PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Statement of issues

1. On 28 September 2012, the Office of Fair Trading (OFT), in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act), referred to the Competition Commission (CC) for investigation the supply or acquisition of private motor insurance (PMI) and related goods and services in the UK.

2. The CC is required to determine whether any feature, or combination of features, of the relevant markets prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.[1] If the CC decides that there is such a prevention, restriction or distortion of competition, there will be an 'adverse effect on competition' (AEC).[2]

3. The purpose of this issues statement is to assist those submitting evidence to focus on the issues we envisage being relevant to our investigation. We have identified these issues on the basis of the OFT's reference decision,[3] our review of the material submitted to and gathered by the OFT, the initial submissions we have received and discussions we have had with a sample of parties, trade bodies, government departments and regulators,[4] and our own initial considerations. The issues raised in this document are intended as topics for investigation and at this stage we have not reached any views or findings on them.

4. We have presented the issues we intend to investigate in the form of theories of harm. Theories of harm are by definition theories and their identification does not in any way imply that we have reached views on whether they apply. Also, their identification does not preclude us from finding an AEC on another basis.

5. We now invite parties to provide us with their reasoned views on these theories of harm. We ask parties to support their views with relevant evidence (including original documentation and analysis). We also invite parties to tell us if they believe either that *(a)* the issues we have identified should not be within the scope of our investigation or are mischaracterized, or *(b)* there are further issues not identified or issues which we have indicated we are not minded to pursue which we should consider. If parties wish to make such representations, we ask that they indicate clearly why the issues they identify either should or should not form part of our investigation.

6. As our thinking develops, we expect to issue further documents for consultation prior to the publication of our provisional findings. If we find provisionally that there is an AEC, we will at that point begin a consultation on possible remedies.

7. At the same time as publishing this issues statement, we have also published an administrative timetable which provides parties with an overview of our process and our intended timetable.

8. To submit evidence, please email **pmi@cc.gsi.gov.uk** or write to the address below **by 5pm on Wednesday 9 January 2013**:

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[1] See section 134(1) of the Act.
[2] As defined in section 134(2) of the Act.
[3] See the OFT reference decision, September 2012.
[4] See Annex A for a list of parties and government departments/regulators with which we have had discussions so far.

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Outline of PMI and related goods and services

9. Many parties are involved in the provision of PMI (ie car (not motorbike) insurance to non-commercial customers) and related goods and services. The focus of the evidence submitted to the OFT and the initial submissions we have received has been on the following:

   (a) insurers (parties which supply motor insurance to cover for the costs arising from a motor accident);

   (b) brokers (parties which act for consumers in finding appropriate PMI);

   (c) credit hire companies (CHCs) (parties which provide replacement vehicles to non-fault claimants, seeking to recover the cost from fault insurers);

   (d) price comparison websites (PCWs) (parties which provide websites on which the prices of motor insurance (and other goods and services) can be compared);

   (e) direct hire companies (parties which provide replacement vehicles under a contract with the party which will pay for the service);

   (f) repairers (parties which undertake the repair work to vehicles damaged in motor accidents);

   (g) parts and paint suppliers (parties which supply the parts and paint for repair work to vehicles);

   (h) claims management companies (CMCs)[5] (parties which act for non-fault claimants to manage the various aspects of their claims, eg repair work, the provision of a replacement vehicle and personal injury (PI); and

   (i) solicitors (solicitors who act for a claimant (or defendant) in the event of a claim (in particular for PI)) arising from a motor accident).

   In addition, many other parties provide goods and services which are related to PMI, for example claims verifiers, costing engineers, roadside recovery vehicles and the emergency services.

10. As set out in *Market Investigation References: Competition Commission Guidelines, CC3* (paragraph 1.21), we consider the definition of the relevant markets and the examination of competition within those markets to be overlapping parts of the same analysis. Therefore, initially, we will begin our analysis using a high-level framework and, as our investigation progresses and we understand better the nature of competition between parties, we will form our views on the definition of the relevant markets. As noted in CC3 (paragraph 2.2), there is inevitably an element of judgement

[5] Sometimes called accident management companies.

involved in defining the market and we will adopt in our investigation the methodology most appropriate for the purposes of our investigation. Our examination of competition will also take into account, as necessary, constraints outside the relevant market, segmentation within the relevant market, and ways in which some constraints may be more important than others.

Theories of harm

11. We have grouped the theories of harm (ToHs) we have identified into five broad areas, as follows:

- ToH 1: harm arising from the separation of cost liability and cost control (moral hazard).
- ToH 2: harm arising from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services.
- ToH 3: harm due to horizontal effects (market concentration).
- ToH 4: harm arising from providers' strategies to soften competition.
- ToH 5: harm arising from vertical relationships (vertical integration).

In this issues statement we discuss each area in turn, in some cases identifying a number of more specific ToHs within an area.

12. It appears to us that some characteristics of the market are not by themselves a cause of harm but may affect the extent of harm arising from other features of the market (such as the cyclicality of insurers' profitability). We have not discussed such characteristics as giving rise to harm but we will consider them under the ToHs we have identified where relevant. An exception to this approach is with regard to barriers to entry into the provision of PMI or establishing a PCW, which appear to be particularly important as a pre-condition for harm from concentration (ToH 3). Therefore, we discuss this issue separately (see paragraphs 109 to 114).

13. We note that none of the ToHs we have identified, and none of the five broad areas into which we have grouped them, are mutually exclusive. There are clearly some interrelations between different theories (for example, between vertical relationships and the extent of concentration), and we have sought to indicate these interrelations where they may arise.

14. Before setting out the five broad areas of our ToHs, we first discuss the general nature of PMI and consider whether harm may arise for some consumers from not being able to understand and evaluate the product effectively.

Transparency and product complexity

15. PMI is a complex product and policy documents are lengthy contracts, which many consumers may not read properly.[6] For this reason, some customers may not be aware of the details of their PMI cover, such as the compensation level for different types of damage and the ancillary covers included and not included (see paragraph

[6] Moreover, where PMI is purchased online, some consumers might not read the policy documents until they are received through the post in hard copy, which will be after having purchased the policy.

60). Moreover, at the point of renewal, some of the terms of the policy may change (eg the excess) without the customer realizing.

16. It appears to us that this complexity and lack of transparency may make it difficult for some consumers to compare policies and make informed choices balancing price and quality when buying PMI. Insurance also has the inherent characteristic that the quality of the product (eg the reliability of the provider) is typically not visible to the consumer at the point of purchase. For both of these reasons, some consumers may be unaware that other policies may offer them better value (when considering the range of cover, level of cover, price, etc).

17. However, it is within the remit of the Financial Services Authority (FSA) (in due course, the Financial Conduct Authority (FCA)), as the regulator of insurers and brokers, to ensure that sufficient information is provided to consumers in a way that they understand and, to our knowledge, the FSA is considering this issue in relation to PMI.[7] For this reason, we do not intend to consider more generally the issue of the complexity of PMI and the transparency of information supplied at the point of sale by providers of PMI (ie insurers and brokers) to consumers. Nevertheless, we will consider the complexity of PMI and the transparency of information available to consumers to the extent that these issues impact on the ToHs we intend to investigate, as set out in this issues statement.

ToH 1: Harm arising from the separation of cost liability and cost control (moral hazard)

18. This issue was the focus of the OFT's investigation prior to its reference to us.

Legal aspects relevant for PMI

General legal principles

19. In the UK every driver is legally obliged to take out third-party motor insurance, ie insurance that covers the cost of damage and/or injuries sustained by another party (or parties) in the event of causing a road accident. However, few consumers have third-party-only cover. It is possible, in addition to third-party cover, to insure the cost of fire and theft to the policyholder's vehicle (ie in a third party, fire and theft policy) but most consumers buy a policy which, in addition, insures the damage to their own vehicle sustained through an accident (ie a 'comprehensive' policy). Comprehensive insurance policies sometimes also cover the policyholder for other costs arising from an accident, for example legal expenses, the provision of a courtesy car, etc. Alternatively, if not included as standard, these 'add-ons' can be added to the policy at additional cost (see paragraphs 59 to 65).

