Study refers in places to the motor insurance product market, even though the relevant product markets are narrower than all motor insurance. References to the motor insurance product market are meant to indicate, collectively, all of the narrower motor insurance product markets described in this section.

Product Markets for EL and PL Insurance

6.21 This section considers the relevant product markets for EL and PL insurance. As explained below, this Study considers separate relevant product markets for EL and PL. As with motor insurance, there may be narrower relevant product markets as well. However, it is not necessary to define narrower markets for the purpose of this Study. The definition of narrower markets would not impact the analysis of rivalry or barriers to entry, nor would it impact the recommendations that follow. This section begins by considering demand side substitution possibilities across different types of EL and PL insurance. It then considers supply side factors related to liability cover.

Demand-side Substitution

6.22 With regard to demand, buyers often purchase EL and PL together. These two products are substantively different in that they cover different types of risks. As a result, they are not interchangeable.[8] Therefore, a rise in the price of EL would not lead buyers to buy "more" PL cover and "less" EL cover. Therefore, EL and PL are not part of the same relevant product markets, and the

7 With regard to the CGU/Norwich Union case, the Commission stated: "The Commission admits, also, a certain degree of supply side substitutability in the insurance sector since certain insurance products require a common set of skills and resources including risk management, administration I.T. systems and claims management" (Case No COMP/M.1886 - CGU/ Norwich Union, p. 3)

8 Because buyers often purchase both EL and PL, they may actually be complementary to each other as opposed to being substitutes.

relevant product markets for EL and PL are no wider than these two respective categories of insurance.

6.23 The ability of buyers to substitute different EL policies for one another is limited, as is the case with regard to motor insurance. EL coverage is for specific risks, and different businesses have different risk profiles. There is also no prospect to arbitrage low premium policies for high premium policies. Instead, EL products are risk-specific and can be targeted and tailored to individual businesses. Thus, there is little or no prospect for demand-side substitution from EL cover to other products or services. This is also the case for PL policies.

6.24 Unlike motor insurance, there is no legal compulsion to purchase EL or PL insurance. Even so, indemnity for their liability exposure is viewed as essential by many businesses and may be needed to tender for contracts. When required by tender, having liability insurance is a prerequisite to conduct business.

6.25 Circumstances within particular sectors of the economy can be so different from each other as to require different risk assessments and risk management tools. As with motor insurance product markets that are specific to buyer characteristics, EL or PL cover for particular sectors may constitute relevant product markets in their own right. Thus, relevant EL and PL product markets may be narrower than all EL insurance and all PL insurance. However, due to a lack of disaggregated data, this Study focuses on and defines a relevant product market for EL insurance, and a separate relevant product market for PL insurance. The focus on EL insurance and PL insurance, as opposed to subcategories, does not impact the competitive analysis or the Recommendations in this Study.

6.26 Other reviews of competition in insurance markets have drawn similar conclusions. For example:

(a) A review of the Dutch insurance industry prepared for the Dutch Competition Authority found that demand side substitution was unlikely across private, non-life insurance products, though some substitution to self-insurance or financial hedging products may be possible for large companies.[9]

(b) A report for the Office of Fair Trading in the UK commented on industry specificity with regard to liability insurance. It found that overall liability cover was similar across the market and that "insurers use special policy forms for certain business sectors (e.g. for 'contracting' trades)."[10]

(c) The European Commission indicated in its review of Northern States Agency and Converium AG's acquisition of shares in Global Aerospace Underwriting Managers Limited that insurance products are not substitutable from the point of view of demand. It stated:

"In a number of previous decisions, the Commission has indicated that insurance and reinsurance are considered to belong to different product markets. In past decisions, the Commission has also stated that in the insurance sector a distinction is to be made between life and non life insurance. In addition, the Commission has also held that non life insurance from the demand side could be divided into as many product markets as there are different kinds of risks covered, such as aerospace, marine, commercial & real estate, etc, since their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer for the risk insured."[11]

The Commission also found that supply-side considerations could lead to broader markets, but that in this specific case a narrow market was found. It stated:

"[F]rom a supply side perspective, the conditions for insurance of different risk types are quite similar and most large insurance companies are active in several risk types. This suggests that many different types of non life insurance should be included in the same product market. ... The Commission's investigation however has indicated that the life and non life insurance have different characteristics and are probably separate markets. In addition, the Commission's investigation has revealed that the aerospace insurance has specific features due to the particular nature and size of the risks it covers, so that it could be regarded as a distinct product market within the broader insurance sector."[12]

6.27 While there are separate relevant product markets for EL and PL, the analyses for both are very similar from a competition perspective. At times this Study refers to the liability insurance relevant product market. This is meant to refer jointly to the EL and PL relevant product markets.

Supply-side Substitution

6.28 Authorisation to write liability insurance covers all types of liability insurance, including both EL and PL. Thus,

9 NERA (1999), "Assessing Mergers in the Insurance Sector in The Netherlands", Report for the Nederlandse Mededingsautoriteit, p. 26.
10 Parson, C. (2003), *An analysis of current problems in the UK liability insurance market*, A supplemental report to OFT659 Liability insurance, OFT, June, p. 10-11. See also OFT (2004). "Liability insurance: A report on an OFT fact- finding study", August, p. 76, Paragraph E.10.
11 European Commission (2003), Case No COMP/M.3035 - Berkshire Hathaway/Converium/Guam, 28 February, p. 5, paragraph 25.
12 European Commission (2003), Case No COMP/M.3035 - Berkshire Hathaway/Converium/Guam, 28 February, p. 5-6, paragraphs 25-26.

an insurer does not need any supplementary regulatory approval to expand to new segments within the liability class of business if it is authorised to provide any type of liability coverage. In the case of new and recent entrants, when an insurer initially applies to IFSRA for authorisation upon entering the Irish market, it must submit a business plan. If it decides significantly to alter that plan it must get approval from IFSRA. If the insurer can demonstrate that it has the necessary solvency to cover potential claims, it would not ordinarily experience regulatory difficulties gaining IFSRA's approval for this change.

6.29 As with motor insurance, many of the same assets and skills are required to produce EL and PL insurance. Access to claims and expected loss data, however, are critical successfully to move to new liability insurance sectors. Without these data, shifting between markets or segments can be difficult and risky because the insurer will not know how to price cover in the new segment. The risks covered differ for EL and PL insurance and therefore the data on loss experience in one area will not help price insurance in the other area, even for the same industry.

Summary of Liability Insurance Product Markets

6.30 Due to limited demand-side substitution possibilities, it would be appropriate to define a series of very narrow relevant product markets with regard to EL and PL insurance. Supply-side considerations, however, would indicate that markets should be broader if supply is readily substitutable between different liability insurance products. Given the importance of risk-related data, insurers may not easily switch from the provision of one type of liability insurance to another if they lack sufficient data regarding expected claims. This Study makes recommendations designed to facilitate the collection and publication of detailed market-level data on EL and PL insurance. These data are intended to make it easier for insurers to enter the Irish market or to expand from one liability insurance sector to others. Thus, relevant EL and PL insurance product markets may be broader in the future.

6.31 This Study refers in places to the liability insurance product market, even though the relevant product markets are narrower than all liability insurance. References to the liability insurance product market are meant to indicate, collectively, all of the narrower EL and PL insurance product markets described in this section.

Conclusions Regarding Relevant Product Markets

6.32 For the purposes of this Study, there are separate relevant product markets for individual motor, EL and PL insurance categories.[13] It is not necessary for the purposes of this Study to detail the precise, narrow motor, EL, and PL market definitions. Precise definitions would not alter the analyses or recommendations that follow. The recommendations made later in this Study should have the effect of widening the relevant product markets by facilitating supply side substitution.

General Geographic Market Considerations

6.33 Relevant geographic markets are defined according to the ability and willingness of customers to switch among suppliers in different areas in response to changes in relative prices. As discussed below, the relevant geographic market(s) applicable to all of the relevant product markets are at least as broad as the State. Some may actually be international in scope.

6.34 It is possible for insurers based anywhere in the State to serve customers in any other part of the State and the remainder of the EU. Insurance products can be bought and sold over the phone, by post, on the Internet, through local offices and through intermediaries. Thus, the relevant geographic market is at least as broad as the State if buyers can easily access and would substitute to alternative suppliers using these means. Furthermore, if the scope of the geographic market is at least national, then the question arises as to whether the geographic market is international for any of the relevant product markets.

6.35 In general, there have been difficulties throughout the EEA in exploiting the full benefits of the Single European Market for insurance.[14] Various legislative measures have been taken at European level and implemented nationally to improve the functioning of the Single European Market for insurance. However, this market remains far from completely integrated. This has been widely recognised. For example, in a speech in May 2002, Mr. Pat Cox, then President of the European Parliament said, "In spite of all legislative efforts of recent years, we must recognise that insurance remains the most fragmented part of the financial services sector."[15]

6.36 Insurance contract laws differ among Member States. In the case of mass risks, the law that applies is generally the law of the state in which the buyer resides. The Comité Européen des Assurances, a

13 Substantially less data and information are available with regard to liability insurance as compared to motor insurance. Thus, it is more difficult to conduct analysis at a disaggregated level with regard to EL and PL is

14 Many of the recommendations made in this Study are designed to facilitate cross-border supply of insurance. This Study will be sent to DG Internal Market to assist in efforts to promote the development of the Single European Market.

15 Speech by Mr Pat Cox MEP, President of the European Parliament, Guest Speaker at the Annual Lunch of the Irish Insurance Federation on 20 May 2002 in the Conrad Hotel, Dublin (www.iif.ie).

trade association for European insurers, maintains that harmonising national legislation governing insurance contracts would make a significant contribution to the completion of the European insurance market because it would facilitate the design of products for sale throughout the Single European Market.[16]

6.37 Other practical difficulties exist for insurers that want to market an insurance product on a "freedom-of-services" basis throughout the Single European Market. These include differences in laws to protect consumers, which have to be complied with according to the procedures in each Member State (e.g., "general good" requirements). They also include fundamental differences in expected claims costs. These cost differences require insurers to have detailed local knowledge. They also make it difficult to make cross-border price comparisons. Insurers have a need for in-country capabilities with regard to customer service, claims management and policing against claims fraud. None of these issues are an insurmountable barrier to cross-border trade. Many individual functions can be outsourced, if necessary. Insurers also require expertise in defending personal injury claims in national Courts. These factors entail additional complexity arising from freedom-of-service sales beyond what would be experienced in selling within a single Member State.

6.38 Some intermediaries and buyers have indicated that buyers are reluctant to purchase insurance from foreign companies. IFSRA has stated that there is a "trust factor" making it more difficult for overseas suppliers of financial services, including insurance, to sell to Irish customers.[17] This is especially the case if they cannot easily satisfy themselves about the solvency and/or claims handling practice of an insurer regulated elsewhere, and with which they are not familiar.

6.39 From the point of view of the supplier, assessing and pricing risk in another Member State can be facilitated by, inter alia, market-wide historical statistics on claims. Any difficulty in gaining access to reliable, timely data in this respect increases the difficulty of entry to the market. Companies already in a market have such data, which places potential entrants at a competitive disadvantage.

6.40 Overall, EU/EEA markets still tend to be national in scope, especially for mass risks. In the case of large risks, there is increased possibility of cross-border provision. In Ireland's case, the main supplier in this regard is the Lloyd's market.

Geographic Market for Motor Insurance

6.41 With regard to demand-side substitutability, the market evidence indicates that customers in Ireland can and do buy motor insurance from providers located outside of their local region but within the State. Some, like Quinn-direct and Hibernian, have been successful by serving customers throughout the State by providing quotes over the Internet.[18]

6.42 Furthermore, the potential for supply-side substitution is important. To the extent that a physical location is required to sell insurance, if an insurer has a location and is already selling motor insurance policies in one area, the Authority is not aware of any substantial impediments to that insurer setting up another office in a different part of Ireland and starting to supply motor insurance in that part of the country.

6.43 By comparison, insurers outside the State must obtain a licence if they are to sell motor insurance in the State. In addition, all Member States require motor insurers to appoint a local claims representative and become a member of, and contribute to, the local Motor Insurance Bureau and guarantee fund. In Ireland's case, there is an additional requirement to sign the Declined Cases Agreement. More significantly, at present there are a number of impediments to the supply of motor insurance in Ireland for insurers located outside the state. These impediments are discussed in greater detail in Chapter 8. Due to these impediments, overseas insurers, even those who are already listed as authorised by IFSRA, should be considered to be potential entrants in the Irish market, not as firms that currently participate in the relevant market because of supply-side substitution possibilities.

6.44 Accordingly, given the relative ease of geographical substitution within the State, but more difficulty in supplying directly from abroad - even from other parts of the Single European Market - the geographic market for motor insurance is defined to be the State.

Geographic Market for Liability Insurance

6.45 The geographic market for liability is the State in the case of mass risks but is broader for large risks.

6.46 Mass risk liability policies can be and are purchased by buyers from across the State from insurers using centralised operations. This is, for example, the model adopted by Quinn-direct.[19] Others, AXA[20] for example, supply using more of a local presence and tout their

16 CEA, *Prospects for Simplifying European Legislation*, p. 9, available from the Comité Européen des Assurances website at http://www.cea.assur.org/cea/download/publ/article191.pdf
17 IFSRA (2003), Testimony of Ms. Mary O'Dea before Joint Oireachtas Committee on Enterprise and Small Business, 23 November, available from the Houses of Oireachtas website at http://www.gov.ie/committees-29/c-enterprise/20031120-J/Page1.htm.
18 See "Quinn Financial Services" available from the Quinn-direct website at http://www.quinn-direct.com and "Motor" available from the Hibernian website at http://services.hibernian.ie/direct/HibernianDirectWeb/motor_home.jsp.
19 See http://www.quinndirect.com/
20 See http://www.axa.ie/about/about_us.html

local service. Firms pursue different strategies in this regard. The viability of the former strategy indicates that there are no significant impediments for buyers in making purchases from Irish insurers, independent of their geographic locations.

6.47 With regard to supply side considerations, as with motor insurance, there are no restrictions on an insurer that serves customers in one part of the State switching or expanding to serve customers elsewhere in the State. Indeed, present suppliers serve the entire country. This supply is typically handled using one main or head office, though one insurer does maintain a more local presence. For these reasons, the relevant geographic markets are at least national in scope.

6.48 The extent of international supply in Ireland varies by product. Insurers authorised elsewhere in the Single European Market to sell liability insurance can use their existing authorisation to establish in Ireland ("freedom of establishment") or to supply on a freedom-of-service basis. If there was evidence of a substantial amount of liability insurance being provided in Ireland from elsewhere in the EU on a cross-border basis, the market might be considered European, or at least multi-national. There is relatively little such evidence in the case of mass risks. According to the European Commission:

"With the exception of reassurance and insurance of certain large risks, the geographical dimension of the market in life and non-life insurance business is generally defined on a national basis, due to the need for adequate distribution channels; established market structures; fiscal constraints and differing regulatory systems."[21]

6.49 The situation is different with regard to large risks. Large risk policies can select either the contract law of the home or host country to interpret and enforce the policies. There is also evidence of cross border provision of large risk liability cover, especially from Lloyd's. Lloyd's stated at the Joint Oireachtas Committee on Enterprise and Small Business in April 2004 that it wrote €298m in direct insurance business in Ireland in 2003, growing from €263m in 2001.[22] Lloyd's indicated that in it does not provide all categories of insurance in Ireland. It predominantly underwrites large risks and usually does not "write insurance for small businesses or for private individuals". More than half of 2003 premium income represented general liability insurance, of which 46% is EL and 16% is professional indemnity. In Ireland, Lloyd's is particularly active in large risk liability cover for construction, medical and pharmaceuticals, bloodstock, sports, leisure and entertainment and some energy risks. It also referred to its role as the home of hard-to-place risks, involving liability cover for high hazard trades such as roofing contractors. Lloyd's indicated that it typically does not underwrite risk for small businesses or private individuals because of a lack of sufficient economies of scale to supply these services on a cross-border basis. It would only cover mass risks as part of some form of scheme.[23]

6.50 Lloyd's stated that by its estimates, it underwrote 8% of all insurance business in Ireland in 2002. Its share of the liability insurance sector in Ireland would be higher than 8% because it predominantly writes liability insurance. Lloyd's estimated that its share of the liability insurance market in Ireland is around 20%. Because it serves primarily larger risks, its individual premiums tend to be larger. Therefore, it underwrites a smaller percentage of the total number of risks.[24] As Lloyd's focuses on providing cover of large risk liability cover in Ireland, there is substantial cross-border supply in this market.

6.51 The differences in cross-border supply of mass and large risk cover for both EL and PL insurance implies that the relevant geographic markets differ for these two types of risk. The relevant geographic markets are defined as being the State for mass risk EL and mass risk PL cover. For large risk EL and large risk PL cover, however, the relevant geographic market is defined to be broader than the State. The full extent of the international scope of this market has not been determined.

Conclusions on Relevant Markets

6.52 The relevant markets for motor insurance are narrowly defined by buyer characteristics and are Statewide in scope. At times, these are analysed collectively and discussed as the motor insurance market. EL and PL markets are also likely to be narrowly defined, though less information in this regard was available to this Study. Nevertheless, demand-side substitution is limited across types of liability policies, indicating that it is appropriate to define narrow markets. The geographic extent of competition for EL and PL insurance is the State for mass risks but international for large risks. Like motor insurance markets, liability markets are at times analysed as a group in this Study.

Concentration in Relevant Markets

6.53 The number of insurers actively underwriting has been decreasing for at least two decades internationally. This trend has been evident throughout Europe. In 1980, there were some 7000 insurance companies in Western Europe.[25] This had fallen to 3000 independently owned entities by 2002, partly due to mergers and acquisitions,

21 Case No COMP/M.1453 - AXA/GRE, p. 2
22 Lloyd's (2004), Testimony of Mr Julian James before Joint Oireachtas Committee, 28 April, available from the Houses of Oireachtas website at http://www.oireachtas.ie/documents/committees29thdail/jcesb/280404.rtf
23 Lloyd's (2004), Testimony of Mr Julian James before Joint Oireachtas Committee, 28 April, available from the Houses of Oireachtas website at http://www.oireachtas.ie/documents/committees29thdail/jcesb/280404.rtf
24 See previous footnote.
25 See C Parsons et al (2004), *Report on the Economics and Regulation of Insurance*, London: Cass Business School, City of London.

Table 6.1: Shares of Gross Written Premium Income and HHI, Motor Insurance, Ireland, 2003

Insurer	Gross Written Premium Income(€'000)	Share of Gross Written Premium Income (%)	HHI
Hibernian	492,037	26.0	676
AXA 453,103	23.9	571	
Quinn-direct	196,469	10.4	108
Allianz	191,044	10.1	102
FBD 180,074	9.5	90	
Eagle Star	176,279	9.3	86
RSA 102,831	5.4	29	
Others	102,985	5.4	8
Total	**1,894,822**	**100.0**	**1,670**

Source: IIF (2004) *Factfile*, p. 30

as well as insolvencies. Between 1990 and 2002, there were over 2500 mergers and acquisitions involving European insurers.[26]

Concentration in Motor Insurance Markets

6.54 This section begins with share and concentration information for motor insurance overall. This allows trends over time to be considered. It then provides recent concentration data for individual relevant motor insurance markets.

6.55 The Blue Books show net premium income in respect of individual insurers. In 1994, 20 companies earned net premium income greater than £500,000 (€630,000).[27] By 2003, this number was down to 15. Two insurers accounted for about half of all net premium income in 2003; AXA's share was 25% and Hibernian's share was 26%.[28]

6.56 The IIF Factfile shows gross written premium income for its member companies. Table 6.1 presents 2003 motor insurance gross written premium income, and shares of this income, for IIF member companies. This Table also presents an HHI based on these data.

6.57 The HHI value of 1,670 indicates that the overall national motor insurance market is moderately concentrated.[29]

6.58 Mergers have had a role in increasing concentration over time. Table 6.2 below shows mergers that occurred between 1994 and 2002 in the Irish motor insurance market. The first column shows the current name of the insurer. The second column shows the companies that merged to form the current entity. The third column shows the year in which the transaction took place. A number of the mergers were notified to and cleared by the Commission. In a number of the cases, the Commission's published findings discuss the impact on the Irish market.[30]

Table 6.2: Selected Mergers Involving Irish Non-Life Insurers

Insurer	Merger	Year
Hibernian[31]	Hibernian/Friends First[32]	2000
	CGU/Norwich Union[33]	2000
	CGU/Hibernian[34]	1999
	Commercial Union/General Accident[35]	1998
Eagle Star[36]	Eagle Star/Irish National	1997
Royal & SunAlliance[37]	Royal & Sun Alliance/AMEV	1997
	Royal Insurance/Sun Alliance	1996
AXA	AXA/GRE	1999

Source: *Authority Research*

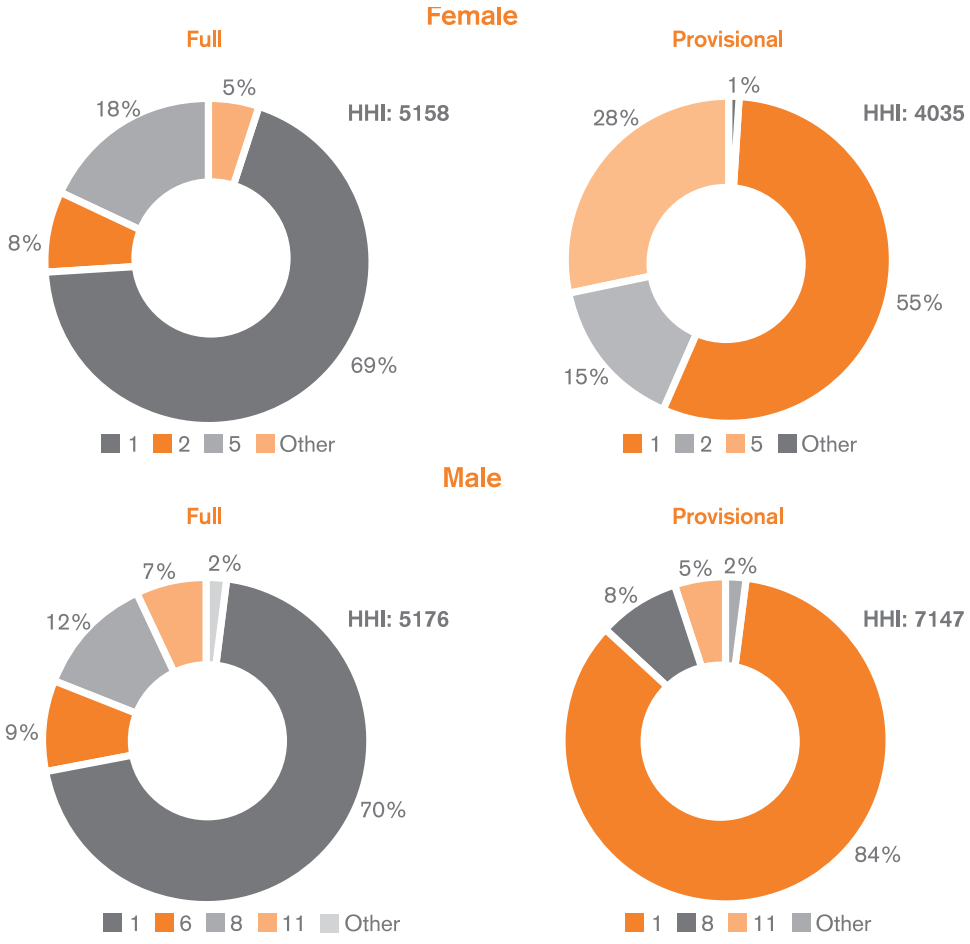
26 During the period 1990-2002 there were 2595 mergers and acquisitions involving European insurers, 1,669 of which resulted in a change in control. Cummins, D. and M. Weiss (2004). "Consolidation in the European Insurance Industry: Do Mergers and Acquisitions Create Value for Shareholders", available online at the Wharton Financial Institutions Center website at http://fic.wharton.upenn.edu/fic/papers/04/0402.pdf
27 Department of Enterprise, Trade and Employment (1995), *Blue Book 1994*, Table 15, p. 48.
28 IFSRA (2004), *Insurance Statistical Review 2003*, Table 15, p. 71.
29 See Chapter 5 for a discussion of HHI values.
30 Case No IV/M.759 - Sun Alliance/Royal Insurance, 1996; Case No COMP M.1777 - CGU/Hibernian; and Case No COMP/M.1886 - CGU/Norwich Union, 2000.
31 "Norwich and CGU to announce £19bn merger", *The Irish Times*, February 21, 2000.
32 Creaton, S. (2000), "Hibernian acquires Friends First book", *The Irish Times*, June 27.
33 "Norwich and CGU to announce £19bn merger", *The Irish Times*, February 21, 2000.
34 "Norwich and CGU to announce £19bn merger", *The Irish Times*, February 21, 2000.
35 "Norwich and CGU to announce £19bn merger", *The Irish Times*, February 21, 2000.
36 Canniffee, M. (1997), "Takeover move to consolidate market", *The Irish Times*, February 13
37 Keogh, O. (2000), "Consolidation changer face of insurance in Republic", *The Irish Times*, October 23.

6.59 These mergers and acquisitions have served to increase overall concentration. In 1994, the share of net earned premium income for motor held by the leading four suppliers was 51%. By 2003, this had increased to 69%.[38] Similarly, by 2003, the shares of the largest eight insurers increased from 73% to 95%.[39] Overall, the motor insurance HHI increased from 1,003 in 1994 to 1,545 in 2003. These figures indicate that the industry has become more concentrated over the previous decade.

6.60 While overall motor insurance concentration is moderate, several individual motor insurance markets are much more highly concentrated. The MIAB included detailed data regarding concentration in its 2002 and 2004 Reports.[40] It had obtained raw policy data from insurers and analysed various segments within each type of motor insurance. Both comprehensive and third party fire and theft insurance were considered. The segments are categorised by gender, age (17-20, 21-24, 25-30, 31-50, 51-70 and 70+) and type of license (full or provisional). The names of individual insurers are not given in the MIAB analysis. Instead, codes were assigned to each insurer in examining shares of sales within segments. The data in the 2004 MIAB report are based on submissions in 2001 from Allianz, AXA PMPA, Eagle Star, FBD, Quinn-direct, Royal & Sun Alliance[41], St. Paul, AIG and Hibernian.

6.61 Some of the individual segments are highly concentrated, with HHIs near or above 5,000. Examples are provided in Figure 6.1 below. With respect to third-party, fire and theft policyholders aged 17-20, Company 1 had market shares for full licence holders of 69% for females and 70% for males.[42] Its shares for provisional licence holders were 55% for females and 84% for males. Company 5 had a market share in the case of females of 18% for full licence holders and 28% for provisional drivers. In the case of males, its market share was 1% for full licence holders and also 1% of provisional licence holders. Shares for other companies and the HHIs for the markets are detailed in Figure 6.1. The HHIs range from just over 4,000 to in excess of 7,000.

Figure 6. 1: Market Shares and HHI for Motor Insurance Third Party, Fire and Theft Policyholders Aged 17-20, Ireland, 2001



Source: MIAB (2004) *Report 2004*, September 27, in section "Private Motor Insurance Review, 1997-2001", p. 30

38 IFSRA (2004), *Insurance Statistical Review 2003*, Table 15, p.71.
39 IFSRA (2004), *Insurance Statistical Review 2003*, Table 15, p.71. This analysis does not include Lloyds. The Authority is not aware of any evidence that Lloyds' presence in the market has fluctuated significantly during this period.
40 Analysis of concentration by individual markets or segments is not possible from the insurers' statutory returns as shown in the Blue Books because they do not break down total premiums by individual markets or segments.
41 MIAB (2004), Report 2004, September 27, in section "Private Motor Insurance Review, 1997-2001", p. 1. The Royal & Sun Alliance data includes AMEV.
42 These shares are based on the number of exposures. "The exposure to risk [is] measured in vehicle years (i.e. one vehicle year of exposure equals one vehicle on full cover for one year or two vehicles for six months." MIAB (2004), *Report 2004*, September 27, in section "Private Motor Insurance Review, 1997-2001", p. 72.

6.62 Another example of market that is highly concentrated is that for motorcycle insurance. Though data of the type presented in Figure 6.1 above is not currently available for motorcycle policies, the number of suppliers is currently limited to 3.[43] Thus, the HHI must be at least 3,333.[44] Before 2004, Royal Sun Alliance and Hibernian (or their predecessor companies) were the only suppliers.[45] Following a long period of very limited choice for buyers, AXA, already a major motor insurer in Ireland, recently entered the motorcycle market and took over some of Hibernian's business.[46]

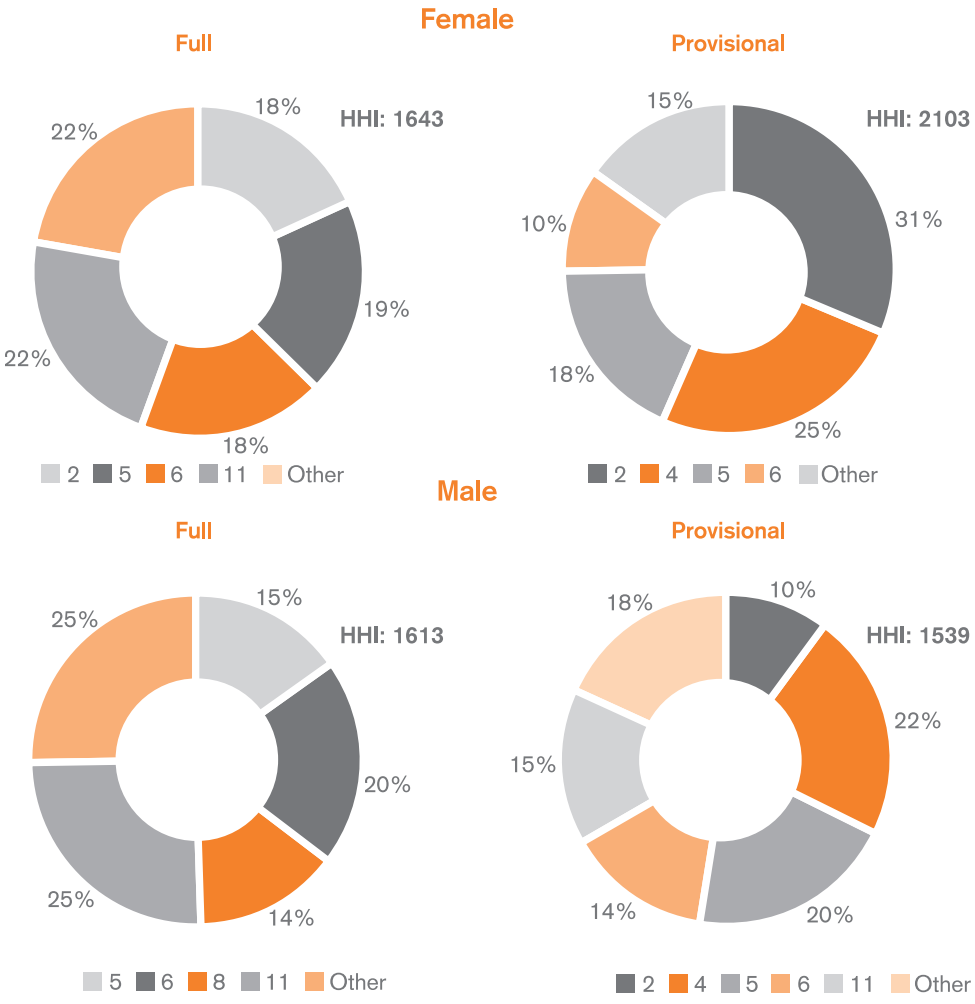
6.63 In contrast, there is less concentration in many other motor insurance markets. For example, for 25-30 year old policyholders, the HHI is less than 1,800 for males with full licenses and also for males with provisional licences. It is less than 1,800 for females with full licences, although it is 2,103 for females with provisional licences. These data are detailed in Figure 6.2 below.

6.64 The data presented in Figures 6.1 and 6.2 make clear that the level of concentration is not uniform across individual motor insurance markets. Some are moderately concentrated while others are very highly concentrated.

Concentration in Liability Insurance Markets

6.65 Data are not available that allow for the consideration of concentration of narrow EL or PL markets or even for mass risk EL, mass risk PL, large risk EL, large risk PL, total EL or total PL. Instead, all that is available is total liability insurance data. The data we currently have is not broken down according to types of EL or PL. However, the Authority has seen evidence that indicates there is an inability to switch between insurers in certain areas:

Figure 6.2: Market Shares and HHI, by Insurer, for Comprehensive Policyholders Aged 25-30, Ireland, 2001



Source: MIAB (2004) *Report 2004*, September 27, in section "Private Motor Insurance Review, 1997-2001", p. 65

43 "Cost of riders' premiums puts Irish motorbike sales in a slump", *The Irish Times*, November 10, 2004
44 The smallest possible HHI figure results when all participants have an equal share. Thus three firms with an equal share of 33.3% of the market would lead to an HHI of 3,333.
45 Royal Sun Alliance underwrote policies via intermediary Carol Nash; Hibernian provided cover onlt through direct channels.
46 *The Irish Times* reports that AXA took over Hibernian's Bikecare Scheme with Aon. "Cost of riders' premiums puts Irish motorbike sales in a slump", *The Irish Times*, November 10, 2004. Hibernian remains an underwriter in the market. Details are available from the Hibernian website at http://services.hibernian.ie/direct/HibernianDirectWeb/mcycle_home.jsp

"Approximately 50% of companies found that when they wanted to change insurer, the existing insurer was the only one willing to give them a quotation. This shows a frightening lack of competitive leverage for businesses when trying to negotiate one of their biggest costs."[47]

"Much of today's discussion has centred on the narrow area of motor insurance. However, employers' and public liability insurance are huge premiums for my members and they tell me there are too few players."[48]

"It is nearly impossible to get a quote from an insurance company, therefore you have no option but to obtain your policy with your current broker or insurance company. Due to the fact that you have to stay with one company you are forced to pay a very large premium. As they have very little competition against them therefore you are caught in a web of large fees. Even if you never claim from them, you never receive a reduced rate, only more hikes in premiums."[49]

"Choice in the market is severely limited. At our last renewal date we put a proposal to the only potential competitor of our current insurer, who replied to the broker with a one-line response refusing the quote. This means we had absolutely no choice in placing our insurance elsewhere. Currently there are only three insurance companies in the market which may be willing to take on our business."[50]

6.66 Data on liability insurance earned premium income for Irish insurers indicates that the overall liability marketplace is moderately concentrated. Table 6.3 below provides 2003 earned premium income, share and HHI information for liability insurance. The HHI was 1211 in 2003.

6.67 In 2003, the largest four insurers accounted for 57.5% of the liability marketplace; and the largest seven firms, 84.9%. However, these data do not include business written outside Ireland and supplied to Irish buyers on a freedom-of-service basis (e.g., Lloyd's).

6.68 The consideration of an overall liability marketplace likely conceals many individual EI and PL markets in which buyers have few alternatives. Buyers in various niches report that they have difficulty in getting more than one or two quotes for their liability risks. Examples include construction trades, hotels, leisure and community and voluntary groups. Thus, concentration is likely to be much higher in these areas than in the overall liability marketplace. The IIF recognises that there is only a small number of providers of insurance in certain motor and liability segments.[52]

Conclusion

6.69 This chapter provided an analysis of the relevant markets for motor, EL and PL insurance. Relevant product markets were found to be narrow, but geographic markets were found to be at least as broad as the State, and broader than the State for large risks.

6.70 The available data indicate that some of the individual motor or liability markets are highly concentrated. Though drawing conclusions in this regard requires further analysis of rivalry and entry barriers, the levels of concentration in these markets indicate that they may be less competitive than other, less concentrated motor or liability insurance markets. Concentration is so high in some markets that it is possible that further analysis would reveal single firm dominance in these markets.

Table 6.3: Shares of Gross Written Premium Income and HHI, Liability Insurance, Ireland, 2003[51]

Insurer	Gross Written Premium Income €'000	Share of Gross Written Premium Income (%)	HHI
Hibernian	159,181	18.5	342
Allianz	149,326	17.4	303
Quinn-direct	95,652	11.1	123
Irish Public Bodies	90,381	10.5	110
RSA	80,982	9.4	88
FBD	80,842	9.4	88
Eagle Star	74,345	8.6	74
Others	129,143	15.0	83
Total	**859,852**	**99.9**	**1211**

Source: IIF (2004), *Factfile* 2004, October, p. 30

47 AIR (2004), *Submission to The Competition Authority and Joint Oireachtas Committee on Enterprise and Small Business*, March, p. 7.
48 SFA (2003), Testimony of Mr. Kieran Crowley to the Joint Oireachtas Committee on Enterprise and Small Business, 13 November.
49 CIF (2003), Testimony of Mr. George Hennessy to the Joint Oireachtas Committee on Enterprise and Small Business, 13 November.
50 CIF (2003), Testimony of Mr. George Hennessy to the Joint Oireachtas Committee on Enterprise and Small Business, 13 November.
51 This analysis does not include Lloyd's.
52 "There is not necessarily a lack of competition, but there is a relatively small number of providers of liability and motor insurance in certain niches of the market." IIF (2003), Testimony of Mr. Michael Kemp before Joint Oireachtas Committee on Enterprise and Small Business, 1 July.

Chapter 7

INSURANCE MARKET RIVALRY AND SWITCHING COSTS

INSURANCE MARKET RIVALRY AND SWITCHING COSTS

Introduction

7.1 This Chapter considers rivalry in the motor and liability markets as defined in Chapter 6. It also considers the existence and magnitude of switching costs. The extent of rivalry is critical for competition analyses. Vigorous rivalry puts downward pressure on prices, forcing them toward marginal cost. It also leads to innovation that generates product improvements and cost reductions. All of these effects generate substantial benefits for consumers. Where rivalry is weak, however, buyers are harmed by higher prices, lower levels of quality and less innovation.

7.2 Even where vigorous rivalry exists, buyers can only take advantage of this rivalry if switching costs are low. Where there are high barriers to switching suppliers, it is more difficult for buyers to take advantage of the opportunities available in the marketplace. Instead, customers facing high switching costs can become "locked in" to their present supplier, leading to higher prices and, with regard to motor, EL and PL insurance, fewer benefits for policyholders. By comparison, if switching costs are low, buyers search for and take the best deals available to them in the marketplace.

