

COMPETITION ACT 1998

DECISION OF THE DIRECTOR GENERAL OF FAIR TRADING PURSUANT TO SECTION 14(2) No CA98/1/2001

24 JANUARY 2001

NOTIFICATION BY THE GENERAL INSURANCE STANDARDS COUNCIL ("GISC")

Relating to a finding by the Director General of Fair Trading (the "Director") that the rules notified by GISC to the Director for a decision under Section 14 of the Competition Act 1998 (the "Act") do not infringe the prohibition imposed by Section 2 of the Act (the "Chapter I prohibition").

I INTRODUCTION

1. This decision relates to GISC's rules dated June 2000 and later amended on 15 June 2000 and 24 October 2000¹ (the "Rules").
2. On 30 June 2000, GISC notified its Rules to the Director for a decision on the application of the Chapter I prohibition imposed by Section 2 of the Act, requesting confirmation that the Rules do not infringe the Chapter I prohibition or that, in the alternative, the Director grant the Rules an individual exemption under Section 4 of the Act.
3. A summary of the notification was placed on the Office of Fair Trading's (the "Office's") public register and was published in the Office's Weekly Gazette². An advertisement was placed in the Office's Weekly Gazette³ and 'Post Magazine and Insurance Week' requesting third parties to comment on the notified Rules.
4. This decision is issued under the Act in accordance with Rule 15 of The Competition Act 1998 (Director's rules) Order 2000⁴ (the "Director's rules"). It states the facts on which the Director relies and his reasons for the decision⁵.

II THE FACTS

A THE PARTIES

5. GISC is a self-regulatory body for the general insurance industry and was established to create a harmonised set of standards for those engaging in

¹ See further paragraph 13.

² Issue 21/2000, 15 – 21 July 2000.

³ Issue 35/2000, 21 – 27 October 2000.

⁴ SI 2000 No 293.

⁵ Rule 15(1), Director's rules.

general insurance activities from a permanent place of business in the United Kingdom (“UK”) (and, to a limited extent, qualifying entities outside the UK). GISC is established as a company limited by guarantee.

6. Currently, it is not intended that general insurance will fall within the statutory jurisdiction of the Financial Services Authority on the coming into force of the Financial Services and Markets Act 2000. It is in this context that GISC has been developed from within the industry as a self-regulatory body.
7. GISC began accepting members and its Rules came into effect on 3 July 2000.
8. GISC has requested a decision on the basis that it will regulate the whole of the general insurance community in the UK and estimates that there are up to 16,000 eligible members⁶. The main categories of entities under the existing regulatory framework for general insurance which are eligible to become members of GISC are insurers; Lloyd’s brokers⁷; registered brokers⁸; independent intermediaries⁹ and company agents¹⁰ (which categories may include retail outlets selling general insurance).
9. Membership of GISC is currently voluntary. In the course of 2001, however, GISC intends to bring into force Rule F42. Rule F42 will prohibit members of GISC from carrying on general insurance activities with any intermediary which is not operating within the GISC regime¹¹.

B. THE NOTIFICATION

10. The Rules apply to members of GISC. The Rules also apply indirectly to appointed agents and appointed sub-agents who, although not members of GISC, are regulated through the appointed agent and appointed sub-agent agreements that they enter into with members¹².
11. Activities that are regulated by GISC are selling, advising, broking and any other activity which, when engaged in in connection with a general insurance product, is regulated by the General Insurance Code for Private Customers or the Commercial Code contained in the Rules. These activities are regulated if they are carried on from a permanent place of business in the UK in connection with one or more general insurance products. General insurance

⁶ GISC originally estimated that there were up to 30,000 members. GISC has said that the uncertainty in the size of the community that it may regulate is due to the lack of data concerning the number of firms selling general insurance in the UK and that the revision does not reflect any conclusion that significant sectors currently selling general insurance will cease to do so under the GISC regime.

⁷ Lloyd’s brokers are authorised to deal direct with Lloyd’s underwriters on behalf of clients.

