

Completed acquisition of the members' agency business of Christie Brockbank Shipton Private Capital Limited by Hampden Agencies Limited

The OFT's decision on reference under section 22(1) given on 14 July 2006. Full text of decision published 11 August 2006.

Please note that the square brackets indicate figures or text which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Hampden Agencies Limited** (Hampden) is the largest members' agent at Lloyd's of London (Lloyd's). It is wholly owned by Hampden Holdings Limited. Hampden's UK turnover for the financial year to 31 December 2005 was approximately £15.5 million.
2. **Christie Brockbank Shipton Private Capital Limited** (CBSPC) was, prior to the transaction, the third largest members' agent at Lloyd's. It is wholly owned by Christie Brockbank Shipton Insurance Holdings plc (CBSIH). CBSPC's UK turnover for the financial year to 31 December 2005 was approximately £5.5 million.

TRANSACTION

3. Hampden acquired CBSPC's members' agency business (CBS) on 1 April 2006. Post-merger, CBSIH is concentrating its business activities on the management of its own corporate underwriting vehicle, Insurance Capital Partners LP.
4. Hampden notified the transaction on 12 May 2006 and the statutory deadline for consideration is 31 July 2006.

JURISDICTION

5. As a result of this transaction, Hampden and CBS have ceased to be distinct. Hampden and CBS overlap in the supply of members' agency services to members of Lloyd's and the share of supply test in section 23 of the Enterprise Act 2002

(the Act) is met as their combined share of the supply of members' agency services to members of Lloyd's exceed 25 per cent as a result of the merger. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RELEVANT MARKET

6. Hampden and CBS overlap in the supply of members' agency services to members of Lloyd's.

Lloyd's insurance market

7. Lloyd's is a leading insurance market regulated by the Financial Services Authority (the FSA). Much of this regulatory function has been delegated to the Council of Lloyd's.
8. Lloyd's is made up of members who provide capital for the syndicates that undertake the insurance business by setting premiums, accepting risks and paying claims. Syndicates are run by managing agents.
9. As of 1 January 2006 there were 2203 members of Lloyd's, each of whom accepts insurance business worldwide for their own profit and loss on a several liability basis. A member's underwriting capacity (or liability) is measured in terms of the total amount of insurance premiums which the member can accept. Historically, all members were private individuals underwriting with unlimited liability. After a period of substantial losses, in 1994 Lloyd's introduced corporate members with limited liability and since 2003 no new unlimited liability individual members can be admitted, leading to a decline since 1995 from 14,744 unlimited liability individual members to 1,497 in 2006.
10. Members receive advice in relation to their underwriting activity from members' agents, such as the parties. This advice covers analysis on syndicate participation and monitoring of syndicate performance as well as other administrative services¹. Lloyd's requires every member to be represented by a members' agent. Corporate members can gain dispensation from this requirement and 96 of the 706 limited liability members (in fact, most of the large corporate members) have done so.² Due to the decline in the number of individual members, the number of members' agents has also decreased significantly from 37 in 1995 to three in 2005.

¹ These services include the provision of estimates of profits & losses and analyses from historical data bases; handling transactions with Lloyd's and dealing with accountants and banks; and maintaining IS systems.

² In order to obtain dispensation, corporate members need to demonstrate sufficient capability and understanding of underwriting at Lloyd's, and confirm that they will carry out adequate syndicate financial review and due diligence. They also need to show adequate resources and expertise for doing so.

11. Members' agents are authorised by the FSA and approved and regulated by Lloyd's, including prescribing a standard form of agreement and regulating fees. Fees are usually charged on the basis of the amount of a member's underwriting capacity and generally comprise a basic fee and a profit commission.

Product market

12. Hampden maintains that for the purpose of this transaction the relevant frame of reference should be the provision of members' agency services to members of Lloyd's, as established by the OFT in *Argenta/Anton*.³ No evidence was forthcoming in the course of this investigation to lead us to deviate from that view.

Geographic market

13. Members' agents only operate in the Lloyd's insurance market in London and therefore this is the geographic frame of reference.

