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POSITION PAPER

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FERMA's Position on the Revision of the EU Public Procurement Directives

Executive Summary

The Federation of European Risk Management Associations brings together 23 risk management associations in 22 European countries, representing over 5600 risk managers active in a wide range of organisations. FERMA provides the means of co-ordinating risk management and optimising the impact of these associations outside their national boundaries on a European level.

Risk and insurance managers working in the public sector must comply with the EU public procurement directives (PPD) when purchasing insurance policies for their organisation. However, the existing EU rules for public tenders are not adapted to the buying of insurance by public sector companies. FERMA's position is that the PPD are too cumbersome and inflexible for the volatile and cyclical nature of the insurance market, which disincentivizes the participation of insurers in public tenders. This reduced competition leads public sector companies to struggle to find enough insurance capacity to cover their risks and causes them to pay higher premiums than private sector businesses.

In an increasingly complex and fast-changing environment, the resilience of public sector companies is essential, since (i) they are more exposed to certain risks and (ii) disruptions of their activities will be felt directly by citizens, which rely on the public services they provide. Public sector companies' access to sufficient insurance coverage is critical to their resilience and is in the best interests of all citizens, who are the one to ultimately shoulder the losses sustained by the public sector if the risks are not transferred to the market.

We advocate for the PPD to be amended to allow for more flexibility when public sector companies purchase insurance policies. We call on the European Commission to consider the following policy options:

1. *Adapting the PPD to introduce lighter requirements for insurance contracts.* We have identified several areas of possible regulatory improvement, although this option wouldn't solve the fundamental issues of the directive concerning the purchase of insurance.
2. *Excluding insurance policies from the scope of the PPD.* Such an exclusion would align with the existing exclusions of loans and other financial products and would be compatible with the overall objectives of the PPD.
3. *Allowing ex post reporting on the purchase of insurance policies.* This option would provide a greater degree of transparency while giving public sector companies the flexibility they require. However, this option would nonetheless represent an additional administrative burden compared to a simple exclusion (policy option 2).

We look forward to working with the Commission on this important issue and stand ready to discuss possible policy solutions further.

1 Problem description

In the European Union (EU), the awarding of public tenders is governed by three directives, known as the EU Public Procurement Directives (PPD). These are:

- Directive 2014/23/EU on the award of concession contracts,
- Directive 2014/24/EU on public procurement, and
- Directive 2014/25/EU on procurement by entities operating in the water, energy, transport and postal services sectors.

Their aim is to provide a level playing field for businesses across Europe to access public markets for contracts over a certain value. In the case of insurance products, the EU public procurement rules apply from either EUR 143,000 (for central government authorities), EUR 443,000 (for entities operating in water, energy, transport and postal services) or EUR 221,000 (for any sub-central authorities or bodies governed under public law) of premiums over the whole contract period.

In practice, the aforementioned thresholds mean that a large part of insurance policies contracted by public sector companies fall under EU rules for public tenders. **However, the current EU public procurement directives are ill-suited to the needs of public sector companies and generate market inefficiencies.**

1.1 Administrative burden

The procurement process is notably burdensome for both public sector corporate client and (re)insurers. This complexity limits the pool of available insurance providers, leading to reduced competition, which can ultimately result in higher costs or, in the worst-case scenario, a lack of insurance coverage.

Public procurement is a long process, which can take at least three months to complete. In comparison, a private company of similar size would be able to purchase similar coverage in a matter of weeks – although the exact amount of time may vary depending on the type of insurance policy and the specificities of the companies involved.

This is especially problematic because the insurance market is seasonal: insurance contracts usually last 12 months and start on 1 January, which means that a lot of activity is concentrated in Q4 of a given year, when renewals are negotiated. In this busy period, insurers often prioritise allocating their insurance capacity to private companies first. Indeed, as illustrated by one FERMA member with previous experience in the insurance sector, insurers could sign four workers' compensation policies with private companies in the time they would need to respond to one EU public tender.