⁸ Registered brokers are registered with and satisfy the requirements of the Insurance Brokers’ Registration Council under the Insurance Brokers (Registration) Act 1977.

⁹ Independent intermediaries operating under the Association of British Insurers’ (“ABI”) General Insurance Business Code of Practice act on behalf of prospective policyholders.

¹⁰ Company agents operating under the ABI’s General Insurance Business Code of Practice are employees or agents of up to six companies selling general insurance products, which accept responsibility for them.

¹¹ See further paragraph 14.

¹² See further paragraph 34.

products are the general insurance contracts listed in Schedule 2 to the Insurance Companies Act 1982 and include relevant contracts of reinsurance and retrocession. The classes of general insurance business include accident; sickness; land vehicles; railway rolling stock; aircraft; ships; goods in transit; fire and natural forces; damage to property; motor vehicle liability; aircraft liability; liability of ships; general liability; credit; suretyship; miscellaneous financial loss; legal expenses; and assistance.

12. The Rules contain a General Insurance Code for Private Customers and a Commercial Code. In addition, the Rules contain provisions regarding E-commerce; membership; membership practice requirements; monitoring and investigation; enforcement; and intervention. The membership practice requirements include financial requirements (provisions regarding insurance money segregation, professional indemnity insurance and solvency); complaints handling; and competence and training.
13. The Rules were amended on 15 June 2000 to incorporate Rule F42 and related amendments. In addition, by press release of 24 October 2000, GISC announced changes to the footnote to Rules G24 and G25 relating to solvency. Both of these revisions constitute material changes in the information contained in the application, in accordance with Rule 4(4) of the Director's rules. The Director's decision relates to the Rules as amended.
14. The operation of Rule F42 is currently suspended. Once in force, Rule F42 will require that, subject to any relevant Rule waiver by GISC, members of GISC shall not and shall ensure that their appointed agents and appointed sub-agents shall not, in the course of their general insurance activities conducted from a permanent place of business in the UK, deal directly with any person in circumstances which would involve that person engaging in general insurance activities as an intermediary (from their UK offices), where that person is not a member¹³.

III LEGAL AND ECONOMIC ASSESSMENT

A INTRODUCTION

15. Section 2(1) of the Act provides that agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the UK and have as their object or effect the prevention, restriction or distortion of competition within the UK, are prohibited unless they are exempt in accordance with the provisions of Part I of the Act. For these purposes, "the UK" means the UK or any part of it¹⁴.
16. Section 60(1) of the Act sets out the principle that, so far as is possible (having regard to any relevant differences between the provisions concerned), questions arising under Part I of the Act in relation to competition within the

¹³ GISC's Rules define the scope of each term (member, appointed agent and appointed sub-agent, general insurance activities and intermediary).

¹⁴ Section 2(7), Act.

UK are dealt with in a manner which is consistent with the treatment of corresponding questions arising in European Community law in relation to competition within the Community. In particular, under Section 60(2) of the Act, the Director must act (so far as is compatible with the provisions of the Act) with a view to securing that there is no inconsistency with the principles laid down by the EC Treaty and the European Court and any relevant decision of the European Court¹⁵. Under Section 60(3) of the Act, the Director must also have regard to any relevant decision or statement of the European Commission.

B THE RELEVANT MARKET

(a) The relevant product market

17. The relevant product market comprises all those products which are regarded as reasonably interchangeable by reason of the product's characteristics, price or intended purpose¹⁶.
18. The regulatory scope of GISC is the conduct of general insurance activities by insurers and intermediaries from a permanent place of business in the UK. GISC has submitted that there are three relevant product markets for the purposes of its notification: (i) general insurance; (ii) reinsurance, which includes the provision of retrocession services¹⁷; and (iii) the provision of advisory, broking and related services for general insurance products (the provision of intermediary services).
19. The Rules will apply to undertakings engaged in general insurance activities. The Director considers that, in these circumstances, it is the activities of these undertakings that are relevant to the determination of the relevant product market. The Director's analysis has been of the impact of GISC's Rules on the entirety of the general insurance community that GISC intends to regulate.
20. It has not been necessary for the Director to come to a final view as to whether the relevant product markets are narrower than those proposed by GISC given the Director's conclusions below on whether the Rules prevent, restrict or distort competition within the meaning of Section 2 of the Act.

