

FCA Wholesale Insurance Broker Market Study

On Wednesday 8 November 2017, the UK Financial Conduct Authority (FCA) announced the terms of reference (ToR) for a market study concerning the wholesale insurance broker sector. The study will determine how competition is currently working in the wholesale insurance broker sector, and how brokers influence competition in the underwriting sector. A copy of the market study is available [here](#).

What will the market study examine?

The market study will address three main topics:

- (i) **market power** (of individual broker firms);
- (ii) **conflicts of interest** (between the broker's remuneration and the client's coverage needs); and
- (iii) **broker conduct** (particularly, coordination between firms and the potential for exclusion of certain insurers).

The ToR define wholesale insurance broadly to include: risk business, from overseas and the United Kingdom, placed by brokers with Lloyd's syndicates and insurance companies operating in the London Insurance Market.

The market study will focus on large, complex or specialist risks which require bespoke pricing and coverage. In respect of reinsurance, the FCA intends to include in the market study both facultative and treaty reinsurance businesses. The FCA expects to exclude from the focus of the market study SMEs and smaller (i.e. non-global or local) corporates, with the exception of pooled portfolios placed in blocks in the London Insurance Market.

Summary of topics

1. Market power

The FCA will examine whether individual broker firms possess market power and, if so, whether this is harming competition. The FCA has been told, for example, that some broker firms may have used their market power to cause underwriters to sign up to facilities and pay for additional (and potentially unnecessary) services, or to seek enhanced commission that is out of proportion to the benefit received.

The FCA will also consider the extent to which there are barriers to entry to the market by new brokers or to expansion by small brokers. One element that the FCA has highlighted in this area is the possible impact of the development by larger brokers of data services, resulting in the concentration of data in the hands of a small number of brokers.

2. Conflicts of interest

The FCA is concerned that brokers may be selecting insurers on the basis of the level of remuneration provided to the broker, rather than the needs of the client. The FCA identifies the following areas where there may be potential for conflicts of interest: (i) directing clients towards the use of guaranteed underwriting facilities that provide brokers with higher remuneration, or towards insurers that pay contingent commissions; (ii) leveraging data and other advisory services supplied by broker firms; (iii) tying of reinsurance (i.e. in order to place a risk with an insurer, a broker might insist on reinsurance from that insurer being placed with the same broker); and (iv) the use of broker-owned managing general agents (MGAs).

3. Broker conduct

The FCA wishes to explore the extent to which broker conduct might (i) exclude some insurers; or (ii) dampen competition between brokers through tacit coordination. The provision of new services by broker firms (e.g. MGAs and data services) may weaken competition in the underwriting sector. The FCA is also concerned that indirect information sharing between brokers may lead to coordinated outcomes, for example where brokers are provided with pricing terms of competing firms.

The FCA notes that:

“We understand that some segments of the industry have very high retention rates as well as relatively high and similar commission rates. To the extent that we find evidence of such market outcomes, we will aim to understand whether these are the result of a competitive process, or a coordinated outcome”.

It adds that:

“At the same time, given the way the industry operates and the general ongoing dialogue between firms, firms should be mindful that they do not directly share any competitively sensitive information such as, for instance, their appetite to act in certain business lines or for certain clients and, if so, on what terms.”

Although it is not formally consulting on the ToR, the FCA states that it welcomes comments from stakeholders on the topics within the ToR, and also asks questions relating to the following:

1. any important elements of the dynamics of the wholesale insurance broker sector which the FCA has not covered in the ToR;
2. recent changes or drivers of these changes in the sector;
3. the impact of such changes;
4. how the industry can be expected to develop in the next 5-10 years;

5. whether the scope of the market study is appropriate to assess whether competition is working well;
6. whether there are any other potential issues that the FCA should consider in the course of the market study; and
7. observations on the three main topics identified in the ToR.

What does this mean for the insurance broker industry?

The FCA has put the insurance broker sector on notice that its commercial arrangements are to be subjected to close scrutiny in the light of the competition rules. The references in the ToR to the existence of market conditions and practices that might facilitate co-ordination, the possibility of tacit coordination, and the risks of information exchange provide an indication of a number of areas on which the FCA will focus.

The FCA also reminds brokers of their obligations under Principle 11 of the FCA’s Principles for Business, that requires self reporting if a broker may have committed a significant infringement of any applicable competition rule.

This FCA’s market study follows ‘dawn raids’ by the FCA of several aviation insurance brokers in April 2017, in respect of suspected information exchange. That investigation was recently transferred to the European Commission’s Competition Directorate General.

Both the FCA’s market study and the European Commission’s investigation reflect an increased focus on the insurance broker sector. The FCA conducted its last review of the sector in 2007, and has highlighted the fact that there have been significant developments in the market since then (e.g. the greater use of facilities).

At the conclusion of the study, the FCA will decide whether or not the wholesale insurance broker sector is working well. If it concludes that it is not, it has a number of powers available to it, including:

1. The adoption of market wide remedies, such as rule-making or publication of guidance;
2. The adoption of firm-specific remedies, such as variation or requirement powers, cancelling permissions or imposing financial penalties;
3. Investigation of individual firms under the competition rules, using wide powers conferred on the FCA in 2015 to investigate possible breaches of the competition rules and to take enforcement action against individual firms; and
4. A “market investigation reference” (MIR) to the Competition and Markets Authority (CMA) for a more detailed investigation of the sector (a recent example being the FCA’s MIR in September 2017 in respect of investment consultancy and fiduciary management services).

The FCA also has the ability to use its enforcement powers under the Financial Services and Markets Act 2000 (FSMA) in relation to any issues that it uncovers in a market study carried out using its competition powers.

What will happen now?

The FCA intends to publish an interim report in autumn 2018, which will set out the FCA’s analysis and preliminary conclusions including, where appropriate, possible remedies to address any concerns identified. A final report will be published subsequently. There is an initial opportunity now for those who may be affected by the market study to make submissions to the FCA on any topics raised by the ToR. The FCA is seeking comments by 19 January 2018.

The FCA will shortly begin to gather information from industry stakeholders. The FCA proposes that this will be done through individual meetings with stakeholders; through a roundtable event; and also through market research with purchasers of insurance policies.

In the light of the factors highlighted by the FCA, it may be appropriate for individual brokers and other market participants to revisit their competition law compliance arrangements, in order to assess whether they have any areas of potential exposure, and to review their ‘dawn raid’ preparedness procedures.

Careful consideration should be given by insurers, brokers and purchasers of insurance policies to their responses to any information requests received from the FCA.

In addition, any organisation which feels that it is currently being prevented from competing effectively in the wholesale insurance broker sector may see this market study as an opportunity to present any concerns to the FCA.

If you have any questions or comments in relation to the above, please contact the authors or your usual Mayer Brown contact.

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