20. By law the fault party is required to put the non-fault party 'back into the position he would have been but for the accident', ie to compensate the non-fault party for any damage and/or injuries. This implies that the cost of services chosen by the non-fault party to address the consequences of an accident are paid for by the fault party's insurer, which may include the cost of repairs, a temporary replacement vehicle, medical treatment and legal costs. The fault party has no right to choose the provider

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[7] We note that the OFT called on the FSA to work with insurers and insurance brokers to ensure that consumers are provided with appropriate information when purchasing motor legal protection, which is a product generally sold alongside, or included within, a PMI policy. The OFT saw the FSA as best placed to take action because it could use the Financial Services and Markets Act 2000 to ensure that consumers are treated fairly (see the OFT market study, paragraph 1.12). The FSA has set out its approach in its Insurance Conduct of Business Sourcebook, which requires that insurers take reasonable steps to ensure that a customer is given appropriate information about a PMI policy or product.

of these services or to specify the terms of any services provided. The only control on cost is the non-fault party's legal duty to mitigate his loss. Therefore, the repairer to conduct the repairs to the non-fault driver's car and the CHC to provide the temporary replacement vehicle will typically be chosen by the non-fault party's insurer or broker, or by a CMC to which either the insurer or broker (or another party) has referred the case. Alternatively, the non-fault party may arrange for the provision of these services himself and seek reimbursement from the fault insurer directly. The non-fault party is entitled to have his or her car restored to its condition prior to the accident and, while it is being repaired, the non-fault party is entitled to the use of a temporary replacement car, on the basis of it being 'like for like, subject to need'.

21. To attract business, service providers often pay referral fees to those who put them in touch with parties involved in an accident, in particular with non-fault parties. As a result of LASPO,[8] the payment and receipt of referral fees by regulated professions for claims with a PI element will be banned from April 2013 (applying to solicitors, insurers, brokers and CMCs); however, referral fees will still be able to be paid to and received by all businesses for claims where there is no PI element (and by non-regulated businesses, including CHCs and repairers, regardless of the nature of the claim).[9]

22. Figure 1 summarizes the interaction between parties and service providers in relation to a material damages claim.

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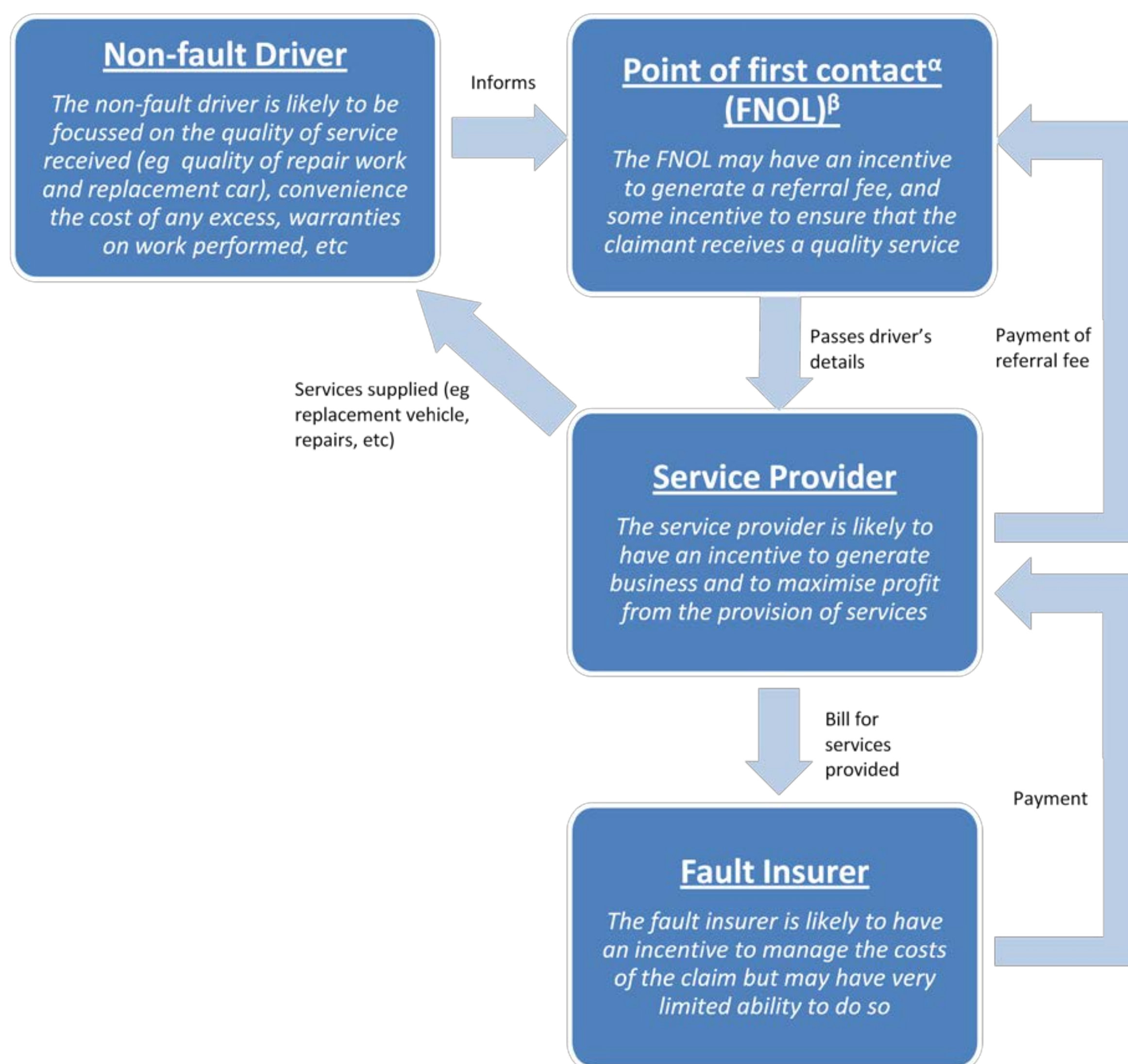
[8] Legal Aid, Sentencing and Punishment of Offenders Act, 2012 (LASPO). See sections 56–60.

[9] It is our understanding that the parties acting for a non-fault claimant often pursue separately the different claims relating to the same accident (eg the non-fault insurer may handle the claim for repairs, a CHC may handle the claim for a replacement vehicle and a PI solicitor may handle the claim for damages as a result of PI). Alternatively, one or more of these claims might be aggregated to become elements of a consolidated claim (eg a CHC might handle the claim for both repairs and a replacement vehicle).

FIGURE 1

Parties and relationships in a material damages claim after a road accident



Source: CC, based on Figure 3.1, OFT market study.
α The first person or company a party to an accident gets in touch with after the accident (in most cases this is the party's own insurer or broker but it could be a dealership with which the party has a relationship, a vehicle recovery provider, a vehicle repair centre, the police, etc).
β First notification of loss.

Additional aspects relevant for PI claims

23. Many PI claims are pursued under Conditional Fee Agreements (CFAs), also called 'No Win No Fee' agreements, under which claimants do not bear the cost of their own solicitor's costs. If the claimant loses, the solicitor forgoes the fee; while if the claimant wins, the defendant pays the claimant's legal costs, including a success fee. Currently, this success fee is calculated by reference to the legal costs related to the claim itself (up to 100 per cent of the legal costs), though from April 2013 this will change to be up to 25 per cent of the damages awarded.[10]

[10] LASPO, sections 44–45.

