Competition Act 1998

Decision of the Director General of Fair Trading
pursuant to section 47(4)

11 May 2001

Application by the Institute of Insurance Brokers ('IIB')
under section 47(1)

Non-confidential version

Relating to a finding by the Director General of Fair Trading (the 'Director') that the IIB has not shown sufficient reason why he should withdraw or vary his decision issued on 24 January 2001 with respect to the rules of the General Insurance Standards Council ('GISC')\(^1\) (the 'Decision').

I INTRODUCTION

1. On 30 June 2000, GISC notified its rules dated June 2000 and later amended on 15 June 2000 and 24 October 2000\(^2\) (the 'Rules'), to the Director for a decision under section 14 of the Competition Act 1998 (the 'Act'). GISC requested a decision that the Rules do not infringe the prohibition imposed by section 2 of the Act (the 'Chapter I prohibition') or that, in the alternative, the Director grant the Rules an individual exemption under section 4 of the Act.

2. On 24 January 2001, the Director issued his Decision that the Rules do not infringe the Chapter I prohibition.

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\(^1\) Decision CA98/1/2001.
\(^2\) paragraph 13, Decision.
3. On 22 February 2001, the IIB submitted an application pursuant to section 47(1) of the Act requesting that the Director withdraw or vary the Decision.

4. This decision is issued in accordance with section 47(4) of the Act.

II SUFFICIENT INTEREST IN THE DECISION

5. As required by section 47(3) of the Act, the Director has considered whether the applicant has sufficient interest to ask him to withdraw or vary the Decision. For these purposes, the applicant must have sufficient interest itself or must represent persons who have sufficient interest.

6. The Director is satisfied that the IIB has sufficient interest in the Decision to make an application under section 47(1) of the Act on the grounds that its members are insurance brokers, the activities of which will be regulated directly or indirectly by GISC in accordance with the Rules.

III THE IIB’S SUBMISSIONS WITH REGARD TO THE DECISION

7. The IIB asks the Director to withdraw or vary the Decision on the basis that the Director has incorrectly concluded that the Rules notified by GISC do not have as their object or effect the prevention, restriction or distortion of competition within the UK within the meaning of the Chapter I prohibition.

8. The IIB’s application relates to the following provisions of the Rules:

   - Rule F42, the substance of which is summarised at paragraph 14 of the Decision;
   - membership fees;
   - the segregation of monies; and
   - the granting of waivers to the Rules.

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3 section 47(3) Act.
4 paragraph 29, Decision.
A. Rule F42: competition to provide supervisory and other regulatory services

9. The IIB submits that it is in competition with GISC as a provider of supervisory and regulatory services and that GISC also faces competition from other regulatory associations. In the IIB’s view, the effect of Rule F42 is that its members and those of other regulatory associations will be forced to join GISC and, in these circumstances, they will be deterred from submitting to additional regulation from other bodies because of the costs involved.

10. The IIB has argued that the Decision is defective in that it has failed to analyse the impact of Rule F42 on competition between providers of supervisory and regulatory services.

B. Rule F42: competition between the regulated firms

11. The IIB submits that, as a result of Rule F42, independent intermediaries which do not join GISC will be driven out of business. The IIB has argued that by failing to address this point, the conclusion in the Decision that the Rules do not have an appreciable effect on competition is defective.

12. Further, the IIB has argued that membership of GISC will adversely affect the competitiveness of intermediaries because:

- changing regulatory regimes may impact on an intermediary’s ability to compete;
- the competitive advantage of belonging to a superior regulatory regime will either be lost or, if retained, will result in additional membership and compliance costs; and
- Rule F42 will work substantially to the advantage of GISC member networks.

C. Membership fees

13. The IIB submits that the Rules for calculating membership fees discriminate between insurers and intermediaries in that the percentage of revenue used to calculate members’ fees is different for insurers and intermediaries.\(^5\)

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\(^5\) For the year 3 July 2000 to 2 July 2001, annual membership fees for GISC are based on 0.1% of revenue for intermediaries and 0.025% of revenue for insurers, both subject
D. Segregation of monies

14. The IIB submits that the exception in the Rules from the requirement to segregate insurance monies for intermediaries who have obtained confirmation from GISC that their general insurance activities are secondary to their main business activity is discriminatory and anti-competitive. This exception will enable organisations for whom general insurance is a secondary activity to gain substantial competitive advantage through cashflow and working capital advantages.

