MS17/2.2: Annex 6

Market Study

Wholesale Insurance Broker Market Study

Final Report: Annex 6 – Co-ordinated effects

February 2019

Annex 6: Coordinated effects

Introduction

1. The Wholesale Insurance Broker Market Study seeks to understand whether competition in the London broking industry works effectively. To do this the market study focuses on several areas of potential concern, one of which is the consideration of whether the broking market is susceptible to tacit coordination. Note that this assessment is separate from the concerns that led us to launch a competition enforcement investigation in relation to airline insurance broking. That investigation was taken over by the European Commission in October 2017 and is ongoing.

2. This Annex lays out the detail of our analysis of tacit co-ordination. Our findings are reflected in Chapter 5 of the final report.

3. Coordination between suppliers may distort or restrict competition, leading to harm to end clients. Coordination arises when, as a result of repeated interaction with rivals, suppliers in the market decide on a strategy of avoiding or limiting competition. This strategy might be implemented when firms are aware, and take into account, that competition with rivals (such as undercutting their prices in order to win more business) will lead to competitive responses by rivals, with the result that their profits will ultimately be lower than if they avoided or limited competition. The effect of coordinated behaviour is that prices are higher (or the quality/service aspects of firms' offers are lower) than would otherwise be the case.

4. In this Annex, we examine the susceptibility of the LIM (and sub-segments of this marketplace) to coordination amongst broking firms, and whether the 3 necessary and cumulative conditions for coordination to be sustainable are met.[1] These conditions are as follows:
   - Firms need to be able to reach an understanding and monitor the terms of coordination. Where there is no explicit agreement, firms need to have sufficient awareness of each other and be able to anticipate each other's reactions so as to identify a mutually beneficial outcome
   - Coordination needs to be internally sustainable among the coordinating group – i.e. firms have to find it in their individual interests to adhere to the coordinated outcome; the firms must lack an incentive, or have a positive disincentive, to compete because they appreciate how each other will react. However, coordination does not need to be perfect or continuous to fulfil this criterion
   - Coordination also needs to be externally sustainable, in that coordination is unlikely to be undermined by competition from outside the coordinating group or from the reactions of clients

5. We address each of these conditions in this annex.

[1] See paragraph 250 of the CMA's Market Investigations Guidelines (henceforth 'the Guidelines'): https://www.gov.uk/government/publications/market-investigations-guidelines

Ability to reach and monitor the terms of coordination

6. The Guidelines[2] state that the following structural characteristics may help firms reach an understanding and monitor the terms of coordination: a non-complex and stable economic environment; simple and relatively undifferentiated products; clients with easily identifiable characteristics; firms that are relatively symmetric (although coordination may also be possible in markets displaying elements of asymmetry); firms with cross-shareholdings, participating in joint ventures with each other and/ or in reciprocal supplier/buyer relationships; the need of firms to make a long-term market commitment; and the existence of institutions, regulations and/or practices facilitating the sharing of information.

7. We first consider the extent to which broking firms would be able to reach an understanding in the LIM (and what the 'focal point' for coordination would be), and then we consider the extent to which firms would be able to monitor the terms of coordination.

Reaching an understanding

8. We have assessed each of the structural characteristics listed above.
   - **Economic environment:** based on the evidence we have available, we do not consider the economic environment in which London brokers operate to be sufficiently complex to prevent firms reaching an understanding. For example, while the underwriting sector experiences hard and soft cycles and these affect the economics of the broking industry, there has been a prolonged soft market with relatively stable conditions for several years.
   - **Product differentiation:** broking firms typically offer differentiated products, which are less easily subjected to coordination than homogenous products. There are 2 key aspects to this differentiation.
     - First, broking firms compete with each other on a number of factors, 1 of which is broking placement expertise. Broking firms are perceived by customers to have different specialties in risk segments, and as a result are selling differentiated products to policyholders and intermediaries (see Chapter 3). Similarly, some broking firms offer specialised placement vehicles such as facilities and MGAs, which represent an additional dimension of product differentiation offered by brokers.
     - Second, broking firms differ by their wider product offerings. For example, some brokers offer a range of non-placement services to policyholders, intermediaries and insurers, and therefore offer a differentiated product from their rivals.