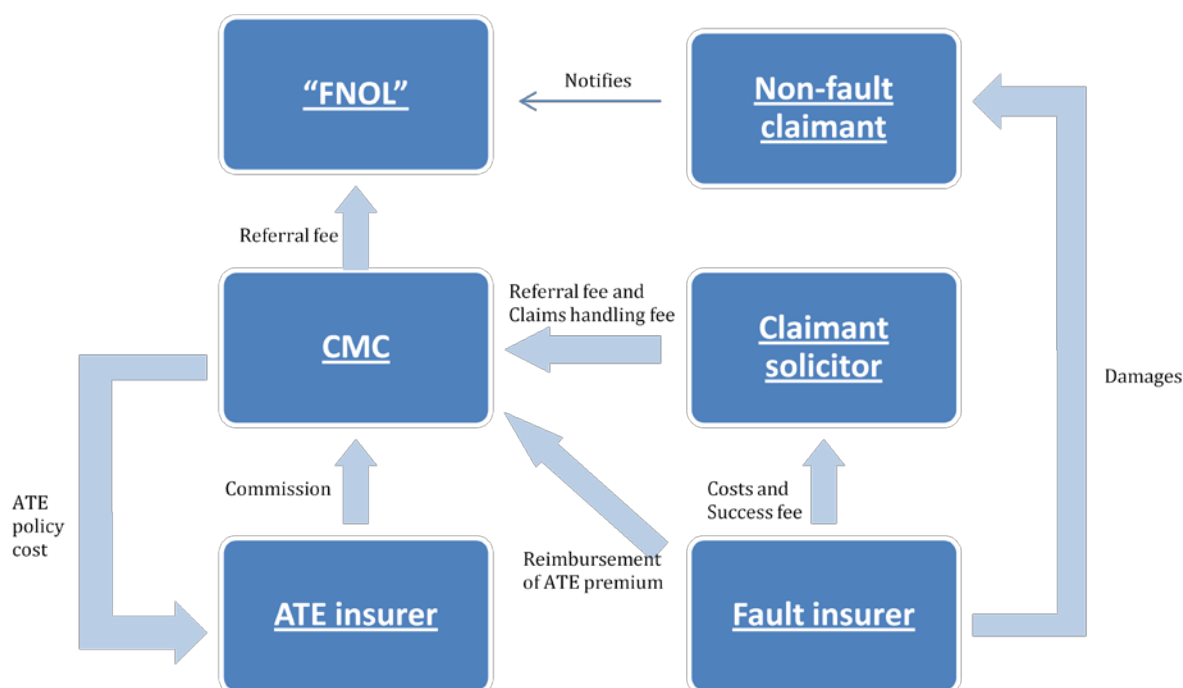
24. After the event (ATE) insurance makes pursuing a claim even less risky for claimants as it insures the claimant against the risk of having to pay the other side's cost in the event that he or she loses the case. Currently, the ATE premium paid by claimants (or their representative solicitors) is recoverable in successful cases, though this will no longer be possible after April 2013 (due to measures in LASPO).[11]

25. LASPO and other proposed reforms apply mainly to civil procedure in the courts in England and Wales. As far as we are aware, the relevant bodies in Scotland and Northern Ireland are considering whether or not it may be appropriate to implement similar measures and we will continue to monitor developments through the course of our inquiry.

26. Figure 2 summarizes the typical interaction between parties and service providers in relation to a PI claim.

FIGURE 2

Parties and payments in a successful PI claim after a road accident



Source: CC.

Incentives arising in relation to non-fault claims

27. The present situation gives rise to incentives which may cause distortions. If there is a non-fault claim, the person receiving the service does not pay for it, but a third party does. As a result, the person receiving the service may have little incentive to keep the price of the service down (save for the legal duty to mitigate loss) and firms providing services to non-fault parties are less likely to compete on price. As a result of this separation of cost liability and cost control it is possible that:

[11] LASPO, section 46.

(a) services provided to non-fault parties may be more expensive than they need to be—for example, repairers might charge higher labour rates, or an additional management fee, for repairs which are to be paid for by a non-fault insurer; and

(b) there may be an incentive to 'over-provide' services, ie to provide a higher quality of service than is required—for example, a CHC might provide a high-value replacement car to a non-fault party even though the customer would have been content with a less expensive car.

28. However, in any comparison with prices charged in other contexts (eg with the cost of repairs and replacement vehicles provided to fault parties), it will be important to consider the differences in the services provided. For example, a repair service to a non-fault party may be provided on credit terms, which generates an additional cost. Also, it will be important to consider the rights of a non-fault party to be put back into the position prior to the accident (subject to mitigation), with the cost to be borne by the fault party, which is a different standard from that to which a fault party is entitled (which is that specified in the terms of his or her insurance policy).

29. A further factor which might increase the extent of overpricing or overproviding (as described in paragraph 27) is their effect in increasing the costs of the fault insurer, by which the non-fault insurer, which may control the costs, may achieve a competitive advantage.

30. Overall, each insurer is likely to be in the fault position for some claims and in the non-fault position for other claims, which is likely to result in all costs being pushed up despite this not being in the interest of most insurers.[12]

31. Given that there appears to be competition between insurers in the supply of PMI,[13] we would expect insurers to pass on to consumers at least a part of any increase in costs resulting from the separation of cost liability and cost control through increased premiums.

32. Referral fees represent a cost of acquiring business for many providers of services to non-fault parties (eg CMCs, CHCs, solicitors, etc). As these costs need to be recovered, they result in costs to fault insurers. However, whether there is a more cost-efficient method by which such service providers could attract business is unclear. Given that there appears to be competition between insurers in the supply of PMI, insurers are likely to pass on the costs they suffer as fault insurers (partly or in full) to consumers through increased premiums, though, as insurers also receive referral fees and are likely to pass on (some or all of) these revenues in decreased premiums, the net financial effect on consumers is unclear. Overall, given that other types of companies (such as CMCs, roadside recovery vehicles or even the emergency services) may receive a referral fee, while only fault insurers pay the non-fault party's bill, it appears likely that the net effect on premiums is upwards.

Measures to mitigate this harm

33. We are aware that insurers have engaged in various practices in an attempt to mitigate the harm arising from the separation of cost liability and cost control. These measures include: *(a)* bilateral agreements between insurers, under which they either

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[12] This situation is commonly called a 'prisoners' dilemma'.
[13] See the OFT market study, paragraph 2.14.

deal with claims on a reciprocal basis[14] or agree to handle claims in ways which reduce their mutual costs; *(b)* the General Terms of Agreement (GTA), which sets standardized rates for credit hire charges; and *(c)* efforts by insurers when representing a fault party to 'capture' the non-fault party in order to be able to control the services provided. However, it appears to us that such efforts can also be seen as part of the harm arising from the problem of the separation of cost liability and cost control, since the cost of these efforts, and any possible detrimental effects on competition arising from them,[15] could be avoided if that problem did not exist. Therefore, in our assessment we will consider whether such measures are effective in addressing the problem and the extent to which they may result in additional costs to insurers and to consumers.

34. We are also aware that these measures may themselves give rise to other problems. For example, if consumers are not aware of their legal rights, the presence of *(a)* bilateral agreements, or *(c)* the capture of non-fault parties by fault insurers, may result in the services provided to non-fault parties being of lower quality than that to which they are entitled and would otherwise choose. We intend to consider such issues under ToH 2 where we consider, more generally, the possible harm arising from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services (see paragraphs 39 to 45).

Practical implications of statutory and regulatory changes

35. LASPO will lead to changes which will affect the incentives and competitive strategies of all firms involved in PI claims, including those arising from road traffic accidents. In addition, the Ministry of Justice (MoJ) is considering further reforms to reduce the cost of PI claims, including *(a)* raising the threshold of damages for claims that can use the RTA protocol scheme to £25,000 (and extending it to include Employers' and Public Liability claims);[16] *(b)* reducing the fixed costs recoverable by PI solicitors when progressing claims through the RTA scheme; *(c)* creating independent medical panels to support better diagnosis in whiplash claims arising from road traffic accidents; and *(d)* increasing the threshold of damages for PI claims arising from road traffic accidents to enable them to be brought through the small claims track. These reforms would be likely to lead to changes in the business models of insurers, CMCs and solicitors, though, as the reforms are yet to take effect, the nature of the changes is difficult to predict.

36. The extent of the measures being considered by the MoJ has important practical consequences for any analysis we might conduct in relation to PI claims arising from motor accidents. Any data which we might use in our analysis leading up to our provisional findings would pre-date the measures coming into force and would be unreliably indicative of the future, and, even after that time, the situation will remain in flux. Since we will be unable to assess the effect of the statutory and regulatory changes within our timetable, it will be impossible for us to assess how effective these measures are likely to be and to what extent the incentives described above as they apply to PI claims are likely to be affected.

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[14] For example, two insurers may agree to bear the cost of addressing the needs of their respective non-fault customers, rather than procuring services for them at the cost of the other insurer. If the risk profiles of the two customer bases are different, a side payment can be made to reflect the different costs incurred.

[15] The GTA, and any similar agreements, may have anti-competitive effects, in particular as the rates set in the GTA may act as ceiling prices in the market.

[16] The RTA pre-action protocol sets out a procedure which claimants of damages arising from road traffic accidents which include a PI element (currently up to a value of £10,000) must follow. The RTA portal is an electronic interchange which facilitates the exchange of correspondence and documentation in line with the RTA protocol.

37. In our view, given the considerable changes which are about to occur in relation to PI, it is an inopportune time for us to investigate whether there are issues of competition in this area. Nevertheless, while investigating other issues (as set out in this issues statement), we will continue to consider evidence relating to PI if it is informative in regard to those issues. Beyond that, we are minded to leave the area of PI to be considered by the MoJ.

Summary

38. We intend to investigate whether the separation of cost liability and cost control in the supply of services (excluding PI) to non-fault parties involved in motor accidents increases the costs of the services supplied (due to a lack of price competition or an unwarranted increase in quality).

