THE EUROPEAN COMMISSION ADOPTS THE NEW INSURANCE BLOCK EXEMPTION REGULATION

On 24 March 2010, the European Commission (Commission) adopted its new insurance Block Exemption Regulation (BER).[1] It covers two types of cooperation: (1) compiling information and conducting studies for the purpose of enabling each insurer to accurately calculate the average cost of covering a specific risk; and (2) pooling of capacity in order to provide co-insurance or co-reinsurance cover for a specific risk.

When a particular type of cooperation is covered by a BER, it means that the Commission *assumes* that the cooperation does not raise antitrust concerns. This is because it fulfills the conditions set forth in Art. 101-3 TFEU, namely that it creates certain efficiencies; that there is no less restrictive alternative to achieve these efficiencies; that consumers benefit—at least in part—from these efficiencies; and that the cooperation does not substantially restrict the process of rivalry between competitors. In effect, the BER relieves companies participating in the cooperation from the burden of proof in this regard (cf. Art. 2 of Regulation n°1/2003).

The new insurance BER will be valid for seven years. If one compares this BER with its predecessors from 1993 and 2003, it introduces three remarkable changes. First, it no longer covers agreements regarding standard policy conditions, nor does it cover agreements regarding technical specifications for security devices (e.g., for fire alarm or theft prevention) or approval for installers of such devices. Second, the Commission tightens somewhat the conditions under which cooperation aimed at facilitating the calculation of the cost of coverage for a given risk can be block exempted. Third, it adopts a more economic approach towards co-insurance and co-reinsurance pools.

Let us review each of these changes in turn.

1. THE NARROWER SCOPE OF THE BER

In recent years, the Commission has systematically examined whether it made sense to maintain its BERs in other sectors because of the alleged sector-specific features of the agreements (e.g. cars, air transport, maritime transport). The trend is to either repeal these block exemptions or narrow their scope.

In its 2009 report on the functioning of the BER, the Commission had already tentatively concluded that neither the setting of standard policy conditions, nor the setting of technical specifications for security devices (or approval conditions

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for installers and maintenance service providers) were sector-specific. According to the Commission, the former exist in other sectors (e.g. banking) while the latter fall into the general domain of standard setting.[2]

In a Communication that accompanies the new BER, the Commission confirms this conclusion.[3] With regard to the security devices, it adds that the existing BER had lost most of its *raison d'être* anyway because insurers were entitled to set specifications *only* in so far as the European Union had not already regulated the matter. Those days are now largely over since "harmonization is now extensive".[4]

However, in order to address concerns about loss of legal certainty caused by the withdrawal of the BER, the Commission promises to give further guidance on the legality of these two types of cooperation in the revised version of its 2000 Guidelines on horizontal restraints. It plans to publish a draft of this version for "stakeholder consultation during the first half of 2010".[5]

The Commission has, however, expressed some antitrust concerns about each type of agreement.

With regard to the setting of insurance policy conditions, it notes that "whilst there is a need for comparability between insurance products for consumers, too much standardization can be harmful for consumers and can lead to a lack of non-price competition.[6]

As for the few cases in which technical specifications for security devices (and approval criteria for installers or maintenance service providers) have not yet been harmonized by the European Union, the Commission observes that usually different sets of specifications exist in each Member State. This leads to (undesirable) "fragmentation of the internal market" and to "less consumer choice" (since consumers cannot obtain insurance coverage for security devices that do not meet the specifications or approval criteria agreed upon by the insurers.[7]

2 Points 14 and 30 of Report COM (2009) 138 final of 24 March, 2009.

3 Points 22 and 26 of Communication COM (2010) 100/3 of 24 March, 2010.

4 *Id.*, point 27.

5 *Id.*, points 24 and 26.

6 *Id.*, point 23.

7 *Id.*, point 27.

A particular type of agreement that is not—or no longer—covered by a BER may still meet the four conditions of Art. 101-3 TFEU, but the companies that have entered the agreement will bear the burden of proving that it does (see above).

