



Competition Issues in the Non-Life Insurance Market

Final Report & Recommendations (March 2005)

EXECUTIVE SUMMARY

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 than 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 may be 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:

1. Reduced switching costs for non-life insurance markets;
2. Lowering entry barriers for non-life insurance markets;
3. Reducing legal barriers to entry for non-life insurance markets; and,
4. 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?** *IFRSA 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?** *IFRSA 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?** *IFRSA 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 IFRSA 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 uncertainty 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 these 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?** *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).* 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.