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Competition Act 1998

Decision of the Director General of Fair Trading  
No CA98/16/2002

General Insurance Standards Council

13 November 2002  
(Case CA98/01071/00)

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## **SUMMARY**

The Director General of Fair Trading (the Director) has concluded that GISC's rules (the Rules) do not infringe the prohibition imposed by Section 2(1) (the Chapter I prohibition) of the Competition Act 1998 (the Act).

This decision follows a judgment of the Competition Commission Appeal Tribunal (the CCAT) in September 2001 which set aside a previous non-infringement decision by the Director. The CCAT found that the Rules, in particular Rule F42, which required GISC members to deal only with intermediaries who were also regulated by GISC, had the object and effect of restricting competition to an appreciable extent in breach of the Chapter I prohibition. Subsequently GISC dropped Rule F42 and, as a result, the Director has now concluded that the remaining Rules no longer infringe the Chapter I prohibition.

# I THE FACTS

## Background

- 1 On 24 January 2001 the Director made a decision that the Rules, notified to him on 30 June 2000 by GISC, did not infringe the Chapter I prohibition (the non-infringement decision).<sup>1</sup>
- 2 Following an appeal by the Institute of Independent Insurance Brokers (the IIB) and the Association of British Travel Agents (ABTA), the CCAT on 17 September 2001 set aside the non-infringement decision, deciding that the Rules fell within the Chapter I prohibition, by virtue of Rule F42.<sup>2</sup> The CCAT remitted to the Director certain other issues relating to the Rules.
- 3 On 12 December 2001, HM Treasury announced its intention to make general insurance subject to statutory regulation, under the auspices of the Financial Services Authority. GISC announced on 14 December 2001 that it would not implement Rule F42 and that Rule F42 was no longer part of the Rules.

## The parties

- 4 GISC is a private company limited by guarantee which was launched in 2000 to provide a self-regulatory regime for the selling, advising on and brokering of general insurance in the UK. General insurance was not subject to statutory regulation in the UK at the time of notification of the Rules and that remains the case at the date of this decision.
- 5 Membership of GISC is open to persons engaged in general insurance activities from a permanent place of business in the UK (and, to a limited extent, qualifying entities outside the UK). At present, GISC has 6,404 members.

## The Rules

- 6 Members enter into a membership contract with GISC, which incorporates the Rules. The Rules include provisions relating to membership and professional standards for members (such as training, complaint handling, client money and solvency requirements).

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<sup>1</sup> Decision CA98/1/2001. Since notification to the Director, the Rules have been amended twice: on 24 October 2000 and 1 December 2001.

<sup>2</sup> *The Institute of Independent Insurance Brokers and Association of British Travel Agents v Director General of Fair Trading*, judgment of 17 September 2001. The CCAT also set aside decisions of the Director rejecting applications made to him by the IIB and ABTA under section 47 of the Act.

7 As noted at paragraph 3 above, Rule F42 is no longer part of the Rules.

## **II LEGAL AND ECONOMIC ASSESSMENT**

### **Introduction**

8 Under section 2(1) of the Act, 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 appreciable prevention, restriction or distortion of competition within the UK, are prohibited (the Chapter I prohibition) unless they are exempt in accordance with the provisions of Part I of the Act.

### **The relevant market**

9 There may be a number of relevant markets in relation to the sale of general insurance products. However, since the Director considers that even adopting the perspective of the narrowest market definition, the Rules do not infringe the Chapter I prohibition, it is unnecessary for him to reach a conclusion on the relevant market for the purposes of this decision.

10 In its ruling of 17 September 2001, the CCAT held that there is also a market for the provision of regulatory or certification services in the general insurance sector.

### **Agreements between undertakings, decisions by associations of undertakings and concerted practices**

11 GISC is an association of undertakings. The Rules are therefore a decision by an association of undertakings for the purposes of the Chapter I prohibition. For the purposes of the Chapter I prohibition, the Rules are also an agreement between the undertakings who are members.

### **Effect on trade within the UK**

12 The regulatory scope of GISC is its members' general insurance activities in the UK. The Rules therefore affect trade within the UK within the meaning of section 2 of the Act.