ToH 2: Harm arising from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services

39. Following an accident, one of a number of parties will be a driver's point of first contact (see Figure 1). This may be the insurer, the broker, a dealership with which the driver has a relationship, a roadside recovery vehicle, the emergency services, etc. Where the driver is at fault, the claim (assuming he has a comprehensive policy) will typically be handled by his or her insurer. Where the driver is not at fault, the claim may be handled by the non-fault insurer, the non-fault driver's broker, passed to a CMC or captured by the fault insurer. In all these cases, whether the driver is at fault or not, another party controls the procurement of services even though it is the driver, and any passengers in the non-fault vehicle,[17] who will be the beneficiaries. In other words, there is typically another party which acts on the claimant's behalf.

40. This separation between the beneficiary of post-accident services and the procurer of those services could result in harm as the incentives of the different parties may not be aligned. For example, the fault insurer may have the incentive to repair the damaged car at the lowest possible cost, possibly accepting a low quality of repair, while the claimant would want the car returned to its pre-accident condition. The claimant may not be able to verify the quality of the repair or may believe himself to be unable to dispute the repair approach chosen (eg whether to repair or replace parts and the kind of parts used). Similarly, the non-fault claims handler may have the incentive to refer repair work to the provider willing to pay the highest referral fee rather than the repairer providing the best quality and service to the claimant. It appears to us that there are many such ways in which the services procured by a party on behalf of a customer may not be those which are in the customer's best interests, whether in relation to repairs, a replacement vehicle, a solicitor, etc.

41. It seems to us that many customers may be unaware of their rights in choosing the party to provide them with post-accident services. As such, an underlying cause of this potential harm may be a lack of transparency both at the point at which a policy is sold and when post-accident services are provided to claimants.

42. Alternatively, it appears to us that some customers may be directed towards services which they might not otherwise choose through various actions of their insurer or claims handler. For example, an insurer/claims handler might say that if a customer wishes to choose his own repairer, rather than to allow the use of the insurer's/claims

[17] Passengers in the non-fault vehicle, if injured, may claim for damages against the fault driver.

handler's own preferred repairer, the work will not be guaranteed or the customer must pay the excess in the policy (though this may be recovered subsequently if the customer was not at fault in the accident).[18] It appears to us that presenting customers with such choices is likely to be effective in steering customers towards the providers which serve the insurer's or claims handler's best interests.

43. The effects of the possible misalignment of incentives between the beneficiary of post-accident services and the procurer of those services may affect competition between the providers of those services as they may compete to provide services to the procurer (ie the insurer, CMC, etc) rather than to the consumer (ie the claimant). For example, CHCs and repairers might compete for work from CMCs on the basis of which can pay the highest referral fee rather than the quality of service they offer to the consumer (though, in the case of non-fault work, the quality might remain high due to the separation of cost liability and cost control (see ToH 1)). Repairers might compete for work from insurers on the basis of whether they offer the lowest possible rates (eg for labour) rather than whether they do a good job in repairing vehicles.

44. In such circumstances, the quality of service to which the customer is entitled under either his insurance policy (in particular if at fault) or under law (in particular if not at fault) may not be delivered.

45. Given the various ways in which consumers may be put at a disadvantage due to information asymmetries, leading to a lack of alignment between their interests and those of the parties which procure post-accident services on their behalf, we intend to investigate this issue further. Given that the FSA/FCA has ongoing responsibility for the regulation of how insurance is sold to consumers, we will consider any work the FSA/FCA is doing in this area as we undertake our own analysis.

ToH 3: Harm due to horizontal effects (market concentration)

46. It may be that there are horizontal effects on competition (ie effects arising from high market concentration) in regard to the supply of each of the relevant goods and services (see paragraph 9).

Insurers

47. Given the relatively large numbers of insurers providing PMI, there appears to be little scope for harm from horizontal market concentration, ie market power due to a small number of competitors selling PMI policies. However, parties commenting to the OFT raised the concern that, in certain market segments, the number of insurers quoting for policies is much lower (in particular, for policies for drivers in Northern Ireland, young and inexperienced drivers and possibly also for elderly drivers). The Consumer Council of Northern Ireland told the OFT that, according to its 2009 research, at that time at most 15 insurers typically quoted for the supply of PMI to a consumer in Northern Ireland, while up to 51 insurers may have quoted to a consumer in Great Britain.

48. Given these views, we intend to assess the extent of any market segmentation and consider whether the reduced number of rivals in some segments may allow those operating in that segment to charge a higher price (or reduce quality). This will involve considering why other insurers do not enter into these segments (see para-

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[18] We have been told that, under the terms of some PMI policies, the non-fault driver might have to pay an amount which is twice the stated excess in order to use a repairer other than the insurer's preferred repairer (though all of this amount should be recoverable once the claim is settled by the fault party).

graphs 109 and 110). Given that it would appear that the barriers to moving from one market segment into another are quite low, we intend to conduct our analysis of harm arising from market concentration at a high level initially to inform us whether we should continue to look at it in more detail. In our assessment, we will consider the effects of the underwriting cycle[19] on profitability and pricing to avoid wrongly attributing temporary periods of higher profitability in a market segment to concentration.

Price comparison websites

49. Every time a consumer purchases PMI through a PCW, the PMI provider (ie insurer or broker) pays a cost-per-acquisition (CPA) fee to the PCW. Given that there are currently only four large PCWs offering quotes for PMI,[20] there may be scope for these PCWs to use their market position to charge a higher CPA to PMI providers than they would if the number of competing PCWs were larger. We note that some PMI providers told the OFT that they needed to be listed on several PCWs, which made the limited number of PCWs more problematic as they had fewer alternatives. However, we note that some PMI providers (or brands) do not to sell through PCWs at all.[21]

50. The incentives for a PCW to increase the CPA is likely to be mitigated by both *(a)* each PCW needing to sign up a large number of providers in order to compete against other PCWs (ie there are network effects); and *(b)* PMI providers having other routes to market (eg directly through their own websites and call centres and, for insurers, through brokers).

51. The possible market power arising from a small number of PCWs would result in harm if it were to lead to higher CPAs. This in turn may cause PMI providers to raise their prices (ie higher PMI premiums).[22] However, we note that PCWs are likely to have benefits for consumers since they simplify the comparison of policies offered by different providers and therefore reduce consumers' search costs. Recently, the OFT produced a market study report on PCWs which highlighted these benefits[23] and, in its reference decision, the OFT noted that the rise of PCWs had intensified price competition between providers of PMI. Currently, it is unclear to us how these benefits are affected by the number of PCWs and whether they would diminish if there were more.[24]

52. Since it is unclear whether the four large PCWs have market power and, if so, the extent to which any increase in CPA leads to customer harm and whether this harm is outweighed by any benefits for consumers from there being a limited number of PCWs, we intend to consider this issue. However, given that there have been few concerns expressed by parties on this issue, we intend to conduct this analysis at a high level initially to inform us whether we should continue to look at it in more detail. If we find that it warrants further investigation, this will involve considering barriers

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[19] The underwriting cycle refers to a cyclical fluctuation in the profitability of PMI (and other insurance) resulting, for example, from reassessments of risks (eg due to an increase in the costs of certain types of claims); see Fenn, Vencappa (2005): Cycles in insurance underwriting profits: Dynamic panel data results. CRIS Discussion Paper, University of Nottingham, for a summary of reasons discussed in the academic literature.

[20] *Comparethemarket*, *Go Compare*, *Confused?* and *Moneysupermarket*.

[21] For example, Direct Line.

[22] This consumer harm would be greater if the presence of 'most-favoured-nation' (MFN) clauses in the contracts between insurers and PCWs (see paragraphs 90–95) were to lead to an increase in insurers' prices through other sales channels as well.

[23] *Price Comparison Websites*, published 23 November 2012.

[24] For example, it is possible that, if there were more PCWs, either fewer consumers would obtain quotes through each PCW, diminishing the beneficial network effects for each PCW (and PMI providers), or consumers would search through more PCWs than they do currently, increasing their search costs.

faced by new PCWs to launching and becoming established (see paragraphs 111 to 114).