E. Granting of waivers by GISC

15. The IIB submits that GISC’s ability to waive Rule F42 is wholly subjective and not susceptible to appeal. By failing to take account of this, the IIB considers that the Decision’s analysis of the effect on competition of Rule F42 is defective.

IV THE DIRECTOR’S DECISION WITH REGARD TO THE APPLICATION

16. The Director has considered whether the submissions made by the IIB in its application under section 47(1) of the Act show sufficient reason why he should withdraw or vary the Decision.

A. Rule F42: competition to provide supervisory and other regulatory services

17. As explained at paragraph 5 of the Decision, the Rules will apply to the activities of undertakings with a permanent place of business in the UK, operating in the general insurance market. The Decision therefore assessed whether the Rules would adversely affect competition within that market and did not address the question of whether the Rules could or were intended to affect competition within a market for supervisory and other regulatory services.

18. As noted at paragraph 29 of the Decision, 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. The Director considers that regulation of this nature is not an

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to a minimum membership fee of £200 and a maximum membership fee of £100,000 – see paragraph 7, Appendix 2, Rules.

Practice Requirement G1(18.2), Rules.
economic activity but is implemented in the wider public interest. The function of GISC is to consider, prepare and implement rules which regulate the economic activities of undertakings in the general insurance sector. In light of European case law, this does not constitute an economic activity. Furthermore, GISC does not itself carry out general insurance activities. Consequently, the Director has no grounds for believing that, in carrying out its regulatory functions under the Rules, GISC competes economically with the IIB or any other trade association or supervisory body. On this basis, the Director is of the view that, for the purposes of the Act, GISC is not an undertaking in its own right.

B Rule F42: competition between regulated firms

19. As noted at paragraph 25 of the Decision, GISC intends to regulate the whole of the general insurance community in the UK. Rule F42 is intended to achieve this since, once in force, it will bring into effect a form of compulsory regulation for intermediaries.

20. The Director concluded that a mandatory scheme of this nature would not infringe the Chapter I prohibition provided the agreement which establishes it does not, to an appreciable extent:
   − impose or increase barriers preventing entry into or continued operation in the general insurance industry; or
   − reduce or distort competition between insurers, between intermediaries or between insurers and intermediaries (for example, by resulting in the exchange of price or non-price information).

21. In the Decision, therefore, the Director considered whether the Rules would, individually or collectively, have any of these effects and was satisfied that they would not. He therefore concluded that Rule F42 will not give rise to an appreciable restriction or distortion of competition in the general insurance market.

22. The IIB has submitted that changing regulatory regimes may, in the future, impact on the ability of an intermediary who is a member of GISC to compete with other intermediaries, insurers and other industry players. GISC has introduced a new self-regulatory regime for the entirety of the general insurance community that it intends to regulate. In these circumstances, there is no reason to believe that intermediaries who fall within GISC’s regulatory framework will, by virtue of this, be disadvantaged as compared with their competitors.

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7 paragraph 33, Decision.
8 paragraph 35, Decision.
23. The IIB submits that the Director has failed to consider the impact on competition through the lowering of regulatory standards. Under section 14(2) of the Act, the Director was asked to consider the application of the Chapter I prohibition to the Rules notified by the GISC. This required an objective analysis of the Rules to determine whether they had as their object or effect an appreciable prevention, restriction or distortion of competition within the UK. For these purposes, as set out in the Decision\(^9\), the Director considered whether the Rules would impose or increase barriers to entry into or continued operation on the general insurance market; reduce or distort competition between markets participants; or otherwise prevent, restrict or distort competition, for example through the exchange of information. It was not necessary and would not have been appropriate for the Director to carry out a comparative analysis of the different types of regulation that may currently or in the future exist in the industry. The primary concern of the Director was to determine whether the GISC Rules themselves were objective, transparent and non-discriminatory and did not raise barriers to entry, a position that would stand regardless of the existence of alternative forms of regulation which may impose higher or lower requirements on those that they regulate.

24. As noted by the IIB, the Rules do not prohibit members of GISC from also being members of other trade associations or regulatory bodies. It is open to independent intermediaries and other segments of the market to seek to differentiate their services from others by setting up and promoting themselves as being subject to enhanced standards. The Director’s Decision does not prevent this from occurring. The IIB has submitted that there are additional costs involved in belonging to a further trade association or regulatory body in addition to GISC. This was not the basis on which the Director considered the application of the Chapter I prohibition to the Rules. In his analysis, the Director considered the Rules and concluded that they do not impose significant barriers to operating in the general insurance industry as the costs of compliance with GISC regulation appear to be reasonable\(^10\).