7.3 This chapter begins by considering the extent of rivalry in the relevant markets. There are several ways in which rivalry can deviate from vigorous competition. These are considered first. The chapter subsequently considers the costs and difficulties involved with switching insurance to new suppliers. Where barriers to switching are found, recommendations are made to remove or lessen these barriers.

Rivalry

7.4 This section considers several possible ways that rivalry in the relevant markets might be muted. First, there may be little competition because the market is supplied by a dominant firm. Another is collusion on prices, either explicit or tacit. A third is the segmentation of the overall marketplace. With regard to segmentation, we discuss whether the level of competition is uniform across individual motor and liability insurance markets. Finally, markets may not be fully competitive because they have only a few rivals, even though these rivals are not explicitly or tacitly colluding.

7.5 This section begins by considering dominant firm behaviour. It then considers the possibility for collusion. Both explicit and tacit collusion are addressed. The potential for a coordinated segmentation of the overall marketplace is analysed next, and a discussion of non-collusive rivalry follows.

Markets with Dominant Firms

7.6 As discussed in Chapter 6, relevant insurance markets may be narrow. If such a market has one supplier with a large market share, and if there are significant barriers to entry[1], then the market is served by a dominant firm.

7.7 Chapter 6 provided several examples of such markets. As detailed in Figure 6.1, the Third Party, Fire and Theft market for female policyholders with full licenses aged 17-20 had a supplier with a 69% market share in 2001. The market for Third Party, Fire and Theft for males aged 17-20 with provisional licenses has a supplier with an 84% market share in this same year. Though data are not available, the comments detailed in Chapter 6 from buyers, indicate that several liability markets may be served by dominant firms.

7.8 With high entry barriers, markets served by dominant firms would be expected to experience little competition. Instead, the dominant firms would be expected to elevate prices substantially over competitive levels.

Collusion and Coordinated Pricing Behaviour

7.9 In relation to collusion on prices, an explicit agreement on prices, service levels, or other competitively significant variables is called a cartel. Explicit cartel behaviour is illegal.[2]

7.10 There is a long history of weak competition, price regulation, and cartel-like behaviour in the Irish non-life insurance sector. For example, in the motor insurance business, Section 107 of the Insurance Act, 1936 empowered the Minister for Industry and Commerce to fix, by order, premium rates for motor insurance. This power was never exercised. Instead, "informal control machinery" was used to control pricing.[3] An example of the "informal control machinery" was the Irish Standing Committee of Accident Offices Association. During the 1960's and at least some of the 1970's, the Committee, with agreement from the Minister, decided on increases in basic premium rates

1 Barriers to entry are analysed in Chapter 8.
2 See Section 4 of the Competition Act 2002 – available for download from www.tca.ie
3 Committee of Inquiry into the Insurance Industry (1972), *Interim Report on Motor Insurance,* Stationary Office: Dublin, para. 2.10.

called "tariff rates". As of 1972, 50% of the insurers engaged in business in Ireland were members of this Committee. Members of the Committee were only allowed to increase their rates by percentages up to the levels agreed with the Minister. Price control was an important feature of Irish insurance markets. Practices of this sort were gradually wound up after Ireland's entry to the EEC. The Authority has received no evidence that explicit cartel behaviour has occurred recently in either motor or liability insurance.[4]

7.11 In addition to explicit cartels, it is also possible for firms to collude tacitly. Tacit collusion is a concern in markets served by a small number of firms, such as the markets for comprehensive motor insurance for male or female drivers aged 25-30 with full licenses detailed in Figure 6.2. It involves firms coordinating behaviour to raise price or otherwise reduce competition without any explicit agreement. Each firm knows that it can raise prices and sustain these prices if other firms do not undercut them. This strategy would not be profitable if others undercut the elevated prices because the higher-priced firm would lose customers. The overall effect of tacit collusion is for the firms collectively to share the benefits of increased prices and profits and the buyers to pay higher prices.

7.12 Tacit collusion requires certain elements to be successful. First, firms must reach an implicit agreement on the terms of coordination. If the collusion is in regard to price, then what prices will be charged? If it is with regard to customer allocations, which supplier will serve which buyers? Additionally, tacit collusion is only profitable if all of the competitors cooperate with the coordinated behaviour. If one firm tries to undercut its rivals by lowering prices and increasing its unit sales and market share, the coordinated behaviour may break down. To be effective, the firms colluding tacitly must be able to identify any cheating from the terms of coordination. Finally, the firms must be able to punish any cheating. Punishment is required because it is in each firm's interest to "cheat" or "deviate" if it can get away with this.[5,6]

7.13 By way of example, one means of coordinating behaviour is to follow the pricing leads of one supplier. If one firm were to announce publicly that it was going to increase prices by, say, 20%, others can decide whether to follow this lead. In other words, an announcement of an expected 20% price increase could be seen as an invitation to all competitors to coordinate their own price increases at that level.[7] This means of reaching an agreement can lead to effective tacit collusion if deviations from the coordinated price increase can be detected and deterred via a punishment strategy.

7.14 Concerns about tacit collusion are stronger in markets where information is extensively shared among rival suppliers, even where – as is the case with insurance – this is legal.[8] This is because information sharing among rivals can be used to detect deviations from the terms of coordination. By making it easier to detect cheating, information sharing makes it easier to support collusive behaviour.

7.15 However, tacit collusion can be difficult to establish and maintain over time. The prospects for successful tacit collusion do not appear favourable in motor insurance, and are even less so with liability insurance, where the risks are more diverse and the pricing more customised. Coordination on prices requires a high degree of price transparency and other features.[9] Price transparency may be difficult to achieve with regard to motor insurance due to the diversity of prices that may be charged. Premiums may vary, for example, across different types of cars. Having a large number of prices also makes it more difficult to reach an agreement on the prices to be charged because so many separate prices need to be agreed.

7.16 Price coordination may be even more difficult to achieve with regard to liability insurance due to the lack of standardisation regarding the risks faced by buyers. This lack of standardisation leads to greater customer-specificity with regard to pricing. Such specificity, and the lack of public pricing data for individual contracts, indicates that determining the terms of coordination and detecting any deviations from these terms would be difficult for EL and PL insurance.

7.17 Furthermore, changing market shares suggests that collusion is not present. Data provided by the MIAB and detailed in Figures 7.1 and 7.2 (next page) indicate that market shares do change dramatically over time in individual motor insurance markets.[10]

4 There have been collusion cases in the insurance industry in Italy, Germany and Finland. News releases are available at the relevant national competition authorities at http://www.agcm.it/agcm_eng/COSTAMPA/E_PRESS.NSF/0/a00a2dc960857318c1256f32005c61e1?OpenDocument, 19 October 2004; http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2003/2003_07_22.shtml, 22 July 2003; http://www2.helsinginsanomat.fi/english/archive/news.asp?id=20030408IE3, 8 April 2003.

5 For an introduction to the economics of tacit collusion, see Ivaldi, M., B. Jullien, P. Rey, P. Seabright and J. Tirole, (2003), *The Economics of Collusion*, IDEI Toulouse, available from the European Commission's website at http://europa.eu.int/comm/competition/mergers/review/the_economics_of_tacit_collusion_en.pdf

6 The Competition Authority (2002). *Notice in Respect of Guidelines for Merger Analysis*, Decision N/02/004, p. 20. This is available from the Authority's website at www.tca.ie

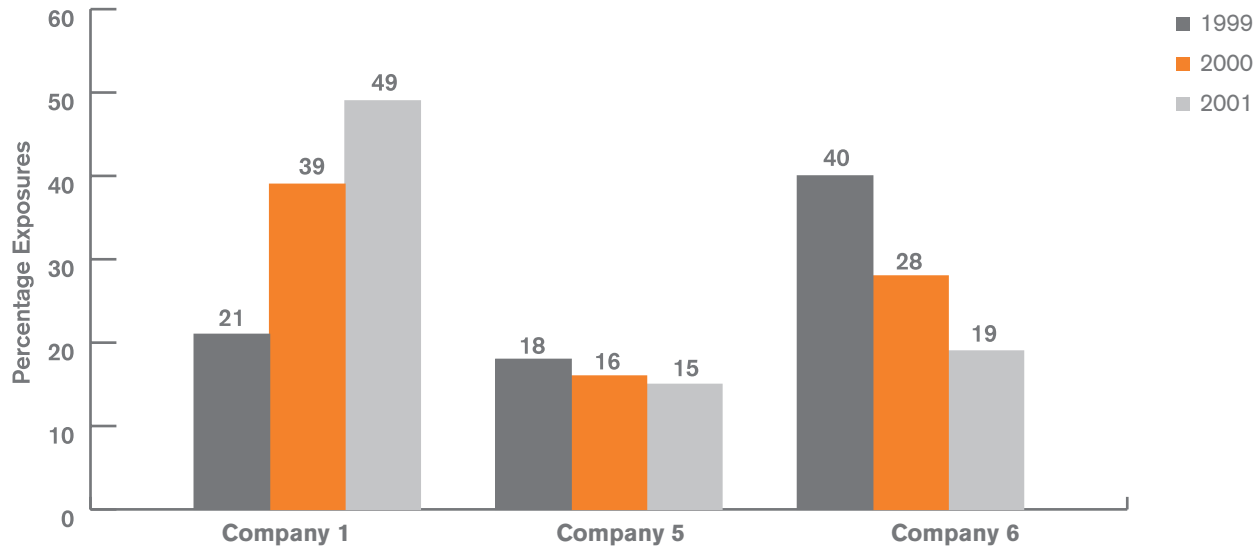
7 Coordination need not be led by one of the competitors itself. Instead, industry associations can serve to coordinate behaviour. If the IIF were to announce that a particular Court decision would have an impact on insurers by increasing their expected costs by 10%, this may serve to indicate to the rivals that they should coordinate pricing at a level 10% above current prices.

8 The Insurance Block Exemption Regulation is discussed in Chapter 4.

9 The Competition Authority (2002), *Notice in Respect of Guidelines for Merger Analysis*, Decision N/02/004, in Section 4 outlines these factors in detail. This is available from the Authority's website at www.tca.ie

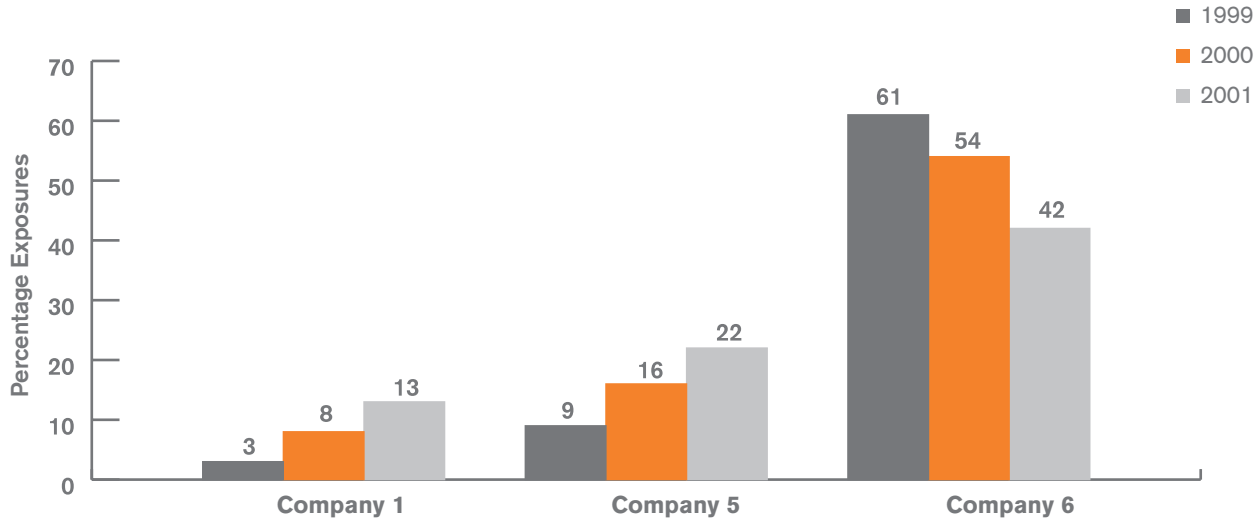
10 Market shares are measures by exposure years.

Figure 7.1: Selected Company Market Shares for Third Party, Fire and Theft Cover for Young Male Drivers, Ireland, 1999-2001



Source: MIAB (2004) *Report 2004* and *Private Motor Insurance Review 1997-2001*, p.88-102

Figure 7.2: Selected Company Market Shares for Comprehensive Cover for Young Male Drivers, Ireland, 1999-2001



Source: MIAB (2004) *Report 2004* and *Private Motor Insurance Review 1997-2001*, p.88-102

7.18 Difficulties with regard to tacit collusion in liability insurance were summarised in a report for the Office of Fair Trading in the UK as follows:

> **"[C]ollusive price-fixing agreements between liability insurers would by quite difficult for the conspirators to police. Unlike many products, which are more or less identical in all characteristics except price, liability insurance policies are often quite individualised, with terms and conditions tailored to the needs of particular industry sectors or even particular firms (especially larger businesses). Different liability insurance covers can also be combined and packaged with other risks in a number of different ways. Products of this sort are much less likely to support successful collusion."**[11]

7.19 In sum, there is little or no evidence of price coordination in either motor or liability insurance markets in Ireland. This is not surprising, as the characteristics of the insurance market ensure that price collusion is unlikely. For these reasons, coordination on outputs (or market segmentation) may be of greater concern than price coordination. Potential market segmentation is discussed on the next page.

11 C. Parson (2003), *An analysis of current problems in the UK liability insurance market, A supplemental report to OFT659 Liability insurance*, OFT, June, p. 60.

Coordination to Segment Markets

7.20 Firms may coordinate on other competitively significant variables instead of (or in addition to) prices. One such possibility is to segment markets. A way this could work would be to have each firm serve a separate market or group of markets. Each would then appear to be a dominant firm in the markets allocated to it.

7.21 Many of the arguments detailed above with regard to price coordination, such as the difficulty of colluding on liability insurance due to the specialised nature of the product, apply here as well. It would also be difficult to detect "cheating" on such a scheme. Coordination in this way would also be unstable over time because growth and profitability in different sectors would not likely match. Some sectors will grow faster than others for demographic reasons, and profitability can be affected by many factors, rendering some markets more attractive than others. These changes alter incentives to participate in the arrangement, making it more likely that one or more firms will see it to be in their interests to enter into markets not allocated to them.

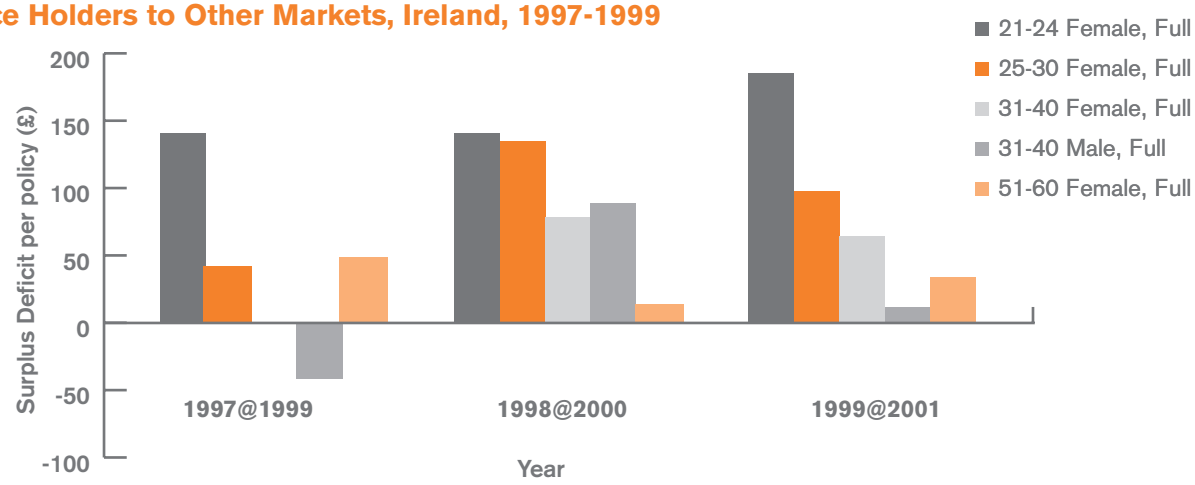
Unilateral Effects

7.22 As discussed in Chapter 6, several relevant insurance markets have only a small number of providers actively supplying products and writing policies. Even in the absence of dominance, the firms in these markets may not face the same level of competitive pressure when setting prices as firms in other markets. Markets served by more suppliers may see more vigorous rivalry and hence lower margins for competitors. By contrast, markets served by fewer suppliers may see less rivalry, and suppliers may earn greater margins as prices increase above competitive levels. These suppliers would earn supra-normal profits in these markets. Such an exercise of market power in insurance markets would be detrimental to insurance buyers in these markets.

7.23 Data on profitability for various motor insurance markets are provided in the MIAB reports. The MIAB analysis is designed to compare the relative performance of market segments in terms of premium, cost and profitability.[12] The MIAB acknowledges that the data it analyses are not complete and hence cannot provide a full assessment of overall profit or loss for specific markets.[13] Nevertheless, the MIAB indicates that it and the IIF agree on the principle findings of the MIAB analysis. In part, this is based on a report prepared by Tillinghast Towers-Perrin for the IIF. The MIAB indicate that this report provides evidence showing that certain motor insurance segments are consistently more profitable than others.[14] The MIAB and Tillinghast Towers-Perrin studies suggest that females aged 21-24 earn a consistent and relatively large positive margin for insurers.[15]

7.24 Figures 7.3 (below) and 7.4 (next page) below provide an illustration of the relative per policy excesses of earned premium incomes over estimated claim costs for several segments of comprehensive motor insurance buyers. The figures focus on female drivers aged 21-24. Figure 7.3 compares drivers with full licenses in this category to males of this age group and older females. Figure 7.4 provides similar information for female drivers aged 21-24 but is for drivers with provisional licenses.[16]

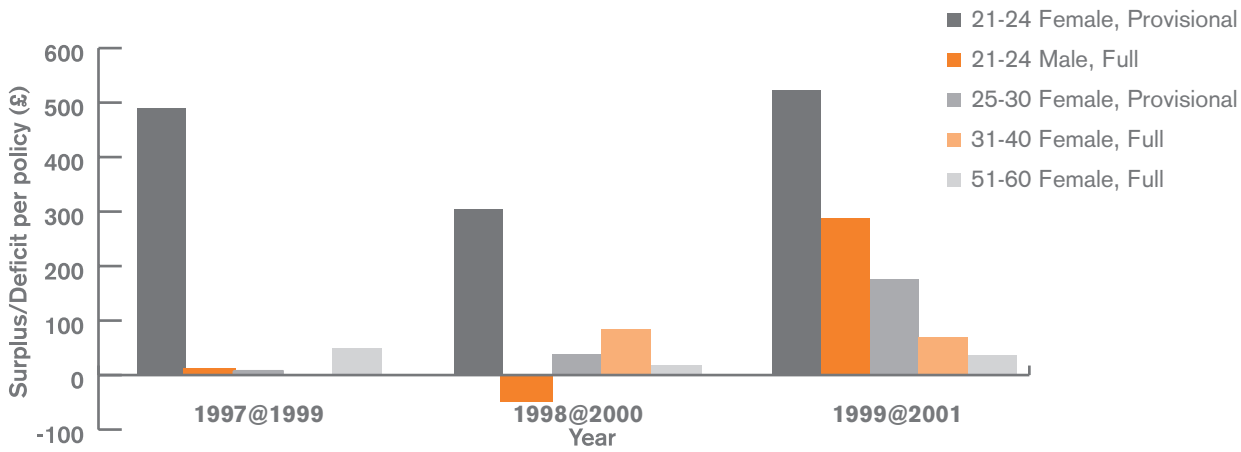
Figure 7.3: Comparison of Profit Margins per Comprehensive Policy for Female Full Licence Holders to Other Markets, Ireland, 1997-1999



Source: MIAB (2004) *Report 2004* and *Private Motor Insurance Review 1997-2001*, p. 88-102

12 MIAB (2004), *Report 2004*, September 27, p. 154.
13 Additional data needed to expand the analysis include estimates of costs incurred but not yet reported, distribution costs, commissions, reinsurance costs, taxes, investment income from insurers asset portfolios and reinsurance recoveries.
14 "[G]raphical representations in the IIF [TTP] study show clearly the favourable margins for females across the market relative to males." MIAB (2004), *Report 2004*, September 27, p. 155.
15 MIAB (2004), *Report 2004*, September 27, p. 154.
16 Margins are considered two years after the term of the policies in question. For example, the profitability of 1998 policies is considered using claims costs through 2000.

Figure 7.4: Comparison of Profit Margins per Comprehensive Policy for Female Provisional Licence Holders to Other Markets, Ireland, 1997-1999



Source: MIAB (2004) *Report 2004* and *Private Motor Insurance Review 1997-2001*, p. 88-102

7.25 The figures indicate that the difference between earned premium income and estimated claim costs per female policyholder aged 21-24 was consistently positive and greater than that for males of the same age or other females. This confirms the findings of the MIAB and Tillinghast Towers-Perrin described above, namely that the margins earned on female policyholders aged 21-24 are consistently large and positive, indicating that premiums in this market have been substantially in excess of the costs of claims for an extended period of time.

7.26 Suppliers would not earn consistently large margins on specific classes of customers over time if the marketplace were competitive. In the absence of barriers to entry, the market represented by females aged 21-24, should draw additional entry if it were generating consistently large economic profits for suppliers. This entry would place downward pressure on prices as incumbent firms are forced to cut them to maintain customers. Entry and price competition would erode the margins earned on policies sold in the market over time. The ability to earn supra-normal profits tends to suggest the existence of barriers to entry. When combined with a very high market share by one firm, such barriers would indicate a dominant position. That entry has not occurred suggests competition is not working well for consumers.

Concluding Comments on Unilateral Effects Analysis

7.27 The available information indicates that both concentration and profitability vary across markets. Information regarding differences in market concentration is provided in Chapter 6, and information regarding the differing patterns of profitability in individual markets is presented above. Sufficient data are not available to link concentration information for individual markets to the extent to which insurers generate persistent and large margins from these markets. This would be a useful avenue for future research.

7.28 Empirical research has been conducted with regard to the impact of concentration in individual markets on the pricing of liability insurance. Chidambaran, Pugel and Saunders study 18 lines of property liability insurance in the US over the 10-year period from 1984 to 1993. They find that "one determinant of pricing performance is the concentration ratio for the line. An appreciable negative relationship exists between the economic loss ratio and the line's concentration ratio." They indicate that one explanation for their results is that higher levels of concentration are conducive to the muting of pricing rivalry. They also state that differences in firm efficiency may account for their results, but that they believe muted competition is a plausible explanation for their findings.[17]

17 Chidambaran, N.K., T. Pugel, and A. Saunders (1997). "An Investigation of the Performance of the U.S. Property-Liability Insurance Industry", *The Journal of Risk and Insurance*, Vol. 64, No 2, June, pp. 371-381.

Switching Costs

7.29 This section considers barriers to switching and switching costs. Switching costs can inhibit rivalry by making it more difficult for buyers to take their business to different insurers. This leads to buyer "lock in", which makes it more difficult for buyers to take advantage of the competitive opportunities available in the marketplace. Switching costs also lessen the gains from vigorous competition. A price cut, for example, will generate fewer new customers when customers face switching costs. As such, switching costs dampen competition. If switching costs are high there may be little or no competition to win customers from other suppliers.

7.30 Insurance is a product that buyers purchase infrequently, usually once a year. As with many financial products, buyers may not be aware of all the products' attributes that they should consider in choosing between competing products. Many buyers are willing and able to do the research, especially in the case of motor insurance, and to shop around themselves. Others prefer to use an intermediary.

Renewal Notices

7.31 Renewal notices are statements provided by an insurer indicating the premium applicable if the buyer wants to effect a further year of indemnity. These are sent around the time that an existing policy is about to expire.

Issue of Concern

7.32 For many EL and PL policies, renewal notices are received very close to when old policies expire and new policies would begin. This does not give businesses sufficient time to investigate alternatives and compare policies from different insurers. Having an ability to shop for a new policy is important because the quote to continue indemnity provided on the renewal notice may be significantly different that the existing premium.

Analysis

7.33 In the case of private motor insurance, since November 2002 motor insurers have been legally required to send out renewal notices and no-claims discount information at least 15 working days before the existing policy expires.[18] Receiving information on premiums and no claims discounts sufficiently far in advance enables buyers to shop around, if desired, prior to the time at which their old policy needs tobe renewed.

7.34 In the case of liability insurance, there have been many reports of buyers not receiving renewal notices in good time. For example, a 2003 survey of members by the Alliance for Insurance Reform ("AIR") and a 2002 survey of members of the Irish Small and Medium Enterprises Association Limited ("ISME") showed that less than half of respondents received their renewal notices more than two weeks in advance of renewal. The results of these surveys are detailed in Table 7.1 below.

Table: 7.1: Time Gap between Receipt of Insurance Renewal Notification and Renewal Date, Liability Insurance, Ireland, 2002-2003

Date of Renewal Notice Receipt	ISME (%)	AIR (%)
Two or more weeks in advance	49	40
Less than two weeks before renewal	31	49
On the day of renewal	7	7
After the renewal date	13	4

Source: Irish Small and Medium Enterprises Association Limited and Alliance for Insurance Reform. As presented in Europe Economics (2004). *Study on Irish Non-life Insurance with particular reference to Motor Insurance, Employer's Liability and Public Liability Insurance*, February 16, Table 4.3, p. 89

7.35 The IIF/IBEC have an agreement on communications that includes an undertaking by insurers that a renewal notice for coverage for personal injury claims arranged through an intermediary will be sent at least 15 days in advance of the expiration of a liability policy.[19] This agreement does not apply generally to all business customers; it only applies to renewal notices sent to IBEC members.

7.36 Liability policies are more complicated and less standardised than motor policies. While shopping around for motor policies can be completed effectively in 15 days, the same is not true of many EL and PL policies, particularly if insurers in other Member States are to be canvassed. The steps involved in a search for a new policy may include preparing data detailing the risks posed by the buyer, shopping the risk to insurers, evaluating the risk by insurers, pricing the policy by insurers, drafting contracts, etc. According to buyer groups:

(a) "Community and Voluntary Pillar would suggest that longer lead times (30 days renewal notice) in relation to liability insurance would facilitate a greater "shopping around" on the part of the client."[20]

18 MIAB (2004), *Report 2004*, September 27, p. 4.
19 IIF & IBEC (2003), *Communication Guidelines for Insurers and Policyholders*, April, p.3, available from the IIF website at http://www.iif.ie/media.htm

(b) "All business insurance renewal notices must be served, at a minimum, eight weeks in advance of their conclusion."[21]

(c) "In view of the complexity and the size of the renewal of liability insurance, a statutory minimum period of renewal notice accompanied with a certificate of claims and provisions for claims should be set at 60 days."[22]

For some policies, even a full month is not likely to be sufficient to allow the buyer to conduct an effective shop and consider its alternatives.

7.37 Furthermore, liability policy renewal notices do not include "no claims discount" information or any other information that a buyer can use to demonstrate experience to alternative insurers. If the buyer wants to shop around for alternative quotes, either through an intermediary or directly, it has a need for documentary evidence from the existing insurer regarding its claims history. The buyer's own records cannot generally be used to prove that it has had no claims. On the contrary, its records would only provide evidence of the claims that have been made against the policyholder for which indemnity has been sought. The provision of claims history information with EL and PL insurance policy renewal notices will enable the buyer to demonstrate its experience to other potential insurers. Shopping the market for new cover would therefore be facilitated if a claims history were supplied to the buyer along with the renewal notice in line with the principle operating for private motor insurance.

Recommendations

7.38 The recommendations below relate to the provision of information by insurers to facilitate buyer decision-making upon renewal, including the consideration of alternative EL and PL policies. The first recommendation relates to the provision of renewal notices sufficiently far in advance of the expiration of existing cover to allow buyers to seek, evaluate, and select among alternative policies.

Recommendation I1

IFSRA should modify its code of conduct for insurers to require that renewal notices for liability insurance be sent by insurers so as to reach buyers at least eight weeks prior to the expiration of the buyer's existing policy.

7.39 An early renewal notice with claims history information should be useful to buyers. It should trigger discussions with intermediaries or insurers with sufficient time for options to be developed and considered. Recommendation I1 calls for renewal notices to be received eight weeks prior to the expiration of the existing policy. This should be sufficient time for buyers to procure and evaluate quotes from alternative insurers. For some liability policies, one month should provide sufficient time to shop the policy to other insurers, but other policies may take longer. As described by intermediary Coyle Hamilton to the Joint Oireachtas Committee:

"Coyle Hamilton starts the renewal process between six to eight weeks prior to the expiry date of a policy. Recently, it has been extended to 12 weeks because as businesses have become more complex, insurers need more information. Coyle Hamilton agrees with the Construction Industry Federation on this point."[23]

Buyers should have sufficient time to develop alternatives, and Recommendation I1 is designed to provide sufficient time for an adequate evaluation of alternatives by most EL and PL purchasers.[24]

7.40 If a renewal notice is received late by the buyer, then the buyer should be able to continue coverage, at the lesser of the old premium rate and the new premium rate, for a period sufficient to enable it consider alternative policy options. The extension should provide the buyer the full period to consider alternatives allowed by the code of conduct. For example, if renewal notices are required eight weeks prior to the renewal date but a buyer receives notice five weeks prior to this date, the old coverage should be extended for an additional three weeks to allow the buyer sufficient time to shop for a new policy.

Recommendation I2

IFSRA should modify its code of conduct for liability insurers to require that, if a renewal notice is received late under the framework set out in Recommendation I1, then the buyer has the option to extend the cover under the old policy, at the minimum of the old rate and the quoted new rate, for the amount of time needed to extend the buyer's time available to shop for new cover consistent with the eight week time period contained in Recommendation I1.

20 Community and Voluntary Pillar (2004), *Submission to the Competition Authority re: Insurance from the Community and Voluntary Pillar of Social Partnership*, July, submission to The Competition Authority, response to questions 21, p. 7.
21 Alliance for Insurance Reform (2004), *Submission by the Alliance for Insurance Reform*, submission to Joint Oireachtas Committee, 2004, recommendations directed at IFSRA, p. 8
22 Irish Hotels Federation (2004), *Competition Issues in the Non-Life Insurance Market*, 15 April, submission to The Competition Authority, p. 2.
23 Coyle Hamilton (2004), Testimony of Mr. John Bisset before the Joint Oireachtas Committee on Enterprise and Small Business, 21 April.
24 Insurers provide some renewal notices to intermediaries, who in terms provide renewal notices to buyers. Recommendations regarding the provision of renewal notices in this case are provided in Chapter 10.

7.41 This Recommendation has two purposes. The first is to ensure that late renewal notices cannot be used to lock in customers. If a renewal notice – and hence the quote to continue indemnity cover for an additional year – is received late, the buyer is guaranteed an opportunity to consider alternatives without financial penalty. If the premium quoted represents an increase, then the extension price is the old price; if it is a decrease, then it is the new price. This is needed so that, if the premium is being reduced, then the limited extension is not a means for the insurer to lock in a higher price for some period of time. The second purpose is to provide incentives for insurers to send renewal notices earlier.

7.42 The next recommendations deal with claims history information. They relate to motor and liability insurance. The first relates to providing claims history information with renewal notices. However, buyers need not wait for a renewal notice before considering alternative policies. The second recommendation requires claims history information to be provided, even absent a renewal notice.

Recommendation I3

IFSRA should modify its code of conduct for motor and liability insurers to require that renewal notices include a certified history of claims for the buyer. Claims histories should cover at least the previous five years and include any outstanding claims from earlier years.

Recommendation I4

IFSRA should modify its code of conduct for motor and liability insurers so that they are required to provide a certified claims history to any buyer upon request. Claims history information should be provided in hard copy if so requested by a buyer.

7.43 Claims history information should be provided in hard copy if so requested by a buyer. However, insurers may wish to make this information available through electronic means, for example, over the Internet. This may reduce costs and increase the ease of access to this information.

7.44 The claims history information called for in Recommendations I3 and I4 is more detailed than the "claims free" certifications currently provided to motor policyholders. A minor accident and a major accident are both claims, but they have different implications in terms of severity, insurer cost, and the riskiness of the policyholder. So too is the distinction between a stolen vehicle claim and an accident resulting from drink driving.

7.45 Claims histories need to be recognised as valid or authentic by other insurers. The next Recommendation calls for the development of a standardised format for such histories. This may be particularly important for liability policyholders where claims information may be more diverse.

Recommendation I5

IFSRA, in cooperation with the IIF, should develop a standardised format for motor and liability claims histories. This format should enable insurers to certify the accuracy of any information provided.

7.46 Using a standardised format will facilitate both ease of switching and quicker analysis of risk profile by potential new insurers. Policyholders will not have to prove otherwise their claims history and insurers can be confident that the information they receive is true and accurate.

7.47 Switching insurers benefits the individual or business making the switch, but it also generates positive externalities. Individuals that do not switch suppliers gain from the increased competition that is generated by those that do. Given that benefits accrue to all buyers, it is beneficial to encourage switching by creating an environment in which customers can fully evaluate and take advantage of their options in the marketplace. The Recommendations in this section allow such an evaluation. Furthermore, given the broad benefits to all buyers that result, individual buyers should not have to bear the costs of, for example, receiving a claims history. Instead, these histories should be provided free of charge.

7.48 This section makes five recommendations related to the provision of information by insurers to buyers. The information called for includes quotations for policy renewals and claims history data. It is recommended that both types of information be provided sufficiently far in advance of policy expiration to enable buyers to consider alternative cover. These recommendations are proportional to the concerns raised. Some claims history information is provided already, as with a "no claims discount", and renewal notices are provided under current practice. The Recommendations call for giving buyers information earlier and also giving access to more information.

7.49 The Joint Oireachtas Committee considered this issue and recommended that insurers should remind buyers of renewal dates two months prior to renewal and to submit a quotation to the buyer one month prior to renewal. In particular, the Committee's recommendation # 51 is, "Insurance companies should be required to remind policy holders of the renewal date two months prior to renewal and to submit a quotation to the policy holder one month prior to the renewal date."[25] (This recommendation was new to the Committee's 2004 Report.)

7.50 The Joint Oireachtas Committee's recommendation involves a two-step process. The Recommendations in this Study are simpler. These Recommendations involve a one-step process whereby a renewal notice, with a premium quotation in the event of a renewal, is provided with sufficient time to consider alternatives should the buyer decide to shop for alternatives. A renewal notice without a quotation does not provide a critical piece of information for the business to evaluate in deciding whether to look for alternatives, i.e., the price. Instead, the Recommendations seek to provide quotations and claims history information in sufficient time to develop and consider alternatives, if desired.

7.51 The Joint Oireachtas Committee's Recommendation # 25 states, "Policyholders should see clear evidence of the benefit of being claim free. Accident-free policyholders or those with low levels of accidents should be seen to be rewarded."[26] This Study does not specifically address this recommendation. However, in a competitive environment with low switching costs, the market would be expected to price risks appropriately. This includes the provision of appropriate claims-free discounts. Recommendations I3 and I4 relate to the provision of claims history information to buyers. Together with this Study's other Recommendations related to lessening switching costs and barriers to entry, these two Recommendations should facilitate achieving this goal of the Joint Oireachtas Committee.

Pricing Transparency

7.52 Buyers can make more informed purchasing decisions when they have detailed pricing information available to them. This information allows them to consider the products on offer from a seller and also enables them to make comparisons across sellers.

Issue of Concern

7.53 Buyers of motor insurance in Ireland are provided with one overall price for their policy. They are not provided with information on the components of this price.

Analysis

7.54 Motor insurance can include different types of coverage. As discussed in Chapter 2, these include liability; third party, fire and theft; and comprehensive. Additional insurance coverage comes at a price – the premium for comprehensive insurance is greater than that for third party, fire and theft. With a breakdown of the premium by the types of cover offered, buyers can determine whether they want all of the coverage offered or whether they would prefer to reduce their premiums by opting for less far reaching cover.

7.55 The lack of price transparency provided to many buyers now makes it difficult to consider altering coverage. Increased transparency would also facilitate comparisons across insurers.

7.56 Motor insurance pricing can also be made more transparent with regard to group ratings. Motor insurance is priced based both on group and experience ratings. Consumers do not know the group to which they are being compared. Making this information available to consumers would further enable them to consider the reasonableness of any premium quotations offered and to make comparisons across insurers.

Recommendation

7.57 The Recommendation below relates to motor insurance price transparency and addresses both coverage pricing and group rating information. This Recommendation is to facilitate shopping for alternative policies and informed buyer decision-making.

Recommendation I6

IFSRA should modify its code of conduct to require motor insurers to provide initial quotations and renewal notices that break down premiums so as to show the premium charged for different types of cover, such as liability, fire and theft, and comprehensive insurance. Discounts (e.g., accident free discounts) and group risk class descriptions (e.g., male driver aged 26-30) should be detailed as well.

7.58 The MIAB made a similar recommendation. Its Recommendation # 15 is, "That a regulation be introduced to standardise renewal notices - detailing the calculation of premium from compulsory cover to the full coverage offered with elective elements clearly indicated and showing any loadings or discounts applied in both monetary and percentage terms."[27] The Joint Oireachtas Committee also made a similar

25 Joint Committee on Enterprise and Small Business (2004). *Second Report, Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July 19, Recommendation # 51, p. 9. This recommendation was new to the Committee's 2004 Report.
26 Joint Committee on Enterprise and Small Business (2004). *Second Report, Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July 19, Recommendation # 25, p. 94.
27 MIAB (2004), *Report 2004*, 27 September, p. 126

recommendation. Its Recommendation # 26 states, "All policyholders should, on renewal, receive information on the basis on which the premium is calculated."[28]

7.59 Recommendation I6 calls for the provision of risk class and price component data. This is to assist the consumer in determining what coverage to buy and to make comparisons across insurers. This information is available to insurance companies, and its provision with quotations can be achieved with limited cost.[29] Thus, the Recommendation is proportionate to the concern raised.

Search Costs

7.60 Prices in many markets are readily available to buyers. In these markets, price discovery requires little effort. In other markets, however, pricing information can be much more difficult to obtain. When buyers need to search for prices, they may not find the best value for money available in the market. Instead, they continue searching for better prices until the expected benefits of continued search are lower than the costs of continuing the search.