### **The prevention, restriction or distortion of competition in the UK**

- 13 The CCAT found that a number of the Rules actually or potentially restricted or distorted competition to an appreciable extent in breach of the Chapter I prohibition. It is useful to set out these findings before assessing the extent to which they are affected by the removal of Rule F42.
- 14 In addition, third parties (notably IIB and ABTA) have identified other aspects of the Rules, which, they contend, distort competition.

**(a) The findings of the CCAT**

***Rule F42***

- 15 Rule F42 provided that:

*'subject to any Rule waiver issued by GISC, Members shall not, and shall ensure that their Appointed Agents and Appointed Sub-Agents shall not, in the course of their General Insurance Activities, deal directly with any person in circumstances which would involve that person in engaging in General Insurance Activities as an Intermediary where that person is not a Member'.*

- 16 The CCAT found that Rule F42:

- limited the freedom of the insurer Members of GISC to deal with whom they pleased;
- represented a significant fetter on the competitive freedom of intermediaries by forcing them to join GISC and become subject to its mandatory rules; and
- created a monopoly in the regulation of the general insurance industry which potentially eliminated alternative forms of self-regulation and thereby restricted or distorted competition between the independent broking sector on the one hand and the tied agents and direct sales arms of insurers on the other.

- 17 By virtue of the first of these two findings, the CCAT concluded that Rule F42 was *'intrinsically a restriction on competition for the purposes of Article 81(1) of the EC Treaty, quite irrespective of whether or not the mandatory rules which it supports are in themselves anti-competitive or whether the GISC Rules serve some wider public interest'*.<sup>3</sup> It was satisfied that the restriction was appreciable on the grounds that it applied to the vast majority of insurers and intermediaries active in the general insurance industry.

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<sup>3</sup> Paragraph 214 of the CCAT's judgment.

- 18 In relation to the last finding, the CCAT remitted to the Director the question of whether the creation of GISC as the only regulator of the general insurance sector had the restrictive effects it envisaged as possible.

***Rule F24***

- 19 This rule provides that:

*'Insurers may not appoint an Independent Intermediary as an Appointed Agent or permit an Independent Intermediary to be appointed as their Appointed Sub-Agent for the purposes of offering or selling their General Insurance Products.*

*An Independent Intermediary may only be appointed as an Appointed Agent or Appointed Sub-Agent of one Intermediary'.*

Under the Rules, an 'independent intermediary' is '*an intermediary who, in respect of any product type, offers or sells the products of more than one insurer*'.<sup>4</sup> A 'product type' is defined as '*any category of products which are competing or substitutable for one another*'.

- 20 The CCAT found that the effect of these provisions was that an intermediary, which opted to be an appointed agent or appointed sub-agent of an insurer, rather than join GISC in its own right, could not deal with another insurer in relation to products of the same product type. Similarly, an intermediary which became the appointed agent or appointed sub-agent of another intermediary was prevented from dealing with any other intermediary. Accordingly, an independent intermediary which chose to accept agency status rather than joining GISC would lose the ability to shop around and find the best deal in the market for its client and would therefore lose the essence of its independence.
- 21 The CCAT went on to find that these provisions in conjunction with Rule F42 had the potential to lead to a substantial shift in the structure of the market with a move away from independent intermediaries, free to deal with whomsoever they wish, towards a system of tied agency arrangements. It considered that this was potentially a significant distortion of competition and remitted the matter to the Director for further consideration.

***Rule F34***

- 22 This rule provides that '*where a Member decides to resign from membership it must ensure that any General Insurance Activities which are outstanding are*

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<sup>4</sup> Section B-Definitions of the Rules.

*properly completed or responsibility for compliance with the Rules in respect of the resigning member's Customers is accepted by another member prior to resignation*'.

- 23 The CCAT considered that the phrase 'properly completed' in Rule F34 was unclear. However, it went on to find that the effect of the rule '*would seem to make it effectively impossible for GISC Members to leave the association without either discontinuing business altogether or ceding its business to another GISC Member*'.<sup>5</sup> Accordingly, it concluded that the restrictive effects of Rule F42 appeared to be significantly reinforced by the provision.

#### ***Other issues***

- 24 Third parties, notably ABTA and IIB, have also argued that the following aspects of the Rules are discriminatory and therefore distort competition:
- rules in relation to the segregation of monies and the disclosure of charges; and
  - the GISC membership fees.