The extensive documentation required from insurers further disincentivizes their participation in public tenders. It must be stressed that (re)insurers already evolve a highly regulated market, which considerably reduces the likelihood that tenderers are concerned by exclusion grounds and/or do not meet essential selection criteria (i.e. suitability to pursue the professional activity, economic and financial standing, and technical and professional ability); this fact is however not reflected in the amount of data points that they are asked to provide as part of the European Single Procurement Document (ESPD). Lastly, it must be stressed that the insurance market is a global market, and that certain risks can only be covered by British or American (re)insurance firms, which have often no interest in participating in long and inflexible EU public tenders.

For the above reasons, the PPD fail to foster competition between (re)insurers. Public tenders for insurance policies routinely result in only receiving one or two offers, and frequently none at all. Reduced competition in public tenders is especially a concern for new and/or high risks (e.g., covering electric bus depots or battery energy storage systems in property insurance) and in specialized

insurance lines (e.g., aviation, cyber, offshore, etc.). In such cases, the risk appetite from (re)insurers is very low, meaning that the pool of available providers is already more limited that for other risks. Adding extra administrative burden makes it even more challenging – and sometimes impossible – to find enough capacity in the (re)insurance market. Consequently, insurance managers working for public sector companies have to resort to negotiating directly with (re)insurance providers after their public tender failed – the PDD only effect is that they wasted time in the purchasing process.

1.2 Complexity of insurance programmes

The PPD are not flexible enough to accommodate the complexities of insurance programmes, and public sector corporate buyers could obtain better coverage through direct negotiation rather than through public tenders.

Insurance policies are complex products, whose value cannot be reduced to the amount of premiums paid. Deductibles, wordings, exclusions, requirements, terms and conditions, etc. are all aspects that need to be considered to properly assess the true value of an insurance contract for a given organisation. Moreover, the (re)insurance market is a dynamic one, with new innovative products being developed on a regular basis.

In practice, it is difficult for a public corporate insurance buyer to exactly state *ex ante* what they want out of a public tender. Large corporates are complex in terms of risk exposure, and consequently (re)insurers' quotes are not based on pre-determined fees but are tailored to the individual needs of the clients. Experience shows that insurers tend to adapt their original offer during the negotiation phase with their corporate clients, and it is therefore imperative that an active negation process can take place between insurer and insured.

However, this flexible approach stands in opposition with the requirement to define a finalized product in the beginning of the EU public procurement process. Currently, if a public corporate buyer wants to substantially amend its initial call for tenders, they need to start the process from scratch – be it to correct mistakes, to adapt to market conditions or to include additional specifications. This adds a considerable bureaucratic burden both on the buyer and the potential providers, who must submit their offer again.

Moreover, large enterprises, public and private, often use multi-layered insurance programmes to cover for their complex risk profile, each layer being the object of its own contract – possibly concluded with different insurers. Programmes with a large limit may require the use of quota share or excess of loss schemes, which require multiple (re)insurers to cooperate in order cover for risks that they would individually be unable or unwilling to underwrite.

Such programmes go against the fundamental assumption that public tenders must be won by one bidder only. Although public sector companies can manage to build multi-layered insurance programmes, the PPD make this process more difficult and cumbersome, as each layer much be the object of its own tender. Furthermore, under the current EU rules the withdrawal of an insurer covering for single layer of the programme can in some cases force public sector companies to publish a new tender for the entirety of the programme, thus penalizing not only the buyer but also every other (re)insurer involved.

1.3 Volatility of the insurance market

The price of insurance capacity is volatile, and public sector companies are often at a disadvantage when negotiating with (re)insurers, leading them to paying higher premiums than their private counterparts and exposing them to the risk of not finding coverage at all.

The insurance market is a highly volatile and cyclical market, with (re)insurers reassessing the price of their capacity for the next year based on the losses sustained by their clients and the claims they

paid during the previous one. This means that premiums can be low one year and increase significantly come the renewals period.