Issue of Concern

7.61 Pricing information can be difficult to acquire in insurance. Prices are policy-specific and often relate to customer-specific information. EL and PL premiums are even more problematic than motor in this regard as claims information and potential risks are often not standardised. Developing prices from alternative providers may require risk presentations and the collection of a large volume of customer-specific information. As a result, search costs for insurance quotations can be high, especially for liability premiums.

Analysis

7.62 Search costs are an inherent part of the insurance marketplace. Nevertheless, attempts have been made to reduce search costs. ISFRA, for example, publishes motor insurance price comparison tables.[30] These tables can be useful to identify potential suppliers and to indicate the types of questions consumers should ask when considering their options. IFSRA publishes surveys in areas of financial services in addition to motor insurance.[31] All of these surveys are designed to raise awareness about price variations and to encourage buyers to shop around.

7.63 In certain industries, EL and PL search costs are particularly high. If insurers lack sufficient information to customise pricing for the relevant industry or segment, buyers or representative groups can assemble data to illustrate the claims experience for their risk profile. This process can be time consuming, and may require coordinated efforts across buyers to gather sufficient data. The services of an intermediary may be needed to complete this type of project. Search costs can also be high when value for money is difficult to assess, for example due to non-price cover requirements or restrictions.

7.64 The Authority has heard evidence of an initiative taken in the community and voluntary sector where a particular type of housing project had been able to get quotes for EL and PL from only one insurer. With the help of an intermediary, it assembled a range of information on similar risks, including claims experience and risk reduction procedures. This proved to be of interest to several insurers. A range of competitive quotes was then received, which were significantly lower than the premium previously being paid. This type of evidence indicates the benefits that can be achieved from additional search, even if this search is costly.

7.65 The Authority has also heard evidence of action taken in the commercial non-haulage sector to address a situation where only one insurer was available to supply. In this case, a representative body assembled data on the claims experience of its members over a period of five years. This was done in conjunction with an intermediary. This exercise revealed a consistently low claims ratio (i.e., claims were only a small fraction of premiums paid). In addition to this exercise, the representative body developed close links with its members on risk management. As a result, another insurer was attracted to the niche, putting downward pressure on insurance prices.

7.66 There are other examples in the public domain where various trades and sectors, through associations of members working with intermediaries, have been able to assemble information about their risks. The information has been sufficient to bring the trade or sector to the interest of insurers that had not previously covered them. This work may not be easy or straightforward, but the fact that it can be done implies that competition in individual liability insurance markets can be increased when information about the risks in the market are made available.

7.67 A considerable added value of such an exercise is that the assembly of records on accidents and claims can help to focus efforts on risk reduction. For example, a pattern of particular types of accidents may highlight the need for appropriate training or procedures to reduce such accidents.

28 Joint Committee on Enterprise and Small Business (2004), *Second Report, Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July 19, Recommendation # 26, p. 73.
29 Underwriters already provide comparative information to customers when they first take out a policy. See, for example, Hibernian Direct and Allianz Direct websites: http://www.allianzdirect.ie/ and http://www.hiberniandirect.ie/direct/HibernianDirectWeb/homepage.jsp
30 IFSRA (2004). *Motor Insurance Cost Survey*, 12 December, available from the IFRSA website at http://www.ifsra.ie within the Consumer section under Cost Surveys
31 IFSRA currently publishes cost surveys for life insurance, credit cards, personal loans, home insurance and personal accounts.

Recommendations

7.68 IFSRA's motor insurance cost surveys relate to specific types of mass-market policies. IFSRA's programme of publishing this type of information should be expanded to include cost surveys on more tailored policies, such as EL and PL insurance. Given that there is less standardisation with regard to EL and PL insurance than for motor insurance, these cost surveys will need to be carefully crafted. The design of these surveys may require consultation with buyers and insurers.

Recommendation I7

IFSRA should publish cost surveys on liability insurance. These cost surveys should cover both EL and PL insurance for representative buyers, such as small business from several different industries. These cost surveys should be updated at least annually.

7.69 Buyers and their representative groups who wish to secure lower premiums through increased competition should, where possible, assemble data at a market-wide level to illustrate the claims experience of their risk profile.[32] This can result in new insurers being attracted into the market, and the onus is on buyers to assemble and present such information. While there are examples of this being done, often with considerable effort, it would be easier to develop insurance quotations if detailed, market-wide data for specific industries were available in a timely, reliable and non-discriminatory way. Availability of such data would help insurers more easily to assess and price risk throughout the market.

7.70 With regard to preparing risk presentations for industries or firms to assist in shopping risks and determining alternative quotations, IFSRA should publish a buyer guide detailing the types of data required, providing examples of the types of benefits than can be derived, and other practical advice. Ultimately, buyers or their representatives may need assistance from intermediaries in assembling and presenting these data, but a public guide would provide assistance and motivation to groups considering to undertake such exercises – or get others to start thinking about such efforts. Buyer action is critical to making these efforts pay off, but IFSRA can provide advice to assist these private efforts. This type of service is a natural add-on to the consumer awareness efforts currently pursued by IFSRA.

Recommendation I8

IFSRA should publish a buyer guide detailing the potential benefits of assembling sufficient data to illustrate claims experiences and risk profiles in a particular industry or for a group of buyers. The buyer guide should also detail the types of information needed to complete this task.

7.71 Recommendation I8 does not call for any action by private industry. Instead, it calls for IFSRA to expand its existing buyer awareness programme by publishing a buyer guide. The Recommendation is proportional to the concerns raised.

Intermediaries

7.72 Intermediaries can play an important role in facilitating competition between underwriters. Intermediaries advise customers on the suitability of the various products offered by different underwriters. They also can direct buyers to the most suitable insurers for their risks. The services offered by intermediaries generally reduce the costs of searching for insurance quotations in the marketplace, comparing the prices discovered and determining best value for money.

7.73 The use of an intermediary is more common for liability insurance; there are an increasing number of direct writers of motor insurance. This Study discusses issues related to intermediaries, including issues related to their system of remuneration, in Chapter 10.

Self-Insurance

7.74 In many industries, self-supply is an alternative to purchasing inputs from third party vendors. The potential for self-supply can place a check on the exercise of market power by third party suppliers. This helps to discipline pricing in the market.

Issue of Concern

7.75 Businesses in Ireland are not permitted to self-supply motor insurance, though they are permitted to self-supply EL and PL coverage.

32 This information can also be used to develop strategies to reduce risk.

Analysis

7.76 Third party motor insurance supply is required to protect injured parties. If financially weak firms were to self-supply motor coverage and then go bankrupt, injured third parties may not receive appropriate compensation. Furthermore, businesses that are healthy today may not be healthy or able to pay compensation several years into the future. Weak firms may be tempted to reduce costs by cancelling motor coverage.

7.77 The motor risks posed by businesses vary by company and industry. Firms transporting hazardous materials, for example, are riskier than those not dealing with such materials. Thus, the potential for meeting claims that self-insurance would entail, thus, is related to individual business risks. Many businesses are financially able to self-insure, or provide their own "standard" coverage with the assistance of third party coverage for catastrophic accidents.

7.78 Many businesses cannot self-supply motor coverage in a way that guarantees sufficient coverage for injured third parties. For example, small businesses may not be able to self-insure because they lack the financial capacity to pay a large claim. Though these events may be rare, a self-insuring business needs to be able to meet its obligations to injured third parties. As a result, companies with insufficient financial resources should not be permitted to self-insure.

7.79 There are provisions in the Road Traffic Acts that allow exemption from third party motor insurance requirements.[33]

Recommendation

7.80 Companies should not be permitted to self-insure without meeting strict criteria with regard to their ability to meet their obligations in the event of a serious accident. Thus, financial criteria would be needed to restrict eligibility for self-insurance to those businesses that could actually meet their potential obligations. We recommend that the Department of Transport develop a programme to facilitate self-insurance of motor risks for qualified businesses.

Recommendation I9

The Department of Transport should establish guidelines, procedures, and reporting requirements that would permit eligible firms to self-insure motor risks.

7.81 The Department of Transport programme would need to deal with a number of complex issues. For example, part of the premium charged to a business taking motor cover through an insurer is used to pay the insurer's MIBI-related costs.[34] Self-insuring firms would not be contributing to MIBI via a third party insurer. Would such businesses be required to make contributions to MIBI?

7.82 The Joint Oireachtas Committee has also recommended that self-insurance should be facilitated, where appropriate. Its Recommendation # 40 states, "Organisations, meeting certain financial criteria, should be able to self-insure for all motor risks."[35]

7.83 Recommendation I9 is proportional to the concerns raised. It does not require any business to self-insure. Rather, it calls for the development of a programme to allow businesses to self-insure, if financially able. Any such programme would need to deal with issues, such as MIBI contributions by self-insuring businesses, in an appropriate manner.

Conclusion

7.84 This Study did not find evidence of collusion or coordinated behaviour by insurers. Nevertheless, it did find evidence that competition works slowly and that the markets are not all vigorously competitive. There are markets where dominance appears likely. In these markets, entry appears too slow to prevent the incumbent firm from earning significant monopoly profits. These profits are not persistent, however, as entry over time will challenge the incumbent's dominance. Other markets are characterised better as oligopolies, and competition appears sluggish in these markets also.

7.85 This Chapter makes nine recommendations designed to make it easier for buyers to switch insurers. These are to enable customers to take full advantage of the opportunities available in the marketplace. Several recommendations are specific to motor insurance, and others are specific to liability insurance. Many may be applicable more broadly. For example, the provision of claims histories with homeowner policy renewal notices may make it easier to switch suppliers of homeowner insurance.

33 Road Traffic Act, 1961, Section 60 details the conditions to be met in order to qualify as an exempted person. Available from The Office of the Attorney General website at http://www.irishstatutebook.ie/ZZA24Y1961S60.html
34 MIBI is discussed in Chapters 4 and 8.
35 Joint Committee on Enterprise and Small Business (2004), *Second Report, Second Interim Report on Reforms to the Irish Insurance Market,* Houses of the Oireachtas, July 19, Recommendation # 40, p. 71.

Chapter 8

INSURANCE MARKET BARRIERS TO ENTRY

INSURANCE MARKET BARRIERS TO ENTRY

Introduction

8.1 This chapter considers entry barriers to the markets defined in Chapter 6. The existence and magnitude of any barriers to entry is an important part of a competition analysis. Where barriers to entry are low, entry will erode any market power that existing suppliers may have. Supra-competitive pricing attracts entry. This entry enhances competition and drives down prices for customers. By comparison, where entry barriers are high, a firm can make persistent economic profits. The barriers prevent entry from driving down prices.

8.2 As discussed in Chapter 5, some entry barriers are natural features of a market. Others are functions of the business policies pursued by the firms active in the market. A third type of barrier results from the operation of regulatory or other governmental requirements. This Chapter considers a group of regulatory and other similar requirements that have the effect of limiting rivalry on the market. Recommendations are made to reduce or eliminate these barriers.

8.3 This Chapter begins with a description of recent entry activity in the marketplace. It then considers whether there are barriers to entry resulting from government regulation or industry practice, and, if so, how they can be removed. The issues raised by each potential barrier to entry are discussed first. Each is then analysed, and recommendations to remove the barrier are made. Concluding comments follow.

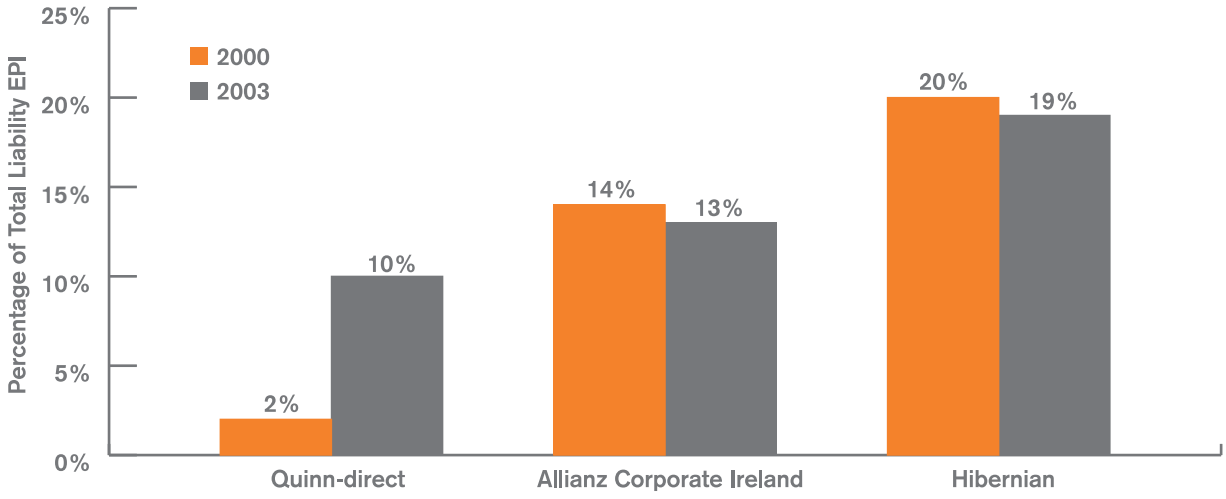
Recent Entry Experience

8.4 There has been recent entry into some of the relevant motor and liability insurance markets. Quinn-direct has been the most successful entrant into a range of markets. Set up in 1996, the company now employs over 600 people in Cavan, Enniskillen and Dublin.[1] It has been especially successful in liability insurance, even when other underwriters were exiting the market:

"On employers and liability insurance, one of the key focus areas here today, we continue to be a catalyst for change. We have assisted businesses when others have pulled out, and we are growing that portfolio. In 2002 it increased by more than 300% over last year's figures, and it has increased also by 300% in the six months to date this year, in comparison to the equivalent period last year."[2]

8.5 Figure 8.1 below shows the liability insurance market shares measured using Earned Premium Income, for Quinn-direct, Allianz and Hibernian in 2000 and 2003. It shows substantial growth for Quinn-direct over this period.

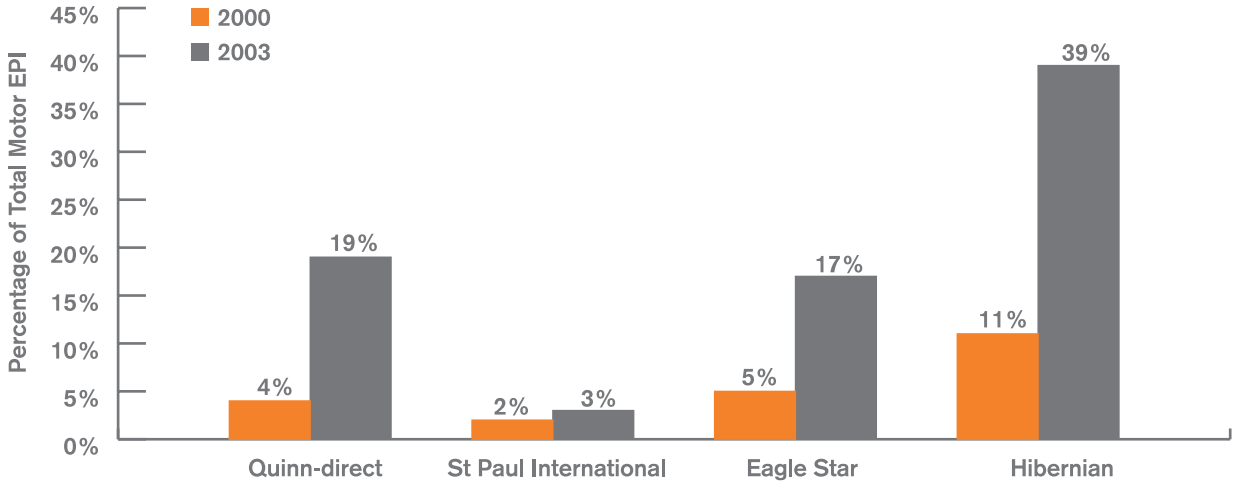
Figure 8.1: Liability Insurance Market Shares for Selected Companies, Ireland, 2000-2003



Source: *Blue Books* and *Insurance Statistical Review 2003*

1 Quinn Financial Services, "About Us", details available from the Quinn-direct website at http://www.quinn-direct.com/about_us.html
2 Quinn-direct (2003), Testimony of Mr. Kevin Lunney before the Joint Oireachtas Committee on Enterprise and Small Business, 1 July.
3 "Cost of riders' premiums puts Irish motorbike sales in a slump", *The Irish Times*. 10 Nov 2004.
4 For a complete list of St. Paul International's products, see the St. Paul Travelers Ireland website at http://www.stpaul.ie/

Figure 8.2: Motor Insurance Market Shares for Selected Companies, Ireland, 2000-2003



Source: *Blue Books* and *Insurance Statistical Review 2003*

8.6 There has also been recent entry into individual markets by insurers active in other Irish markets. AXA's entry into the motorcycle insurance market in 2004 was discussed in Chapter 6.[3] Another entrant into individual markets is St. Paul International. Entering Ireland in 1995, it specialises in motor trader's insurance.[4]

8.7 Data on market shares are not available on specific, narrow motor insurance markets. Shares of overall motor insurance earned premium income can be compared, however. Figure 8.2 below provides shares for several insurers. It shows significant growth for Quinn-direct, Eagle Star, and Hibernian.

8.8 Figure 8.2 above demonstrates that successful entry is possible in the motor insurance marketplace. It also shows that smaller incumbents can grow rapidly. In short, entry and expansion are possible. Nevertheless, as shown in Chapter 7, there are motor and liability insurance markets where rivalry is weak. Barriers to entry must be slowing or blocking entry into those markets.

Barriers to Entry

8.9 Chapter 7 found that competition in at least some of the relevant markets was sluggish and that these markets were not fully competitive. In the absence of vibrant competition, barriers to entry serve to slow market entry, make it more costly and limit its impact on enhancing the competitiveness of markets. This harms customers.

8.10 This section considers a series of barriers to entry into motor and liability insurance markets in the State. These barriers include solvency requirements, the functioning of the Insurance Protection Fund, the lack of market information, the structure and funding of the Motor Insurance Bureau of Ireland and the Declined Cases Agreement, among others. These are discussed below.

Background

8.11 There are no regulatory restrictions on the number of suppliers in the markets. An insurer authorised in any part of the Single European Market can supply insurance in Ireland.[5] As discussed in Chapter 4, EU Directives are designed to facilitate market entry by allowing insurers to expand their businesses into other parts of the EU by establishing businesses in other countries or by providing cross-border services. Neither of these approaches requires the authorisation of the regulators in the host country. While conditions must be fulfilled in order to establish operations on a cross-border basis in a new Member State, these conditions are similar in type throughout the EU/EEA. Some insurers from other Member States have established a presence in Ireland, and a certain degree of cross-border business is transacted. There still remain limitations on the extent to which entry can be accomplished on a freedom-of-services or cross-border basis.

8.12 One difficulty with cross-border supply is the uncertainty generated by the legal system. The Study found a lack of transparency with regard to legal system awards resulting from person injury cases. Due to the asymmetry of information between potential entrants and incumbent suppliers, this serves as a barrier to entry. This was confirmed by testimony before the Joint Oireachtas Committee by

3 "Cost of riders' premiums puts Irish motorbike sales in a slump", *The Irish Times*. 10 Nov 2004.
4 For a complete list of St. Paul International's products, see the St. Paul Travelers Ireland website at http://www.stpaul.ie/
5 IFSRA (2003), Testimony of Ms Mary O'Dea before the Joint Oireachtas Committee on Enterprise and Small Business, 20 November.

the Director of Worldwide Markets for Lloyd's. He stated that many Lloyd's underwriters have concerns about underwriting risks in the Irish market. "For many of the Lloyds underwriters in London, Ireland is regarded as challenging territory."[6] He also commented on the legal system in Ireland. "[F]eatures of the Irish legal environment which requires a special approach to the underwriting of Irish liability business."[7] These statements confirm that foreign insurers view Ireland as a market requiring specialised knowledge and experience, in part due to the legal environment. The legal system is discussed in Chapter 9.

Solvency Requirements

8.13 In accordance with EU Directives, all Member States impose minimum solvency requirements upon the insurers that they regulate. Each Member State is however permitted to impose solvency requirements that are more stringent than the required minimums. EU and Irish solvency requirements are discussed in Chapter 4.

Issue of Concern

8.14 IFSRA imposes solvency requirements in excess of the minimum required by the EU. It also imposes higher solvency requirements upon entrants than upon insurers with established businesses in the State. The increased requirements imposed on entrants might dissuade potential entrants that could meet the EU requirements but not the discretionary requirements imposed by IFSRA. Thus, these requirements may serve to restrict entry. Increased solvency requirements also increase costs, which further discourages entry.

Analysis

8.15 There are two issues with regard to solvency requirements set by IFSRA. The first is the increased level for new entrants in comparison to incumbents, and the second is their level in excess of EU requirements. With regard to the asymmetry, there is a general preference, from a competition point of view, that regulated firms be treated equally. This allows firms to compete on the merits, succeeding or failing in the marketplace due to their prices, costs, services provided, and product qualities. With equal treatment, market advantages come from efficiency and innovation, not from favoured regulatory treatments. More efficient firms will grow over time while less efficient firms will see their sales decline. Regulation should not determine the winners in the market, nor should regulators select these winners. Of course, where there are sound policy reasons to deviate from equal treatment, regulators can and should do so.

8.16 IFSRA has explained that it imposes increased solvency requirements on entrants because there is a higher risk of failure in the start-up phase than when an insurer is more established. Newly authorised companies are required to submit accounts more frequently than the normal annual return. This assists with the tracking of its financial position by the regulator and applies at least for the first three years of operation.[8]

8.17 Preventing the failure of an insurer is a sound public policy concern. Third parties suffering injury are harmed if insurers fail and are unable to pay claims in full. Thus, if new insurers have a higher risk of failure, prudential regulation should impose higher standards, such as increased solvency requirements, on new providers. An increased risk of failure can justify asymmetric solvency requirements, but the additional requirements imposed on entrants should be justified and proportionate to their increased risk of failure.

8.18 Given that there is always some risk of failure, increased solvency requirements must improve the safety of the insurance marketplace and the reliability with which third party claims are paid. However, increasing prudential standards may have only a very small impact on safety while requiring large increases in capital. As such, prudential requirements must be proportionate, to ensure burdens imposed do not outweigh benefits. Competition policy and prudential regulation work together in this area. Though reducing solvency requirements for entrants may encourage entry, unsafe entry puts customers - and potentially injured third parties - at risk that the cover purchased will not be able to pay claims. Because payouts may be needed for several years into the future, this is especially important. Thus, solvency ratios must balance different policy goals, including those of competition policy.

8.19 With regard to the second issue of Irish solvency standards being greater than EU standards, IFSRA has stated that most companies maintain solvency levels exceeding its requirements.

"Most companies maintain solvency levels well in excess of our requirements and we are not the only Member State to require companies to maintain solvency levels in excess of the required minimum."[9]

8.20 In this case, IFSRA's requirements may not have a large impact on the insurance marketplace. More specifically, the constraints imposed by IFSRA's minimum solvency standards do not bind the decisions with regard to capital levels made by insurers that

6 Lloyd's (2004), Testimony of Mr Julian James before the Joint Oireachtas Committee on Enterprise and Small Business, 28 April.
7 Lloyd's (2004), Testimony of Mr Julian James before the Joint Oireachtas Committee on Enterprise and Small Business, 28 April.
8 OECD (2002), *Insurance Solvency Supervision*, OECD Country Profiles, p. 148, available from the ICEA website at http://intranet.icea.es/solvencia/Documentos/Insurance%20Solvency%20Supervision%20OECD%20Country%20profiles.pdf
9 IFSRA (2004), Testimony of Dr. Liam O'Reilly before the Joint Oireachtas Committee on Enterprise and Small Business, 7 April.

choose to maintain solvency levels in excess of requirements. Such insurers decide to hold levels of capital above minimum requirements for non-regulatory reasons. If the regulatory constraint that certain levels of capital be held is not a binding factor, then a reduction in the present IFSRA standard should not be anticipated to impact the behaviour of these firms. A reduction in regulatory requirements will not lead to lower capital levels for insurers in this case.

8.21 IFSRA has indicated that many insurers do actually hold capital substantially in excess of regulatory requirements. It is widely understood that the largest insurers maintain solvency margins between 200% and 360%. Changes in regulatory capital requirements will not likely result in significant changes in actual levels of capital for these insurers.

8.22 It is helpful to understand the many factors that contribute to decisions made regarding capital levels. Though related to banking and not insurance, a recent study that examined the determinants of the level of capital held by banks and building societies is informative.[10] It notes that UK financial institutions hold substantially more capital than required by regulation. The study suggests a variety of reasons for this:

(a) Covering unexpected additional risks, such as business risk;

(b) Financing long term business strategy;

(c) Retaining any excess capital because they anticipate high adjustment costs of raising capital in future;

(d) Meeting a preference from credit agencies and bondholders for high capital levels; and

(e) Wanting to be as well capitalised as peers.

The conclusion of this paper is that regulatory capital requirements are only one of many factors that drive financial institution decisions about total capital levels. They hold excess capital for deliberate business policy reasons, apart from regulatory solvency concerns. A recent paper by Milne adds another reason why financial institutions hold levels of capital substantially in excess of regulatory requirements - to reduce the threat of regulatory intervention.[11] These same factors are likely to contribute to capital decision-making by insurers.

8.23 Furthermore, IFSRA has indicated that it has no evidence that companies have been dissuaded from entering the Irish insurance marketplace because of its new entrant or on-going solvency requirements:

"The solvency requirements we have are broadly in line with the solvency requirements in place in other EU countries. We have not identified that as being a specific barrier, but it is an important issue we bear in mind when we develop the sales codes."[12]

8.24 Similarly, insurers have indicated that the IFSRA solvency requirements do not adversely impact their businesses. For example:

"Obviously the higher solvency requirements for new entrants require a higher level of capital to begin with. We do not feel this is over-demanding, and Quinn-direct has shown that it has been able to work with this regime successfully."[13]

8.25 The Authority has not received evidence that IFSRA's capital requirements have deterred insurers from entering the Irish market. This Study did find uncertainty as to what the requirements for a new entrant would actually be.

Recommendations

8.26 There may be a valid reason for imposing more stringent solvency standards on entrants than on existing suppliers. No standards imposed on new entrants, however, should be in excess of what is strictly required to compensate for increased risk of failure. Asymmetric solvency standards can place entrants at a disadvantage. Furthermore, requiring capital levels in excess of EU standards can also serve to deter entry, even if IFSRA's regulatory requirements are not binding on incumbents and no insurers have indicated that they have been deterred. Capital levels in the industry may change in the future, and insurers may re-evaluate their entry prospects, especially in the light of the recommendations in this Study. As such, solvency requirements for entrants should be as stringent as required for prudential purposes, but no higher. This is also true of on-going solvency requirements for incumbents. These concerns lead to the following recommendations:

10 Alfon, I, I. Argimon, and P. Bascunana-Ambros (2004), *What determines how much capital is held by UK banks and building societies?*, Occasional Paper Series 22, FSA, July.
11 Milne, A. (2002), "Bank Capital Regulation as an Incentive Mechanism: Implication for Portfolio Choice," Accepted for publication by the *Journal of Banking and Finance*, 26 (1), p. 1-24.
12 IFSRA (2003), Testimony of Ms Mary O'Dea before the Joint Oireachtas Committee on Enterprise and Small Business, 20 November.
13 Quinn-direct (2004), Submission by Quinn-direct Insurance Limited in response to request for submissions within the Preliminary Report of the Competition Authority, *submission to The Competition Authority*, p. 3.

Recommendation I10

IFSRA should issue guidelines detailing the regulatory requirements, including solvency standards, it will apply to insurers seeking to enter the Irish motor or liability insurance marketplace. To the extent that new entrants are required to meet standards in excess of those for existing suppliers, the guidelines should justify these increased standards.

8.27 The principles underpinning Recommendation I10 are transparency and proportionality of regulation. Of course, these principles apply whether the regulation relates to new entrants or existing providers.

Recommendation I11

The IFSRA guidelines called for in Recommendation I10 should include the justification for any solvency standards that are in excess of the EU requirements. Any standards in excess of EU requirements should be proportionate.

8.28 A review of the EU regulatory standards is now under way. This is known as Solvency II and will focus on capital requirements, supervisory practices and transparency through improved reporting by companies. This will introduce a more risk-based approach to capital requirements. In other words, companies that can demonstrate that they are managing and providing for risks in a prudent manner will benefit from lower capital requirements.[14] Such an approach to solvency regulation is appropriate. IFSRA is involved in the Solvency II project. In addition, the Department of Finance is a Member of the European Financial Services Policy Group whose task includes the review of insurance solvency requirements.[15] As Solvency II progresses, IFSRA and the Department of Finance should stress the principle that regulatory requirements should be as high as necessary for prudential reasons, but no higher. This applies both to existing insurers and new entrants.

8.29 Recommendations I10 and I11 are proportionate to the concerns identified. These concerns relate to uncertainty on the solvency standards for new entrants and also that solvency standards may be too high, either for entrants or incumbents. The recommendations seek to provide clarity regarding the regulatory requirements for entrants. They also seek to establish solvency requirements for entrants and incumbents at levels appropriate to the risks posed.

8.30 The Joint Oireachtas Committee addressed this subject in its recommendation # 48. This recommendation is, "The Irish solvency requirements for new entrants be exactly the same as for existing market participants."[16] As indicated above, requirements need not be identical for entrants and incumbents. Any deviation from symmetry, however, should be transparent and proportionate to the risks posed by new entrants. The Joint Oireachtas Committee also addressed the subject of whether Irish solvency requirements should exceed EU minimums. More specifically, the Joint Oireachtas Committee recommended, "Irish solvency requirements be no higher than the norm required by EU regulation."[17] While reduced solvency requirements may lessen entry barriers, there may be sound and proportionate prudential reasons for imposing increased solvency requirements. Furthermore, if lower standards lead to impressions that insurers are not safe, reduced standards may actually increase entry barriers by reducing consumer confidence and reducing switching. Recommendations I10 and I11 do not specifically call for Irish standards to match EU standards. Instead, they ask for solvency requirements to be determined in a way that is justified and transparent.

Policyholder Protection Fund

8.31 Even with solvency requirements and prudential supervision, there remains a possibility of an insurer becoming insolvent. One policy response to this eventuality is to establish a policyholder protection fund so that buyers of insurance would still have some protection against losses or claims.[18]

Issue of Concern

8.32 Policyholder coverage by these funds is determined by the regulation of the insurer's home state. The extent of coverage, both in terms of claimant eligibility and the fraction of claims covered, is not uniform across EU Member States. Indeed, the existence of policyholder protection funds is itself not uniform.

14 We note that the expectation is that capital requirement levels may increase as a result of Solvency II. "This [EU Solvency II Directive] may lead to an increase in our current solvency requirements." IFSRA (2003), Testimony of Ms Mary O'Dea before the Joint Oireachtas Committee on Enterprise and Small Business, 20 November. If so, then levels of excess capital may fall, and regulatory requirements may become binding.

15 Details are available from the European Commission's Internal Market website at http://europa.eu.int/comm/internal_market/finances/docs/actionplan/policygroup/fspg1_en.pdf

16 Recommendation # 48, Joint Committee on Enterprise and Small Business (2004), *Second Report, Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July, p. 68. (This recommendation was new to the Committee's report in July 2004.)

17 Recommendation # 49, Joint Committee on Enterprise and Small Business (2004), *Second Report, Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July, p.68. (This recommendation was new to the Committee's report in July 2004). In addition, the Joint Oireachtas Committee's recommendation # 19 states: "The Irish Financial Services Regulatory Authority review the Irish solvency regulations to ensure that they are in the best interests of policyholders, existing insurance companies operating in Ireland and potential entrants". Joint Committee on Enterprise and Small Business (2004), Second Report, *Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July, p. 67. (The Joint Oireachtas Committee report indicates that this recommendation has been accepted but not yet implemented.)

18 Policyholder protection funds are described in Chapter 4.

8.33 The existence of differential rules for fund operation creates uncertainty for consumers regarding whether liability for third party claims and return of premium for the unexpired risk period will be covered in the event of the failure of their insurer. This reduces the willingness of consumers to purchase insurance from suppliers attempting to compete on a cross-border basis and thus inhibits the establishment of an integrated market for insurance. Consumer confidence, both directly and through intermediary advice, creates a barrier to non-Irish suppliers. Furthermore, the asymmetric handling of schemes across Member States is a regulatory distortion of competition in that it favours some providers and disfavours others.

Analysis

8.34 When Independent Insurance Company, a UK insurer, collapsed in 2001, 600 business policyholders in Ireland were left exposed to claims. As a UK company, Independent Insurance was under supervision of the UK regulator. When a UK insurer collapses, only private policyholders or policyholders with cover for compulsory liabilities are eligible for compensation under the UK Policyholders Protection Act. Irish policyholders that purchased their insurance policy from the Irish branch of Independent or were part of Carol Nash Insurance Consultants' Irish book of business fell under the UK Policyholder Protection Act. If these policies met certain requirements, they were protected.[19]

8.35 Ireland's policyholder protection fund is known as the Insurance Compensation Fund. As described in Chapter 4, it was used to cover policies after the collapse of the insurer PMPA in the 1980s. The Insurance Compensation Fund is funded only on an as-needed basis. In the case of the failure of PMPA, this funding took the form of a levy on all non-life insurers. The *ad hoc* nature of the present system causes regulatory uncertainty. This uncertainty may distort competition.

8.36 There is little uniformity of guarantee funds across Member States. Sixteen European countries have a guarantee fund that covers motor insurance, although the funds in Sweden, Iceland and Norway do not provide protection for undertakings in winding-up. Eight countries have a protection scheme for non-life insurance, and six countries have a scheme for life insurance. Malta, Spain and the UK have systems that provide guarantees for both life and non-life policies. Germany also provides protection for life and non-life insurance but accomplished this using two separate systems. France and The Netherlands only have schemes for the protection of life insurance. The Dutch scheme for life insurance is similar to that of Germany. Denmark, Ireland, Finland and Norway have schemes that only provide protection for non-life insurance.[20]

8.37 IFSRA has recognised the importance of buyer trust when selecting suppliers of financial services. For example, it stated to the Joint Oireachtas Committee:

"Part of the issue with financial services generally, not just insurance, is that people believe, even in terms of general insurance, that there is a trust factor. When we had overseas competition in the banking sector, if people did not recognise the brand names when placing deposits, for example, they were reluctant to move."[21]

Similarly, a report to the European Financial Services Round Table noted:

"For insurance products, a lack of confidence in the long-run reliability of unknown foreign suppliers is a particularly relevant obstacle."[22]

8.38 Due to the trust factor, customer confidence can have a significant impact on competition by having an impact on customer willingness to purchase from or switch to certain suppliers. Buyers would not be expected to have enough information to judge at the time of purchase whether a particular insurer will be able to meet claims in the future.[23] As discussed in Chapter 4, this is one reason why insurers are regulated. Where a buyer might not be familiar with an insurer based in another Member State, the existence of a policyholder protection fund might reassure the buyer that it is safe to seek insurance on a freedom-of-services basis from the insurer.

8.39 The possibility of introducing some minimum harmonisation of guarantee schemes is currently under discussion at EU/EEA level. This potential harmonisation would ensure protection to buyers of insurance (and third party claimants) in the event of the collapse of an insurer. Within these discussions, Ireland is represented by IFSRA and the Department of Finance. The necessity of having these discussions at EU/EEA, rather than national, level arises from the possibility that an insurer and the relevant policyholders could be in different Member States.

19 Details of the failure of Independent are discussed in a Dail debate with the Minister of State at the Department of Enterprise, Trade and Employment. The official Dail Debate Report is available from the Government of Ireland website at http://www.gov.ie/debates-01/16oct/sect5.htm. In the case of claims arising from compulsory third party insurance for motor insurance not falling under the UK Act, MIBI would assess if insurance losses were recoverable.

20 European Commission (2004), Internal Market DG, Working Group on Insurance Guarantee Schemes, MARKT/2501/04-EN, "Evaluation of the answers to the questionnaire on motor insurance and other compulsory insurance and the questionnaire on the costs/financing of guarantee schemes," 3 March, available from the European Commission's website at http://europa.eu.int/comm/internal_market/insurance/docs/markt-2501-04/markt-2501-04_en.pdf and http://europa.eu.int/comm/internal_market/insurance/docs/markt-2501-04/markt-2501-04-annexes1-3.pdf

21 IFSRA (2003), Testimony of Ms O'Dea before the Joint Oireachtas Committee, 20 November, p. 16.

22 Heinemann, F and M. Jopp (2002), *The Benefits of a Working European Retail Market for Financial Services*, Report to the European Financial Services Round Table, 27 February, p. 3.

23 Of course, an intermediary may raise this concern to a buyer.

8.40 One concern that has been raised regarding policyholder protection funds is that they encourage buyers to use weaker insurers, even if they believe that these insurers will not be able to meet claims in the future. Low premiums may attract customers to such insurers, and these customers would not be concerned about the potential for failure because the fund would be available to meet claims. For example, IBEC has stated:

"It would be appropriate to consider such a fund [guarantee fund] to avoid any situation where a business, having contracted insurance finds itself uninsured as a result of the insurer becoming insolvent. This would need however to be balanced against the potential for reckless under-pricing of insurance and thereby incurring additional costs indirectly on other businesses, who may through their premiums in part fund such a contingency provision. If such were to be the case, we believe the broader business community would not welcome such a development."[24]

8.41 This concern is not justified. All insurance companies need to meet minimum EU and home state solvency standards. A fund should not, therefore, encourage the patronage of weak insurers. Regulators examine statutory returns and carry out regular inspections of insurers, which should minimise (but not completely eliminate) the danger of insolvency. In any event, a function of regulators is to deal with any solvency shortcomings on the part of insurers - independent of whether there is a policyholder protection fund. Furthermore, insurers' shareholders and directors will exert balancing pressure to avoid failure.

Recommendations

8.42 To "level the playing field" and promote entry, IFSRA and the Department of Finance should develop a guarantee scheme that covers all mass risks in Ireland and that does not favour or disfavour insurers based upon their home state. Ultimately, the protection fund should treat all Irish buyers, and the insurers serving them, equally.

Recommendation I12

IFSRA should modify the coverage of the Insurance Compensation Fund so that it covers all Irish mass risk insurance policyholders, independent of the home state for any insurer, so long as the home state has solvency requirements above some minimum standards.