     These factors suggest that a hypothetical coordinated agreement would not cover all broking firms or all segments of the marketplace.
   - **Client characteristics:** clients of brokers have several identifiable characteristics which could allow broking firms hypothetically to coordinate by market segmentation. For example, clients differ by the geographic scope of coverage required for their risks, their level of sophistication (for example whether they employ an expert risk manager), and the specialist nature of their risks.
   - **Symmetry of broking firms:** the Guidelines state that relatively symmetric firms – for example in terms of cost structures, market shares or spare

[2] The Guidelines, paragraphs 252 & 253.

capacity levels – may more easily respond to incentives to reach an understanding with each other. As discussed above, we consider that there is differentiation across broking firms in terms of their expertise in risk segments, use of facilities and MGAs, and offerings of non-placement services. These asymmetries across firms mean it is unlikely that a hypothetical coordinated agreement would cover the whole of the marketplace i.e. it is unlikely it would include all firms and all sub-segments of the market.

- **Cross-shareholdings:** we are not aware of any cross-shareholdings in this industry.
- **Joint venture participation and/or supplier/buyer relationships:** we are not aware of any joint ventures or relevant supplier-buyer relationships in this industry. However, we have found evidence that brokers place some business with rival brokers. This business practice might allow broking firms to gain an insight into the pricing and terms of business of rivals. To the extent this reveals information on each other's wider pricing and terms of business, this mechanism would help firms reach an understanding, and monitor the terms of a hypothetical coordinated agreement. We discuss the evidence on this market feature later in this Annex.
- **Long-term market commitments:** relative to other industries, broking firms do not need to make very large sunk investments to enter the market, and their economic assets are not long-lived. Therefore, we consider that this aspect would not drive repeat interactions between firms over many years.
- **Institutional, regulatory and other considerations:** we are unaware of regulatory factors that could affect the likelihood of coordination existing in the LIM, and note that the wholesale insurance broking market is quite lightly regulated in the UK.[3] We understand that, within Lloyd's of London, brokers regularly gather and physically meet with insurers. This allows for repeated interactions with rivals. We have no specific concerns, and note that the face-to-face interactions could also give rise to efficiencies.

9. The structural characteristics above suggest that a hypothetical coordinated agreement is unlikely to cover all broking firms or all segments of the marketplace. This is due to differences in specialisation by brokers in the marketplace, differences in placement method across firms (such as the varied use of MGAs and facilities), the existence of distinct client groups (for example by the geographic scope of coverage demanded, and/or their relative sophistication when purchasing insurance), and differences in product offerings, with only a portion of broking firms selling services to insurers. However, this provisional finding does not imply that a hypothetical coordinated agreement could not exist, merely that it would likely be restricted to a subset of firms operating in a specific insurance segment or segments, and/or serving a particular client group or groups.

10. Before discussing whether such a subset of firms could coordinate within a specific insurance segment or segments, and/or over a particular client group or groups, we assess the possible focal points for coordination.

Coordination on price

11. Brokers compete on a range of factors, one of which is their 'price'. Unlike many retail markets, there is no single 'price' that captures the expenses clients face when

[3] See details in Annex 2 of the Terms of Reference: https://www.fca.org.uk/publication/market-studies/ms17-2-1.pdf

employing a wholesale broker. Based on the evidence we have been provided with to date, the following factors combine to form the 'price' of a wholesale broker:

- the premium (paid by the insured)
- standard commission (paid by the underwriter)
- additional commission(s) (also paid by the underwriter) such as Subscription Market Brokerage, profit commissions, and contingent commissions, and
- client fees (paid by the insured)

12. A key aspect of a broker's 'price' is that not all of the 4 elements above may exist for a given policy. For example, a broker may charge no (net) commission and only a fee, the broker may charge both a (net) commission and a fee, or rely only on (net) commission-based remuneration. This feature would make it more difficult to agree on price as the focal point because there are multiple ways of deviating from the agreement by lowering price using one or more of the elements above. Since prices are bilaterally negotiated, this reduces the amount of price transparency in the marketplace and would allow firms to deviate. By way of example, even if a hypothetical agreement on standard commission were reached, firms comprising the coordinating group could deviate by providing a rebate, or even rebating the standard commission in full and instead charging a (lower) fee.