COUNTERFACTUAL

14. The parties maintain that the market is declining and unable to sustain more than two members' agents and therefore that CBSPC's exit was inevitable. CBSPC cited a drop in profits of [] per cent in 2006, a need to increase its client base if it were to survive and a consideration of refinancing options in support of its claim.
15. However, evidence arising from CBSPC's internal documentation does not support this proposition as CBSPC was a profit making entity at the time of the merger and could operate as a stand-alone entity, at least in the short term. The OFT therefore does not believe that the first part of the evidentiary standard required by the OFT Mergers substantive assessment guidance for a failing firm defence is met by the parties.⁴ Hence the OFT has considered the effect of the transaction against a counterfactual of the prevailing conditions of competition.

³ OFT's Decision of 23 December 2004 in relation to the Anticipated acquisition by Argenta Private Capital Limited of Anton Private Capital Limited

⁴ See OFT Mergers Substantive Assessment guidance, page 35, paragraph 4.37.

HORIZONTAL ISSUES

Non-coordinated effects

17. Hampden provided share data for members' agency services based on the value of underwriting capacity and the volume of client numbers.⁵ Post-merger, Hampden has consolidated its position as the largest members' agent with a share of supply of approximately 65 per cent by volume or value with increments of about 25 per cent in each case. Argenta Private Capital Limited (Argenta) will be the only remaining competitor with a share of approximately 35 per cent by volume and by value. The merger has therefore reduced the number of members' agents from three to two competitors.
18. Hampden submits that members' agents do compete with each other and spend a considerable amount of time and expense trying to attract new business through advertising, road shows, and meetings with independent financial advisors (IFAs), accountants and tax advisers. The parties described themselves as direct competitors, with their customers selecting more on the basis of quality of service and the personal relationship between a member and its members' agent, than on price. Third parties also characterise the parties as competitors.
19. There is evidence of a degree of switching directly between the parties and Lloyd's confirms that members' agents have competed for nine and seven new members in 2005 and 2006 respectively. Some members suggest there is limited competition on price as they would not switch for a 5-10 per cent fee increase. However, there is also evidence that price competition takes place for individual customers (in 2005, 30 per cent of Hampden customers negotiated lower fees (£24), which they could not in the absence of price competition) and across the sector as a whole (CBSPC innovated by stopping charging profit commission 10 years ago as a competitive move). This price competition may be lost post-merger.
20. On non-price competition, third parties also suggest the quality of service (particularly, syndicate analysis) and the personal relationships with their members' agent is important. In relation to the former, CBSPC stated that it has always strived to provide the best analysis and highest quality of service to clients and was concerned about the loss of key staff to their competitors and actually lost 2 of their top senior advisers to Hampden in 2005. This suggests a level of non-price competition that may be lessened following the merger.
21. Hampden believes that post-merger there remains sufficient constraint on their ability to alter price or quality of service. Firstly, it believes Argenta is a soundly

⁵ In this context, the share of capacity data refers to the proportion of Lloyd's underwriting capacity that is advised by a particular members' agent.

based and well run business who will compete fiercely post-merger. However, as third parties also acknowledge, it is the only realistic alternative for members. With only one such competitor for customers to switch to, it may be profitable to increase price or reduce quality of service to a level that would not have been profitable pre-merger.

22. Secondly, Hampden submits that other companies which perform some of the functions of members' agents, such as Lloyd's IFAs (e.g. the Newton Follis Partnership) and other Lloyd's analysts (e.g. AM Best) could place a constraint on members' agents to the extent that they aim to provide additional analysis to members. However, since regulation obliges members to obtain advice from a members' agent and these other intermediaries cannot offer the full range of members' agency services (e.g. place members onto syndicates), they do not appear to be an effective constraint. Third parties confirm this view that such intermediaries are only an optional service that members can purchase in addition to members' agency services.
23. Hampden also maintains that it will be constrained by the threat of individual members ceasing to be members and reinvesting their capital into Lloyd's via a share in an existing corporate member. On the whole, third parties did not see this as an alternative as they would lose some particular features: double use of assets; greater flexibility in the extent of market participation (as buying and selling capacity has a lesser impact on capital gains tax); and personal decision-making regarding syndicate participation. It also follows that if members were unlikely to switch members' agents in response to a 5-10 per cent fee increase, they would be unlikely to exit in response to such a change. The threat of exit in this way may not therefore be sufficient to make an increase in price or reduction in the quality of service unprofitable.
24. Finally, Hampden stated that Lloyd's regulation would constrain their ability to alter price or quality of service. Although Lloyd's monitors the fees that members' agents charge and can intervene in the setting of their fee structures, it can only do so for the 'list' price, which effectively sets a ceiling on the fees, which are published annually in the Register of Agent Charges at Lloyd's. However, members are still able to negotiate a lower fee and Lloyd's confirms that it does not receive information relating to these individually negotiated fee and profit commission changes. For these customers it may be possible that prices can be increased without Hampden being required to obtain approval from Lloyd's, because these customers are currently paying less than the Lloyd's approved price, and their negotiating ability may be decreased in the absence of CBS.
25. Customers and other third parties were concerned that post-merger Hampden will be able to increase price or reduce quality of service.