8.43 This coverage should be limited to insurers regulated in EU/EEA countries with solvency requirements determined by IFSRA to be sufficiently stringent.[25] This is required so that Irish customers do not subsidise insurers from countries with a lower level of oversight that may pose an unacceptably high risk of failure.[26,27]

8.44 Coverage from the Insurance Compensation Fund in the event of a failure of a foreign-regulated provider should be limited to coverage not provided by the policyholder protection fund sponsored by the failing insurer's home state. In the event of a failure, all Irish policyholders should contribute to the fund, including those served by insurance companies providing service in Ireland on a freedom-of-services basis. These requirements on cross-border providers should be imposed under the "greater good" provisions of the Third Non-Life Insurance Directive.[28] In this way, current inconsistent policyholder protection fund programs will not advantage or disadvantage providers of insurance in Ireland. These requirements should remain until harmonisation of policyholder protection funds is implemented across the EU/EEA.

8.45 The establishment of a guarantee fund as detailed in Recommendation I12 may have a beneficial impact on other areas of insurance regulation. Solvency requirements could be lower, for example, because the social concerns arising from having unpaid claims to injured Third Parties would be lessened. As noted by the MIAB:

"If a private policyholders' protection fund were in place, in accordance with MIAB recommendations 58 and 59, this could reduce the need to have such high solvency requirements for new entrants to the market. After the collapse of Independent Insurance Company, private policyholders in Ireland only had protection because of the existence of such a fund in the UK."[29]

24 IBEC (2003), *Re: Competition Issues in the Non-Life Insurance Market*, submission to The Competition Authority, 27 April, p. 2.
25 The standard adopted should be no stricter than Irish standards.
26 Without this requirement, IFSRA may need to regulate or at least closely monitor any company whose failure could result in claims against the Insurance Compensation Fund. This may infringe the right of insurers to supply cross-border on a freedom-of-services basis as guaranteed by EU Directives.
27 IFSRA may determine that minimum EU standards are sufficient in this regard. Any deviations from EU standards should be justified.
28 The "greater good" requirements are discussed in Chapter 4.
29 MIAB (2004), *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance), Preliminary Report and Consultation Document, MIAB Response*, submission to The Competition Authority, March, response 12, p. 4.

8.46 Recommendation I12 does not call for the guarantee fund to be "pre-capitalised".[30] It can be, but this is not necessary for the recommendation itself. Pre-funding would place a burden on policyholders and insurers. In submissions, several insurers argued that these burdens would unfairly impose unnecessary costs on prudent insurers, costs that would ultimately be passed on to buyers. In the absence of pre-funding, immediate benefits from the guarantee fund can be achieved without the need for distortionary levies.

8.47 The benefits of a guarantee fund can only be achieved if information regarding its existence and coverage is known.

Recommendation I13

IFSRA should issue a policy statement making the Insurance Compensation Fund's coverage clear to all mass risk insurance policyholders. This policy statement should also make clear how coverage from the fund would be implemented, and how this coverage would be funded. Any levies collected should be used for the purposes of financing the Insurance Compensation Fund.

Recommendation I14

IFSRA should modify its code of conduct for insurers to require policies and quotes to indicate their coverage by the Insurance Protection Fund and the coverage provided by the fund.

8.48 Ireland already has an insurance guarantee arrangement, but this arrangement is funded and used on an *ad hoc* basis. Recommendations I12 to I14 call for the basis for the use of the system to be formalised in a pro-competitive manner. As such, these recommendations are proportional to the concerns raised.

8.49 Consistent with the recommendation of the Joint Oireachtas Committee,[31] IFSRA and the Department of Finance should continue to seek harmonization of guarantee schemes at a EU/EEA level to ensure protection to buyers of insurance (and third party claimants) in the event of the collapse of an insurer. This will lessen or remove the entry barrier - or more specifically, the barrier to cross-border supply into Ireland - identified here. The arrangements called for in Recommendations I12 to I14 are an interim measure designed to eliminate the identified entry barrier until a unified EU/EEA approach to this problem can be adopted.

Information Sharing

8.50 Competition law and economics generally disfavours the sharing of data among competitors. In most markets, information sharing is viewed as anticompetitive because it may facilitate collusive or coordinated behaviour.

8.51 Insurance is a special case where data sharing can promote competition. Sellers of insurance only discover their costs after they set prices, and the ultimate claims costs may not be known until many years after the receipt of premiums. For motor, this is usually within three years. With some liability insurance, however, it can be many years later.[32] The more information that a seller has about claims in the market, the more precisely it can calculate its costs and hence the more keenly it can price. The wider publication of such data can also reduce the costs of new entry, an additional stimulus to competition.

Issue of Concern

8.52 There is only limited availability of data regarding the Irish insurance marketplace. This concern was noted in many submissions and other materials considered as part of this Study. For example:[33]

(a) According to the MIAB: "The experience of MIAB is that this [availability of earlier and more comprehensive data] would assist competition in segments of the market, as well as the market as a whole, but the extent is difficult to determine in advance. Data does effect decisions on entry to the Irish market but there are also many other relevant factors, such as unpredictability and volatility of the legal environment which is perceived as pro-plaintiff."[34]

30 The MIAB did call for pre-funding via the insurance levy. It also called for the excess funds collected to handle the PMPA claims top-up be used as an opening balance. MIAB's Recommendation # 60 states: "That a Policyholders Protection Fund be allocated an opening balance, estimated at £19ml, from the motor insurance levy collected up to 1993 from which sufficient allocation has been made to satisfy administration of the liabilities of the old PMPA." MIAB (2004), *Report 2004*, p. 11.

31 Joint Oireachtas Committee recommendation #3 is, "The Government negotiate a common European market protection for insurance policy holders against the insolvency of an insurer." Joint Committee on Enterprise and Small Business (2004). *Second Report, Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July 2004, Recommendation 49, p. 70. (Recommendation is accepted and will be reviewed by JOC.)

32 The Cass report indicates that some forms of liability insurance are characterised by a 'long tail' of claims, many years beyond origin of the claim. C. Parsons et al, *Report on the Economics and Regulation of Insurance*, London: Cass Business School, City of London, p. 51. The MIAB Report 2004 indicates "the Statute of Limitations for personal injury claims is three years, with exceptional cases allowed a longer period to initiate litigation." MIAB (2004), *Report 2004*, 27 September, in section Analyses of Insurers' Statutory Returns-"Blue Book" Analyses, 1997-2001, p. 19.

33 This concern is a general one in insurance and is not specific to motor and liability insurance. For example, in it's submission, Centura stated, "When researching the health insurance market prior to entry, the sourcing of relative data was found to be very difficult. In particular, if claims data were available and if it were produced in a usable format, this would remove one of the main barriers to entry in a duopoly market." (Centura (2004), *Competition Issues in the Non-life Insurance Market*, submission to The Competition Authority, p. 6.)

34 MIAB (2004), *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance) Preliminary Report and Consultation Document, MIAB Response*, submission to The Competition Authority, March, pp. 1-2.

(b) According to the Brokers Federation of Ireland: "The lack of statistical information has hindered new [insurer] entrants to the Irish market...There is a need for the Regulator to require all licensed insurers to produce appropriate and timely information, which (market information, not individual insurer information) should be available via the Regulator to aspiring new entrant suppliers. It is believed that the availability of such market information would be in the best interests of both insurers and the insuring public as it will enable insurers to underwrite and price risks scientifically as currently such statistical information is unavailable."[35]

(c) According to insurer Quinn-direct: "The earlier publication of the IFSRA Blue Book would be of benefit in general to the industry and potentially would lead potential entrants to gain a more timely understanding of the loss position within the Irish Market. Quinn-direct would support this approach."[36]

(d) According to the Brokers Federation of Ireland: "Whilst agreeing in principle with the summary [that the main barrier to entry relates to information asymmetry between incumbents and potential entrants] contained in paragraph 20 the Federation are also of the opinion that the claims culture inherent in Ireland, the associated legal system and the unwillingness on the part of some insurers historically to contest dubious and doubtful claims has in addition been a major deterrent to new market entrants."[37]

(e) According to IBEC: "We would expect that publication of such data on a most recent or contemporaneous basis would most probability be beneficial to alleviate entry barriers."[38]

(f) According to Centura: "The lack of data had the following effects on the establishment of the business:

- Greater time and costs involved in determining premium rates.
- A constraint in product innovation, as no detailed claims
- Information is available and therefore there is added difficulty in pricing potential product changes
- Difficulty in obtaining reinsurance on the basis of rates that are built on less data
- Investors require a greater return depending on their level of risk. Lower information availability increases risk and consequently increases the cost of capital."[39]

(g) According to the MIAB: "The absence of comprehensive market-wide data could be a barrier to entry for an insurer into a segment if they have no previous experience in the segment. MIAB is not convinced that the market should be defined to embrace all segments, as described by Europe Economics. This may reflect an over reliance on strict economic definitions while ignoring the concentration in segments."[40]

8.53 The availability of appropriate information is especially important in smaller markets, where even a specialist may not have many observations in a year. For this reason, sharing data in a timely fashion may be more important in a small economy like Ireland. Indeed, many industry participants have cited the scale of the Irish market as a disincentive to entry.[41,42]

8.54 When there is less information about a specific risk, different types of risk may be lumped together into a common grouping. This will seem unfair to what might be termed "lower-risk" clients, because they are grouped with other somewhat similar but in fact higher risks. This leads to lower-risk clients paying higher premiums than their real risk profile would have required. Better information about risk, at a useful level of detail, helps in tackling this problem.

Analysis

8.55 A practical necessity for entry into an individual insurance market is detailed information on the risks presented by the buyers in the market. To the extent that the available information regarding the market provides insufficient detail on potential risks (in timing, extent or reliability), it is difficult for insurers to expand into new markets.

8.56 Information about the risks presented by groups of buyers can be acquired from the buyers themselves or their intermediaries. Important data on the likelihood, frequency and severity of claims is provided by the claims experience over recent years for that type of buyer. Information on the track record of specific buyers, and the safety procedures for these buyers is also relevant to pricing specific policies.

8.57 Insurers that have built up their own data on risks in a particular market from their own customers have important information that those outside the market do not have. In this sense, the absence of such

35 Brokers Federation of Ireland (2004), *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance), Preliminary Report and Consultation Document*, submission to The Competition Authority, p. 7.
36 Quinn-direct (2004), Submission by Quinn-direct Insurance Limited in response to request for submissions within the Preliminary Report of the Competition Authority, submission to The Competition Authority, p. 2.
37 Brokers Federation of Ireland (2004), Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance), Preliminary Report and Consultation Document, submission to The Competition Authority, p. 9.
38 IBEC (2003), Re: *Competition Issues in the Non-Life Insurance Market*, submission to The Competition Authority, 27 April, p. 1.
39 Centura (2004), Competition Issues in the Non-life Insurance Market, submission to The Competition Authority, p. 6.
40 MIAB (2004), *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance) Preliminary Report and Consultation Document*, MIAB Response, submission to The Competition Authority, March, p. 4
41 IIF (2003), Testimony of Mr. Michael Kemp before the Joint Oireachtas Committee on Enterprise and Small Business, 1 July.
42 Mike Murphy (2004), Testimony of Mr. Mike Murphy before the Joint Oireachtas Committee on Enterprise and Small Business, 21 April.

information can be a barrier to entry because those in the market face lower costs than those seeking to enter.[43] This barrier is not necessarily insurmountable. If buyers within a particular category pool their efforts to gather data on claims experience for a multi-year period, they can attract interest from insurers. This is particularly the case if they can demonstrate that they have also developed and are operating relevant safety procedures. This work can be done with the assistance of intermediaries. Examples of this are presented in Chapter 10, and these examples indicate that there can be entry into new markets if the necessary information can be assembled. This is particularly the case for liability insurance, where risks may be very different across industries. Data pooled across industry participants can have a substantial impact in such cases.

8.58 The fact that data sharing can have a positive effect on competition in insurance is recognised in EU law. There is an insurance "block exemption" regulation[44] that provides for certain types of cooperation among rivals with regard to the pooling and sharing of data. This cooperation is subject to strict conditions. In particular, the collective creation of reliable, high-level statistical data on the intensity and frequency of claims in respect of historic risks is allowed. In order for the block exemption to apply, no individual insurer, nor any insured parties, may be identified. In addition, no insurer should be obliged to use the data. A third is that the results should be made available on reasonable terms that do not discriminate between insurance undertakings, including those not active in the geographical or product markets to which the data relates.

8.59 The work done by the MIAB, which analysed raw motor insurance data from insurers, is a good example of how the creation of reliable statistical data at a market-wide level can comply with competition law. The MIAB produced analysis for Comprehensive Cover and Third Party, Fire and Theft Cover. Beginning with general overviews, it used the data to analyse run-off income and costs, market share, segmentation and pricing structures and looked closely at individual firm's young policyholder exposures.[45]

8.60 The MIAB recommended that the central, on-going gathering of statistics on motor insurance premium and claims costs by driver profile be formalised by IFSRA.[46] The collection of these data is to ensure that reliable information is available to inform public policy in future years and to improve market intelligence. This market intelligence may, for example, help identify profitable markets for entry. IFSRA is now implementing this work and is in consultation with the industry on how to further develop the MIAB's recommendation. The data are collected in their pre-existing format to minimise costs for insurers.

8.61 The data being collected by IFSRA are premium, type of cover, and group ratings factors such as age, gender and vehicle type. These data are the "raw" policy data. After collection, these data are being amalgamated, assembled and will ultimately be published. The data are being processed by a third party vendor and are to be made generally available.

8.62 No data on liability markets are available that provide the same level of detail as the MIAB data provide for motor insurance. Such information would assist in the assessment and pricing of risk for liability policies. Notwithstanding the complexity of the task of setting up the collection of such data, it would be beneficial to the working of the market if such a system of data collection and dissemination could be established.

8.63 In January 2005, the Australian insurance regulator APRA ("Australian Prudential Regulatory Authority") launched the National Claims and Policies Database ("NCPD"). This is a database intended to improve the availability of comprehensive data about claims and premiums of public liability and professional indemnity insurance. The current lack of comprehensive data makes it difficult to set appropriate premiums for these insurance classes. The publication of data is intended to improve the availability and affordability of public liability and professional indemnity insurance. All authorised general insurers, including Lloyd's, are required to submit data. The database has been developed and will be administered by Fujitsu Australia, who is currently collecting data for 2003 and 2004. Aggregated data will be published in May 2005. The database will provide a source for consumers to compare policies, provide information on the costs of insuring, and allow Government to identify problem areas and monitor reform programmes.[47]

8.64 In Ireland there have been buyer-led initiatives to improve data quality with regard to EL and PL insurance. Some representative organisations, whose members faced large increases in premiums in the last two to three years, have worked with intermediaries to collect relevant data about their specific areas of activity.

43 Stigler, G. (1968), *The Organization of Industry*, Homewood Illinois: Richard D Irwin, Chapter 6, "Barrier to Entry, Economies of Scale, and Firm Size," pp. 67-70.

44 Commission Regulation 358/2003, available from the European Union website at http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_053/l_05320030228en00080016.pdf. This block exemption is discussed in Chapter 4.

45 The data ran from 1997-2001 and the MIAB followed policies over this period. The data was coded to prevent firm recognition in firm-level analyses. MIAB (2004), *Private Motor Insurance Review* 1997-2001.

46 MIAB (2004), *Report 2004, Commercial Motor Insurance Review 2000 - 2001*, September, recommendation # 5, "That central gathering of statistics on motor insurance premium and claims costs by driver profile be formalised by IFSRA, including monitoring by the new insurance regulator of data quality, to ensure that reliable information is available to inform public policy in future years and to improve market intelligence as provided for in EU Regulation No 3932/92.", appendix p. 206.

47 Details are available from the APRA website at http://www.apra.gov.au/media-releases/05_06.cfm, 1 February 2005 and http://www.apra.gov.au/media-releases/04_46.cfm, 17 November 2004

In some cases, this has led to new underwriters being interested in the risk, and offering quotes significantly lower than had been available up to that point. This resulted in choices for the members of these organisations that they did not have previously and that would not have otherwise been available. The example of a scheme for electricians is described below:

"Electricians are heralding the new insurance package, estimated to be worth in the region of €3 to €4 million to the insurers, as proof positive that their trade is far safer than insurance companies have been suggesting for years. So far in 2004, no member of the ECSSA has made a personal injury insurance claim.

Before the deal was struck, Eagle Star and AON were presented with an extensive survey showing that electricians were among the least likely insurance claimants in the construction industry. ECSSA members will now pay less in insurance cover, a very welcome development as the escalating costs had been threatening to drive many private contractors out of business."[48]

The success of this and other schemes demonstrates the importance of increased data pooling and sharing.

Recommendations

8.65 The lack of data serves as a barrier to entry into a relatively small insurance market like that in Ireland. Given this, several recommendations are made that aim to make more information available to the marketplace, or to release information that would eventually be available on a timelier basis.

8.66 The Study found that nearly all industry participants agreed that the *Insurance Statistical Review* is published too late and would be of greater use if it were released sooner.[49] For example:

(a) According to Quinn: "The earlier publication of the IFSRA Blue Book would be of benefit in general to the industry and potentially would lead potential entrants to gain a more timely understanding of the loss position within the Irish Market. Quinn-direct would support this approach."[50]

(b) According to IBEC: "We assume this question [The Competition Authority Consultation Question 6] alludes to the Blue Book and our experience is that much of the data therein is and has been far too late in publication. This is particularly concerning with significant market changes in insurance costs and experience in recent years. We consider many businesses may also welcome disaggregation if this would indicate relative better risk profiles."[51]

8.67 The data in the Insurance Statistical Review are high level data used by IFSRA to monitor insurers for prudential reasons. These data include volume by insurance class, claims analysis per insurance company and underwriting results. The Insurance Statistical Review for 2003 was published October 2004. As described by IFSRA:

"We intend to publish the blue book towards the end of the third quarter of this year. The issue is that insurance companies have by law up to six months in which to submit their annual statutory returns. These returns require to be signed off by both actuarial experts and auditors. That is why there has been a delay."[52]

8.68 Recommendation I15 calls for the release of the *Insurance Statistical Review* on a timelier basis, while Recommendations I16 and 117 are to facilitate this schedule.

Recommendation I15

IFSRA should seek to publish the *Insurance Statistical Review* by June.

Recommendation I16

IFSRA should require insurers to submit the data in electronic form by March so as to facilitate the publication of the *Insurance Statistical Review* by June.

Recommendation I17

The Department of Finance should bring forward legislation to require insurers to submit their annual statutory returns for a year via electronic means by March of the following year.

8.69 The next recommendation relates to the detailed, policy-by-policy motor insurance data currently being collected by IFSRA.

48 "Shock value: insurance reduced for electricians", *The Examiner*, 6 Aug 2004.
49 The Insurance Statistical Review is now published by IFSRA. This publication replaced the Insurance Annual Report. The Insurance Annual Report, also known as the "Blue Book", had previously been published by Department of Enterprise, Trade and Employment.
50 Quinn-direct (2004), *Submission by Quinn-direct Insurance Limited in response to request for submissions within the Preliminary Report of the Competition Authority,* submission to The Competition Authority, p. 2.
51 IBEC (2003), *Re: Competition Issues in the Non-Life Insurance Market*, submission to The Competition Authority, 27 April, p. 1.
52 IFSR (2004), Testimony of Mr. Frank Brosnan to Joint Oireachtas Committee, 7 April, p. 37.

Recommendation I18

IFSRA should complete the establishment and on-going implementation of its programme to centralise the gathering and publishing of statistics on motor insurance premium and claims costs by driver profile.

8.70 The "raw" policy data collection programme discussed above relates solely to motor insurance. The next recommendation extends this to mass risk liability insurance. The recommendation is to mirror for EL and PL insurance what is now being developed for motor insurance. Currently, no separate statistical series are available for EL and PL insurance.

Recommendation I19

IFSRA should establish a system for the on-going collection and publication of "raw" policy data on mass risk EL and PL policies. These data should be collected market-wide and reported by relevant industry segments.

8.71 Some insurers have raised concerns about the central collection of statistics. First, insurers have raised the issue of the costs that they must bear to collect, collate, and present these data. Such costs, they indicate, ultimately will be borne by buyers. Second, some insurers fear that the public availability of detailed statistics would reduce the incentive privately to collect such data or to develop innovative approaches to data collection because this "intellectual property" would then be shared. Third, better data might lead to a clearer identification of "problem" segments, with cases in such segments being charged higher premiums or even having difficulty in securing quotes. This would obviously be a concern for the buyers in question. For example:

(a) According to one insurer: [53]

- "We also believe that such information is the property of each insurer."
- "The sharing of such data would be contrary to this view. Competition law difficulties with sharing of this type of information between competitors would also arise."

(b) According to Quinn-direct: "From a purely competitive position, we would have some concerns in respect of the compulsory sharing of loss statistics split out by Company. We would feel that in line with any other business we have invested significantly in developing our own business practices and niche markets that allow us a competitive advantage. The publication of detailed statistics on this has the potential to be anti-competitive in our view and would discourage companies from innovating in an attempt to improve competitiveness." [54]

8.72 These concerns must be balanced against the benefits likely to result from the data collection exercises. One public benefit is the reduction of entry barriers and the increase in competition that will result. Benefits from enhanced competition flow through to the buyers of insurance products. With regard to the incentives to engage in other data collection exercises, providing a common platform for relatively high-level data collection would do nothing to inhibit enhanced data work by individual insurers or others. Indeed, increased competition may stimulate innovative data work as a source of competitive advantage for incumbents. Data regarding the total level of EL and PL coverage, by broad industry segment, is not likely to impair any significant competitive advantages for individual insurers.[55] With regard to the third concern, any problem segments that are identified will result in more accurate pricing, providing better incentives for buyers to manage and mitigate risks. Cross subsidisation is a sign that competition is not as strong as it could otherwise be, and this may expose such cross subsidisation. Improved risk management and efficient, risk-related pricing is a better outcome for the economy and society overall than continued cross subsidisation of high-risk policyholders by low-risk policyholders. Furthermore, the cost of data collection for insurers should not be large. The data being aggregated are by and large a by-product of operating in the market.

8.73 One additional issue has been raised, whether historical data are of use to insurers in a changing environment where international developments, such as the decline of equity returns, the rise of reinsurance premiums and the changes being brought about in the insurance reform programme, have a large impact on the marketplace. With these changes, it is argued, it would be dangerous for an insurer to rely on past trends. While it is advisable to treat past trends with caution, it would be up to existing insurers and new entrants to determine the reliability of historical data and the reliance to be placed on it. Indeed, insurers must address this same problem with respect to their own data on an on-going basis. In addition, a central facet of data production and

53 Confidential submission to TCA, April 2004, p. 2.
54 Quinn-direct (2004), *Submission by Quinn-direct Insurance Limited in response to request for submissions within the Preliminary Report of the Competition Authority*, submission to The Competition Authority, p. 1.
55 With regard to incentives to undertake innovative data analysis, the MIAB stated the following with regard to the compulsory sharing of data. "However, innovations in data analyses could actually be encouraged in companies who see an advantage in more sophisticated techniques than the headline loss ratios available from compulsory shared data." MIAB (2004), *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance) Preliminary Report and Consultation Document, MIAB Response*, submission to The Competition Authority, March, p. 1.

sharing is the speed with which data are made available. The recommendations above are designed to speed the provision of data to the marketplace so that these data are still fresh when released.

8.74 One additional recommendation is made in this area.

Recommendation I20

IFSRA should collect and publish retrospective annual data on retained reserves and the ultimate costs of accidents paid out for motor, EL, and PL insurance for the relevant year.

8.75 Recommendation I20 calls for summary information regarding motor and liability insurance premiums and claims experience. For example, consider the motor insurance premiums collected in 1999. Some claims for accidents covered by these premiums were paid in 1999. Some were paid in 2000. Still others were paid in 2001 and later years. Recommendation I20 calls for the publication of data on the claims experience for 1999 premiums in 2000, with updated data on claims experience for these policies in each of 2001, 2002, and later years. This recommendation calls for *ex post* transparency regarding claims experiences.

8.76 The recommendations in this section call for the speedier release of information that would otherwise be publicly released, the completion of a data gathering and publishing programme already underway, and the development of a new data gathering and publishing programme. The recommendations call for the production of data available in the ordinary course of business or otherwise assembled for existing regulatory purposes. Given the paucity of data currently available and the importance of public information on risks and the costs associated with these risks, especially in a relatively small economy like Ireland's, these recommendations are proportionate to the concerns raised.

Motor Insurers' Bureau of Ireland

8.77 As required by EU Directives, Member States have responsibility to enforce compulsory motor insurance requirements and must establish a guarantee fund to deal with claims arising from uninsured or untraced vehicles. All firms wishing to offer motor insurance in any Member State must join the local guarantee fund. In Ireland, this is the Motor Insurers' Bureau of Ireland.[56]

Issue of Concern

8.78 The present funding structure for MIBI may raise barriers to entry into motor insurance in Ireland. It discourages potential entrants on the basis that it either raises costs or is perceived by potential entrants to do so. Some examples in this regard, highlighted at the Joint Oireachtas Committee, are as follows:

(a) An insurance intermediary, in referring to the difficulty of attracting insurers to the Irish market, said the following: "Those who establish a motor insurance business must be members of the Motor Insurers' Bureau of Ireland. This is of grave concern for new entrants to the market. We try to interest them in establishing a business here; we produce our facts and figures, do a great deal of work and make our presentation only for this MIBI issue to arise."[57]

(b) An insurer said the following: "the funding of the MIBI represents a significant cost element to the insurance industry. This is one of the issues of greatest concern to us, particularly in regard to the proportional share of the historical liabilities taken on by new entrants. This matter is deserving of review."[58]

8.79 As presently structured, MIBI funding requirements result in new entrants paying costs for settling claims arising from accidents that occurred prior to their entry. Any such payments made are sunk costs. These expenses in respect of accidents that occurred prior to entry actually increase the more successful the entrant is in the marketplace. As such, these costs act as an inappropriate tax on entry and expansion and thus harm competition.

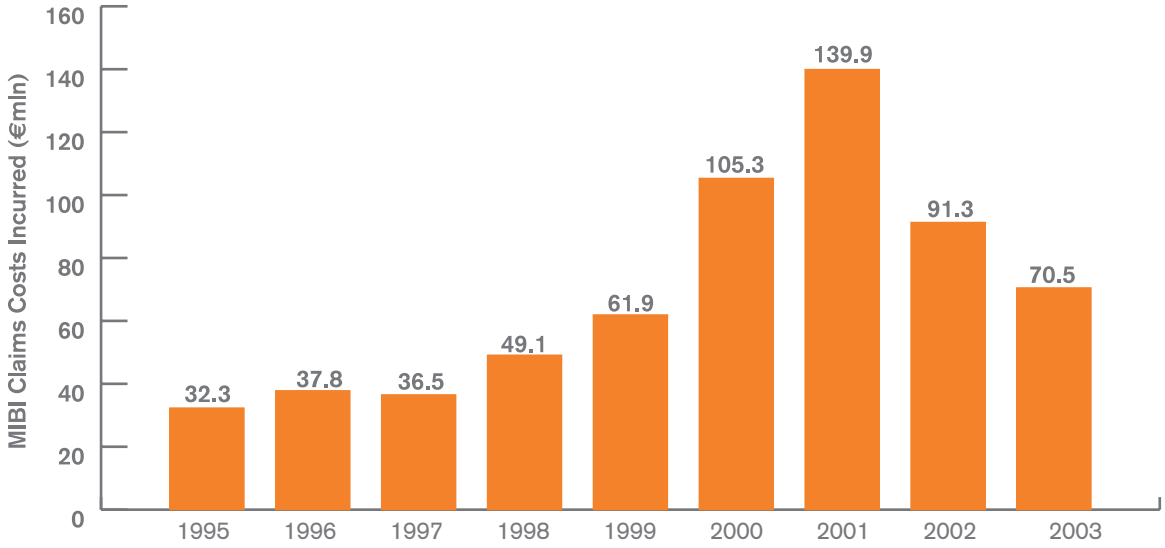
8.80 A separate issue considered was the possibility that the MIBI might be used to facilitate collusive practices. On this specific point, the Authority is satisfied, based on the evidence provided, that MIBI is not a forum for collusive practices. Although competitors meet there, they do so in the context of strict MIBI-related agendas, minuted meetings, and attendance by MIBI staff at all meetings.

Analysis

8.81 Estimates of the numbers of uninsured drivers and the costs associated with uninsured driving vary considerably. The number of uninsured drivers is very difficult to calculate reliably, but two estimates given to the Joint Oireachtas Committee by Deputy Brennan, Minister for Transport, in 2003 and 2004, respectively, were as follows:

56 EU Directives and MIBI are discussed in Chapter 4.
57 IBA (2003), Testimony of Mr. Kavanagh before the Joint Oireachtas Committee, 23 July. Available from Government of Ireland's website at http://www.gov.ie/committees-29/frame.htm
58 Quinn-direct (2004), Testimony of Mr. Kevin Lunney before the Joint Oireachtas Committee, 1 April.

Figure 8.3: MIBI Claims Costs Incurred (€millions), 1995-2003



Source: MIAB (2004) *Report 2004*, Main Report, pp. 37 and 87.

(a) "There are approximately 80,000 uninsured drivers on the roads. To put that into perspective, the Motor Insurance Bureau will pay out €90 million this year to the victims of uninsured drivers. The levy placed on insurance firms to cover those claims now makes up 10% of all insurance premia. If there were no uninsured drivers, premia would drop 10% immediately. When one pays a car insurance premium, 10% goes to cover uninsured drivers. That figure of 80,000 cars is also 5% or 6% of total car numbers."[59]

(b) "There are probably 100,000 people driving without insurance around the country, which is 5% of the total. Their bills are levied on the remaining 95% of us."[60]

8.82 MIBI incurred costs just over €30m in 1993 in respect of uninsured claims, as shown in Figure 8.3 above. By 2001, the amount incurred had more than quadrupled to almost €140 million. However, from the 2001 peak, the incurred cost fell to just over €70m in 2003, which represented a significant drop. The MIBI incurred costs of €70.5m in 2003 represented 3.7% of gross written premiums in that year as indicated in Table 8.1 below. This indicates the magnitude of the MIBI "tax" for that year. Furthermore, MIBI costs per registered vehicle totalled almost €80 in 2001, falling to almost €50 per registered vehicle in 2002.

8.83 MIBI is funded via levies on insurers. MIBI levies insurance companies every six to eight weeks to cover the costs of claims that have recently been settled. These levies are based on previous year market shares, and so an entrant has no exposure to MIBI expenses in its first year in the market. However, in the second year, it will bear costs for claims recently settled. These will include claims resulting from accidents that occurred prior to its actual entry.

Table 8.1: MIBI claims Costs Incurred per vehicle; as % of Gross Written Premium; as % of Earned Premium Income, 1997-2003

	1997	1998	1999	2000	2001	2002	2003
MIBI Claims Costs Incurred per registered vehicle (€)	25.48	32.50	38.49	62.53	79.05	49.35	N/a
MIBI Claims Costs Incurred as a percentage of Gross Written Premium	3.9%	4.6%	5.2%	7.6%	8.3%	4.8%	3.7%
MIBI Claims Costs Incurred as a percentage of Earned Premium Income	4.2%	5.1%	5.8%	8.5%	9.5%	5.7%	4.1%

Source: MIAB (2004) *Report 2004*, Main Report, p. 9 and 37; MIAB (2004) *Report 2004*, Analyses of Insurers' Statutory Returns - *Blue Book* Analyses, p. 3

59 Minister of Transport (2003), Testimony of Deputy Brennan before the Joint Oireachtas Committee 15 July, available from the Government of Ireland website at http://www.gov.ie/committees-29/c-enterprise/20030715-j/Page1.htm

60 Minister of Transport (2004), Testimony of Deputy Brennan before the Joint Oireachtas Committee, 6 May, p. 4.

Thus, entrants bear costs for claims related to a time when they were not in the market. This payment of costs is a burden on new entrants and is asymmetric.

8.84 Furthermore, the amount of the burden on an entrant is uncertain in advance of actual entry. The entrant will not know, when setting its prices for a year, what MIBI-related expenses it will need to bear in the future. This uncertainty makes it more difficult for the entrant to plan its entry strategy.[61] Given that MIBI-related expenses may be roughly 5% of a premium, this potential cost is an important consideration when deciding whether to enter the Irish marketplace.8.85 In addition to the payments made by MIBI, there is another type of uninsured claim about which there are no market-wide statistics, i.e., cases where there is an "insurer concerned". This type of case refers to accidents that are caused by persons for whom the insurer denies indemnity.[62] In such cases the insurer that issues a certificate on the vehicle involved in the accident is regarded as "insurer concerned" and handles the case itself. After settling the claim, the insurer may attempt to recover funds from the policyholder, though this is not usually feasible. Liabilities related to insurer concerned cases are not reflected in the MIBI figures.

8.86 The full cost of claims in respect of uninsured driving would incorporate "insurer concerned" cases, in addition to the claims paid by MIBI. Collating market-wide data on the level of "insurer concerned" cases would facilitate a greater understanding of the costs arising from uninsured drivers and the grounds for refusal of indemnity. Having such figures regularly collected would allow for a fuller picture of the cost of uninsured and defectively insured driving in Ireland on an on-going basis. This would provide useful information to both entrants and policymakers.

8.87 Finally, motor insurance in Ireland is structured around individual drivers. By comparison, insurance coverage of cars, and not individual drivers when using cars, is the norm across the EU. Only Ireland and the UK use the "use of vehicle" model of motor insurance. Since "insurer concerned" claims are actually covered by insurers, not MIBI, Irish insurance in effect already covers cars indirectly. The asymmetry in the approach to coverage makes the Irish marketplace less familiar to non-Irish suppliers. In particular, the asymmetry in the legal approach to insurance makes it more difficult for foreign insurers to develop and write policies for Ireland. Having a uniform approach to motor insurance coverage would facilitate the single market in financial services. In particular, it would facilitate entry into Ireland by insurers located in continental Europe. It would also have the ancillary benefit of not leaving victims of allegedly defectively insured vehicles without compensation or facing litigation to enforce their rights under EU law.

Recommendations

8.88 Uninsured driving has a significant impact on motor premiums for insured drivers in Ireland. It also impacts competition because barriers to entry flow from the uncertainty that uninsured driving creates and the structure of MIBI. To reduce the magnitude of these barriers, recommendations are made to collect and publish relevant information, restructure MIBI levies, improve the efficiency of claims handling by MIBI and alter the nature of motor coverage itself.

8.89 With IFSRA's October 2004 release of the *Insurance Statistical Review*, information on the cost of MIBI-related payments is now available. Recommendation I21 calls for the expansions of this information to include "insurer concerned" payments.

Recommendation I21

IFSRA should collate and publish in the Insurance Statistical Review market-wide data on the level of "insurer concerned" payments.

8.90 Motor policies in effect cover vehicle use and not individual drivers nor vehicles due to coverage for "insurer concerned" payments. The underlying reason is that the Road Traffic Act in Ireland requires insurance for the use of the vehicle and not that the insurance is based on the vehicle.[63] This is in contrast to most other European countries.[64] The recommendation below is that the coverage of vehicles be made explicit, and not implicit. This is to promote a uniform approach to motor insurance with other Member States. A uniform approach will make it easier to provide motor insurance cross-border.

Recommendation I22

The Department of Transport should bring forward legislation to alter the Road Traffic Acts to require motor insurance on the vehicle, as opposed to the use of the vehicle.

61 This uncertainty has recently been lessened now that the MIBI's costs incurred and outstanding provisions are published in the *Insurance Statistical Review.*

62 There are several situations in which this may arise, including: (1) the policyholder may have made a false declaration about their driving history, (2) the use by the driver at the time was not covered (for example, if the vehicle was being used for commercial as opposed to private purposes, and (3) the policyholder "lent" the vehicle to someone who was not indemnified under the policy and borrowing individual's own policy does not provide a "driving other cars" extension. MIAB (2002), *Report 2002*, p. 462-464.

63 The Road Traffic Act, 1961 states in article 56.1 that insurance is required for the "use of the vehicle", available from The Office of the Attorney General website at http://www.irishstatutebook.ie/ZZA24Y1961S56.html

64 For a more detailed discussion see MIAB (2002), *Report 2002*, p. 478-480. Details of the EU directives are available at the COBX website at http://www.cobx.org/public/NXhomeEng-Public.htm

8.91 This recommendation contributes to implementing a suggestion of the Comité Européen des Assurances, which has recommended that national legislation governing insurance contracts be harmonised. This is to facilitate the design of products that can be sold throughout the EU and so facilitate the development of a European-wide insurance market.

8.92 The MIAB made a similar recommendation. In particular, its recommendation #34 is, "That detailed consideration be given to amending the Road Traffic Acts to require insurance on the vehicle, as in mainland Europe, rather than allowing claims to be declined on the basis of the driver's use but with appropriate measures to address the rights of insurers where premiums have been underpaid."[65]

8.93 Due to the magnitude of MIBI-related claims and the resulting levies on insurers to cover these claims, it is important to keep MIBI expenses as low as possible. This is to reduce the impact of MIBI levies on new entrants and also to reduce premiums for those that do purchase motor insurance. In March 2004 MIBI began a programme whereby it enters into service level agreements with insurers that provide claims management services to it. These agreements require insurers to handle MIBI cases in the same manner as their own. The concern was that MIBI cases were being handled too slowly, leading to increased administrative expenses and ultimately to increased payouts. A goal of these agreements is to speed claim handling time. MIBI now audits offices handling its claims to ensure that the required procedures are being followed.

Recommendation I23

MIBI should assess the impact of its new service level agreements following the first year of their operation and publish a report on its findings. This report should detail the performance of individual service providers and compare their performance to how these providers handle their own cases. Claims payments should be compared against the PIAB's Book of Quantum categories for each service provider. Annual updates should be prepared and published as well.

8.94 Firms that manage the claims on behalf of the MIBI are reimbursed by contributions from all insurers. This has the danger of not providing strong incentives to manage and minimise such costs. If the outcome of the initial review called for in Recommendation I23 is not favourable in that the service agreements have not significantly improved performance with regard to managing cases, then an alternative mechanism should be found to manage MIBI cases.

Recommendation I24

If the outcome of the initial service level agreement review called for in Recommendation I23 does not show significant improvement in the time and cost it takes to resolve claims, then the claims management and settlement process should be put to tender by MIBI.