13. Notwithstanding the above, we have also assessed whether realised broker 'prices' are transparent. We have examined a random sample of broker prices at the policy level (calculated as policy remuneration divided by policy GWP), for a given firm-Lloyd's risk code combination.[4] By examining pricing by risk code, our assessment of prices takes place at a level of granularity that should ensure that the underlying risks are comparable. The results of our analysis are shown in the figure below, with each dot representing the price and GWP of a policy in 2016. One firm has been randomly selected for each of the 9 risk code diagrams below. Firm names have been removed from the chart to preserve confidentiality.

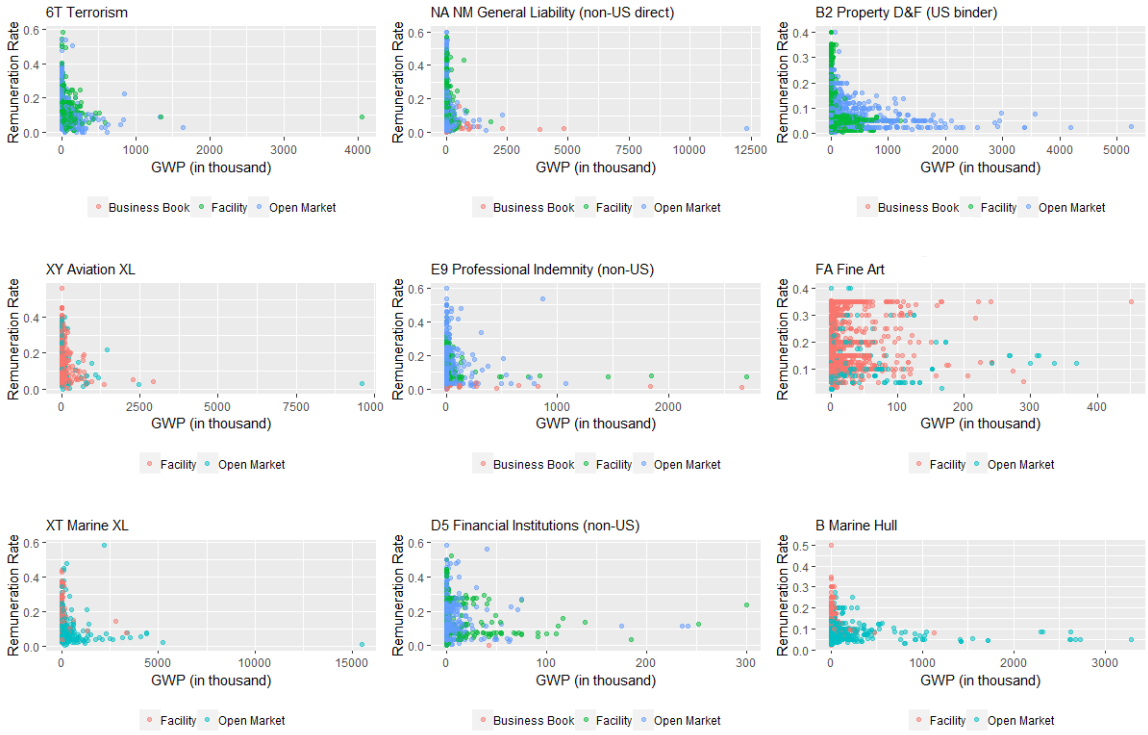
14. The figure shows that there is substantial price dispersion at the risk code level. While the results show that there are several price points in a few cases, we consider that the overall extent of price dispersion would make the reaching and monitoring of any common understanding on 'price' difficult.

15. We have provisionally concluded that brokerage in the LIM is unlikely to be subjected to tacit price coordination due to market complexity (such as the degree of price dispersion and the multiple components of the price) and the lack of price transparency, making the reaching and monitoring of any common understanding difficult.

16. We note that, under an explicit coordinating agreement, firms may be able to overcome market complexity by sharing brokerage slips amongst the coordinating group, and in this way both reach an agreement on price and enable each other to monitor adherence to the agreement.

[4] See link for a list of Lloyd's risk codes: https://www.lloyds.com/market-resources/underwriting/risk-codes

Figure 1: Price (broker remuneration / GWP) dispersion by risk code[5]



Coordination on non-price factors

17. We have considered whether firms could hypothetically coordinate tacitly over non-price factors. Over the course of the market study we have received evidence (see Chapter 3 of the main report) that broking firms compete on a range of non-price factors, such as placement expertise, and various non-placement services such as claims processing and handling. We have provisionally found that reaching a coordinated agreement on these factors is unlikely due to the nature of placement expertise (discussed further below), and the differences between broking firms in terms of their range of non-placement offerings to clients.