2. JOINT COMPILATIONS, TABLES AND STUDIES

The BER remains available for insurers who enter into cooperation agreements in order to accurately assess the cost of coverage for a given risk. However, the new BER will be less generous than its predecessors. Whereas the past BERs allowed insurers to jointly calculate the net premium, the new BER only allows them to collect the statistical data concerning the frequency and scope of claims and requires each insurer to calculate its own net premium on that basis.[8]

This requires a few words of explanation.

A *gross* (or commercial) premium is the end price which an insurer charges the insured for the insurance product. This price includes a *risk* premium which covers the cost of the insured product, (sometimes) a security charge, overheads (such as distribution cost, company tax, etc.), and profit. The *risk* premium itself is composed of two elements: on the one hand, the *net* premium which aims at covering the cost of the insured product based on statistical evidence concerning the past (frequency and scale of claims) and, on the other hand, a component which adjusts the net premium either upwards or downwards as it incorporates the results of studies concerning the future (i.e., general circumstances likely to materialize and to have an impact on the frequency or scale of claims). Insurers add a security charge when their portfolio is not large enough to guarantee that the risk premiums will be high enough to cover the losses resulting from claims.

The Commission recognizes that, since "the costs of insurance products are unknown at the time the price is agreed and the risk covered" and "calculation of risk is a key issue in pricing all insurance products", "access to past statistical data in order to technically price risks [is] crucial".[9] Art. 2 (a) and (b) of the new BER therefore allow, in principle, insurers to engage in an exchange of

8 Art. 2 (a) of the BER.

9 *Id.*, point 8.

statistical evidence concerning the frequency and scope of past claims related to a given risk (which is relevant to determine the level of the net premium) and to jointly conduct studies concerning the likely evolvement of that risk in future (which is relevant for the cost component that determines, in combination with the net premium, the level of the risk premium). In other words, the BER no longer covers the joint calculation of the net premium (i.e., the first cost component of the risk premium) but only the "joint compilation" of the statistical data that serve as a basis for its calculation.

This narrows the scope of the BER. The previous BERs indeed covered the joint setting of net premiums—building on legal precedent established in *Nuovo Cegam* and *Concordato Incendio* concerning recommendations issued by national insurance associations on net premiums.[10]

Moreover, in order to guarantee the pro-competitive nature of the joint compilation of statistical data regarding a given risk, the Commission requires that these data be available on fair and reasonable terms not only to insurers who are potential new entrants in the relevant product and/or geographic market but also to consumer or customer organizations.[11]

3. COMMON COVERAGE OF CERTAIN TYPES OF RISKS

The common coverage of certain types of risks refers to two distinct commercial practices: co-insurance and re-insurance.

In co-insurance cases the insured finds himself confronted with several insurance companies who are each partly responsible for the cover of the risk. These companies are not jointly responsible to him. They each cover a part of the risk for their own account. A leading underwriter will set the gross premium and the terms of the insurance contract. The other insurers will be "followers" in that they will subscribe to these conditions. Insurers can give their co-insurance arrangements an institutionalized form by setting up a group which underwrites in their name and for their account the insurance of all future risks of a particular kind.

10 Cf. respectively O.J. 1984 L 99/29 and O.J. 1989 15/25

11 Art. 3-2 (d) and (e) of the BER.

In re-insurance cases, only one insurer is responsible for the entire cover of a particular risk, but it will cede all or part of the risk to one or more other insurers for reinsurance purposes. The insurer (cedent) will have to collect the reinsurers' contributions to the cover of losses once these have occurred. As in the case of co-insurance, the insurers may want to institutionalize their re-insurance arrangement by setting up a co-reinsurance group.

Ad-hoc co-insurance and reinsurance arrangements outside a formal pooling group are expressly excluded from the scope of application of the BER (Art. 1-4). In its Communication, the Commission observes that these arrangements "may be a less restrictive option depending on the analysis on a case-by-case basis".[12]

In one of the introductory recitals of its BER, the Commission recognizes that co-insurance or co-reinsurance pools "can, in certain limited circumstances, be *necessary* to allow the participating undertakings of a pool to provide insurance or reinsurance for risks for which they might only offer insufficient cover in the absence of the pool" (italics added). The Commission already recognized this in 2003. However, it now explicitly adds that in such circumstances, the pools "do not generally give rise to a restriction of competition under Article 101-1 of the Treaty".[13] In other words, irrespective of the pool's market share, it falls outside the scope of Art. 101 if it can be shown that in the absence of the pool, there would be no coverage at all for the risk in question.