8.95 MIBI has indicated that there are a number of reasons why handling MIBI claims may be difficult to tender. With regard to tendering, MIBI has stated:

"MIBI motor claims handling is a specialised task which has been outsourced to some of the largest motor claims companies for many years. Issues which would arise in a "tendering out" situation would include;

- **A significant lead time and learning curve would be needed for any successful tenderer (other than an existing large motor insurance company) to become competent and capable in this particular niche.**
- **The current practise of outsourcing to six insurance companies would not be viable as the six could not tender as one entity.**
- **The current situation of each motor insurer paying MIBI claims costs as a pro-rata to its market share could be problematic as there would be no link between claims processing and liability for claims payout.**
- **The incentive for an entity not involved in paying MIBI costs to handle MIBI claims in a diligent and prudent manner would be questionable.**
- **Issues of pricing for such a "tendering out" situation and solvency of the entity paying the claims could arise."** [66]

8.96 There may be a number of reasons why tendering may be complex, but there is no reason to think that it is not feasible. If MIBI wanted to put this work out to tender, it could do so. If the service is tendered, a carefully written contract would be needed to manage solvency issues and other concerns. With sufficiently well capitalised bidders to manage default risk and an appropriate payment from MIBI to cover the value of expected claims, the management of MIBI cases can be contracted to a third party. With regard to the specific concerns raised by MIBI:

65 Department of Enterprise, Trade and Employment (2002), *Final Report of the Motor Insurance Advisory Board (Annotated version of the recommendation)*, April, available from the Department of Enterprise, Trade and Employment's website at http://www.entemp.ie/publications/commerce/2002/miab/miab.pdf

66 MIBI (2004), *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance) Preliminary Report and Consultation Document, MIAB Response*, submission to The Competition Authority, March, pp. 2-3.

(a) Even if "outsiders" had a learning curve, the existing providers of this service could bid for the work, and a tender process in which most of the existing six providers of claims services participated would likely be highly competitive.

(b) The present arrangement would not be viable, but the existing participants could tender individually or as parts of teams with other insurers or service providers.

(c) Pro-rata levies could still be made with regard to expected costs. A tender process may actually more closely link claims processing with end liability for claims payout.

(d) A tender process could result in the winning bidder receiving a pool of funds designed to be the expected payout amount from MIBI. These funds could be provided as one pool or on a per case basis. The claim handler could then manage claims processing and becoming the residual claimant on the funds. If it is very efficient, it could retain surplus funds, while also taking on responsibility for deficits. This would provide much stronger incentives to handle claims in a diligent and prudent manner than the present system.

(e) Tendering always involves pricing considerations, and any solvency risk can be managed via reinsurance.

8.97 Recommendation I25 below states that costs incurred for claims from an accident year should be allocated to the insurers active in that year. Instead of collecting when claims are paid, however, the recommendation calls for expected MIBI reimbursements and fees to be collected up front. This is to avoid having insurers pay claims that should have been paid by another insurer if that other insurer were to exit the market or go bankrupt. Together with Recommendation I27, this recommendation resolves the barrier to entry created by an entrant's need, under the present system, to cover MIBI payments arising from accidents that occurred prior to the entrant's actual entry into the market. Recommendation I26 calls for MIBI-related charges to be transparent to consumers.

Recommendation I25

MIBI should collect levies to cover the expected costs to manage and settle uninsured claims resulting from accidents in a given year as a per-policy or per vehicle fee assessed at the time policies are sold to customers in that year.

Recommendation I26

IFSRA should modify its code of conduct for insurers so that insurers would be required to detail per-policy or per-vehicle MIBI levies as a separate line item on motor insurance bills.

Recommendation I27

If the funds collected pursuant to Recommendation I25 to pay MIBI claims arising from accidents in a particular year are exhausted, the additional costs of MIBI claims from that year should be allocated to insurers on the basis of the motor insurance market shares of all insurers active in that year.

8.98 These recommendations have several goals. The first is to allocate expenses for handling cases of uninsured drivers to the insurers active in the market at the time the accidents occurred. This is to remove the entry barrier that results from the current system of levies. Second, since the proposed system does not place responsibility for MIBI expenses on current insurers but instead on insurers active historically, uninsured driver expenses are assessed and collected at the time policies are written. This is to avoid the risks that could result from the failure of an insurer, which might not be able to meet MIBI responsibilities if the levies were to continue to be made *ex post*. Finally, Recommendation I27 is to provide a mechanism to handle costs should the initial assessments not prove accurate. If they are low, then additional levies will be needed to cover MIBI claims.[67] These levies should be charged to the entities that wrote policies in a given year so as to avoid the entry burden identified above. This implies that insurers that exit may have continuing liabilities for claims after they have ceased selling to Irish consumers. However, such an insurer would also have liabilities resulting from the winding up of claims from its historic policies.[68]

8.99 IFSRA and the Department of Transport should consider adopting additional measures to eliminate the entry burden arising from MIBI-related levies. For example, new entrants into the motor insurance business in the State may be exempted from making MIBI contributions for a certain amount of time or until their market shares reach a certain level. Possible "grace periods" may be three years or a three percent share of motor insurance policies.[69,70] Grace periods

67 It is also possible that MIBI assessments collected by insurers and paid to MIBI in a given year according to Recommendation I16 will exceed MIBI's costs to process and pay claims arising from accidents involving uninsured drivers in that year. Excess per-policy or per-vehicle levies may be viewed as assessments on customers, and surpluses may be viewed as representing excess "taxes" collected that should be returned to customers. This would likely involve substantial administrative expenses. Thus, any surpluses that exist after paying all claims for an accident year should be paid to the Exchequer.

68 Insurers that fail or otherwise cease to exist may not be able to meet their responsibilities under Recommendation I18. In this case, its responsibilities may be shared on a pro-rated basis by other firms active in the market in the year in question.

69 Safeguards may be needed to avoid having an entity avoid MIBI-related fees by entering via several separate subsidiaries, each with less than a three percent share of policies.

70 An additional option is to combine these. The grace period would last for three years or until a market share of 3% is reached, whichever is sooner.

give entrants incentives to grow their businesses as rapidly as possible upon entry. They may act as a subsidy to entrants, however, and so the actual market impact of such a system should be evaluated after its effects have been felt for a number of years so as to determine if it is has led to excess entry. If so, the grace periods can be ended for future entrants.

8.100 Finally, the Department of Transport, in consultation with the Authority, should consider whether corporate governance safeguards are needed for MIBI to avoid the potential for it to become a mechanism for coordinated behaviour. As detailed above, the Authority has not determined that this has been a problem in the recent past. Nevertheless, certain safeguards may be appropriate to avoid actual or potential concerns in this regard, or even the appearance of concerns. For example, minutes of MIBI Board meetings may be published and made generally available, for example, via posting on the Internet.

8.101 The present structure of MIBI-related levies places a serious burden on entrants because it charges entrants for costs related to claims that occurred prior to its entry. This is an asymmetric burden on new providers. Some mechanism for dealing with claims arising from uninsured motors is needed. The recommendations in this section call for changes in the levy structure and other changes at MIBI that will eliminate the burden identified. The recommendations are proportional to the concerns raised.

Declined Cases Agreement

8.102 The Declined Cases Agreement ("DCA") is a mechanism for providing insurance to individuals that have difficulty obtaining cover.[71] Under the DCA, a designated insurer will provide cover to an individual seeking insurance if he or she has approached at least three insurers and has not been able to obtain cover from them.[72] In general, the insurer first approached will be required to provide the individual with a quote. If the person searching for motor insurance had a policy from any insurer within the previous three years, that insurer will be asked to provide a quote. All insurers active in the motor insurance marketplace in Ireland are required to participate in the DCA. Several hundred cases are handled under the programme annually.

Issue of Concern

8.103 Due to the DCA, an entrant may need to provide quotes for policies outside its area(s) of expertise or portfolio spread. The entrant may not be able to accurately price such a policy because it will not have sufficient experience to understand the potential risks and costs involved with the cover. As a result, it may make a significant loss on the policy. The DCA creates uncertainty for an entrant and makes entry less likely.

Analysis

8.104 Potential motor insurance entrants have indicated that this scheme creates uncertainty for them because an insurer with expertise and information in particular niches might have to quote in respect of niches where it has no experience. Assessing and pricing risk can be difficult in this environment. For example, one insurance broker described the impact of the Declined Cases Agreement as follows:

"The DCA has caused us some problems ourselves; usually because the policyholder has changed vehicle completely. We have had two occasions where a [redacted] has sold his [redacted], bought a taxi, and demanded we insure it as no-one else will! On each occasion [redacted] has had to do so, even though we don't in any way insure taxis or any other commercial vehicle. Stories like this are exactly the reason why UK insurers are unduly careful about the Irish market."[73]

8.105 One possible strategy for an entrant is to cover its uncertainty by charging a high premium for the policy. Indeed, the Declined Cases Committee can consider individual quotes and decide that a quote is so high, or the conditions attached so severe, that it is tantamount to a refusal to provide cover. Such refusals are not allowed.

8.106 One way to make the assessment and pricing of a risk easier for an insurer operating outside its usual areas of expertise would be to have timely, reliable, market-level data available at a disaggregated level. The publication of such information is called for by Recommendation I18. The availability of such data would not completely resolve the concern because individual buyers refused cover due to their individual driving record would still require considerable analysis and judgement before setting a price. However such data would remove some of the disadvantages in dealing with unfamiliar risks.

8.107 Some risks might be regarded as uninsurable because of a high probability of a claim. There are grounds for refusing cases if to provide insurance

71 The DCA is discussed in Chapter 4.
72 The only circumstances in which the Declined Cases Agreement will not operate are where to provide insurance would be contrary to the public interest.
73 Confidential Submission, p. 2.
74 The Declined Cases Agreement allows for cases to be refused on public interest grounds. See Memorandum of Agreement, 18 June 1981 between the Minister of Industry, Commerce and Tourism insurers operating in Ireland. This is discussed in the MIAB (2004), *Report 2004*, appendix p. 193.

would be contrary to the public interest.[74] There is little information available in the public domain as to what circumstances would or would not trigger a refusal of insurance based on public interest considerations. The DCA does not specify the public interest test to be used.

Recommendations

8.108 The uncertainty that results from the Declined Cases Agreement acts as a barrier to entry. The recommendations below are designed to lessen this barrier by making clear the public interest considerations that justify a refusal to quote insurance and by making greater information available to insurers about cases handled through the DCA.

8.109 The first recommendation relates to the public interest test used for DCA cases. It seeks public information regarding the circumstances under which an individual can be denied insurance. Of the several hundred cases registered under the DCA per year, only a small number are actually declined coverage. Incumbent insurers will have some experience with this, though based on a limited number of cases; entrants have none. The Department of Transport and the Declined Cases Committee should publish the criteria used to determine whether coverage can be denied by insurers.

Recommendation I28

The Department of Transport and the Declined Cases Committee should publish a statement detailing the criteria used in applying the public interest test as to when motor insurance may be denied to high risk drivers.

8.110 The next recommendation seeks to shed light on the terms under which coverage under the DCA has actually been provided. It seeks disaggregated data on actual cases. Though there may not be many instances of coverage in particular categories in any given year, when aggregated over time, these data should provide guidance to insurers, including potential entrants, as to what types of premiums have been charged in recent years for certain types of high risk cases. Currently, only data on the number of cases handled under the Declined Cases Agreement are available publicly, and these data are only available because they were published by the MIAB.[75]

Recommendation I29

The Department of Transport should publish detailed annual statistics on the cases handled under the Declined Cases Agreement. These data should be broken down by vehicle type (e.g., motorcycle) and driver categories and should also provide data on the average premiums charged for these policies and the spread of these premiums. These data should be provided on an on-going basis. Claims information on Declined Case Agreement cases from previous years should also be made available if possible. No personal information should be published.

8.111 The Department of Transport should consider additional ways to lessen the burden on entrants caused by the DCA. For example, as discussed in the section on MIBI above, grace periods may be a means to avoid burdens on entrants for their first few years as an active participant in the marketplace.

8.112 The recommendations in this section call for the publishing of a policy statement and a relatively limited amount of data on specific cases. These recommendations are limited in scope and targeted at the concerns raised. As such, they are proportionate.

Ombudsman Scheme

8.113 There is an ombudsman scheme to handle complaints by insurance customers. This system is funded via a general levy on the insurance industry.

Issue of Concern

8.114 The costs of the ombudsman scheme are borne by all insurers, including those that provide excellent customer service and have few or no customer complaints. This forces insurers that provide high quality service to pay expenses related to adjudicating claims relating to insurers that provide low quality service.

Analysis

8.115 Insurers providing low quality customer service result in costs borne by those providing high quality service. By not forcing an insurer to internalise the full costs of handling complaints against it, the present ombudsman scheme funding structure creates negative externalities. This reduces incentives to

75 MIAB (2004), *Report 2004*, September, p. 53.

improve customer service and increases costs for firms providing high quality service. This distorts competition and provides adverse incentives.

8.116 Other ombudsman schemes are funded on the basis that a company that loses a case against it pays a fee to cover the cost of operating the scheme. This causes firms with the largest number of claims against it to fund the system.

Recommendation

8.117 The recommendation below seeks to modify the funding of the ombudsman scheme to remove the adverse incentives that the current system creates.

Recommendation I30

IFSRA should alter the funding structure of the Ombudsman Scheme so that an insurer pays a levy to fund the system when there is an adverse ruling against it.

8.118 This recommendation calls for a reallocation of ombudsman scheme expenses in a manner that resolves the concern raised. Its implementation should not impose excess costs on the industry. Indeed, by internalising costs, it should result in fewer complaints and a lower costs system overall.

Conclusion

8.119 Chapter 7 found that some of the relevant markets at issue are not as competitive as they might be. While there is some competition, this competition is sluggish and not as vibrant as it could be. High concentration and high prices are apparent in some markets. The Study found barriers to entry and mobility in insurance markets in the State. Such barriers would prevent market forces from fully eroding market power in the markets that are less competitive.

8.120 Several barriers to entry are discussed in this chapter. These barriers result from the structure of regulation (e.g., solvency requirements), the financing arrangements for schemes such as MIBI, the availability of market data, and other sources. Recommendations are made to lessen or remove the barriers identified.

8.121 The insurance marketplace is structured in a manner that has the potential to be vigorously competitive. Since markets are not working as well as they could, the removal of barriers to entry should improve market performance to the benefit of insurance buyers in the State.

Chapter 9

IMPACT OF THE LEGAL SYSTEM ON INSURANCE COMPETITION

IMPACT OF THE LEGAL SYSTEM ON INSURANCE COMPETITION

Introduction

9.1 The legal system is an essential infrastructure for insurance, and how the legal system operates in turn affects, and is affected by, competition in the insurance sector. In exchange for a premium paid up front, purchasers of motor, EL, and PL insurance receive indemnity for legal liability in respect of injury or damages that a third party alleges were caused by the policyholder's negligence.[1] Policyholders expect that if they are accused of having caused injury or damage when they were not guilty of negligence that their insurer will defend them, and in cases where there is a liability to the injured party, that the insurer will discharge that Court decree or settlement. When an accident results in a claim by a third party the allegedly injured party has the onus of proof both on liability and quantum. Where the potential defendant's insurance company considers that they cannot successfully defend the case in Court, the only issue to be resolved is the amount of compensation payable. If the parties can agree a value, then resolving the claim is not difficult. If they cannot reach an agreement, then the legal system provides the framework for resolving disputes either on liability or the value of the claim or both.

9.2 Dispute resolution has several important impacts on insurers and insurance markets. First, the levels of compensation paid to injured third parties can be large. These are direct costs for insurers. Second, there are large costs involved with reaching a determination on liability or quantum. These two elements are in principle no different than other insurer costs - or costs in any other industry. In particular, they are part of the costs of doing business.

9.3 There is a third impact, however, of dispute resolution on the pricing of insurance and the level of competition in insurance markets. This impact results from uncertainty in the frequency of findings of negligence and the consistency in the levels of compensation awarded. Uncertainty regarding the magnitude of awards makes it more difficult for insurers to determine their expected costs, and so makes it more difficult to determine the prices for insurance policies needed to cover expected costs. Moreover, variability in Court outcomes impacts insurers in an asymmetric manner. Incumbent insurers have had their own experiences with legal precedents typical in a jurisdiction that they can use to help determine costs. By comparison, entrants have less information on the prospects of defending their policyholders or levels of compensation payable for a certain type of injury or in certain areas. This asymmetry puts entrants at a disadvantage and hence serves as a barrier to entry.

9.4 In the other direction, competition in insurance markets may affect how the legal system functions. In a competitive market, rivals strive to reduce costs and innovate. To the extent that legal services represent a large cost outlay for insurance providers, innovations that reduce legal costs would give an insurer an advantage over rivals. Thus, innovation in this area would be expected as part of the competitive process in motor and liability insurance markets.

9.5 This chapter analyses the legal system and its impact on the insurance industry. The first section below provides background information regarding the links between insurance and the legal system. The following two sections provide additional detail regarding the impact of the legal system on (1) insurer costs and pricing and (2) competition and entry barriers in insurance markets. Both of these impacts are then highlighted by a review of recent legal system reforms and their likely impacts on costs, competition, and pricing. Next, suggestions for potential remedies to remove the entry barrier into relevant insurance markets caused by the legal system are provided. Concluding comments follow.

Background on the Legal System

9.6 The legal system provides a mechanism for determining and distributing compensation to third parties injured in accidents caused by the negligence of others. This compensation is often provided by insurance companies that have indemnified their customers in exchange for the up front payment of a premium.

9.7 Consider, for example, the case of a third party injured in an automobile accident through the negligence of a policyholder. This individual may sustain both physical and financial harm, including:

(a) Medical expenses related to treating injuries;

(b) Rehabilitation expenses;

(c) Pain and suffering;

(d) Property repair or replacement expenses; and

(e) Lost wages.

1 Comprehensive motor insurance also covers repairs to, or replacement of, the policyholder's vehicle.

9.8 Some of these elements may be easy to quantify. Bills, for example, can quantify expenses incurred to repair one's car or repair or replace property. Lost wages for an individual forced to miss work for one month during recovery may also be simple to quantify. Other injuries may be more difficult to quantify. Examples include damages for pain and suffering and lost wages resulting from missed job promotion opportunities or when an injured party can no longer continue in the same line of work. When attempting to reach a settlement with an injured third party, many issues may be subject to dispute. Even before considering whether the policyholder has any liability and if so, how much the insurance company must pay to the claimant, there may be disputes as to the operation of the indemnity under the policy.[2] The policyholder may not have disclosed relevant information to the insurance company or may have been in breach of policy terms.[3] Assuming that indemnity is in order, the next question that must be resolved is whether the policyholder has any liability to the injured party, which may also be subject to dispute.

9.9 The court system provides a forum for resolving disputes. There are also other means of resolving disputes, including arbitration. Even outside the court system, dispute resolution mechanisms and negotiated settlements are still heavily dependent upon the courts. This is for several reasons. First, the courts may be needed to implement any resolution achieved through other means. Second, the attractiveness of the other systems depends upon their efficiency relative to the courts. Do they provide resolution faster or slower than the courts? Are they lower or higher cost to use? Finally, the "performance" or results of the other systems are judged relative to the courts. Do they produce higher or lower awards? Are their results less or more biased than the courts in specific types of cases or accident circumstances? Do they produce sensible financial awards?

9.10 In addition to providing mechanisms for settling disputes, the legal system impacts disputes and dispute resolution more broadly. Court precedents indicate whether it is likely that the insurer can successfully defend a claim made against a policyholder. For example, the courts provide precedents regarding the duty of care expected of defendants. The courts and relevant legislation dictate the types of damages that may be awarded where negligence is proven or conceded and also the amount of compensation that may be payable for injuries of differing severity. In Ireland, compensation for financial damages secured by victims of accidents may exceed their actual net losses because of the potential for double compensation.[4] In contrast, any benefits received are deducted from compensation awards in the Netherlands.[5] With regard to how claims are adjudicated, France and New Zealand only allow a very limited right to access the courts to pursue tort claims for injuries,[6] while parties have wide access to the courts in Ireland. The legal system also sets expectations and governs access to relevant evidence. In short, the legal system is part of the "infrastructure" supporting the overall insurance industry.

Impact on Pricing

9.11 The legal system has a direct impact on the prices charged for insurance. Insurance is part of the mechanism through which the costs resulting from accidents or certain other events that cause harm are distributed over members of society - including both insured and un-insured individuals and businesses. In a competitive market, the price of insurance reflects the sums expected to be paid to indemnify policyholders and also reflects the costs of determining and making these payments. These are all costs for an insurer, and premiums are intended to cover all of these costs. Thus, the ultimate consumers of insurance are directly impacted by the expected costs of claims and the costs of resolving disputes. Both the costs of using the legal system to settle disputes and the compensation awards that result are discussed in this section.

Cost of Dispute Resolution

9.12 The costs of resolving claims, including litigation costs, have been significant in Ireland. The September 2004 final report of the MIAB provides figures for litigation costs, by class of insurance business, between 2001 and 2003. In Table 9.1 (next page) "Compensation" includes both general damages for pain and suffering and special damages for wages, medical bills, out of pocket expenses, and property damage; "Non-compensation" costs are costs and disbursements paid to other parties such as lawyers and experts. The data are based upon the year of settlement and are based on partial returns supplied by companies representing 57% of the IIF's motor market and 69% of the IIF's liability market in 2003.[7]

2 Grounds for refusing indemnity under motor policies are very limited under EU Directives on Harmonisation of Motor Insurance. Relevant Directives: Directive 2000/26/EC of the European Parliament and of the Council of 16 May 2000 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles and amending Council Directives 73/239/EEC and 88/357/EEC (Fourth motor insurance Directive), Official Journal L 181, 20/07/2000 P. 0065 - 0074; Directive 90/232/EEC of the European Parliament and of the Council of 14 May 1990 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles (Third motor insurance Directive), Official Journal L 129, 19/05/1990 P. 0033 - 0035.

3 Disputes about whether policy indemnity is valid are often referred to arbitration if not resolved through the Ombudsman scheme. See www.ombudsman-insurance.ie and http://www.ifsra.ie/frame_main.asp?pg=%2Fconsumer%2Fcr%5Fwtc%5Fintr%2Easp&nv=%2Fconsumer%2Fcr_nav.asp

4 The Law Reform Commission (2002), *Report on the Deductibility of Collateral Benefits from Awards of Damages*, December, p. 5, available at The Law Reform Commission website athttp://www.lawreform.ie/Collateral%20Benefits%20Report%20%20Final%20Version%20_Printer%205%20Feb%200.pdf

5 Bacon & Associates (2002), *A Review of the Costs to the Irish Economy of a proposed Personal Injuries Compensation Scheme*, September, table 2.1, available from The Bar Counsel Law Library website at http://www.lawlibrary.ie/eventsnews/piab3.asp

6 See previous footnote.

7 These shares are weighted by gross written premiums.

Table 9.1: Costs Incurred in Settling Claims, Ireland, 2001-2003 (in 000)

Motor Third Party Personal Injury Claims

	2001	2002	2003
Compensation	297,068	265,091	284,988
Non-Compensation	112,843	107,178	118,253
Total Outlay	409,911	372,269	403,241
Non-compensation as % of total outlay	27.5	28.8	29.3
Ration of Non-compensation to Compensation	0.38:1	0.40:1	0.41:1

Employer's Liability Claims

	2001	2002	2003
Compensation	55,590	56,769	60,232
Non-Compensation	24,971	28,004	31,051
Total Outlay	80,561	84,773	91,283
Non-compensation as % of total outlay	31.0	33.0	34.0
Ration of Non-compensation to Compensation	0.45:1	0.49:1	0.52:1

Public Liability Claims (Involving Injury)

	2001	2002	2003
Compensation	43,618	42,602	47,495
Non-Compensation	22,178	24,244	31,020
Total Outlay	65,796	66,846	78,515
Non-compensation as % of total outlay	33.7	36.3	39.5
Ration of Non-compensation to Compensation	0.51:1	0.57:1	0.65:1

Source: MIAB (2004) *Report 2004*, p. 58

9.13 These results indicate that non-compensation outlays are generally near or above 40% of compensation paid. The MIAB final report estimated that the average costs associated with litigation overheads across industry segments were 46% of total compensation paid in 2003.[8] Other studies have found similar results. For example, the 2001 McAuley Report found non-compensation costs were 38% of the value of compensation paid.[9] These costs translate directly to insurer costs. Given the level of these costs, dispute resolution expenses (i.e., compensations and non-compensation outlays) have a large impact on the price of insurance.

Compensation Awards

9.14 Compensation awards are generally higher in Ireland than in other EU countries. For example, the 2004 Final Report of the MIAB studied awards for pain and suffering ("general damages") for several general injury profiles. In the claimant category "paraplegia, married male age 40 with dependants", it found 2001 awards were 39% higher in Ireland than in England. Awards were 154% greater in Ireland when the claimant's profile was "amputation of arm below the elbow". Additional comparisons for these two profiles are provided in the Table 9.2.

8 MIAB (2004) *Report 2004*, p 6.
9 McAuley (2001), *Second Report of the Special Working Group on Personal Injury Compensation,* Department of Enterprise Trade and Employment, Dublin, Table 30, p 132. 38% is the sum of the plaintiff's (24%) and defendant's costs (14%).

Table 9.2: Percent by which Awards in Ireland Exceed Those of Other EU Countries, by Claimant Profile, 2001

Country	Paraplegia, married male age 40 with dependants	Amputation of arm below the elbow
Belgium	57%	93%
Denmark	534%	653%
France	233%	353%
Germany	65%	365%
Italy	68%	430%
Netherlands	40%	249%
Portugal	408%	535%

Source: MIAB (2004) *Report 2004*, p. 137

9.15 The two examples of case profiles discussed in detail above both relate to large claims.[10] Analysis of data from Irish motor insurers suggests that claims worth over £100,000 represent less than 1% of all claims.[11] However, the divergence in compensation levels between Ireland and other European countries is even greater at the lower end of the range of claim values, which is where there is the greatest volume of claims.

"There is strong empirical evidence that, as a result of this pressure, damages awarded in Ireland are now high by European standards and far higher than those awarded in the UK. Greenford (2002) shows that, dependent on the type of injury, damages awarded in Ireland can be up to eight times higher than in UK. His figures are based on personal injury settlements agreed by insurers. A 1996 report by Deloitte and Touche compared damages awarded by the courts rather than insurance settlements and came to the conclusion that damages in Ireland were four times higher than in England. The McAuley Report (2001) found that damages in Ireland were over 12 times that of England for similar injuries. Evidence suggests that the discrepancy between Irish and English levels of damages is greatest in relation claims for minor injury. This is very significant, because the vast majority of liability and third party motor claims are in respect of such minor injuries."[12]

9.16 While the levels of litigation costs and compensation awards impact on pricing, they do not impact on the overall level of competition in the marketplace. In a competitive environment, insurance premiums reflect the expected costs of claims. If the costs of claims are high, then insurance prices should also be high. Alternatively, insurance premiums should be low in areas where the costs of claims - both in terms of their compensation levels and the costs of determining liability- are low. Thus, the high value of awards in Ireland does not impact on competition among insurers in and of itself. Instead, the high value of awards results in greater premiums, but these elevated premiums are reflective of costs and do not necessarily indicate that market power is being exercised. In competitive environments, insurance premiums reflect costs and are not elevated by or otherwise reflect market power for the sellers of insurance.

Impact on Competition

9.17 Competition in the insurance industry is nevertheless directly affected by the legal system. As discussed above, the prices that prevail in insurance markets are heavily dependent upon the legal system and its costs. The impact of the legal system on insurance markets is broader, however. In particular, the uncertainty that the legal system generates impacts upon competition. Uncertainty impacts the precision with which insurers can price. It also may create or magnify barriers to entry into insurance markets. This section first discusses variability in awards. It then discusses the impact of this variability on competition, both via the extent of rivalry in pricing and barriers to entry.

Variability in Court Awards

9.18 The Committee on Court Practice and Procedure's 2004 report on personal injuries litigation noted that concern had been expressed about the inconsistency of personal injury awards in Ireland.[13] (The Hon. Mrs. Justice Susan Denham was the chairperson of the Committee, and this report is hereinafter referred to as

10 MIAB (2004) *Report*, p. 137. report found that the values of these claims in 2001 were STG£152,672 for the paraplegia profile and STG£114,504 for the amputee profile.
11 MIAB (2004) *Report*, p. 136. This is inclusive of litigation costs.
12 C. Parsons et al (2004), *Report on the Economics and Regulation of Insurance*, London: Cass Business School, City of London, p. 95, footnotes omitted.
13 The Committee on Court Practice and Procedure (2004), *Inquiry to examine all aspects of practice and procedure relating to personal injuries litigation*, 29th Report, June, problems 13 and 33, p. 24 and p. 25.

the "Denham Report".) The Committee itself identified the absence of recorded data on the level of general damages awards as a problem with Ireland's system of personal injuries litigation.[14] In addition, the Committee stated:

"Finally, the Committee considers it important that steps are taken to achieve greater consistency in the level of awards by different judges. The increased number of High Court and Circuit Court Judges over the past two decades and the relatively low number of written judgments in personal injury cases has increased the risk of inconsistency in the level of awards. The Committee believes that it should be permissible to make submissions to the court in relation to previous comparable awards. To do this the information must be available and, if necessary, rules of court amended."[15]

9.19 In sum, only limited data are available, but the impression among insurers is that similar cases can result in very different awards in Ireland. The Denham Report also stated that it was important that steps be taken to achieve greater consistency in awards. Variability in Court outcomes - or even the impression of such variability - can impact the commercial behaviour of insurers. This can impact on insurer pricing or entry decisions, for example.

Impact of Uncertainty on Price Competition

9.20 As discussed in Chapter 2, insurers manage risk by aggregating a large number of policyholders. Aggregation produces a less variable stream of payments to cover claims. Due to the law of large numbers, deviations from expected claims costs can be minimised by having a sufficiently large number of risks pooled together.

9.21 There are several different types of uncertainty with regard to insurance. The first is whether there will be an accident or other event that could form the basis of a claim. Next, there is the extent of the injuries alleged and financial losses claimed. These two elements relate to the underlying risks being insured and thus are inherent to the supply of insurance. They are unavoidable uncertainties and are intrinsic to insurance.

9.22 Risks related to the resulting outcomes of the legal system do not relate to the underlying risks being insured. Instead, variability in Court determinations on liability and varying compensation levels for similar injuries creates additional uncertainty for insurers, and it is important that variability is minimised. For some types of claims, the number of policies may not be sufficiently large for the law of large numbers to yield a good prediction regarding expected claims costs. As a result, the uncertainty added by the legal system makes it more difficult to determine insurance premiums with precision. As such, it dampens price rivalry among the insurers in the market.

Impact of Uncertainty on Barriers to Entry

9.23 Chapter 5 of this Study addressed the impact of barriers to entry on competition, prices, and the exercise of market power. High entry barriers can adversely impact competition because they make it difficult for new entrants to get into the market, compete for business, and win customers. In contrast, competition is enhanced when entry barriers are low. In this case, new entrants can take advantage of the profit opportunities offered by the marketplace - including the opportunity to enter new markets and earn profits where prices are above competitive levels. Entry into a market with supra-competitive prices benefits the firm taking advantage of the profit opportunity; it also benefits customers who gain by having alternative options from which to purchase goods and services.

9.24 Uncertainty makes it more difficult for firms to plan and execute business strategies. The uncertainty that flows from supplying an insurance contract to a buyer is part of the business of insurance. When selling an insurance policy, it is not known whether a buyer will face insurable losses. This uncertainty is symmetric in that it is faced both by existing suppliers and new entrants. Thus, this type of uncertainty is not a barrier to entry into insurance markets.

9.25 Uncertainty created by the legal system can be a barrier to entry. The legal system can in many ways create greater uncertainty for insurers considering entering a new market than for those already active in it (than would otherwise be the case, as there may always be some extra cost uncertainty for new entrants). Are claims typically settled rapidly or are some handled in only a very slow manner? Are compensation level variances low for similar injuries or types of claims or are compensation levels highly varied? Is dispute resolution transparent and predictable or is it susceptible to manipulation with outcomes difficult to predict? The structure and performance of the legal system directly impacts on these questions. These issues impact both incumbent suppliers and new entrants alike.

14 The Committee on Court Practice and Procedure (2004), *Inquiry to examine all aspects of practice and procedure relating to personal injuries litigation*, 29th Report, June, problem 11, p. 26.
15 The Committee on Court Practice and Procedure (2004), *Inquiry to examine all aspects of practice and procedure relating to personal injuries litigation*, 29th Report, June, p. 94.

9.26 As indicated in the Denham Report and discussed above, however, only very limited information is available regarding actual Court decisions. Incumbent insurers have information regarding the outcomes of their own cases. Insurers considering entry into the Irish market do not have similar information. Hence, the availability of only limited information regarding outcomes in Court places entrants at a disadvantage relative to incumbents and thus serves as a barrier to entry into the Irish motor and liability insurance markets.

Recent Legal Reforms and Additional Remedies

9.27 There have been several recent reforms of the legal system, some of which have been specific to the handling of personal injury claims. These reforms are part of the Government's Insurance Reform Programme for which an Action Plan was published[16] in October 2002. This Programme seeks to bring about a reduction in the cost of claims, for the benefit of all consumers. The benefits of the Programme are economy-wide because insurance is an input used by businesses in all sectors of the economy. A Ministerial-level Committee, chaired by the Tánaiste, and comprising the Minister for Transport and the Minister for Justice, Equality & Law Reform, as well as the Chairperson of the Motor Insurance Advisory Board, oversaw progress on the implementation of the Insurance Reform Programme until September 2004. Two key elements of the Insurance Reform Programme are the establishment of the Personal Injuries Assessment Board (the "PIAB" or "Board") and the commencement of the Civil Liability and Courts Act, 2004. This section provides a broad outline of these two elements of the Insurance Reform Programme. After this, additional legal system reforms are identified that would reduce the barriers to entry into insurance markets that result from the legal system as identified in the previous section.

Personal Injuries Assessment Board

9.28 One of the important changes to the legal system introduced in 2004 was the establishment of the Personal Injuries Assessment Board. The PIAB provides an independent assessment of personal injury compensation claims for victims of negligent workplace, motor and public liability accidents. From 1 June 2004 all personal injury claims arising from workplace accidents (where the employee is seeking compensation from his/her employer) that cannot be settled directly between the parties must be registered with the PIAB before legal proceedings can be initiated. The PIAB was extended to encompass public liability and motor accident cases on 22 July 2004. Thus, from 22nd July 2004, all personal injury cases where negotiated settlements have not been possible, except for medical negligence, must be submitted to the PIAB for either assessment or release prior to instituting legal proceedings.[17] The objectives of the PIAB are to reduce the costs of delivering compensation by avoiding litigation where possible and also to speed up the delivery of compensation to victims of accidents where no Court determination on legal issues is required. By eliminating the need for litigation in cases where legal issues are not in dispute, the PIAB is anticipated to reduce significantly the cost of delivering compensation entitlements to third parties. Furthermore, the PIAB's procedures are designed to offer speedier assessments to the benefit of genuine claimants. PIAB proceedings are handled without oral hearing. Historically, less than 10% of cases involving legal proceedings[18] required a Court hearing but they all carried litigation overheads and the PIAB should be a deterrent to those unnecessary costs being incurred.

9.29 The goal of the PIAB is to pay the same compensation as would otherwise be achieved but with a significantly lower delivery overhead. To do this, it uses an extensive set of data on actual litigated cases and cases settled through negotiation as summarised in its Book of Quantum.[19] The Book of Quantum is essential for the successful operation of the PAIB and was published in June 2004. The Book of Quantum shows ranges of compensation to which people may be entitled for General Damages. In addition, claimants are entitled to financial losses such as wages and medical expenses. Independent, internationally recognised consultants compiled the Book of Quantum based on data from cases resolved in 2003. The Courts, insurers, the state claims agency and the self-insured sectors all provided data for this effort. The Book of Quantum will enable people to satisfy themselves that awards made by the PIAB are in accordance with current levels of compensation. By making this information generally available, it should also facilitate direct settlements without reference to the Board or the Court system.

9.30 The PIAB assesses both general damages for pain and suffering and special damages for wages, medical bills, out of pocket expenses, and property damage.[20] The PIAB uses a panel of independent medical examiners to review claimants where there may be a lack of clarity on the medical prognosis and these reports form the basis of assessments that are otherwise based on details from the claimant's treating doctor. The Board does not replace the court system, and either party can opt for its case to be heard in

16 Published by An Tanaiste, Mary Harney TD - see website of Enterprise, Trade & Employment
17 This requirement is regardless of the date of accident. See "About PIBA" available from the Personal Injury Assessment Board website, http://www.piab.ie.
18 Annual Reports of the Courts Service.
19 See http://www.piab.ie/pdf/bookofquantum.pdf
20 Serious cases may also involve future losses or expenses which are actuarially calculated.

court. For example, if the claimant is not satisfied with the PIAB's award, he or she can reject it and pursue litigation. Similarly, the respondent can deny liability at the outset and PIAB will release the case with an authorization for the claimant to commence litigation if they wish to pursue the matter further.

9.31 The PIAB and the publication of the Book of Quantum should impact both insurer costs and competition. By reducing the costs of delivering compensation, the PIAB will likely reduce insurer costs, allowing insurers to reduce prices. Furthermore, by reducing uncertainty regarding compensation levels, the publication of the Book of Quantum is the first step in making data generally available regarding the value of claims from actual personal injury cases. This should impact the ability of insurers to add precision to their pricing and also provide information on claims costs to potential entrants. The Book of Quantum, however, only provides information regarding the ranges of pain and suffering awards, and then only by broad injury categories. It does not provide data on the variability of the compensation levels for different levels of severity but these will emerge as PIAB makes awards of which it intends to publish anonymised details on its website.[21]

Civil Liability and Courts Act, 2004

9.32 The Book of Quantum discussed above summarises data on compensation awards in Ireland. Under Section 22 of the Civil Liability and Courts Act, 2004, the courts shall have regard to the Book of Quantum. Thus, this centralised source of information on compensation will influence views on compensation levels outside of the PIAB. This should somewhat increase the predictability of awards and facilitate direct settlements without the need to incur litigation costs. Reduced award variability lessens uncertainty for insurers, makes their products easier to price, and encourages entry into the marketplace.