18. Under a hypothetical tacit agreement to coordinate on placement expertise, the coordinating group would lower their quality, so long as this reduces their costs; all else constant their margins would increase. Deviation under this setup would mean a firm in the coordinating group increasing its quality to win clients and gain market share. A punishment strategy would involve the other firms in the coordinating group subsequently improving placement quality to win back clients.

19. Coordinating on placement expertise would appear to be an unusual and risky strategy. Expertise is difficult to quantify (and therefore agree upon and subsequently monitor), cannot be adjusted rapidly (and so would not be useful as either a punishment or a deviation strategy), and represents the outcome of years of investment in staff and so represents the core value proposition of the business. A coordinated agreement to reduce placement expertise (even if this could be signalled and monitored) and thereby reduce costs would be a dramatic and risky change to a business model because it

[5] Firm names have been removed from each chart to preserve confidentiality.

would damage the coordinating group's ability to win future work against the competitive fringe. We regard this focal point as being unlikely.[6]

Coordination on placement market shares or wins/losses

20. We have also considered whether firms might tacitly coordinate with respect to market shares and/or with respect to wins and losses of clients.

21. Under a placement market share focal point, each firm in the coordinating group would have a focal point of its own share of revenue or premium in a broking risk segment. We consider that a market share focal point would be difficult to agree and monitor for the following reasons:

- We are not aware of a database that would allow firms to accurately and consistently calculate their own market share in disaggregated market segments.[7] In the absence of such a database, firms would have to estimate their shares by using their known revenue/premium and estimating the market size. This practice would be prone to substantial error, making it difficult to reach an agreement and monitor adherence, and so would likely act to destabilise an agreement.
- Even if reliable third-party data existed that allowed firms to consistently and accurately calculate their own market share, this focal point could be destabilised by third-party actions unrelated to the firms in the coordinating group:
  - if the market(s) subject to coordination contain firms outside the coordinating group then client gains or losses by these outside firms would change the market shares of firms in the coordinating group. These market share changes could be interpreted incorrectly as deviation, leading to a punishment strategy being implemented and destabilising coordination; and
  - if a large client expands its coverage (for example if it switches some of its captive insurance to being insured by an external underwriter then this would increase the market share of its existing broker. This could be interpreted as deviation, leading to a punishment strategy being implemented.

22. We have therefore concluded that a market share based focal point is unlikely under a tacit coordination concern. However, for the same reasons discussed above under explicit coordination it may be possible for the coordinating group to share enough information between themselves that they could reach and monitor such an agreement. The remainder of this Annex focuses on a client allocation theory of tacit coordination.

23. Under a wins and losses focal point, firms in the hypothetical coordinating group would tacitly allocate clients between themselves, leading to reduced competition and

[6] In any event, broking firms have markedly different shares of risk segments (a proxy for expertise because this represents the revealed preferences of clients), and these shares are changing over time, suggesting that there is not coordination over expertise.

[7] We explored whether there are any third party data sets that could allow brokers to calculate their own market share. We are only aware of one such data set. Brokerage placement data is regularly submitted by brokers to a firm called Xchanging, which organisations such as Lloyd's of London access for market intelligence. We have discussed the nature of the data that is available and have concluded that while the information is very useful for insights at an aggregated level, the way in which data are submitted by firms means that market shares would be unreliable for the purposes of monitoring adherence to an agreement at granular risk class levels. Since we consider that competitive conditions are likely to differ by risk type, a granular assessment would be necessary under a market share focal point, and therefore we have concluded that a third party data set does not exist that would enable firms to reliably calculate their relevant market shares.

elevated prices being paid by these clients. Each firm in the coordinating group would then monitor their client base for any wins/losses from other members of the hypothetical coordinating group. Under this form of coordination there would be higher 'prices' in the form of elevated client fees and/or brokerage commissions.

24. We have considered whether an agreement could be reached across all firms and all risk segments/clients, or a subset. The structural characteristics of the industry suggest that a hypothetical coordinated agreement is unlikely to cover all broking firms or all segments of the marketplace due to differences in specialisation, placement method, the existence of different client groups, and differences in product offerings across broking firms.

25. If a hypothetical tacit agreement were to exist it would likely be over a specific set of clients, for a group of firms that are broadly similar. We have identified 2 candidate subsets of the marketplace: (i) clients with global programmes; and (ii) clients in niche market segments. As discussed in Chapter 3, there are features of each of these 2 segments that may act to restrict the number of firms in the short term, thereby facilitating coordination.