There is a legal precedent for this statement. In *P&I Clubs*, the Commission concluded that neither Art. 101 TFEU, nor Art. 102 TFEU—which prohibits individual or collective abuse of dominance—were applicable to a complex claim-sharing arrangement pursuant to which the Clubs had offered their member shipowners a minimum level of cover of US$4.25 billion for their contractual and third party liabilities.[14] It did so because a market enquiry had shown that this arrangement was necessary to allow the participating Clubs to provide that level of cover. More specifically, the fact that the

12 Cf. footnote 7.

13 Recital 13. In its 2009 Report, the Commission had already noted that "many pools do not consider this possibility in their analysis and mistakenly argue that they require the BER for legal certainty reasons whereas in fact they are likely to be outside its scope" (point 20).

14 O.J. 1999 L125/12.

Clubs held a combined share of almost 90 percent of the relevant market did not stand in the way of antitrust clearance because the market enquiry had shown that insurers needed at least a 50 percent market share to offer cover above US$3 billion.

In the BER itself, the Commission maintains the distinction between pools that cover new risks, which are block exempted for a period of three years from the date of the first establishment of the pool regardless of the pool's market share (Art. 6-1), and other pools, which are block exempted on condition that the combined market share of the pool participants does not exceed a certain percentage (Art. 6-2). However, the BER also introduces two novelties.

First, it broadens the definition of "new risks" to include not only risks that did not previously exist, but also "in exceptional cases, risks the nature of which has, on the basis of an objective analysis, changed so materially that it is not possible to know in advance what subscription capacity is necessary in order to cover such a risk" (Art. 1-6). The dividing line between existing risks that have dramatically changed and are therefore "new" under the BER and "ordinary" existing risks may be a thin one. Risks relating to the development or diffusion of new technologies, such as new energy sources, may be a new risk. Existing risks, such as drought or flooding, may have materially changed due the climate change and may therefore exceptionally be recognized as new risks. Conversely, risks of terrorism may have become normal risks today.

Second, while the market share ceilings for the applicability of the BER to co-insurance pools (i.e., 20 percent) or to co-reinsurance pools (i.e., 25 percent) remain unchanged, the Commission now indicates that the market shares of the participating undertakings must include gross premium income they have earned not only *within* the pool but also in *other* pools or independently *outside* any pool on the same product and geographic market (Art. 6-3).

Incidentally, the reference to turnover generated by insurers in other pools obviously means that insurers can simultaneously participate in several pools—something they were not allowed to do under the previous BER if they exercised "a determining influence on the commercial policy of the group" in one or more of these pools.[15]

15 Cf. Art. 8 (g) of Regulation n° 358/2003 of 27 February 2003, *O.J. L 53/8.*

CONCLUSION

The insurance BER is one of the few sector-specific block exemptions that will remain in place, but the Commission has now narrowed its scope to limit it to just two forms of cooperation that raise sector-specific antitrust issues.

As to the first form of cooperation (compiling statistical data and conducting studies), the Commission has even adopted a stricter approach by limiting the scope of the BER to the joint collection of information necessary to assess the frequency and the scope of the risk concerned—thereby excluding the joint calculation of net premiums based on such information.

As for the second form of cooperation (co-insurance and co-reinsurance pools), the Commission has somewhat softened its approach by broadening the concept of *new* risks. This may bring more pools within the scope of the BER, regardless of their market share. On the other hand, the market share ceilings for the block exemption of pools covering *existing* risks have been tightened somewhat. However, the most important point is probably to be found in one of the BER's introductory recitals, namely that pools that are truly indispensible for the coverage of an existing risk fall entirely outside the scope of Art. 101-1 TFEU and therefore require no block exemption.

If you would like more information on Arnold & Porter or the Commission's new insurance block exemption regulation, please feel free to contact:

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