26. Overall there is evidence of a significant level of competition between the parties pre-merger and concern, supported by customers and other third parties, that the loss of that competition will not be sufficiently offset by the remaining competitor or other constraints, such as regulation. Hampden may therefore be able to charge fees higher than they otherwise would have been (e.g. members may be less able to negotiate fee reductions; and/or former CBS clients may start paying profit commission and therefore be subject to de facto fee increases), and/or reduce the quality of service that it otherwise would have provided absent the merger. In the light of the above considerations, the OFT believes that it may be the case that there is a substantial lessening of competition as a result of this merger.

Coordinated effects

27. One customer raised the concern that a reduction in the number of members' agents may increase the possibility of coordination between the two remaining competitors. It is not clear whether this sector has the characteristics necessary to facilitate collusion and the OFT has not reached a conclusion on this issue in the light of its conclusions on non-coordinated effects.

Barriers to entry and expansion

28. As stated above, members' agents must be authorised by the FSA and approved by Lloyd's. Hampden and third parties agree that it is extremely unlikely that a third party would be able to enter the market and establish a new viable regulated members' agency business given the economies of scale and declining customer base. One customer suggested that Lloyd's should be considering ways of reducing the regulatory burden on entering the market for members' agency services to encourage more effective entry.
29. Potential entry from Lloyd's Members' Agency Services (LMAS), which has the status of members' agent but only handles the affairs of resigned members who have reason to be seriously dissatisfied with their current members' agent, or whose old members' agent is insolvent, has been suggested as a possibility by a number of third parties. However, Lloyd's has indicated that it has no plans at present to expand the service provisions of LMAS. It therefore seems unlikely, in the view of the OFT, that any entry from LMAS in the provision of members' agency services would be a timely constraint on the parties.
30. The OFT did not receive any evidence to suggest that there were significant barriers to expansion i.e. that members' agents could not easily increase capacity to take on more clients. However, the OFT does not believe that Argenta's potential expansion would offset the concerns identified above because Hampden's incentives would be likely to remain the same.

31. Overall, the evidence indicates that new entry or further expansion cannot be expected to act as an effective and timely competitive constraint on the parties post-merger.

Buyer Power

32. Hampden submits that members exert buyer power by negotiating fee levels that they are prepared to pay. However, there is also evidence that customers who have negotiated fees in the past have also been subject to unilateral fee increases by their members' agent. Overall, the OFT does not consider that the degree of buyer power (if any) held by members is particularly high or is sufficient to offset any reduction in competition arising as a result of the transaction.

THIRD PARTIES

33. A number of customers were concerned and believed that the merger would reduce their degree of choice. Customers and other third parties also expressed concerns that post-merger Hampden will be able to increase price or reduce quality of service. These concerns have been considered above in the non-coordinated effects section.
34. One customer raised the concern that a reduction in the number of members' agents may increase the possibility of coordination between the two remaining competitors. This concern has been addressed above in the coordinated effects section.
35. Some third parties raised a concern that post-merger Hampden will have a much wider scope for influencing managing agency's fees, voting arrangements or the conduct of syndicates by threatening to starve them of capital. The OFT has not reached a conclusion on this issue, as the reference test is met in respect of the non-coordinated effects described above.