Clients with global risk programmes

26. Based on the available evidence there are likely to be only a small number of firms that can fully compete to supply brokerage services for clients with global risk programmes. This is due to brokers needing particular expertise and/or a global network of retail offices or representatives.[8] These barriers, in particular the global network of offices, are likely to persist over the medium/long term. Under this form of coordination a hypothetical coordinating group would allocate clients with global risk programmes between themselves, tacitly agreeing not to compete for each other's clients of this type. In the event of a client deciding to open up their programme to tender, the other firms would not submit competitive bids so as to avoid retaliation in future. The softening of competition under this scenario would be expected to lead to broker prices (in the form of client fees and/or broker commissions) increasing above competitive levels over time.

27. We consider that it would be possible for these firms to tacitly agree not to compete aggressively with each other for clients with global programmes. It would be possible to monitor adherence to this agreement because there are a limited number of these clients with global risk programmes, and losing such a client would immediately be known and interpreted as deviation. It is likely that the 'lost to' broker would also be known in the marketplace, allowing targeted punishment to be inflicted.

28. We have examined whether market outcomes are consistent with client allocation. The use of different brokers – known as 'multi-homing' – is one indication of active competition among brokers for clients' business.[9]

29. We have analysed contract-level data to identify whether clients use different brokers when placing multiple risks, or whether they predominantly use the same broker. We found that across all risks, out of around 70,000 policy holders in our dataset, around 94% used 1 broker (note that this includes also clients with 1 policy). If we restrict the analysis to those clients with policies in more than one high-level risk class, the

[8] This view is based on our understanding of the marketplace as a regulator of financial services, our examination of the customer bases of brokers in our sample of firms, and the views of parties and clients during the course of our investigation.

[9] It is important to note that the inverse is not necessarily true—the use of a single broker for multiple risks could indicate a lack of competition but could equally indicate client satisfaction due to quality.

proportion of clients using one broker falls to 76%. Finally, 62% of clients with policies in at least 3 risk classes used 1 broker.

30. We have repeated this analysis focusing on the largest clients (by GWP) of brokers in our sample. These clients are a proxy for clients with a global risk programme. We found that these clients are less likely to use a single broker. Table 1 below (presenting figures for the largest 100 clients) shows that clients typically use more than 1 broker in a given Business Class. For example, only 29% of this client group used 1 broker in the Energy class in 2016. Qualitatively similar results apply for the largest 250 clients (see Table 2).

Table 1: Proportion of largest 100 clients using one broker, by High Level Business Class (2016)

Relative share	Accident and health	Aviation	Casualty FinPro	Casualty Other	Energy	Marine	Property (D&F)	Specialty Other
All clients in a given risk class	67%	56%	42%	71%	52%	55%	36%	52%
Clients buying more than 1 policy in a given risk class	65%	55%	38%	65%	51%	55%	35%	49%
Clients buying more than 10 policies in a given risk class	48%	40%	24%	35%	29%	37%	29%	24%

Source: FCA analysis of broker data request.

Table 2: Proportion of largest 250 clients using one broker, by High Level Business Class (2016)

Relative share	Accident and health	Aviation	Casualty FinPro	Casualty Other	Energy	Marine	Property (D&F)	Specialty Other
All clients in a given risk class	70%	60%	51%	73%	57%	56%	44%	56%
Clients buying more than 1 policy in a given risk class	66%	58%	48%	69%	56%	55%	43%	52%
Clients buying more than 10 policies in a given risk class	45%	39%	29%	37%	29%	37%	33%	25%

Source: FCA analysis of broker data request.

31. This evidence suggests that a client allocation concern is unlikely to be occurring at an aggregate or 'high level business class' level of market segmentation. This conclusion assumes that the largest 100/250 clients (by GWP) in our broker sample is a good proxy for clients with global risk programmes.

Clients in niche market segments

32. We have also considered whether it is plausible for brokers to be able to tacitly coordinate in one or many niche market segments. We have calculated the number of brokers active in different niche segments, using data collected from the RFI. We found that there are several segments with a fairly small number of brokers currently (using 2016 data) supplying brokerage services. This could be explained by the view that in some niche markets there are a smaller number of brokers currently with the level of expertise and reputation required to win or place business.