In such a market, it is not in the best interest of public sector companies to require them to disclose what they are willing to pay at the start of the public procurement process. Indeed, in soft market conditions, public corporate buyers might pay more than they should for a given insurance policy; in hard market conditions, they might fail to attract bidders and therefore have to start the process again, which takes time, resources and might lead them to overpay for their coverage.

This problem is mitigated to some extent by the possibility to renew an insurance contract without having to go through a public tender. This is especially useful in hard market conditions, as direct negotiations with the insurer can help public sector companies to obtain better terms and conditions that they would otherwise. Moreover, it is important to recognize that long-term, renewable insurance contracts offer value that cannot be quantified solely in numerical terms, as they facilitate claims processing and provide the opportunity for early renewals in increasingly rigid markets.

However, it is currently not possible to directly renew an insurance contract beyond 4 to 6 years (i.e. three times after the conclusion of the original contract). Depending on the market conditions at the time, the need to use a public tender may have serious consequences for the contracting company. For example, one of FERMA's member needed to insure a public works project, knowing that their current insurer was the only one able and willing to provide coverage. After 4 years, they resorted to a public tender: the same insurer automatically won and used this opportunity to increase premiums. It must be stressed that such a scenario is not the worst outcome possible, since public sector companies also risk their insurance provider stepping down, leaving them with no coverage at all.

Additionally, public sector companies need to do a new public tender if they want to introduce significant changes to when renewing a policy with their current insurer. This puts them at a disadvantage compared to private companies when it comes to adapting to evolving market conditions or seizing new opportunities.

1.4 Why does this matter?

Companies are confronted with an increasingly complex and volatile risk, from natural catastrophes to geopolitical risks. In this context, the resilience of public entities in particular is a key issue, because (i) they are more exposed to certain risks (e.g., state-sponsored cyberattacks), and (ii) EU societies cannot afford to have their activities disrupted, as they often provide essential public services.

Insurance is an essential risk transfer tool to bolster resilience, and the PPD hamper the ability of public sector companies to use it to its fullest potential. Public enterprises should not be discriminated against by (re)insurance providers merely because they have to comply with stricter regulations than the private sector.

Improving the insurability of public sector companies is in the best interest of EU citizens. Public sector companies currently self-insure risk that the market is unwilling or unable to cover, either by setting aside financial reserves to this end and/or by establishing captive (re)insurers. This is not a cost-effective to finance risks compared to transferring them to the private insurance sector, even more so because funds that are saved to cover for uninsured losses is money that is not going into providing public services. Furthermore, if a public sector company incurs significant losses, these losses are ultimately shouldered by public authorities, and therefore by the tax-payer – the more risks are transferred to private insurers, the less burden there is on public finances.

2 Policy recommendations

It appears clearly that the PPD are not fit for purpose regarding the purchasing of insurance by public sector companies and need to allow for more flexibility. FERMA acknowledges that some EU policymakers may nevertheless choose to treat this issue as an unfortunate side effect of the well-intentioned objectives of the directives to foster transparency in public tenders and fight against corruption.

We consider that introducing streamlined processes for public sector companies to purchase insurance products does not contradict the overall purpose of the PPD. Public sector companies are as a rule less politicized than other types of public entities (i.e. central or local government authorities) and have generally strict governance processes in place to avoid corruption and the mismanagement of resources. Moreover, public sector companies remain subjected to public law, the principles of which will continue to apply to their action. Lastly, insurance is but a relatively small part of the budget of any public entity and amending the PPD for the purpose of facilitating the buying of insurance policies is unlikely to have a significant impact on other types of public tenders or on the overall behaviour of public sector companies.

We call for the European Commission to consider the following policy options to address the issues we previously described.