#### **(b) Competition assessment of the Rules in the absence of Rule F42**

- 25 As is apparent from the above, the CCAT's findings as to the application of the Chapter I prohibition focussed essentially on the object and effect of Rule F42. In the absence of this rule, there is no longer any restriction as to whom insurer members may deal with. Hence, the incentive that this restriction created for intermediaries to join GISC disappears so that membership becomes a purely voluntary matter which they are free to determine independently on the basis of their commercial judgment. Furthermore, since, in the absence of Rule F42, the Rules are no longer of mandatory application across the general insurance industry, there are no grounds for concluding that they might establish GISC as the exclusive regulator of the general insurance sector.
- 26 Accordingly, on the basis that Rule F42 is not to be implemented, the Director is satisfied that the restrictions the CCAT identified as flowing directly from Rule F42 (and outlined in paragraph 17) fall away.
- 27 For the reasons set out below, the Director is also satisfied that the potentially restrictive effects found by the CCAT to arise from Rule F24 and Rule F34 will not occur in the absence of Rule F42.

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<sup>5</sup> Paragraph 190 of the CCAT's judgment.

### ***Rule F24 and Appointed Agent Status***

- 28 The Director considers that, without Rule F42, there is no reason for significant numbers of independent intermediaries to become appointed agents or sub agents within the scope of Rule F24. This is because, in the absence of Rule F42, insurers who are members of GISC will be free to deal with independent intermediaries who operate outside of GISC's regulatory regime.
- 29 Accordingly, on the basis that Rule F42 is not implemented, the Director is satisfied that the Rules will not lead to a substantial shift in the structure of the broking industry and therefore will not have a distortive effect on competition.

### ***Rule F34***

- 30 As noted earlier, the CCAT's concern was that Rule F34 appeared to make it impossible for members to leave GISC without discontinuing general insurance business or transferring such business to another GISC member. As the CCAT noted, the effect of such a rule would be to lock members into GISC so that no matter how onerous or inappropriate the Rule might be or become, members would be unable to escape. The Director accepts that if that was the effect of Rule F34, it would amount to a potential restriction or distortion of competition, even in the absence of Rule F42. However, for the reasons set out below, the Director is satisfied that Rule F34 does not have and is not likely to have such an effect.
- 31 GISC has recently published guidance on its website on how it applies the Rules relating to cessation of membership, including Rule F34. In relation to compliance with Rule F34, it has advised that, unless a resigning member is to transfer its outstanding business to another GISC member, it must confirm that any general insurance activities which are in progress at the time of resignation will be completed in accordance with the Rules thereafter. For example, if the member receives a complaint before the resignation, it will continue to handle it in accordance with the procedures laid down in the Rules even after the resignation takes effect. Provided such confirmation is forthcoming from the member in question at the time it tenders its resignation, and subject to completion of any ongoing investigations concerning possible misconduct or compliance breaches, GISC has advised that the resignation will take effect on expiry of the requisite notice period.
- 32 GISC has provided the Director with material relating to some of the 367 resignations that GISC has received since the CCAT's ruling. This shows that members have been able to resign from GISC without having to cede their business to another member or discontinue business altogether. Also, this

supports the proposition that GISC has been applying Rule F34 in accordance with its published guidance and that it has not operated as an impediment to members wishing to leave the association.

- 33 The Director considers that the uncertainty surrounding the meaning of 'properly completed' in Rule F34 which was identified by the CCAT in its judgment<sup>6</sup> has been clarified by the GISC guidance. In the light of that and the evidential material referred to, the Director is satisfied that Rule F34 no longer has the potential to prevent a member leaving GISC without discontinuing business altogether or ceding its business to another GISC member. Accordingly, the Director considers that Rule F34 does not in practice have the object or effect of appreciably restricting competition within the meaning of the Act.

### *Insurance monies segregation*

- 34 Under the Rules on financial requirements, intermediaries must segregate insurance monies received from or held on behalf of insurers or customers from their own and keep it in designated separate bank accounts. However, there are a number of circumstances in which the requirement to segregate insurance monies will not apply, including if:

- the activities of the intermediary are secondary to its main business activity; or
- the annual net brokerage of the intermediary is less than £5,000 and premiums handled are less than £50,000 per annum.<sup>7</sup>

- 35 The Director has received representations from some intermediaries alleging that: 1) the segregation of monies requirement will have a disproportionate impact on smaller undertakings and on those with a cyclical business, where cash flow may fluctuate during the course of the year; and 2) that the disapplication of the segregation requirement will distort competition in favour of those intermediaries whose general insurance activities are secondary to their main business activity.