9.33 The Civil Liability and Courts Act, 2004[22], also strengthened the deterrents to questionable claims. Under Section 25 of the Act, a person is guilty of an offence if he or she provides false or misleading evidence in an action, or to a solicitor or expert, if this is done with intent to mislead. Section 29 of this Act provides for fines of up to €100,000 and jails terms of up to 10 years for an offence. These provisions apply equally to future cases as well as to litigation currently outstanding. Section 26 provides for the dismissal of actions or defences where the Court is satisfied that a party to a personal injury claim has knowingly tendered evidence which is materially false or exaggerated. These reforms are designed to discourage exaggerated claims, which should increase the predictability of outcomes in litigation.

9.34 The Civil Liability and Courts Act, 2004, also contains a number of other important reforms in the legal system for personal injuries. Many of these reforms are procedural, including:

(a) Section 7, which reduces the time available to file a claim following an accident (or knowledge of cause of action) from three to two years;

(b) Section 8, which requires that a letter of claim be issued within two months of the alleged accident, enabling investigations to be undertaken while the evidence is still fresh;

(c) Section 10, which requires personal injury litigation to be commenced with a Personal Injury Summons that sets out full details of the plaintiff's injuries, losses, and alleged cause of action;

(d) Section 14, which requires parties to swear an Affidavit attesting to the truth of their pleadings, making it easier to prosecute false statements;

(e) Section 15, which provides the opportunity for early mediation conferences upon request of any of the parties or at the behest of the Court, encouraging earlier resolution of disputes; and

(f) Section 18, which provides for pre-trial hearings on certain issues, facilitating faster, more focussed trials.

9.35 Other reforms in the Civil Liability and Courts Act, 2004, relate to disclosure. These include:

(a) Section 11, which requires disclosure by the plaintiff of previous claims and relevant medical history;

(b) Section 12, which requires more specificity in a defendant's defence to a claim; and

(c) Section 17, which requires parties to state their minimum and maximum settlement terms well in advance of trial, facilitating settlement discussions.

9.36 Finally, this Act introduced reforms related to the information available for use in legal proceedings and when developing cases. These reforms include:

(a) Section 20, which provides for the Court to appoint its own experts to assist the Court on technical medical, engineering or other specialists areas;

(b) Sections 23 and 24, which provide for the use of standard actuarial tables and discount factors, which should enhance the predictability of

21 Source: PIAB.
22 Available at http://www.oireachtas.ie/documents/bills28/acts/2004/A3104.pdf

compensation awards and reduce litigation costs by reducing the need for expert testimony in these areas; and

(c) Section 30, which requires the Courts Service to establish a publicly accessible register of every personal injury claim detailing the identity and occupation of the parties and the name of their solicitors, assisting with the identification of repeat claimants and reducing fraud.

9.37 This is an extensive set of reforms. The theme of "early and honest disclosure" pervades many of these measures. Such disclosure should make it possible to "get all of the facts on the table" at an early stage in litigation. These disclosures should enable each side of a litigation to assess the merits of its case. By narrowing the issues over which there are disputes, these disclosures should also encourage the reasoned assessment of likely outcomes, ultimately increasing the prospects for early finalisation. This should further reduce litigation costs in general, reduce costs for insurers, and lead to lower insurance premiums for consumers if reduced costs are passed on to policyholders.

9.38 Several of these measures should also impact on competition. The regard given to the Book of Quantum by the Courts has already been discussed. However, other reforms, such as reducing the time available to file claims and the requirement for a letter of claim within two months of the accident should also reduce uncertainty regarding the value of claims and hence allow insurers to price more precisely and enhance rivalry.

Additional Measures to Reduce Barriers to Entry

9.39 The establishment of the PIAB and the enactment of the Civil Liability and the Courts Act, 2004 represent first steps to reducing the costs of the legal system and addressing the uncertainty the legal system creates. Other measures are needed to address the barriers to entry created by the legal system.

9.40 There is little information available to entrants on the basis of awards and the levels of damages in personal injury cases. Several steps may be taken to generate information regarding Court decisions in personal injury cases and to make this information public. Suggested approaches to these issues are provided below. Other ways to handle these concerns may be available as well.

Recommendation L1

The Courts Service and the Department of Justice, Equality and Law Reform should consider potential reforms to generate and publish information regarding Court decisions and levels of awards for personal injury cases. Such reforms might include:

(a) The Department of Justice, Equality and Law Reform could bring forward legislation to require that all court decisions in personal injury cases be delivered in writing in addition to any oral delivery. Written decisions need not be long and complex. Indeed, transcripts of findings delivered orally may suffice.

(b) The Courts Service could publish the results of all personal injury cases. This could involve the use of a standardised structure for case reporting. Such a structure could detail the apportionment of liability, the grounds for the finding of negligence, the amount awarded for special damages and the amount awarded for general damages in respect of pain and suffering to date (and into the future, if relevant).

(c) Cases reported by the Courts Service could be detailed using a standardised classification of injury descriptions consistent with the categorisation in the Book of Quantum released by the PIAB.

(d) The data published by the Courts Service of personal injury cases could be made public through a searchable database available over the Internet.

(e) The Courts Service could publish data on legal cost awards, including information on legal costs relative to total damages awarded.

In considering any proposals, the impact on insurer costs and prices, insurer rivalry, and barriers to entry into insurance markets should be included in the cost/benefit analysis.

9.41 The steps outlined in Recommendation L1 would result in the creation and dissemination of important information regarding the legal system. This information would assist insurers, including entrants, in assessing the Irish insurance marketplace. It would also make detailed information available to policymakers, including legislators and regulators, to assist in their study of other suggestions for reforms to the legal system. Additional reforms might include:

(a) The Judicial Studies Institute could undertake a study of the variability in compensation awards for

similar injuries. This study would be based on the data on general damages collected and made public in (b) and (d) above.

(b) The findings of such a study should be made public to shed light on the extent of award variability and assist potential entrants in considering the Irish legal system based on facts, and not impressions.

9.42 Recommendation L1 is consistent with other recent proposals for legal system reform. For example, The Denham Report made the following two recommendations:

(a) Recommendation # 15: The Committee recommends that there be published information on awards in general damages made in personal injuries litigation.

(b) Recommendation # 16: The Committee recommends that the Judicial Studies Institute consider establishing a Working Group to gather, compile and publish such information.

9.43 The suggestions in Recommendations L1 and paragraph 9.42 are designed to lessen the entry barriers detailed above and should only be adopted after careful consideration of their likely costs and benefits. If such consideration finds that the benefits exceed the costs, then the suggestions would be proportionate to the goals and concerns identified and would not impose undue burdens on insurers or other parties. Indeed, the suggestions all relate to the creation and publication of information and are designed to increase the transparency of the legal system. The suggestions place little or no burden on individuals, insurers, or other businesses. Instead, they call for the courts to become more transparent. The burden on the private economy is, thus, very small. The benefits from reduced uncertainty, lower entry barriers, lower insurer costs and lower insurance prices would far exceed any private costs. Furthermore, the availability of data would significantly enhance the ability for policy analysis related to the performance and reform of the legal infrastructure. Reduced variability would also promote other policy objectives, such as fairness in the legal system.

Concluding Comments

9.44 Competition among insurers impacts how the legal system functions. In a competitive motor and liability insurance markets, innovations regarding approaches to dealing with the legal system, its costs and the uncertainty it generates would be part of the competitive process. There has been some evidence of this type of innovation recently.[23] Overall, the level of innovation has been low considering the magnitude of legal costs in the overall cost structure for insurers. Competition in insurance in this regard is far different than competition in the airline industry, where every cost for an airline is under scrutiny. Though not detailed further in this report, the Recommendations made in Chapters 7 and 8 regarding insurance markets and Chapter 10 regarding intermediaries, should operate to increase the level of competition in this regard.

23 For example, entrant Quinn-direct has attempted to streamline the claims process with proactive settlement of claims. "From the outset we also attempted to streamline the claims process with proactive settlement of claims... We have committed to consultation, specifically in claims management and all stages of claims processing and we attempt at all times to have proactive management in the settlement of cases through consultation with the insured ... We are attempting to settle our cases as quickly as possible. However, the key aspect to this is that it is done fully in consultation with the insured. We are working extremely hard to keep cases out of the legal process, to ensure they are settled as quickly as possible. We are working to a target well in excess of 50% to keep our cases out of the legal process. We are working continuously to achieve a higher level associated with this. We believe it will bring the costs down." Quinn (2003). Testimony of Mr. Kevin Lunney before the Joint Oireachtas Committee on Enterprise and Small Business, July 1st.

Chapter 10

INTERMEDIARIES

INTERMEDIARIES

Introduction

10.1 This chapter discusses insurance intermediaries. Intermediaries play an important role in matching buyers with insurance underwriters. The matching process can, however, involve much more than finding the right supplier. Intermediaries often help develop the risk profile for the buyer and present this profile to potential insurers. In this way, they help buyers in understanding their needs and options and also in finding the right provider of cover.

10.2 This chapter begins with a discussion of the definition of the relevant intermediary markets. It then considers the level of concentration and whether the structure of the intermediary industry is structurally conducive to competitive outcomes. It then discusses the nature of rivalry in the industry and whether there are significant barriers to entry. Next, the nature of the intermediary/client relationship is considered, along with the potential for this relationship to lead to conflicts of interest. Finally, this chapter considers whether there are barriers to switching among intermediaries. Throughout the discussions of the potential for conflicts of interest and switching recommendations are developed to remedy the concerns raised.

Market Definition

10.3 This section discusses the definition of the relevant markets for insurance intermediaries using the framework set out in Chapter 5. Product market considerations are discussed first, and geographic market considerations are then discussed. Both the demand and supply sides of the marketplace are analysed. The conclusion of the analysis is that the relevant market for the purposes of this Study is the market for provision of independent assistance and advice to buyers in the placement or taking up of motor, EL and PL insurance in the State.

Product Market

10.4 As discussed in Chapter 5, the relevant product market is comprised of the goods and services that are close substitutes for each other from the point of view of buyers. If buyers can easily switch and would switch between products in response to changes in relative prices, then these products place competitive constraints on the pricing of each other and are included in the same relevant product market. Supply side substitution possibilities are also considered. To understand the potential intermediary product markets, we first look at the role played by insurance intermediaries in the marketplace.

The Role of Intermediaries

10.5 Insurance intermediaries provide several services to their customers. These services include searching across insurers to determine coverage options, explaining these options to buyers, and arranging insurance cover once an option has been selected. Intermediaries, thus, assist buyers of insurance by helping to find and place cover for them. The Insurance Act, 2000 defines an insurance intermediary as any person who, on a professional basis, (a) assists or offers to assist third parties in the placing or taking up of insurance or (b) gives or offers to give advice regarding insurance policies to third parties.[1]

10.6 Intermediaries may provide other services to buyers as well. These services include identifying what a buyer's insurance requirements are, advising on risk management, identifying hazards, assisting with filing claims and other insurance-related procedures, and identifying other steps that can be taken to lower insurance premiums. These services may be particularly important in high-risk cases but also may be important in more standard cases.

10.7 An intermediary is an agent of the buyer. However, an intermediary also provides services to insurers. Intermediaries, for example, help insurers distribute their products and educate customers about policy terms. In particular, intermediaries help insurers find buyers and can assist in the administration of the sale and service of the policy. They may collect premiums and help with the adjustment of policies over time. Thus, intermediaries help to match buyers and sellers of insurance while also providing other services to both sides of the market.

10.8 Some services provided by intermediaries simultaneously benefit both buyers and insurers. For example, it is important for some businesses to be able to present their risk profile to potential insurers so that a tailored policy can be developed. In these cases, having an accurate risk presentation is essential for both the buyer and insurers. From the buyer's point

1 Section 16 of the Insurance Act, 2000, available from the Office of the Attorney General website at http://www.irishstatutebook.ie/ZZA42Y2000S16.html

of view, the risk must be properly presented in order to ensure that it is properly covered while allowing credit, if appropriate, for risk-reduction measures. For the insurer, this information is important in setting the premium. In addition, if the intermediary wants to have repeat business with the insurer, it has an incentive to present a risk accurately in order to build up and maintain a reputation with the insurer.

10.9 In addition to matching and facilitating transactions between individual buyers and sellers, intermediaries also match groups of buyers with insurers and facilitate cover for these groups. In particular, they aggregate groups of buyers into larger schemes and present these schemes to insurers. This work often involves identifying buyer groups and assisting these groups in putting together information on their risk profile and claims experience, and in devising risk management strategies that are particular to such groups. Intermediaries also work to market or promote these groups to insurers, helping to generate competition among insurers to provide insurance to the group. By collecting data from group members, the intermediary enhances the ability of insurers to calculate accurate premiums for group members.

10.10 Intermediaries can provide a more valuable service as their "network" of insurers expands. The more insurers the intermediary has access to, the more quotes it can pursue and the more options it can present to its clients. Similarly, insurers gain as an intermediary's pool of clients expands because this gives them access to a larger pool of potential customers.

10.11 The services provided by intermediaries vary from client to client. Some cases are more complicated and require more work, for example, in collecting data, in addition to searching insurers for cover. Other cases may only involve searching for policies and facilitating a transaction between the buyer and insurer. Liability insurance is often in the former category, and motor insurance the latter. Some services may be provided even in the absence of a search for insurance. For example, the identification of hazards and provision of advice on risk management, which may accompany the provision of liability insurance, can also be carried out independently from the purchase of insurance.

10.12 Intermediary firms range in size from the larger firms such as Marsh or Coyle Hamilton Willis, to smaller sole proprietors.[2] There is also a degree of vertical integration in the market, with a number of insurers having their own intermediary arm. For instance the intermediary Hibernian Direct is a member of the Hibernian Group.

Demand-side Substitution

10.13 Insurance intermediaries provide a specialised service, especially with regard to EL and PL insurance. To be successful, intermediaries require a detailed knowledge of insurance products and the insurers themselves. This is needed to determine client needs and to search for quotes across insurers. Some insurers may better handle certain types of risks or claims. Intermediaries may also have a detailed knowledge of specific industries or types of risks. This is needed to understand the insurance needs of particular buyers, to advise on risk reduction strategies, and to gather relevant data. Some intermediaries specialise in particular types of risk. This may involve specific industries (e.g., hospitality), types of insurance, or types of claims. The specialised service provided by intermediaries is less important with regard to motor insurance, however, where products are more standardised. With regard to motor insurance, individual consumers can search the market by contacting the various insurers in the marketplace directly. Though potentially less efficient, such a strategy is feasible. Some intermediaries "wholesale" services to other intermediaries. For instance, an intermediary may deal with another intermediary who holds an appointment from a particular insurer that they would like to purchase a policy from.

10.14 Given different areas of specialisation, it may be appropriate to define narrow relevant intermediary markets. These markets may cover specific types of insurance or types of buyers. This is because buyers may have little, if any, ability to switch from an intermediary active in one type of insurance to an intermediary active in another. A business that requires EL or PL insurance may choose not to use an intermediary that specialises in other types of insurance; and a business needing cover tailored to its industry cannot use the services of intermediaries that specialise in servicing other industries. Furthermore, as detailed above, intermediaries supply a range of services, including searching for quotes and advising on risk management strategies. A buyer interested in obtaining a quote for an EL insurance policy may not readily switch to purchasing risk management services in response to an increase in the price of intermediary services for searching for quotes. These two services provided by intermediaries - searching for cover and advising on risks - though related, are not likely to be viewed as good substitutes for each other. This suggests that the relevant intermediary product markets should be narrowly defined by type of insurance and type of intermediary service or activity.

2 See Table 10.1 for a breakdown of intermediaries by turnover.

10.15 Nevertheless, this Study is based on a broader insurance intermediary market that is not specific to type of insurance or specialisation of activity. The use of a broader market does not impact the Study's conclusions or recommendations, and so it is not necessary to define, analyse, or consider the potential for narrower intermediary markets.[3]

Supply-side Substitution

10.16 A review of the supply side of the market reinforces the approach of analysing broader intermediary markets for the purposes of this Study. Many intermediaries are active with regard to a broad range of insurance products, including motor, EL, PL, and possibly other types of insurance such as homeowners policies.

10.17 Furthermore, the Authority has not received evidence that it is difficult for intermediaries to shift between types of insurance. Difficulties with supply-side substitution could emanate from either the need for knowledge of the specialised risks or the need to have agreements with the relevant insurers for different types of cover. Neither appears to be a significant obstacle for intermediaries to move between different types of products. The need for knowledge of a specialised risk can be overcome with research and experience, and the need for agreements with insurers providing certain types of cover can be met where an intermediary puts forward an appropriate business case to an insurer. Thus, supply-side considerations reinforce the view that it is appropriate to base the analysis in this Study on a broader market for intermediary services as opposed to a collection of narrower markets specific to the provision of intermediary services for specific types of insurance or risk.

10.18 The evidence and discussion of the previous sections on demand and supply side substitution possibilities suggests that the appropriate relevant product market, for the purposes of this Study, is the market for the provision of independent assistance and/or advice to buyers in the placement or taking up of motor, EL and PL insurance.

Geographic Market

10.19 The methodology used to define relevant geographic markets is similar to that used to analyse product markets. Geographic markets include the locations of suppliers viewed by buyers as being close substitutes. As close substitutes, suppliers in these locations serve to place a competitive constraint on each other's behaviour. Geographic markets can be local, regional, national, or international.

10.20 Some buyers might find it more convenient to use a local intermediary, particularly if they choose to carry out business in person rather than by phone, post or over the Internet. In addition, some intermediaries have indicated that they only supply quotes to local buyers. According to the Professional Insurance Brokers Association ("PIBA"):

"PIBA members usually rely on their local area for most business and do not tend to place large amounts of major corporate business. Their customers are mostly individuals and small local businesses."[4]

While this may be true for PIBA members, there are many intermediaries that accept business throughout the country, independent of whether they have an office local to the client. Examples of intermediaries operating nationally include Aon Ireland, Marsh Ireland and Coyle Hamilton Willis.[5] Thus, buyers can and do substitute between intermediaries across the State, and so the relevant geographic market is at least as broad as the State. Even if demand for intermediaries is local, however, there are no barriers to an intermediary in one local area switching to or opening an office in another location. Thus, intermediaries can easily enter new local areas, and so supply-side substitution possibilities reinforce the appropriateness of considering geographic markets that are wider than local or regional areas but instead cover the State.

10.21 There is little evidence of consumers in Ireland using intermediaries from other countries. Indeed, this situation is replicated elsewhere in the Single European Market. In the Financial Services Action Plan ("FSAP"), it was noted that, while Member States had developed consumer protection safeguards in relation to insurance intermediaries, variations in national legislation had acted to "hamper

3 In addition to the potential for narrower markets, the Study considered the potential for a broader "insurance distribution" market. Not all buyers require the services of an intermediary to purchase insurance. Individual consumers, for example, can purchase motor insurance directly from an insurer. In the case of motor insurance there is evidence of buyers switching between direct sellers and intermediaries as part of shopping around. This also happens, although to a lesser extent, in liability insurance, but due to the greater complexity of the product, the use of an intermediary is more likely. Furthermore, as the policy becomes more complex, the importance of having a broker's advice becomes even more important. Given that the market as defined is not highly concentrated however, the conclusions of this Study would not be altered if a broader "insurance distribution" market were defined that included direct sales efforts for insurers with the services supplied by independent intermediaries.

4 PIBA (2004). *Response of the Professional Insurance Brokers Association (P.I.B.A.) to The Competition Authority's Preliminary Report and Consultation Document Competition Issues in the Non Life Insurance Market (with particular reference to motor, employer's liability and public liability insurance)*, submission to The Competition Authority, 18 April, p. 18.

5 The websites for these three companies make clear that they supply services nationally without having local branch office networks. Coyle Hamilton Willis, for example, has offices in Dublin, Limerick and Cork. See www.coylehamilton.ie. See also www.aon.ie and www.marsh.ie.

the free provision of services".[6] It was recognised in the FSAP that there was a need for a "clear and common approach to regulation of insurance intermediaries, thus facilitating the free provision of services while strengthening consumer protection at a high level".[7]

10.22 The Insurance Mediation Directive[8], which came into force in January 2005, was introduced against this background. The preamble to that Directive mentions the "inability of insurance intermediaries to operate freely throughout the Community".[9] Though the long-term goal is for expanded cross-border provision of insurance intermediation services, this has not yet materialised to any significant extent. If this is successful, then the relevant geographic market for intermediaries may be broader than the State in the future. Currently, however, intermediaries located outside of Ireland are not close substitutes for those inside the State.

10.23 The relevant geographic market for intermediaries analysed for the purposes of this Study is the State.

Conclusion on Relevant Market

10.24 The relevant market combines the product market and geographic market findings discussed above. The relevant market used to analyse non-life insurance intermediation is the market for the provision of independent assistance and/or advice to buyers in the placement or taking up of motor, EL and PL insurance in the State. In this Study, we refer to this market as the "motor and liability insurance intermediation market".[10] While there may be narrower relevant markets within the "motor and liability insurance intermediation market", the analyses and recommendations that follow do not depend crucially on precise definitions.

Concentration in the Motor and Liability Insurance Intermediation Market

Number of Competitors

10.25 There are two types of insurance intermediaries: multi-agency intermediaries and authorised advisors. A multi-agency intermediary can receive and transmit orders from buyers to any insurer from which it holds a written appointment. It can also provide advice regarding the products offered by any insurer from which it holds an appointment. A multi-agency intermediary may have appointments from multiple insurers, or it may choose to have only one appointment (i.e., a single-agency intermediary) or be tied to a specific insurer (i.e., a tied agency intermediary). Authorised advisors can also receive and transmit orders. Unlike a multi-agency intermediary, however, an authorised advisor can provide broad-based advice regarding the most suitable products for clients independent of whether it has a written appointment from the producers of those products. The different types of intermediaries are discussed in greater detail in Chapter 4 and summarised in Box 10.1 below.

Box 10.1: Types of Insurance Intermediaries

Authorised Advisor: Can receive and transmit orders from buyers to insurers from which it has a written appointment and can provide advice regarding products offered by any insurer in the marketplace.

Multi-agency Intermediary: Can receive and transmit orders from buyers to insurers from which it has a written appointment and can provide advice regarding products offered by insurers from which it holds appointments.

Single-agency Intermediary: A multi-agency intermediary with only one insurer appointment.

Tied-agency Intermediary: A multi-agency intermediary tied to a specific insurer.

Restricted Intermediaries: Restricted intermediaries are multi-agency intermediaries.

10.26 IFSRA maintains a register of insurance intermediaries, both full and part-time, under Section 31 of the Insurance Intermediaries Act 1995. The register includes approximately 2400 intermediaries.[11] Approximately 450 of these are authorised advisers

6 "*Action Plan for a Single Financial Market*", Single Market News, Special Feature no 17, July 1999, available from the European Commission website at http://europa.eu.int/comm/internal_market/smn/smn17/s17mn20.htm

7 "*Action Plan for a Single Financial Market*", Single Market News, Special Feature no 17, July 1999, available from the European Commission website at http://europa.eu.int/comm/internal_market/smn/smn17/s17mn20.htm

8 *Directive 2002/93/EC* of the European Parliament and of the Council of 9 December 2002 available from the European Union's website at http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_009/l_00920030115en00030010.pdf

9 *Directive 2002/93/EC* of the European Parliament and of the Council of 9 December 2002 on insurance mediation, p. 1 available from the European Union's website at http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_009/l_00920030115en00030010.pdf

10 This Study focussed on motor, EL and PL insurance. Though not considered in detail, many of the findings of the Study may be relevant to other types of insurance, such as housing or professional indemnity insurance.

11 The Section 31 register is a register of investment product intermediaries of which insurance intermediaries are a subset. At time of writing, the total number of firms on the register is 3066. The breakdown of the different classification of the components of the register is: Multi-agency Intermediary - 1915; Authorised Advisor - 458; Solicitor - 107, Certified person (accountant) - 561; Section 10 investment Firm - 25. Not all of the firms on the register are insurance intermediaries. Multi-agency Intermediaries and Authorised Advisors are intermediaries. In addition, some of the solicitors and most of the certified persons are intermediaries although exact figures are not available. However, solicitors and certified persons can only provide intermediary services on an incidental basis. The quantitive test for establishing where intermediary services are provided on an incidental basis is that income from this activity must be less than 20% of annual income. While some of the Section 10 firms do deal with insurance companies they do so as investment firms placing funds with different managers rather than in the normally understood meaning of an insurance intermediary. Source: IFSRA.

and the remainder are multi-agency intermediaries, some of which are single-agency intermediaries or tied agents. Some of the intermediaries on the IFSRA register are only active in the area of life insurance and so are not active in the non-life sector.

10.27 PIBA, a representative body for insurance intermediaries in Ireland, estimates that there are 600-700 intermediaries conducting non-life business on other than an incidental basis in the State.[12] This is out of approximately 1500 full time insurance intermediaries, about 750 of which are members of PIBA.[13] In addition, there are several hundred other part-time intermediaries, including sole proprietors. The Irish Brokers Association ("IBA") has approximately 500 members of varying sizes (from "major national and international brokers to localised family firms").[14] The majority of IBA members deal in both life and general insurance.

Concentration

10.28 PIBA estimated the annual turnover[15] of the intermediaries conducting both life and non-life insurance business on the IFSRA register. Its estimates are provided in Table 10.1 above.

Table 10.1: Estimate of Intermediaries' Turnover, Ireland, 2003 (year ending July)

Turnover Band	Number of firms in band
up to €75,000	1159
€75,000 - €150,000	477
€150,001 - €700,000	552
€700,001 - €1.5m	155
€1,500,001 - €3m	29
€3,000,001 - €6m	15
€6,000,001 - €15m	8
€15m +	5
Total	**2400**

Source: PIBA (2004), *Submission to the Competition Authority*, p. 23 that actual concentration levels differ significantly.

10.29 While these data cannot be used precisely to estimate the level of concentration in the motor and liability insurance intermediation market, they are indicative. Actual concentration in the motor and liability insurance intermediation market may be higher or lower than indicated below, the Authority has received no evidence that actual concentration levels differ significantly.

10.30 Assuming the revenue for each firm is the mid-point of the band, and assuming that the revenue for each firm in the €15m+ band is €25m, total intermediary revenue can be estimated. This is shown in the Table 10.2 below.

Table 10.2: Estimate of Total Intermediary Turnover, Ireland, 2003 (year ending July)

Turnover Band	Number in Band	Assumed Turnover per Firm	Total Turnover
Up to €75,000	1159	€37,500	€43,463,000
€75,001 - €150,000	477	€112,500	€53,663,000
€150,001 - €700,000	552	€425,000	€234,600,000
€700,001 - €1.5m	155	€1,100,000	€170,500,000
€1,500,001 - €3m	29	€2,250,000	€65,250,000
€3,000,001 - €6m	15	€4,500,000	€67,500,000
€6,000,001 - €15m	8	€10,500,000	€84,000,000
€15m +	5	€25,000,000	€125,000,000
Total	**2,400**		**€843,976,000**

Source: PIBA (2004), *Submission to the Competition Authority,* p. 24

12 PIBA (2004). Response of the Professional Insurance Brokers Association (P.I.B.A.) to *The Competition Authority's Preliminary Report and Consultation Document Competition Issues in the Non Life Insurance Market (with particular reference to motor, employer's liability and public liability insurance)*, submission to The Competition Authority, 18 April, p. 23.

13 "This [1500 brokers] is made up of 750 PIBA firms, 500 IBA firms and approximately 250 non-affiliated brokers." PIBA (2004). *Response of the Professional Insurance Brokers Association (P.I.B.A.) to The Competition Authority's Preliminary Report and Consultation Document Competition Issues in the Non Life Insurance Market (with particular reference to motor, employer's liability and public liability insurance)*, submission to The Competition Authority, 18 April, p. 23.

14 See http://www.irishbrokers.com/2004/pub/pub_mem.ASP

15 Turnover is defined as commission and fees from life and non-life insurance business and other investment intermediary business. PIBA (2004). *Response of the Professional Insurance Brokers Association (P.I.B.A.) to The Competition Authority's Preliminary Report and Consultation Document Competition Issues in the Non Life Insurance Market (with particular reference to motor, employer's liability and public liability insurance)*, submission to The Competition Authority, 18 April, p. 22.

Table 10.3: HHI Calculation for a Hypothetical Intermediary Market Restricted to the Largest 28 Intermediaries, Ireland, 2003 (year ending July)

Turnover Bracket (1)	Number of Firms (2)	Assumed Turnover per Firm (3)	Total Turnover of Firms in Bracket =(2)*(3)	Market Share for Each Firm in Bracket(4)	Square of Market Share for Each Firm in Bracket (5)=(4)*(4)	HHI Contribution for All Firms in Bracket =(2)*(5)
€3m - €6m	15	€4.5m	€67.5m	1.627	2.649	39.73
€6m - €15m	8	€10.5m	€84m	3.797	14.421	115.36
€15m +	5	€25m	€125m	9.042	81.750	408.75
Total	**28**		**€276.5m**			**563.86**

Source: Authority calculations

10.31 Given the assumptions made with regard to revenue, the top 28 intermediaries are found to have approximately 33% of total insurance intermediary turnover. The resulting marketplace is unconcentrated. Indeed, if the top 28 intermediaries were a market unto themselves, the HHI for this 28-firm market would be about 550.[16] This is shown in Table 10.3 above. Given this low level of concentration, the overall intermediary marketplace must also be unconcentrated because the HHI would fall from 550 as the calculations are expanded to include smaller entities. These figures represent all intermediaries, including those specialising in life insurance only. The inclusion of such intermediaries means that these calculations are for a group of firms that is broader than those active in the relevant market being analysed for the purposes of this Study - the motor and liability insurance intermediation market. The HHI for the market being considered in this Study, or any relevant submarkets, may be higher. Nevertheless, the number and sizes of firms involved suggests that the intermediary market used for the purposes of this Study is also unconcentrated.

10.32 This level of HHI indicates that the market is structurally of the type normally associated with vigorous competition. As such, if the market is transparent and lacks switching barriers, it would likely be highly competitive. If there are switching barriers and other impediments to competition in the market, however, then individual suppliers may possess market power. As a result, this Study focuses on transparency and barriers to switching in the intermediary marketplace. First, however, this Study addresses rivalry and the existence of barriers to entry into the motor and liability intermediation market. Given the level of concentration detailed above, barriers to entry are not likely to be large. Following this rivalry and entry barriers discussion, the Study addresses intermediary incentives and industry practices that inhibit switching, limit price transparency, or otherwise prevent consumers from taking advantage of the competitive options available in the marketplace. Where such practices are found, the Study makes recommendations to remedy the concerns identified and ensure that the market works well for customers.

Rivalry and Barriers to Entry

10.33 Given the large number of intermediaries, the level of rivalry in the marketplace has the potential to be very high and the level of entry barriers is very likely to be low. As a result, new customers are likely to have many choices in the intermediary marketplace, and, in the absence of switching barriers, existing customers would also have a range of options of which they could take advantage.

Rivalry

10.34 It is likely that there are many different business strategies being pursued in the intermediary marketplace and also many ways in which market participants can compete with each other. One common way for firms to compete is on prices. Price competition involves reducing margins so that the firm's offerings look more attractive in the market. Margins are not likely to be high in vigorously competitive markets. There are other ways in which intermediaries can compete, however. Two ways of in which intermediaries can compete are by making differentiated offerings via the provision of specialised services and the development of innovative schemes or other products. These are discussed below.

16 As discussed in Chapter 5, a market with a HHI of less than 1,000 is regarded as unconcentrated.

10.35 In addition to the basic functions of providing independent advice to buyers and placing insurance on behalf of buyers, some intermediaries offer a variety of additional services to buyers. As described above, these services include analysing risks and preparing risk reduction programmes. Such services provide a means of differentiating the offerings of individual intermediaries and attracting customers. This is one method of competing in the market.

10.36 Another means of competing involves devising branded schemes that target coverage to individual customer groups. There are many such schemes. In addition to pricing, these schemes may involve other services, such as risk management or reduction programmes. In cases where an intermediary and a group of buyers, such as a trade, profession, industry, or other segment of buyers, successfully work together to devise a scheme, there is an expansion of choice for the buyers. Each newly devised scheme adds innovation to the marketplace. Examples of innovation of this type include Hibernian/AXA[17], which introduced a scheme for "single-person motorcycles", and Hibernian, which introduced a scheme called "Ignition" for "less experienced" drivers.[18]

Barriers to Entry

10.37 For a person or company to be entered onto IFSRA's register of insurance intermediaries it must satisfy IFSRA that it has the necessary competence, skills and probity to serve as an intermediary. The person or company must also show that at least one insurer has undertaken to do business with it before it is entered onto the register. To place business with an insurer, an intermediary must have an agency appointment from that insurer.

10.38 An intermediary only needs one appointment to be listed on IFSRA's register. Intermediaries, however, often require multiple insurer relationships to be successful. Insurers have indicated to the Authority that they have commercial criteria for agency appointments, including criteria related to competence and probity.[19] As detailed in Chapter 5, insurers do not have an incentive to restrict intermediary entry to the point that market power is developed at the intermediary level. Thus, there are likely to be efficiency reasons for the imposition of commercial criteria by insurers. In particular, insurers have legitimate reasons for wanting the intermediaries with whom they work to be knowledgeable and professional service providers. This is especially the case as intermediaries often serve as the insurer's interface with buyers.

10.39 There are several requirements for intermediaries that may serve as barriers to entry. For example, intermediaries are required to publish information in national newspapers whenever one of their relationships with an insurer ends. This is a sunk cost. Furthermore, the extent of intermediary regulation has increased in recent years. The costs related to meeting regulatory requirements can also be a sunk cost. Sunk costs can serve as entry barriers.

10.40 There are currently approximately 2400 firms on the IFSRA register.[20] While the total number of intermediaries has been declining in recent years, there has been both entry by new intermediaries and exit by others. The entry barriers identified above would therefore not appear to be large, and the overall barriers to entry into the motor and liability intermediation market are not high.

Conflicts of Interest

10.41 A great deal of emphasis has been placed recently on issues of conflicts of interest in the insurance intermediary business. This section first explains the issues that have been raised and then addresses remedies to these concerns. Remedies relate to remuneration transparency and the transparency of the intermediary's search of the market for the buyer. Background information is provided first. A discussion of intermediary incentives follows. The discussion of intermediary incentives highlights the potential for, or the appearance of, conflicts of interest. This potential is illuminated via a discussion of international work on this issue, and a discussion of intermediary responsibilities follows. The section then provides additional analysis of these issues. This analysis is focused on the arguments advanced by intermediaries regarding this topic. The section concludes with a series of recommendations related to transparency.

Background

10.42 Intermediaries receive remuneration by way of commission from insurers and/or fees from buyers. Where any fees are charged, the fact of a fee must be clearly indicated, and fees are, in practice, brought to the attention of buyers. Many buyers however, do not know the actual commission received by their intermediary for placing insurance on their behalf. Intermediaries have expressed a willingness to provide such information to buyers on request. For example, the IBA has stated:

17 Wheeler, J. (2005). *Insurance firms to cut costs for motorcyclists*, *The Irish Times*, 2 February.
18 McAleer, M. (2004). *Boost for young drivers*, *The Irish Times*, 24 November.
19 This was indicated to the Authority during a confidential meeting with an insurer.
20 Source: IFSRA.

"The IBA would also support the following measures:

"The IBA would also support the following measures:Information to consumers highlighting their right on request to seek information on commission/fees or any other aspect of business placed with insurance brokers while avoiding the unnecessary and damaging proposals on mandatory disclosure of broker commissions; (while in the UK the FSA felt this would not be nescessary for the personal insurance market the IBA would support going even further than the FSA and implementing this on request for both personal and corporate sectors)"[21]

Similarly, Marsh has stated:

"The issue of transparency has become important and we are happy, as indicated in the IBA report, where clients request it, to tell them what the commissions are."[22]

Given that intermediaries are agents of buyers, they have an obligation to provide such information if the buyer requests it. As discussed in greater detail below, however, intermediaries have indicated to the Authority that relatively few buyers make such requests.

10.43 Table 10.4 below provides information on total motor and liability commissions[23] paid for 2001, 2002 and 2003.[24] It also provides the percentages of gross written premium represented by these commissions. During this period, commissions for motor insurance increased by 0.7 percentage points and those for liability insurance increased by 0.4 percentage points.

10.44 Overall, motor and liability commission payments totalled €163.8m in 2003. This is a significant amount, and thus the incentives provided by commission arrangements have the potential to have a substantial impact on the decisions made by intermediaries and hence on the insurance purchasing decisions made by their clients.

Intermediary Incentives

10.45 The buyer appoints an intermediary as its agent. As discussed in detail below, the nature of the principal/agent relationship in insurance is such that there may be potentially competing incentives for the agent when acting on behalf of the principal (i.e., the buyer). It may also be difficult for the principal to determine both the incentives faced by the agent and the quality of the agent's advice.

10.46 Many commissions are *ad valorem* (i.e., the commission is a percentage of the premium). The payment of *ad valorem* commission to intermediaries implies that when underlying premiums rise, the amount payable to intermediaries rises proportionately.[25] The resulting financial incentives for the intermediary have the potential to conflict with an intermediary's obligations to search for and recommend the best value policies for its clients. Furthermore, the commission rates offered by two insurers may differ, presenting another potential for the intermediary's financial incentives to conflict with the interests of its client, the buyer.

10.47 This compares to flat fee commissions whereby payments are made to intermediaries in the form of fixed fees that are not related to the size of the premium. Instead, fees are related to the work done by the intermediary. With flat fee commissions, the levels of commission paid do not necessarily rise with the premium. Such a compensation arrangement does not provide incentives for intermediaries to look more favourably on higher-priced policies.

10.48 In addition to basic commission, some insurers pay extra commissions for volume or profitability of business. These extra commissions are paid in respect of overall performance for a specific period, usually a year. They generally refer to the intermediary's book of business as a whole rather than to a specific line. They can be based upon the volume or profitability of the intermediary's business with the insurer.[26]

Table 10.4: Total Commission Paid on Motor and Liability Insurance and as a Percent of Gross Written Premium, Ireland, 2001 - 2003 (in €000)

Year	Total Motor Commissions	Percent of Motor GWP	Total Liability Commissions	Percent of Liability GWP
2001	60,791	3.6%	46,084	8.0%
2002	78,886	4.0%	64,873	7.7%
2003	82,201	4.3%	81,586	8.4%

Source: *Blue Books* and *Insurance Statistical Review 2003*

21 IBA (2004), *Response to Competition Authority Consultation Paper on Non-Life Insurance Industry*, submission to The Competition Authority, 16 April, para 4.24 f., p. 77.
22 Marsh (2004), Testimony of Mr. Grogan before the Joint Oireachtas Committee, 28 April.
23 These data do not include fees paid by buyers.
24 Commissions had historically been capped at 5%. This cap was removed in 1999.
25 If commission rates are graduated so that they increase with the total amount of premium paid, then the increase may be greater than proportional.
26 In many instances, commissions, including graduated commissions, provide incentives for the recipient to increase the volume of goods sold. This is typically pro-competitive because it encourages expanded output. With regard to insurance, however, the intermediary has an obligation to its client, the buyer, which is not present in many other instances whereby upstream producers sell to end customers via downstream firm. This obligation is the source of the potential conflict of interests.