Other sectors

53. The supply of the other goods and services which we have considered (see paragraph 9) appears to be characterized by a large number of providers (ie brokers, CHCs, direct hire companies, repairers, CMCs, parts and paint suppliers and solicitors). We are aware that some of these services are typically provided on a regional or local basis (eg individual repairers and some brokers) but, in these cases, there appears still to be a large number of providers. For this reason, we do not see scope for harm from horizontal effects in the supply of these other goods and services and we do not intend to consider them further in this regard.[25] We will consider possible harm involving some of these providers in relation to ToH 1 (see paragraphs 18 to 38), ToH 2 (see paragraphs 39 to 45) and ToH 5 (see paragraphs 77 to 108).

ToH 4: Harm arising from providers' strategies to soften competition

54. It may be that there are practices in relation to the supply of PMI and related goods and services which have the effect of softening competition, with the effect of increasing prices (or reducing quality) to consumers.

Strategic product differentiation of PMI

55. The degree of product differentiation in PMI policies means that consumers need to shop around to compare the different levels of cover included (as well as the price). Since consumers value their time and will thus incur a cost when they spend time searching for the right policy, the degree of product differentiation in PMI policies may lead to harm for some consumers compared with a situation where there is a smaller degree of product differentiation. Such harm may be direct, ie high search costs, or indirect if search costs are such that they prematurely stop consumers searching and consumers buy sub-optimal policies.

56. Since firms enjoy some market power if customers cannot switch easily or effectively because of the cost (or opportunity cost) of finding better deals, they may have an incentive to increase customers' search costs to obtain or maintain market power. As a result, they may differentiate their products more than in a situation where search costs are lower. For PMI providers (ie insurers and brokers), this may be achieved by, for example, offering their products under several different brands, offering both bundled products (ie including add-ons) and unbundled products, and offering products with different degrees of quality (ie some with better cover than others, eg a lower amount of excess).

57. However, we note that product differentiation is likely also to yield benefits for consumers since it makes it more likely that one of the PMI policies on offer will exactly fit a consumer's needs.

58. We intend to investigate whether the interrelation between search costs (due to the complexity of PMI policies) and product differentiation results in net consumer harm.

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[25] The OFT concluded on the basis of information received in response to its call for evidence that the five or six CHCs submitted over 70 per cent of all credit vehicle hire invoices received by insurers; see the OFT market study, paragraph 2.15, and its summary of the information received in response to the call for evidence, paragraph 9.2. We have seen no indication, and see no reason to believe, that this extent of concentration is likely to lead to harm.

Drip-in pricing (partitioned pricing)

59. Drip-in pricing is when consumers see only part of the full price when they start to shop and price increments are dripped in through the sales process as additional products and services are added to an initial, basic product. Sometimes these additional services may be compulsory but the price for them is not displayed until the end of the transaction process (eg a debit/credit card payment fee). Where the additional service is optional, it is sometimes given as an 'opt-in' and sometimes as an 'opt-out', and this presentational difference may have consequences for the number of consumers who purchase the extra services.[26] Such drip-in pricing may be used by PMI providers for sales through all sales channels or just some (eg sales through PCWs).

60. For PMI policies, add-ons might include additional insurance covers (eg breakdown cover, windscreen cover or legal expenses cover) or additional levels of insurance cover (eg the provision of a courtesy car in the event of the driver being at fault in an accident or no claims bonus (NCB) protection). In some comprehensive policies, some of these additional services are provided as standard, but in others they are optional. Some of these additional services may also be available from other providers (eg breakdown cover, windscreen cover or legal expenses cover) but some may only be available from the insurer or broker providing the PMI (eg the provision of a courtesy car or NCB protection).

61. Drip-in pricing for optional add-on services may be detrimental for customers if they subconsciously assume that they already own the main insurance policy, or already see themselves in the position of the owner, when they are still in the purchase process. If so, ceasing the purchase would be perceived as a loss even though more charges are being added. This is known as 'loss aversion' or an 'endowment effect'. Moreover, customers may consider the base price and the charges for the add-ons separately and may 'anchor' on the base price, which they see first, placing less significance on the additional price elements presented later. This may be true in particular if they believe that other providers use the same practice and apply similar charges for similar add-ons, and if there are high search costs relative to the benefits customers would expect to achieve from further price research. If the price for the final overall policy (including add-ons) is not shown (or mentioned) prominently, customers may find it difficult to calculate (or may not make the effort to do so), which will impede their ability to compare between policies offered by different providers.

62. Having to opt out of add-ons may also lead to customer harm if consumers do not notice that they are buying the add-on or erroneously conclude that a given add-on must be important (given that it has been added automatically) and, in either case, end up purchasing a product or service which does not offer value for money for them.

63. We note also that drip-in pricing may lead to the under-consumption of add-ons by some customers as some are likely to value an add-on service but be cautious of overpaying and be unwilling to research prices given that the price typically only becomes apparent late in the sales process.[27]

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[26] See the OFT study Advertising of Prices, in particular, Appendix C, paragraphs 77–86.
[27] The OFT also thought it possible that some customers might benefit from a low-priced basic offer because their purchases are effectively cross-subsidized by selling more comprehensive packages at a higher price to other customers. However, the OFT thought it very unlikely that consumers would benefit from offsetting efficiencies arising from the misleading use of drip-in pricing in advertising (see Appendix C, paragraph 86, of its study).

64. Empirical studies have found that drip-in pricing may generate a bias in behaviour such that consumers end up buying more, and paying more, when drip-in pricing is used than when the total price is shown from the start. An OFT experiment showed that participants searched less with drip-in pricing than when the full price per unit was shown. Repeated purchases led to improved purchase decisions, but this learning did not completely eradicate the customer detriment due to the drip-in pricing.[28]

65. We intend to investigate whether the prevalence of drip-in pricing at the point of sale of PMI (through all sales channels) affects competition for PMI or the goods and services added on and results in net consumer harm.

Transparency and complexity of add-on products and services

66. Many of the additional products and services which might be bought alongside PMI are complex (eg legal expenses cover, windscreen cover, breakdown cover and NCB protection (see paragraph 60)). With these products, it may be difficult for consumers to know what is included and excluded and the information which might be available to consumers at the point of sale might not enable them to understand the products fully or estimate their value.

67. This characteristic of many of the add-on products and services available alongside PMI may also be true of PMI but it appears to us that it is within the remit of the FSA/FCA to consider whether consumers have sufficient information in order to be able to make informed choices when purchasing PMI (see paragraph 17). For this reason we do not intend to consider further harm arising from the complexity of PMI or a lack of transparency in how it is sold.

68. The sale of some of the add-on products often sold with PMI may also be within the remit of the FSA/FCA (eg because they are also regulated insurance products) but because of the overlap between how these products are sold and the possible harm arising from drip-in pricing (see paragraphs 59 to 65) we intend to consider further whether harm does arise in relation to the complexity of these products and/or any lack of transparency in relation to them.

Increasing the obstacles to customers switching PMI provider

69. There are various factors which might make it harder for consumers to switch their PMI provider (ie insurer or broker), enabling providers to increase the prices (or reduce the quality of policies) offered to customers on renewal.

Automatic renewal

70. The automatic renewal of PMI policies (unless explicitly cancelled) might discourage or make it harder for consumers to switch.[29]

Charging a cancellation fee

71. A high PMI cancellation fee may be a barrier to switching if customers do not consider the cancellation fee as part of the effective price when buying the PMI policy.

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[28] See the OFT study on advertising of price, paragraph 3.32.

[29] While automatic renewal may reduce the risk of driving without insurance, a reminder letter to the insured might be sufficient for the purpose (and would not impede switching).

Protected no-claims discounts

72. An NCB is a discount off the PMI premium which drivers may obtain for not having had any claims in the last number of years. These years of NCB are transferable between insurers and are confirmed by the current insurer in a certificate sent with the renewal quote/notice. If drivers claim under their PMI policies, they lose some years off their NCB.

73. Consumers can protect their NCB with an optional insurance cover so that, in the event of a claim, they do not lose years from their NCB (and continue to benefit from the discount off their premium). However, we noted that a consumer's insurer would still be aware of the accident and the insurance premium in the following year might still rise even if the NCB is protected.

74. We considered whether, in the event of trying to switch, a consumer's new insurer would price a premium for the consumer with the same information as the consumer's existing insurer. We noted that if the consumer had had an accident/claim in the year, both the current insurer and the potential new insurer would be aware of it as this information is part of the standard set of questions all insurers use. With regard to NCBs, the ABI confirmed that the consumer may be able to transfer the number years of NCB accrued to a new insurer (see paragraph 72), but added that it may be unclear to the new insurer how this level of NCB has been achieved. The ABI said that insurers' practices differ considerably, for example in *(a)* the amount of NCB lost as a result of a claim, *(b)* the effect of NCB protection (eg how many claims are allowed while the NCB is protected), and *(c)* the number of years at which the NCB level is capped (eg five years, ten years, etc). Moreover, some insurers may award extra years NCB as a marketing tool to attract customers.[30]

75. Overall, it appears to us that there is unlikely to be a material difference in the information available to a potential new insurer when pricing a policy and that which is available to a consumer's existing insurer. However, since it is unclear whether a protected level of NCB can be transferred effectively to a new insurer (or 'replaced' by a discretionary award of extra years by a new insurer), we plan to gather more information on the protection of NCBs and, if this information suggests that it may act as barrier to switching, we will consider this issue further.