- 36 The Director considers that, in the absence of Rule F42 and in the light of GISC's clarification of Rule F34, the above concerns are no longer relevant. Without Rule F42, membership of GISC is a voluntary matter, hence

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<sup>6</sup> See note 5 above.

<sup>7</sup> The following categories of intermediary are also excluded from the segregation requirement:

- *the intermediary is regulated by a recognised regulatory/ professional body approved by GISC, whose requirements provide an equivalent level of protection for insurance monies;*
- *the intermediary is a single or multi-tied agent; and*
- *the intermediary's general insurance activities are covered by agency agreements which ensure that insurance cover is maintained where payment has been received by the intermediary.*

intermediaries are under no compulsion to join GISC and subject themselves to the GISC insurance monies segregation regime if they consider it adversely affects their commercial interests. Also, existing members who feel that they may be disadvantaged by the requirement in question or by its disapplication are free to leave GISC.

- 37 In view of this, the Director concludes that even if the insurance monies segregation requirement has the effects alleged in paragraph 36 above (an issue on which the Director expresses no view), it does not amount to an appreciable restriction or distortion of competition in breach of the Chapter I prohibition.

### ***Disclosure of charges***

- 38 The GISC requirements on disclosure of costs and remuneration<sup>8</sup> provide for disclosure on request for commission (when the member acts on behalf on the client), but disclosure in all circumstances for 'any fees or charges'. The aim of these requirements is to ensure transparency of costs for consumers.
- 39 It has been argued that these provisions are discriminatory and not objective in that they only require the disclosure of commission on request but require disclosure in all circumstances for any fees or charges other than the insurance premium. Also, they allegedly put insurers who sell direct to the public at a competitive advantage *vis-à-vis* intermediaries, in that, unlike the latter, direct insurers will be able to 'hide' some of their fees and charges in the premium rather than disclosing them. As a result, the intermediary's prices may appear to the consumer to be higher, and hence less attractive, than those offered by the direct sale insurance company.
- 40 The Director considers that the above concerns are no longer relevant in the absence of Rule F42 and in view of GISC's clarification of Rule F34. Even if the disclosure requirement has the effects alleged in paragraph 40 above (an issue on which the Director expresses no view), it does not amount to an appreciable restriction or distortion of competition in breach of the Chapter I prohibition for the reasons set out in paragraph 37 above.

### ***Fees***

- 41 GISC membership fees are based on a percentage of members' revenue in their last complete financial year. The percentage and revenues used to calculate members' fees are different for insurers and intermediaries with insurers being charged 0.025 % of their gross premium income less commission paid and

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<sup>8</sup> Rule C3.4 in the GISC General Insurance Code for Private Customers and Rules D14 to 17 of the Commercial Code.

intermediaries charged 0.1% of net retained brokerage.<sup>9</sup> In both cases the fees will be at least £200 and no higher than £100,000.

- 42 It has been contended that, in view of the different percentages used to calculate the fees of insurers and intermediaries respectively, the fees provision discriminates in favour of insurers and thereby has the effect of distorting competition.
- 43 As above, the Director considers that this contention is no longer relevant. Even if the fees charged by GISC have the effects alleged in paragraph 43 above (an issue on which the Director expresses no view), they do not amount to an appreciable restriction or distortion of competition in breach of the Chapter I prohibition for the reasons set out in paragraph 37 above.

### **III DECISION**

- 44 On the basis of the facts and for the reasons set out above, the Director has decided, pursuant to section 14 of the Act that, absent Rule F42, the Rules notified by GISC, taken individually or collectively, do not infringe the Chapter I prohibition.

**John Vickers**  
**Director General of Fair Trading**

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<sup>9</sup> Net retained brokerage is the net amount retained by an intermediary of all brokerage, fees, commissions and other related income (e.g. administration charges, overrides, profit shares) due to the intermediary in respect of or in relation to general insurance activities.