(b) The relevant geographic market

21. The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of

¹⁵ The European Court is defined as the Court of Justice of the European Communities and includes the Court of First Instance (Section 59(1), Act).

¹⁶ Case 27/76 *United Brands Co. and United Brands Continental BV v Commission* [1978] 1 CMLR 429; see also Case 85/76 *Hoffmann-La Roche & Co. AG v Commission* [1979] 3 CMLR 211.

¹⁷ When a risk has been reinsured, retrocession is the further agreement between the reinsurer and another insurer or reinsurer to accept all or part of the risk.

competition are appreciably different in those areas¹⁸.

22. GISC has submitted that the relevant geographic markets for general insurance and intermediary services are national and that the relevant geographic market for reinsurance is global.
23. GISC intends to regulate the provision of general insurance products throughout the UK in a uniform way. It has not been necessary for the Director to come to a final view as to whether the relevant geographic markets are narrower than those proposed by GISC given the Director's conclusions below on whether the Rules prevent, restrict or distort competition within the meaning of Section 2 of the Act.

C. AGREEMENTS BETWEEN UNDERTAKINGS, DECISIONS BY AN ASSOCIATION OF UNDERTAKINGS AND CONCERTED PRACTICES

24. GISC is an association of undertakings. GISC's adoption of the Rules is a decision of an association of undertakings for the purposes of Section 2 of the Act. The Rules may also be characterised as an agreement or concerted practice between the members of GISC who are undertakings for the purposes of Section 2 of the Act.

D. EFFECT ON TRADE WITHIN THE UK

25. GISC intends to regulate the whole of the general insurance community in the UK. The Rules will therefore affect trade within the UK within the meaning of Section 2 of the Act.

E. THE PREVENTION, RESTRICTION OR DISTORTION OF COMPETITION IN THE UK

26. The Director has considered whether any of the Rules notified by GISC, by themselves or in combination with the other Rules, have as their object or effect an appreciable prevention, restriction or distortion of competition within the UK for the purposes of the Chapter I prohibition¹⁹.
27. As part of this analysis, the Director has considered whether the Rules:
 - (i) impose or increase barriers preventing entry into or continued operation in the general insurance industry;
 - (ii) reduce or distort competition between insurers, between intermediaries or between insurers and intermediaries; or

¹⁸ Case 27/76 *United Brands Co. and United Brands Continental BV v Commission* [1978] 1 CMLR 429.

¹⁹ Paragraph 2.18, The Chapter I Prohibition (OFT 401, March 1999).

(iii) result in the exchange of price or non-price information²⁰.

28. In this context, the Director's analysis of the Rules has included consideration of the membership procedures and fees; the enforcement and intervention procedures; the financial requirements (segregation of monies, professional indemnity insurance and solvency); the commission and status disclosure requirements in the General Insurance Code for Private Customers and the Commercial Code; the confidentiality of commercially sensitive information; and Rule F42.
29. The Director has decided that none of the Rules notified by GISC, by themselves or in combination with the other Rules, have as their object or effect an appreciable prevention, restriction or distortion of competition within the UK for the purposes of the Chapter I prohibition. The Rules are aimed at ensuring that members of GISC are competent to carry on general insurance activities and that there are safeguards in place to protect consumers. In order to achieve these necessary protections, the Rules impose standards which members must meet and procedures for enforcing them. To be effective, a self-regulatory framework of this nature will necessarily act as a control, to ensure competence and consumer protection, on the undertakings that operate in the relevant market. It does not follow from this that such a framework will, therefore, result in an appreciable prevention, restriction or distortion of competition. Indeed, in this case the Director is satisfied that the consumer benefits flowing from the Rules will not be undermined in this way. The Rules do not impose significant barriers to operating in the general insurance industry as the requirements and costs of compliance appear to be reasonable and will not result in an appreciable reduction or distortion in the overall level of competition. To be sure, the Rules impede businesses that lack competence or that operate in ways that jeopardise consumers. But that is not anti-competitive. Indeed, it may be positively pro-competitive as between the competent businesses that have proper safeguards in place to protect consumers.
30. The Director considers that the terms of membership and the membership application, enforcement and intervention procedures in GISC's Rules are transparent, non-discriminatory and based on objective standards. GISC's membership fees do not operate as a barrier preventing entry into or continued operation in the general insurance industry for the purposes of Section 2 of the Act²¹. The Rules contain a clear description of the membership application, enforcement and intervention procedures that GISC will operate, under which GISC must provide reasons for its decisions and which include an appeals procedure.