10.49 By providing supplemental payments, for example for achieving a certain amount of business for a specific insurer, extra commissions have the potential to skew further intermediary incentives. For example, they may encourage intermediaries to recommend specific policies that generate extra payments, even though better value options exist for the buyer. If the extra payments kick in when certain targets are reached, the intermediary may have very strong incentives to promote specific policies when its sales are near the targets, irrespective of the interests of buyers.

10.50 In Ireland, the "standard commission" structure is typically an ad valorem structure, i.e., commissions are based on a percentage of the premium paid. Rates vary according to type of insurance and particular insurers. "Additional Remuneration" structures, such as overrides[27] are a feature of the Irish non-life insurance intermediation. Soft commissions in the form of non-cash benefits and volume discounts, a particular kind of override, are also a feature of the market.[28]

10.51 There is another conflict of interest concern when commission is earned based upon the profitability of the business to the insurer. Profitability relates to the difference between revenues and costs. Consider a scheme providing cover to a group of similar buyers. Insurer profitability may be high because costs were low. This may occur, for example, if the scheme encourages buyers to take additional steps to manage risk. It may also occur, however, because prices are high. Thus, these types of commissions may provide intermediaries with incentives to encourage increased prices for the cover provided to buyers. With regard to a scheme, this incentive may manifest itself by giving the intermediary incentives to make the pool of buyers look riskier than it truly is at the time the search for quotes is undertaken. This will result in a higher premium and more profitable book of business once the actual claims experience is known.

10.52 For the combination of motor, EL and PL, the Authority has determined that extra commissions amounted to approximately €7m in 2001, €9m in 2002 and €12m in 2003.[29]

International Cases and Reviews

10.53 An investigation is taking place in the US on "contingent commissions" which are, in effect, extra commissions. The US investigation deals inter alia with specific allegations that the contingent commission system created incentives for an intermediary to steer customers towards favoured insurers. In New York v Marsh & McLennan,[30] the State of New York stated:

(a) "Contingent commissions" created an "improper incentive" for Marsh, a broker, resulting in Marsh "steering" business to the insurers that offered the highest commissions;[31]

(b) Marsh engaged in bid-rigging where Marsh provided an insurer with a target premium, rather than requesting a competitive bid;[32] and

(c) Marsh obtained fictitious quotes from insurers "in order to deceive its clients into believing that true competition had taken place".[33]

These allegations are the manifestations of the conflict of interest concerns discussed above in a particular case.[34]

10.54 New York State Attorney General Eliot Spitzer summarised the findings of his office's investigations into insurance as:

"By looking closely at these contingent commissions, we uncovered another side of the insurance industry. Not only do insurance brokers receive contingent commissions to steer business, but many brokers, with the assistance and collusion of insurance companies, engage in systematic fraud and market manipulation in order to ensure that profitable and high volume business goes to a few selected insurance companies. In other words, we found that favoritism, secrecy and conflicts rule this market, and not open competition."[35]

10.55 To date, the State of New York has filed two civil and three criminal cases in this area. The civil cases are against Marsh & McLennan[36] and Universal Life

27 Overrides are commissions paid to intermediaries in addition to standard commissions and are typically related to the volume of business secured by the intermediary, and/or the persistency or profitability of the business for the insurer. See IFSRA (2005), *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January 2005, p. 16.
28 For additional details on the types of commission structures common in Ireland see IFSRA (2005), Review of Remuneration Structures and Transparency, Consultation Paper CP9, January 2005, pp. 15 - 16.
29 These estimates are based on data submitted by Irish insurers.
30 The full complaint is available from the Office of the New York State Attorney General website at http://www.oag.state.ny.us/press/2004/oct/oct14a_04_attach1.pdf?OpenElement
31 Complaint, The People of the State of New York vs. Marsh & McLennan Companies, Inc. and Marsh Inc., p. 2, available from the Office of the New York State Attorney General website at http://www.oag.state.ny.us/press/2004/oct/oct14a_04_attach1.pdf?OpenElement
32 Complaint, The People of the State of New York vs. Marsh & McLennan Companies, Inc. and Marsh Inc., p. 16, available from the Office of the New York State Attorney General website at http://www.oag.state.ny.us/press/2004/oct/oct14a_04_attach1.pdf?OpenElement
33 Complaint, The People of the State of New York vs. Marsh & McLennan Companies, Inc. and Marsh Inc., p. 3, available from the Office of the New York State Attorney General website at http://www.oag.state.ny.us/press/2004/oct/oct14a_04_attach1.pdf?OpenElement
34 The Authority has not received information suggesting that bid rigging supported by intermediaries has occurred in Ireland.
35 Spitzer, E. (2004). Testimony of State of New York Attorney General before the United States Senate Committee on Governmental Affairs Subcommittee on Financial Management, the Budget and International Security, 16 November, p. 4.
36 This case settled on 31 January 2005. Marsh agreed to pay $850 million into a fund to compensate clients.

Resources[37]; the criminal cases are against executives at AIG, ACE and Zurich American Insurance.[38]

10.56 Concerns regarding commission overrides have been expressed in Europe as well. For example, the Dutch Competition Authority, Nederlandse Mededingings Autoriteit ("NMa"), published a consultation paper in November 2004 on insurance intermediaries.[39] This consultation paper discusses the potential for commission to bias intermediaries. Some of the identified influences on intermediaries arise from:

(a) Financial incentives: the majority of intermediaries are paid on a commission basis. Commissions are paid by insurance companies based on a number of factors.[40] Insurance broking based on an hourly fee basis is used more frequently for when providing services to companies.[41]

(b) Ownership structure: Insurers own certain intermediaries and it is not always clear to consumers which intermediaries are owned by insurers.[42]

(c) Financing: Insurers provide loans to intermediaries at favourable conditions.[43]

Each of the influences identified by the NMa is also a feature of the Irish non-life insurance intermediation.

10.57 In addition, IFSRA recently published a consultation paper on this subject.[44,45] The purpose of its consultation is to seek:

"... to review remuneration structures and disclosure requirements in the insurance industry. We need to look at the current disclosure requirements to ensure they are clear and easy to understand. In addition, as the Financial Regulator, we are particularly concerned about certain types of remuneration -or payment for work or services -within this sector."[46]

IFSRA lists several concerns in this consultation paper. These include that IFSRA is "concerned that the charging structures are complex and confusing for the consumer"[47], "that certain types of remuneration may provide an incentive not to act in the best interests of a client",[48] and "about the ... lack of transparency of remuneration structures".[49]

IFSRA's consultation questions include:

(a) Should the commission structures be simplified and made more transparent to the consumer? If yes, how would you suggest that this be achieved? (Question 9)

(b) Should certain types of remuneration be banned or restricted by the Financial Regulator, for example, override commission, indemnity commission, soft commissions, inducements, non-cash benefits, etc.? (Question 10, subparts omitted)

(c) Do you think that the structure of the remuneration system conflicts with the obligations set out in the existing codes of practice? If so, how can this be addressed? (Question 12)

(d) Is commission a suitable method of payment or would it be more appropriate for intermediaries to charge a fee for their services instead? If so, what do you think would be the impact of this change, for the consumer, for the intermediary and for the insurance company? (Question 13)

(e) Do consumers understand how an intermediary is paid for his/her services and how much in financial terms the intermediary earns from the sale of a policy to a consumer? Is it relevant information for the consumer? (Question 14)

(f) Do you think it is necessary for consumers to be informed of all types of remuneration? If so, what is the best way to do this? (Question 15)

(g) Do you think disclosure of commission is necessary in respect of all types of insurance business? If not, please specify the types of business where you believe it is not necessary and your reasons for this view. (Question 16)

(h) Should we impose specific disclosure requirements for non-life insurance business? (Question 26)

37 Universal Life Resources, Inc. is still under investigation by the New York State Attorney General and the New York State Insurance Department; details are available at http://www.ins.state.ny.us/p0501251.htm (The investigation is ongoing.)
38 Six executives from three companies have pleaded guilty in these cases. Details are available from the Office of the New York State Attorney at http://www.oag.state.ny.us/press/2005/jan/marshsettlement_pr.pdf http://www.oag.state.ny.us/press/2005/jan/marshsettlement_pr.pdf
39 NMa, (2004). *Consultatiedocument, Het Intermediaire Distributiekanaal*, November.
40 The NMa identified 8 different types.
41 NMa, (2004). *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, p. 23.
42 NMa, (2004). *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, p. 21.
43 NMa, (2004). *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, p. 28.
44 The Joint Oireachtas Committee had recommended that IFSRA conduct such a review. For example, its Recommendation # 53 states, "IFSRA should carry out a fundamental review of the insurance broker market with a view to substantially improving the operation of that market, particularly in relation to transparency for the consumer." In addition, its Recommendation # 35 is, "IFSRA, the Irish Financial Services Regulatory Authority should give consideration to the issue of whether brokers should operate only on a fee basis." Second Report, Second Interim Report on Reforms to the Irish Insurance Market, Houses of the Oireachtas, July 2004, p. 80 respectively p. 75. In addition, the MIAB had also called for such a review in 2002 in its recommendations regarding transparency.
45 IFSRA (2005). *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January, available from the IFSRA website at http://www.ifsra.ie/data/CP_Files/Consultation%20Paper%20CP9.pdf
46 IFSRA (2005). *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January 2005, p. 2.
47 IFSRA (2005). *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January 2005, p. 7.
48 IFSRA (2005). *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January 2005, p. 12.
49 IFSRA (2005). *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January 2005, p. 12.

(i) What factors should we consider in relation to disclosure requirements for non-life business? (Question 27)

(j) What type of disclosure would be suitable to non-life insurance product information and remuneration? In particular, how should override arrangements and non-cash benefits be disclosed to the consumer? (Question 28)

Intermediary Responsibilities

10.58 Intermediaries have a professional responsibility to act in the best interests of their clients and have said that in placing business, they are not influenced by whether the insurer pays commission. For example, during testimony before the Joint Oireachtas Committee, Coyle Hamilton stated that it was not influenced by whether an insurer paid it commission.[50] It also stated that, having looked at its own private motor insurance book in the previous number of months it could confirm that, in 100% of the cases involved, all of its clients were given the cheapest premium available to it.

"We are not influenced, in who we place business with, by whether the insurer pays commission. We believe our first obligation is to our customers and it is to provide best advice to our clients. We are also obliged by IFSRA and by regulation to provide best advice to our clients and we are happy that we do so. On the issue of best advice, as part of a broader survey, we looked at our own private motor insurance book in the past number of months and in 100% of the cases involved, all of our clients were given the cheapest premium available to us."[51]

In a similar fashion, a representative of PIBA testified before the Joint Oireachtas Committee that:

"On competition, ask any broker and he will say it is red hot. We are all fighting among each other for the business and the best interests of our clients."[52]

10.59 In addition to the professional obligations set out above, intermediaries have a statutory obligation to act in the best interests of their clients, irrespective of commission payments. This requirement should control incentives arising from commissions. The relevant IFSRA Handbooks state that the intermediary "must take reasonable steps to ensure that neither it nor any of its officers or employees offers or gives or solicits or accepts any inducement which is likely to conflict significantly with any duties of the recipient or the recipient's employer to act at all times in the best interests of clients."[53] The Handbooks also state that an intermediary "...may not enter into a soft commission agreement unless such agreement is in writing."[54] Furthermore, an intermediary "must ensure that any business transacted under a soft commission agreement does not conflict with the best interest of its clients".[55] A soft commission agreement is one in which an intermediary receives goods or services to direct business through another entity.[56]

10.60 Intermediaries provide "terms of business" letters to their clients. These letters are required to state the intermediary's policies with relation to conflicts of interest.[57]

10.61 What is in the best interest of a buyer can be difficult to determine. In addition to price, there are other factors intermediaries can consider. These include the familiarity of different insurers with particular risks, their speed of claims processing, and other more qualitative evaluations. Furthermore, the contractual terms offered by insurers may differ. As a result, making comparisons across quotes is more complex then simply picking the lowest price. These factors serve to make it more difficult to determine exactly what is in the buyer's best interest.

50 Coyle Hamilton (2004). Testimony of Mr. Jim O'Mahony before the Joint Oireachtas Committee, 21 April.
51 Coyle Hamilton (2004). Testimony of Mr. Jim O'Mahony before the Joint Oireachtas Committee, 21 April.
52 PIBA (2003), Testimony of Mr. Fitzgerald before the Joint Oireachtas Committee, available from the Joint Committee on Enterprise and Small Business website at http://www.irlgov.ie/oireachtas/Committees-29th-D%C3%A1il/jcesb-debates/JESB230703.rtf
53 IFSRA, *Handbook for Authorised Advisors*, p. 14 available from the IFSRA website at http://www.ifsra.ie/data/in_car_files/Handbook%20for%20Authorised%20Advisors.doc. See also IFSRA's *Handbook for Restricted Intermediaries*, p. 7, available from the IFSRA website at http://www.ifsra.ie/data/in_car_files/Handbook%20for%20Restricted%20Intermediaries.doc, In the Handbooks, "inducement" is defined so that it does not cover either disclosable commission or goods or services which can reasonably be expected to assist in the provision of client services to clients and which are provided or are to be provided under a soft commission agreement. See IFSRA's *Handbook for Restricted Intermediaries*, p. 38. See also IFSRA, Handbook for Authorised Advisors, available from the IFSRA website at http://www.ifsra.ie/data/in_car_files/Handbook%20for%20Authorised%20Advisors.doc, p. 34
54 IFSRA, *Handbook for Authorised Advisors*, p. 14 and IFSRA, Handbook for Restricted Intermediaries, p. 13.
55 IFRSA, *Handbook for Authorised Advisors*, Para 14.1, p.14 available from the IFSRA website at http://www.ifsra.ie/data/in_car_files/Handbook%20for%20Authorised%20Advisors.doc
56 IFSRA, *Handbook for Restricted Intermediaries*, p. 37, available from the IFSRA website at http://www.ifsra.ie/data/in_car_files/Handbook%20for%20Restricted%20Intermediaries.doc
57 IFSRA, *Handbook for Restricted Intermediaries*, available from the IFSRA website at http://www.ifsra.ie/data/in_car_files/Handbook%20for%20Restricted%20Intermediaries.doc, p. 8. See also, IFSRA, Handbook for Authorised Advisors, available from the IFSRA website at http://www.ifsra.ie/data/in_car_files/Handbook%20for%20Authorised%20Advisors.doc

Analysis

10.62 With the possible exception of large buyers, there is there is little or no buyer knowledge or awareness of the level of commission. Commissions are built into the overall price of the insurance product and are not separately itemised on premium notices. The intermediary is an agent for the buyer. As such, the buyer is entitled to know the intermediary's commission or other compensation arrangements. If this information were made readily available to buyers, then the intermediary/client relationship would become more transparent.[58]

10.63 Some representative groups of buyers have called for a statutory declaration of all intermediary charges and commissions. Examples include:

(a) The Construction Industry Federation has stated, "Clients should be able to negotiate broker fees based on work done rather than fixed percentage rates. Where fixed rates continue to apply, they should be separately identified to clients for each type of insurance."[59]

(b) The Alliance for Insurance Reform ("AIR") recommends that IFSRA end its exclusion for all non-life insurance from obligations to declare additional commissions and incentives.[60,61] It has also stated, "There should ... be a statutory declaration of all the broker's charges and commissions."[62]

(c) "Brokers should be forced to compete for business in the same way as other professions with a requirement that their fee income from placing particular business is totally transparent. The benefit of any over-riding commissions, rebates or incentives from insurance companies should be fully disclosed with the insured also having the right to benefit from such arrangement."[63]

In addition, some intermediaries have also called for complete disclosure of charges and commissions. For instance, Dandelion has stated, "The commission/fee charged to the client by the broker should be clearly stated."[64]

10.64 Similarly, the MIAB has recommended that commissions be disclosed for motor insurance policies.[65] The report of the MIAB in 2004 explains that this recommendation includes "commission as a percentage of the total premium payable", but that the issue has been "deferred pending further discussions with regulators and other market bodies on transparency."[66]

10.65 If the buyer knows how much the commission is, it can evaluate the service that it receives from the intermediary. This evaluation may cause it to shop around, negotiate new terms, substitute the commission with a fee based on the level of service the buyer requires, or make no changes at all. Even if no changes are made, this decision would be an informed choice of the buyer's.

10.66 Intermediaries argue that consumers are not willing to pay for their service based on an hourly charge. For instance the PIBA have stated:

"The experience of the PIBA is that most clients prefer to deal with a broker on a commission basis - no sale, no fee."[67]

10.67 Further, the use of commission enables intermediaries to provide advice to their customers that they might not otherwise receive. As summarised by the NMa:

"A number of reasons for the limited interest of working on an hourly rate basis for the consumer market became apparent in conversations between [the NMa] and parties involved in insurance. First of all, consumers who do not purchase any products are subsidised by the ones that do. When somebody is advised, but does not purchase a product, the advice is free. Implementation of a charge for advice would mean that fewer consumers would seek advice from an intermediary, which could lead to less insurance policies being sold. A second reason is that consumers are not willing to pay for taking out an insurance policy in the form of an hourly rate, but find an all-in premium acceptable."[68]

58 In research conducted for the Financial Services Authority in the UK relating to the purchase of savings and investment products, which like non-life insurance is often sold on a commission basis, there was considerable support amongst buyers to know how much the intermediary made from the sale of a product. For details see IFF Research Limited and NOP Research Group (2004) Polarisation - Menu testing research, London, FSA. Consumer Research Paper 24, p. 4. Available from http://www.fsa.gov.uk/pubs/consumer-research/index-2004.html
59 Construction Industry Federation (2004). Testimony of Mr. George Hennessy to the Joint Oireachtas Committee, 21 April 2004.
60 AIR, Submission by The Alliance for Insurance Reform, submission to the Joint Oireachtas Committee, March 2004.
61 IFSRA's handbooks require intermediaries to disclose "details of the commission structure(s), if any, through which the ... Intermediary is, or may be, remunerated". Restricted Intermediary handbook p. 9. See also Authorised Advisor handbook at p. 9. This requirement is not, however, imposed on insurance intermediaries but rather only on other types of investment intermediaries. Life insurers have additional disclosure requirements in the Life Assurance (Provision of Information) Regulations, 2001, available from the Office of the Attorney General at http://www.irishstatutebook.ie/ZZSI15Y2001.html. Life assurance intermediaries are required to provide a statement that includes all charges, expenses, intermediary remuneration and sales remuneration. This information is set out in the form specified in S.I. No. 15 of 2001.
62 AIR (2003). Testimony of Mr. English before the Joint Oireachtas Committee, 20 November.
63 Irish Hotels Federation (2004). *Competition Issues in the Non-Life Insurance Market*, 15 April, p. 2
64 Dandelion (2004). Competition Issues in the (Non-life) Insurance Market, submission to The Competition Authority, 13 July, p. 8.
65 Recommendation # 15 of the MIAB in 2002 stated: "That a regulation be introduced to standardise renewal notices - detailing the calculation of premium from compulsory cover to the full coverage offered with elective elements clearly indicated and showing any loadings or discounts applied in both monetary and percentage terms."
66 Motor Insurance Advisory Board (2004). MIAB Report 2004, 24 September, p. 126.
67 PIAB (2003). Testimony of Mr. Diurmuid Kelly before the Joint Oireachtas Committee, 23 July.
68 NMa, (2004), *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, translation of para 67, p. 24-25.

10.68 Even with disclosure, some buyers may prefer to continue to use a commission-based system for remunerating intermediaries. Even so, compensation transparency would help buyers to shop around for the combination of price and service that they want - both with regard to the insurance products themselves and intermediary services. This information is needed if buyers are to make comparisons across intermediaries. It enables an evaluation of the services provided by individual intermediaries and a determination of whether other intermediaries provide better value - or whether an intermediary is needed at all. The lack of transparency protects intermediaries from competition and from disintermediation. The operation of the market for intermediary services would benefit from buyer knowledge of intermediary commissions.

10.69 During discussions with the Authority, intermediaries have argued that they make commission information available on request. They also state that few buyers ask for this information. As described by Dandelion:

"Indeed, it [commission] is so well masked that few people, when arranging their insurance, ever consider how much they're paying their broker for his work and whether that level of payment is appropriate."[69]

10.70 Since most buyers do not ask for this information, intermediaries argue that providing it would be an unnecessary cost. It is important however, that this information be provided, even if few buyers ask for it. Buyers may not ask for this information because they do not know that it is available if requested. Furthermore, some may not even know that they are purchasing through an intermediary. If buyers were aware of this information, they would have the opportunity to manage their intermediary relationships differently.[70]

10.71 Intermediaries also argue that any requirements in this area need to be symmetric. In particular, if intermediaries have to provide such information, but direct sellers do not, intermediaries may be put at a competitive disadvantage. As stated by the IBA:

"If there is to be transparency of distribution costs, it must be applied to all distribution channels. Clients need to be told the cost of distribution through the Internet channel, the banking channel and the branch channel as well as the broker channel."[71]

10.72 Providers of insurance via direct channels are not obligated to search across insurers to recommend the best product for the buyer. They provide a product, and the Internet or other direct sales channels provide a way to distribute this product to customers. Unbundling the distribution costs for these types of sales would not provide useful information for buyers. Intermediaries, by comparison, provide an independent service to buyers. In particular, they provide advice and represent more than simply a means to distribute products. As such, there is no need for the disclosure requirement as claimed by some intermediaries.

10.73 Intermediaries have indicated that extra commissions from insurers may be designed to encourage intermediaries to do extra work, such as establish electronic data interchange capability. In such a case, commissions would encourage behaviour that lowers the cost of providing services to customers, and so these commissions can be efficiency-enhancing and in the interests of buyers. In particular, there can be reasons for extra commissions other than attempting to influence intermediary recommendations. This is not, however, a reason to avoid commission disclosure. If commissions are higher because additional services are provided, then intermediaries should be able to justify additional fees by the levels of service they provide. Services are one element of intermediary competition. Disclosure would allow buyers to make choices regarding the level of services they want to purchase.

Recommendations

10.74 Commission disclosure enables the buyer to evaluate the benefits of having an intermediary and to compare the price/service combination of one intermediary with another.

Recommendation B1

IFSRA should modify its codes of conduct to require intermediaries to inform buyers of the precise monetary payment that the intermediary receives for placing the buyer's business and on what basis that monetary payment is calculated (e.g., whether the payment is an ad valorem or other payment structure). This information should be included in a breakdown of premium provided with each price quote and each renewal notice for the policy. Where there are multiple intermediaries involved, the precise monetary payments to be paid to each intermediary should be included in these breakdowns.

69 Dandelion (2004). *Competition Issues in the (Non-life) Insurance Market*, submission to The Competition Authority, 13 July, p. 4.

70 As an example, one case was described where a buyer paid €61,000 for EL and PL. Subsequently, upon examining the insurance certificate, the buyer learned that the premium itself was €50,000, meaning a commission of €11,000 (22%) had been paid. If the buyer had known the intermediary commissions in advance, it may have managed its search for cover differently. AIR (2003). Testimony of Mr. McCaughey before the Joint Oireachtas Committee, 20 November.

71 IBA (2004). Testimony of Mr. David Cowman before the Joint Oireachtas Committee, 29 April.

10.75 Recommendation B1 relates to ad valorem and other, similar commissions. However, there may also be commissions related to the overall volume or profitability of an intermediary's business with an insurer. With regard to extra commissions based on volume, the danger of a conflict of interest arises - especially where an intermediary is getting close to meeting any volume targets. Conflicts can exist even when volumes are substantially below any targets, however, as intermediaries steer business to insurers providing greater commissions or work to meet targets in their compensation scheme.

10.76 Extra commissions or overrides should also be disclosed to customers. In the absence of transparency, the potential customer, who expects the intermediary to act in their best interests, does not know whether the intermediary has financial incentives related to additional payments that do not appear on the quote the customer receives. This information is important, however, to evaluate the service provided by the intermediary.

10.77 There are practical difficulties related to setting out disclosure of extra commissions in a way that would relate specifically to an individual buyer. First, overrides are paid on the basis of the volume and/or profitability of the business that the intermediary delivers to the insurer, for example, over an entire year. Therefore, at the time of an individual sale, there may not be any guarantee that the intermediary will reach the targets in the compensation plan or how much will be paid overall. If the intermediary's arrangement with an insurer is based on the volume of business placed during a full calendar year, for example, an intermediary making a sale in March may not know whether it will ultimately reach the targets by year-end. Thus, at the time the sale is made the intermediary would not know what the actual contribution of the policy would be to its total commissions. Second, some intermediaries have indicated that the individual sales staff would not be told the basis upon which extra commissions are paid, with that information being confined to directors only. As summarised by one intermediary:

"The salesperson does not know from the screen how much the broker is earning, he/she only knows the price that the client will pay and the various benefits of the policies (e.g. excess levels, use restrictions, etc.) With modern systems the broker's earnings are not capable of being a factor in deciding where to place the risk."[72]

10.78 With regard to the first point, Recommendation B2 below calls for the detailed disclosure of the nature of any extra commission the intermediary may earn from the sale of a policy. Any such disclosure should be made in simple, easy to understand language. The second concern does not impact on the Recommendations. It may be true that individual employees do not know the financial details of their employer. Nonetheless, individual employees may themselves be provided with incentives to promote particular policies, and transparency regarding commissions will enable buyers to evaluate the benefits of using an intermediary as opposed to buying direct from an insurer, and also to make comparisons across intermediaries.

Recommendation B2

IFSRA should modify its codes of conduct to require intermediaries to inform buyers of the nature and basis of any payments they may receive from insurers in addition to *ad valorem* commission payments. Any disclosures should be made in an easy to understand format. This information should be included in a breakdown of premium provided with each price quote and each renewal notice for the policy. Where exact amounts are unknown, reasonable estimates should be provided.

Recommendation B3

IFSRA should modify its codes of conduct to require intermediaries to publish on an annual basis the total value of commission overrides received from each insurer in respect of policies written for buyers in Ireland. The information provided should be disaggregated by the type of policy written (i.e., motor). Any disclosures should be made in an easy-to-understand format and be made generally available, for example, via intermediary or IFSRA websites.

10.79 Similar requirements are being considered or imposed in other jurisdictions. For example, the US National Association of Insurance Commissioners has recently adopted model legislation that will increase the disclosure of compensation details for insurance intermediaries. Under the legislation, the amount of compensation from the insurer and the method for calculating the compensation, including any contingent compensation, would need to be disclosed to the intermediary's clients. In cases where compensation is not known, a reasonable estimate must be supplied. According to the model legislation the intermediary must:

72 [Confidential] (2004), Submission to The Competition Authority, 9 June, p. 2.

"Disclose the amount of compensation from the insurer or other third party for that placement. If the amount of compensation is not known at the time of disclosure, the producer shall disclose the specific method for calculating such compensation and, if possible, a reasonable estimate of the amount."[73]

10.80 There have been calls for limiting the forms of compensation intermediaries can receive. Some buyer groups have suggested that intermediaries should be paid by the buyers only. This would eliminate insurer-paid commissions altogether. For example:

(a) The Small Firms Association has stated, "... [intermediaries] perform a valuable service. In the past they have probably done themselves no favours by being remunerated on a commission basis where this would be seen to have been maximised by higher premiums. It would be better for their cause if they were remunerated on a fixed fee basis".[74]

(b) The Construction Industry Federation has stated, "Clients should be able to negotiate broker fees based on work done rather than fixed percentage rates."[75]

10.81 IFSRA is considering whether to eliminate certain forms of compensation as part of its current consultation process. There does not appear to be any reason to do this on a statutory basis. Some intermediaries are opting to eliminate certain forms of compensation in response to what customers want. Transparency is likely to encourage the elimination of certain types of remuneration, and in an environment of transparency, there does not appear to be any need to interfere with market forces in this way.

Recommendation B4

IFSRA should not limit the forms of compensation that intermediaries can receive as a result of its current consultation process. Instead, IFSRA should mandate in its codes of conduct the disclosure of all forms of compensation intermediaries receive from insurers,

Recommendation B4 (continued)

whether as commission or otherwise, as part of premium quotations, renewal notices, and all other written communications offering to supply insurance to customers.

10.82 In essence, Recommendations B1 - B4 set up a structure whereby any forms of compensation are permitted, so long as insurance buyers are aware of them. With full disclosure, the market will determine what sorts of compensation are paid. If customers dislike certain forms of compensation, such as profitability-based overrides, then buyers will require a discount to accept these forms of compensation. Insurers and intermediaries may react to this, either by providing discounts, losing business or altering compensation structures. In response to adverse buyer reactions to the information being revealed in the US investigations, many intermediaries throughout the world, including Ireland, have indicated that they are no longer taking extra commissions.[76] In addition, some EL and PL products are now available on the basis that the intermediary will not accept any commission from the insurer and instead will agree commercial insurance fee structures upfront with the buyer.[77] With transparency, competition in the marketplace will lead to appropriate compensation mechanisms being employed.

10.83 The Joint Oireachtas Committee has raised an issue related to whether insurers should be allowed to discontinue their dealings with intermediaries that do not meet certain targets, for example, in terms of volume of business.[78] In essence, refusing to deal with an intermediary involves a particularly severe form of "break point" in a compensation schedule. In addition, the Committee has recommended that insurers deal with all intermediaries.[79] Given the present structure of the upstream insurance market, however, insurers should be able to select the intermediaries to which they give appointments. Requiring insurers to deal with specific intermediaries may raise insurer costs and thus may actually harm consumers. This Study does not recommend the adoption of the Joint Oireachtas Committee's suggestions in this regard.

73 NAIC (2004). *Compensation Disclosure Amendment to the Producer Licensing Model* Act, p. 1, available from the NAIC website at http://www.naic.org/committee_activities/executive/docs/BrokerActAdoptedclean.doc

74 SFA (2003). Testimony of Mr. Kieran Crowley before the Joint Oireachtas Committtee, 13 November, available from the Joint Oireachtas Committee website at http://www.gov.ie/committees-29/frame.htm

75 Construction Industry Federation (2004). Testimony of Mr. George Hennessy before the Joint Oireachtas Committee on Enterprise and Small Business, 21 April.

76 Marsh Ireland for example states: "Please note, with effect from 15 October 2004, Marsh has suspended its practice of market services agreements (MSA's) with insurance carriers." Details are available from the Marsh Ireland website at http://www.marsh.ie/2399c8a4-5fca-4146-ab9a-074ad05fa2fe.W5Doc

77 E.g., many larger buyers already have such arrangements. In the case of SMEs, the Arachas "premium share" product involves no commission being accepted from insurers. Other examples are understood to be in existence or imminent.

78 Specifically, the Joint Oireachtas Committee's recommendation # 32 is, "There should be no production quota's established by any insurance company that might inhibit or prevent brokers from giving independent advice to their clients." Joint Committee on Enterprise and Small Business (2004). Second Report, Second Interim Report on Reforms to the Irish Insurance Market, Houses of the Oireachtas, July 19, Recommendation # 32, p. 78.

79 The Joint Oireachtas Committee's recommendation # 52 is, "IFSRA make regulations to permit insurance brokers, subject to a competency test, to deal on behalf of their clients with any insurance company and that the term "authorised advisor" be discontinued. Firms that presently call themselves "insurance brokers" and who do not qualify under the competency test should be required to call themselves "Multi Agency Intermediaries." Joint Committee on Enterprise and Small Business (2004). Second Report, Second Interim Report on Reforms to the Irish Insurance Market, Houses of the Oireachtas, July 19, Recommendation # 52, p. 78.

10.84 Large buyers sometimes negotiate fees to be paid for intermediation services. In such cases, the commission that the intermediary would normally receive from the insurer is often deducted from the price of the premium quoted to the buyer. The negotiated intermediary's fee is then added on separately. This unbundles the intermediary's service from the insurance product. Unbundling allows the buyer both to assess the service being received from the intermediary against payments made and to test the market for alternative intermediaries. The use of fees is much less common for smaller buyers. Nevertheless, the fee option is available to such buyers. Indeed, PIBA has indicated that any client who wishes to pay by fee will be accommodated.[80]

10.85 Buyers can, if interested, negotiate fee arrangements with intermediaries. Recommendation B5 is designed to ensure that arrangements regarding commissions are clear.

Recommendation B5

IFSRA should modify its codes of conduct to require that, when an intermediary and a buyer have agreed to a fee arrangement, any commissions paid to the intermediary be deducted from negotiated fee arrangements or the insurance premium due, unless the negotiated fee arrangement explicitly states otherwise.

10.86 Buyers often do not know which insurers an intermediary has searched on their behalf. Intermediaries are obliged to let the buyer know which insurers they have agency appointments from[81], and they do this through their terms of business letters. However, there is no obligation to indicate which insurers were contacted in any particular case. It is understood that intermediaries will provide this information to a buyer on request, but many buyers do not ask for it.

10.87 A representative group of buyers[82] has indicated that many buyers working through intermediaries are unclear as to who their insurer is and sometimes confuse the intermediary with the insurer. Another representative group of buyers[83] has said that buyers often believe that their intermediaries have access to all insurers, which is certainly not always true, and that if clients have tried one intermediary, they have tried all the options. Finally, a third group of buyers[84] has said that many consumers mistakenly assume that an intermediary searches the entire market for the most competitive quote. These results suggest that many buyers do not understand the extent to which the intermediary has searched the market on their behalf.

10.88 Intermediaries are obliged to include in their terms of business letters a list of the insurers with which they have agency agreements.[85] However, this does not necessarily mean that all of those insurers are contacted for every client or insurance need.[86] Indeed, an intermediary may have several insurer appointments overall but not all may be relevant for a particular type of insurance. Under present requirements, an intermediary can indicate that it holds several appointments, even if it only has one appointment for any particular type of insurance.

Recommendation B6

IFSRA should modify its codes of conduct to require intermediary notifications of insurer appointments to be specific to types of insurance (e.g., motor).

10.89 If the buyer knows which insurers the intermediary has approached in its particular case, the buyer can decide whether to look for additional quotes directly or through another intermediary. The buyer can also better assess the service of the intermediary and decide whether to stay with that intermediary or consider using another one. Finally, with full details of the search, including any quotations received, together with the commissions payable on these quotations, the buyer can better evaluate the extent of any conflict of interest with regard to the intermediary's recommendations.

Recommendation B7

IFSRA should modify its code of conduct to require that intermediaries forward to the buyer details of all the quotations secured. Consistent with Recommendations B1 and B2, these quotations must include information regarding commission and other compensation due or potentially due to the intermediary.

10.90 Intermediaries need not search every insurer. Indeed, the most efficient intermediaries may be able to identify, in advance, the two or three insurers that would, even after a larger search, end up producing the lowest priced or best value quotes. More extensive searches would only waste resources and

80 PIBA (2003). Testimony of Mr Diarmuid Kelly before the Joint Oireachtas Committee, 23 July
81 See, for example, IFSRA, Handbook for *Restricted Intermediaries*, p. 31. See also, IFSRA, Handbook for *Authorised Advisors*, p. 31
82 IBEC (2003), Re: *Competition Issues in the Non-Life Insurance Market*, submission to The Competition Authority, 27 April, response to question 23, p. 2
83 AIR (2003). Testimony of Mr. McCaughey before the Joint Oireachtas Committee, 20 November
84 MIAB (2004), *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance) Preliminary Report and Consultation Document, MIAB Response*, submission to The Competition Authority, March, response to Question 23, p. 7
85 IFSRA, *Handbook for Authorised Advisors*, p. 31 and IFSRA, *Handbook for Restricted Intermediary*, p. 31. These publications are both available from the IFSRA website at http://www.ifsra.ie/frame_main.asp?pg=%2Fconsumer%2Fcr%5Fintr%2Easp&nv=%2Fconsumer%2Fcr%5Fnav%2Easp
86 In some cases, a particular insurer will not be relevant to the needs of the buyer in question.

drive up costs for these insurers. Nevertheless, understanding the extent and results of the search completed is useful information for buyers.

10.91 Commission may be used to compensate intermediaries for purposes such as the provision of work related to the administration of a scheme. There may be other, more transparent forms of compensation available as well. Either may be used, subject to disclosure. A buyer would need to know about such payments in order to assess whether the intermediary has an actual or potential conflict of interest.

10.92 Overall, seven recommendations are made above relating to the potential for conflicts of interest for insurance intermediaries. These recommendations relate to pricing transparency and the disclosure of information and are designed to address the concerns raised in the least intrusive manner as possible. For example, the recommendations do not limit the types of compensation insurers and intermediaries may use. They impose only limited costs on insurers, and also on IFSRA. Even so, the recommendations have clear pro-competitive and pro-customer benefits. Thus, they are proportionate to the concerns raised. The recommendations are intended to inform IFSRA's Review of Remuneration Structures and transparency.[87]

Customer Decision-making and Switching Barriers

10.93 This section relates to switching intermediaries. It first addresses whether customers understand the meaning of the different types of intermediaries. Without such an understanding, it is difficult to judge the service provided by an intermediary because the buyer's expectations may not be accurate. The process of switching between intermediaries is addressed next. The section concludes with an analysis of the practice of "blocking".

10.94 There are a number of potential impediments to switching between insurance intermediaries. For example, insurance products can be complex, and the services provided by intermediaries unclear. The availability of data and other information may inhibit switching. Therefore, switching may have also been limited historically by a lack of information on commissions and other intermediary pricing. The following quotes from the AIR, based on a pole of their membership, are illustrative:

"93% had no idea of the fees, including loss ratio bonuses, capacity bonuses or soft commissions, being paid to their insurance broker by their insurance company."