2.1 Adapting the Public Procurement Directives

The PPD need to be adapted to fit the needs of public corporate insurance buyers, in order to simplify existing processes and introduce a greater degree of flexibility in public tenders. We have identified several areas where EU policymakers could improve upon the existing framework:

- Clarifying the conditions under which public tenders can be amended without starting the process all over again, notably to allow the corrections of mistakes made in good faith in the original tender.
- Clarifying the conditions under which an insurance contract can be renewed, to allow for the contracting company to introduce substantial change to its (re)insurance policies by negotiating directly with its current provider, so as to be able to better adapt to market conditions.
- Allowing public sector companies to directly renew their insurance contracts more than three times, preferably by setting no hard limit at all.
- Allowing each layer of a multi-layered insurance programmes to be considered separately for the purpose of calculating the value of the tender, which would also avoid jeopardizing the whole programme in the eventuality of one (re)insurance provider withdrawing coverage.
- Allowing for non-price criteria in the awarding of insurance contracts, thus acknowledging that several aspects must be considered to assess the value that an insurance policy brings to an organisation.
- Reducing the amount of documentation asked of insurers in the European Single Procurement Document (ESPD), taking into consideration that the (re)insurance market is already highly regulated.

Such amendments to the PPD would contribute to reduce the administrative burden of public sector companies and (re)insurers alike and could promote competition and allow the public sector to obtain more insurance capacity at prices closer to those enjoyed by private companies.

However, FERMA does not favour this policy option, as it doesn't solve the fundamental underlying issues of the PPD regarding the purchasing of insurance policies. Indeed, some key-issues cannot be solved without substantially altering the core dispositions of the directives: for

example, allowing for the syndication of insurers (a prerequisite for quota share insurance programmes) would means that a single contract can be awarded to multiple bidders. Moreover, simplifying the purchase of insurance for public sector companies in such a way would mean introducing exceptions across multiples articles of the directives, thus complexifying the overall legal framework and making it less understandable to most stakeholders, which in most cases need to comply with the PPD for purposes other than the buying of insurance.

2.2 Excluding insurance from the scope of the Directives

Another policy option would be to exclude insurance policies from the scope of the PPD, in line with the existing exclusions of loans and other financial services. This is the solution that FERMA favours.

Insurance policies are financial instruments sharing many similarities to those currently excluded from the scope of the PPD. Like other financial instruments, they serve as a form of risk financing, they operate within a well-functioning and highly regulated market. Like loans, they are complex products that require both flexibility and specialized expertise to be tailored to the needs of a given organisation, and their dynamic nature cannot be accommodated by the rigid framework of public procurement. Insurance policies cannot be more easily misused than loans. There is therefore no reason for insurance policies to remain within the scope of the PPD where loans and other financial services are not.

Excluding insurance policies from these directives would encourage greater participation from insurers, thereby fostering competition, and ultimately provide public sector companies with a greater level of protection at a lower cost. The above-mentioned principles of the public tenders will be maintained in any case, as public sector companies remain subject to public law in their respective member states.

It must be stressed that such an exclusion would not produce substantially different results than the current public tendering process. Indeed, public sector companies are already frequently negotiating directly with (re)insurance providers when their public tenders fail due to a lack of bidders. Excluding insurance from the scope of the PPD would simply save them time.

2.3 Allowing *ex-post* reporting on the purchase of insurance

A final policy option would be to allow for public sector companies to report on the reasons why they selected a given insurance policy after they purchase it. On the one hand, public sector companies would be empowered to negotiate directly with (re)insurers rather than having to go through the regular public tendering process, which would give them the flexibility needed to obtain better coverage. On the other hand, they would have to justify their choice, which would grant a greater level of transparency to the purchasing process. The information to be provided in such an *ex-post* report would need to be defined by the EU policymakers in collaboration with the stakeholder involved (i.e. insurance managers and (re)insurers) to ensure a suitable balance between flexibility and transparency.

It should however be noted that this solution would add an additional administrative burden on public sector companies – and indirectly on (re)insurers. This extent of this burden would depend on the data points that need to be reported, but it would in any case represent a point of friction that would not exist if insurance policies were simply excluded from the scope of the PPD. It would also be unfair for insurance policies to be subjected to this requirement while loans and other financial instruments – despite being similar in nature – would not be.

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