²⁰ *EPI Code of Conduct* [1999] OJ L106/14, *London Sugar Futures Market Limited* [1985] OJ L369/25, *The London Grain Futures Market* [1987] L19/22, *London Cocoa Terminal Market Association Limited* [1985] OJ L369/28 and *Coffee Terminal Market Association of London Limited* [1985] OJ L369/31.

²¹ Annual membership fees are based on a percentage of members' revenue and are subject to a minimum of £200 and a maximum of £100,000.

31. The financial requirements in the Rules are transparent, non-discriminatory and based on objective standards. The exceptions to the financial requirements that are provided for in the Rules seek to make the application of the Rules proportionate to particular sectors and reflect the size and diversity of the general insurance community that GISC intends to regulate through its Rules.
32. The Director has not identified any provisions in the General Insurance Code for Private Customers or the Commercial Code which have as their object or effect an appreciable prevention, restriction or distortion of competition within the meaning of the Chapter I prohibition. In particular, the provisions in the Codes (and the Rules more generally) do not introduce artificial regulatory barriers in the number of insurers with whom an intermediary may do business or vice versa. The Director does not have any evidence to suggest that the Rules will result in the exchange of commercially sensitive information between those regulated by GISC which may raise concerns under the Chapter I prohibition.
33. The Director has considered the impact that Rule F42 will have on intermediaries (who will be subject to a form of compulsory regulation as a result of the Rule) and on members (who will be restricted in the intermediaries with whom they may carry on general insurance business), once it has come into force²².
34. Rule F42 is the means by which GISC will try to achieve its objectives and establishes a common regulatory framework for intermediaries, who will have to comply with GISC's Rules whether they choose to join GISC as full members or are regulated as appointed agents or appointed sub-agents via their relationships with members. Rule F42 does not require that all intermediaries become full members of GISC. The definition of intermediary in the Rules excludes, among others, appointed agents and appointed sub-agents. This section of the general insurance community is regulated through a principal member of GISC, with whom they have entered into an appointed agent or appointed sub-agent agreement. The principal will accept responsibility for their appointed agents' and appointed sub-agents' compliance with the Rules.
35. Rule F42 will prevent members of GISC and their appointed agents and appointed sub-agents from carrying on general insurance business with UK intermediaries who are not members of GISC. The Director does not have any indication that this Rule will result in significant numbers of intermediaries exiting from the market such that competition in the market will be reduced appreciably. Furthermore, it is open to members to enter into appointed agent and appointed sub-agent agreements to allow them to continue to do business with intermediaries who choose not to become GISC members. The Director has therefore concluded that Rule F42 will not give rise to an appreciable restriction or distortion of competition.

²² See further paragraph 14.

IV NON-INFRINGEMENT

36. On the basis of the facts and for the reasons set out above, the Director has decided pursuant to Section 14(2) of the Act that the Rules notified by GISC do not infringe the prohibition imposed by Section 2 of the Act.
37. This decision is given pursuant to Section 14(2) of the Act and constitutes a decision for the purposes of Section 16(1) of the Act.

John Vickers
Director General of Fair Trading