Summary

76. We intend to consider further whether there are factors which might make it harder for consumers to switch their PMI provider, enabling providers to increase the prices (or reduce the quality of the policies) offered to customers on renewal. In particular, we intend to consider further the prevalence and effect of both automatic renewals and cancellation fees and the effect of NCB protection.

ToH 5: Harm arising from vertical relationships (vertical integration)

77. There are various vertical relationships between insurers, brokers and the providers of related goods and services, and these vertical relationships may be significant to our assessment of many of the issues set out in this issues statement (eg ToH 2). However, it may be that some of these vertical relationships give rise to harm in their own right, which we discuss in this section.

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[30] We also note that some insurers appear to offer ten-month policies but award a full year's NCB at the completion of the ten months.

Ownership of PCWs by insurers/brokers

78. Some PCWs are fully or partly owned by providers of PMI (ie insurers or brokers), which may enable these providers to gain information on their rivals' quotes and to affect their rivals' access to their integrated PCWs. In particular, these insurers/brokers may be able to: *(a)* understand better their competitors' underlying risk and pricing models; *(b)* undercut their rivals' quotes before the list of quotes is returned to the consumer or manipulate directly the ranking of quotes on the PCW; or *(c)* limit access to their integrated PCWs to some insurers. We do not suggest that any insurers/brokers and integrated PCWs have engaged in such practices, but we discuss whether each of these potential strategies is likely in turn. We discuss these practices first in regard to insurers and then in regard to brokers.

Understanding competitors' risk and pricing models

79. Insurers which own a PCW may be able to access a vast amount of price information from their rivals' quoting behaviour on the PCW, which might allow the owning insurers to infer to some extent the risk and pricing models of their rivals. Since insurers make substantial investment in research and the analysis of customer risk to optimize their pricing structures, this may enable the PCW-integrated insurer to optimize its own prices by freeriding on its rivals' research. Moreover, this information could enable a PCW-integrated insurer to compare its own pricing structure with those of its rivals with the aim of targeting specific market segments.

80. However, while this activity may affect competition between insurers offering PMI, it is difficult to see how consumers are likely to suffer from such behaviour. This would be the case only if a PCW-integrated insurer concluded from the comparison that it could increase its prices but, even then, such a price change would be due fundamentally to a reassessment of risks. Moreover, we would expect insurers quoting through PCWs to be highly sensitive to its PCW-integrated rival analysing its quotes to gain any advantage. In addition, non-integrated insurers would constrain the PCW-integrated insurer from doing so by being able to delist their products from the PCW.

Price undercutting or direct manipulation of quote rankings

81. A PCW-integrated insurer might also gain information on rivals' prices in order to be able to ensure that its own price for a given policy quote was always slightly cheaper than its rivals' quotes (for comparable policies). This might be done by the PCW-integrated insurer undercutting its rival in real time as quotes are provided to a consumer (ie indirectly manipulating quotes).[31]

82. However, as above, this behaviour would only be detrimental for customers if the PCW-integrated insurer's prices would have been lower absent the information on its rivals' prices. If these prices would have been higher absent the information on rivals' prices, customers would benefit from the price matching, at least in the short term. Moreover, any harm from undercutting would be partly mitigated if customers were to use several PCWs before they decided to buy.

83. In the long term, the competitive advantage due to the access to rivals' prices may lead to an increase in market share for the PCW-integrated insurer (ie if the PCW-integrated insurer's prices are lower, customers may buy its policies rather than those of other insurers). However, the ability to use that market position by increasing

[31] This could occur if the PCW owner operates the PCW such that all other quotes are gathered first before it quotes, ensuring that its price is just lower than the lowest rival quote.

prices appears to be limited since the PCW-integrated insurer would still be constrained by other insurers. Other insurers may have a cost disadvantage due to higher investment in developing their risk models and pricing strategies but they would still be able to quote for PMI policies. It appears quite unlikely that the PCW-integrated insurer would be able to increase its market share to an extent that economies of scale would allow for a very large cost differential to its rivals, in particular given that those insurers which are integrated with a PCW are already large and have well-developed risk models such that the benefit from the additional information obtained from their integrated PCWs is likely to be limited. In addition, such behaviour by a PCW-integrated insurer is constrained as rival insurers could withdraw from the PCW if the benefit from being present on it (due to the additional sales made) became lower than the detriment incurred by indirectly giving their rival insurer access to their pricing information.

84. We also note that, in theory, a PCW-integrated insurer might be able to manipulate directly the quotes obtained through its PCW to ensure that its PMI policies appear among the top quotes. For example, this could be achieved by the PCW including within the headline prices of the PMI products offered by its integrated insurer's rivals any add-on services which are available (eg courtesy car provision) to make them appear more expensive. However, as above, such behaviour by a PCW-integrated insurer would be constrained by its rival insurers being able to withdraw from the PCW at any time.

Limiting access to integrated PCWs

85. At the extreme, a PCW-integrated insurer could foreclose a rival insurer by delisting its rival's brands from the PCW for some or all quotes. Alternatively, the PCW might seek to increase its rival's costs by charging a higher CPA.[32]

86. We note that a PCW is more attractive for customers (and thus also for insurers or brokers) the more PMI brands it lists and, for this reason, it appears unlikely that a PCW would engage in such behaviour. We also note that rivals foreclosed in this way would have other routes to market and note that no party appears to have raised this potential harm in their submissions to the OFT.

Brokers

87. Whilst the discussion above focuses on PCW-integrated insurers, there is the possibility of similar incentives operating for a PCW-integrated broker.[33] In particular, a PCW-integrated broker could undercut or manipulate its rivals' quotes in the same way as a PCW-integrated insurer.

Summary

88. We note that the strategies we have identified are likely to be profitable only if the consequent increase in profits from higher sales of PMI is larger than the decrease in profits from reduced sales through the PCW (including possibly the withdrawal of some insurers from the PCW). We also note that, of the large number of providers of PMI, only two insurers and one broker are integrated into a PCW, which suggests

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[32] It is worth noting that, as a result of MFN clauses, any increase in PMI prices on one PCW as a result of a CPA increase would apply through all other channels covered by the MFN.
[33] *Comparethemarket* is owned by a broker, BGL Limited.

that this vertical integration is unlikely to represent a barrier to entry into supplying PMI or starting a PCW.

89. Overall, it appears to us that, of the strategies we have considered, only the undercutting of prices or direct manipulation of quotes may plausibly give rise to harm. Therefore, we intend to investigate this issue but, in light of the incentives of a PCW and the lack of complaints, we intend to do so initially only at a high level in order to determine whether to look at it in more detail. We do not intend to consider further the possibility of PCW-integrated insurers/brokers understanding better their rivals' risk and pricing models or limiting access to their PCWs.

PCWs requiring insurers and brokers to accept MFN clauses

90. It appears to be common for PCWs to require insurers to quote the same price for a given policy on the PCW as for sales through other online distribution channels (ie they impose an MFN clause). However, insurers told the OFT that the average customer gained through a PCW is more risky than a customer acquired directly, partly because of an imperfect mapping of risk profiles from the PCW to an insurer's own system (eg because the information obtained by the PCW differs from the information requested by the insurer in direct sales), and partly due to a higher propensity of some consumers to enter false information on a PCW to obtain a lower quote. In addition, the cost of sales may differ between sales channels, as the costs to an insurer of gaining a sale from an enquiry to it directly (by having its own website) are unlikely to be the same (per policy sold) than the CPA on a PCW. For all these reasons, the premiums of policies sold on a PCW should be higher than those of policies sold through other online channels, though MFN clauses between PCWs and insurers restrict this from happening.

91. If a PCW imposes an MFN clause, insurers are likely to price their policies sold online on the average risk and cost of sale through all online sales channels, which might dampen competition between the PCW and other online sales channels (eg direct online sales or online sales through a broker).