ASSESSMENT

36. The parties overlap in the supply of members' agency services to members of Lloyd's. The transaction has brought together the first and third largest members' agents at Lloyd's and reduced the number of competitors from three to two.
37. There is evidence that pre-merger Hampden and CBS were competing on price and non-price factors for both active and newly admitted members of Lloyd's. This competition will be lost as a result of the merger, which has led to customers expressing concern. In the view of the OFT, Hampden may not be sufficiently constrained by Argenta, the remaining competitor, other intermediaries, Lloyd's corporate underwriting vehicles or existing Lloyd's regulation. Indeed it is possible that the regulatory environment may give rise to barriers to market entry. As a

result, the OFT believes that Hampden may be able to profitably increase fees or reduce quality of service to a greater degree than it otherwise would have been able to absent the merger.

38. Consequently, the OFT believes that it is or may be the case that the merger has or may be expected to result in a substantial lessening of competition in the supply of members' agency services to members of Lloyd's.

EXCEPTIONS TO THE DUTY TO REFER

Market of insufficient importance

39. Hampden maintains that the merger affects a service of very limited importance to the field and a fee which is a tiny proportion of the investment of individuals who are well served by the existing structure.
40. Evidence available to the OFT does not indicate that the provision of members' agency services to members of Lloyd's is a market of insufficient importance as based on the parties turnover, the market concerned generates annual revenues of at least £21 million.⁶

Customer benefits

41. Hampden submits that the acquisition will provide economies of scale and improve the level of services to members (by investment in research and extending their ability to market such products to a wider base of potential clients). It submits that the merger has created benefits for members which outweigh any nominal or theoretical reduction in competition. A few customers agree with this proposition and consider it is vital to have a financially sound agent.
42. However, Hampden has not provided evidence to show that the alleged benefits will only arise directly as a result of the transaction, nor produced detailed and verifiable evidence that any benefits arising from economies of scale will be passed on to its customers. Given the above, the OFT has not been able to take the alleged efficiency gains into account in its 'first phase' assessment of this merger.⁷

⁶ See OFT Mergers Substantive Assessment guidance paras 7.5 – 7.6.

⁷ See OFT Mergers Substantive Assessment guidance paras 7.7 – 7.10.

UNDERTAKINGS IN LIEU

43. Where the duty to make a reference under section 22(1) of the Act is met, pursuant to section 73(2) of the Act, the OFT may, instead of making such a reference to the Competition Commission, accept from the parties concerned such undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it.
44. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns addressed above. The OFT's guidance on undertakings in lieu of reference states that undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut.⁸
45. Hampden has proposed undertakings in lieu of reference to resolve competition concerns that the OFT may have in relation to the merger. Hampden has offered to enshrine in an undertaking the broad arrangements that Lloyd's has imposed on the two remaining members' agents in its letter to them of 22 June 2006 (pursuant to paragraph 63 of the Underwriting Byelaw). These arrangements relate, among others, to publication of conflict of interest policies between members' agents and their code of practice for dealing with managing agents, as well as appropriate board level review of written advice to members. In addition, Hampden has proposed that it will consult and/or agree with any Lloyd's customer group (e.g. High Premium Group or Association of Lloyd's Members) its intended fee structures.
46. In the OFT's view, the first proposed undertaking only addresses any implication which the reduction of members' agents may have for capacity auctions and major syndicate transactions involving unaligned members. The second proposed undertaking may not, in the OFT's view adequately address any potential increase in fees and in any event does not address any potential reduction of quality of service for members. The OFT therefore considers that the above undertakings do not resolve the identified competition concerns and do not meet the clear cut requirement.
47. Accordingly, the OFT has decided not to exercise its discretion under section 73(2) of the Act.

⁸ See OFT Mergers Substantive Assessment guidance para 8.3.

DECISION

48. Despite the fact that this is a completed merger and that the businesses of Hampden and CBS have to a large extent already been integrated, the OFT remains under a duty to refer the merger where it believes that it is or may be the case that the merger has resulted, or may be expected to result, in a substantial lessening of competition.
49. This merger will therefore be referred to the Competition Commission under section 22 (1) of the Enterprise Act.