"75% of companies surveyed did not or were not able to change insurance brokers in the last five years."[88]

10.95 As discussed earlier, the Dutch competition authority recently published a discussion of consumer switching behaviour with regard to intermediaries.[89] Consistent with the switching impediments discussed above, it found that there was difficulty regarding switching for several reasons, including:

(a) Complexity: Complexity of financial products: consumers need a large amount of information and knowledge to compare intermediaries based on the independence of advice, quality and cost.[90]

(b) Switching costs: A 2003 survey indicated that consumer do not switch because of financial penalties (86%), viewed as being too much of a hassle (68%) and the process is too time consuming (64%).[91]

(c) Lack of transparency: It is not clear to consumers what they are paying for the services provided in the form of commission. Whether the intermediary is tied to the insurer is also unclear.[92]

(d) Search behaviour: Consumers are generally not interested or educated about financial products. Studies have also shown that consumers tend to seek advice from one adviser.[93]

Public Understanding of the Regulatory Classification System

10.96 The existing classification system uses the terms "multi-agency intermediaries", "authorised advisers", "single-agency intermediaries" and "tied intermediaries". The meaning of these terms is detailed in Box 10.1.

10.97 It is difficult for many people outside the insurance sector to understand these terms. For example, what is the difference between a single-agency intermediary and a tied intermediary? In effect, both will provide a buyer with quotes from only one insurer. As discussed above, many buyers mistakenly believe that their intermediary has searched the whole market for the best policies. This is often not the case. False impressions such as these indicate that the present classification and disclosure system is not working; many buyers do not understand the nature of the intermediaries with which they work. This confusion relates to buyers that are businesses and individual consumers. Furthermore, many buyers are unaware that there may be multiple intermediaries involved with a particular policy.

87 See IFSRA (2005), *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January 2005.
88 AIR (2004), *Submission to The Competition Authority and the Joint Oireachtas Committee on Enterprise and Small Business*, March.
89 NMa, (2004). *Consultatiedocument, Het Intermediaire Distributiekanaal*, November.
90 NMa (2004), *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, p. 33.
91 NMa (2004), *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, p. 34.
92 NMa (2004), *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, p. 34.
93 NMa (2004), *Consultatiedocument, Het Intermediaire Distributiekanaal*, November, p. 35.

10.98 A similar concern with regard to intermediary classifications in respect of motor insurance intermediation was raised by the MIAB report in 2002. Recommendation # 16 of the MIAB Report 2002 states:

"That a regulation be introduced to tackle potential "confusion of illusion of choice" by requiring insurers who offer motor quotations under a number of business names and product images or through any direct outlets to state the identity of the insurance group of which they are part and that equally brokers should be obliged to provide each client with a list of the motor insurers for which they hold an appointment consistent with the provisions of the Investment Intermediaries Act 1995."[94]

10.99 If buyers are to assess their intermediary, as well as their alternatives, they need to understand the role played by their intermediary, the extent of their intermediary's capabilities, the breadth of their intermediary's search for quotes, and the capabilities of their alternatives. This leads to the following recommendations:

Recommendation B8

IFSRA should modify the classification system for intermediaries to make it clearer for buyers. The classification system should include standardised definitions of the classes of intermediaries active in the marketplace. The new classification system should distinguish clearly, for example, between tied and single agency intermediaries and also between single and multi-agency intermediaries.

Recommendation B9

Each intermediary should include the IFSRA-approved statement of the functions performed by its type of intermediary in all contracts, quotations, renewal notices, advertisements and electronic communications sent by the intermediary to a buyer.

10.100 As an example of the potential problems raised by the current classification system, consider the regulatory status of the direct sales arm of a motor insurer that also sells another type of insurance underwritten by another producer. Such a firm is a multi-agency intermediary, even though it only sells one insurer's motor insurance - its own! Clearly a consumer can be misled to believe that such an entity has conducted a broad search for quotes when in fact it has not searched past its own offering.

10.101 Authorised Advisors and Restricted Intermediaries are currently required to give their clients a copy of their statement of Authorised Status and a list of the product producers for whom they hold written letters of appointment. In the case of an Authorised Advisor, this list of producers needs to include the nature of the service held by the appointment. Both categories of intermediaries are also required to disclose their regulatory status on business notepaper and business cards, in all advertisements and on all electronic communications with clients or potential clients. In addition to these requirements a Restricted Intermediary needs to disclose the previous statements in the following forms, depending on the number and type of appointment(s) held.[95]

(a) "Full Legal Name of Intermediary is a Multi-Agency Intermediary regulated by the Irish Financial Services Authority" if two or more are held appointments;

(b) "Full Legal Name of Intermediary is a Single-Agency Intermediary with (Product Producer) and is regulated by the Irish Financial Services Authority" if one appointment is held and they not tied;

(c) "Full Legal Name of Intermediary is a Tied Agent of (Product Producer) and is regulated by the Irish Financial Services Authority", if the agent is tied.

10.102 These disclosures indicate the regulatory status. They do not, however, indicate the meaning of the regulatory status. Recommendation B9 calls for these statements to be expanded to include a brief description of their meaning.

10.103 IFSRA's website currently includes the Authorised Advisor and Restricted Intermediary handbooks and other materials in the industry section of its website. It does not include, however, a discussion of the different types of insurance intermediaries and their responsibilities in its consumer section.[96] In addition, neither the motor insurance nor the home insurance Consumer Guides make any distinction between the different types of intermediaries. A reference to the differences between intermediaries in the relevant Consumer Guides or a separate Consumer Guide for Insurance and Investment Intermediaries would help improve consumer awareness and understanding of

94 Motor Insurance Advisory Board (2002). MIAB *Report 2002*, p. 3.
95 IFSRA, Handbook for Authorised Advisors, p. 31 and IFSRA, *Handbook for Restricted Intermediary*, p. 31-32. These publications are both available from the IFSRA website at http://www.ifsra.ie/frame_main.asp?pg=%2Fconsumer%2Fcr%5Fintr%2Easp&nv=%2Fconsumer%2Fcr%5Fnav%2Easp
96 Its consumer section does state the following with regard to motor insurance, "Alternatively, you can buy through an intermediary (broker or agent). The premium for an identical policy with the same company may be different depending on how you buy it. In particular, brokers may have special deals or may be able to provide a quotation from an insurer elsewhere in Europe." See "Financial Products Guide: Motor Insurance" available from the IFSRA website at http://www.ifsra.ie/frame_main.asp?pg=%2Findustry%2Fin%5Fins%5Fintr%2Easp&nv=%2Findustry%2Fin_nav.asp

the different types of intermediaries and their responsibilities to their clients.[97]

Recommendation B10

IFSRA should publish a customer advisory notice detailing the different types of insurance intermediaries and explaining the responsibilities of each type to buyers.

10.104 This section includes three recommendations that relate to the publishing of information by IFSRA and modestly expanding the information already published by intermediaries. The costs required to implement these recommendations are small, and the recommendations are proportionate to the issues raised regarding the present intermediary classification system and the public's understanding of it.

The Process of Changing Intermediaries

10.105 As discussed above, the Study found that it can be difficult for buyers to change intermediaries. Buyers may be pleased with the price and coverage of their insurance policy but not happy with the services provided by their intermediary. In such a case, the buyer should be able to switch to a new intermediary that it anticipates will provide a higher quality of service. No providers should have "locked in" customers. Indeed, the threat of having customers switch to a new provider is one of the most important motivations for firms to continue to provide superior quality service over time. As the following quote taken from the MIAB Report from 2004 illustrates, the threat of switching intermediaries is a powerful one:

"Policyholders who secure a better quote elsewhere often find that it is matched by the existing insurer if there is a threat of losing the business. Equally, brokers value client retention and policyholders seem to switch brokers less frequently than they change insurers."[98]

10.106 In order to effectuate a switch, insurers require a letter indicating that the buyer wishes to change intermediaries. This mandate is needed to transfer the authority to act on the buyer's behalf from one intermediary to another. The process of changing intermediaries itself is not time consuming or complex. However, practices have evolved that can inhibit switching to new intermediaries. These are discussed below.

10.107 One such practice involves the insurer contacting the buyer's former intermediary and allowing a period, typically seven days, for the former broker to object to the change. Insurers and intermediaries have indicated that the purpose of this practice is to establish if the buyer owes money to the former intermediary.[99,100] This is not a valid justification for interfering with a buyer's right to switch intermediaries. If money is owed - which may be subject to dispute - this is for the buyer and intermediary to resolve. Of course, if premium is owed to the insurer, the insurer is not obligated to extend coverage to the buyer in the event of a switch to a new intermediary. It is a matter between the buyer and the former intermediary to sort out any residual issues, however, and any such issues should not inhibit or delay the buyer's decision to transfer its custom to a new intermediary.

10.108 A further issue regarding switching is timing. Some buyers may not begin considering switching until a renewal notice has been received. However, insurers do not send renewal notices to buyers if an intermediary is involved. Instead, insurers send renewal notices to the intermediary, and the intermediary then sends the renewal notice to the buyer. Recommendation I1 calls for EL and PL renewal notices to be sent with sufficient time for the buyer to develop alternative quotations for the cover provided. To prevent locking in buyers by having intermediaries hold or delay renewal notices, Recommendation B11 calls for renewal notices to be sent by insurers to both buyers and their agents, the intermediaries of record.

Recommendation B11

IFSRA should modify its code of conduct to require renewal notices be sent both to buyers and any intermediaries that act as their agent.

10.109 If buyers decide that they want to switch intermediaries, they should so indicate to both the insurer and holding intermediary. This notification should not be required until sufficiently long after the receipt of a renewal notice, however, so that the buyer has sufficient time to consider options.

97 The Consumer Guides published by IFSRA are available from the IFSRA website at http://www.ifsra.ie/frame_main.asp?pg=%2Fconsumer%2Fcr%5Fintr%2Easp&nv=%2Fconsumer%2Fcr%5Fnav%2Easp

98 Motor Insurance Advisory Board (2004). MIAB *Report 2004*, 24 September, p. 143.

99 "There were also concerns about clients not being able to switch brokers if they have debts with their incumbent brokers...At that stage the relationship has deteriorated and it is only fair that if there is any amount correctly due to the incumbent broker that it should be paid." Dolmen (2004), Testimony of Mr David Dillane before the Joint Oireachtas Committee, 21 April.

100 In a confidential meeting with The Competition Authority, an insurer indicated it was normal procedure to contact the previous intermediary in order to ensure there were no outstanding issues.

Recommendation B12

FSRA should modify its code of conduct to include clear requirements including timescales for changing intermediaries. These requirements should ensure that buyers have sufficient time after the receipt of a renewal notice to consider thoroughly their options regarding switching insurers and switching intermediaries.

10.110 The recommendations in this section relate to the process of switching intermediaries. Being able to switch is essential for there to be effective competition among intermediaries. The recommendations call for notifications and the development of timescales and other procedures as part of IFSRA's codes of conduct. These recommendations are proportional to the concerns identified. Indeed, Recommendation B11 is necessary if Recommendation I1 is to be effective. In the absence of Recommendation B12, the renewal notices called for in Recommendation I1 may not reach buyers in time for these buyers to consider their options thoroughly.

Blocking

10.111 Some insurers will only give a quote to one intermediary for a particular risk. Even if a buyer is dissatisfied with the intermediary, the insurer will not provide another quote for the risk where the request for the quote comes to the insurer via a second intermediary. This is called "blocking". Blocking makes it difficult to switch intermediaries, especially for a buyer that is satisfied with the policy and service provided by the insurer. It also makes it more difficult for the buyer to test the market using multiple intermediaries.[101]

10.112 The justification offered for this practice is to prevent free riding by a second intermediary. If another intermediary could use the materials prepared by the first intermediary to present the risk to the insurer, then the second intermediary would be taking advantage of the work performed by the first. In this event, the second intermediary benefits from the work without bearing the cost of completing the work itself. It can take advantage of this cost savings by undercutting the pricing of the intermediary that actually prepared the work. Knowing this may happen, however, reduces the incentives for the first intermediary to develop a thorough risk presentation in the first place. This discourages first intermediary from carrying out the necessary research with the buyer, potentially resulting in lower quality risk analysis. Lower quality risk analysis makes it more difficult for the insurer to price the policy.

10.113 Some insurers will, however, provide alternative quotes for a risk using other intermediaries, provided the risk presentation is done from first principles. This avoids the free rider issue.

10.114 Free riding issues can also be avoided if the buyer pays the intermediary for the development of the risk presentation. In this case, the first intermediary is compensated for its efforts.

10.115 Even in the absence of an explicit fee arrangement, however, buyers should receive copies of any risk presentations prepared on their behalf. This will help prevent conflict of interest issues by enhancing the transparency of the buyer/intermediary relationship and the intermediary's search.

Recommendation B13

IFSRA should modify its codes of conduct to require that the intermediary provide the buyer with a copy of the risk presentation sent to each insurer.

Recommendation B14

IFSRA should modify its codes of conduct to require that intermediary contracts with buyers for EL and PL policy searches include the price to be charged for any risk presentation given to a buyer as called for in Recommendation B13. In the absence of such a price, the risk presentation should be provided by the intermediary to the buyer free of charge.

10.116 Agency law already requires that intermediaries provide a buyer with a hard copy of the risk presentation on request. However, this requirement may not be sufficient as buyers are often not aware that they have this option. In view of the fact that intermediaries should be allowed charge for the risk presentation, this recommendation is proportional.

10.117 Insurers have several different approaches they can take to dealing with a request for an alternative quote for a risk that has already been quoted. They can refuse to provide a quote, refuse to provide a lower quote, refuse to provide a quote without a new risk analysis, or they can offer a new quote. PIBA described this as follows:

101 This practice was confirmed during the Joint Oireachtas Committee hearings. For example, according to the testimony of Mr David Dillane, "Some underwriters and insurers have rules about whom they will quote for based upon certain criteria, such as who first presented the risk or with whom they have the best opportunity at acquiring the risk." Dolmen (2004), Testimony of Mr David Dillane before the Joint Oireachtas Committee, 21 April.

"Frequently when customers attempt to change broker, the new broker is told by the insurer that the holding broker has special "scheme" rates and that the insured will face higher premiums if the broker persists in his attempt to acquire the business."[102]

In addition, PIBA described a specific example as follows:

"The existing insurer refused to accept the business being changed to our agency. The insurer insisted they wanted new proposals and threatened that 'they might not accept the proposals' via ourselves. It was clear the insurer wanted their big customer to retain the business to the exclusion of the insured's wishes."[103]

10.118 The Study did not find evidence that buyers are typically aware of the approach insurers take in this regard. This is an issue IFSRA might consider investigating and publishing an advisory notice on.

10.119 Additional information should be made available to assist buyers in testing the market for alternative insurance quotes and for alternative intermediary services. This leads to the following two Recommendations.

Recommendation B15

IFSRA should modify its codes of conduct to require that each insurer active in the Irish market publish a statement regarding how it handles buyers of EL, PL and commercial motor insurance policies who are presented to them separately by different intermediaries. These statements should be made generally available, for example, via posting on insurer websites.

Recommendation B16

IFSRA should publish a table summarising the information from insurers called for in Recommendation B15.

10.120 If buyers do not know whether insurers will quote a policy, then it is more difficult for them to plan a strategy for determining their options in the marketplace. It is also more difficult for intermediaries to assist potentially switching clients. Recommendations B15 and B16 call for the release of information and can be implemented with little cost. As a result, the recommendations are proportional to the concerns identified.

10.121 The Joint Oireachtas Committee has released a recommendation with regard to blocking. In particular, its Recommendation # 34 states, "Insurance companies should not discriminate against competing brokers in making available renewal information."[104] This would, in effect, prohibit blocking. Given concerns regarding the potential for free riding, this is not in the best interest of the functioning of the overall insurance or intermediation marketplaces.

Summary and Conclusion

10.122 This Chapter considered the structure and performance of the motor and liability insurance intermediation market in Ireland. After defining this market, this Chapter considered its structure. It found that the number of intermediaries is relatively large and that there are low barriers to entry and exit. Indeed, there have been changes in the total number of intermediaries active in the market. Given its structure, this market has the potential to be highly competitive.

10.123 Nevertheless, there are impediments to competition in this market. Buyers generally lack information on the extent of intermediary search and the commissions earned by intermediaries for the placement of policies. Thus, the downstream intermediation market is not transparent. This lack of transparency is a significant concern because intermediaries have professional and legal obligations to act in the best interests of their clients. Thus, the incentives arising from the commissions paid by insurers to intermediaries can cause conflicts of interest for intermediaries. Given the lack of transparency, buyers are unable to consider the extent to which any conflicts have impacted intermediary recommendations.

10.124 This Study makes recommendations regarding the disclosure of commission and related information so as to increase the transparency of intermediary compensation. It also makes recommendations regarding disclosure of the results of the intermediary's search for quotes. Together, these recommendations will greatly enhance the transparency of the motor and liability insurance intermediation market. Transparency is essential for informed decision making and therefore for the development of vigorous competition.

10.125 The Study next considered the ability of buyers to switch intermediaries. Certain practices have arisen in the marketplace that inhibit buyer switching from one intermediary to another. These practices include the insurer notifying the holding intermediary when the buyer decides to switch and giving the holding intermediary a time period during with it can object.

102 PIBA (2004). *Response of the Professional Insurance Brokers Association (P.I.B.A.) to The Competition Authority's Preliminary Report and Consultation Document Competition Issues in the Non Life Insurance Market (with particular reference to motor, employer's liability and public liability insurance)*, submission to The Competition Authority, 18 April, p. 73.
103 See previous footnote.
104 Joint Committee on Enterprise and Small Business (2004). *Second Report, Second Interim Report on Reforms to the Irish Insurance Market*, Houses of the Oireachtas, July 19, Recommendation # 34, p. 78.

10.126 Recommendations are made to facilitate switching between intermediaries when buyers decide to do so. These include having insurers send renewal notices both to the intermediary and to the policyholder. Several additional recommendations are made relating to the practice of "blocking" and to clarify the regulatory classification system for intermediaries.

10.127 The importance and expected impact of these recommendations compares favourably to the expected costs of implementation. The recommendations relate primarily to providing information, for example, on the extent and findings of an intermediary's search for cover and on its compensation arrangements with insurers. These are not costly recommendations to implement. By comparison, the benefits should be substantial. For example, the recommendations related to commission transparency should improve the functioning of intermediation marketplace. Few markets work well when prices are not transparent to customers.

10.128 Intermediaries operate downstream from insurers. With greater transparency and easier switching at this downstream level, the intermediary business will be unable adversely to impact competition among insurers. Indeed, intermediaries can assist new insurers enter the upstream underwriting market for motor or liability insurance. An entrant into an insurance market with an attractive product offering can market this offering direct to buyers or via intermediaries. With transparent intermediary compensation and searches for quotes, the entrant's offering will be apparent to buyers. Due to conflict of interest considerations and issues of transparency, intermediaries are not now as effective at facilitating upstream entry as would otherwise be the case.

10.129 The intermediary marketplace is currently regulated by IFSRA. These regulations include codes of conduct. As discussed in Chapter 4, there are three principle reasons for the economic regulation of businesses. These reasons are information failure, externalities, and the control of market power. The recommendations in this Chapter propose modest advances in these regulations. Though modest, these advances in regulation should have a significant impact on increasing transparency in the motor and liability intermediation market. Most of the recommendations here relate to information failures. Markets often do not function well when relevant information is not available to buyers or sellers. Of course, these recommendations are also motivated by the public policy goal of limiting market power.

10.130 Once the intermediary marketplace is transparent and open for switching, it will no longer serve as an entry barrier into insurance markets. Absent its ability to serve as a barrier to entry upstream, insurers will have incentives to encourage vigorous competition among intermediaries. Indeed, any deviation from vigorous competition among intermediaries harms insurers by leading to a double "marginalisation". See Chapter 5.

10.131 With the increased competition in motor, EL and PL markets, resulting from this Study's recommendations regarding these insurance markets, and with a transparent intermediation market, any vertical restraints such as minimum purchase requirements imposed by insurers on downstream intermediaries are likely to be pro-competitive and efficiency enhancing. Of course, any actual restraint would need to be analysed to determine its specific effects. Nevertheless, vertical restraints in markets structured like these typically manage specific business problems and do not restrict competition.

Chapter 11

RECOMMENDATIONS

RECOMMENDATIONS

11.1 This Study has analysed competition in the Irish non-life insurance sector with particular emphasis on motor, EL and PL insurance. This Chapter draws together, for the convenience of the reader, the Authority's recommendations. The first section lists the Authority's 30 recommendations relating to competition in motor, EL and PL insurance. The second section lists the Authority's recommendation relating to the Irish legal system. The final section lists the Authority's 16 recommendations relating to the insurance intermediary sector.

Recommendations Relating to the Insurance Sector

11.2 Recommendations I1 to I30 relate to competition in the Motor, EL and PL insurance sector. The majority of the recommendations in this section are directed at IFSRA, but a number are directed at the Department of Transport (I9, I22, I28 and I29), the Department of Finance (I17) and the MIBI (I23. I24, I25 and I27). IFSRA should seek to incorporate the implementation of the relevant recommendations into their next corporate plan, while the other relevant parties should seek to implement the relevant recommendations in cooperation with IFRSA where appropriate.

Recommendations Relating to Switching Costs and Rivalry

- **Recommendation I1:** IFSRA should modify its code of conduct for insurers to require that renewal notices for liability insurance be sent by insurers so as to reach buyers at least eight weeks prior to the expiration of the buyer's existing policy.
- **Recommendation I2:** IFSRA should modify its code of conduct for liability insurers to require that, if a renewal notice is received late under the framework set out in Recommendation I1, then the buyer has the option to extend the cover under the old policy, at the minimum of the old rate and the quoted new rate, for the amount of time needed to extend the buyer's time available to shop for new cover consistent with the eight week time period contained in Recommendation I1.
- **Recommendation I3:** IFSRA should modify its code of conduct for motor and liability insurers to require that renewal notices include a certified history of claims for the buyer. Claims histories should cover at least the previous five years and include any outstanding claims from earlier years.
- **Recommendation I4:** IFSRA should modify its code of conduct for motor and liability insurers so that they are required to provide a certified claims history to any buyer upon request. Claims history information should be provided in hard copy if so requested by a buyer.
- **Recommendation I5:** IFSRA, in cooperation with the IIF, should develop a standardised format for motor and liability claims histories. This format should enable insurers to certify the accuracy of any information provided.
- **Recommendation I6:** IFSRA should modify its code of conduct to require motor insurers to provide initial quotations and renewal notices that break down premiums so as to show the premium charged for different types of cover, such as liability, fire and theft, and comprehensive insurance. Discounts (e.g., accident free discounts) and group risk class descriptions (e.g., male driver aged 26-30) should be detailed as well.
- **Recommendation I7:** IFSRA should publish cost surveys on liability insurance. These cost surveys should cover both EL and PL insurance for representative buyers, such as small business from several different industries. These cost surveys should be updated at least annually.
- **Recommendation I8:** IFSRA should publish a buyer guide detailing the potential benefits of assembling sufficient data to illustrate claims experiences and risk profiles in a particular industry or for a group of buyers. The buyer guide should also detail the types of information needed to complete this task.
- **Recommendation I9:** The Department of Transport should establish guidelines, procedures, and reporting requirements that would permit eligible firms to self-insure motor risks.

Recommendations Relating to Barriers to Entry

- **Recommendation I10:** IFSRA should issue guidelines detailing the regulatory requirements, including solvency standards, it will apply to insurers seeking to enter the Irish motor or liability insurance marketplace. To the extent that new entrants are required to meet standards in excess of those for existing suppliers, the guidelines should justify these increased standards.

- **Recommendation I11:** The IFSRA guidelines called for in Recommendation I10 should include the justification for any solvency standards that are in excess of the EU requirements. Any standards in excess of EU requirements should be proportionate.
- **Recommendation I12:** IFSRA should modify the coverage of the Insurance Compensation Fund so that it covers all Irish mass risk insurance policyholders, independent of the home state for any insurer, so long as the home state has solvency requirements above some minimum standards.
- **Recommendation I13:** IFSRA should issue a policy statement making the Insurance Compensation Fund's coverage clear to all mass risk insurance policyholders. This policy statement should also make clear how coverage from the fund would be implemented, and how this coverage would be funded. Any levies collected should be used for the purposes of financing the Insurance Compensation Fund.
- **Recommendation I14:** IFSRA should modify its code of conduct for insurers to require policies and quotes to indicate their coverage by the Insurance Protection Fund and the coverage provided by the fund.
- **Recommendation I15:** IFSRA should seek to publish the Insurance Statistical Review by June.
- **Recommendation I16:** IFSRA should require insurers to submit the data in electronic form by March so as to facilitate the publication of the Insurance Statistical Review by June.
- **Recommendation I17:** The Department of Finance should bring forward legislation to require insurers to submit their annual statutory returns for a year via electronic means by March of the following year.
- **Recommendation I18:** IFSRA should complete the establishment and on-going implementation of its programme to centralise the gathering and publishing of statistics on motor insurance premium and claims costs by driver profile.
- **Recommendation I19:** IFSRA should establish a system for the on-going collection and publication of "raw" policy data on mass risk EL and PL policies. These data should be collected market-wide and reported by relevant industry segments.
- **Recommendation I20:** IFSRA should collect and publish retrospective annual data on retained reserves and the ultimate costs of accidents paid out for motor, EL, and PL insurance for the relevant year.
- **Recommendation I21:** IFSRA should collate and publish in the Insurance Statistical Review market-wide data on the level of "insurer concerned" payments.
- **Recommendation I22:** The Department of Transport should bring forward legislation to alter the Road Traffic Acts to require motor insurance on the vehicle, as opposed to the use of the vehicle.
- **Recommendation I23:** MIBI should assess the impact of its new service level agreements following the first year of their operation and publish a report on its findings. This report should detail the performance of individual service providers and compare their performance to how these providers handle their own cases. Claims payments should be compared against the PIAB's Book of Quantum categories for each service provider. Annual updates should be prepared and published as well.
- **Recommendation I24:** If the outcome of the initial service level agreement review called for in Recommendation I23 does not show significant improvement in the time and cost it takes to resolve claims, then the claims management and settlement process should be put to tender by MIBI.
- **Recommendation I25:** MIBI should collect levies to cover the expected costs to manage and settle uninsured claims resulting from accidents in a given year as a per-policy or per vehicle fee assessed at the time policies are sold to customers in that year.
- **Recommendation I26:** IFSRA should modify its code of conduct for insurers so that insurers would be required to detail per-policy or per vehicle MIBI levies as a separate line item on motor insurance bills.
- **Recommendation I27:** If the funds collected pursuant to Recommendation I25 to pay MIBI claims arising from accidents in a particular year are exhausted, the additional costs of MIBI claims from that year should be allocated to insurers on the basis of the motor insurance market shares of all insurers active in that year.
- **Recommendation I28:** The Department of Transport and the Declined Cases Committee should publish a statement detailing the criteria used in applying the public interest test as to when motor insurance may be denied to high risk drivers.
- **Recommendation I29:** The Department of Transport should publish detailed annual statistics on the cases handled under the Declined Cases Agreement. These data should be broken down by vehicle type (e.g., motorcycle) and driver categories and should also provide data on the average premiums charged for these policies and the spread of these premiums. These data should be provided on an on-going basis. Claims information on Declined Case Agreement cases from previous years should also be made available if possible. No personal information should be published.

- **Recommendation I30:** IFSRA should alter the funding structure of the Ombudsman Scheme so that an insurer pays a levy to fund the system when there is an adverse ruling against it.

Recommendations Relating to the Legal System

11.3 Recommendation L1 relates to the legal system and how it impacts on competition in the insurance sector. The recommendation is directed at The Courts Service and the Department of Justice, Equality and Law Reform.

- **Recommendation L1:** The Courts Service and the Department of Justice, Equality and Law Reform should consider potential reforms to generate and publish information regarding Court decisions and levels of awards for personal injury cases. Such reforms might include:

  (a) The Department of Justice, Equality and Law Reform could bring forward legislation to require that all court decisions in personal injury cases be delivered in writing in addition to any oral delivery. Written decisions need not be long and complex. Indeed, transcripts of findings delivered orally may suffice.

  (b) The Courts Service could publish the results of all personal injury cases. This could involve the use of a standardised structure for case reporting. Such a structure could detail the apportionment of liability, the grounds for the finding of negligence, the amount awarded for special damages and the amount awarded for general damages in respect of pain and suffering to date (and into the future, if relevant).

  (c) Cases reported by the Courts Service could be detailed using a standardised classification of injury descriptions consistent with the categorisation in the Book of Quantum released by the PIAB.

  (d) The data published by the Courts Service of personal injury cases could be made public through a searchable database available over the Internet.

  (e) The Courts Service could publish data on legal cost awards, including information on legal costs relative to total damages awarded.

  In considering any proposals, the impact on insurer costs and prices, insurer rivalry, and barriers to entry into insurance markets should be included in the cost/benefit analysis.

Recommendations Relating to Intermediaries

11.4 Recommendations B1 to B16 relate to competition in the insurance intermediaries sector. These recommendations are directed at IFSRA. Recommendations B1 to B7 are designed to feed into IFSRA's Review of *Remuneration Structures and Transparency.*[1] IFSRA should seek to incorporate the implementation of recommendations B8 to B16 into their next corporate plan.

Recommendations Relating to Intermediary Conflicts of Interest

- **Recommendation B1:** IFSRA should modify its codes of conduct to require intermediaries to inform buyers of the precise monetary payment that the intermediary receives for placing the buyer's business and on what basis that monetary payment is calculated (e.g., whether the payment is an ad valorem or other payment structure). This information should be included in a breakdown of premium provided with each price quote and each renewal notice for the policy. Where there are multiple intermediaries involved, the precise monetary payments to be paid to each intermediary should be included in these breakdowns.
- **Recommendation B2:** IFSRA should modify its codes of conduct to require intermediaries to inform buyers of the nature and basis of any payments they may receive from insurers in addition to ad valorem commission payments. Any disclosures should be made in an easy to understand format. This information should be included in a breakdown of premium provided with each price quote and each renewal notice for the policy. Where exact amounts are unknown, reasonable estimates should be provided.
- **Recommendation B3:** IFSRA should modify its codes of conduct to require intermediaries to publish on an annual basis the total value of commission overrides received from each insurer in respect of policies written for buyers in Ireland. The information provided should be disaggregated by the type of policy written (i.e., motor). Any disclosures should be made in an easy-to-understand format and be made generally available, for example, via intermediary or IFSRA websites.
- **Recommendation B4:** IFSRA should not limit the forms of compensation that intermediaries can receive as a result of its current consultation process. Instead, IFSRA should mandate in its codes of conduct the disclosure of all forms of compensation intermediaries receive from insurers, whether as commission or otherwise, as part of premium quotations, renewal

1 See IFSRA (2005), *Review of Remuneration Structures and Transparency*, Consultation Paper CP9, January 2005.

notices, and all other written communications offering to supply insurance to customers.

- **Recommendation B5:** IFSRA should modify its codes of conduct to require that, when an intermediary and a buyer have agreed to a fee arrangement, any commissions paid to the intermediary be deducted from negotiated fee arrangements or the insurance premium due, unless the negotiated fee arrangement explicitly states otherwise.
- **Recommendation B6:** IFSRA should modify its codes of conduct to require intermediary notifications of insurer appointments to be specific to types of insurance (e.g., motor).
- **Recommendation B7:** IFSRA should modify its code of conduct to require that intermediaries forward to the buyer details of all the quotations secured. Consistent with Recommendations B1 and B2, these quotations must include information regarding commission and other compensation due or potentially due to the intermediary.

Recommendations Relating to Customer Decision-making and Switching

- **Recommendation B8:** IFSRA should modify the classification system for intermediaries to make it clearer for buyers. The classification system should include standardised definitions of the classes of intermediaries active in the marketplace. The new classification system should distinguish clearly, for example, between tied and single agency intermediaries and also between single and multi-agency intermediaries.
- **Recommendation B9:** Each intermediary should include the IFSRA-approved statement of the functions performed by its type of intermediary in all contracts, quotations, renewal notices, advertisements and electronic communications sent by the intermediary to a buyer.
- **Recommendation B10:** IFSRA should publish a customer advisory notice detailing the different types of insurance intermediaries and explaining the responsibilities of each type to buyers.
- **Recommendation B11:** IFSRA should modify its code of conduct to require renewal notices be sent both to buyers and any intermediaries that act as their agent.
- **Recommendation B12:** IFSRA should modify its code of conduct to include clear requirements including timescales for changing intermediaries. These requirements should ensure that buyers have sufficient time after the receipt of a renewal notice to consider thoroughly their options regarding switching insurers and switching intermediaries.
- **Recommendation B13:** IFSRA should modify its codes of conduct to require that the intermediary provide the buyer with a copy of the risk presentation sent to each insurer.
- **Recommendation B14:** IFSRA should modify its codes of conduct to require that intermediary contracts with buyers for EL and PL policy searches include the price to be charged for any risk presentation given to a buyer as called for in Recommendation B13. In the absence of such a price, the risk presentation should be provided by the intermediary to the buyer free of charge.
- **Recommendation B15:** IFSRA should modify its codes of conduct to require that each insurer active in the Irish market publish a statement regarding how it handles buyers of EL, PL and commercial motor insurance policies who are presented to them separately by different intermediaries. These statements should be made generally available, for example, via posting on insurer websites.
- **Recommendation B16:** IFSRA should publish a table summarising the information from insurers called for in Recommendation B15.

11.5 The Authority believes that the above recommendations have the potential to make the motor, EL and PL insurnace markets work better for consumers and business alike. The sharp rises in insurance premiums that characterisedthe 2000 - 2001 period have abated somewhat. However, this is no reason for complacency. Insurance premiums will eventually rise again at high rates. By implementing the recommendations advocated in this study, the motor, ELand PL insurnace markets will become more competitive, thus ensuring that rises in premiums will be minimised and importantly, that rises in premiums will be less attributable to the exercise of market power.

Appendix

APPENDIX I

Background and Terms of Reference

A.1 In September 2002, The Competition Authority launched its "Study of Competition Issues in the Non-Life Insurance Market" jointly with the Department of Enterprise, Trade and Employment. The Study was carried out under section 30(1) of the Competition Act 2002.

A.2 The terms of reference for the Study are as follows:

- To identify anti-competitive practices or other constraints on competition in the non-life insurance market in Ireland, with particular reference to motor insurance, employer's liability and public liability insurance;
- To highlight any anti-competitive practices or other constraints that are particular to the Irish market;
- To make recommendations for legislative and other changes to ensure that competition works well for consumers in the Irish market;
- To make, in the case of any problems identified at EU level, recommendations for change at that level.

Process

A.3 During 2003, a number of consultants were appointed, following a tender process, to assist the Authority in carrying out research into motor and liability insurance. Each of these reports is reproduced in Vol. 2 of this Study.

- Cass Business School, City University, London was commissioned in April 2003 to undertake research on the economics and regulation of insurance.
- Vincent Hogan and Colm Harmon, Department of Economics, University College, Dublin were commissioned in March 2003 to carry out research on the prospects of empirical analysis on the non-life insurance markets under consideration.
- Europe Economics, London was commissioned in July 2003 to carry out an analysis of competition in the relevant insurance markets.
- Dorothea Dowling carried out an analysis of the 2002 insurance annual returns (published December 2003).

A.4 In February 2004 the Authority published a consultation paper, which contained initial findings and sought feedback from interested parties. 16 submissions were made in total. These were:

- Alliance for Insurance Reform
- Brokers Federation of Ireland
- Carole Nash
- Centura
- Chambers of Commerce of Ireland
- Community and Voluntary Pillar of Social Partnership
- Dandelion
- Department of Transport
- Hibernian General Insurance Limited
- Irish Business Employers Confederation
- Irish Hotels Federation
- Motor Insurance Advisory Board
- Motor Insurance Bureau of Ireland
- Professional Insurance Brokers Association
- Quinn-direct Insurance Limited
- Irish Brokers Association

A.5 In addition to inviting formal submissions from interested parties, the Authority also held a number of informal hearings to discuss issues arising in the study and to seek further information. The Authority met with:

- AA Ireland
- AIG (Europe) Ireland Ltd.
- Alliance for Insurance Reform
- Allianz Ireland Plc.
- AXA Insurance Ltd.
- Brokers Federation of Ireland
- Chambers of Commerce of Ireland
- Chubb Insurance Ltd.
- Community and Voluntary Pillar
- Construction Industry Federation
- Consumers Association of Ireland
- Department of Transport

- Dublin Chambers of Commerce
- Health and Safety Authority
- Hibernian
- Irish Business Employers Confederation
- Irish Financial Services Regulatory Authority
- Insurance Institute of Ireland
- Irish Pubic Bodies Mutual Insurances Ltd.
- Irish Brokers Association
- Irish Hotels Federation
- Irish Insurance Federation
- MoneyMate Ltd.
- Motor Insurance Bureau of Ireland
- Professional Insurance Brokers Association
- Quinn-direct Insurance Limited
- Royal & SunAlliance Insurance PLC.

A.6 The Authority Commissioned Henry J. Kahwaty of LECG Ltd to assist with research, analysis and drafting during the final two months of the Study.

Resources

A.7 The Authority and the Department of Enterprise Trade and Employment committed resources valued at approximately €0.5m over the period of the study. In addition, the Authority committed significant internal resources to the Study – 1 full time Case Officer for 30 months, 1 Research Assistant for 3 months in addition to regular input from a Divisional Director.

Appendix II

APPENDIX II

List of Acronyms

AA	Authorised Advisors
AIR	Alliance for Insurance Reform
CPI	Consumer Price Index
DCA	Declined Cases Agreement
EEA	European Economic Area
EL	Employer's Liability
EPI	Earned Premium Income
FSAP	Financial Services Action Plan
GPI	Gross Premium Income
HHI	Herfindahl Hirschman Index
IBA	Irish Brokers Association
IBEC	Irish Business and Employers' Confederation
IFSRA	Irish Financial Services Regulatory Authority
IMD	Insurance Mediation Directive
ISME	Irish Small and Medium Enterprises Association Limited
JOC	Joint Oireachtas Committee on Enterprise and Small Business
MAI	Multi-agency Intermediaries
MIAB	Motor Insurance Advisory Board
MIBI	Motor Insurance Bureau of Ireland
NMa	The Dutch Competition Authority (Nederlandse Mededingings Autoriteit)
PIBA	Professional Insurance Brokers Association
PL	Public Liability
SMEs	Small and Medium Sized Enterprises
Solvency 1	Directives 2002/12/EC and 2002/13/EC
SSNIP	Small but Significant Non-transitory Increase in Price

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