92. Moreover, MFN clauses might have the effect of dampening competition between PCWs as, if a PCW with an MFN clause increases its CPA, it knows that any consequent increase in the price of PMI put through by an insurer would need to apply to all the insurer's online sales. Therefore, the PCW cannot be disadvantaged relative to its rival PCWs (or other rival sales channels covered by the MFN clause). As a result, PCWs may have a greater incentive to increase their CPAs than in the absence of MFN clauses.

93. However, MFN clauses may also have benefits since they ensure that business attracted by a PCW does not switch to another online sales channel at a cheaper price. 'Capturing' the customers who would have switched in the absence of a 'you won't find cheaper online elsewhere' type guarantee appears to be an efficient way for a PCW to obtain a return on the investment needed for it to make its service attractive to both PMI providers (ie insurers and brokers) and customers (ie through its advertising). PCWs facilitate the comparison of PMI policies offered by different providers (including price) and, if their investments were not protected by MFN clauses, PCWs may invest less to encourage insurers and brokers to sign up, which would be likely to cause consumers to face higher search costs (see paragraph 55).

94. It also appears to us that the MFN clauses between PCWs and insurers generally relate to online sales and insurers are able to sell at different prices through other channels (eg through their own call centres or through brokers (offline)). Although most consumers research the price of motor insurance online when considering

switching, many still use call centres, which provides some constraint on the dampening effect from such MFN clauses (see paragraph 92).

95. Although we recognize that MFN clauses can have detrimental effects on competition and have been considered by competition authorities in many contexts, in light of the benefits of MFN clauses and the offline alternatives available to consumers of PMI, and given the apparent competition in the supply of PMI, we do not intend to consider this issue further in our investigation.

Insurers—broker relationships (through equity or contract)

96. Some insurers prevent brokers from quoting for their policies on PCWs unless they achieve a certain turnover. This could be in order for the insurer to use the PCW distribution channel principally for its own direct sales and to focus the brokers selling their policies to focus on other distribution channels. However, this strategy could disadvantage smaller brokers and might imply that the top quotes on PCWs are higher than in the absence of that restriction (eg if the broker is a specialist for the type of policy requested and would be able to offer a competitive price). This may reduce the range of policies available on PCWs and may mean that some policies are bought on a PCW at higher prices than if some other brokers had been listed. Similarly, we are aware that some insurers appear to cause brokers to quote higher prices for their policies on PCWs than when selling through other channels. However, in response to these concerns, we note that the policies not offered or only offered at high prices on PCWs are most likely still to be available through other sales channels and therefore, in our view, harm to customers would only be likely to arise if a large share of consumers of PMI only considered policies available on PCWs.

97. The principal concern in relation to vertical relationships between insurers and brokers is one of input foreclosure, ie the possibility that a broker-integrated insurer with market power in a segment could increase the price of its PMI products in that segment to rival brokers to increase their costs. At the extreme, the integrated insurer could cease selling its products in that segment through rival brokers at all, causing its integrated broker to gain market share.

98. A similar concern is the possibility of customer foreclosure, ie where the owned or contractually-related broker delists some of its rival insurers' policies to increase the sales of its vertically-related insurer's policies. Alternatively, the integrated broker may advise its customers more often to buy the integrated insurer's policies rather than other insurers' policies. However, this would be profitable only if the higher profit from increased sales of the integrated insurer's policies were to outweigh the loss of commissions due to lower sales of rival insurers' policies. Moreover, given that there are many brokers, and many other sales channels through which insurers can sell their policies to consumers, it appears unlikely that any brokers integrated with insurers have significant market power. For this reason, it appears that the scope for any significant consumer detriment from customer foreclosure is likely to be limited.

99. Overall, it does not appear to us that vertical relationships between insurers and brokers are likely to give rise to competition issues unless there is market power in either market and so, for this reason, we do not intend to consider further the vertical relationships between insurers and brokers unless we find market power arising from concentration in some segments of PMI (see ToH 3).

Repairer—insurer relationships (through equity or contract)

100. A number of insurers have relationships with repairers, either by owning them or by contracting with a number of them to create a network. Insurers refer their insured drivers' vehicles to a repairer in their network when they have an accident (ie fault repairs) and will also refer non-fault repairs if captured (or if applicable under the terms of a bilateral agreement with the non-fault insurer). As far as we are aware, repairer–insurer relationships are not exclusive and repairers in such relationships can therefore work for other insurers, as well as repair cars unrelated to PMI claims.

101. In these relationships, input foreclosure (ie the possibility that a repairer with market power in a local area, which is integrated with an insurer, could increase the price of the repairs it offers to rival insurers in that area to increase their costs) appears unlikely given the highly fragmented car repair market, which would limit repairers' ability profitably to increase their prices. The only exception would be in concentrated local repair markets.[34,35] In such circumstances, the increase in the repair cost to insurers which did not own, or did not have contracts with, a repairer in the area (eg through higher labour rates) would increase the claims costs, and therefore possibly the price of PMI, for insurers selling into those areas. (Alternatively, rival insurers may increase premiums more generally, but to a smaller extent.) This might yield a small competitive advantage to the integrated insurer. However, overall, it seems to us that the effect would only be significant if the number or size of such areas was large.

102. Currently, we do not have information on the concentration of car repairers at a local level, but it appears doubtful that the number of areas where there is both a high market concentration in car repair and the presence of an insurer-affiliated repairer is large. However, since we do not have sufficient information to exclude this possibility, we intend to investigate at a high level whether there are any areas where both repair is concentrated and some repairers have vertical relationships with insurers in order to consider whether to investigate this potential harm in more detail. Moreover, it is unclear to us how the nature of competition between repairers for the referrals of insurers, which may be focused on price or the size of referral fees offered rather than on quality (see ToH 2), is affected by the presence of these vertical relation-ships.

Insurer—parts/paint manufacturer/distributor relationships (through contract)

103. Currently, we have limited and incomplete information about the contracts between insurers and parts and paint manufacturers or distributors and we are not able to judge whether harm from such relationships is likely. It appears that these contracts typically involve an insurer incentivizing, requesting or requiring its repair network to use a given part or paint supplier in return for a referral fee (or a discount) and some-times an additional upfront payment by the parts/paint manufacturer/distributor.

104. The contracts which we have seen so far do not suggest that these relationships are exclusive and the parts/paint supplier is likely to supply many other insurers. However, in some cases the contracts specify a price for parts/paint and a discount

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[34] In the insurer–broker relationship, the insurer produces the input (the PMI policy) sold on by the broker (ie the insurer is upstream and the broker downstream). In the repairer–insurer relationship, the repairer produces the input (the repair) which is paid for by the insurer who procures the repair service on behalf of the insured (ie the repairer is upstream and the insurer downstream). A similar concern may arise with respect to repairer–CMC relationships or repairer–broker relationships.

[35] In principle, such harm may also arise for vertical links between CMCs and insurers. However, since the services of CMCs (such as advice, claims administration, or a reference to a lawyer or a CHC) can also be provided on the phone or online, these service providers are unlikely to be restricted to serving a small geographic area and therefore this appears to be an unlikely area for harm.

applies if the repair work for the insurer involved exceeds a certain volume (or staggered discounts apply depending on the number of repairs). If the volume thresholds are reached, the discount granted (or referral fee paid) means that the average price of the parts/paint used in the repairs, and thus the repair bill, is lower than absent such discounts. However, other insurers which do not benefit from these discounts may suffer a detriment since the bills for their repairs may be based on the higher parts/paint price excluding the discount. In particular, the costs to these insurers would be higher than the average costs were no discounts to be available to any insurers. In other words, the presence of these contracts, achieved due to the buying power of some large insurers, may create a form of input foreclosure on other smaller insurers, raising their costs. Other customers whose repairs are not covered by insurance have the same disadvantage if the same parts/paint are used and the higher price billed for their repairs. Nevertheless, as some insurers gain from the agreements while others may lose, the overall effect is unclear.

105. We note that, for non-fault repairs which are paid by a rival insurer, the scope to increase repair costs (by entering into an agreement with a parts/paint provider) may be limited because such work is typically subject to independent audits, which appear to consider average costs for the required repairs (unless the average prices used in the cost assessment were already inflated by this practice).

106. We also note that competition from repairers which are not involved in such vertical agreements may act as a constraint, as smaller insurers may be able to obtain 'average' parts/paint prices by using such repairers.