33. It is our view that, over time, some of this competitive advantage might erode as rival firms catch-up or acquire staff with the right niche expertise. We have therefore decided that this form of coordination would not be sustainable over the medium term, even if it were possible in the short term. The remainder of this Annex therefore focuses on customer allocation of clients with global risk programmes.

Internal sustainability

34. We now consider whether there are mechanisms through which the internal stability of coordination can be achieved, such that all firms that are part of the coordinating group find it in their individual interests to adhere to the coordinated outcome. In a coordinated market, it is often in a firm's short-term interest to deviate from the terms of coordination in order to increase profits unilaterally. However, if such deviation results in lower profits in the future because of the reaction of the other members of the coordinating group, a firm may be deterred from deviating.

35. The Guidelines[10] state that the following market characteristics can help increase the internal sustainability of coordination: a concentrated market, market transparency (which facilitates detection of deviation and increases the speed with which deterrence can take place), and other factors (such as the existence of excess capacity) which also increase the speed with which deterrence can take place.

36. **Concentration:** based on the evidence available to us there are only 3 or 4 firms that can fully compete to place clients with global programmes. We have calculated concentration levels for the top 3/5/10 brokers (by GWP in 2016) for 3 different client groups: the largest 100/250/500 clients by GWP. Which are again a proxy for clients with a global risk programme. The relative market shares of the top 3, 5 and 10 brokers are summarised in Table 3.

Table 3: Relative market share of 3, 5 and 10 largest brokers among 100, 250 and 500 largest insurance clients (respondents to policy-level data question only)

Relative share	100 largest clients	250 largest clients	500 largest clients
Top 3	59%	54%	54%
Top 5	72%	68%	69%
Top 10	93%	92%	92%

Source: FCA analysis of broker data request. N = 26.

37. The table shows that the combined shares of the top 3/5/10 broking firms are reasonably high. However, it is not the case that the top 3 or even 5 firms account for close to 100% of these market segments. The table shows that a substantial portion (around 30%) of these segments are accounted for by the largest 6 to 10 firms, which

[10] Paragraph 254.

would be viewed as the competitive fringe under the posited theory of harm. As above, assuming that that the largest 100/250 clients (by GWP) in our broker sample is a good proxy for clients with global risk programmes, the market shares data in the table above is evidence against the internal sustainability of coordination.

38. **Transparency:** as discussed above, there would be a high degree of transparency between the members of this hypothetical coordinating group because there are a limited number of 'global clients', and therefore deviation from the agreement by poaching another firm's client would immediately be identified, allowing targeted punishment to be inflicted on the deviating firm.

39. **Cross-sales:** data provided to us as part of our information requests show that each of the brokers in the hypothetical coordinating group place some business with each other. This activity might provide insights into each other's pricing and increase transparency.

40. The data show that in 2016 the (3 or) 4 firms in the hypothetical coordinating group did place very small amounts of business with each other. However, Table 4 below shows that this practice is not symmetric, with Broker 1 not placing business with Broker 4 (see the zero in the bottom left of the table), but Broker 4 did place business with Broker 1 (see the 1 in the top right of the table).[11]

41. The lack of symmetry suggests that this practice is unlikely to be being used to signal prices to other members of the hypothetical coordinating group. The use of cross-sales may therefore instead reflect the specialised nature of broking, where even larger firms' local/retail broker offices place business with rivals at the wholesale level.

Table 4: Cross-sales by the four firms in the hypothetical coordinating group

	Cross-placing broker			
Receiving broker	Broker firm 1	Broker firm 2	Broker firm 3	Broker firm 4
Broker firm 1	1	1	1	1
Broker firm 2	1	1	1	1
Broker firm 3	1	1	1	1
Broker firm 4	0	1	1	1

Source: FCA analysis of broker data request. A 1 represents positive GWP while a 0 represents zero GWP. Names of broking firms and the volumes of business have deliberately been hidden to preserve confidentiality.

42. **Firm incentives:** the incentive to deviate from a client allocation agreement by poaching a client will depend on how profitable such a strategy would be. This depends on (a) the amount and profitability of additional clients a deviator will be able to capture; (b) the speed at which such deviation will be detected by competitors; and (c) if and when a deviation has been detected, the consequences for profits of any subsequent punishment period.