25. The IIB has not produced any evidence to show that Rule F42 will work substantially to the business advantage of GISC member networks such that competition would be restricted or distorted to an appreciable extent.

\(^9\) See in particular paragraph 27, Decision.
\(^10\) paragraph 29, Decision.
C. Membership fees

26. The Director does not consider that the use by GISC of different percentages of revenue to calculate membership fees for intermediaries and for insurers is, in itself, sufficient to show that the Rules infringe the Chapter I prohibition. Not all differences in treatment will be discriminatory within the meaning of section 2 of the Act. Indeed, in addition to the percentage of revenue that is taken into account and which is the subject of the IIB’s application, the definition of revenue for insurers and intermediaries is significantly different, reflecting the different ways in which they generate income. An insurer’s revenue is taken to be its gross premium income arising from general insurance activities less commission paid to intermediaries and introducers. An intermediary’s revenue is taken to be its net retained brokerage, which 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. For the year 3 July 2000 to 2 July 2001, annual membership fees for GISC are based on 0.1% of revenue for intermediaries and 0.025% of revenue for insurers, both subject to a minimum membership fee of £200 and a maximum membership fee of £100,000.

27. The IIB has not produced any evidence to show that the different membership fee structures would provide insurers with a significant competitive advantage as a result of which they would be able to undercut the premiums being offered by intermediaries, distorting competition to an appreciable extent within the meaning of the Chapter I prohibition. Of significance to the Director’s Decision was the fact that the minimum and maximum levels of membership fees apply uniformly to insurers and intermediaries and the Director found that the membership fees did not operate as a barrier preventing entry into or continued operation in the general insurance industry\(^\text{11}\).

D. Segregation of monies

28. The Rules contain membership practice requirements, including financial requirements\(^\text{12}\). These include a requirement that intermediaries segregate insurance monies received from or on behalf of a customer and place such monies in separate insurance bank accounts.

\(^{11}\) paragraph 30, Decision.
\(^{12}\) Practice Requirement G1, Rules.
29. There are several exceptions to the application of the segregation requirements\textsuperscript{13}. In particular, the requirement to segregate insurance monies will not apply where the intermediary has sought and obtained confirmation from GISC that it is satisfied that general insurance activities are secondary to the main business activity of the intermediary\textsuperscript{14}. It is this disapplication of the segregation requirements that the IIB claims infringes the Chapter I prohibition.

30. Any exception to a general requirement will create a difference in treatment, but this difference is not always anti-competitive within the meaning of the Chapter I prohibition. The exceptions to the financial requirements, including this exception to the requirement to segregate insurance monies, seek to make the impact of the Rules proportionate, taking into account the wide community that is potentially subject to GISC regulation\textsuperscript{15}. Further, the IIB has not produced sufficient evidence to show that intermediaries who will benefit from the disapplication will, for example, be able to undercut other intermediaries as a result of not being subject to the segregation requirement, such that competition in the market would be appreciably distorted.

E. Granting of waivers by GISC

31. The Director considered whether the terms of membership and the membership application, enforcement and intervention procedures in the Rules were transparent, non-discriminatory and objective and was satisfied that they were. As noted at paragraph 30 of the Decision, the membership application, enforcement and intervention procedures that GISC will operate are clearly described, require GISC to provide reasons for its decisions and include an appeals procedure. In the light of these points and of his overall assessment that Rules do not give rise to a barrier to entry and do not restrict or distort competition, the fact that GISC has the ability to waive Rule F42 does not alter the Director’s assessment of the competitive effects of the Rules.

\textsuperscript{13} Practice Requirement G1(18), Rules.
\textsuperscript{14} Practice Requirement G1(18.2), Rules.
\textsuperscript{15} paragraph 31, Decision.
V REJECTION OF THE APPLICATION

32. For the reasons set out in the preceding paragraphs, the Director has decided pursuant to section 47(4) of the Act that the IIB has not shown sufficient reason why he should withdraw or vary the Decision.

33. This decision is given pursuant to section 47(4) of the Act and constitutes a decision for the purposes of section 47(6) of the Act.

John Vickers
Director General of Fair Trading