107. Another effect of the vertical relationships between insurers and parts/paint manufacturers/distributors is that, by incentivizing or requiring their repair networks to use the insurers' preferred parts/paint supplier, other suppliers of parts and paint have a portion of the market foreclosed to them (customer foreclosure). However, in order for these relationships adversely to affect competition between parts/paint suppliers, the relationships must involve repairers with significant market share across the geographic region in which the parts and paint suppliers compete (most parts and paint manufacturers are likely to compete on a national or international basis but some parts/paint distributors might operate in much smaller regions).

108. Currently, it is unclear to us whether harm may arise from vertical relationships between insurers and parts/paint providers, either as a result of input foreclosure or customer foreclosure. Therefore, we intend to investigate this issue at a high level initially before deciding whether to consider it in more detail. Moreover, it is unclear to us how the nature of competition between parts/paint providers for the business of insurers, which may be focused on price or the size of referral fees offered rather than on quality (see ToH 2), is affected by the presence of these vertical relationships.

Possible countervailing effects: entry and barriers to entry

Insurers

109. Based on the information we have seen, it appears likely that there are economies of scale in selling PMI. In particular, it appears likely that a larger number of customers from a market segment (eg young, inexperienced drivers) will enable an insurer better to assess the risk of drivers in this segment and will therefore enable a more profitable risk pricing. However, it is unclear to us what scale is necessary in order to achieve this advantage. In addition, it appears that insurers who offer a portfolio of insurance products (motor, home, pet, travel, etc) may benefit from economies of scope, due to the sharing of central overheads (call centres, finance, human

resources, etc), the ability to generate higher investment returns from having more funds to invest, and proportionally lower solvency requirements (due to the greater diversification of risks).

110. In order to compete in the market, an insurer will also need regulatory approval and, in order to compete effectively, may also need to establish vertical relationships with brokers, repairers, etc, or bilateral agreements with other insurers, which may be costly and time-consuming to establish. However, the difficulty of gaining this approval and of establishing such relationships would be relevant only for entry into the PMI market overall and is unlikely to be a key barrier to entry into PMI segments, which are the focus of our ToH (ToH 3).

PCW

111. Based on the information we have seen, it appears likely that, in order to establish a PCW (for PMI policies), considerable investment is required in order to provide an attractive service, both for consumers of PMI, who wish to find suitable policies, and for providers of PMI (ie insurers and brokers), who wish to reach consumers. This is supported by the fact that some providers of PMI sell only through PCWs which receive more than a certain number of quote requests.

112. Given that the relationships between PCWs and insurers or brokers appear to be non-exclusive, the presence of existing relationships between insurers or brokers and incumbent PCWs would not prevent insurers listing on a new PCW.

113. However, regulatory requirements are likely to constitute a barrier as PCWs need to obtain the relevant permissions from the FSA and will need to comply with the FSA's guidance on the sale of PMI through PCWs.[36]

Summary

114. If our high-level review of the possible harm arising from horizontal effects in PMI and/or PCW indicates that further investigation is warranted, we will then consider the extent of entry barriers into relevant market segments of PMI and/or into establishing a PCW (as appropriate), with a view to concluding whether entry or the threat of entry is a countervailing factor that precludes harm from market concentration (ToH 3).

Possible detriment and relevant customer benefits

115. In our analysis, we will seek to identify any detrimental effects on customers which might result from any AEC. These detrimental effects could take the form of higher prices, reduced quality (in particular, in relation to a consumer's needs) or reduced choice.

116. If we provisionally conclude that there is an AEC, then in considering remedies we will consider whether any relevant customer benefits arise from the features that prevent, restrict or distort competition, within the meaning set out in *CC3*, paragraphs 4.26 to 4.31.

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[36] *Guidance on the selling of general insurance policies through price comparison websites,* FSA, October 2011.

Overall summary of the issues on which we intend to focus

117. In summary, we intend to focus our investigation on the following issues:

- Whether the separation of cost liability and cost control in the supply of services (excluding PI) to non-fault parties involved in motor accidents increases the costs of the services supplied (due to a lack of price competition or an unwarranted increase in quality) (ToH 1).

- Whether consumers may be put at a disadvantage due to information asymmetries and a lack of alignment between their interests and those of the parties which procure post-accident services on their behalf (ToH 2).

- The extent of any market segmentation in the supply of PMI and whether the reduced number of rivals in some segments may allow those operating in that segment to charge a higher price (or reduce quality). This will involve considering the barriers faced by PMI providers to moving into new segments. Given that it would appear that the barriers to moving from one market segment into another are quite low, we intend to analyse this issue at a high level initially to inform us whether we should continue to look at it in more detail (ToH 3*(a)*).

- Whether the four large PCWs have market power and, if so, the extent to which any increase in CPA leads to customer harm and whether this harm is outweighed by any benefits for consumers from there being a limited number of PCWs. However, we intend to conduct this analysis at a high level initially to inform us whether we should continue to look at it in more detail. If we find that it warrants further investigation, this will involve considering barriers faced by new PCWs to launching and becoming established (ToH 3*(b)*).

- Whether the interrelation between search costs (due to the complexity of PMI policies) and product differentiation results in net consumer harm (ToH 4*(a)*).

- Whether the prevalence of drip-in pricing at the point of sale of PMI (through all sales channels) affects competition for PMI or the goods and services added on and results in net consumer harm (ToH 4*(b)*).

- Whether the complexity of products and services offered as add-ons to PMI and any lack of transparency of information supplied at the point of sale in relation to them results in net consumer harm (ToH 4*(c)*).

- Whether there are factors which might make it harder for consumers to switch their PMI provider, enabling providers to increase the prices (or reduce the quality of the policies) offered to customers on renewal. In particular, we intend to consider further the prevalence and effect of both automatic renewals and cancellation fees and the effect of NCB protection (ToH 4*(d)*).

- Whether a PCW-integrated insurer might undercut its rivals' prices or manipulate the quotes provided through the PCW in a way which gives rise to harm. However, in light of the incentives of a PCW and the lack of complaints, we intend to investigate this issue initially at a high level only in order to determine whether to look at it in more detail (ToH 5*(a)*).

- Whether there are any areas where both repair is concentrated and some repairers have vertical relationships with insurers, such that rival insurers may face higher repair costs. We intend to conduct this analysis at a high level initially

in order to consider whether to investigate this potential harm in more detail (ToH 5*(b)*).

- Whether harm may arise from vertical relationships between insurers and parts/ paint providers, either as a result of input foreclosure or customer foreclosure. We intend to investigate this issue at a high level initially before deciding whether to consider it in more detail (ToH 5*(c)*).

118. We do not intend to consider further the following issues:

(a) the complexity of PMI and the transparency of information supplied at the point of sale by providers of PMI (ie insurers and brokers) to consumers (other than as this relates to issues which we are considering);

(b) possible horizontal effects in relation to brokers, CHCs, direct hire companies, repairers, CMCs, parts/paint suppliers or solicitors;

(c) the possibility of PCW-integrated insurers/brokers understanding better their rivals' risk and pricing models or limiting access to their PCWs;

(d) PCWs requiring insurers and brokers to accept MFN clauses; and

(e) the vertical relationships between insurers and brokers (unless we find market power arising from concentration in some segments of PMI).

ANNEX A

List of parties with which the CC has had discussions prior to this issues statement

General insurer A

General insurer B

General insurer C

General insurer D

Association of British Insurers (ABI)

Credit hire company A

Credit hire company B

Credit hire company C

Credit Hire Organisation (CHO)

Broker A

British Insurance Brokers Association (BIBA)

Bodyshop A

National Association of Bodyshops (NAB)

Motor Accident Solicitors Society (MASS)

Consumer Council Northern Ireland (CCNI)

Ministry of Justice (MoJ)

Her Majesty’s Treasury (HMT)

Department for Transport (DfT)

Office of Fair Trading (OFT)

Financial Services Authority (FSA)

Rt Hon Jack Straw MP

Glossary

ABI	Association of British Insurers
Act	Enterprise Act 2002
AEC	Adverse effect on competition
ATE	After the event
CC	Competition Commission
CFA	Conditional fee agreement
CHC	Credit hire company
CMC	Claims management company
CPA	Cost per acquisition
FNOL	First notification of loss
FCA	Financial Conduct Authority
FSA	Financial Services Authority
GTA	General Terms of Agreement
LASPO	Legal Aid, Sentencing and Punishment of Offenders Act 2012
MoJ	Ministry of Justice
MFN	Most favoured nation
NCB	No claims bonus
OFT	Office of Fair Trading
PCW	Price comparison website
PI	Personal injury
PMI	Private motor insurance
RTA	Road traffic accident
ToH	Theory of harm