43. Annex 3 shows that brokers generate revenue by selling their expertise and their ability to administer the complex process of risk placement. Brokers are remunerated through commissions and client fees on placement of a risk, but some brokers, typically larger organisations, also earn revenue from selling non-placement services such as risk assessments and data analytic services. These revenue sources provide two specific reasons why broking firms would have an incentive to deviate from a hypothetical coordinating agreement.

[11] We have data for this year only.

44. First, we have found evidence that economies of scale exist for broking firms (see Annex 3). As the amount of GWP placed by a broking firm increases, its costs per pound of GWP fall. This would give broking firms an incentive to win additional business to reduce their average costs and thereby improve profit margins. In the context of a coordinated effects concern, the existence of economies of scale would instead be expected to give broking firms an incentive to compete and grow market share so as to realize economies of scale.

45. Second, we have found evidence that there are benefits in which winning an additional brokerage client gives the broking firm useful data concerning risks, which the firm can monetise by selling to insurers as part of their consultancy and/or data analytics business. This additional revenue from winning an extra client would also give an incentive to brokers to compete and grow market share in the supply of placement services.

46. **Human broker incentives:** evidence received from our information requests suggests that individual (human) brokers have a strong financial incentive to grow their business, and win new clients. Annex 3 shows that broker's front-line staff are incentivised to win new business; some brokers explicitly encourage this through their remuneration KPI's weighting the acquisition of new business more heavily than retaining old business. In addition, winning a large client would increase a human broker's value in the labour market as this is a signal of that individual's competence and specialist knowledge, thereby improving their outside option if they wished to move to another firm. Consequently, a hypothetical coordinating agreement at the firm level could be destabilised by conflicting incentives of their human brokers on the ground; these actions could be interpreted as deviation from an agreement, and therefore would act against the sustainability of an agreement.

47. **Buyer power:** the clients subject to the hypothetical coordinated agreement are large and sophisticated. Strong buyers may have the ability to stimulate competition between brokers, either by threatening to redirect business from their current broker to a rival, or to potential entrants, or by threatening to divert business away (see next section). Buyers could also reduce the possibility of coordination being sustainable by designing procurement auctions between brokers. We are not able to quantify this effect, but we recognise the potential when weighing the evidence in the round.

48. We have provisionally concluded that while there are factors that point towards coordination being internally sustainable, firms and the human brokers within them face strong incentives to win business and therefore deviate. We consider that these incentives might be sufficient, in combination with strong buyers, to destabilise hypothetical coordination. We also consider that the evidence on cross-sales does not support the current existence of tacit coordination in the marketplace.

External Sustainability

49. In the interests of completeness, we now consider whether coordination would be externally sustainable, such that there are no significant outside factors that could destabilise any hypothetical agreement between the three or four firms in the hypothetical coordinating group.

50. We have identified 2 possible external factors:

- **Competitive fringe:** we have put forward a hypothesis that there are likely to be only 3 or 4 firms that can currently fully compete to place global insurance programme. Since the hypothetical coordinating group comprises those firms that are the credible competitors, there is by assumption no competitive fringe. For this reason we have concluded that a competitive fringe does not exist that could destabilise this hypothetical coordinated agreement
- **Self-supply:** the main alternative to using the LIM that we have considered is captive insurance, also known as self-insurance. We found that it is predominantly large corporates which have the financial strength to self-insure (see Chapter 3). This can involve the establishment of a 'captive' insurance company to self-insure 'working' or 'attritional' exposures, and, beyond that, retaining catastrophe exposures on the firm's balance sheet. The extent of this constraint is uncertain; however, our understanding of the market suggests that this outside option is limited to certain risks, and therefore is unlikely to be a complete substitute for brokerage. For this reason, we have concluded that the option to self-supply would not destabilise a coordinated agreement

51. As a result, we consider that a hypothetical coordinated agreement may be externally sustainable.

Conclusion

52. In this Annex, we have examined the susceptibility of the LIM (and sub-segments of this marketplace) to tacit coordination and whether the 3 necessary and cumulative conditions for coordination to be sustainable are met. While we have concluded that an agreement could be reached, and would likely be externally sustainable, we also consider that coordination is not likely to be internally sustainable. In addition, the evidence on cross-sales and multi-homing suggests that client allocation is not currently occurring in the marketplace. Since the 3 conditions are necessary (and cumulative), we are not minded to pursue this theory of harm any further unless new evidence comes to light.

12 Endeavour Square
London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk