

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Provisional findings report

Notified: 17 December 2013

The Competition Commission has excluded from this published version of the provisional findings report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [§]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Glossary

Summary

The reference

1. On 28 September 2012, the Office of Fair Trading (OFT) referred the supply or acquisition of private motor insurance (motor insurance) and related goods or services in the UK to the Competition Commission (CC) for investigation and report. The reference was made under sections 131 and 133 of the Enterprise Act 2002 (the Act).
2. The CC is required to decide whether ‘any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom’.¹ If the CC decides that there is such a feature or combination of features, then there is an adverse effect on competition (AEC).² This report sets out our provisional findings based on the evidence we have reviewed and the analysis we have carried out to date. We are required to publish our final report by 27 September 2014.

Provisional findings

3. We identified two relevant markets:
 - (a) motor insurance; and
 - (b) price comparison websites (PCWs).
4. A range of post-accident services were also relevant to our analysis, particularly claims management, repairs, salvage and car hire.

¹ Section 134(1) of the Act.

² Section 134(2) of the Act.

5. In the motor insurance market, we found strong rivalry in the sale to consumers of basic motor insurance. But we provisionally identified features of the supply of motor insurance and related services giving rise to AECs in the following areas:
- (a) (i) separation of liability for costs and control of costs in the handling of non-fault drivers' claims; and (ii) various practices and conduct of the parties managing such claims, which together results in higher costs to at-fault insurers and mean that consumers pay higher motor insurance premiums;
 - (b) (i) lack of effective monitoring by insurers and CMCs of the quality of car repairs; and (ii) significant limitations in consumers' own ability to assess the quality of repairs, with the result that cars are too often not repaired to the standard to which consumers are entitled; and
 - (c) (i) insufficient information provided to consumers in the sale of add-on products to motor insurances; and (ii) point-of-sale advantages enjoyed by insurers in the sale of add-on products, with the result that it is more difficult for consumers to identify the best-value offers and consumers may purchase add-on products at an inflated price.
6. In the PCW market, we found that some of the contracts between insurers and PCWs contained conditions that limited price competition, reduced innovation and restricted entry. We also identified that PCWs have a degree of market power by virtue of the number of single homing consumers (that is, consumers who do not shop around between PCWs). These wide 'most-favoured nation' (MFN) clauses, and practices having an equivalent effect where a PCW takes advantage of single homing, are a feature of the PCW market. The result is that consumers pay higher motor insurance premiums.
7. Each of the AECs we have identified are set out in Section 10.

The reference product

8. Under the Road Traffic Act 1988, motorists are obliged to hold a valid insurance policy to cover 'third party' risks, ie the risk that they will cause death or personal injury to another person or damage to another person's property while driving and consequently have to pay damages.
9. In addition to the risks which are compulsorily insurable, risks covering fire and theft are also often covered. However, the most commonly purchased type of motor insurance is comprehensive insurance. This covers damage caused to the insured's own vehicle and the insured's own medical expenses arising from an accident as well as third party, fire and theft. Comprehensive cover may also provide extra benefits such as a courtesy car, roadside assistance, or windscreen repair or replacement. These benefits are either included in the comprehensive cover or can be purchased as an add-on for an additional premium.
10. By law, the at-fault party in an accident is required to compensate the non-fault driver for any damage to property, personal injury and consequential loss. We are not considering personal injury claims as part of our investigation. The cost of services chosen by the non-fault party to make good the consequences of an accident will effectively be the liability of the at-fault party's insurer. The non-fault party is entitled to have their car restored to its condition prior to the accident and to the use of a 'broadly equivalent' temporary replacement vehicle ('replacement car') pending completion of repairs to their car. Provision of a replacement car is subject to the non-fault driver's duty to mitigate their loss with regard to their need. Neither the at-fault party nor their insurer may choose the provider of these services, or specify the terms on which services are provided, notwithstanding their ultimate liability. The repairer and the provider of a replacement car will typically be chosen by the non-fault party's insurer or by a claims management company (CMC). Alternatively, the

non-fault party may arrange these services and seek reimbursement from the at-fault insurer. A third possibility is that the non-fault party agrees that the at-fault insurer organize the provision of the services.

Industry background

11. Our terms of reference are confined to the insurance of private motor cars (and exclude commercial vehicles and motor cycles). There were around 25.7 million privately registered cars as at 31 December 2012. This is around 75 per cent of the vehicles registered in the UK.
12. Insurance policies are underwritten by insurers. We estimate that the value of the gross written premium (GWP) for private motor insurance was just over £10 billion in 2012, of which £7.4 billion, about 69 per cent of the market, was accounted for by the ten largest motor insurers. The largest motor insurance provider is Direct Line Insurance Group, which is responsible for almost one-quarter of the sales made by the ten largest insurers. Insurance policies are sold through a number of different distribution channels. The ten largest insurers sold over one-third of their GWP direct by telephone or online, with 31 per cent sold via brokers and nearly one-quarter sold via PCWs. PCWs have become an increasingly important sales channel for motor insurance accounting for a significant percentage of new business sales.
13. Of the four largest PCWs, two are owned or part-owned by the larger insurers and one by a large broker. Of the ten largest motor insurance providers, three also own brokers.

The claims process

14. Following a road traffic accident, policyholders can claim for any loss they have incurred. Claims usually involve repair to damaged vehicles and property and com-

compensation for any injuries or losses incurred. In many cases, the costs incurred in repair and compensation are covered by motor insurance and insurers are therefore closely involved in the claims management process.

15. In 2012, Datamonitor recorded that there were 2.9 million claims notified and the gross claims incurred amounted to £8.6 billion, giving an average claim cost of £2,933. Average claims costs have been rising year on year since at least 2007, while the number of claims over the same period has fallen.
16. Data provided by the Association of British Insurers shows that in 2012, 28 per cent of claims costs related to personal injury, which are not covered in this investigation. 65 per cent of claims costs were categorized as accidental damage, property damage and other costs. The costs of vehicle repairs, write-offs and replacement cars following a road traffic accident, the subject of our investigation, were included in these latter three categories.
17. Using data provided to us by five of the ten largest insurers on claims costs relating to road traffic accidents excluding windscreen, fire and theft claims in 2012, we estimated that:
 - (a) 60 per cent related to claims by non-fault claimants (ie claims on insurers by third parties when the insurers' policyholders were at fault);
 - (b) 13 per cent related to non-fault claims by policyholders on their own policy;
 - (c) 15 per cent related to at-fault claims by policyholders for their own damage; and
 - (d) 12 per cent related to claims when there was split liability.
18. We estimated that in 2012, up to 600,000 cars were written off as a result of accidents.

19. The drivers involved in a road traffic accident involving a vehicle collision may, or may not, know or agree at the time of the accident which driver is at fault and which is the non-fault driver. The drivers' insurers need to identify which driver caused the accident in order to establish which insurer will need to pay any resulting claims. Drivers usually contact either their insurer or the broker which sold them their insurance policy, in order to inform them of the accident and to describe the circumstances of the accident, which is called the first notification of loss (FNOL).
20. The claims handler will seek to make an immediate assessment of who is at fault. If an immediate assessment is not possible, the claim will be passed to specialist claims handlers for further investigation.
21. We estimated that, at FNOL, insurers established who was at fault in 75 per cent of cases; 20 per cent of cases were categorized as split liability; and 5 per cent of cases were not decided. Evidence from the ten largest motor insurers suggested that the categorization of a driver as non-fault very rarely changed.

At-fault claims

22. The legal entitlements of the at-fault driver involved in a road traffic accident are as stipulated in their motor insurance policy. Following a vehicle collision, if the at-fault driver has a comprehensive insurance policy, they are generally able to make a claim under their own insurance policy to cover the cost of repair to the vehicle, subject to a pre-agreed excess. A comprehensive insurance policy will also sometimes include the provision of a courtesy car to the at-fault driver.
23. At-fault repairs are usually managed by the at-fault insurer, sometimes outsourced to a CMC. Under most motor insurance policies, the owner is entitled to have their

vehicle repaired at a repairer of their choice but the insurer retains a right to approve the repair estimate prior to the work being undertaken.

Non-fault claims

24. The right under tort law of the non-fault driver involved in a road traffic accident is to be put into as good a position as they would have been in had the accident not occurred, at the cost of the at-fault driver.
25. The non-fault driver may claim compensation from the at-fault driver to cover:
 - (a) repair of vehicle damage, or in the case of a write-off, a cash payment equivalent to the pre-accident value of the vehicle, less the salvage value;
 - (b) the reasonable costs of car hire; and
 - (c) any other losses incurred as a result of the accident.
26. Although the legal systems differ between England and Wales, Northern Ireland and Scotland, the differences are not significant in relation to most areas of the claims management process, although they may result in variations in the ultimate claim costs.
27. Several parties might be involved in a non-fault claim process, including the non-fault broker, the non-fault insurer, the at-fault insurer, a CMC, a repairer and a replacement car provider:
 - (a) the non-fault driver is likely to contact their insurer or broker immediately after the accident, but might also contact a repairer or car dealership;
 - (b) the non-fault driver might be contacted by the at-fault insurer, in an attempt by the at-fault insurer to 'capture' and manage the non-fault claim; and
 - (c) other service providers, such as CMCs and credit hire companies (CHCs), might contact the non-fault driver following a referral from another party.

28. Our survey of non-fault claimants found that the claimant's own insurer was mainly responsible for managing the claim in 42 per cent of cases, and the at-fault insurer was mainly responsible for managing the claim in 32 per cent of cases. A CMC was mainly responsible for managing the claim in 16 per cent of cases.
29. When a non-fault claim is managed by the non-fault insurer or by a CMC, subrogation allows the insurer or CMC, once it has provided the replacement car and the repair, to benefit from the rights of the non-fault party to recover from the at-fault insurer.

The relevant markets

30. Many parties are involved in the provision of motor insurance. We have focused our investigation on:
- (a) insurers (which supply motor insurance to cover for the costs arising from a motor accident);
 - (b) brokers (which act as agents for insurers in selling motor insurance);
 - (c) PCWs (which provide websites on which the prices of motor insurance, and other goods and services, can be compared);
 - (d) CMCs (which manage various aspects of drivers' claims, eg repair work, the provision of a replacement car and compensation for personal injury);
 - (e) car hire companies (which provide replacement cars while a claimant's own car is unavailable, either under contract to an insurer or CMC (direct hire) or directly to non-fault claimants, with the cost recovered directly from fault insurers (credit hire));
 - (f) repairers (which undertake the repair work to vehicles damaged in motor accidents); and
 - (g) parts and paint suppliers (which supply the parts and paint for repair work to vehicles).

31. Our terms of reference refer to private motor insurance and related goods or services. There are two kinds of related services that are relevant to our inquiry: PCWs and post-accident services.
32. Motor insurance is sold by insurers and brokers. Different types of cover are sold and the price of motor insurance policies depends on a driver's particular risk factors. We did not separate the market by seller, cover type or customers.
33. Although some suppliers operate on a local or regional basis, most insurance sales are transacted by telephone or online, and we conclude that the appropriate geographic market for motor insurance is national, rather than regional or local.
34. PCWs facilitate the buying and selling of motor insurance. They are 'two-sided markets' with two groups of users: consumers searching for motor insurance and motor insurers. We decided that PCWs constitute a distinct market whose geographic scope is the UK in its entirety.
35. Post-accident services are an important part of the supply chain for the motor insurance market and consequently the efficiency with which these services are supplied may affect the price of motor insurance. We considered the main post-accident activities that were relevant to our investigation to be claims management, repairs, salvage and car hire.
36. We provisionally conclude that the markets that are relevant to our assessment of competition were:
 - (a) motor insurance; and
 - (b) PCWs.

Theories of harm

37. We investigated different ways in which competition could be harmed (also known as 'theories of harm' or 'ToH') in the relevant markets and used these to structure our investigation.
38. For competition to function effectively, customers need to be willing and able to: access information about the various offers available in the market; assess these offers to identify the good or service that provides the best value for them, taking account of the full costs of provision as well as the benefits; and act on this assessment by switching to purchasing the good or service from their preferred supplier. There are complexities in the motor insurance industry which may hamper the effective functioning of competition.
39. We initially identified five potential areas of harm, not necessarily mutually exclusive:
- (a) separation of cost liability and cost control ('separation');
 - (b) the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services;
 - (c) market concentration;
 - (d) competition-softening strategies by sellers; and
 - (e) vertical relationships.
40. On initial investigation of the relevant markets, we were able to discount some of our theories. We observed low levels of concentration that allowed us to discount our third theory of harm except in relation to PCWs. We observed high levels of switching in our investigation of our fourth theory of harm, so our further investigation under this theory focused on the sale of add-on products. Under the fifth theory of harm, we concentrated on MFN clauses in contracts between insurers and PCWs.

Separation of cost liability and cost control (theory of harm 1)

41. Separation occurs because, under tort law, a non-fault driver is entitled to compensation for their loss from the at-fault driver through the at-fault driver's insurer. The cost liability lies with the at-fault driver, and, ultimately the at-fault insurer but the cost control lies with the party managing the claim. This party could be the non-fault insurer or an intermediary such as a CMC or a CHC rather than the at-fault insurer. The value of the claim that can be recovered by the party managing the claim is determined not by the actual cost incurred, but by the level of claim which a court would consider 'reasonable'.
42. At-fault insurers have an incentive to 'capture' a claim so that they can control costs effectively. A captured claim is one where the at-fault insurer agrees with the non-fault driver that it will manage the claim. We estimate that claims were captured in about 32 per cent of cases and there was separation of cost liability and control in about 64 per cent of cases.
43. We identified a number of ways in which claims are made at a level higher than the cost actually incurred:
 - (a) Claims handling and car hire intermediaries charge at-fault insurers more than the cost incurred in the provision of replacement cars. They in turn compete, via referral fees, to obtain work from the insurer and in so doing provide non-fault insurers, brokers and others with an opportunity to earn additional income from these fees.
 - (b) Some non-fault insurers charge at-fault insurers more than the cost of repairs incurred (though the practice of one insurer is currently subject to litigation in the Court of Appeal).
 - (c) When cars are written off, some at-fault insurers do not receive the full salvage value of the car.

44. We found that, the higher costs passed on to at-fault insurers are likely to be broadly reflected in higher premiums. We would expect that the effect on individual premiums would vary according to drivers' risk of having an at-fault accident, meaning higher-risk drivers will be particularly affected .
45. Also, at the same time, the revenue stream to non-fault insurers and brokers described in paragraph 43 is likely to reduce the premiums charged by insurers and therefore partially offset the higher premiums attributable to the higher costs to fault insurers. The overall effect on individual premiums is likely to vary according to the drivers' risk profile.
46. Taking both into account, we identified a net increase on premiums.
47. Separation may lead to direct benefits to customers if CHCs/CMCs provide better service than at-fault insurers, but we think these direct quality-of-service differences are small. We noted that the existence of alternative providers, such as CHCs/CMCs, is likely to act as a deterrent to at-fault insurers providing a poor-quality replacement car service.
48. Associated with these effects, an inefficient supply chain, involving excessive frictional and transactional costs, has emerged. Insurers and brokers are competing to find ways of earning a rent from their control of non-fault claims, rather than concentrating on offering the lowest price and best quality of claims handling and other service to customers. Furthermore, since the greatest effect is on drivers with the most adverse risk factors, prices to individual drivers are not fully reflective of expected costs. These are not effects that would be observed in a well-functioning motor insurance market.

49. These effects are currently greatest in the provision of replacement cars which, when cost liability and control are separate, is usually done via credit hire. The effects are currently smaller in repairs and write-offs where different non-fault insurers have different practices, and frictional and transactional costs are currently lower.
50. We therefore identified two features of the supply of motor insurance and related services which we provisionally conclude have, in combination, an AEC:
- (a) separation—that is, that the insurer liable for the non-fault driver's claim, ie the insurer to the at-fault driver, is often not the party controlling the costs; and
 - (b) various practices and conduct of the other parties managing such non-fault drivers' claims which (i) were focused on earning a rent from control of claims rather than competing on the merits; and (ii) gave rise to an inefficient supply chain involving excessive frictional and transactional costs.
51. We provisionally conclude that these features distort competition in the motor insurance market. We estimate a net adverse effect on consumers of between £150 million and £200 million per year. Since the estimated GWP across the industry is around £11 billion, this net effect corresponds to 1.3 to 1.8 per cent of the average premium, or about £6 to £8 per motor insurance policy.

Possible underprovision of service to those involved in accidents (theory of harm 2)

52. There are two reasons why claimants might not get post-accident services of the quality to which they are entitled by law:
- (a) Insurers and other claims managers procuring repairs, replacement cars and write-offs do not have the necessary incentive to ensure that claimants get the quality of service to which they are entitled.
 - (b) Claimants may not be sufficiently well informed to judge whether they receive the quality of service to which they are entitled either because they are not aware of

their legal or contractual rights, or because they do not have the technical skills to assess quality.

53. We did not see evidence of systematic underprovision for replacement cars and write-offs. We therefore focused our investigation on repairs.
54. On first investigation we did not find evidence suggesting that there was a systematic underprovision of repairs, but to investigate further we commissioned an independent assessment of repair quality.
55. Following the completion of the independent assessment of repair quality, our overall assessment of the evidence is as follows:
 - (a) Evidence from insurers suggests that they carry out repair audits (which in most, but not all, cases cover quality), require PAS accreditation and offer warranties; but these do not in themselves ensure that repairs are carried out to the legal standard.
 - (b) Evidence from repairers suggests that excessive pressure on costs could be leading to 'cutting corners' on repairs, with some examples of poor-quality repair.
 - (c) Evidence from consumers themselves suggests that the great majority of non-fault claim vehicles are repaired to their pre-accident condition, but many consumers might not be able to assess accurately the quality of repairs.
 - (d) The independent assessment of the cars by experts indicated that the proportion not repaired to pre-accident condition is considerably higher than suggested by consumers themselves.
56. We believe that more weight should be attached to the evidence from experts. That is, evidence from repairers and from the results of the vehicle inspections by independent engineers. We recognize that consumers might not be able to assess

accurately the quality of repairs. Consequently, our provisional view is that too many non-fault claimants receive a quality of service below the legal standard.

57. Most of the evidence relates to non-fault claims and to repairs managed by insurers but we considered that the position for at-fault claims and repairs managed by CMCs is likely to be similar.

58. We consider that the market is not working well in the following ways:

(a) Competition between repairers to obtain business from insurers is focused on low cost rather than high quality of repair; that is, repairers are insufficiently rewarded for offering a high quality of repair. In a well-functioning market, repairers would be sufficiently incentivized to provide claimants with repairs up to the legal standard.

(b) Insurers do not have the necessary incentive to ensure that claimants get the quality of service on repair to which they are entitled, for instance because reputational effects are weak.

59. We therefore identified the following two features of the supply of motor insurance and related services which we provisionally conclude have, in combination, an AEC:

(a) insurers and CMCs do not monitor effectively the quality of repairs; and

(b) there are significant limitations to claimants' ability to assess the quality of car repairs.

These features distort competition between repairers to obtain business from insurers and other managers of drivers' claims.

The sale of add-on products (theory of harm 4)

60. 'Add-ons' are additional insurance products that provide cover for various risks over and above the core risks covered by a basic motor insurance policy, usually sold on top of the basic motor insurance policy for an additional premium.
61. We found that different levels of information are provided by different motor insurers and that overall the information provided is insufficient for consumers to make informed purchasing decisions. It may therefore be difficult for consumers to identify the best-value offers in the market. In NCB protection, the problem is particularly acute because of the nature of the product. A lack of transparency of NCB scales and a lack of clarity on the difference between NCB and NCB protection means that consumers are unable to evaluate properly the protection on offer and the impact on their insurance premium.
62. Insurers have a point-of-sale advantage when selling add-ons because it is difficult and time consuming for customers to compare the combined price of basic motor insurance policies and add-ons across different providers. The point-of-sale advantage is a source of market power for insurers.
63. It is possible to compare on PCWs whether the most commonly purchased add-ons are part of a basic motor insurance policy or can be purchased as an add-on. However, this comparison is relatively limited because the PCWs only provide a generic description of each add-on and not one that explains how the products differ between motor insurers. In addition, the PCWs provide only an indicative price of each add-on rather than the actual price that is returned following click-through to the motor insurer's website. Further, the quotes returned by a PCW are ranked based on the price of the basic motor insurance policy. This excludes the price for the selection

of add-ons displayed by the PCW, thus restricting the ability of consumers to make comparisons of the total price of the motor insurance policy including add-ons.

64. A point-of-sale advantage may also be generally present for consumers who renew their policies or purchase through direct channels rather than through PCWs.
65. We identified the following two features of the supply of motor insurance which we provisionally conclude have, in combination, an AEC:
 - (a) information asymmetries between motor insurers and consumers in relation to the sale of add-ons; and
 - (b) the point-of-sale advantage held by motor insurers when selling add-ons.
66. We provisionally conclude that these two features distort competition in the motor insurance market. This is because they mean it is more difficult for consumers to identify the best-value offers in the market and may lead to consumers purchasing products at an inflated price.
67. The customer detriment arising from the AEC is particularly difficult to quantify. We intend to carry out further work to ascertain the level of detriment caused by the features described above and the extent to which this impacts motor insurance premiums.

Price comparison websites and MFN clauses (theory of harm 5)

68. PCWs are a 'two-sided' markets where PCWs provide motor insurance price comparisons to consumers and sales opportunities to insurers and brokers. About 23 per cent of all business is conducted through PCWs and about 55 to 60 per cent of new business comes through PCWs. We found evidence that price competition between

insurers on PCWs is intense, and we believe that PCWs could therefore be a pro-competitive force in the market.

69. PCWs earn a commission on insurance policies that are sold through their intermediation. Insurers set the premiums at which their policies are available. The premium covers expected costs, including the negotiated commission fee for sale through the PCW. PCWs are not wholesalers of insurance—they do not set retail prices.
70. On the retail side of the market, because many consumers do not shop around between different PCWs (that is, they ‘single home’), we estimate that around 30 per cent of PCW users are accessible to insurers only through a single PCW. However, most consumers use more than one sales channel to search for insurance. There are four large PCWs, very roughly of equal size, so that we estimate that each PCW can exclusively deliver to an insurer approximately 8 per cent of all consumers who use PCWs for purchase.
71. Most insurers therefore consider it essential to list on all the major PCWs. The range of policies offered by different PCWs does not therefore differ greatly. A small number of brands choose not to list on PCWs at all, especially those with the most established direct selling operations.
72. We examined concentration and market power in the PCW market and we also considered the ‘MFN clauses’ contained in the contracts between PCWs and insurers. The two issues are linked: horizontal market power allows the PCWs to negotiate effective MFN clauses. We found that these can have a problematic effect on competition. An MFN clause restricts the ability of the insurer to charge on other sales outlets a price different from the price offered through the PCW.

73. We categorize MFN clauses into two broad types: 'wide' and 'narrow'. Wide MFN clauses specify that the premium may not be lower on any other PCW or on the insurer's own website (and, in some cases, in any sales channel at all); narrow MFN clauses specify that the insurer's own website will not offer policies at a lower premium than available on the PCW.
74. Wide MFN clauses soften price competition between PCWs. With a wide MFN clause in place, a PCW does not face the possibility that a retail customer will find the same policy more cheaply on a competing PCW. There is little incentive for a PCW facing a competitor with a wide MFN clause to seek better prices for their retail consumers from insurers because that better price would be passed on to the competitor also. There is, therefore, little reward for price reductions. Conversely, a PCW with a wide MFN clause need not be concerned when it raises commission fees. It is safe in the knowledge that this will not make sales through its channel less competitive compared with sales through other PCWs.
75. Narrow MFN clauses will not usually have the same impact on competition because they maintain the possibility of premiums varying on different PCWs. We identify one special case in which narrow MFN clauses can lead to a substantial softening of price competition but we found that this applies only for brands which are listed both on PCWs and on a strong direct sales channel, and whose competitiveness against PCW channels the insurer wishes to maintain. We found that the number of brands meeting these conditions is small.
76. We consider that the softening of price competition due to wide MFN clauses will lead to less entry, less innovation and higher commission fees, all leading to higher premiums.

77. The common strategy for an entrant seeking to gain a foothold in a market by offering a cheaper product is precluded by wide MFNs. We found evidence that entry has been deterred because of the difficulty of offering a differentiated product.
78. Innovation by PCWs, to the extent that it reduces the expected cost of supplying insurance—for example, through better fraud prevention—will not be incentivized as much when wide MFN clauses are present because the lower cost of provision will not be reflected in a lower premium.
79. Premiums are higher with wide MFN clauses because it is not possible for competing PCWs to offer lower prices to gain market share. We found evidence of price reductions and commission reductions being offered by PCWs but these being turned down by insurers because of the presence of wide MFNs in contracts with other PCWs.
80. We consider that narrow MFN clauses, but not wide ones, may be necessary for the survival of PCWs as a business model. A narrow MFN provides some credibility to the proposition that the policies found on the PCW have prices that cannot be found more cheaply simply by going to the direct website of the provider. Without that reassurance, consumers would learn that PCWs could not be trusted to be a better alternative to direct search and demand for their services might disappear.
81. For a search among insurers to be valuable to the retail consumer—and to contribute to rivalry among insurers—it must return the identity of the seller, and so necessarily has to return the information that is needed for the consumer to bypass the PCW and go to the direct website. Without narrow MFN clauses there is a risk that retail consumers might undermine the business models of PCWs.

82. We believe that PCWs enhance rivalry in the insurance market. A risk to the existence of PCWs from the absence of narrow MFN clauses would therefore be damaging to competition. We do not find that wide MFN clauses are necessary for the continued existence of PCWs.
83. We examined whether the market power derived from single homing, which allows PCWs to negotiate MFN clauses, could be used to deliver equivalent results through other behaviour. We found that it might be possible for a PCW to achieve price parity by using, or threatening, selective delisting of insurers to soften price competition between PCWs. This is not an identical outcome to that achieved through MFNs, but it approaches it.
84. We identified the following feature in the supply of motor insurance and related services which we provisionally conclude has an AEC: wide MFN clauses in contracts between motor insurance providers and PCWs, and practices having equivalent effect where a PCW takes advantage of single homing to prevent a provider of motor insurance and PCWs from competing on price.
85. We provisionally conclude that this feature distorts competition between PCWs, and thus ultimately restricted entry to the PCW market, reduced innovation by PCWs and increased premiums for motor insurance to the retail customer.

1. The reference

- 1.1 On 28 September 2012, the OFT, in exercise of its powers under sections 131 and 133 of the Act, referred to the CC for investigation the supply or acquisition of motor insurance and related goods and services in the UK.
- 1.2 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 AEC.²
- 1.3 The terms of reference and a more detailed description of how we have conducted our investigation so far is set out in Appendix 1.1
- 1.4 Our investigation relates to motor insurance supplied to or acquired by drivers of privately owned motor cars designed and used for private use. It excludes motor cycles. Therefore, it concerns around 25.7 million cars or around 75 per cent of the vehicles registered in the UK.
- 1.5 The OFT identified two features of the motor insurance market it had reasonable grounds to suspect prevented restricted or distorted competition. They were:
- (a) the insurers of at-fault drivers, that are responsible for meeting claims for the provision of repairs or replacement vehicles to non-fault drivers, appear unable to exercise choice over how these services are provided. Insurers of at-fault drivers also appear to find it difficult to assess the extent to which the costs claimed are reasonable, and appear to exercise only limited control over the cost of these services; and

¹ See [section 134\(1\)](#) of the Act.

² As defined in [section 134\(2\)](#) of the Act.

(b) the insurers of non-fault drivers, brokers, credit vehicle hire providers, credit repairers and others that supply services to motor insurers therefore have the opportunity, and the incentive, to take advantage of the insurer of the at-fault drivers' lack of control over costs. They do this by following practices that allow them to generate revenues through referral fees or rebates, while simultaneously increasing the costs that the insurer of the at-fault driver has to meet.

1.6 The OFT was also concerned that features of the market encouraged insurers to compete in a way that may cause further consumer detriment over the long term. Insurers appeared to have had a focus on gaining a competitive advantage by becoming more successful at increasing revenues through referral fees and rebates, while raising their rivals' costs. The OFT noted that it would like to see insurers focused on the quality and value of the service that they provide to insured drivers.

1.7 The OFT investigation took place whilst a number of government bodies were looking at difference aspects of motor insurance. One area of focus was personal injury claims, where the Jackson Review of civil litigation costs³ led the Ministry of Justice (MoJ) to implement reforms through LASPO.⁴ This came into force in April 2013. It has led to changes which affect the incentives and competitive strategies of all firms involved in personal injury claims, including those arising from road traffic accidents. In addition, at the beginning of our investigation the MoJ was considering further reforms to reduce the cost of personal injury claims.

1.8 The measures considered by the MoJ had important practical consequences for any analysis we might have conducted in relation to personal injury claims arising from motor accidents. Any data we might have used in our analysis leading up to our provisional findings would have pre-dated the measures coming into force and would

³ www.judiciary.gov.uk/NR/rdonlyres/8EB9F3F3-9C4A-4139-8A93-56F09672EB6A/0/jacksonfinalreport140110.pdf.

⁴ Legal Aid, Sentencing and Punishment of Offenders Act, 2012. See sections 56–60.

have been an unreliable indicator of the future. Since we would be unable to assess the effect of the statutory and regulatory changes within our timetable, it would have been impossible for us to assess how effective these measures were likely to be. For these reasons, we have not considered personal injury claims in our investigation.

1.9 Our provisional findings are set out in Section 10.

2. Background

Introduction

2.1 This section provides background information on the provision of insurance policies, including the types of vehicles that are the subject of this investigation, types of motor insurance and the provision of insurance policies including summary information on motor insurance providers, brokers and PCWs. It also outlines the role of CMCs, CHCs and body repair shops.

Background on provision of insurance policies

Motor vehicles subject to this investigation

2.2 Table 2.1 shows the breakdown of the 34.5 million vehicles registered in the UK as at 31 December 2012. It shows that the vast majority (28.7 million or 83 per cent) of vehicles were cars.

TABLE 2.1 Vehicles registered in the UK at 31 December 2012 by body type

	'000	%
Cars	28,722	83
Motor cycles	1,225	4
Light goods vehicles	3,281	10
Heavy goods vehicles	461	1
Buses & coaches	166	0
Other vehicles	667	2
Total	34,522	100

Source: DfT: www.dft.gov.uk/statistics/series/vehicle-licensing/.

2.3 Of the 28.7 million cars, 89 per cent were privately registered, as shown in Table 2.2.

TABLE 2.2 Vehicles registered in the UK at 31 December 2012 by ownership

	'000	%
Privately registered	25,701	89
Company registered	2,377	8
Between keepers	645	2
Total	28,722	100

Source: DfT: www.dft.gov.uk/statistics/series/vehicle-licensing/.

- 2.4 Our investigation relates to motor insurance supplied to or acquired by drivers of privately-owned motor cars designed and used for non-business (private) use (and excludes motorcycles). It therefore concerns around 25.7 million cars, or around 75 per cent of the vehicles registered in the UK.

Types of motor insurance

- 2.5 There are two types of motor insurance:

- (a) 'non-comprehensive' insurance (ie 'third party' or 'third party, fire and theft'). Third party cover insures against liability for death or injury to third parties,¹ as well as damage to property of third parties, and is required under the Road Traffic Act 1988 before a vehicle can be driven, and in the case of 'third party, fire and theft' cover extends to fire and theft of the vehicle; and
- (b) 'comprehensive' insurance, which in addition to third party cover also covers damage caused to the insured's own vehicle and the insured's own medical expenses arising from an accident. Comprehensive cover may also provide extra benefits such as a temporary replacement vehicle, roadside assistance, and windscreen repair or replacement, but these may not be standard. If these benefits are not included in the basic policy offered by an insurer, they may be sold as add-ons to the basic cover.

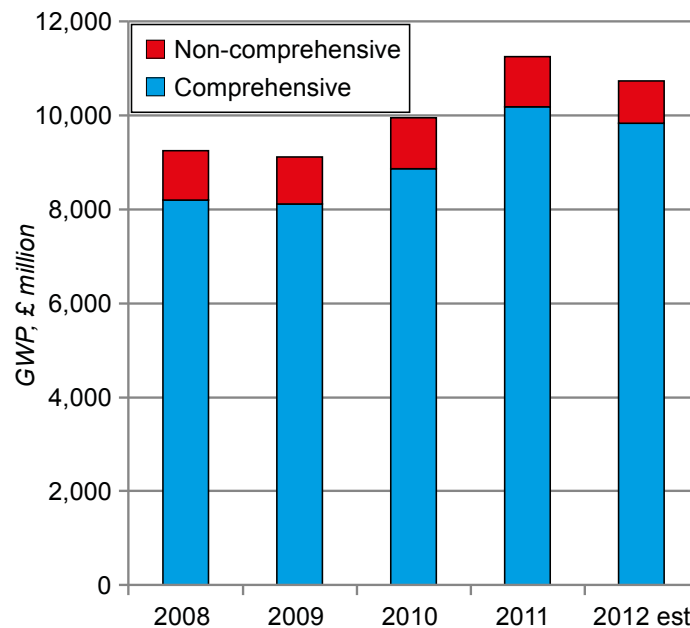
- 2.6 The most commonly sold type of motor insurance is comprehensive insurance. Over 90 per cent of motor insurance gross written premiums (GWP) in 2012 related to comprehensive policies.² The proportion of non-comprehensive policies has declined year on year since 2008. Figure 2.1 shows total industry GWP split between comprehensive and non-comprehensive motor insurance policies, 2008 to 2012.

¹ Third parties would include passengers in the insured party's vehicle.

² Datamonitor, *UK Private Motor Insurance: Market Dynamics and Opportunities*, Table 2, p12. Estimated GWP in 2012 (excluding motorcycles) was £10,739 million, of which comprehensive policies accounted for £9,836 million and non-comprehensive policies £902 million.

FIGURE 2.1

**Split of GWP between type of motor insurance policy,
2008 to 2012 (estimate)**



Source: Datamonitor, *UK Private Motor Insurance: Market Dynamics and Opportunities*.

2.7 Insurers told us that intense competition in the comprehensive insurance market and the knock-on effect on pricing had rendered non-comprehensive products obsolete for many customers. Insurers told us that they had also sought to limit their risk exposure as, historically, non-comprehensive policies, being most popular with young and/or newly-qualified drivers, accounted for greater underwriting losses. In particular, these policies did not prevent insurer exposure to third party personal injury, which had represented an increasing cost for insurers recently.³

Average insurance premiums

2.8 Recent figures for average comprehensive car insurance premiums from Confused.com/Towers Watson suggest that there has been a fall from £858 in Q2

³ Datamonitor: UK Private Motor Insurance 2012, p31.

2011 to £652 in Q3 2013.⁴ The AA found that there had been a fall from £648 in October 2012 to £568 in October 2013.⁵

Provision of insurance policies

- 2.9 Insurance policies are underwritten by insurers. The ten largest motor insurers are: Admiral Group plc (Admiral), Ageas NV/SA (Ageas), Aviva plc (Aviva), AXA Insurance UK plc (AXA), CIS General Insurance Limited (CISGIL), Direct Line Insurance Group plc (DLG), esure Insurance Limited (esure), Liverpool Victoria Insurance Company Limited (LV), Royal & Sun Alliance Insurance plc (RSA) and Zurich Insurance plc (Zurich).
- 2.10 Table 2.3 shows the ten largest motor insurers' GWP, average number of policies in 2012, and average GWP per policy based on information provided to us by the ten largest insurers. At this stage, we do not have an explanation for the considerable difference between the average GWP per policy shown in Table 2.3 and the average car insurance premiums quoted in paragraph 2.8 and we intend to investigate this further.

TABLE 2.3 **GWP, average number of motor insurance policies, and GWP per policy, 2012, for the ten largest insurers**

	2012 GWP £m	Average number of policies in year '000	Average GWP/policy £
DLG	[X]	[X]	[X]
Aviva	[X]	[X]	[X]
LV	[X]	[X]	[X]
Admiral	[X]	[X]	[X]
AXA	[X]	[X]	[X]
Ageas Insurance	[X]	[X]	[X]
Esure	[X]	[X]	[X]
RSA	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]
Zurich	[X]	[X]	[X]
Total	[X]	[X]	393

Source: The ten largest insurers.

⁴ Confused.com/Towers Watson quarterly index for comprehensive cover.

⁵ AA British Insurance Premium Index: www.theaa.com/newsroom/bipi/201310-bipi.pdf.

- 2.11 From the figures provided by the ten largest motor insurers, GWP totalled £[X] billion in 2012. With an estimated total market size in 2012 of £10.7 billion,⁶ we estimate that the ten largest motor insurance providers represent about [X] per cent of the total market. The largest motor insurance provider is DLG, which is responsible for almost one-quarter of the sales made by the ten largest insurers. The GWP of the four largest motor insurers accounted for [X] per cent of the GWP of the ten largest insurers (and [X] per cent of the estimated total market size in 2012), with a large drop in GWP between the fourth largest PMI insurer ([X], with [X] per cent of the total market) and the fifth largest insurer ([X], with [X] per cent of the total market).
- 2.12 Insurance policies are sold through a number of different distribution channels—direct online or direct by telephone; through brokers (see paragraphs 2.14 to 2.22) or PCWs (see paragraphs 2.23 to 2.32) or through partnerships with retailers or banks/building societies. Overall, across the ten largest motor insurers, over one-third of GWP was sold direct (telephone and online), with 31 per cent of GWP sold via brokers and nearly one-quarter of GWP sold via PCWs.⁷ Table 2.4 shows the overall split of GWP and the number of policies sold across the top ten insurers by sales channel.

⁶ 2012 GWP estimated in Datamonitor: *UK Private Motor Insurance: Market Dynamics and Opportunities*, p12.

⁷ We asked the ten largest insurers to provide a split of their GWP and policies sold by sales channel for 2012. Due to the timing of our request (shortly after year end), some providers were able to give us 2012 figures but other providers could only give us 2011 figures (all the providers have a December year end). All the insurers provided figures for new business but excluded renewals so the figures do not tie to the total GWP. Most insurers allocated sales to the original quote channel, regardless of the channel through which the sale was completed (for example, if a quote was generated online but then completed by telephone, the channel designated for the sale was online). Some insurers also applied this approach with regard to renewals in subsequent years, where the designated channel for the renewal sale was that through which the original sale was made.

TABLE 2.4 Split of GWP and number of policies by sales channel, 2011/12

	<i>per cent</i>	
	<i>Sales channel split</i>	
	<i>By value (GWP)</i>	<i>By volume (number of policies)</i>
Direct—Internet	20	23
Direct—telephone	17	15
Brokers	31	32
PCWs	24	21
Retail partnerships	2	2
Banks/building societies	1	1
Other	6	7
Total	100	100

Source: CC calculations based on data provided by the parties.

2.13 We next discuss brokers and PCWs in more detail.

Brokers

2.14 Insurance brokers act as an intermediary between their customers and insurance companies, and use their knowledge of risks and the insurance market to find and arrange suitable policies. They usually offer products from more than one insurer. Some insurers distribute motor insurance policies only through brokers and partners (eg Ageas Insurance).

2.15 ‘Insurance broker’ became a regulated term under the Insurance Brokers (Registration) Act 1977, which was designed to thwart the bogus practices of firms presenting themselves as brokers but in fact acting as representatives of one or more favoured insurance companies. The term now has no legal definition following the repeal of the 1977 Act. However, the sale of general insurance (which includes motor insurance) has been regulated by the FSA (now the FCA) since 14 January 2005 (see paragraph 3.29). Any person or firm authorized by the FCA can call themselves an insurance broker.

- 2.16 In most cases, brokers receive their income from commissions and charges relating to the arrangement, sale and administration of insurance. Sometimes brokers may also be involved in the handling of their customers' claims.
- 2.17 Brokers carry out varying amounts of activity on behalf of the insurer: the 'traditional' broker simply sells insurance on behalf of the insurer but all post-sale servicing, including claims handling, is transferred to the insurer; the 'intermediary' broker carries out more work by receiving delegated authority from a panel of insurers to sell motor insurance policies, and may also carry out post-sale servicing, including claims handling.
- 2.18 Brokers use a range of distribution channels, including traditional high street branches, telephone and online, including PCWs. Brokers can be categorized into three main types: specialist, traditional and online direct, although we note that some brokers can fall into more than one category:
- Specialist brokers use PCWs and sell direct (by telephone and online). Examples of these types of brokers are Ageas Retail and BISL.
 - Traditional brokers use branches, telephone and online channels, and affinity partnerships ('white label' agreements). Examples of this type of broker are Swinton and Endsleigh. They may also use affinity partnerships which combine an insurer (or panel of insurers) and a well-known brand which is used to market and sell the insurance policy, eg M&S, Post Office, and Auto Trader. Affinity deals can be effective for targeting specific customer segments, cross-selling, and for achieving brand power.
 - Online direct brokers use Internet and social media distribution channels only and tend to be smaller.

2.19 Disintermediation (ie direct sales by insurers, using both telephone and online channels, replacing the traditional broker model) has been a general trend in the insurance market in the last 20 years. However, competition between direct and broker businesses has been significantly blurred by the expansion of PCWs, as consumers arranging insurance through such sites are presented with a range of insurance brands and will be largely unaware of whether the policy is being arranged through a broker or directly with the insurer.

- *Market shares—brokers*

2.20 Datamonitor reported that around one-third of motor insurance business in 2011 was sold through brokers,⁸ ranging from small, high street operations to large national companies. Although direct sales by insurers accounted for the largest share of motor insurance policies (42 per cent in 2011), this share has fallen. Datamonitor attributed this decline to brokers adapting to a PCW-defined market, taking advantage of a cost-effective route to market and gaining exposure to a wide potential customer base, as well as the success of affinity partnerships. Datamonitor suggested that smaller brokers had benefited from the level playing field created by a price-driven, commoditized product. Datamonitor also found that, while price was the dominant purchasing consideration for consumers, branding still remained critical for a majority of policies sold (see paragraph 2.32).⁹

2.21 We noted that there is significant demand for non-standard motor insurance, which brokers may be well placed to provide.¹⁰ We noted, for example, that Groupama Insurance Company Limited (owned by Ageas (UK) Limited since November 2012)

⁸ Datamonitor report, *Personal General Insurance: UK Private Motor Insurance*, published September 2012, stated that 36 per cent of PMI business in 2011 was through brokers. The figures we collated from the top ten insurers showed that 30 per cent of motor insurance by GWP and 28 per cent by number of policies were sold through brokers in 2012.

⁹ Datamonitor's General Insurance Consumer Survey 2012.

¹⁰ Non-standard motor insurance does not have a precise definition. It may include insurance for learner and young drivers, and to cover high-performance cars, modified cars, kit cars, imported cars and classic cars.

had opted to shift its focus away from standard motor insurance towards specialist lines, with [✂] per cent of its motor insurance book classified as non-standard.

- 2.22 Appendix 2.1 provides further details on five large brokers: Acromas, Ageas Retail (owned by Ageas), BISL, Endsleigh (owned by Zurich) and Swinton (owned by Covea).

Price comparison websites

- 2.23 There are four large PCWs which allow consumers to compare and purchase motor insurance policies. These are:

- Comparethemarket.com, owned by BISL Limited, which is part of the BGL Group;
- Confused.com, owned 100 per cent by Admiral;
- Gocompare.com, owned 50 per cent by esure; and
- Moneysupermarket.com.

The market shares of the four large PCWs are similar and are shown in Appendix 9.3, Figure 4.

- 2.24 Other PCWs include Google and Tesco Compare. Further details on each are provided in Appendix 2.1.
- 2.25 The original focus of three of the four large PCWs was motor insurance, though they all now offer many products, including other general insurance products (eg home, travel), financial products (eg personal loans, savings, credit cards) and other products (eg energy). [✂]
- 2.26 The business model for each PCW is a simple one: motor insurance providers pay the PCW a fee per sale (ie a cost per acquisition known as CPA fees in the industry

but referred to as commission fees in this document) for each motor insurance policy sold which was introduced by the PCW.

2.27 Since the content offered by PCWs is provided by the motor insurance providers which sell through multiple channels, it is unlikely to be tailored to any one PCW. Each PCW, therefore, builds a distinct brand identity to differentiate itself from other PCWs and to attract consumers to its website. As a result, PCWs spend heavily on advertising. Datamonitor reported that all four of the large PCWs were among the top ten motor insurance advertisers in 2011, with all of them pursuing advertising campaigns focused on television advertising, and that this medium represented at least 90 per cent of their advertising spend. All the four large PCWs told us that they did not promote motor insurance to any particular consumer demographic.

2.28 PCWs' costs are mainly advertising or marketing, and creating and maintaining their websites. Confused.com told us that the large majority of its costs were direct in nature and related to the build, maintenance, development and promotion of the PCW. Gocompare.com told us that media costs (online and offline) constituted around 90 per cent of its costs. Both of these PCWs told us that, given the high proportion of income that is generated from motor insurance, most media costs were attributed to motor insurance. Comparethemarket.com told us that [redacted]. Comparethemarket.com said that [redacted].

- *Usage of PCWs*

2.29 Customers who purchase motor insurance through a PCW access on average between one and two PCWs:

- Our survey of motor insurance policyholders found that respondents looked at, on average, 2.2 PCWs when they last compared insurance providers or policies, with 42 per cent looking at Comparethemarket.com, 46 per cent looking at

Gocompare.com, 23 per cent looking at Moneysupermarket.com, and 15 per cent looking at Confused.com (see Appendix 2.2). Our survey found that 12 per cent of respondents looked at other PCWs and 14 per cent of respondents did not know which PCW they had looked at.¹¹

- A 2012 Datamonitor survey found that, in 2012, Comparethemarket.com was the most popular PCW for customers purchasing motor insurance, with 67 per cent of those customers who purchased through a PCW having searched using Comparethemarket.com. The other three large PCWs had lower but roughly similar levels of usage (Confused.com: 49 per cent; Gocompare.com: 43 per cent; and Moneysupermarket.com: 48 per cent). Datamonitor found that usage of PCWs outside the four large PCWs was limited, with only 5 per cent of consumers who went on to purchase through a PCW using another PCW.

2.30 Datamonitor found that, as of September 2012,¹² 54 to 56 per cent of new motor insurance business was being written by insurers through PCWs.^{13,14,15} However, responses to Datamonitor's General Insurance Consumer Survey 2012 found that 23 per cent of consumers made their final purchase on a PCW, from a sample that included those renewing with the same insurer. We found that this latter figure was more in line with the figures provided to us by the ten largest motor insurers regarding their GWP by sales channel, which suggested that, in 2012, 26 per cent by GWP and 28 per cent by number of policies were sold through PCWs. We noted that there was a large gap between the proportion of consumers using PCWs for research (around 77 per cent) and the proportion making a final purchase on them (around 20 to 30 per cent).

¹¹ PCWs included in 'Other' included Compare NI, Google, Quote Zone, Tesco Compare, uSwitch and several others.

¹² Datamonitor references this finding to 'aggregator experts' but does not specify who these aggregator experts are.

¹³ New motor insurance business does exclude renewals with the same insurer.

¹⁴ Datamonitor report, *UK Private Motor Insurance 2012*, p62.

¹⁵ Data from ebenchmarkers suggests that [55–65] per cent of new motor insurance was written through PCWs.

2.31 Datamonitor's report stated that the growth of PCWs had had a significant effect on motor insurers' sales strategies by creating a more price-sensitive market, with consequent effects on the structure and pricing of policies, eg with less cover being included in the basic motor insurance product in order to produce a cheaper price. This drove the resulting headline quote, with more only being available as an add-on (known as 'hollowing out').

2.32 Datamonitor also found that a majority of consumers do not select the cheapest quote on a PCW. Of consumers surveyed who purchased motor insurance from a PCW, 37 per cent selected the cheapest quote and 56 per cent selected a policy from within the top five but not the cheapest. Although showing the importance of a high ranking, this data also suggests that price is not the sole consideration for consumers when selecting a policy on a PCW, with product differentiation and brand also being important.

Relationships between insurers, brokers and PCWs

2.33 There are vertical relationships between insurers and PCWs/brokers:

- (a) One of the four large PCWs is owned by one of the ten largest motor insurers, one is part-owned by one of the ten largest motor insurers and another is owned by a large broker.
- (b) Three of the ten largest motor insurance providers also own brokers. These operate on a non-exclusive basis and appear to enable the motor insurance provider to capitalize on its brand, by attracting customers who do not necessarily fit its underwriting risk profile but who do wish to engage with the brand.

CMCs and CHCs

2.34 CMCs are organizations which typically offer to manage a claim from start to finish. They often act on behalf of insurers and brokers but also may have claims referred to

them by other parties such as motor dealerships or solicitors, or may be approached directly by non-fault claimants. CMCs manage claims for property damage and personal injury in addition to claims relating to accident damage. The range of services provided by CMCs can include:

- (a) handling the FNOL;
- (b) managing repairs, which may be through a network of approved repairers;
- (c) providing replacement vehicles;
- (d) providing credit repair and credit hire for non-fault claimants (in credit repair and credit hire the service provider receives no payment until the claim is settled by the at-fault insurer);
- (e) handling claims and recovering claims costs from the at-fault insurer; and
- (f) recovering uninsured losses.

2.35 CHCs are organizations which provide rental vehicles on a credit hire basis to non-fault claimants. Companies providing credit hire typically also provide vehicle rentals under direct hire arrangements. In addition, CHCs may provide other services such as repair management, credit repair and claims management such that the distinction between CHCs and CMCs is blurred.

2.36 Some of the largest CMCs and CHCs are Ai Claims Solutions, Accident Exchange Group, Easi Drive Limited, Claimfast, Enterprise Rent A Car, FMG Support, Helphire, Innovation Group, Kindertons, Network Services (Nationwide) Limited, Quindell and WNS Global Services (UK).

Repairers

2.37 Three of the large motor insurers own vehicle repair companies: Aviva owns Solus Accident Repair Centres Limited; DLG owns UK Assistance Accident Repair Centres Limited; and RSA owns RSA Accident Repairs Limited. Other repair businesses may

be part of other companies, such as motor dealerships, or be independent. The independent companies typically have a regional, rather than national, presence. The large insurers and CMCs/CHCs generally have established networks of approved repairers in order to control repair costs and manage the level of service provided to their customers.

3. Legal and regulatory framework and the claims management process

Introduction

3.1 This section is in two parts:

- The first part describes the legal and regulatory framework relating to motor insurance.
- The second part provides an overview of claims and the claims management process.

Legal and regulatory framework

Principle of insurance

3.2 A contract of motor insurance is a contract of indemnity. The indemnity essentially is an agreement by the insurer that it will recompense the policyholder in the circumstances identified in the contract. Where a policyholder causes loss or injury by negligent driving, the insurer will indemnify the policyholder for their liability to the non-fault driver in so far as that liability is covered by the contract of insurance.

Principle of compensation under tort law

3.3 The law of negligence, part of the law of tort, imposes a duty on individuals not to cause loss or damage to others in breach of their duty of care. When individuals breach their duty, either by act or omission, and cause damage or loss, they are normally liable to compensate those who suffer the damage or loss.

3.4 The law of negligence has developed in the courts to protect people who wrongly suffer loss or damage by the acts of others. A person who suffers a loss as a result of another person's negligence is entitled to be compensated by being put into 'as good a position as he or she would have been if no wrong had occurred'.¹ Compensation is monetary. In a motor accident the negligent driver will be liable to pay the injured

¹ *Livingstone v Raywards Coal Co (1880) 5 App. Cas. 25.*

driver damages rather than, for example, to take action such as repairing the damaged vehicle.

- 3.5 The non-fault driver is entitled to be compensated for the diminution in value of his car, as well as for consequential losses such as the loss of use of the vehicle.

Claims by non-fault drivers under tort law

Compulsory third party insurance

- 3.6 As noted in paragraph 2.5, the Road Traffic Act 1988 provides that motorists are obliged to hold a valid insurance policy to cover 'third party' risks, ie the risk that they will cause the death of or personal injury to another person or damage to another person's property while driving and consequently have to pay damages. Third party motor insurance is the only form of motor insurance that is compulsory by law.² The Road Traffic Act 1988 further provides that at-fault insurers have to indemnify non-fault parties directly. The intention is to ensure that all non-fault parties are protected, regardless of the financial status of the at-fault driver.³

Principle of subrogation

- 3.7 In the context of a road traffic accident, non-fault drivers typically have their claim managed by a third party rather than procuring the appropriate services themselves. Sometimes services are provided directly by the at-fault insurer. More often, non-fault drivers choose to have their claims managed by their own insurer (if they have a comprehensive policy) or another service provider (such as a CMC). When a non-fault driver's claim is managed by their own insurer, and the insurer has indemnified the policyholder in accordance with the terms of the insurance policy, subrogation operates, so that once the non-fault insurer has put the policyholder back into the

² Failure to insure 'third party' risks is a criminal offence, the punishment for which is a fine of between £200 and £5,000 and six to eight points on the driver's licence.

³ In the event that an at-fault driver does not hold third party motor insurance, non-fault drivers can obtain compensation from the Motor Insurance Bureau.

position they were in before the accident, the non-fault insurer is able to exercise the policyholder's rights under tort law to claim compensation from the at-fault driver. In practice, the non-fault insurer usually pursues the at-fault driver's insurer in order to recover the costs that have been incurred. The at-fault insurer can challenge the value of the subrogated claims,⁴ for example if the costs are not related to the accident, or if they are unreasonable.

- 3.8 We understand that insurance policies (as well as contracts between CMCs/CHCs and non-fault drivers) typically include a clause expressly assigning the rights of recovery against third parties to the insurer (or CMC) when the insurer (or CMC) has indemnified the policyholder for non-fault losses.⁵ Subrogation in this sense is a contractual arrangement for the transfer of rights against third parties and is founded upon the common intention of the parties.⁶

Direct losses arising from a road traffic accident

- 3.9 The damage to the vehicle caused by the accident represents a loss. In practice, the vehicle will either require repair or will be written off. In either case, the non-fault driver is entitled to receive compensation for the loss suffered.

- *Repairs*

- 3.10 The non-fault driver must act reasonably in seeking to repair his car, and the repair costs must be reasonable in order for them to be entitled to recover the costs.
- 3.11 In *Coles v Hetherton*⁷ (in which, at the date of this report, judgment is awaited from the Court of Appeal), the High Court decided that where a vehicle is negligently

⁴ We note that, although not the technical legal meaning, the industry uses the terms subrogated bills, invoices or claims to refer to the documentation sent by subrogated parties (eg non-fault insurers who have indemnified a non-fault driver on the basis of their comprehensive policy) to fault insurers. We have used this shorthand terminology throughout the report.

⁵ Padfield, A, 2012, *Insurance Claims*, 3rd ed, p249.

⁶ *Banque Financière de la Cite v Parc (Battersea) Ltd and Others*, [1999] 1 AC 221.

⁷ *Coles and Others v Hetherton and Others*, [2012] EWHC 1599 (Comm).

damaged and reasonably repaired, the measure of the non-fault driver's loss can be taken as the 'reasonable cost of repair' (rather than the actual cost of repair). That 'reasonable cost of repair' is merely a way of ascertaining the diminution in the value of the car, and therefore is not necessarily the repair cost actually incurred. It was noted that recovery was possible regardless of repair or payment for repair, and that the 'reasonableness of the repair' charge is to be assessed from the position of the individual non-fault driver (without reference to their insurers or to any benefits they may obtain under their insurance policy). This means that it is not relevant whether the cost of the repair could have been lower by virtue of the non-fault insurer's bargaining power.

3.12 Provided that the costs are reasonable, there are no restrictions on the non-fault driver's right to choose a garage and/or mandate original equipment manufacturer (OEM) parts, but in practice the non-fault insurer, the fault insurer or a CMC will often determine which garage is used (see paragraph 3.81).

3.13 If, after the repair, the value of the vehicle were less than before the accident, the non-fault driver would be entitled to claim the difference in value.

- *Written-off vehicles*

3.14 In general terms, a vehicle is deemed to be beyond economic repair (and hence a write-off) when:

- the estimated cost to repair the vehicle exceeds the pre-accident value of the vehicle less any costs that could be recovered for its salvage (the estimated salvage value); or
- the vehicle is so significantly damaged to render the vehicle unable to be repaired.

Consequential losses

3.15 A non-fault driver is entitled to compensation for indirect losses, such as personal injuries, the loss of earnings, the need for a replacement vehicle or other costs incurred as a consequence of the accident as well as to compensation for the physical and direct damage caused to the non-fault driver's vehicle.

- *Replacement vehicle*

3.16 If a non-fault driver's vehicle is not driveable or temporarily unavailable (generally due to repairs), the non-fault driver can seek compensation for the loss of use of the vehicle. The non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need for an alternative vehicle can be established.

Reasonable need is rarely difficult to show and scenarios in which they would clearly not have need for an alternative vehicle are likely to be relatively limited.

3.17 In practice, claims for compensation under tort law usually involve the cost of a replacement car which is broadly equivalent to the customer's own vehicle (often referred to in the industry as a 'like-for-like' replacement car) for as long as is reasonably necessary.⁸ This is subject to the non-fault driver's duty to mitigate⁹ their loss with consideration to their need.

3.18 A replacement car may be provided either on a credit hire or direct hire basis (see paragraph 3.88). A non-fault driver can only claim the costs of credit associated with a credit hire (ie the costs over and above the 'spot rate'¹⁰) if they can demonstrate that they had no real choice but to use the services of a credit hire company (ie the

⁸ The hire duration is usually determined by the repair duration.

⁹ As with any victim of a tort, a claimant whose car has been damaged is under an obligation to mitigate the extent of his losses. His obligation is to act reasonably in the circumstances (*Martindale v Duncan* [1973] 1 WLR 574). This means the claimant must take reasonable steps to reduce the extent of the loss flowing from the negligent act of the defendant.

¹⁰ The rate that is charged by car hire companies to retail customers.

customer is impecunious¹¹). Regardless of whether a direct hire or credit hire rate has been claimed, the non-fault driver need only show that the rate is reasonable.¹² They will be able to claim compensation for the actual rate incurred even if it is above local averages, provided it falls broadly into the range of local hire rates.

- 3.19 If the non-fault driver enters a hire agreement of either type, the courts will consider whether they were offered an equivalent vehicle free of charge, when assessing the reasonableness of the claim for hire costs. The courts will not normally take account of the availability of a replacement vehicle under a non-fault driver's insurance policy. A non-fault driver does not have to accept an offer of a replacement vehicle from the at-fault insurer. However, under tort law principles, it might be unreasonable to claim credit hire rates if the at-fault insurer offered the non-fault driver an equivalent replacement vehicle at a lower cost. The at-fault insurer will have to demonstrate that sufficient information had been provided to the non-fault driver in order to allow the non-fault driver to make an informed decision whether to hire from a credit provider or to accept the offer from the at-fault insurer.¹³ In practice, this type of strategy to capture customers is unusual. We note that under the ABI General Terms of Agreement between subscribing insurers and credit organizations (the GTA—see paragraph 3.89), insurers and CHCs agree not to intervene once a non-fault driver has been captured by another entity (referred to as the 'first to a customer' principle).
- 3.20 The duration of the hire must be reasonable. The at-fault insurer may argue that the non-fault driver has delayed in getting the car repaired and therefore kept the hire car for an unreasonable length of time. However, we understand that this can be a

¹¹ However, the assessment of what the tort law entitlement requires in a given case will be informed by the specific facts of that case, which, in view of the nature of the 'impecuniosity test', may lead to some practical difficulties for CMCs/CHCs in assessing whether a non-fault customer requires a replacement vehicle on credit terms. If the claimant secured credit hire, but is held not to have been impecunious, he or she will not be entitled to claim the full credit hire rates.

¹² We note that in practice credit hire rates are often lower than 'spot rates' charged to retail customers. As a consequence, claimants are generally able to recover the full credit hire rates even when not impecunious.

¹³ In which case the non-fault driver would only recover the cost that the at-fault insurer would have incurred. See *Evans v TNT Logistics Limited & Admiral Insurance Services Limited*, [2007] Lloyd's Rep. I.R. 708 and *Copley v Lawn and Madden v Haller*, [2009] EWCA Civ 580.

difficult argument to make where it is arguable that any delay was in fact the responsibility of the garage or repairer.

- *Other consequential losses*

- 3.21 As a consequence of the motor accident, a non-fault driver may suffer personal injury and be unable to work. Non-fault drivers can claim for their loss of earnings and the pain suffered. This is subject to them acting reasonably. As noted in Section 1, we have not considered personal injury claims in our investigation.

Claiming under contract: general principles

- 3.22 Following an accident, a policyholder, whether at-fault or non-fault,¹⁴ may claim under their own motor insurance policy, so long as it is comprehensive. The terms of the motor insurance contract will set out and define what is covered as well as how and in what circumstances a policyholder can claim. The policy may have exclusions for certain types of loss or conditions for being able to claim.
- 3.23 Contractual provisions might restrict the policyholder's choice of the garage that is going to repair their vehicle. For instance, certain policies give the option to the insurer to mandate a body shop or require any quote made by a body shop to be approved by the insurer.
- 3.24 Also, the policyholder will typically have to pay costs of repairs up to the excess set out in their policy. Similarly, they may receive a replacement vehicle in accordance with the terms of their policy. Depending on the premium they paid, this may be a courtesy car from the insurer's repairer (if the non-fault insurer is also managing the

¹⁴ When a non-fault insurer indemnifies its policyholder, it will be able to recover costs from the at-fault insurer under subrogation. In practice, insurers managing a non-fault claim will often provide (directly or through intermediaries such as CHCs) a level of service matching the legal entitlement under tort law.

customer's repair) or, only where the customer has purchased additional cover, a like-for-like replacement vehicle from the insurer's direct vehicle provider.

3.25 In case of a write-off, the policyholder will typically be entitled to the pre-accident value of the vehicle minus the excess. Some policies do not provide any replacement vehicle in this situation.

3.26 We discuss claims by at-fault drivers on their own policy in more detail in paragraphs 3.57 to 3.60 and claims by non-fault drivers managed by their own insurer in paragraphs 3.69 to 3.73.

Regulatory framework

3.27 In recent years, UK and EU authorities have taken several initiatives to amend the institutional and regulatory framework of insurance regulation.

3.28 Until 31 March 2013, regulation of the insurance industry in the UK was carried out by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000 (FSMA). Since 1 April 2013 insurance companies have been regulated by two new regulatory institutions under the terms of the Financial Services Act 2012 (which amended the FSMA, the Banking Act 2009 and the Bank of England Act 1998):

(a) The Prudential Regulation Authority (PRA), which is part of the Bank of England, is responsible for the prudential regulation and supervision of insurers. This includes the authority to grant and, in specific circumstances, to vary or cancel permissions to carry on insurance business and to require the maintenance of adequate financial resources (prudential supervision).

(b) The Financial Conduct Authority (FCA) regulates insurance firms for conduct purposes. This includes the authority to ensure that regulated firms treat cus-

tomers fairly as well as to investigate marketing, sales, claims and complaint handling practices (conduct of business supervision).

- 3.29 An insurer providing motor insurance cover in the UK falls within this regulatory framework.
- 3.30 In 2009, the EU revised the supervisory framework by adopting a new legislative framework for the banking industry (Basel III) and insurance industry (Solvency II). The new Solvency II regime is likely to enter into force by 1 January 2016 and would therefore need to be transposed into UK law (and be in force) by that date.
- 3.31 The changes brought by Solvency II will entail, among other things:
- (a) a new, more sophisticated, approach to risk and capital requirements, requiring valuations to be done in a prudent and market-consistent manner;
 - (b) higher standards of risk management and governance;
 - (c) increased supervision powers for authorities, eg increased powers to challenge firms on risk management issues; and
 - (d) increased disclosure and reporting requirements.
- 3.32 According to some analysts' commentaries on the capital requirements of Solvency II, this regime could increase consolidation in the insurance industry, since costs of compliance for smaller insurers may become prohibitive, and smaller insurers with limited diversification of risk may need to hold relatively more capital than larger, more diversified insurers.
- 3.33 In 2010, the European Insurance and Occupational Pensions Authority was created. It is responsible for monitoring the insurance industry as a whole and for facilitating collaboration between national authorities.

Claims and the claims management process

- 3.34 Claims usually involve repair to damaged property (eg vehicles or structures) and/or compensation for any injuries and/or losses caused (eg personal injury, vehicle write-offs, loss of vehicle use or loss of earnings). In many cases, the costs incurred in repair and compensation are covered by motor insurance and insurers are therefore closely involved in the claims management process.
- 3.35 This subsection first provides a summary of the volume and value of motor insurance claims and then presents an overview of the claims management process, including the provision of vehicle repair and the provision of replacement cars pursuant to motor insurance policies.

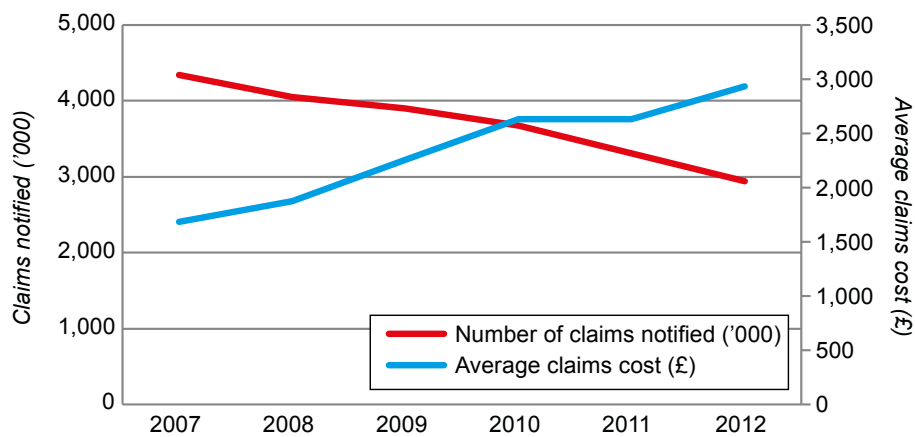
Volume and value of motor insurance claims

- 3.36 Datamonitor reported that in 2012 there were 2.9 million claims notified and that the gross claims incurred amounted to £8.6 billion, giving an average claim cost of £2,933. Figure 3.1 shows that average claim costs have risen year on year since 2007: the average cost of a claim was £1,684 in 2007 and £2,942 in 2012. This is despite a fall in the number of claims over the same period. Datamonitor stated that this increase was the result of rising claims relating to personal injury, despite road traffic casualties declining due to cars and roads getting safer.¹⁵

¹⁵ Datamonitor, *UK Private Motor Insurance*, 2012.

FIGURE 3.1

Number and average cost of claims, 2007 to 2012

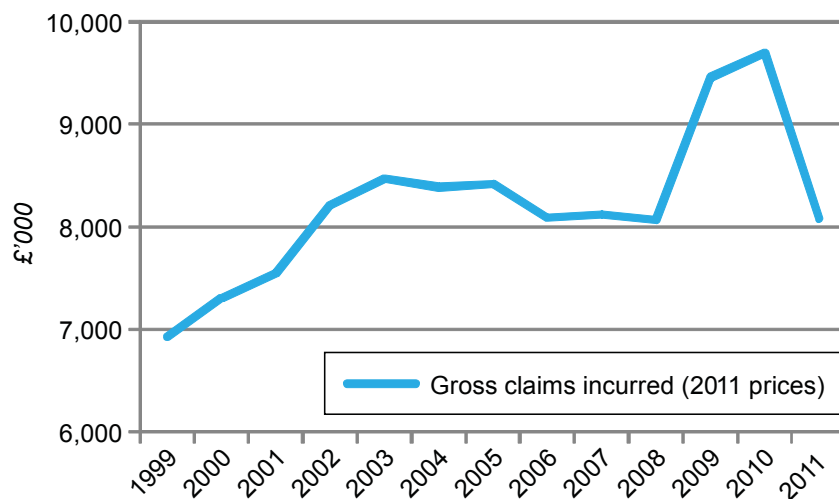


Source: Datamonitor: *UK Private Motor Insurance: Market Dynamics and Opportunities*.

3.37 The Association of British Insurers (ABI) reported that, in 2011, motor insurance claim costs fell to £8.1 billion,¹⁶ which was more in line with the annual level of claims through most of last decade (as shown in Figure 3.2, which shows gross motor insurance claims in the period 1999 to 2011 based on ABI data).

FIGURE 3.2

Gross motor insurance claims incurred in the UK



Source: ABI.

¹⁶ ABI, *UK Insurance Key facts*, 2012.

3.38 Table 3.1 shows data on the number of claims and claims frequency from a report by Mintel. The data for 2003 to 2011 was sourced from the ABI. The figures for 2012 were estimated by Mintel based on data covering the first three quarters of the year. Mintel estimated that there would be 2.8 million motor insurance claims in 2012, down from 4.4 million in 2006; and that the frequency of motor insurance claims (ie the number of claims in a year as a percentage of the number of insured cars) has declined from 18.9 per cent in 2003 to 12.5 per cent in 2012.

TABLE 3.1 **Total number of private car insurance claims notified and claims frequency, 2003 to 2012***

	<i>Exposure in vehicle years m†</i>	<i>Annual change %</i>	<i>Number of claims notified m</i>	<i>Annual change %</i>	<i>Claims frequency %</i>
2003	20.9	1.5	4.0	1.5	18.9
2004	21.9	4.8	4.1	3.9	18.7
2005	23.6	7.4	4.3	3.7	18.1
2006	24.6	4.5	4.4	3.9	18.0
2007	24.4	-0.7	4.3	3.1	17.5
2008	24.0	-1.9	4.0	-6.7	16.7
2009	24.0	0.1	3.9	-3.7	16.0
2010	23.4	-2.5	3.6	-5.6	15.5
2011	23.5	0.3	3.3	-10.0	13.9
2012 (est)‡	22.7	-3.4	2.8	-13.1	12.5

Source: Mintel: Motor Insurance – UK, March 2013.

*The table covers private cars and excludes motorcycles and other personal vehicle claims.

†Exposure in vehicle years is a guide to the number of vehicles insured, measuring the period of time a policy is in force during a given year.

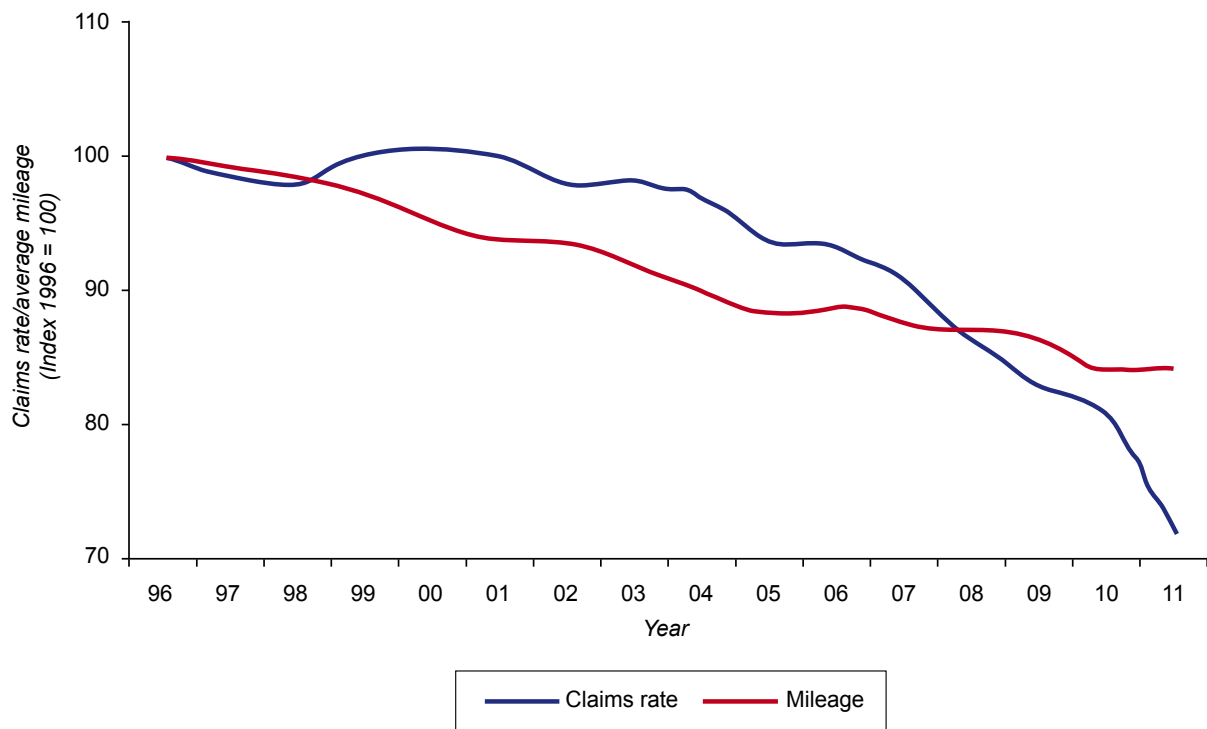
‡Mintel's estimate is based on data from the first three quarters.

3.39 Table 3.1 shows that the number of motor insurance claims has declined since 2006, and the constant total claims cost shown in Figure 3.2 is consistent with Figure 3.1 showing that average claims costs have increased since 2007.

3.40 Figure 3.3 shows that as the average annual mileage of cars in the UK has fallen, there has been a decline in claims frequency.

FIGURE 3.3

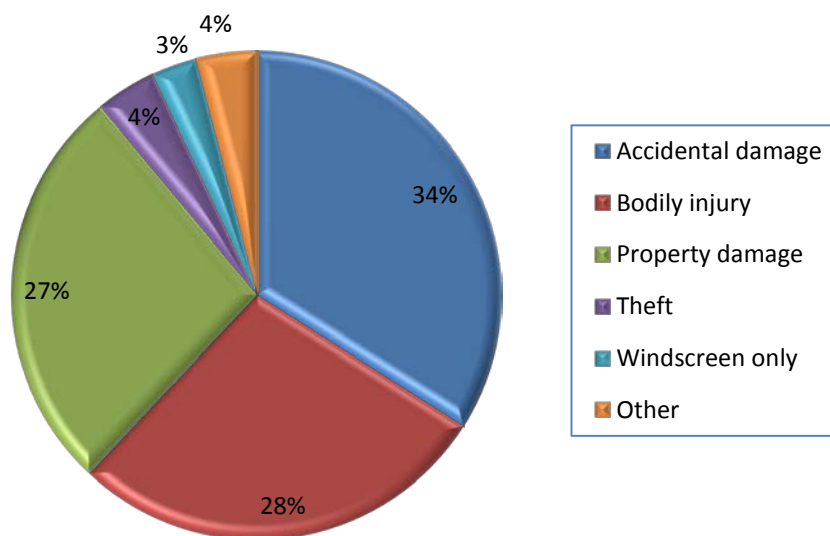
Insurance claims rate versus average annual mileage*



Source: www.trendtracker.co.uk/blog/2012/10/the-uk-car-body-repair-market.

3.41 Figure 3.4 shows a breakdown by the ABI of motor insurance claims costs in 2012 by types of claims based on data submitted by its members in accordance with a template provided by the ABI.

FIGURE 3.4
Claims costs, 2012



Source: ABI.

3.42 The ABI told us that accidental damage category relates to claims payable to policyholders for damage to their own vehicle and personal injury claims from policyholders and their partners (if appropriate), while the property damage category should relate to payments made to third parties for repairs to their property caused by the actions of the insured parties. However, the ABI noted that each claim often comprised different types of costs, and categorization of costs in the submissions from its members depended on the individual insurers' systems.

3.43 The ABI told us that repair costs arising from a road traffic accident should be reported in the accidental or property damage categories and the costs of replacement cars would be likely to be reported in the accidental or property damage categories or the 'other' category. We noted that the accidental damage, property damage and other categories together accounted for 65 per cent of total claims costs in 2012.

3.44 We also noted that within the total number of claims, there was a large number of claims which related only to windscreens which had a low average claim cost. Datamonitor reported that in 2012, 3.3 million motor insurance claims were notified and settled in the same year, of which 1.2 million related only to vehicle windscreens and the average cost of these claims was £121.¹⁷

3.45 The General Insurance Market Research Association reported that, in 2011 and 2012, accidents were the reason for approximately [3/4] of claims made under comprehensive insurance policies and vehicles being vandalized or damaged accounted for approximately one-quarter of claims.

3.46 Based on data provided to us by six of the ten largest insurers, we estimated that claims costs relating to road traffic accidents (ie excluding windscreen and fire and theft claims) in 2012 were divided as follows:

- 62 per cent related to claims by non-fault claimants (ie claims on insurers by third parties when the insurers' policyholders were at-fault);
- 12 per cent related to non-fault claims by policyholders on their own policy (before recoveries from the at-fault insurer);
- 14 per cent related to at-fault claims by policyholders for their own damage; and
- 11 per cent related to claims when there was split liability.¹⁸

We understand that the disparity between the cost of claims by non-fault claimants and claims by at-fault claimants is largely because the cost of personal injury claims and providing replacement cars is generally higher for non-fault claimants than at-fault claimants.

¹⁷ Datamonitor: *UK Private Motor Insurance: Market Dynamics and Opportunities*.

¹⁸ Figures do not add up to 100 per cent due to rounding.

3.47 Based on the information we received, we estimated that write-offs accounted for between 365,000 and 600,000 motor insurance claims in 2012 (see Appendix 6.3, paragraphs 3 and 4.

Claims experience by channel

3.48 We asked the motor insurers about the level of their claims in each of the channels they used to distribute motor insurance. The lower the level of claims experience (ie the lower the percentage claims/loss ratio), the more favourable the position for the insurer. Of the eight insurers which provided us with data, four told us that claims were generally higher for sales made via PCWs compared with sales made via other channels, as follows:

- Admiral told us that the claims experience in the first year of cover for policies purchased through PCWs was highest, followed by policies purchased over the telephone. Claims experience in the first year of cover was lowest for policies purchased online.
- AXA told us that [REDACTED]. Its total loss ratio¹⁹ [REDACTED].
- DLG told us that, over the lifetime of the customer, business transacted through [REDACTED].²⁰
- esure provided data on claims showing that [REDACTED].

3.49 However, we noted that the differences in claims cost appeared to be due to the mix/demographic profile of customers buying through a particular channel, rather than the riskiness of the channel itself, as follows:

- Admiral told us that the mix of business was very different between the three channels, and that it was not entirely correct to use the figures as the basis for a fair comparison between the three groups. For example, the mix of customers

¹⁹ Ultimate loss ratio is total forecast claims divided by total forecast premium expected to arise from a policy or class of business. Losses include those paid and notified and an estimate of those yet to be notified.

²⁰ [REDACTED]

coming through PCWs included a much higher proportion of young drivers, which in turn led to a much higher level of claims cost.

- DLG told us that it experienced a [£] 'burn cost'²¹ in 2012 on business generated through [£], but this was likely to be a function of the slightly different demographic profile of [£].
- Additionally, we noted that the loss ratio would be affected by the level of premium: a high loss ratio could be attributable to one or both of a high burn cost and a low premium.

3.50 The other four insurers had inconclusive data regarding the difference in their claims experience between their direct and PCW channels, as follows:

- Aviva only started selling policies via PCWs in 2011 and told us that the data was not representative.
- RSA provided data on burn cost as follows: direct website £[£]–£[£]; direct telephone £[£]; broker £[£]; PCWs £[£]–£[£]; and partnerships £[£]–£[£].
- Zurich provided data on burn cost as follows: direct website £[£]; direct telephone £[£]; broker £[£]; and PCW £[£]. It did not provide us with an average for direct sales.
- Ageas Insurance provided data for brokers and partnership channels but as it does not sell direct to customers it did not provide any information on this channel.

The claims management process

3.51 Following a road traffic accident involving a vehicle collision, each driver involved is required by the Road Traffic Act 1988 to stop and, if required by any person on reasonable grounds, to give their name and address (and also the name and address of the owner of the vehicle) and the registration number of the vehicle. If any person involved in the accident has been injured, the driver must also present his certificate

²¹ Burn cost is effectively average claims cost per policy.

of insurance at the time of the accident to (a) any person who has required the driver to produce it on reasonable grounds, or (b) a police officer. When the accident involves injury and the driver is unable to produce his certificate of insurance (this would be the case, for instance, where the other driver is injured and not in a position to exchange certificates of insurance), he must report the accident to the police as soon as is reasonably practicable and, in any case, within 24 hours of the occurrence of the accident and the insurance certificate must be taken to a police station within seven days.

- 3.52 In this subsection, we describe how fault is typically established, the claims management process for at-fault and non-fault claims, including the provision of vehicle repairs and replacement cars, and vehicle write-offs.

Establishing fault

- 3.53 The drivers involved in a vehicle collision may, or may not, know or agree at the time of the accident which driver is the at-fault driver and which driver is the non-fault driver. The drivers' insurers need to identify which driver caused the accident in order to establish which insurer will need ultimately to pay any resulting claims (eg for repair costs and replacement car costs). Drivers usually contact either their insurer or the broker which sold them their insurance policy in order to inform them of the accident and to describe the circumstances of the accident (the FNOL).²²
- 3.54 Our survey of non-fault claimants²³ found that, following an accident, 68 per cent of non-fault claimants first contacted their own insurer; 11 per cent had first contact with the at-fault insurer; and 20 per cent had first contact with another organization such as a garage, vehicle recovery provider or the police. We found that 84 per cent of

²² In some cases, drivers will, instead of contacting their insurer or broker, contact another party such as a CMC or the car dealership from where they bought their car, or will be contacted by the at-fault insurer (see paragraph 3.65).

²³ www.competition-commission.org.uk/assets/competitioncommission/docs/2012/private-motor-insurance-market-investigation/130628_wp21_survey_report.pdf.

non-fault claimants were proactive and made the first contact, rather than being contacted by another party.

- 3.55 The claims handler at the insurer or the broker will seek to make an immediate assessment of whether its customer is the at-fault or non-fault driver. In order to establish fault, claims handlers ask customers relevant questions based on typical accident scenarios, types of accident damage, the accident scene and the Highway Code. If an immediate assessment is not possible, the claim will be passed to specialist claims handlers for further investigation, which may include gathering witness statements or other evidence from the scene of the accident.
- 3.56 We found that, at FNOL, insurers on average established fault in 75 per cent of cases; 20 per cent of cases were categorized as split liability; and 5 per cent of cases were not decided. Evidence from the ten largest motor insurers suggested that the categorization of a driver as non-fault changed following FNOL in between 2 and 12 per cent of cases.

At-fault claims

- 3.57 The legal entitlements of the at-fault driver involved in a road traffic accident are as stipulated in their motor insurance policy.
- 3.58 Following a vehicle collision, the at-fault driver's vehicle may require repair and, if the repair means that the vehicle will be unavailable for a period, the driver may also require a replacement car. If the at-fault driver has a comprehensive insurance policy then they are generally able to make a fault claim under their own insurance policy to cover the cost of repair to the vehicle, subject to a pre-agreed excess. A comprehensive insurance policy will also sometimes include the provision of a replacement car to the at-fault driver (often provided by the repairer) but, in other cases, a replace-

ment car will only be provided if replacement car cover has been purchased as an add-on to the basic motor insurance policy (either for a basic courtesy car or on a like-for-like basis).

- 3.59 Fault repairs are usually managed by the at-fault insurer, sometimes using an out-sourced CMC. Most policies allow the owner to have their vehicle repaired at a repairer of their choice but the insurer retains a right to approve the repair estimate prior to the work being undertaken. Some motor insurance policies contain incentives for fault claimants to use the insurer's approved repairers, such as the provision of a courtesy car or the repairs being guaranteed only if the repair is carried out by an approved repairer, or the payment of an additional excess if a non-approved repairer is used.
- 3.60 If the at-fault driver does not have comprehensive insurance (ie only third party cover or third party, fire and theft cover), they will not be able to make a fault claim for their own loss and will need to pay for the repair of their vehicle and any replacement car provision.

Non-fault claims

- 3.61 The non-fault driver involved in a road traffic accident is entitled under tort law to seek redress from the at-fault driver in order to be put back into the position they would have been in had the accident not occurred, at the cost of the at-fault driver.
- 3.62 The non-fault driver may claim compensation from the at-fault driver to include:
- (a) if the vehicle is repaired:
 - (i) the reasonable cost of the repairs of vehicle damage (see paragraphs 3.10 to 3.13 and 3.80 to 3.85); and
 - (ii) the reasonable costs of car hire (see paragraphs 3.16 to 3.20); and

(b) if the vehicle is written off:

- (i) a cash payment equivalent to the pre-accident value of the vehicle (ie the cost of purchasing an equivalent vehicle of similar age and condition at the time of the accident, which is usually based on published price guides) (see paragraphs 3.90 to 3.94); and
- (ii) the reasonable costs of car hire as in (a)(ii).

3.63 The non-fault driver is also entitled to compensation for personal injury (eg damages for pain, suffering and loss of amenity, and the costs of care) and other consequential costs (such as loss of earnings, vehicle recovery and storage, public transport costs, etc).

3.64 Although the legal systems differ slightly between the UK jurisdictions (England and Wales, Northern Ireland and Scotland), the differences are not significant in relation to most areas of the claims management process, although they may result in variations in the ultimate claim costs.

Parties who may be involved in non-fault claims

3.65 Several parties might be involved in a non-fault claim process, including the non-fault broker, the non-fault insurer, the at-fault insurer, a CMC, a repairer and a replacement car provider (eg a CHC).²⁴ These parties might get involved in the claims management process in various ways:

- (a) the non-fault driver is likely to contact their insurer or broker immediately after the accident, but might also contact a repairer or car dealership;
- (b) the non-fault driver might be contacted by the at-fault insurer, in an attempt by the at-fault insurer to 'capture' the non-fault driver; and

²⁴ Others might also be involved, eg the emergency services, vehicle recovery providers, salvage firms, car dealerships, legal expenses insurers, etc.

(c) other service providers, such as CMCs and CHCs, might contact the non-fault driver following a referral from another party (eg the non-fault insurer or broker, a repairer, a vehicle recovery provider, the emergency services, etc).²⁵

- 3.66 Under tort principles, the non-fault claimant has the right to choose the provider of each of the services required.
- 3.67 In Section 6, we consider issues arising when there is a separation of cost liability and cost control (eg when services are provided by the non-fault insurer, or a CMC or CHC, and the costs are recovered from the at-fault insurer. In Section 7, we consider whether there are implications for the quality of service received by claimants and for competition from the beneficiary of post-accident services (ie the claimant) being different from the procurer of them (ie the non-fault insurer, the at-fault insurer, CMC, CHC or other service provider).

Different claims management processes according to how claims are made

- 3.68 Our survey of non-fault claimants²⁶ found that the claimant's own insurer was mainly responsible for managing the claim in 42 per cent of cases, and the at-fault insurer was mainly responsible for managing the claim in 32 per cent of cases. A claims management company was mainly responsible for managing the claim in 16 per cent of cases. The remaining claims were mainly managed by a solicitors' firm (4 per cent), a repairer (2 per cent), a dealership (1 per cent) or another organization (1 per cent). The survey found that in 3 per cent of cases respondents did not know who had been mainly responsible for managing the claim.

²⁵ Where one of these parties provides some but not all of the claims management services needed by the non-fault claimant, the party may pass the details of the claimant to other parties which provide other services (eg a repairer might perform a repair but pass the claimant's details to a CHC).

²⁶ www.competition-commission.org.uk/assets/competitioncommission/docs/2012/private-motor-insurance-market-investigation/130628_wp21_survey_report.pdf.

- *Claims by a non-fault claimant managed by their own insurer*

3.69 A non-fault claimant may choose to contact their own insurer to manage the claim because they believe that it is most efficient and appropriate to use their own insurer; or do not wish to deal with the at-fault insurer or a CMC or are unaware or uncertain about these options. A claimant who is ultimately determined to be the non-fault party may have to use their own insurer if fault has not been established when the claim is made because there will be no at-fault insurer to capture the claim at that point and CMCs may be unwilling to provide their services in these circumstances.

3.70 When a claimant who is determined to be the non-fault party contacts their own insurer, the claim is likely to fall into one of three categories:

- (a) If liability is agreed rapidly, the non-fault insurer will usually manage the claim and seek to and recover damages from the at-fault insurer pursuant to the principle of subrogation (see paragraph 3.7). Often the non-fault insurer will manage the repair itself and seek to recover the repair costs from the at-fault insurer, but refer the provision of a replacement car to a CHC.²⁷ In these cases, the CHC will enter into a credit hire agreement with the claimant to provide a replacement car and seek to recover the hire costs directly from the at-fault insurer (see paragraph 3.88(a)). Non-fault insurers sometimes arrange the provision of a replacement car themselves: this occurs mainly when the non-fault insurer has a bilateral agreement with the at-fault insurer.
- (b) If liability is not agreed rapidly, an insurer will usually settle the costs in accordance with the claimant's policy and seek to recover the costs from the insurer of the other driver (and should be successful in doing so if the claim is ultimately determined to be non-fault). The insurer may seek to refer the claimant to a CHC for a replacement vehicle—whether a CHC supplies a replacement vehicle will

²⁷ Of the ten largest insurers, only CISGIL does not refer claims to CHCs. All the others, and all major brokers, refer to a CHC unless there is a relevant bilateral agreement with the at-fault insurer.

depend on its assessment of liability (though some CHCs provide a replacement vehicle only when liability has been agreed). A CHC is likely to provide a replacement vehicle only when liability has not been agreed it has strong reasons to believe the claimant is non-fault.

(c) A non-fault insurer may refer a claim to a CMC, in which case the CMC will manage the claim and recover both repair and car hire costs from the at-fault insurer. We found that only one of the ten largest insurers referred some (but not all) of its non-fault claims to a CMC. A CMC is likely to take on a claim only if liability has been agreed or if there are strong reasons to believe the claimant is non-fault.

3.71 When the non-fault insurer settles either the cost of the repair or both the cost of the repair and the replacement car, the non-fault insurer may require the claimant to pay the policy excess, although in principle it can be recovered subsequently from the at-fault insurer. Some non-fault insurers will treat the claim as a fault claim until the claims cost has been recovered from the at-fault insurer, with the effect that the non-fault claimant may temporarily lose their NCB²⁸ and may pay a higher premium if their policy is renewed during this period. However, if the non-fault insurer is satisfied that the customer is not responsible for causing the accident, it may decide to waive the excess (because the claims costs will be recovered from the at-fault insurer) and to keep the NCB unaffected. Eight of the ten largest insurers told us that they usually waived the excess for non-fault claims. We note that, even when liability is settled, a non-fault claimant may still see an increase in their premium as a result of the accident, as insurers may perceive the driver to be a higher risk.

²⁸ A non-fault claimant's NCB may be temporarily lost when claiming under their motor insurance policy and subsequently reinstated following an admission of liability from the at-fault insurer or the recovery of the non-fault insurer's costs incurred in relation to the claim.

3.72 When non-fault claimants have motor legal expenses insurance, they will not have to pay the excess as it will be recovered by their policy as an uninsured loss.

3.73 CMCs/CHCs told us that, in the past, when insurers paid directly for the services they provided to non-fault claimants (ie under the old 'knock-for-knock' regime), the provision of replacement car services to claimants was poor and often below a claimant's legal entitlement. CMCs/CHCs said that the emergence of credit hire had improved replacement car services significantly for consumers. We did not hear views to the contrary, though we were told that this higher level of service to non-fault claimants was now the norm, regardless of whether the service was provided by a CMC/CHC or by the at-fault insurer (ie on a captured basis).

- *Claims by a non-fault claimant managed by the at-fault insurer*

3.74 Because the at-fault insurer bears the cost of a non-fault claim by the non-fault driver, it is usually interested in providing claims management services directly to the non-fault claimant in order to control these costs better. Typically, the at-fault insurer will seek to obtain the contact details of the non-fault driver from their at-fault customer and will contact the non-fault driver directly in order to try to 'capture' their claim.²⁹ Our survey of non-fault claimants found that in 51 per cent of cases when the non-fault driver did not contact their own insurer following a road traffic accident, the reason given was that the at-fault insurer had already contacted them. The non-fault claimant is not obliged to accept an offer of services from the at-fault insurer, even though the at-fault insurer might be the first party to make contact.

3.75 When the non-fault claimant is captured by the at-fault insurer, the at-fault insurer will procure the provision of repair services from a repairer and will arrange for a replacement car to be provided usually under a direct hire arrangement.

²⁹ This is also sometimes called 'third party intervention'.

3.76 In Section 7 we discuss, among other things, whether the incentives faced by the at-fault insurer might lead to non-fault claimants receiving lower quality of post-accident services than those to which they are entitled.

- *FNOL to a broker*

3.77 If a non-fault claimant purchased their motor insurance policy through a broker, they will often make their FNOL to the broker rather than the insurer as the policy documentation will be in the broker's name. In these circumstances, the broker is likely to refer the non-fault claimant either to the non-fault insurer or to a CMC/CHC to provide claims management services.

3.78 When the broker refers the non-fault claimant to a CMC/CHC, the CMC/CHC will typically arrange for repairs to be undertaken on a credit repair basis and for a replacement car to be provided on a credit hire basis. The CMC/CHC will settle the claim and make a subrogated claim on the at-fault insurer to recover the costs.

- *FNOL to another service provider*

3.79 A non-fault claimant may make the FNOL to another service provider, such as the dealership from which the claimant purchased the car, or a repairer or breakdown service. A dealership or repairer would be likely to undertake the repairs itself but would typically refer the non-fault claimant to a CMC/CHC to manage the claim. The non-fault claimant may be provided with a courtesy car by the dealership or repairer or with a replacement car arranged by the CMC/CHC on a credit hire basis. The CMC/CHC will settle the claim and make a subrogated claim on the at-fault insurer to recover the costs.

Non-fault vehicle repairs

- 3.80 When the non-fault claimant's vehicle has been damaged, they will be entitled to either (a) the repair of their vehicle³⁰ or (b) if the vehicle is deemed to be a write-off, the pre-accident value of the vehicle in cash (see paragraphs 3.90 to 3.94).
- 3.81 Non-fault repairs are usually managed by the non-fault insurer, by a CMC or by the at-fault insurer (if the non-fault claim is 'captured'). Accordingly, the non-fault claimant might receive repair services from any one of the following:
- (a) a repairer of the non-fault claimant's choice (whether captured or not);
 - (b) a repairer to which the non-fault claimant is referred by the non-fault insurer, in which case the repair would be carried out either by:
 - (i) a repairer owned by the non-fault insurer;
 - (ii) a repairer in the non-fault insurer's approved repair network, which is dedicated to the non-fault insurer (ie it does not perform work for any other work provider); or
 - (iii) a repairer in the non-fault insurer's approved repair network, which is not dedicated to the non-fault insurer (ie it also performs work for other work providers);
 - (c) a repairer to which the non-fault claimant is referred by a CMC (with the same subcategories as (b)); or
 - (d) a repairer to which the non-fault claimant is referred by the at-fault insurer (with the same subcategories as (b)).
- 3.82 Whichever party manages the claim, it will usually require the repairer to submit a repair cost estimate for approval. For a non-fault insurer or CMC, this is important to ensure that the repair costs are 'reasonable', as 'unreasonable' costs may be chal-

³⁰ Claimants are entitled to the diminution in value of the vehicle caused by the accident, which is generally assessed by reference to the reasonable cost of repairs (see paragraph 3.11).

lenged by the at-fault insurer and not be recovered in full; for a fault insurer which has captured a non-fault claim, it will wish to minimize the costs incurred.

- *Repair cost estimation software*

3.83 Repair cost estimates are usually prepared by estimating systems which calculate the hours required to complete a repair job, using manufacturers' or Thatcham³¹ repair times, and specify the parts and paint needed in a repair and their cost. Work providers (eg insurers or CMCs) will have agreements with repairers which specify the remaining variables, eg the labour rate and the discounts for parts and paint off the system-generated price.

3.84 The two most commonly-used repair cost estimating systems are Audatex and Glassmatix. Most insurers which require or recommend their approved repairers to use a certain repair cost estimation system specify the use of Audatex. The *Auto Body Professionals 2012 yearbook* reported that in October 2012 slightly more than 50 per cent of repairers used the Audatex system.

- *Credit repair*

3.85 When a CMC manages a non-fault vehicle repair (whether following a referral of the customer or having attracted the customer directly), it may instruct the repair and only subsequently seek to reclaim the cost from the at-fault insurer, so assuming the credit risk of the repair.³² This would be a credit repair (similar to the way in which a CMC/CHC might offer credit hire (see paragraph 3.89)).

³¹ Thatcham is a not-for-profit organization whose main purpose is to carry out research targeted at containing or reducing the cost of motor insurance claims, whilst maintaining safety and quality standards. Thatcham methods are specific to each make and model of vehicle and set out the process by which each part of those vehicles should be repaired. (See Appendix 7.3, paragraph 29.)

³² Under the terms of a credit repair agreement, the customer is ultimately liable for the costs of the provision of credit repair services should the CMC be unable to recover the costs from the at-fault insurer. However, we understand that CMCs rarely seek to recover costs from non-fault customers.

- 3.86 The advantage of credit repair to non-fault claimants over the repair being performed by their own non-fault insurer can be that no policy excess is payable (though any excess paid is in principle subsequently reclaimable from the at-fault insurer) and the NCB is not put on hold until the at-fault insurer settles the claim (see paragraph 3.71). However, some insurers told us that they would waive the policy excess.

Replacement cars for non-fault drivers

- 3.87 If the non-fault claimant's vehicle is temporarily unavailable (generally due to repairs), the claimant may seek recovery for the temporary loss of use of their vehicle. The non-fault claimant may recover the reasonable costs of car hire, provided the reasonable need for an alternative vehicle can be established. In practice, this usually involves the provision of a broadly equivalent replacement car (often referred to in the industry as a like-for-like replacement vehicle) for as long as is reasonably necessary, subject to the non-fault claimant's duty to mitigate their loss.³³

- 3.88 Replacement car services can be provided to non-fault claimants under a credit hire or direct hire agreement.

(a) Credit hire is where a replacement car is supplied on credit to the non-fault claimant by a CMC/CHC³⁴ and the cost is subsequently recovered from the at-fault insurer. When the non-fault insurer or broker controls the non-fault claimant's claim, the claimant often receives a replacement car from a CMC/CHC under a credit hire agreement, following a referral to the CMC/CHC from the insurer or broker. Assuming the CMC/CHC also assesses the driver to be non-fault, the CMC/CHC typically provides a like-for-like replacement car, subject to the driver's

³³ A non-fault driver can only claim the costs of credit associated with a credit hire if they can demonstrate that it was reasonable in the circumstances to hire the replacement car on credit (ie the customer is impecunious). However, the assessment of what the tort law entitlement requires in a given case will be informed by the specific facts of that case, which, in view of the nature of the 'impecuniosity test', may lead to some practical difficulties for CMCs/CHCs in assessing whether a non-fault customer requires a replacement car on credit terms.

³⁴ Credit hire usually requires the non-fault claimant to enter into a credit agreement with the CMC/CHC, under which the customer is ultimately liable for the costs of the replacement car should the CMC/CHC be unable to recover the costs from the at-fault insurer. However, CMCs told us that they rarely sought to recover costs from non-fault customers.

duty to mitigate their loss with consideration to their need. The CMC/CHC will recover the cost of providing the replacement car directly from the at-fault insurer.

(b) Direct hire is where a replacement car is supplied either by the at-fault insurer³⁵ or by the non-fault insurer, in the latter case often pursuant to a bilateral agreement between the non-fault insurer and the at-fault insurer, with the costs recovered from the at-fault insurer.

3.89 The GTA is a voluntary non-binding protocol between a number of insurers and CMCs/CHCs which sets out the terms, conditions and rates of credit hire for replacement vehicles provided to non-fault claimants. Nine of the ten largest insurers subscribe to the GTA and the Credit Hire Organisation told us that it estimated that approximately 80 per cent of credit hire and credit repair claims are settled under the GTA.

Write-offs

3.90 A vehicle is generally deemed to be a write-off when it is beyond economic repair (see paragraph 3.14).

3.91 Some insurers use slightly different criteria to determine when a vehicle is written off (see Appendix 6.3, paragraph 8).

3.92 If a vehicle is being written off, a customer can elect to retain the vehicle or to give it up to the insurer or CMC managing the claim (which will then arrange for it to be taken away by a salvage company). The payment made to the customer by the insurer differs according to whether or not the customer retains the written-off vehicle, as follows:

³⁵ When a fault insurer captures a non-fault claim, the replacement car is usually provided under direct hire, or the non-fault claimant might receive a replacement car from the repairer.

- (a) If the customer gives up the vehicle, they will receive a payment of the agreed pre-accident value of the vehicle.
- (b) If the customer chooses to retain the vehicle, they will receive a payment of the agreed pre-accident value of the vehicle less the actual or estimated salvage value.
- (c) In a fault claim (and in some own-insurer non-fault claims), the customer will receive a payment in accordance with (a) or (b), as applicable, less the amount of the excess in their motor insurance policy.

3.93 Non-fault insurers and CMCs will seek to recover from the at-fault insurer the agreed pre-accident value and any other charges they incur (eg vehicle storage and collection costs), less the actual or estimated salvage value.

3.94 We discuss vehicle write-offs in more detail in Appendices 6.3 and 7.2.

4. Market definition

Introduction

4.1 In this section we set out our approach to market definition.¹ Our guidelines state that defining the market helps to focus on the sources of any market power and provides a framework for the assessment of the effects on competition of features of a market. However, market definition and the assessment of competition are not distinct chronological stages of an investigation but are overlapping and continuous pieces of work, which often feed into each other.²

4.2 A market is a collection of products provided in particular geographic areas connected by a process of competition. The process is one in which firms seek to win customers' business over time by improving their portfolios of products and the terms on which these are offered, so as to increase demand for the products. The willingness of customers to switch to other products is a driving force of competition. In forming our views on market definition, we therefore consider the degree of demand substitutability. In some markets, supply-side constraints will also be important.³ Market definition in a market investigation flows from the statutory questions the investigation is required to address. Markets defined in answering other statutory questions under other regimes may not necessarily be comparable.⁴

4.3 Our guidelines also state that market definition is a useful tool, but not an end in itself, and that identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of our competitive assessment of a market in any mechanistic way. The competitive assessment takes into

¹ The 'relevant market' is defined in the Act to mean the market for the goods or services described in the terms of reference given to the CC for investigation. The market definition(s) used by the CC need not correspond with the 'relevant market(s)' as used in the Act (see *Guidelines for market investigations: their role, procedures, assessment and remedies*, CC3, April 2013, (CC3), [paragraph 26](#)). In this section, we discuss the appropriate market definition for this investigation.

² CC3, [paragraphs 94 & 132](#).

³ CC3, [paragraph 130](#).

⁴ CC3, fn 74 ([paragraph 132](#)).

account any relevant constraints from outside the market, segmentation within it, or other ways in which some constraints are more important than others.⁵

- 4.4 Our terms of reference refer to the supply or acquisition of private motor insurance and related goods or services. In the remainder of this section, we consider first the appropriate market definition for motor insurance. We then turn to the related services. We consider there to be two main categories of related services relevant to our investigation: PCWs and post-accident services.

Motor insurance

- 4.5 There are normally two dimensions to the definition of a market: a product dimension and a geographic dimension. We consider each of these aspects below.

Product definition

- 4.6 We discuss first whether the market should be defined according to risk factors, type of seller (direct or via a broker) and type of cover, and then whether the market should be wider than motor insurance.

Risk factors

- 4.7 Motor insurance suppliers' prices depend on a particular driver's risk factors, such as age, number of previous accidents, number of years of driving, occupation and post-code where the car is kept. Drivers are typically able to obtain quotes from a number of different suppliers. Competition between suppliers is across drivers with a broad range of risk factors and we noted that it was difficult to divide drivers into distinct risk groups. We did not consider it necessary for our competition analysis to define separate markets according to the level of different risk factors.

⁵ CC3, [paragraph 133](#).

Direct insurers and brokers

- 4.8 As discussed in Section 2, motor insurance can be purchased direct from an insurer or via a broker.
- 4.9 Brokers sell motor insurance to consumers on behalf of a panel of insurers. The broker chooses the most suitable policy for the consumer and provides a quote to the customer on that basis. We noted that brokers could generally be divided into two groups:
- (a) larger national branded brokers, which in effect set their own premiums (and pay an agreed net amount to the company providing insurance); and
 - (b) smaller regional brokers, where the insurance company sets the premium and remunerates the broker at an agreed percentage commission rate (a traditional broking arrangement where the broker acts as agent for the insurer).
- 4.10 We noted that the larger national branded brokers often operate similarly to insurers which sell directly, selling via their own websites, over the phone and through PCWs. Some large national brokers (eg Swinton) and smaller regional brokers retain local outlets and sell from them in person and over the phone. We discuss geographic market definition, including the relevance of local outlets, below—see paragraph 4.17.
- 4.11 We consider that both types of broker compete with other brokers and with direct insurers. Therefore we did not define separate markets for motor insurance sold directly and through brokers.

Cover type

- 4.12 There are three types of basic cover: third party only; third party, fire and theft; and comprehensive. The first two types of cover have decreased in importance over recent decades and are now mainly relevant to the highest-risk drivers. We

considered that competition between motor insurance suppliers was across all cover types and we saw no reason to define separate product markets for the different cover types.

- 4.13 In addition to basic cover, motor insurance policies may include optional additional products known as add-ons. Examples include motor legal expenses insurance, windscreen cover, breakdown cover and NCB protection. We consider add-ons in Section 8. We noted that the cover provided by add-ons could be included by some insurers in the basic motor insurance price and that the most commonly purchased add-ons can be compared on PCWs, though there are limitations to such comparisons. We did not define a separate market for any add-on product and therefore we include them in the motor insurance market. This does not affect our competitive assessment of add-ons in Section 8.⁶

Whether the market is wider than motor insurance

- 4.14 For the above reasons, we did not define separate markets on the basis of risk factors, type of seller or cover type. We next considered whether the market was wider than just motor insurance.
- 4.15 We noted that third party motor insurance was a legal requirement and that there were no demand-side substitutes. We also noted that a change in average motor insurance premiums could only affect market demand if it induced changes in the number of vehicles insured (eg a reduction in price might induce some young drivers to insure their own vehicles rather than use their parents'). We considered that this effect was likely to be weak, and this was supported by what insurers told us. Overall

⁶ Motor insurance add-ons have some similarity with secondary, or aftermarket, products (products purchased only as a result of the customer having purchased a primary product). Our guidelines state that the CC may sometimes consider primary and secondary products to be in separate markets; but may also consider the products to be in the same market where customers take into account the cost of the secondary product when purchasing the primary product; and that whichever of the two definitions is chosen will not determine the outcome of the CC's competitive assessment, since the competitive constraint from other suppliers will be taken into account in either case. See CC3, [paragraph 144](#).

we considered that the market demand for motor insurance was likely to be very price inelastic. This suggests that the market is no wider than motor insurance.

4.16 Our guidelines state⁷ that the composition of a relevant market is usually determined by the degree of demand substitutability, but that the CC will, where relevant, include supply-side factors in defining the market. The guidelines note that there might, for example, be a possibility that firms supplying non-substitute products have the capabilities and assets to redirect production to goods and services that would be substitutes for those in the market. Our terms of reference refer specifically to private motor insurance and thus exclude insurance of commercial and public service vehicles; they also exclude insurance of motorcycles. We did not consider that the market should be widened to include insurance of commercial and public service vehicles and/or motorcycles as conditions of competition for these types of insurance appeared to be different, with many specialist providers which would be unlikely to have the capabilities and assets to impact significantly on the larger private motor insurance market.

4.17 We noted that many suppliers of home insurance also supplied motor insurance and that this could suggest that there was a degree of supply-side substitutability between motor insurance and home insurance as products. However, we also considered that capabilities of individual companies were likely to differ to some extent between home and motor insurance. We also noted that, even if there was significant supply-side substitutability between home and motor insurance, our concern in this investigation was only with issues related to motor insurance. Overall, therefore, we did not consider that the market should be widened to include home insurance.

⁷ CC3, [paragraph 134](#).

Geographic definition

4.18 We noted above that some large national brokers and smaller regional brokers retain local outlets and sell from them in person and over the phone (see paragraph 4.10). Some direct-selling insurers also have local outlets.⁸ We noted that potentially the prices obtained through suppliers with local outlets could differ from those obtained through other motor insurance suppliers (direct-selling insurers and brokers).⁹ But we also noted that their customers could check prices via PCWs even if they continued to purchase their insurance from their local outlet. We considered that suppliers with outlets in a particular local area were likely to compete with each other, but were also likely to face competition from other motor insurance suppliers without local outlets. We did not see evidence that competition from other motor insurance suppliers was so weak that suppliers with retail outlets in a particular local area or region should be regarded as a separate market.

4.19 More generally, the location where a car is kept is one of the risk factors that may affect prices. But competition between suppliers is across drivers with a broad range of risk characteristics and we have already noted that it is not necessary for our competition analysis to define separate markets according to individual risk factors (see paragraph 4.6). We therefore consider that the appropriate geographic market for our assessment of motor insurance is national rather than regional or local.

4.20 We saw some reasons for considering that competition in Northern Ireland operated differently from the rest of the UK and we carried out a separate analysis of competition in Northern Ireland (see Appendix 5.2). In this analysis, we did not reach a final view on whether there was a separate motor insurance market in Northern Ireland.

⁸ For example, AXA in Northern Ireland.

⁹ Direct-selling insurers and larger national brokers set their own prices and the prices charged by insurers selling through smaller regional brokers could depend on the commission rates agreed.

We did not consider that this issue affected the remainder of our analysis which was relevant to both Great Britain and Northern Ireland.

PCWs

- 4.21 A PCW is an Internet platform that facilitates the buying and selling of motor insurance.¹⁰ A PCW provides consumers with a means of comparing motor insurance policies and provides insurers with sales opportunities (both directly via click-through from a PCW's website and indirectly through consumers deciding to contact an insurer as a result of researching policies on a PCW). A PCW therefore has two groups of users: consumers searching for motor insurance policies and motor insurance suppliers (insurers and brokers).
- 4.22 A platform can be distinguished from a standard product in that there is more than one group of users, and demand from each of these depends on the number of users in the other group(s) using the platform. In the case of a PCW, demand from consumers depends on the number of insurers whose prices are quoted on the PCW; and demand from insurers depends on the number of consumers visiting the site. When a number of platforms compete with each other, the resulting market is often described as two-sided. PCWs are therefore potentially a two-sided market.
- 4.23 PCWs are paid by insurers according to the number of policies bought via click-through, but make no charge to consumers for use of the website. Indeed, consumers may be offered inducements to use a PCW (eg a free product such as a cuddly toy), in effect a negative price.
- 4.24 We considered whether PCWs were a separate market by considering possible substitutes for PCWs. In thinking about substitutes, we noted that it was important to

¹⁰ We use the term 'PCW' to describe a motor insurance price comparison website. Generally, websites comparing prices of other products are not included when we use the term 'PCW'

take into account both sides of the market (consumers and suppliers). We start by considering demand-side substitutes.

Demand-side substitutes

4.25 A possible substitute for searching via a PCW would be for consumers to search across the individual websites of motor insurance suppliers. For consumers, searching across suppliers' individual websites is likely to be more difficult and much more time-consuming than comparing policies without a PCW, and hence is likely to be a poor substitute. From a supplier's point of view, it would be fine if consumers searched across individual websites as long as the websites that consumers searched included that supplier's website; but in practice this would tend to require a high level of advertising and promotional activity to ensure that consumers continued to include the supplier's website in those they searched. We noted that some motor insurers had brands that were not quoted on PCWs and that these brands competed to attract consumers direct to their websites or call centres. We considered that these brands to some extent competed with PCWs but that the constraint from such brands on PCWs was not necessarily strong. Indeed, we noted that the owners of these brands had launched alternative brands that were quoted on PCWs, and that this seemed to confirm the importance of PCWs to the sale of motor insurance. Overall, we did not believe that the possibility of searching without a PCW was a sufficiently strong constraint on PCWs to prevent PCWs from being a separate market.

4.26 Another possible substitute for a PCW is to use a broker. A broker provides a service that is similar to that of a PCW in that policies of a number of different motor insurers are compared. However, there are major differences in that a broker's comparison usually involves many fewer insurers and in that the results are interpreted by the broker and the comparison of policies is not seen in raw form by the consumer. Indeed, we noted that many brokers quoted their policies on PCWs. Consequently,

we did not believe that the possibility of buying policies through brokers was a sufficiently strong constraint on PCWs to prevent PCWs from being a separate market.

Supply-side substitutability

4.27 We considered whether there were websites in similar areas that did not currently compare car insurance prices but would be able to redirect their capability and assets to motor insurance comparisons, and could therefore be regarded as supply-side substitutes. We noted that websites known for related areas (for example, Google—general search, uswitch—energy prices, Moneyfacts—savings and loans) already offered motor insurance price comparisons and thus were already in the potential market, but had a small share of total revenue earned by PCWs. It was unclear to us whether there were other significant websites in similar areas that did not currently compare motor insurance prices. But, even if there were, the lack of success in PCWs of the websites we have referred to suggests that any others would be unlikely to have the capabilities and assets to compete in motor insurance price comparison. Hence we considered that supply-side substitution was unlikely to be a significant constraint on PCWs.

Geographic definition

4.28 PCWs operate across the UK. We noted that there were some PCWs concentrating on Northern Ireland and that use of PCWs was lower in Northern Ireland than elsewhere in the UK. We did not reach a final view on whether the PCW market in Northern Ireland differed from the rest of the UK. Nevertheless, as with motor insurance, we did not consider that this issue affected the remainder of our analysis which was relevant to both Great Britain and Northern Ireland.

Post-accident services

4.29 After an accident has occurred, the affected parties make claims against one or more insurers: these claims must be assessed and appropriate restitution or compensation arranged. A high proportion (about 92 per cent)¹¹ of UK drivers have comprehensive motor insurance, and the ability to handle claims well and cost effectively is an important aspect of offering a comprehensive motor insurance service. Furthermore, the cost of meeting third party claims is an important component of the cost of motor insurance. Among the ways motor insurers compete are by offering a claims service to their customers and by seeking to control the costs of claims for which they are liable.¹² Post-accident services are therefore an important part of the motor insurance supply chain market and the efficiency with which these services are supplied may affect the price of motor insurance.

4.30 The main post-accident activities are claims management, repairs, salvage and car hire.¹³ These activities are relevant to our investigation principally in relation to the separation of cost liability and cost control and the possible underprovision of service to those involved in accidents (see Sections 6 and 7). We noted that in these respects their relevance arose from their being part of the supply chain for the motor insurance market. Consequently, we did not consider it necessary for our investigation to define the specific markets associated with each of these activities. However, we note below some points about competition within the supply of these activities—see paragraphs 4.32 to 4.37.

4.31 In order to repair cars for insurers, repairers need to use a repair cost estimation system and to purchase inputs including paint and car parts. We considered competition in repair cost estimation systems (see Appendix 5.1) and possible

¹¹ Based on 2012 GWP—see paragraph 2.6.

¹² We consider issues associated with the separation of cost liability and cost control in Section 6.

¹³ We are not considering compensation for personal injury—see Section 1].

vertical issues in relation to repair cost estimation systems, paint and car parts (see Appendices 9.1 and 9.2), but we did not reach a view on the specific market definition for these activities. We did not consider that the market definition for these activities affected the remainder of our analysis.

Claims management

4.32 Management of claims is often carried out by insurers in-house. CMCs may be commissioned by insurers wishing to outsource the management of their claims or some aspect of them¹⁴ and by non-fault claimants wishing to have their claims managed independently.¹⁵ In regard to the latter, CMCs usually obtain leads via referrals from brokers,¹⁶ repairers and breakdown companies, subsequently obtaining agreement from non-fault claimants to manage their claims—see Section 2. The evidence we saw suggested that there was competition between CMCs at least to some extent for both types of commission. This suggests that there is a broad claims management market, including both insurer-outsourced claims management and work directly for claimants. We did not see evidence that insurers themselves were competing for other insurers' outsourced claims management work, suggesting that it would not be appropriate to include insurers' in-house claims management in the market.

Repairs and salvage

4.33 Claimants are entitled, either under tort law or the terms of their own policy, to be compensated for their loss, either by their car being repaired or (when this is not possible or not economic, ie when the car is written off) by a financial payment. Repair is usually arranged by the insurer or CMC managing the claim.

¹⁴ An insurer's claims would include claims from its policyholders who were at-fault in accidents; from those otherwise claiming on their own insurance; and from those non-fault in accidents, who have asked it to manage their claims.

¹⁵ When commissioned by non-fault claimants, CMCs send a subrogated bill to the at-fault insurer—see Section 3.

¹⁶ Non-fault insurers may also refer non-fault claims to a CMC, rather than manage them in-house or through outsourcing to a CMC. One of the ten large insurers refers some of its non-fault claims to a CMC and smaller insurers may also do so.

- 4.34 Some insurers own their own repair body shops, but most repairs are carried out by independent repairers and all insurers use independent repairers as well as their own body shops. Independent repairers carry out non-insurance as well as insurance work. Repair requires input products including paint, parts and cost estimation systems, and where insurers use independent repairers, they may impose requirements on the input products used. If claimants request it, an insurer or CMC may agree to the repair being carried out by a repairer of the claimant's choice (for example, a car manufacturer's franchised dealer) subject to the insurer or CMC's approval of a quote for the proposed repairs.¹⁷ The National Association of Bodyshops (NAB) told us that insurance work accounted for about 80 per cent of all repair work carried out by body shops.¹⁸ We considered that competition between independent repairers was across both insurance and non-insurance work and that independent repairers competed with insurers' in-house body shops for insurance work. We therefore considered that the repair market was likely to include both independent and in-house body shops, and non-insurance as well as insurance work.
- 4.35 When a car is written off, it is sold for salvage (unless the claimant wishes to retain the damaged vehicle). The insurer or CMC usually sells the car to a salvage firm, and the car would then be broken up for parts and/or scrap metal value, or it may be sold on to a dealer or private individual.¹⁹ We did not consider it necessary for our investigation to reach a view on the appropriate market definition in relation to salvage.

¹⁷ Under tort law, non-fault claimants are able to arrange repair themselves and send the bill to the at-fault insurer.

¹⁸ This excludes credit repair work—see Appendix 7.3, paragraph 14.

¹⁹ Under a voluntary code of practice supported by the ABI and a number of other organizations, insurers categorize write-offs into one of four categories: A—scrap only; B—break for spare parts if economically viable; C—repairable total loss vehicles where repair costs exceed the vehicle's pre-accident value; D—repairable total loss vehicles where repair costs do not exceed the vehicle's pre-accident value (eg constructive total losses, vehicles replaced under 'new for old' schemes (say 60 per cent damage) which would not otherwise have been treated as total losses). Under the code of practice, categories A and B vehicles should not be sold on, but categories C and D vehicles may be sold on.

Car hire

- 4.36 Non-fault claimants are entitled to a vehicle that is broadly equivalent to their own (subject to the non-fault claimant's duty to mitigate their loss with consideration to their need) while their own car is unavailable. Repairers are usually able to provide a courtesy car but courtesy cars may be considered unsuitable to meet the claimants' needs and a hire car then needs to be provided. A hire car may also need to be provided under other circumstances; for example, non-fault claimants (and at-fault claimants with appropriate cover), whose cars are written off rather than repaired, are entitled to a replacement car for a short period; and some at-fault claimants are entitled under their own motor insurance policies to an enhanced courtesy car while their own car is repaired.
- 4.37 A distinction may be drawn between car hire provided directly to insurers (ie direct hire) and credit hire, which is when the hire company provides the car on credit to a non-fault claimant, subsequently sending a subrogated bill to the at-fault insurer. We noted that the distinction between direct hire and credit hire was related to an issue at the heart of our investigation (the separation of cost liability and cost control—see Section 6). Since it was the distinction between direct hire and credit hire, rather than the extent of competition within each of type of hire, that was relevant, we did not consider it appropriate in this investigation to define separate markets for each. We noted that many suppliers provide both credit and direct hire. We also noted that consumers hired cars for reasons unrelated to accidents and that it may be relatively easy for any car hire firms not currently supplying post-accident replacement vehicles to start doing so, ie that there was significant supply-side substitutability.

Provisional conclusion on market definition

- 4.38 The markets that we consider are relevant to our assessment of competition are:

- (a) a motor insurance market (including both basic insurance and add-ons), where insurers and brokers compete to supply motor insurance to consumers; and
- (b) a PCW market, which is a two-sided market where PCWs provide motor insurance price comparisons to consumers and sales opportunities to insurers and brokers.

4.39 In relation to post-accident services, we noted that the main activities relevant to our investigation were claims management, repairs, salvage and car hire. We did not consider it necessary for our investigation to define the specific markets associated with each of these activities, as their relevance to our investigation arose from their being part of the supply chain for the motor insurance market.

5. The nature of competition

Introduction

- 5.1 Motor insurance providers are involved in two activities: the sale of policies and the management of claims. In the first, the provider is selling a good that allows the buyer to drive legally and to have a certain degree of prospective security when it comes to the practical and financial consequences of an accident. We have looked in particular at certain aspects of the sales process—in particular, the sale of add-ons and the use of PCWs through which [55–65] per cent of new policies are sold.
- 5.2 The second activity comes into play if a customer has had or been involved in an accident.¹ In relation to non-fault claims, a basic feature is that tort law gives the non-fault party the right to be put back into the position prior to the accident, with the cost to be borne by the at-fault party's third party liability insurance. This means that one of the basic incentive mechanisms of competition in many markets is not present in the treatment of non-fault parties: the party paying for the service is not the party receiving its benefits. The nature of competition is profoundly changed by this feature of tort law rights.
- 5.3 This section describes our findings on the nature of competition in these two broad domains of activity. It outlines the work that we have carried out to analyse the nature of competition, pointing out the areas which we discuss in more detail in Sections 6 to 9, and those where we have not pursued further investigation.

Theories of harm

- 5.4 To drive effective competition, customers need to be both willing and able to: access information about the various offers available in the market; assess these offers to identify the good or service that provides the best value for them; and act on this

¹ Car insurance policies also cover fire and theft, although these are not the focus of our investigation.

assessment by switching to purchasing the good or service from their preferred supplier, taking account of the full costs of provision as well as the benefits. The motor insurance industry is characterized by complexity in all three of these areas and our theories of harm explore them. Key aspects of that complexity include:

- (a) rights under tort law, which mean that sometimes parties dealing with a non-fault driver's claim do not have to consider the cost implications ;
- (b) the insurance product itself and its associated services known as add-ons, where complexity makes access to information hard, its assessment difficult and action often indirect; and
- (c) the technical nature of car repair, again hampering access, assessment and action.

5.5 Our theories of harm provide a framework for our analysis. We initially identified five areas of potential harm as follows:

- (a) Harm to efficient provision arising from the separation of cost liability and cost control. This arises from a feature of tort law that gives the non-fault party in an accident the right to be put back to the position prior to the accident at the expense of the at-fault insurer. This theory of harm is examined in detail in Section 6.
- (b) Harm to quality of provision arising from the fact that the owner of the car who is the beneficiary of post-accident services is different from and possibly less well informed than the insurer or claims company who is the procurer of those services. This theory of harm is examined in detail in Section 7.
- (c) Harm due to market concentration and unilateral effects.
- (d) Harm arising from insurance providers' strategies to soften competition. The add-on aspects of this theory of harm are examined in detail in Section 8.

(e) Harm arising from vertical relationships (vertical integration) between insurers and the providers of post-accident services. The PCW and MFN clause aspects of this theory of harm are examined in detail in Section 9.

5.6 We noted that none of the areas of harm we identified are mutually exclusive. There are clearly some interrelations between different theories, and we have sought to indicate these interrelations where they may arise.

Competition between insurers

5.7 There are a large number of active suppliers of motor insurance products in the UK—a typical search on a PCW can yield as many as 100 quotes.² Concentration levels are low.³

5.8 The ten largest motor insurers provided us with their financial data for the five years ended 31 December 2012, which we used to calculate their profitability. On average over the period, motor insurance activities alone were loss-making. Across the five-year period, the unweighted average claims ratio was 84 per cent and the unweighted average expense ratio was 28 per cent, resulting in an unweighted average combined operating ratio of 112 per cent.⁴

5.9 However, when investment activities are taken into account, motor insurance activities were profitable, with income (including investment income) less total claims less total expenses (ie the underwriting result plus investment income) across all ten insurers over the five years totalling £1.8 billion.

² Some insurers have several brands, so not every quote represents a single provider. However, there are more than 50 unique providers.

³ Our central estimate of the Herfindahl-Hirschman Index of concentration is below 1,000, which CC guidelines takes as a cut-off point for considering a market to be 'concentrated'.

⁴ Appendix 2.1, Annex A, provides definitions of the terminology relating to insurer profitability.

- 5.10 Appendix 2.1 shows the claims and expense ratios and the combined operating ratio, as well as the underwriting result plus investment income, for each of the ten largest motor insurers over the last five years.
- 5.11 Profitability and concentration are somewhat higher in Northern Ireland than in Great Britain (see Appendix 5.2). We also found that concentration may be particularly high for the sale of insurance to high-risk drivers. However, we do not consider either of these to be higher as a consequence of a failure of competition. Underwriting profits from the sale of motor insurance are low, and we do not believe that entry barriers are high. We find that concentration is currently high largely because of the success of Axa in expanding its market position, something which it has done through competing successfully since 2006. There are some indications that others are now expanding and Axa's growth has abated. We found that there are a number of recent initiatives in Northern Ireland that could have an effect on premiums—a new arbitration procedure for smaller claims⁵ and a graduated driving licence aimed at reducing the riskiness of young drivers⁶—and that these may narrow the gap between Northern Ireland and Great Britain premiums, especially for higher-risk drivers.
- 5.12 The sale of policies occurs through different channels: branch (sometimes through brokers), phone, online and via PCWs. We take the sensitivity of sales to the price level as a good measure of the degree of competition faced by each insurer in those different channels. Two of the largest insurers have supplied us with their own internal estimates of price sensitivity in the different channels, which indicates different degrees of competition faced in each. Table 5.1 shows price elasticity of demand for policies from [X] and [X].

⁵ See Appendix 5.2 paragraph 14

⁶ See <http://www.nidirect.gov.uk/motor-vehicle-documentation-learner-and-restricted-driver-requirements> for details

TABLE 5.1 Sensitivity of sales to premium levels in different channels

% change in quantity/ % change in price	[X]	[X]
Phone	[X]	-1.75
Own website	[X]	-3
PCWs	[X]	-10

Source: CC calculations based on data provided by the parties.⁷

5.13 PCWs are the largest source of new business (around [55–65] per cent) and growing at approximately 8 per cent a year. They also create very high levels of price sensitivity: a price increase of 1 per cent for a [X] brand on a PCW leads to a [X] to [X] per cent reduction in volumes sold. This is an indicator that on PCWs, price competition between suppliers is intense. Many consumers use PCWs to find the cheapest motor insurance policy. [X] told us that it estimated that the proportion of customers on its website who bought the cheapest policy was [X] per cent. Datamonitor estimated that 37 per cent of customers who purchased from a PCW selected the cheapest quote.

5.14 Although price sensitivity is lower for phone and own-website sales, customer switching is nevertheless substantial. Overall, there is clear evidence that switching levels for motor insurance are high relative to comparable products. We commissioned a survey of PMI policyholders. This survey found that 72 per cent of PMI policyholders previously insured their vehicle with another provider. An earlier OFT study found that 61 per cent of car insurance customers had switched in the previous five years, which was the highest rate of switching in the markets the OFT considered.⁸ We considered whether there were significant obstacles to switching—especially in the form of automatic renewal, cancellation fees and no claim bonus protection—which might give rise to competition concerns.⁹ In our assessment we considered information

⁷ One of the parties offered the following caveat to its estimates of elasticities: '[X].'

⁸ www.of.gov.uk/shared_of/reports/financial_products/OFT1005.pdf, July 2008, Chart 3.8.

⁹ See our working paper, 'Theory of harm 4: Obstacles to switching'.

provided by PMI providers and the responses to our consumer survey. On the basis of this evidence, it does not appear that automatic renewals or cancellation fees are obstacles to switching which are likely to give rise to consumer harm. With regard to NCB protection, the findings were less clear, with mixed evidence from our consumer survey. However, we considered this problem to be principally one of the nature of the information provided and purchaser understanding of the product. We therefore consider it further in Section 8, where we analyse add-ons more generally.

Competition between PCWs

- 5.15 The PCW market has four large players and a competitive fringe. Profitability is high, with average operating margins of around 25 per cent (see Appendix 9.3, Annex H) and low capital intensity. Advertising expenditure is high and the four leading platforms compete intensely for consumer attention through their expenditure on television advertising.
- 5.16 There is some vertical integration with insurers/brokers in the PCW market, with three of the four PCWs being wholly or partially owned by insurers or brokers. We investigated (see Appendix 9.3, Annex J) the possibility that these PCWs were using their market power to foreclose other insurers, but found no evidence of the current use of this sort of behaviour.
- 5.17 Section 9 considers the market power that the large PCWs might hold as a result of a substantial proportion of their retail customers ‘single homing’—being accessible only through that channel. We examine in detail the way that MFN clauses have been negotiated and their impact on competition.

Add-ons

5.18 The sale of a basic insurance policy is often the opportunity for the sale of other insurance services, which we refer to as ‘add-ons’. These include products closely tied in to the policy—like NCB protection—as well as others, like roadside assistance, which are less bound up with the policy that is being purchased and are often sold as free-standing products. In Section 8, we investigate two potential competition concerns with the sale of add-ons: that purchase may occur when the seller has a ‘point-of-sale advantage’ and that consumers may be ill-informed about the product they are buying.

Claims management

5.19 The at-fault party in an accident can make a claim only under the contractual terms of their own insurance policy. Policies differ greatly in the terms that they offer concerning replacement vehicles, damage repair or replacement in the case of write-offs. Competition for the provision of services to the at-fault party occurs over contractual terms and prices: some insurers offer high service and high coverage policies, others offer more basic options. For the at-fault party, the choices made at the time of contracting determine the rights that a claimant has.

5.20 The non-fault party is entitled under tort law to be restored to their original pre-accident position. In this, the claimants—or more commonly their agents (for example, insurers or claims management companies or credit hire/repair companies)—do not face any ordinary budget constraint. The courts, however, effectively cap claims to ‘reasonable costs’, a level which is contentious and which is to be assessed from the position of the individual non-fault driver. This means that it is not relevant whether the cost of repair could have been lower by virtue of the non-fault insurer’s bargaining power. ‘Reasonable costs’ are typically substantially higher than those incurred by insurers or CMCs.

- 5.21 The hypothesis we examine in detail in Section 6 is that this feature—the separation of cost liability and cost control—might lead to the inflation of costs, the overprovision of services and high frictional costs associated with litigation and monitoring. In that section, we consider the impact of the separation on the provision of replacement cars, on repairs and on car write-offs.
- 5.22 There are a number of industries that provide inputs to the claims management process: vehicle hire, repair, salvage and even claims management itself. There are complex vertical contracts and other relationships between some insurers and repairers, paint suppliers and parts suppliers, and we have examined the possible harm arising from these relationships. We have concluded that the relationships do not in themselves give rise to an adverse effect on competition (see Appendices 9.1 and 9.2), although aspects of these relationships are examined in more detail when we consider the effects of the separation of cost liability and cost control (see Section 6).
- 5.23 As part of our examination of repairs, we examine in Appendix 5.1 the degree to which concentration in the provision of cost estimation systems might lead to competition concerns. There is one large provider (Audatex) and one small provider (Glassmatics).
- 5.24 We have examined two issues with respect to competition in the job costing market:
- (a) the extent to which the horizontal concentration is a competition concern (see Appendix 5.1); and
 - (b) whether the vertical contracts between insurers and Audatex might amount to foreclosure (see Appendix 9.2).
- In the first case, we concluded that Audatex had achieved its position through a process of competition and that barriers to entry were not so high to make their

position a competition concern (see Appendix 5.1). In the second case, we did not consider that the vertical arrangements with some insurers amounted to foreclosure of any repairers because the Audatex cost is a very small proportion of repair costs. Audatex thus does not pose competition concerns, and it appears to function as a mechanism for reducing frictional costs in repair claim settlement (see Appendix 9.2).

5.25 In Section 7, we consider whether the quality of service provided to those involved in accidents is below the legal standard whether they are at fault or not. The theory we are considering is that the beneficiaries of the service—the claimants—are less well informed than the purchasers—insurance or claims companies—and that these do not have adequate incentives to provide what is legally due.

Conclusion

5.26 For the reasons outlined, we have not found AECs in the following areas:

- (a) market concentration and unilateral effects (Northern Ireland and repair costing systems), except for PCWs, which are analysed in detail in Section 9;
- (b) insurance providers' strategies to soften competition through influence over switching; and
- (c) vertical relationships (vertical integration) between insurers and the providers of post-accident services.

5.27 In the remainder of this report, we examine in greater detail the separation of cost liability and cost control (Section 6); the quality of provision (Section 7); add-ons (Section 8); and PCWs and MFNs (Section 9).

6. Separation of cost liability and cost control (theory of harm 1)

Introduction

- 6.1 As we have described, under tort law, a non-fault driver is entitled to compensation for their loss from the at-fault driver through the at-fault driver's insurer. Separation of cost liability and cost control ('separation') occurs because cost liability lies with the at-fault insurer, whereas cost control lies with the party managing the claim, which is usually different—for example, the non-fault driver's own insurer or a CMC. Sometimes, however, there is not separation as the at-fault insurer is able to 'capture' and manage a non-fault claim itself.
- 6.2 In this section, we first describe the nature and extent of separation. We then discuss how it affects insurers' costs and revenue streams. We consider whether separation is associated with differences in the quality of service received by claimants;¹ then we discuss its effect on consumers. Finally, we set out our provisional view on the effect on competition.
- 6.3 In assessing the effect on competition, we considered a benchmark 'well-functioning market' to be a market which delivered consumers' legal entitlements in an efficient way. We therefore looked at two dimensions: (a) how separation affects insurers' costs and revenue streams and ultimately its effect on the price paid by consumers; and (b) differences in the quality of service received by claimants that were associated with separation to understand any impact of separation on the quality of service received by consumers.² We took both into account in reaching our provisional view on the effect on competition.

¹ In this section, we are concerned only with the impact of separation on quality of service. In the next section, we consider overall level of quality of service relative to claimants' entitlement.

² In this section of the report, we are concerned with any differences in quality of service associated with separation. In the next section, we consider whether the quality of service provided to claimants is in line with their legal entitlement.

Effects and extent of separation

- 6.4 A company managing a non-fault claim will take over the non-fault driver's right of recovery against the at-fault insurer (see paragraphs 3.7 and 3.8). In practice, this involves sending on a bill to the at-fault insurer for services provided to the non-fault driver (a 'subrogated' bill—see Section 3). The party managing the claim will be able to recover the costs passed on to the at-fault insurer provided they are 'reasonable'. Case law suggests that the benchmark used for a reasonable level of costs is to be assessed from the point of view of the claimants if they were procuring services directly. This may be above the actual level of costs incurred by companies managing claims such as non-fault insurers and CMCs/CHCs (eg because such companies have negotiating power with suppliers and benefit from economies of scale).
- 6.5 When there is separation, the company managing the claim is able to earn a rent by increasing its bill above actual costs incurred towards the maximum level that a court would consider reasonable. Consequently there is an incentive for companies to seek to manage claims or an aspect of them (such as provision of replacement cars):
- (a) At-fault insurers have an incentive to 'capture' a claim so that they can control costs effectively—(see Section 3). Our non-fault survey results suggested that at-fault insurers were successful in capturing about 32 per cent of claims (see paragraph 3.68).³ For these captured claims the at-fault insurer has both cost liability and cost control; this is also the case for a further 4 per cent of claims where both drivers were with the same insurer,⁴ but in the remaining 64 per cent of claims separation remains, as the at-fault insurer has cost liability but another party controls the costs of the claim.

³ Data from insurers suggests that the percentage of captured claims is lower, about 25 per cent.

⁴ Appendix 6.5, Table 1, shows there were a total of 36 per cent of claims which were captured by the at-fault insurer or for which the non-fault insurer and the at-fault insurer were the same.

- (b) CMCs and CHCs compete to obtain non-fault claims work from insurers and brokers, for example by offering them referral fees.⁵ CMCs and CHCs can afford to pay referral fees because they can bill the at-fault insurer for more than the costs they incur. They can obtain referrals of non-fault claims from insurers and brokers because, after an accident, the non-fault driver usually notifies their own insurer or broker.
- (c) Non-fault insurers also have an incentive to manage claims themselves because they can make a profit by doing so.

6.6 We noted a number of ways that separation could lead to higher costs for at-fault insurers:

- (a) Non-fault insurers, brokers and other companies (eg garages and breakdown companies) that manage claims normally arrange provision of replacement cars through a CHC, resulting in higher cost to the at-fault insurer than if the at-fault insurer itself provided a replacement car to the non-fault claimant (see Appendix 6.1).
- (b) Brokers often refer non-fault claims to CMCs, resulting in higher cost to the at-fault insurer than if the at-fault insurer itself managed the non-fault claim.⁶ In these cases, the CMC would usually arrange both the provision of a replacement car and repair to the non-fault claimant's car. (Repair is discussed in Appendix 6.2.)
- (c) Some non-fault insurers charge at-fault insurers more for repair than the costs they incur. Not all non-fault insurers do this. The practice of one insurer has been challenged (*Coles v Hetherton*, under appeal at the time of writing—see paragraph 3.11). The outcome of this litigation might influence future behaviour of insurers.

⁵ CHC/CMCs also obtain some business direct from non-fault claimants and from other businesses such as garages and breakdown companies.

⁶ A small proportion of non-fault claims handled by non-fault insurers are also referred to CMCs.

(d) If the damage following an accident is such that it is not economic to repair a non-fault claimant's car (ie it is written off), some CMCs and non-fault insurers charge the at-fault insurer more than the cost they incur (pre-accident value of the car paid to the non-fault claimant less total receipts for salvage). (Write-offs are discussed in Appendix 6.3.)

- 6.7 In addition to paying out more for claims than if they had managed them, at-fault insurers also incur costs in dealing with and seeking to reduce the subrogated bills sent to them by non-fault insurers, CMCs and CHCs. This involves:
- (a) keeping track of the repair process to check for undue delays and to intervene directly when appropriate (for example, by sourcing a part not readily available);
 - (b) verifying that the replacement car is provided for no longer than is necessary and that the category of vehicle reflects the driver's needs; and
 - (c) challenging the subrogated bill if it is considered unreasonably high (eg because of undue delays to repair or if a replacement car is provided for longer than necessary). If the two sides do not reach agreement on the subrogated bill, the result can be litigation proceedings.

We describe the resulting costs for both sides as transactional and frictional costs.

Bilateral agreements between insurers

- 6.8 Many insurers have agreed bilaterally to practices reducing transactional and frictional costs in direct insurer-to-insurer interactions (known as the RIPE process).⁷ Under this process, at-fault insurers only request from non-fault insurers documentary evidence to substantiate claims in exceptional circumstances, with subsequent audit of a small number of claims.⁸ Associated with the wide spread of these agree-

⁷ Each participant in RIPE has bilateral agreements with other participating RIPE insurers (participants), but not necessarily with all other participants. The RIPE document states that there is no intention that participation in the RIPE process forms a contract and the terms of the process are not enforceable in a court of law.

⁸ We understand the RIPE document to provide for 50 claims of each participant to be audited every six months by one of the other participants. If a participant's audit is failed, all participants with a bilateral RIPE agreement with that participant can request a further audit, or documentary evidence for all claims over a period to be agreed by the two participants. If the audit is

ments across insurers, we considered that claim-related transactional and frictional costs in insurer-to-insurer interactions were likely to be lower than where CMCs and CHCs were involved—see paragraph 6.5. The RIPE process is mainly relevant to repairs and write-offs rather than replacement cars, since provision of replacement cars to non-fault drivers is usually through CMCs/CHCs.

6.9 We noted that not all companies participated in the RIPE process.⁹ We also noted ongoing litigation challenging one insurer's approach to repair costs (see paragraph 6.6(c)) and that the costs of this litigation represented a frictional cost, although it was one that was fixed rather than linked to the number of claims. We also considered that, depending on the results of this litigation, there was a possibility that insurer-to-insurer claim-related transactional and frictional costs could increase.

6.10 Some insurers have bilateral agreements covering the level of each of their subrogated bills. Under such agreements, insurers agree to bill at costs lower than the reasonable levels recoverable under tort law, closer to the actual costs incurred. Two types of agreements exist:

(a) bilateral agreements on replacement car provision: under these agreements, the non-fault insurer agrees not to refer the claim to a CHC but to arrange a direct hire at rates agreed with the at-fault insurer; and

(b) bilateral agreements on repairs: the non-fault insurer agrees to apply a discount on the invoiced bill, taking into account the referral fees, rebates and discounts received. One insurer described this as effectively billing the wholesale cost of the repair.

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passed, other participants with a bilateral RIPE agreement with that participant can still request an audit, to be arranged separately between the two participants. A participant can suspend or cancel a bilateral RIPE agreement with another participant at any time.

⁹ [8]

6.11 Bilateral agreements represent an attempt to deal with the consequences of separation. However, the stronger forms of bilateral agreement referred to in paragraph 10 are not widespread. Results from our non-fault survey suggest that only about 5 per cent of replacement cars and 3.5 per cent of non-fault repairs are covered by the stronger forms of bilateral agreement (see Appendix 6.5, Table 1). Insurers told us that these bilateral agreements were not more widespread because they were administratively difficult to manage; because differences between insurers made them more difficult to agree;¹⁰ and because of competition law concerns.

Effects of separation on insurers' and brokers' costs and revenue

6.12 This subsection analyses the impact of separation on insurers' revenue and costs. We consider separately replacement cars, repairs (both credit repairs and those managed by the non-fault insurer) and write-offs, estimating the higher costs faced by the at-fault insurer and the revenues for the non-fault insurer. We discuss the transactional and frictional costs and also costs that insurers themselves incur in managing non-fault claims.

Cost and revenue effects: replacement cars

6.13 A non-fault claimant has a legal entitlement to a replacement vehicle if their car is not drivable or is being repaired. Compensation will usually be considered by the courts to cover the costs of a replacement car which is broadly equivalent to the customer's own vehicle (often referred to in the industry as a 'like-for-like' replacement vehicle). This is subject to the non-fault driver's duty to mitigate their loss with consideration to their need (see paragraph 1.26). As already mentioned, non-fault insurers and brokers usually refer non-fault drivers to a CHC for a replacement vehicle, which is then provided under a credit hire contract.¹¹ On the other hand, when a claim is

¹⁰ Relevant differences included importance of sales through brokers rather than direct to consumers, and size of insurer.

¹¹ Of the ten largest insurers, only CISGIL does not refer claims to CHCs. All the others, and all major brokers, refer to a CHC unless there is a relevant bilateral agreement with the at-fault insurer.

captured by the at-fault insurer, replacement cars are arranged directly between the at-fault insurer and a car hire company (direct hire).

6.14 We found that the average costs of a replacement car paid by insurers were substantially greater when there was separation than when there was not.

(a) A simple comparison for five insurers showed an average replacement car cost in 2012 of about £1,400 when there was separation,¹² compared with about £480 for captured claims and about £370 when the non-fault and at-fault driver had the same insurer (see Appendix 6.1, Annex B, Table 1).

(b) The average duration of a credit hire (incurred on most claims where there is separation) is longer (by about 3.7 days, 31 per cent) than the average duration of a direct hire (incurred when the claim is captured and there is no separation or where there is a bilateral agreement between the at-fault insurer and the non-fault insurer) (see Appendix 6.1, Table 5).

(c) Data from seven CHCs showed an average credit hire charge of about £1,100.¹³ Comparison of the average credit hire daily rate charged by these CHCs with the direct hire daily rate paid by three insurers for similar cars showed that the credit hire daily rate was 2.5 times as high (see Appendix 6.1, paragraph 32, Table 6).¹⁴

6.15 Different explanations were advanced for the longer credit hire than direct hire period. On the one hand, insurers suggested that credit hire periods were unnecessarily extended to inflate bills. In this regard, we noted that at-fault insurers often challenged credit hire bills, subsequently agreeing a lower amount with the CHC; that challenges were most likely to be on the length of hire rather than the daily rate at least if it was a GTA rate; and that, on average, CHCs wrote off 20 per cent of their

¹² Two insurers provided separate figures for claims where a bilateral agreement was in place. In both cases, the average replacement car cost was similar to that for captured claims.

¹³ See appendix 6.1 paragraph 35

¹⁴ Many credit hire claims are settled under the GTA, but average charges by CHCs appear to be above GTA rates—average charges were 2.5 times direct hire rates whereas GTA rates were 2.1 times direct hire rates (see Appendix 6.1, Table 6).

gross revenue, mostly by accepting lower settlement payments. On the other hand, an alternative possible explanation is that credit hires are for more serious accidents requiring longer repairs. This would be consistent with captured claims having on average a lower value than non captured ones, as suggested by insurers (see Appendix 6.2). It may be that there is some merit in both explanations, therefore in the absence of convincing evidence, we did not take into account the longer hire duration in estimating the extra cost of credit hire.

- 6.16 A simple comparison of replacement car costs may be affected not only by the length of hire period, but also by the quality of replacement car (eg whether 'like-for-like' or basic courtesy car). Since we wanted to control for any difference in quality between captured and non-captured claims, we compared average credit hire and direct hire rates for the different classes of cars, weighting each class by the respective number of credit hire days for a sample of seven CHCs (see Appendix 6.1, paragraph 34).¹⁵ We based our estimate of the average total cost of replacement car when there is separation on the average revenue per hire of these CHCs. We estimated that the average cost of a replacement car was £1,100 and that this was approximately £640 greater than the cost of a similar car in the absence of separation (see paragraph 6.14(c) and Appendix 6.1, paragraph 35—precise figures are affected by rounding). Although there is some uncertainty on the precise extent of the cost difference, our result is broadly consistent with what can be obtained using different estimation methods.¹⁶

¹⁵ A number of CMCs/CHCs suggested that the appropriate counterfactual for credit hire was not direct hire, but hire by claimants themselves at retail rates. We considered a benchmark 'well-functioning market' to be a market which delivered consumers' legal entitlements in an efficient way (see paragraph 6.3) and therefore looked at two dimensions. In assessing how separation affects insurers' costs and revenue streams, we considered that this implied using the excess cost of credit hire over direct hire as the measure of the cost associated with separation. We also considered the impact of separation on the quality of service provided. As noted in paragraph 6.38 below, we accepted that the existence of CMCs/CHCs was likely to give at-fault insurers the incentive to provide a high quality of service to non-fault claimants, including, for instance, a like-for-like replacement car in many cases.

¹⁶ Our estimates of the average cost of a replacement car under separation are between £1,085 and £1,400. Assuming that credit hire costs 2.5 times as much as direct hire, the extra cost would be £640 to £830. Taking the figure that credit hire costs 2.1 times as much as direct hire, the extra cost would be £580 to £730 (the numbers are affected by rounding).

6.17 Of this estimated £640 extra cost of credit hire, on average about £340 is paid out in referral fees to non-fault insurers.¹⁷ The remaining £300 is therefore accounted for by higher costs of CHCs and any profits that the CHCs make. There are a number of reasons why the costs of CHCs in providing replacement cars may be higher than the direct hire cost incurred by an at-fault insurer. First, CHCs incur transactional and frictional costs (see paragraph 6.7); second, CHCs may have higher operating costs and not benefit to the same extent from negotiating power with suppliers as larger hire companies used for direct hire by insurers; and third, CHCs incur costs in providing additional services (see paragraph 6.36).¹⁸ We believe for the reasons below that the difference is mostly due to frictional costs. According to the GTA, a CHC has to keep track of the repair, to guarantee that the hire period is not unduly long. For example, if there is a delay in the repair, the at-fault insurer must be informed and it may directly intervene to shorten the delay. All this involves costs. Moreover, litigation costs are significant (see Appendix 6.1, paragraphs 60 to 70). We note that we have not seen evidence that CHCs earn more than normal profits. Indeed, as we found that barriers to entry were low and CHCs compete to obtain referrals by offering high referral fees, we consider it unlikely that CHCs earn more than normal profits.

6.18 Similarly, at-fault insurers also incur significant transactional and frictional costs in dealing with CHCs (see Appendix 6.1, paragraphs 71 to 80). They monitor the duration of repair and of the hire period and often incur litigation costs. It is likely that these costs substantially exceed any transactional costs at-fault insurers would incur in purchasing car hire directly. For this reason, the total extra cost attributable to separation is likely to be significantly more than £640.

¹⁷ These figures relate to referrals to CHCs by non-fault insurers. The position for referrals by brokers and other companies may be slightly different (see Appendix 6.6, Table 9).

¹⁸ CHCs also incur costs associated with additional working capital associated with being paid after the time the service is provided. Such additional costs are likely to be small (except when payment is delayed for a long time due to a dispute over the bill with the at-fault insurer when it can be regarded as a component of frictional costs).

Cost and revenue effects: repairs

6.19 Unlike replacement cars, where most non-captured claims are referred for credit hire, in the case of repairs most non-fault insurers carry out repairs themselves, with referrals for credit repair being made mainly by brokers (though one non-fault insurer refers some but not all claims for credit repair). Overall we estimate that, of the approximately two-thirds of non-fault claims that are not captured by at-fault insurers, in about three-quarters of cases the repairs are managed by non-fault insurers, and in the remaining one-quarter of cases credit repair is involved. In this subsection, we discuss the cost increase faced by at-fault insurers when they do not directly handle a repair. We then consider the revenues obtained by non-fault insurers or brokers.

6.20 We identified that insurers and CMCs managed their non-fault repairs in many different ways, some of which have the effect of increasing their non-fault repair charges passed to at-fault insurers above the costs they incur. Such practices include:

- (a) performing non-fault repairs in repair subsidiaries at retail rates (eg by allowing high labour rates) and extracting the profits as dividends or referral fees ([§]);
- (b) making an upward adjustment to the repair bill to inflate it above the costs incurred ([§]);
- (c) requiring approved repairers to discount the repair bill they charge (or to pay a parallel rebate), but not passing on this discount to the at-fault insurer ([§]);
- (d) charging an administration fee and an engineering fee, and various other extras, to the at-fault insurer in addition to the repair bill;¹⁹ and
- (e) taking rebates (which are not passed on to the at-fault insurer) from suppliers to repair subsidiaries or approved repairers (eg of paint, parts and repair cost estimation systems) in return for requiring the use of these inputs, often resulting in higher input costs for repairers (with the likelihood of higher repair bills) ([§]).

¹⁹ For example, the GTA allows CMCs providing credit repair services to make these additional charges.

We noted that these practices meant that non-fault insurers charged at-fault insurers more than the actual costs they incurred in providing the repair service (unless the additional charges were offset by the non-fault insurers' costs of managing repairs).

6.21 We observed large variation in insurers' practices with respect to directly managed repairs: seven of the ten largest insurers receive referral fees from paint or parts suppliers; five out of ten receive rebates from their approved repairers which are not passed on to the at-fault insurer, or profits from their vertically integrated repair networks, or directly add a mark-up to the invoice received by repairers. As a consequence, the total difference between the cost charged to the at-fault insurer and the cost of repair paid by non-fault insurer varies significantly among insurers. We found that this difference averaged about £95 across insurers (see Appendix 6.2, paragraph 15). On the assumption that non-fault and at-fault insurers have similar repair costs, this value represents an estimate of the average gross cost increase to at-fault insurers.²⁰ However, it does not take into account the costs at-fault insurers save as a result of not having to manage the repair themselves (though at-fault insurers may incur some costs in managing the relationship with the non-fault insurer).

6.22 We found that repairs managed by CMCs tended to be more costly than those managed by non-fault insurers. On average, the difference was about £230 (see Appendix 6.2, paragraph 25). On the previous assumption, this suggests that repairs managed by CMCs tend to cost at-fault insurers about £325 (£230 + £95) more than the repair cost the at-fault insurer would incur (again not accounting for either the costs at-fault insurers save as a result of not having to manage the repair them-

²⁰ We were unable to attach weight to direct comparisons of repair costs across different claim types. This was for two reasons: first, the data we obtained from insurers on average repair costs was difficult to interpret as insurers either were unable to provide any data or could not provide values for costs net of all the rebates and referral fees involved; and second, captured repairs may tend to require less extensive work than non-captured repairs and not be directly comparable (while there is less data available on same-insurer repairs). See Appendix 6.2.

selves, or the transactional and frictional costs they incur in managing the relationship with the CMCs).

6.23 When repairs are managed by non-fault insurers, the non-fault insurer may make a profit. This is represented by the difference between the cost charged to the at-fault insurer and the repair and management costs the non-fault insurer actually incurs. As discussed above (see paragraph 6.19), currently there are significant differences between the practices of individual insurers. For some non-fault insurers, the difference between the cost charged to the at-fault insurer and the repair cost incurred clearly exceeds their cost of managing the repair; for others this is not the case. As we have already noted, there is a possibility that the current situation may change depending on the results of ongoing litigation.

6.24 When insurers or brokers refer a repair to a CMC, they receive revenue in the form of a referral fee. We found that the average referral fee paid for credit repair was about £55 (see Appendix 6.6, Table 6). We noted that this was considerably less than the average referral fee paid for credit hire.

Cost and revenue effects: write-offs and salvage

6.25 Cars are written off when it is not economic to repair them. As with repairs, claims resulting in a write-off may be captured by the at-fault insurer or managed by the non-fault insurer or a CMC. Our analysis for cars that are written off is similar to that for cars that are repaired.

6.26 As with repairs, currently there are differences in the practices of non-fault insurers managing write-offs. For some non-fault insurers, the difference between the cost

charged to the at-fault insurer and the cost incurred²¹ exceeds the cost to the non-fault insurer of managing the write-off. For other non-fault insurers this is not the case. Thus, some but not all non-fault insurers earn revenue from write-offs. We estimate that, on average, non-fault insurers charge just over £50 more than the cost incurred (see Appendix 6.3, paragraph 31).

- 6.27 When write-offs are managed by CMCs, we estimate that the average cost charged to at-fault insurers is about £125 more than the costs incurred.²² Brokers and any non-fault insurers referring claims to CMCs earn revenue from referral fees which we estimate at about £55 per claim (see paragraph 6.24).²³

Summary of cost and revenue effects

- 6.28 We provisionally found that separation usually results in provision of a replacement car on credit hire rather than direct hire terms, at an average extra cost to the at-fault insurer of at least £640 per replacement car, and average revenue to non-fault insurers from referral fees of about £340. Repairs and write-offs with separation are mostly managed by non-fault insurers, some but not all of which charge the at-fault insurer significantly more than the cost of repair. Around a quarter of repairs and write-offs with separation are managed by CMCs, which we estimate cost the at-fault insurer an average of £325 more than the cost of repair, and £125 more than the cost of write-off, with average revenue to non-fault insurers from referral fees of about £55.

Quality and service differences associated with separation

- 6.29 Separation may have implications for the level of service received by non-fault claimants. In this subsection, we first summarize the evidence, from our non-fault

²¹ The cost incurred is the car's pre-accident value less its salvage value.

²² See appendix 6.3, paragraph 30

²³ At the time of referral, it would not be known whether the non-fault claimant's car would be repaired or written off.

survey and elsewhere, regarding quality of service differences according to who managed the claim. We then consider points made by CMCs/CHCs regarding service differences and other matters. Quality and service differences are discussed in more detail in Appendix 6.5.

Quality and service differences: replacement cars

6.30 As shown in Table 6.1, around 15 per cent of respondents to our non-fault survey said that their replacement car exceeded their needs, 70 per cent said it met but did not exceed their needs and 15 per cent said it fell short of their needs (in most of these cases only slightly). The percentage saying the replacement car fell slightly short of their needs was six percentage points greater for claims managed by at-fault insurers, implying that respondents' average experience of the quality of replacement car received was somewhat lower when the claim was managed by the at-fault insurer.^{24,25} A similar proportion of respondents, whose claims were managed by at-fault insurers, considered that the car exceeded their needs to the proportion who considered that it fell short of their needs—for respondents whose claims were managed by non-fault insurers and CMCs, a slightly greater proportion of respondents considered that the car exceeded their needs than that it fell short of their needs. The most common reasons for respondents saying that their replacement car did not meet their needs were that it was less spacious, had a smaller engine, or was a worse make or model than their own vehicle (see Appendix 6.5). The reasons given were similar irrespective of who managed the claim.

²⁴ The difference is statistically significant at the 95 per cent level.

²⁵ The results of our review of a sample of 100 electronic call records showed that a lower proportion of claimants whose claims were managed by fault insurers (70 per cent) than of claimants whose claims were managed by non-fault insurers or CMC/CHCs (92 per cent) received a replacement car similar to their own, also suggesting that quality of replacement car received may be lower for claims managed by fault insurers.

TABLE 6.1 **Non-fault claimants' experience of replacement cars, analysed by who managed the claim**

	<i>All claims</i>	<i>Managed by at-fault insurer</i>	<i>Managed by non-fault insurer</i>	<i>per cent Managed by CMC</i>
<i>How well the replacement car met respondents' needs</i>				
Far exceeded needs	11	11	11	10
Somewhat exceeded needs	6	4	6	7
Met needs	68	66	69	72
Fell slightly short of needs	9	14	8	4
Fell well short of needs	5	5	5	7
Base (weighted)	1,191	345	487	170
<i>Length of time respondents had access to replacement car</i>				
A longer time than needed	3	3	1	6
As long as needed	88	88	90	87
A shorter time than needed	9	9	9	7
Base (weighted)	1,181	341	482	170

Source: CC PMI non-fault survey, Questions D19 & D23.

6.31 The non-fault survey also found that nine in ten respondents had their replacement car as long as they needed it and there was no significant difference in this proportion depending on which party handled the claim (see Table 6.1). We also did not see much evidence of differences in the speed of replacement car provision under credit and direct hire once liability is determined (see Appendix 6.5, paragraph 57). We discuss quality of service for replacement cars further in paragraphs 6.35 and 6.36 below.

Quality and service differences: repairs and write-offs

6.32 Table 6.2 shows data from our non-fault survey relevant to assessing quality of service on repairs:

- (a) When asked about the extent of repair, about 93 per cent of respondents told us that their car had been fully repaired. There was no significant difference between claims handled by the at-fault insurer, the non-fault insurer or a CMC.
- (b) When asked about the condition of the car after the repair, slightly more respondents whose claim was managed by at-fault insurers said that the condition of the

car was slightly worse after the repair.²⁶ A similar proportion of claimants whose claims were managed by at-fault insurers considered that the condition of the car was better to the proportion who considered it worse. The reasons underlying any negative assessment on the vehicle condition, post-repair, were the same regardless of which party handled the claim, mostly relating to not all damage being repaired, or the quality or colour match of paintwork.

- (c) In relation to satisfaction with the repair, slightly more respondents whose claim was managed by at-fault insurers were dissatisfied than those whose claim was managed by non-fault insurers (though not than those whose claim was managed by CMCs).
- (d) When respondents were asked about the post-repair value of the car, about 15 per cent said that the value was lower than before the accident. The percentage was similar irrespective of who managed the claim.

²⁶ The difference is statistically significant at the 95 per cent level.

TABLE 6.2 **Non-fault claimants' experience of repairs, analysed by who managed the claim**

				<i>per cent</i>
	<i>All claims</i>	<i>Managed by at-fault insurer</i>	<i>Managed by non-fault insurer</i>	<i>Managed by CMC</i>
<i>How much damage was repaired</i>				
All of the damage was repaired	93	94	92	97
Most of the damage was repaired	5	5	6	0
Some of the damage was repaired	2	1	2	3
Base (weighted)	1,159	364	492	141
<i>Condition of the car after the repairs were made</i>				
In a lot better condition	5	4	4	5
In somewhat better condition	8	10	8	7
Same	75	73	79	78
Slightly worse	10	12	8	7
Much worse	1	1	1	3
Don't know	1	0	1	0
Base (weighted)	1,163	364	495	141
<i>Satisfaction with the repair service analysed by who managed the claim</i>				
Very satisfied	61	56	66	63
Fairly satisfied	28	30	27	25
Neither satisfied nor dissatisfied	4	6	2	1
Fairly dissatisfied	3	4	2	6
Very dissatisfied	4	3	2	6
Base (weighted)	1,159	364	492	141
<i>Value of the vehicle after the repairs were made (compared to before the accident)</i>				
Vehicle was worth more	1	0	0	0
Vehicle was worth the same	80	81	81	84
Vehicle was worth less	14	15	13	12
Don't know	5	4	6	3
Base (weighted)	1,163	364	495	141

Source: CC PMI non-fault survey, Questions C11, C22 & C24.

6.33 This evidence suggested to us that differences in consumers' experience of repair associated with separation were small. However, we recognized that there were limitations to consumers' ability to assess the quality of the repair—see paragraph 7.11. In Section 7 in our assessment of whether the overall quality of repair is in line with claimants' legal entitlements we identify concerns in relation to the quality of repairs provided. However, those concerns apply to claims managed both by at-fault insurers and by third parties (ie non-fault insurers and CMCs where there was separation). Insurers told us that they managed non-fault repairs similarly whether they were captured or not and this was supported by evidence on how they managed

repairs, for example the approach to repair audits (see Section 7).²⁷ Therefore, we did not identify a service difference associated with separation.

6.34 We noted that there may be respects in which captured non-fault claimants receive a better service than those whose repairs are managed by non-fault insurers. In particular, captured non-fault claimants, dealing only with the at-fault insurer, are not at risk of having to contribute to the cost of repairing their car (to the extent of their excess) or of losing their NCB for a period. By contrast, where claims are managed by non-fault insurers, these seem real risks. Two insurers (Admiral and Zurich) told us that when managing non-fault claims for claimants without legal expenses cover, they sought to recover from the at-fault insurer only the repair cost less the non-fault claimant's excess.²⁸ This means that the non-fault claimant has to pay the excess (similar to an at-fault claim) and recover it themselves from the at-fault insurer. There also seemed some possibility that non-fault claimants whose claims are managed by their own insurers lose their NCB during the period before the claim is settled and that non-fault claimants whose vehicles are written off receive a replacement car for a shorter period (see Appendix 7.2, paragraphs 14 and 15). The quality advantage of repairs managed by at-fault insurers only applies compared with those managed by certain non-fault insurers, not compared with those managed by CMCs.

6.35 We did not find evidence of service differences with respect to write-offs between claims managed by at-fault insurers, non-fault insurers and CMCs (see Appendix 6.3).

²⁷ In relation to CMCs please see paragraph 7.46

²⁸ Admiral told us that when managing non-fault claims for claimants without legal expenses cover it was standard practice to request recovery from the at-fault insurer of the repair cost less the non-fault claimant's excess—this meant that the non-fault claimant had to pay the excess (similar to an at-fault claim) and recover it her/himself from the fault insurer. However, Admiral said that some at-fault insurers would choose to send the excess cheque to Admiral along with the repair reimbursement and in these circumstances Admiral forwarded the cheque to the non-fault claimant.

Evidence from CHCs/CMCs

6.36 CHCs/CMCs told us that they provided better or additional services compared with insurers (both at-fault insurers and non-fault insurers) at no cost to the driver. The services concerned were extra insurance on replacement cars (collision damage waiver), uninsured loss recovery²⁹ and after-the-event insurance.³⁰ We consider these services in Appendix 6.5. We found that one out of nine CMCs/CHCs in our sample provided extra insurance on credit hire but not direct hire replacement cars,³¹ while six out of nine provided uninsured loss-recovery services. We noted that these services were not provided by at-fault insurers. We considered that after-the-event insurance was not relevant to the assessment of separation as it was not needed when claims were managed by the at-fault insurer.³²

6.37 We noted that four out of nine CMCs/CHCs said that they provided replacement cars to non-fault drivers when liability was uncertain or disputed by the at-fault insurer (though the other five did not say this). We considered it unlikely that an at-fault insurer would provide a replacement car unless or until it was confident that a claimant was at fault for the accident. Hence we accepted that the involvement of CHCs/CMCs which provided replacement cars when liability was uncertain was likely to mean that some non-fault claimants received a better quality of replacement car services than in the absence of separation (eg a replacement car rather than any entitlement under their own policy (in most cases a courtesy car), which is what they would receive if liability was not determined at the time of repair).³³

²⁹ Uninsured loss recovery involves pursuing, on behalf of the non-fault driver, the at-fault insurer for loss of earning, loss of personal effects, loss of value to the vehicle, excess etc.

³⁰ ATE insurance covers the non-fault driver in the event that the cost of the services provided to a non-fault driver following an accident by a CMC/CHC and other providers (eg engineers, investigators, lawyers and doctors) cannot be recovered from the at-fault insurer and, therefore, the providers are required to pursue the driver for the settlement of the claim.

³¹ One other CMC/CHC provided extra insurance on credit hire but not direct hire replacement cars at an extra charge to the driver.

³² ATE insurance is not required under direct hire, as the at-fault insurer has (by capturing the non-fault driver) accepted responsibility for the payment of the costs incurred in providing post-accident services to the non-fault driver.

³³ Most drivers have comprehensive insurance and most, but not all, comprehensive insurance policies include a courtesy car. Drivers without comprehensive insurance would not have any entitlement unless another party is liable.

6.38 Another point made by CHCs/CMCs was that liability was resolved more often and more quickly due to the availability of credit hire. CMCs/CHCs also submitted that their presence acted as a deterrent to insurers providing a poor quality of replacement car services. CHCs/CMCs said that in the absence of separation an insurer's incentive would be to minimize its costs—insurers would not have any incentive to provide non-fault claimants with a quality replacement car or indeed with a replacement car at all. They suggested therefore that, in the absence of credit hire, non-fault claimants would receive a lower quality of replacement car than they did now, for example a basic courtesy car or no replacement car at all. We accepted that the existence of CMCs and CHCs (which only occurred when there was separation) was likely to give insurers the incentive to provide a high quality of service to non-fault claimants, including, for instance, a like-for-like replacement car in many cases.

Summary on quality and service differences

6.39 Based on the evidence from our non-fault survey and elsewhere we provisionally found that there was only a small difference in quality of service associated with separation (with slightly more captured than non-captured respondents to our non-fault survey receiving a replacement car slightly below their own assessment of needs).

6.40 We noted some further service differences in relation to replacement cars in that some CHCs/CMCs provided replacement cars when liability was uncertain and that this was likely to mean that some non-fault claimants received a better quality of replacement car services than in the absence of separation. We also found that certain CMCs provided some additional services to consumers. More generally, we also note that the existence of credit hire was likely to act as a deterrent to at-fault insurers providing a poor quality of replacement car services.

6.41 In relation to repair, on the other hand, we noted a quality benefit of separation in that captured non-fault claimants were not at risk of having to contribute their excess to the repair, unlike some non-fault claimants whose claims are managed by their own insurer.

Implications for consumers of separation

6.42 We considered that the main potential implications for consumers of these findings were complex as they could lead to both positive and negative benefits. In summary they were that:

- (a) higher costs for at-fault insurers may lead to higher car insurance premiums;
- (b) the revenue stream to non-fault insurers and brokers may lead to lower car insurance premiums; and
- (c) the separation of cost liability and cost control may be associated with direct benefits to consumers.

In this subsection we discuss these issues in turn and then estimate the net effects on consumers.

Impact of higher costs for at-fault insurers on car insurance premiums

6.43 We are not able to observe a situation where there is no separation of cost liability and cost control across the market. Hence, we are not able to make a direct comparison of insurance premiums when there is no such separation with current insurance premiums. However, we have made a detailed economic assessment of the factors affecting the extent to which cost changes are passed through into price changes which enables us to infer the impact of higher costs on premiums. Our economic analysis (see Appendix 6.4) suggests that the main factors affecting the extent to which cost changes are passed through into price changes for consumers are:

- (a) whether the cost change represents a change in marginal or fixed costs;
- (b) the responsiveness of supply to cost changes (elasticity of supply);

(c) the effectiveness of competition in the market and the price elasticity of market demand; and

(d) whether the change in cost affects all firms in the market equally, or whether there are differences in the effect on different firms.

We now summarize how each of these relates to the higher costs faced by at-fault insurers.

Marginal and fixed costs

6.44 Economic theory suggests that changes in marginal cost (the cost of supplying one more unit) which affect all firms in the market are more likely to feed through into price changes than changes in fixed cost.³⁴

6.45 The cost of insuring an individual driver depends on the expected cost of at-fault claims—the likelihood of its driver being at fault in an accident times the expected cost of handling the claims arising from any such accidents.³⁵ Since the cost increase that we have provisionally found affects the expected cost of handling at-fault claims, we consider that a change in the cost incurred by at-fault insurers in dealing with non-fault claims represents a change in marginal cost, rather than a change in fixed cost.

Responsiveness of supply

6.46 If firms experience difficulties or incur additional costs in supplying more of a product, the constraint they impose on each other will tend to be weakened and the extent to

³⁴ This is because the strength of the constraint on each firm's price depends at least to some extent on the marginal costs of the other firms in the market (because the lower is the marginal cost of the other firms, the cheaper it is for them to attract the customers of the first firm). Hence, if the marginal cost of all firms changes, the constraint on each firm's existing price is weakened and the desire to maximize profits implies that it will increase its price. (In the limit, ie under perfect competition, price is equal to marginal cost.) The position for changes in fixed costs is more complex because they do not affect directly the constraint on each firm's price; though, if a change in fixed costs prompts exit or entry or otherwise affects competition in the market, there will be an effect on market price.

³⁵ Depending on the type of motor insurance taken out, the price will also reflect the likelihood and expected cost of fire, theft and at-fault claims.

which cost changes are passed through into prices will also tend to be reduced. This might be relevant, for example if we are considering:

- (a) the short-term impact of an unexpected cost change and it takes time for firms to change capacity. In these circumstances, the short-term constraint on each firm's prices is weakened and we would expect pass-through of cost changes into price changes to be lower in the short term than in the longer term, ie once there has been time for capacity to change; and
- (b) a market where each firm's marginal cost increases as the amount it supplies becomes greater (decreasing returns to scale): if so, and the amount supplied after the cost change is different from that before the cost change, the change in marginal cost will be reduced and the impact on price lessened.³⁶

6.47 Neither of these two situations applies here. In relation to the first, we are seeking to compare the current situation where there is separation of cost liability and cost control with a benchmark situation where there is no such separation—we are not therefore concerned with short-term effects, for instance due to capacity limitations. In relation to the second, there is no evidence that car insurance is characterized by marginal cost increasing with the amount supplied.

Competition and price elasticity of market demand

6.48 When competition in the market is strong and market demand is inelastic, each firm's price is constrained by customers switching to the products of other firms in the market, rather than by customers switching to different products outside the market or just deciding not to use the product. Hence, an increase in marginal cost affecting all firms in the market relaxes the constraint on each firm's price enabling each to

³⁶ Any such effect would only be material if both the change in marginal cost was relatively large and demand was relatively elastic, so that there was a material change in the total amount supplied.

increase its price (and similarly a reduction in marginal cost intensifies the constraint on each firm's price, requiring it to reduce its price).

6.49 We considered that rivalry in the motor insurance market was strong overall and that motor insurers' prices were constrained by rivalry from other motor insurers. In particular, we noted that:

- (a) The market was fairly unconcentrated, with the largest firm having a [X] per cent share of premium income, the four largest [X] per cent and the ten largest [X] per cent.
- (b) Profitability data did not suggest that motor insurers had earned economic profits (ie profits in excess of the cost of capital) over the last few years, though there was fluctuation from year to year.
- (c) Switching between insurers was high relative to comparable products and there was no obvious obstacle to switching (with the possible exception of NCB protection).
- (d) There was evidence that each insurer's demand was responsive to changes in its own price (with competitors' prices held constant), ie each individual firm's demand was price elastic; though this did vary between channels, being highest for PCWs and tending to be lowest for renewals.

6.50 As set out in Section 3, we noted that third party car insurance was a legal requirement, and a change in average car insurance premiums could only affect market demand if it induced changes in the number of cars insured. Therefore, we considered that the market demand for motor insurance was likely to be very price inelastic. We noted that higher costs were likely to affect disproportionately the premiums of those drivers most likely to cause accidents and that demand from

these drivers might be less price inelastic than the demand from all drivers.³⁷

Nevertheless, we considered that demand from such drivers was still likely to be price inelastic (even if not as price inelastic as demand from all drivers).

Differences in cost changes between insurers

- 6.51 As discussed above, a change in marginal cost that affects all firms in a competitive market with inelastic demand will tend to be passed through into prices. However, it is less clear that this is the case for a change in marginal cost that affects only a small proportion of firms. In imperfectly competitive markets, the extent of the impact on price of cost changes affecting only some of the firms in the market depends on the specific characteristics of the market and the change in costs (see Appendix 6.4).
- 6.52 In the current context, we noted that there were some differences in the cost increase associated with non-fault claims handled or referred by different insurers—in particular, in the case of repair, including use of credit repair.³⁸ However, the higher costs associated with non-fault claims handled or referred by each insurer do not affect that insurer's own marginal cost, only the marginal cost of other insurers (in proportion to the extent to which the first insurer's drivers are not at fault in accidents where the other insurers' drivers were at fault). Since each insurer's drivers would be at fault in accidents where drivers of many other insurers were non-fault, each insurer's marginal cost would be affected by the practices of many other insurers. Hence, the difference between insurers in cost impact is likely to be much less than the underlying difference in practices (we discuss this further in Appendix 6.4, paragraph 13).³⁹
- We noted that there were some differences between insurers in the proportion of claims they captured and in the number of other insurers with which they had

³⁷ Reasons for this included that the cost of motor insurance for such drivers would be higher relative to the total cost of motor-ing and that such drivers may tend to be younger drivers with lower than average income for whom insuring their own car could become unaffordable.

³⁸ There is less difference in replacement cars, although we note that among the largest ten insurers, CISGIL does not use credit hire directly.

³⁹ Some claims are referred to CMCs/CHCs by brokers rather than insurers, and in a few cases referral is made neither by insurer nor broker. This does not alter the underlying point.

bilateral agreements, but we did not consider these of sufficient importance to lead to large differences in the expected marginal cost of at-fault claims.

Conclusion on impact of higher costs on motor insurance premiums

6.53 Our discussion suggests that higher subrogated bills result in a change in marginal cost that for a given level of risk is broadly similar across motor insurers in the market; that the market is characterized by strong rivalry with price-inelastic demand; and that, as we are concerned with comparing the situations with and without separation of cost liability and cost control, short-run capacity effects are not relevant. These circumstances are those where we would expect the higher costs incurred by at-fault insurers to be reflected broadly pro rata in higher premiums. The effect on individual premiums would vary according to drivers' risk of being at fault in accidents, being highest for drivers with the greatest risk.

6.54 We considered that evidence from insurers supported our expectation of broadly pro rata pass-through as they all said that their premium quotes reflected the expected cost of handling at-fault claims.

Revenue stream to non-fault insurers and brokers

6.55 We now turn to the revenue stream accruing to insurers and brokers as a result of the separation of cost liability and cost control (referral fees and similar income). We discuss first insurers and then brokers. We then consider the implications of the point that higher subrogated bills affect the costs of *at-fault* drivers whereas the revenue stream offsets the costs of *non-fault* drivers.

Non-fault insurers

6.56 In relation to the points discussed above (see paragraph 6.40(a) to (d)):

- (a) The revenue accruing to insurers acts as an offset to the expected costs of insuring drivers in proportion to the likelihood of their being not at fault in accidents. Hence, it is similar to a reduction in the marginal cost of car insurance. The logic is the reverse of that given above in relation to higher subrogated costs.
- (b) The analysis in relation to responsiveness of supply is the same as in relation to higher subrogated costs.
- (c) The analysis in relation to competition and price elasticity of market demand is also the same as in relation to higher subrogated costs.
- (d) There is more difference between insurers in the revenue stream than there is in the impact of higher costs (because each insurer's revenue stream is affected by its own policies, whereas each insurer's additional cost is affected by the policies of all other insurers). We have considered the implications of the greater asymmetry between insurers' revenue stream than costs in Appendix 6.4 (see paragraphs 29 to 33). On balance, our view is that pass-through of the revenue stream into lower premiums is likely to be somewhat lower than for costs (which we considered would be fully passed through—see paragraph 6.50), though another implication is that there is more uncertainty as regards the extent of pass-through of revenue than of costs.

6.57 This suggests that the revenue stream arising as a result of the separation of cost liability and cost control is likely to reduce car insurance premiums, though for the reason given in paragraph 6.54(d), the premium reduction to consumers may be somewhat less than pro rata with the revenue stream.

6.58 The evidence from insurers themselves was also somewhat less clear that the revenue stream was taken into account in setting premiums than was the case for costs.⁴⁰

6.59 Overall, we considered that the revenue stream (from referral fees etc) to insurers is likely to reduce motor insurance premiums but the effect may be somewhat less than pro rata.

Non-fault brokers

6.60 We noted that brokers could generally be divided into two groups:

- (a) larger national branded brokers, which in effect set their own premiums (and pay an agreed net amount to the company providing insurance); and
- (b) smaller regional brokers, where the insurance company sets the premium and remunerates the broker at an agreed percentage commission rate (a traditional broking arrangement where the broker acts as agent for the insurer).

6.61 The position for national branded brokers is similar to that for insurers.

6.62 The position for smaller regional brokers is potentially different from that for insurers because, at least in the first instance, premiums are set by the insurers whose policies the brokers sell. These brokers' referral fee income will be reflected in lower premiums if the insurers set lower premiums. We noted that this would be the case if, as a result of receiving referral fee income, lower commission rates are agreed and the insurance companies reflect these lower commission rates in lower premiums. Given that rivalry in the market was strong, we considered that this was likely, but

⁴⁰ Five out of the ten leading insurers said that they treated referral fee and similar income as a negative expense; two said that they took it into account in determining target loss ratios or returns which would affect premiums over the longer term; and one said that such income was not factored into premiums. For the other two insurers, it was unclear how far such income affected premiums.

noted that there was more uncertainty than in relation to insurers and national branded brokers.

- 6.63 Overall, our view is that the effect on premiums of the revenue stream to brokers is broadly similar to that of the revenue stream to insurers, but there are some additional uncertainties.

Conclusion on impact of revenue stream on motor insurance premiums

- 6.64 Our provisional view is therefore that the revenue stream to non-fault insurers and brokers associated with the separation of cost liability and cost control reduces the premiums charged by insurers and therefore partially offsets the higher premiums attributable to higher subrogated costs also associated with the separation of cost liability and cost control.
- 6.65 We noted that the revenue stream was associated with a reduction in premiums in proportion to the risk of drivers being *not at fault* in accidents. However, higher costs were associated with an increase in premiums in proportion to the risk of drivers being *at fault* in accidents. We noted that the consumers affected were unlikely to be the same since, when setting premiums, insurers did not assume that drivers' risk of being at fault in accidents was similar to their risk of being not at fault. In particular, drivers who were less experienced, less attentive and engaged in more risky behaviour were relatively more likely to be at fault in accidents and insurers proxied for these factors by basing premiums on risk factors such as number of years of driving, age, occupation and postcode where the vehicle was kept. Since the effect of higher costs on premiums varied with risk, having the greatest effect on the premiums of drivers with the most adverse risk factors, while the revenue stream affected drivers much more equally, we considered that an effect of separation was that prices to individual drivers were not fully reflective of expected costs.

Direct quality of service benefits to consumers

6.66 As discussed in paragraphs 9 to 6.41, current quality differences between claims managed by at-fault insurers, non-fault insurers and CMCs tend to be small.

Nevertheless, the evidence from our non-fault survey indicates that quality of service is better in relation to replacement cars for claims managed by non-fault insurers and CMCs (see paragraph 6.39) and this would be associated with a consumer benefit from separation.

6.67 As set out in paragraph 6.36, CMCs also sometimes provide non-fault claimants with additional services (beyond those which an at-fault insurer is required to provide under tort law) and this too would provide a benefit to consumers. Moreover, the willingness of some CMCs/CHCs to provide a replacement car when liability is uncertain or disputed may mean that some claimants receive a replacement car when they would not otherwise do so or would receive only a courtesy car. On the other hand, because at-fault insurers (unlike some non-fault insurers) do not ask a non-fault claimant to contribute the excess towards the repair, and because most non-captured repairs are managed by non-fault insurers rather than CMCs,⁴¹ there may also be a service detriment to consumers associated with separation. This detriment would be represented by the 'hassle' experienced by some non-fault claimants in having themselves to recover the excess from the at-fault insurer (with or without the help of a CHC)⁴² plus the value of the excess for any non-fault claimants deterred from recovering the excess.

6.68 The quality of service benefit associated with separation would be greater if account is taken of the impact that services offered by CHCs and CMCs have in improving the quality of service offered to captured claimants, ie if comparing with quality of

⁴¹ As noted in paragraph 6.34, CMCs do not require non-fault claimants to contribute the excess towards the repair.

⁴² As noted in paragraph 6.34, many CHCs provide uninsured loss recovery services which assist non-fault claimants to recover the excess from the at-fault insurer.

service under a benchmark where all claims are captured rather than the current quality of service received by captured claimants.

- 6.69 Overall, we considered that the effects on consumers of current quality of service differences associated with separation tended to be small; though we noted a benefit to some non-fault claimants from receiving a credit hire car when liability had not been agreed between insurers, and a detriment to some non-fault claimants with claims managed by their own insurer from having to pay their excess and recover it themselves from the fault insurer. More generally, we accepted that the existence of CMCs and CHCs, which only occurred when there was separation, was likely to give the at-fault insurer the incentive to provide a good quality of service to non-fault claimants (see paragraph 6.38) and this is discussed further in our conclusion below.

Estimation of the effect of separation on consumers

- 6.70 In this section, we estimate the total impact on premiums of separation from the total increase in subrogated costs and the total revenue stream to non-fault insurers. We then consider the effect of quality of service differences and estimate the net impact on consumers.

Higher costs and increased premiums

- 6.71 We estimated the effect of separation on subrogated costs as follows:
- (a) Credit hire increases cost by an average of £640 per hire compared with an equivalent direct hire (see paragraph 6.28).
 - (b) Credit repair increases cost by an average of about £325 per repair and non-fault insurer repair by an average of about £95 compared with repair managed by at-fault insurers (see paragraphs 6.21 and 6.22).

(c) For write-offs, cost is increased by an average of about £125 per write-off when a CMC is involved and an average of about £55 when a non-fault insurer is involved (see paragraphs 6.26 and 6.27).

(d) Transactional/frictional costs incurred by at-fault insurers in dealing with CHCs and CMCs exceeded the average cost of managing repairs that at-fault insurers would have incurred in the absence of separation, though we were not able to quantify the extent to which they did so.

6.72 Table 6.3 summarizes the resulting calculation. Full details of our calculations are set out in Appendix 6.6.

TABLE 6.3 **Total impact of separation on at-fault insurers' costs**

	<i>Replacement car</i>		<i>Repair</i>		<i>Write-off</i>		<i>Total cost increase</i>
	<i>£ per claim</i>	<i>No of claims ('000s)</i>	<i>£ per claim</i>	<i>No of claims ('000s)</i>	<i>£ per claim</i>	<i>No of claims ('000s)</i>	
Credit hire/repair	640	301	324	85	125	21	
Non-fault insurer handling			95	240	53	64	
Total cost increase (£m)		193		51		6	249

Source: CC.

Note: We assume that frictional and transactional costs incurred by at-fault insurers offset the management costs saved (see paragraph 6.71 (d) and Appendix 6.6, paragraphs 15 and 16) with the result that our overall estimated cost increase is likely to be an underestimate. Also, since frictional and transactional are greatest for replacement cars and management costs are greatest for repairs and write-offs (see Appendix 6.6, paragraph 15), our estimated cost increase for replacement cars is very likely to be an underestimate while our estimated cost increase for repairs and write-offs may be an overestimate.

6.73 On this basis, we estimated the total increase in subrogated costs at £249 million.

We believe that this will be reflected broadly pro rata in higher premiums to consumers (see paragraph 6.53). Hence we estimate an adverse effect on consumers of about £250 million.

Higher revenue and lower premiums

6.74 Similarly, we estimated the revenue stream to non-fault insurers and brokers to be £104 million (see Table 6.4).⁴³ We believe that this will be reflected in lower

⁴³ In calculating the impact on non-fault insurers' profits, it is necessary to deduct from the revenue the costs that non-fault insurers incur in managing repairs and write-offs.

premiums to consumers, though there is more uncertainty than in regard to over-costing and our central estimate is of a somewhat less than pro rata effect (see paragraph 6.59). Hence we estimate an offsetting consumer benefit of somewhat less than £104 million.

TABLE 6.4 Total impact of separation on non-fault insurers' profits

	Replacement car		Credit repair (and write-off)		Repair		Write-off		Total (£m)
	£ per claim	No of claims (‘000s)	£ per claim	No of claims (‘000s)	£ per claim	No of claims (‘000s)	£ per claim	No of claims (‘000s)	
Revenue to insurers	339	184	53	50	95	240	53	64	91
Revenue to brokers	308	117	53	57					39
Total revenues (£m)		98		6	23		3		130
Management costs (£m)*									27
Total profits (£m)									104

Source: CC.

*Estimated costs incurred by non-fault insurers in managing repairs and write-offs.

Quality of service differences

6.75 As a preliminary point, we noted that our estimates of the extra cost of credit hire and for non-fault insurer repair (see paragraph 6.70(a) and (b)) were not affected by any differences between the class of vehicle for captured and non-captured replacement cars or between the quality of service on captured and non-fault insurer repairs.⁴⁴

6.76 As noted above, we considered carefully service differences associated with separation and considered that the differences were currently small. We set out in this subsection our assessment of how these affect our estimation of the effect of separation on consumers.

6.77 As discussed in paragraph 6.67, some (but not all) CMCs/CHCs provide a replacement car when liability is disputed or uncertain (which an at-fault insurer is unlikely to

⁴⁴ Our estimates of the extra cost of credit hire over direct hire are based on a comparison of daily hire rates for specific cars and thus control for differences in quality of replacement car. Our estimates of the extra cost of non-fault insurer repair are based on non-fault insurers' mark-up and are not affected by any difference in quality between non-captured and captured claims. Our estimates of the extra cost of credit repair over non-fault insurer repair are based on the difference in average bill and would be affected by any quality difference between credit repair and non-fault insurer repair, but we noted there did not appear to be evidence of such a quality difference—see Table 6.2.

do), and hence it is likely that some non-fault claimants obtain a benefit from a higher quality of service than in the absence of separation.⁴⁵ However, we sought to estimate the effects of separation compared to a benchmark where consumers' legal entitlements were met in an efficient way (see paragraph 6.3), and we noted our figures only took into account the additional cost of credit hire compared to direct hire, broadly the additional cost over the benchmark. We noted too that, while there would be a benefit to non-fault claimants of better service in regard to replacement cars, there would also be an associated cost to the at-fault insurer. We noted that when given the option (ie when buying a motor insurance policy), relatively few consumers chose to pay extra for a like-for-like replacement car.⁴⁶ This could suggest that the value to most consumers of a like-for-like replacement car (rather than a courtesy car) was fairly low and possibly below the cost of provision to the insurer. However, we recognized that it was difficult to draw inferences for consumers' preferences in a non-fault situation where they have an entitlement under tort law, from their choices when purchasing motor insurance (which was mainly relevant to at-fault claims).⁴⁷

6.78 We were concerned to ensure that we took into account any benefits to consumers associated with our estimated costs of separation. We noted that some CMCs/CHCs provided additional services (see paragraph 6.36 and Appendix 6.5). We also noted that another consequence of some CMCs/CHCs providing a replacement car when liability was disputed or uncertain was that the cost of credit hire might include the costs of providing replacement cars to claimants not ultimately judged to be in a non-

⁴⁵ Since some CHCs provide a replacement car when liability has not been agreed, it is likely that some claimants receive a like-for-like replacement car (subject to need) rather than the replacement car they would have received under the terms of their own policy if a CHC had not been involved (a courtesy car, or possibly no replacement car at all)—see paragraph 6.67.

⁴⁶ Only one out of ten insurers in our sample (DLG) offered an add-on at extra cost with benefits similar to a like-for-like replacement car and this offer was only taken up by about [§] per cent of its policyholders. Two other insurers ([§] and CISGIL) offered 'enhanced courtesy car' cover at extra cost that gave policyholders a better car than a basic courtesy car but not necessarily a like-for-like replacement. About [§] and [§] per cent respectively of these insurers' policyholders took up the offer of enhanced courtesy car cover. The other seven insurers did not offer enhanced courtesy car cover, though all offered a courtesy car either as standard (five insurers) or as an add-on at extra cost (two insurers). See Appendix 8.1, Table 1.

⁴⁷ Consumers' own policies also cover claims where liability cannot be determined and non-fault claims where tort rights cannot be enforced, for example because the at-fault driver is untraceable or uninsured.

fault position; and that such claimants would derive a benefit from the provision of a replacement car which they would not otherwise receive.⁴⁸ However, we noted that the number of such claimants appeared to be small⁴⁹ and that consequently the total benefits received were also likely to be small.

6.79 We noted, however, that there was another difference associated with separation that went in the opposite direction. This was that some insurers required non-fault claimants to pay their excess towards the repair cost and recover it themselves from at-fault insurers (see paragraph 6.34).

6.80 In summary, we considered that our cost figures controlled for most quality and service differences. We noted that some of the service differences we identified may involve a claimant receiving their legal entitlement, or help in pursuing their legal entitlements, where this might not be available in an alternative scenario with no separation. We considered, however, the service differences identified above to be small and not such as materially to qualify our findings in relation to the net effect of separation discussed below.

6.81 As already noted, we accepted that the existence of CMCs and CHCs (which only occurred when there was separation) was likely to give the at-fault insurer the incentive to provide a good quality of service to non-fault claimants, and this is discussed further in our conclusion below.

Net effect on consumers

6.82 We therefore estimated the net effect on consumers due to changes in premiums to be about £150 million (higher premiums associated with higher costs to at-fault

⁴⁸ Claimants not ultimately judged to be in a non-fault position derive a benefit that is associated with a cost that in the first instance falls on the CHC/CMC and that may be expected to be reflected in the cost of credit hire. It is not associated with a cost to the at-fault insurer and hence the argument of the previous paragraph does not apply.

⁴⁹ See Appendix 6.1, paragraphs 51–53.

insurers of £249 million less lower premiums associated with the net revenue stream to non-fault insurers of somewhat less than £104 million). Given that we had controlled for the effect of most quality differences in deriving this estimate (see previous paragraph), we interpreted it as an estimate of the inefficiencies associated with separation. We noted that the bulk of the net effect was attributable to the extra cost of credit hire over direct hire for replacement cars.⁵⁰ We noted too that the main reason for the inefficiencies of separation were the excess transactional and frictional costs associated with credit hire, although other factors such as CMCs/CHCs' lack of negotiating power might also play a role (see paragraph 6.16).

6.83 We recognized that there were a number of uncertainties associated with our calculation. As a check, we considered an alternative estimate using available figures for credit hire and credit repair revenue. Our figures above (see paragraph 6.17) suggest that the excess cost of credit hire over direct hire less average referral fee paid is £300 per hire or 21 to 27 per cent of the average credit hire charge of £1,100 to £1,400. Given our approach to transactional, frictional and management costs (see paragraph 6.70(d)) and estimated credit hire revenue in 2011 of £663 million,⁵¹ this implies consumer detriment from credit hire of £140–£180 million.⁵² A similar approach for credit repair suggests a further consumer detriment of about £35 million,⁵³ implying a total consumer detriment of about £200 million. These figures also suggest that the bulk of the additional costs are attributable to replacement cars rather than repairs.

⁵⁰ The net extra cost of credit over direct hire is £95 million (£193 million cost from Table 6.3 less £98 million revenue from Table 6.4), while the net extra cost of repair and write off is £25 million (total of £57 million cost from Table 6.3 less total of £32 million revenue from Table 6.4). Moreover, the bulk of fault insurers' transactional/frictional costs, which we assume equal to at least the management costs saved due to separation, is attributable to replacement cars rather than repairs and write-offs, see paragraph 6.71(d) and note to Table 6.3, while a smaller proportion of non-fault insurers' costs of managing claims (which increase the net effect by £27 million—see Table 6.4) are likely to be attributable to replacement cars than to repairs and write-offs.

⁵¹ Source: CHO.

⁵² 21 to 27 per cent of £663 million.

⁵³ This is based on an average excess cost of credit repair net of average referral fee of £270 (see paragraphs 6.20 and 6.22), an average credit repair charge of £1,576 and total credit repair revenue of £200 million per year (see paragraph 8 of our working paper on '[Overcosting and overprovision of repairs](#)', published 29 July 2013).

6.84 Taking both calculations into account, we estimated that the net effect on premiums was about £150–£200 million. Since the estimated GWP across the motor insurance industry is about £11 billion across about 25 million policies, the net effect we have estimated corresponds to 1.3 to 1.8 per cent of the average premium, or about £6 to £8 per motor insurance policy.⁵⁴

6.85 As noted in paragraph 6.65, not all drivers are affected in the same way by separation. Premium increases are higher for drivers with a higher probability of being at fault, while premium increases for less risky drivers will be smaller and premiums may even be lower for the least risky drivers.

Effects on competition

6.86 We have provisionally found that in the majority of claims (around two-thirds), cost liability is separate from cost control in the handling of non-fault claims.⁵⁵ This separation arises because the at-fault insurer is liable for the costs of meeting the claim but another party (typically non-fault insurer, CHC or CMC) handles the claim, or aspects of it, and controls the costs. As a result of separation, the party handling the claim has the opportunity to earn a rent on the non-fault claim (by charging the at-fault insurer more than the cost incurred). The amount of this rent is limited by the reasonable costs that can be recovered from the at-fault insurer under tort law (and in practice for many claims the limits set for replacement car costs by the GTA).

6.87 We have provisionally found a number of direct and indirect effects associated with this opportunity to earn a rent:

(a) Claims handling and car hire intermediaries charge at-fault insurers more than the cost incurred, leading to disputes with at-fault insurers and a high level of

⁵⁴We discuss effects on consumer surplus in Appendix 6.7, finding that these effects are likely to be extremely small.

⁵⁵About 30 per cent of non-fault claims are handled by the at-fault insurer (captured claims) and in 6 per cent of claims the non-fault and at-fault insurer were the same.

frictional and transactional costs. Claims handling and car hire intermediaries in turn compete to obtain work via referral fees and this provides non-fault insurers, brokers (and others) with an opportunity to earn a rent.

(b) Some, but not all, non-fault insurers directly charge at-fault insurers more than the cost of repairs incurred (though the practice of one insurer is currently subject to litigation in the appeal courts).

(c) When cars are written off, at-fault insurers may not receive the full salvage value of the car.

6.88 Associated with these effects, we have provisionally found that an inefficient supply chain, involving excessive frictional and transactional costs, has emerged. Insurers and brokers are competing to find ways of earning a rent from their control of non-fault claims, rather than simply 'competing on the merits' (ie offering the lowest price and best quality of claims handling and other service to customers). Furthermore, since the greatest effect is on drivers with the most adverse risk factors, prices to individual drivers are not fully reflective of expected costs (see paragraph 6.65). These are not aspects that would be observed in a well-functioning motor insurance market.

6.89 We noted that these effects were currently greatest in the provision of replacement cars which is usually via credit hire when there is separation (see paragraph 6.82). The effects are currently smaller in repairs and write-offs where different non-fault insurers have different practices; and frictional and transactional costs are currently lower. We noted, however, the ongoing litigation over repair costs and that, depending on the results of this litigation, frictional and transactional costs in repairs could increase.

6.90 We considered the implications of separation for services. We did identify some service differences but found them to be small, and not such as to materially qualify our findings. We considered that it may be appropriate to take into account some of the service differences as part of our consideration of remedies. CHCs/CMCs said that an at-fault insurer's incentive was to minimize its costs—an at-fault insurer did not have any incentive to provide non-fault claimants with a quality replacement car or indeed with a replacement car at all. They suggested therefore that, in the absence of credit hire, non-fault claimants would receive a lower quality of replacement car than they did now, for example a basic courtesy car or no replacement car at all. Our concern is not with the existence of credit hire or credit repair as such but with the inefficient supply chain, involving excessive frictional and transactional costs, and other effects associated with separation. It is these effects that represent a departure from a well-functioning market. We recognize that the current existence of alternative providers as a result of separation is likely to provide at-fault insurers with an incentive to provide a good quality of service and consider that this can be appropriately taken into account in our assessment of remedies.

Provisional conclusion

6.91 We have provisionally found that separation results in an inefficient supply chain, with excessive frictional and transactional costs, for meeting non-fault claims. Insurers and brokers are competing to find ways of earning a rent from their control of non-fault claims, rather than simply competing 'on the merits' (ie offering the lowest price and best quality of claims handling and other service to customers). Furthermore, since the greatest effect is on drivers with the most adverse risk factors, prices to individual drivers are not fully reflective of expected costs. These are not aspects that would be observed in a well-functioning motor insurance market. We consider that these effects represent a distortion of competition in the supply of motor insurance.

6.92 These effects result in higher motor insurance premiums to the detriment of customers. This is because insurers pass on to customers their higher costs from at-fault claims, and while insurers and brokers also pass on their revenue stream from non-fault claims in lower premiums, the latter effect is considerably smaller than the former due principally to frictional and transactional costs.⁵⁶ We estimated the net detriment to customers to be about £150–£200 million. The effects are currently greater for replacement cars and smaller for repairs and write-offs, but depending on the results of litigation, the customer detriment for repairs and write-offs could increase.

6.93 We have identified the following two features of the supply of motor insurance and related services⁵⁷ which have, in combination, an adverse effect on competition:

- (a) Separation—that is, that the insurer liable for the non-fault driver's claim, ie the insurer to the at-fault driver is often not the party controlling the costs; and
- (b) Various practices and conduct of the other parties managing such non-fault drivers' claims which (i) were focused on earning a rent from control of claims rather than competing on the merits; and (ii) gave rise to an inefficient supply chain involving excessive frictional and transactional costs.

We provisionally conclude that these features distorted competition in the motor insurance market.

⁵⁶ Pass-through of the revenue stream may also be slightly less than that of the costs (see paragraph 6.56).

⁵⁷ The provision of claims services to non-fault drivers is related to the supply of motor insurance in a number of ways. It is the insurer to the at-fault driver who ultimately bears the costs of providing these services. Further, the party managing the provision of these services is often the insurer to the non-fault driver or a third party the non-fault driver is referred to by their own insurer or broker.

7. Possible underprovision of service to those involved in accidents (theory of harm 2)

Introduction

7.1 In this section, we consider whether the quality of service provided to those involved in accidents (claimants) is below the legal standard and whether this has detrimental effects on competition and consumers. In the case of non-fault claimants, the legal standard¹ is defined by tort law, and in the case of at-fault claimants it is defined by their insurance contract.

7.2 In this section we are concerned with the quality of service provided to claimants rather than any differences associated with which type of organization managed the claim. We have considered differences between the quality of non-fault claims managed by at-fault insurers (captured claims) and the quality of other non-fault claims above in Section 6. We did not find evidence of service differences with respect to write-offs. We found that those differences were relatively small in relation to replacement cars (see paragraphs 6.29 and 6.30). Insurers told us that repairs were handled in the same way irrespective of whether or not the claim was captured (see Appendix 7.3), and evidence from our survey did not show significant differences depending on who handled the claim (see paragraphs 6.31 to 6.33). Therefore in this section we focus on quality of service across all non-fault claimants.² We also consider as far as possible quality of service received by at-fault claimants.

7.3 We discuss first the reasons why quality of service provided to claimants may be lower than the legal standard. Next, we consider the evidence on quality of service

¹ If a non-fault driver claims under their own policy, including, for instance, because determination of liability is delayed, the service provided to them will be governed by their policy. In relation to core elements of the quality of a repair, we would not expect any difference between the contractual and tort law entitlement, eg relating to the safety of the repaired vehicle. However, if the non-fault driver's own insurer is satisfied that its policyholder was not at fault, the insurer might seek to offer the non-fault driver a level of service matching the entitlement under tort law. For example, in relation to replacement cars, non-fault insurers may refer non-fault drivers to CHCs that will provide a vehicle on credit as per the tort law entitlement.

² We recognized that if quality of service was below the level to which claimants were entitled, we would need to consider whether this was due entirely to quality of service for captured claimants falling below the level to which they were entitled, or whether it was also the case for other claimants.

achieved (ie whether it is lower than the legal standard). Finally, we consider the effects on consumers and the implications for competition.

Reasons why quality of service provided to claimants may be too low

7.4 We investigated if harm might arise from the beneficiary of post-accident services (the claimant) being different from, and possibly less well informed than, the procurer of those services (the insurer, CMC or other organization managing the claim).

7.5 There are two elements to this theory of harm:

(a) Claimants are not sufficiently well informed to judge whether they receive the quality of service to which they are entitled, for instance because they are not aware of their legal/contractual rights or because they are not able to assess quality.

(b) Insurers and other claims managers procuring repair, replacement cars and write-offs do not themselves have the necessary incentive to ensure that claimants get the quality of service to which they are entitled, for instance because reputational effects are weak.

7.6 We consider each of these in more detail in paragraphs 7.7 to 7.16. In the remainder of this section we refer to insurers rather than to 'procurers' or 'insurers and other claims managers' as most claims are managed by insurers. Unless otherwise stated, our analysis and assessment applies to other claims managers such as CMCs, as well as to insurers.

Claimants' awareness of their rights

7.7 Our survey of non-fault claimants suggested that claimants tended not to be fully aware of their legal rights under tort law.

7.8 When told that ‘legally, as the non fault party to an accident your legal right was to be restored to your pre accident position and while your vehicle was being repaired or replaced to have a like-for-like replacement vehicle subject to you having a need for such a vehicle’, 28 per cent of respondents who could remember said that they were made aware of all these rights. However, 10 per cent of such respondents answered that they were made aware of some of these rights and 62 per cent said they were not made aware of any of these rights.³

7.9 Non-fault claimants were aware that they were entitled to have their car repaired and 76 per cent were aware that they were entitled to a replacement car while their car was unavailable.⁴ However, beyond this, understanding was more limited:

(a) Non-fault claimants are legally entitled to have the car repaired at a garage of their choice,⁵ but only 33 per cent of all respondents said that they thought this was the case (though it was higher (61 per cent) when an organization other than an insurer handled the claim).⁶ 45 per cent said that they thought they were entitled to have the car repaired at a garage of the insurer’s choice and 20 per cent said they did not know their entitlement.

(b) 76 per cent of respondents said that they were entitled to have a replacement vehicle while their car was unavailable, but only 49 per cent of respondents knew that they were entitled to a replacement car that met their needs but was not better than their own car. 14 per cent of respondents⁷ thought they were entitled to a replacement which was the same make and model as their own vehicle damaged in the accident (this in certain circumstances may exceed the legal entitlement, which depends on the non-fault claimant’s need). 13 per cent thought

³ Figures in this paragraph are expressed as percentage of respondents, excluding 13 per cent who responded ‘Don’t know’ or ‘Can’t remember’. See [survey report](#) (question D30).

⁴ The figures in this paragraph are expressed as a percentage of all respondents. See [survey report](#) (questions D28 and D29).

⁵ In practice, claimants often delegate the management of the repairs to a third party (non-fault insurer, at-fault insurer or intermediary) who then select the body shop on behalf of the claimant.

⁶ 36 per cent of respondents whose claim was handled by the at-fault insurer and 29 per cent of respondents whose claim was handled by the non-fault insurer said that they were entitled to have the car repaired at a garage of their choice.

⁷ Excludes some respondents who also answered that they were entitled to a replacement vehicle that met their needs but was not better than their car.

the replacement vehicle could be any vehicle depending on what was available at the time or was a particular vehicle specified in their insurance policy. 24 per cent of respondents thought they were not entitled to a replacement vehicle at all.

7.10 The rights of at-fault claimants depend on their insurance contract. We do not have any specific information about at-fault claimants' awareness of their contractual entitlements.

7.11 Another aspect of the extent to which claimants are well informed is whether, during or after receiving the service, they are able to assess the quality of service they have received. If claimants are able to assess the quality of service, they can ask for any issues to be addressed, but if they are unable to assess, for instance, the quality of repair, they will be unable to get problems rectified. We note that this is principally an issue with regard to repair and that if consumers are unable generally to assess quality of repair, this would be an issue for all car repairs rather than an issue associated specifically with claims related to motor insurance.

Incentives and reputation effects

7.12 Generally, the short-term incentive of insurers and other organizations managing claims is to minimize their costs. We distinguished three main categories of situation:

(a) Claims managed by the insurer with cost liability. When this is the case, the

insurer has both the ability and incentive to minimize its costs. Claims in this category include at-fault claims, claims where liability cannot be established and non-fault claims managed by the at-fault insurer (ie claims it has captured or where it insures both non-fault and at-fault claimant).

(b) Non-fault claims managed by the non-fault insurer. When this is the case, the non-fault insurer does not have liability for the costs which are billed to the at-fault insurer. Even so, the non-fault insurer usually still has an incentive to minimize its

own costs. This is because the reasonable costs that can be billed to the at-fault insurer are not limited to the costs actually incurred and the difference between reasonable and actual costs (ie the non-fault insurer's profit) is greater, the lower are its actual costs (the same applies when a claim is managed by a CMC or other organization). Non-fault insurers sometimes bill the at-fault insurer for actual costs (net of all discounts, rebates and referral fees), for example when there is a bilateral agreement between non-fault and at-fault insurer.⁸ However, insurers told us that they managed repairs similarly irrespective of whether they were non-fault, captured or at-fault repairs (see Appendix 7.3), suggesting that cost control was important for all insurer-managed repairs.

(c) *Non-fault claims managed by CMCs.* The position here is similar to non-fault claims managed by non-fault insurers except that CMCs are not party to bilateral agreements requiring billing at actual rather than reasonable costs. Hence CMCs have the incentive to control their own costs.

7.13 If claimants are unaware of their rights and are unable to assess quality of repairs, it is easier for insurers to reduce quality below the legal standard. The short-term incentive to reduce quality may, however, be mitigated by reputation effects. Poor quality of service may eventually be revealed leading the insurer to acquire a reputation for poor service, making the insurer less attractive to customers in future and the provision of poor service less attractive to insurers.

7.14 We noted above (see paragraph 7.11) that claimants may be unable to assess the quality of repair, and that this could be an issue for all car repairs. However, reputation effects could operate here too. For example, if poor repairs are eventually revealed, repairers providing poor service would get a bad reputation and this would

⁸ There are two types of bilateral agreement: full bilateral agreements, which cover relatively few claims, and RIPE agreements, which are quite common.

reduce their short-term incentive to cut costs by underproviding service. We noted that, even if this applied when car repairs were purchased directly by drivers, it might not apply to insurer-managed claims if claimants were unaware that they had the legal right to choose their repairer or, in the case of at-fault claimants, if they had limited contractual rights to choose their repairer. This is because in such circumstances insurers would be likely to choose the repairer with cost minimization, rather than service quality, in mind.

- 7.15 We did not see evidence of systematic underprovision for replacement cars and write-offs (see Appendices 7.1 and 7.2 respectively). We therefore focused on repairs, which we discuss in the next subsection.

Quality of repairs

- 7.16 In this subsection, we consider evidence from consumers (including market research), insurers and repairers on whether claimants receive the services to which they are entitled.

Consumer perceptions of repair quality

- 7.17 Our survey found that four-fifths of vehicles involved in accidents leading to non-fault claims were repaired, with a fifth written off. Of respondents whose cars were repaired, 93 per cent said that all the damage was repaired and only 7 per cent were dissatisfied with the repair service (see Table 7.1). Overall, the majority (75 per cent) of respondents said that their vehicle was in the same condition after the repair as it was prior to the accident, with 13 per cent saying that it was in a better condition and 11 per cent saying that it was worse. Though a small proportion of respondents did not think all the damage had been repaired, we did not consider that these results in themselves suggested that insurers generally failed to provide non-fault claimants with the quality of service to which they were legally entitled.

7.18 When respondents were asked about the post-repair value of the vehicle, the majority (81 per cent) said that the vehicle was worth the same or more compared with before the accident, though 14 per cent of respondents thought that their vehicle was worth less. Non-fault claimants have a legal entitlement to be put into as good a position as they would have been if the accident had not occurred, which would imply a legal entitlement to compensation for any loss in value. However, the survey results did not indicate the extent of perceived loss of value or whether any diminution in value was due to repair quality or simply to a perception that being involved in an accident reduced a car's value. Hence it appeared difficult to draw conclusions from survey responses on cars' post-accident value.

TABLE 7.1 Non-fault claimants' experience of repairs

	<i>All claims %</i>
<i>How much damage was repaired</i>	
All of the damage was repaired	93
Most of the damage was repaired	5
Some of the damage was repaired	2
Base (weighted)	1,159
<i>Satisfaction with the repair</i>	
Very satisfied	61
Fairly satisfied	28
Neither satisfied or dissatisfied	4
Fairly dissatisfied	3
Very dissatisfied	4
Base (weighted)	1,159
<i>Condition of the vehicle after the repairs were made</i>	
In a lot better condition	5
In somewhat better condition	8
Same	75
Slightly worse	10
Much worse	1
Don't know	1
Base (weighted)	1,163
<i>Value of the vehicle after the repairs were made (compared with before the accident)</i>	
Vehicle was worth more	1
Vehicle was worth the same	80
Vehicle was worth less	14
Don't know	5
Base (weighted)	1,163

Source: CC PMI non-fault Survey, questions C11, C22, C24 and C26.

7.19 We also reviewed other evidence relating to consumers' experience of repairs:

- (a) A December 2012 survey by the General Insurance Market Research Association (GIMRA) showed that 94 per cent of customers felt that the repair to their vehicle put it back at least to its condition before the accident and 78 per cent of respondents said that they were extremely or very satisfied with the repair service they received overall (only 6 per cent of respondents were dissatisfied with the repair service overall).
- (b) The GIMRA survey also showed that fewer than 1 per cent of repairs resulted in a complaint about the quality of the repair. This was consistent with data from repairers and insurers themselves:
- (i) Four independent repairers provided data which showed that repair-related complaints arose in only 1 to 5 per cent of repair cases (and not all of these complaints were about the quality of repair).
 - (ii) Two insurer-owned repairers said that they received complaints about the quality of repair in about 1 to 2 per cent of repair cases.
 - (iii) Three insurers provided data which showed that they received customer complaints in 1 to 4 per cent of all the PMI claims they managed. Of these complaints, between 9 and 27 per cent related to repair quality, with the result that repair complaints arose in 0.25 to 0.7 per cent of all PMI claims (although we note that not all PMI claims involve repairs).
 - (iv) Three CMCs said that they received complaints in between 1 and 8 per cent of the repair cases they managed.

7.20 We noted that much of the evidence reflected consumers' perceptions and that consumers' perceptions may be affected by the information issues set out above (see paragraphs 7.7 to 7.11). For example, consumers might not be able to assess whether a repair to their vehicle had been adequately performed. To address this point, we commissioned technical inspections of a subsample of respondents' vehicles. The results of this exercise are discussed below (see paragraphs 7.29 to

7.39). A further possibility is that consumers' lack of knowledge about their legal entitlements and the burdensome nature of the complaint and litigation process may discourage drivers from complaining, in particular in respect of shortcomings that are subjectively perceived as minor.

Other evidence from insurers and repairers⁹

7.21 In these paragraphs we summarize other evidence gathered from a sample of insurers, brokers, CMCs and repairers in relation to potential difference in quality of repair service (we summarized complaints evidence from insurers and repairers in paragraph 7.19(b)).

7.22 Initial evidence from insurers, brokers, CMCs and repairers did not show clear-cut results. We noted that insurers (see Appendix 7, paragraphs 20 to 34) and CMCs (see paragraphs 37 to 39) required repairers to perform vehicle repairs to a certain quality standard, as follows:

- (a) Seven out of the ten largest insurers and four of the seven CMCs in our sample require their approved repairers to have PAS 125 accreditation or manufacturer approval. PAS 125 and manufacturer approvals are technical specifications which provide repairers with the requirements for processes and procedures related to the safe repair of accident-damaged vehicles.
- (b) Insurers and CMCs usually provide a guarantee for the repairs they manage, requiring the repairer to rectify any faults at its own expense. Warranties were typically for five years, though some insurers provided a warranty for three years and some provided a lifetime warranty (as long as the vehicle was not sold).
- (c) All of the ten largest insurers and five out of the seven CMCs from which we gathered evidence said that they monitored the performance of their approved

⁹ In this subsection (paragraphs 7.21 to 7.28), references to insurers are generally just to insurers and do not include CMCs (unlike most of the remainder of paragraphs 7.7 to 7.55—see paragraph 7.6).

repairers. Moreover, seven of the ten largest insurers told us that they performed repair quality audits, including physical checks of vehicle repairs performed by their approved repairers, without being prompted by customer complaints.

(d) Eight out of the ten large insurers told us that they monitored the level of customer complaints in order to identify systematic problems in repair quality.

7.23 Notwithstanding this evidence, we also received submissions from repairers suggesting that the repair quality of insurer-managed repairs was often poor and a similar submission in relation to CMCs (see Appendix 7.3 paragraph 45). These submissions suggested that insurers' incentives were to keep their costs as low as possible which could lead to 'corner cutting' in the repairs they approved.

7.24 Repairers told us that they would not compromise vehicle safety in any of their repairs, but nevertheless some told us about poor-quality repairs:

(a) One repairer said that there was corner cutting by repairers and that this was increasing, as insurers wanted cars repaired as cheaply as possible. It said that corner cutting included using lots of filler in a damaged part rather than replacing it, painting without taking off detachable parts (eg a door handle), not blending the paint on newly-fitted parts with the rest of the car (in particular on metallic cars and older cars where the colour had faded), and patching up rather than replacing parts (eg a broken headlamp). It said that some insurance repairs could compromise vehicle safety, but that the evidence on this was inconclusive. This repairer also said that at-fault insurers sometimes asked for cosmetic corners to be cut.

(b) Another repairer said that repairers could cut corners by using non-OEM parts and that this was particularly possible with credit repair companies, due to these work providers not checking repair quality.

(c) A third repairer said that insurers accepted repair proposals by repairers despite them failing to address properly all accident-related damage.

7.25 Some repairers also told us that the use of non-OEM parts could impact on the look and value of the repaired vehicle. For example:

(a) One repairer said that using non-OEM parts often made achieving a good fit very difficult, which could affect repair quality. This was because repairers were not given extra time by insurers to correct misshapen or badly moulded parts, which incentivized them to undertake 'rushed' work and potentially resulted in poor-quality repairs. For example, shut lines and fit lines could be affected, which impacted on the vehicle's appearance and could affect its value.

(b) Another repairer said that panels which fitted poorly could reduce a car's value by 5 per cent.

(c) A third repairer said that the use of non-OEM parts could impact the resale price of a repaired vehicle.

7.26 In its response to our annotated issues statement and working papers,¹⁰ the National Association of Bodyshops said that insurers' cost control measure could drive incorrect behaviour in the repair process, with certain business models currently being operated by some insurers having a capacity to drive entirely the wrong technical behaviour within the repair process; and that this would result in consumer detriment. It also said that insurers and claims management companies remunerated repairers by methods that emphasized cost-minimization over quality and which had serious potential for consumer detriment. NAB also said that the labour rate on credit hire repair work was generally higher, which meant that, even after paying a referral fee

¹⁰ www.competition-commission.org.uk/assets/competitioncommission/docs/2012/private-motor-insurance-market-investigation/131030_nab_response_to_working_papers.pdf.

to a CMC to gain the work, credit repairs were usually more profitable for repairers than insurer work.

7.27 All of the ten largest insurers, and most but not all of the CMCs from which we heard, told us that they monitored the performance of their approved repairers. We found that most (but not all) of the insurers carried out checks on a sample of vehicles at their repairers' premises (in addition to investigating specific customer complaints). We asked the insurers and some independent repairers what the insurers' repair quality checks involved. We found that these checks were typically part of repair audits, the main purpose of which was, in our view, to control costs rather than to ensure a high quality of vehicle repairs (see Appendix 7.3, paragraphs 30 to 32 and 43).¹¹ We also noted that insurers' quality checks tended to be concerned with whether repair was acceptable. It was unclear whether an acceptable repair was necessarily one meeting the claimants' entitlement.¹² Some submissions from repairers and CMCs also suggest that not all CMCs carry out quality control checks on repairers (see Appendix 7.3, paragraphs 38 and 45).

7.28 We noted the emphasis the insurers put on PAS 125 accreditation and manufacturer approvals. However, we also noted that these were focused on processes and procedures. We also noted the emphasis insurers put on warranties, and that their warranties required consumers to identify the problem and return their vehicles to repairers for rectification. We considered that consumers would not necessarily be sufficiently well informed to know when a car had not been repaired to its pre-accident condition or whether the repair had been adequately rectified. Consequently, we

¹¹ We made this point in our working paper on [underprovision of repairs](#) and received no specific comment on this point.

¹² The claimant is entitled to be put in the position he would have been in if the accident had not occurred. As such, they will be entitled to recover damages for diminution in value, represented by the difference between the pre-damage value and post-repair value of the vehicle. Thus if, despite the repairs, the market value of the vehicle is less than before, the claimant is entitled to claim such diminution in value of the car, in addition to the cost of repair.

considered that PAS 125 accreditation and manufacturer approvals and insurer warranties were unlikely in themselves to ensure a high quality of repair.

MSXI study

- 7.29 We stated in our working paper¹³ that at that time we had found no evidence of systematic underprovision of repairs, but that in order to investigate this issue further we had commissioned MSXI to perform audits of vehicles that had been repaired after an accident. The objective of MSXI's vehicle inspection study was to look into the quality of repairs to vehicles which had been involved in accidents by comparing the pre-accident condition with the post-accident condition of the parts of the vehicle which had been repaired; and to identify any parts damaged through the accident which had not been repaired.
- 7.30 The sample of vehicles to be inspected was derived from respondents to our non-fault consumer survey who had said they were prepared to have their vehicle inspected by a professional assessor. A database of contact details of these owners, together with repair estimate documentation, were provided to MSXI for review. MSXI prioritized inspections according to the type and scale of repairs undertaken and its ability to assess the repairs from documentation provided.
- 7.31 MSXI carried out inspections initially for respondents whose claim was handled by the other driver's insurer (Stage 1) and subsequently for respondents whose claim was handled by their own insurer (Stage 2). In Stage 1, MSXI had a database of 270 cars, made contact with 95 owners and completed 77 inspections. In Stage 2, MSXI had a database of 90 cars,¹⁴ made contact with 51 owners and completed 27 inspections. Insurers told us that they handled repairs in the same way irrespec-

¹³ [Underprovision of repairs.](#)

¹⁴ Acquiring repair estimates was more problematic for Stage 2 than Stage 1 and so the database was smaller.

tive of whether or not the claim was captured (see Appendix 7.3). We therefore considered that it was valid to look at the MSXI results across both Stage 1 and Stage 2 (101 cars).¹⁵

7.32 We noted that respondents' own assessment of the condition of these cars was somewhat worse than average for all cars in our non-fault survey—20 per cent of vehicles inspected by MSXI were considered by respondents to be in worse condition than before the accident, compared with 11 per cent for all respondents (see Table 7.1). We also noted that nearly half of the inspected vehicles had been previously returned to the repairer for rectification. In the light of these points and the composition of the sample (see previous two paragraphs), it would not be appropriate to take the MSXI inspections to be a representative sample of non-fault repairs as a whole.

7.33 The results of MSXI's inspections are summarized in Table 7.2.¹⁶ Nearly half (45 out of 101) of the vehicles inspected were not returned to their pre-accident condition. In only 12 of these 45 cases did the original survey response indicate that the respondent considered that the car's condition was worse than before the accident. Furthermore, many of the vehicles in the sample had already been returned to the repairer for rectification. Only 18 out of 101 vehicles were returned to the owner in pre-accident condition without any need for rectification¹⁷ while 38 vehicles were returned to the owner in pre-accident condition after the vehicles had been rectified.

7.34 Ten out of 101 vehicles were still not in pre-accident condition after rectification. The MSXI survey did not indicate the reasons but, in our view, the inconvenience of going

¹⁵ The total of 101 excludes three claimants who took cash in lieu of repair.

¹⁶ The MSXI report is at Appendix 7.4].

¹⁷ Rectification happens when, after the initial repair, the vehicle owner highlighted 'faults' on its vehicle and returned the vehicle to the repairer in order to have these remedied.

through the rectification process might discourage some drivers from returning their vehicle again to the repairer, in particular if the defects are perceived as minor.

TABLE 7.2 Results of MSXI study

		Number of vehicles inspected			
Was the vehicle returned in pre-accident condition at the time of inspection and had it previously been rectified?					
	All	Respondents considered condition better than prior to the accident*	Respondents considered condition same as prior to the accident	Respondents considered condition worse than prior to the accident†	
Not rectified and pre-accident condition	18				
Rectified and pre-accident condition	38				
Total pre-accident condition	56	11	37	8	
Not rectified and non-pre-accident condition	35				
Rectified and non-pre-accident condition	10				
Total non-pre-accident condition	45	4	29	12	
Base (unweighted)	101	15	66	20	
Number of pre-accident condition and non-pre-accident condition vehicles split by who made the final decision as to who would carry out the repairs and how the decision was taken					
	All	Choice made by you: repairer you knew of	Choice made by you: options provided by insurers	Choice made by insurers	Other*
Pre-accident condition	56	15	9	31	1
Non-pre-accident condition	45	4	5	35	1
Base (unweighted)	101	19	14	66	2

Source: MSXI study, CC PMI non-fault Survey, questions C6, C8 and C22.

*Either a lot better/worse or somewhat better/worse.

†Two claims where 'Who made the final decision?' was reported as being 'the repairer' and 'Don't know'.

7.35 The most common reasons why the vehicle was not returned in pre-accident condition were related to paint finish, panel misalignment and repair being clearly visible. Many vehicles had multiple issues. MSXI's inspectors did not consider that any of the defects could be seen as dangerous, but stated that all would have had a negative effect on car valuation. MSXI also stated that all of the defects could have been detected during an efficient quality control process, prior to the car being handed back to the customer.

7.36 Table 7.2 shows that the proportion of non-pre-accident-condition vehicles was lower when the repairer was chosen by the claimant rather than when the repairer was chosen by the insurer. We noted, however, that results from the consumer survey showed that respondents themselves indicated the opposite: ie that when they

themselves chose the repairer there were a higher proportion of vehicles where not all the damage was repaired and where the condition was slightly worse than before the accident (see Appendix 6.5, Tables 5 and 13). We considered that a possible explanation for these results was that respondents choosing the repairer themselves were more knowledgeable about car repairs and better able than other respondents to assess the condition of their cars.

7.37 The main comments made on the vehicle inspections working paper were (see Appendix 7.4):

- (a) The sample sizes were small.
- (b) The sample was non-random and not representative, eg as regards geographical spread and vehicle age.
- (c) There were differences between the results and respondents' own experience.
- (d) There were discrepancies between the results and the non-fault survey, and GIMRA survey.
- (e) MSXI's inspections were subjective and there was no tolerance in determining whether a repair was or was not of acceptable quality.

7.38 In regard to the first two points, we accept that the sample is small and not representative (see paragraph 7.33). In regard to points (c) and (d), we agree that the results of the MSXI vehicle inspections are not the same as suggested by evidence based on consumers' perceptions of quality and by insurers' own assessments, but since consumers are unable to assess accurately the quality of repairs we need to pay careful attention to the MSXI vehicle inspections.

7.39 In regard to point (e), we do not agree that there is excessive subjectivity in the findings of the inspections—the unavoidable fact that assessments are opinion-based does not in itself bias the results (since in principle it can lead to false positives as

well as false negatives). Nor do we accept that inspection failures arose because of incorrect tolerances—MSXI’s inspectors stated that all the defects they found would have had a negative effect on car valuation. MSXI told us that its inspectors would only classify cars as not in pre-accident condition if the deficiencies were non-trivial or outside what it regarded as industry-accepted tolerances (taking into account where relevant the age of the cars concerned).¹⁸ We noted that the response of some insurers appeared to suggest that a repair could be acceptable even if the car was not returned to its pre-accident condition.

- 7.40 Overall, our summary of the inspection results is that they suggest that a considerable number of cars are not being restored to pre-accident condition and in that respect non-fault claimants are not receiving the quality of service to which they are entitled. The results need to be interpreted with care as the achieved sample was small (101) and is unlikely to be representative of the general population of non-fault claims. Even allowing for this, for example if we assume that the actual prevalence of cars not repaired to pre-accident condition is about half of the MSXI proportion in line with or below our survey respondents’ self-assessment,¹⁹ the implication is that there could be a considerable number of non-fault claimants who are not receiving the quality of service to which they are entitled.

Conclusion on quality of repairs

- 7.41 In our working paper on underprovision of repairs, published in August 2013,²⁰ we said that it appeared to us unlikely that customers were systematically put at a dis-

¹⁸ MSXI said that a deficiency was noted if it was part of the repair, or on the estimate and not carried out and MSXI considered that it should/could have been.

¹⁹ 45 per cent of cars inspected by MSXI were not in pre-accident condition. Survey respondents whose cars were inspected by MSXI were 1.8 times (20/11) as likely as all respondents to say that their car was in worse condition than before the accident (see paragraph 7.29). If we assume that the actual prevalence of cars not being in pre-accident condition is 1.8 times less than the prevalence in the MSXI sample similar to survey respondents’ self-assessment, the adjusted MSXI proportion would be 25 per cent. If we assume that the actual prevalence of cars not being in pre-accident condition is about half of the MSXI prevalence, ie below the level implied by survey respondents’ self-assessment, the adjusted MSXI proportion would be 22 per cent.

²⁰ www.competition-commission.org.uk/assets/competitioncommission/docs/2012/private-motor-insurance-market-investigation/toh_2_underprovision_of_repairs.pdf.

advantage by insurers or CMCs procuring repair services on their behalf. This reflected evidence from insurers and CMCs and consumer survey evidence.

However, in our working paper we also noted:

- (a) submissions from repairers and others suggesting that the repair quality of insurer-managed repairs was often poor; and that excessive pressure on costs could lead to ‘corner cutting’;
- (b) that the main purpose of repair audits appeared to be to control costs rather than to ensure high-quality repair standards, with a number of repairers having suggested that there was limited monitoring of actual repair quality; and
- (c) that evidence from consumers needed to be interpreted in light of the point that many consumers might not be able to assess whether a repair to their vehicle had been adequately performed.

7.42 Summing up, we said that we had to date found no evidence of systematic under-provision of repairs, but that in order to investigate this issue further we had commissioned an independent assessment of repair quality by experts (the MSXI study). We now have the MSXI results, suggesting that a considerable number of cars are not restored to pre-accident condition. Though the MSXI results need to be regarded with caution for the reasons set out above (see paragraph 7.39), we consider that they give support to the submissions from repairers and others that claimants experience detriment from cars not having been repaired to the legal standard.

7.43 In reaching our provisional view, we have considered all the evidence, including that set out in our working paper, responses to the working paper and the MSXI study.

Our overall assessment is as follows:

- (a) Evidence from insurers suggests that they carry out repair audits (which in most, but not all, cases cover quality), require PAS accreditation and offer warranties;

for the reasons set out in paragraphs 7.28 and 7.29, these do not in themselves ensure that repairs are carried out to the legal standard.

- (b) Evidence from repairers suggests that excessive pressure on costs could be leading to 'corner cutting' on repairs, with some examples of poor-quality repair.
- (c) Evidence from consumers themselves suggests that the great majority of non-fault claim vehicles are repaired to their pre-accident condition, but many consumers might not be able to assess accurately the quality of repairs. This is supported by the level of disparity in MSXI findings between MSXI's assessment and consumers' own assessment of the quality of repairs.
- (d) Independent assessment by MSXI experts has indicated that the proportion not repaired to pre-accident condition is considerably higher than suggested by consumers themselves.

7.44 We believe that more weight should be attached to the evidence from experts (ie from repairers and from the results of the vehicle inspections) than to evidence from consumers since consumers might not be able to assess accurately the quality of repairs. Consequently, our provisional view is that non-fault claimants too often receive a quality of service below the legal standard.

7.45 Some of the evidence we have reviewed (in particular, our consumer survey and the MSXI study) relates only to non-fault claims. However, other evidence (that from repairers) relates both to at-fault and non-fault claims. Insurers told us that their approach to repairs was similar irrespective of whether the claim was an at-fault or non-fault claim (and if non-fault, whether captured or not), and we saw no evidence to contradict this. In the light of this and that at-fault claimants have a contractual entitlement for their cars to be restored to pre-accident condition similar to non-fault

claimants' legal entitlement (subject to payment of an excess), we have no reason to treat them differently²¹.

7.46 We also considered whether our provisional view that non-fault claimants receive a quality of service below the legal standard applied to CMCs as well as insurers. MSXI findings did not provide us with direct evidence about the differences and similarities between repairs managed by CMCs and those managed by insurers. We noted that there was some evidence that repairers obtained better prices for CMC work (see Appendix 7.3, paragraph 14). However, we considered that CMCs' incentives were similar to those of insurers (ie to focus on cost rather than quality—see paragraph 7.12), and we also noted some evidence of credit repair companies not checking repair quality (see Appendix 7.3, paragraph 43(c)). Consequently we would not expect CMC-managed repairs to be of higher quality than insurer-managed claims. On balance, therefore, we considered that the position for CMCs was likely to be similar to that for insurers.

Effects of low repair quality on consumers

7.47 It is useful to distinguish between claimants according to whether or not they realize that their car has not been repaired to pre-accident condition.

7.48 About three-quarters²² of the claimants whose cars were inspected by MSXI did not themselves consider that their car's condition was worse than before the accident (see Table 7.2). As these claimants appear to have been unaware of the poor repair quality, it seems unlikely that they experience detriment in the short term. However,

²¹ In relation to core elements of the quality of a repair, we would not expect any difference between the contractual and tort law entitlement, eg relating to the safety of the repaired vehicle. We recognize that there may be scope for difference between a non-fault driver's entitlement under tort law and an at-fault driver's entitlement under contract because of certain restrictions in the insurance contract (eg provisions relating to the type of parts which can be used). However, (a) the contractual entitlement of an individual claimant will be determined by the specific provisions of their contract and (b) the assessment of what the tort law entitlement requires in a given case will be informed by the specific facts of that case.

²² This proportion is subject to considerable uncertainty because, due to small sample size, there were only 45 cars found by MSXI not to be in pre-accident condition.

MSXI inspectors considered that the poor quality of repair would reduce the value of the cars (although were not able to quantify the extent of the reduction in value). This suggests that, as a result of not receiving the quality of repair to which they were entitled, some claimants would receive a lower value for their cars when they sold them.

- 7.49 There are also some claimants who are aware that their car has not been repaired to the pre-accident condition (based on the results of the MSXI inspections around one-quarter of respondents with cars not in pre-accident condition correctly said that their car was in worse condition than prior to the accident).²³ These claimants would be likely to experience some detriment immediately as they would be aware that their cars were in poorer condition. As with the first group, they would also potentially experience detriment when they sold the car. Also, some claimants (nearly half of our sample) had to return their vehicle to the body shop for rectification, which might have involved some detriment.
- 7.50 We noted above (see paragraph 7.24) that we had received submissions suggesting that pressure from insurers to reduce costs had led to corner cutting and that this might be associated with poor quality of repairs. In assessing the effects of poor repair quality on claimants, we need to take into account also any cost savings to insurers. As discussed in Section 6, we expect lower claims costs to be passed through into lower premiums. Consequently, if poor repair quality is the result of cost savings by insurers and CMCs, there are two effects on consumers working in opposite directions: first, a detriment to claimants associated with their not receiving the quality of service to which they are entitled; and second a benefit to all motor insurance buyers from lower premiums.

²³ See previous footnote.

7.51 We were not able to quantify either of these effects. We noted the following points:

- (a) The size of the detriment to claimants would depend on the proportion whose cars were not repaired to pre-accident condition; the proportion of these who were aware that they were not repaired to pre-accident condition and the extent of the detriment experienced by these claimants as a result of the poor repair; and the extent of the loss in value at the time their cars were sold experienced by all claimants whose cars were not repaired to pre-accident condition.
- (b) The size of the benefit to all motor insurance buyers would depend on how much insurance companies are able to save compared with a benchmark situation where repairs were carried out sufficiently well that cars were restored to their pre-accident condition. We noted that MSXI said that the defects could have been detected during an efficient quality control process—hence the costs might be those of implementing an efficient quality control process over and above insurers' existing processes.

Effects of low repair quality on competition

7.52 We considered that there were two reasons why the quality of repair received by claimants may be below the legal standard. The first is that insurers lack the incentive to ensure high repair quality due to claimants not being well informed about their legal rights and to weak reputational effects. The second reason is that claimants themselves have limited ability to assess whether their cars have been repaired to the legal standard.

7.53 Our provisional view is that a considerable number of cars are not restored to their pre-accident condition, as is claimants' legal right, and we saw evidence that insurers' monitoring of repair was concerned with cost rather than quality. Our provisional view is that insurers and CMCs are not monitoring effectively the quality of repairs with the result that repairs tend to be inadequate.

7.54 The evidence also suggests that a substantial proportion of non-fault claimants are not aware of all their legal rights, for example to choose their own repairer. This is significant because, when claimants do choose their own repairer, some evidence suggests that repair quality appears to be higher. Although insurers are not obliged to manage a repair when a claimant chooses the repairer, and claimants may be reluctant themselves to pay for repairs and subrogate the bill to the at-fault insurer, better information would still be of value since claimants would be in a better position to negotiate with insurers on an appropriate repairer (insurers are likely to prefer to manage the repair themselves enabling them to negotiate terms with the repairer). Our view is therefore that non-fault claimants' lack of information reflects at least in part a failure by insurers to inform them of their legal rights.

7.55 As a consequence, we consider that competition is affected adversely in the following ways:

- (a) Competition between repairers to obtain business from insurers is focused towards low cost and against high quality of repair; that is, repairers are insufficiently rewarded for offering a high quality of repair. In a well-functioning market, repairers would be sufficiently incentivized to provide claimants with repairs up to the legal standard.
- (b) Insurers do not themselves have the necessary incentive to ensure that claimants get the quality of service on repair to which they are entitled, for instance because reputational effects are weak.

Provisional conclusion

7.56 We have identified the following features of the supply of motor insurance and related services²⁴ which we provisionally conclude have, in combination, an adverse effect on competition:

- (a) Insurers and CMCs do not monitor effectively the quality of repairs; and
- (b) There are significant limitations to claimants' ability to assess the quality of car repairs.

We provisionally conclude that these features distort competition between repairers to obtain business from insurers and other managers of drivers' claims.

²⁴ The procurement of repair services by parties managing claims on behalf of drivers is related to the supply of motor insurance in a number of ways. It is an insurer who ultimately bears the costs of providing these services—either the driver's own insurer or the insurer of the at-fault driver involved in the accident. Further, the party managing the provision of these services is typically the insurer of the claimant or the insurer of the at-fault driver who has 'captured' their claim or a third party the claimant is referred to by their own insurer or broker.

8. The sale of add-on products (theory of harm 4)

Introduction

- 8.1 Motor insurers offer their customers a range of additional products known as add-ons. They provide cover for various risks over and above the core risks covered by a basic motor insurance policy and are usually sold on top of the basic motor insurance policy for an additional premium. In some cases, the basic motor insurance policies offered by some motor insurers include some of these types of cover, with no additional premium being paid. Examples of motor insurance add-ons are motor legal expenses insurance (MLEI), windscreen cover, breakdown cover, personal injury cover, courtesy car cover, key loss cover, extended foreign use cover and NCB protection.
- 8.2 Our guidelines state that to ensure effective competition, consumers need to be both willing and able to: access information about the various offers available in the market; assess these offers to identify the good or service that provides the best value for them; and act on this assessment by switching to purchasing the good or service from their preferred supplier.¹ Information asymmetries between suppliers and consumers might have adverse effects on competition, particularly in markets for goods or services where consumers are not able to gauge the quality of a good or service when acquiring it.²
- 8.3 In this section, we analyse the transparency and complexity of various add-ons sold by motor insurers and the possible point-of-sale advantages held by motor insurers when selling these add-ons. Further to our guidelines, consumer harm may arise when add-on products are complex and/or when it is difficult for consumers to know what is included or excluded in the cover, in particular if the information available to

¹ CC3, [paragraph 296](#).

² CC3, [paragraph 311](#).

consumers at the point of sale does not enable consumers to understand the product, estimate its value or make comparisons between the products offered by different motor insurers.

8.4 We first provide some background to the sale of add-ons by motor insurers and then consider the ongoing work of the FCA, in particular its recent study into MLEI and its ongoing study into add-ons across general insurance.

8.5 We then assess the two issues identified under ToH 4:

- (a) the transparency and complexity of information provided to consumers by motor insurers at the point of sale of add-ons; and
- (b) the possible point-of-sale advantages for motor insurers when selling add-ons.

8.6 Finally, we consider the outcomes of the sale of add-ons, including their profitability and their perceived value to consumers.

Background

8.7 We note that motor insurers provide add-ons in two different ways depending on which party bears the risk:

- (a) Some add-ons are designed, underwritten, supplied and managed by the motor insurer, eg NCB protection and extended foreign use cover. In these cases, the risk is borne by the motor insurer.
- (b) Some add-ons are designed, underwritten and managed by a third party provider but supplied by the motor insurer, either under its name or under the name of the third party provider, eg breakdown cover. In these cases, the risk is borne by the third party provider and the motor insurer acts as a distributor. The retail price consists of the unit cost (controlled by the third party), the margin (controlled by the motor insurer) and insurance premium tax (payable on the retail cost). As this

is risk-free income for the motor insurer, it is usually recognized as fee income.

The third party supplier is responsible for all claims handling in relation to these products.

- 8.8 Table 8.1 summarizes the most common add-ons offered by the ten motor insurers in our sample.

TABLE 8.1 Summary of most common add-ons offered by motor insurers

	<i>MLEI</i>	<i>Windscreen cover</i>	<i>Breakdown cover</i>	<i>Courtesy car cover</i>	<i>Enhanced courtesy car cover*</i>	<i>Personal injury cover</i>	<i>NCB protection</i>	<i>Extended foreign use cover</i>	<i>Key loss cover</i>
<i>Typical price (£)†</i>	<i>15–40</i>	<i>Typically included in basic policy</i>	<i>25–70</i>	<i>15–25</i>	<i>Not comparable on PCWs</i>	<i>15–27</i>	<i>Driver specific</i>	<i>Not comparable on PCWs</i>	<i>Not comparable on PCWs</i>
Admiral	Included in basic policy	Included in basic policy	Yes (via third party)	Included in basic policy	No‡	Yes	Yes	No§	Yes
Ageas	Yes (via third party)	Included in basic policy	Yes (via third party)	Included in basic policy	No	Included in basic policy	Yes¶	No§	Included in basic policy
Aviva (Aviva Direct)	Yes	Included in basic policy	Yes	Yes	Yes#	Yes	Yes	Yes	Included in basic policy
AXA (AXA Direct)	Yes	Yes	Yes (via third party)	Included in basic policy	No~	Included in basic policy★	Yes	No§	Yes
CISGIL	Yes	Included in basic policy	Yes (via third party)	Included in basic policy♦	Yes	No	Yes¶	Yes^	Included in basic policy
DLG	Yes	Included in basic policy	Yes	Yes*	Yes^	Included in basic policy	Yes■	No	No
esure	Yes	Included in basic policy	Yes (via third party)	Included in basic policy	No	Yes	Yes¶	No§	Yes
LV	Yes	Included in basic policy	Yes	Yes	No	Yes	Yes	Yes	Included in basic policy
RSA	Yes	Yes◇	Yes	Yes◇	No□	Included in basic policy	Yes	Yes	Included in basic policy
Zurich	Included in basic policy	Included in basic policy	Yes (via third party)	Included in basic policy	No	Yes	Yes	No§	Yes

Source: Motor insurers.

*By enhanced courtesy car cover, we refer to an add-on that provides the consumer with a like-for-like replacement car or a replacement car of a superior quality than the standard, Class A courtesy car typically provided under courtesy car cover.

†The typical price for each add-on is based on prices returned from random motor insurance searches on the four largest PCWs.

‡Admiral does not provide enhanced courtesy car cover. However, it does offer its customers a hire car add-on, which provides a hire car if the customer's car is either a total loss or stolen.

§Although these motor insurers do not explicitly offer extended foreign use cover as an add-on, they may provide cover (at a cost) if requested by their customers. Ageas Insurance provides free European Union cover for 90 days in its basic motor insurance policy. Extension to the 90 days or request for cover outside of the EU may or may not be granted but would attract an additional charge if granted.

¶These motor insurers do not treat NCB protection as a standard add-on, because it can only be purchased if certain criteria are met (ie not all consumers are eligible).

#Aviva provides its customers who have purchased the enhanced courtesy car add-on with a replacement car of a superior quality to a standard courtesy car (but not a like-for-like replacement car).

~AXA does not offer its customers an enhanced courtesy car add-on that provides a replacement car of a superior quality to a standard courtesy car. However, it does offer an add-on to extend the maximum duration for which a courtesy car is provided.

★AXA previously offered Driver Injury Cover under its AXA Direct policy, but this was recently withdrawn. AXA offers Personal Accident Cover, which is included within the basic comprehensive motor insurance policies. In addition, AXA provides the option of Personal Accident Plus as an add-on. This applies to both Swiftcover and AXA Direct brands.

♦A courtesy car is only provided if the customer uses an approved repairer.

^Extended foreign use cover is available as an add-on for the Co-operative Car Insurance product only.

*DLG introduced a new courtesy car policy on 8 September 2013 and now offers courtesy car cover as standard through its Privilege and Churchill brands. Provided the car is being repaired at one of DLG's approved repairers, a small hatchback will be provided for the duration of the repairs. Customers with Guaranteed Hire Car (GHC) or Guaranteed Hire Car Plus (GHC+) are not entitled to a courtesy car benefit. There are a very small number of DLG legacy policies which also provide a courtesy car under the basic motor insurance policy.

△ DLG offers GHC and GHC+ as optional add-ons, which enables customers to purchase hire car provision. However, DLG considers the GHC and GHC+ add-ons as distinct from the provision of a courtesy car, because customers opting for GHC or GHC+ are entitled to a hire car even if they use a non-DLG approved repairer and the length of hire is guaranteed for up to 14 consecutive days for GHC and 21 consecutive days for GHC+.

■ DLG does not treat NCB protection as a standard add-on, but as a variation to the pricing on the basic motor insurance policy.

◇ RSA includes windscreen cover and courtesy car cover in the basic More Than motor insurance policy, but they are sold separately (and required to be purchased as add-ons) from the basic eChoice motor insurance policy.

□ RSA does not provide enhanced courtesy car cover. However, it does offer a courtesy car upgrade add-on on More Than policies, which covers courtesy car provision for up to 14 days where the customer does not use a recommended repairer or their vehicle has been lost or stolen.

Note: 'Yes' denotes that the add-on is sold separately from the basic motor insurance policy; 'No' denotes that the add-on is not included and not sold separately from the basic motor insurance policy (ie the add-on is not offered by that particular motor insurer); and 'Included in basic policy' denotes that these add-ons are included in the basic policy and cannot be removed.

8.9 Table 8.1 shows that some insurers include additional cover under the basic motor insurance policy (eg windscreen cover) rather than offering them for an additional premium. This additional cover cannot be removed from the basic motor insurance policy and therefore we do not deem those products to be add-on for the purposes of the analysis. The insurers do not all offer the same add-ons. For example, some add-ons, such as enhanced courtesy car cover and extended foreign use cover, are not included under the basic motor insurance policy and not sold as an add-on by some motor insurers. Of the add-ons listed in Table 8.1, we are only aware of breakdown cover that can be purchased separately from motor insurance, ie as a stand-alone product (for example, from the RAC, the AA and Green Flag). Some add-ons can also be purchased with other types of insurance (eg personal injury).

8.10 Table 8.2 shows a summary of the results of our customer survey in relation to the purchase of the most common add-ons.

TABLE 8.2 Customer survey results in relation to the purchase of most common add-ons

Add-on	Take-up*	<i>per cent</i>	
		Percentage who compared motor insurers†	Good value for money
MLEI	76	52	53
Windscreen cover	85	52	69
Breakdown cover	39	52	64
Personal injury cover	56	47	51
Courtesy car cover	70	53	54
Key loss cover	24	32	35
Extended foreign use cover	30	26	38
NCB protection	80‡	62	69

Source: CC data from our customer survey of motor insurance policyholders. We note that some respondents might have purchased certain add-ons as part of their basic cover and not separately for an additional premium.

*The number of policyholders covered by a specific add-on, regardless of whether the add-on was bought separately (with an additional premium) or included within the basic motor insurance policy.

†We note that the customer survey results did not make clear the extent of the comparisons made by the respondents.

‡80 per cent of customer survey respondents said that they had NCB protection; however, evidence from motor insurers shows that the actual take-up of NCB protection is much lower. This suggests some misunderstanding of the difference between NCB and NCB protection. Moreover, our customer survey found that only around 30 per cent of those who claimed to have NCB protection correctly answered the question designed to test consumers' understanding of this product.

8.11 Our customer survey found that most motor insurance policyholders are covered by one or more add-on.³ Table 8.2 shows that windscreen cover was the most popular add-on, which appears to be at least in part because it is included in many basic motor insurance policies. Our customer survey found that the majority of motor insurance policyholders preferred to be able to choose which add-ons to purchase, rather than having the relevant cover included in their basic motor insurance policy.⁴

8.12 Table 8.3 shows the aggregate net earned premiums (NEP)⁵ for basic cover and each add-on product on a stand-alone basis for a five-year period for seven motor insurers ([X], [X], [X], [X], [X], [X] and [X]).

TABLE 8.3 Analysis of NEP by type of risk

	£ million					2012 share to total NEP %
	2008	2009	2010	2011	2012	
Basic cover	5,302.7	5,285.6	5,558.9	5,699.5	5,176.7	91.6
Breakdown	172.3	188.0	186.0	175.4	161.1	2.8
NCB protection	129.0	117.7	122.6	154.2	152.0	2.7
MLEI	70.6	84.6	87.5	104.2	109.4	1.9
Windscreen	20.7	20.3	25.0	28.3	21.9	0.4
Personal injury	-	0.0	0.2	0.3	0.2	0.0
Courtesy car	15.4*	40.7	44.1	39.5	36.5	0.6
Other	2.5	2.6	2.7	2.6	2.0	0.0
Total	5,713.0	5,739.5	6,024.3	6,204.1	5,659.8	100.0

Source: CC analysis.

*The 2008 NEP for the courtesy car add-on does not include [X] which could not provide a figure for this year.

8.13 Table 8.3 shows that basic cover and add-ons accounted for 92 per cent and 8 per cent of total NEP in 2012 respectively. Breakdown cover and NCB protection accounted for 2.8 and 2.7 per cent respectively, and no other add-on accounted for more than 2 per cent. Based on NEP across the whole private motor insurance

³ Our survey found that the modal number of add-ons taken up by respondents was five.

⁴ Our survey asked respondents whether they preferred to have add-ons offered to them separately, so that they could be added, or whether they preferred to have them already included in the basic motor insurance policy. Most respondents, 53 per cent, said that they had either a slight or strong preference for add-ons to be offered separately, while 32 per cent said that they preferred them to be included in the basic motor insurance policy.

⁵ NEP is GWP, net of Insurance Premium Tax (IPT) and premiums ceded to reinsurers and any changes in provisions for unearned premiums.

market of £7.9 billion in 2012,⁶ this suggests that add-ons are worth around £630 million a year.

Financial Conduct Authority's study

- 8.14 The FCA regulates the financial services industry in the UK. Its aim is to protect consumers, ensure that the industry remains stable and promote healthy competition between financial services providers. It has rule-making, investigative and enforcement powers that it uses to protect and regulate the financial services industry.
- 8.15 In June 2013, the FCA published its report into MLEI.⁷
- 8.16 In July 2013, the FCA confirmed that it was undertaking a market study into the sale of general insurance add-ons, focusing on whether there was effective competition for add-on products.
- 8.17 In this section, we first consider the FCA's review of MLEI and then its ongoing market study into general insurance add-ons.

MLEI

- 8.18 The main conclusions of the FCA's report into MLEI were that:
- (a) MLEI is a product which can be useful in enabling policyholders to pursue legal rights to recover uninsured losses;
 - (b) consumers have little understanding of what the product does and the benefits it provides; and
 - (c) the opt-out⁸ selling of MLEI is not consistent with good consumer protection (despite MLEI being the add-on most commonly sold with motor insurance on an opt-out basis).

⁶ Datamonitor: UK Private Motor Insurance: Market Dynamics and Opportunities.

⁷ See www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research.

- 8.19 The report recommended that firms should:
- (a) provide consumers with better explanations of MLEI; and
 - (b) review the basis on which MLEI is provided, especially where this is on an opt-out basis.
- 8.20 The report said that the FCA would look again at the supply of MLEI after one year and firms which had not amended their business practices in line with best practice by that time were likely to face regulatory action.

General insurance

- 8.21 The FCA is currently investigating the potential sources of consumer detriment in the sale of general insurance add-ons.

- 8.22 [X]⁹

Transparency and complexity of information provided to consumers

- 8.23 In this section, we consider:
- (a) the descriptions of add-ons (sold separately from the basic motor insurance policy) by motor insurers at the point of sale;
 - (b) what our customer survey evidence suggests on consumers' understanding of a selection of add-ons; and
 - (c) the transparency of the NCB offered to consumers.

⁸ Opt-out selling means the product is pre-selected by the provider rather than actively selected by the consumer and therefore the consumer is required to opt out from purchasing the product.

⁹ The FCA's experiments demonstrated that the way in which add-on insurance is presented to consumers can have very large effects on important outcomes, such as take-up of add-ons; the extent to which consumers are prepared to compare add-ons; and the price they pay.

Descriptions of add-ons provided by motor insurers at the point of sale

- 8.24 We reviewed the descriptions of add-ons provided on their websites by the ten motor insurers in our sample, in order to assess the quality and quantity of information made available to consumers at the point of sale (see Appendix 8.1).
- 8.25 We did not perform a separate analysis of the descriptions of add-ons provided to consumers who purchase motor insurance on the telephone, because the sales guides or scripts used by calls handlers provide a similar level of information to that provided on the motor insurers' websites.
- 8.26 We focused on those add-ons that appear complex and difficult for consumers to understand and evaluate: personal injury cover; NCB protection; extended foreign use cover; key loss cover; and courtesy car cover. We also considered enhanced courtesy car cover, given the importance of replacement car provision to our analysis in Section 6. We did not analyse windscreen cover, because it is typically included in the basic motor insurance policy offered by the ten motor insurers in our sample, nor breakdown cover, because there are many stand-alone products available for this type of cover.
- 8.27 When analysing the descriptions of add-ons provided by the ten motor insurers in our sample, we assessed whether the insurers provide sufficient information to allow consumers to make an informed decision as to the suitability of the add-on for their needs and whether the information is in plain English (ie it avoids unnecessarily complex language or terminology).
- 8.28 We note that the descriptions of add-ons are typically accessed via help or information buttons or links on the main landing page of the motor insurer's website. The descriptions typically summarize the key elements of the cover and the level of costs

covered by the product. There is also usually a link to a more detailed description and/or a summary of cover and/or policy wording if the consumer requires further information, but we have focused our analysis on the initial description provided on the motor insurer's main landing page, we consider this to be the information that consumers are likely to access or compare (to the extent that they do so) at the time of making a purchase decision.

8.29 We found that the descriptions of add-ons provided by the ten motor insurers in our sample on their websites avoid the use of complex language or terminology and, on the whole, provide a comprehensible, high-level overview of the key features of each add-on. However, there is considerable variation in the level of detail provided to consumers by the ten motor insurers in our sample. This suggests that it is particularly difficult to strike an appropriate balance between providing the relevant information to the consumer and ensuring the information is understandable and not unnecessarily complex due to the complexity of the add-ons sold by the motor insurers. Even taking this into account, our view is that, overall, the current level of detail provided to consumers appears to be insufficient. In general, the depth and detail of the information provided to consumers appears insufficient to allow them to make an informed decision as to the suitability of the add-on for their needs. Although the consumer may have recourse to the policy wording or summary of cover for further information (easily accessible on the motor insurer's website), these documents provide a great deal of information not always presented in lay terms.

8.30 Our assessment of the descriptions provided by the ten motor insurers in our sample (and the descriptions themselves) are set out in Appendix 8.1, but we set out below some examples to illustrate the deficiencies in the descriptions:

(a) Aviva describes NCB protection as protection 'from up to 2 "at-fault" claims in a 3 year period. If any of your named drivers has had one "at-fault" claim in the last

2 years you can still protect your NCD, but it will only be protected against 1 at-fault claim in a 3 year period.' This description does not make clear that although the add-on protects the driver's NCB, it is not an absolute protection of his/her current premium (which can be affected by at-fault and non-fault claims even if a driver's NCB is maintained); nor does it make clear that there is a difference between an NCB and NCB protection (although NCB is explained separately within the policy wording).

(b) LV describes courtesy car cover as follows:

for a small additional fee you can be covered for a courtesy car.

We'll pay for the courtesy car while your car is being repaired by our selected repairer service, or for up to 14 days if your car is damaged beyond economical repair, can't be driven or has been stolen and not recovered. We'll insure the courtesy car; you'll just have to pay for the fuel.

This description does not make it clear exactly which passengers are covered by the product. We note that there is some variation in the coverage of this add-on. Some personal injury products provide cover for the customer and their partner only, whereas other personal injury products also provide cover for named drivers and/or passengers.

(c) Zurich describes personal injury cover as follows: 'This cover provides up to £30,000 for you or your passengers in the event of death, loss of limbs, sight or hearing following an accident in your car or while getting into or out of it. Our Personal Accident Cover is provided by Ultimate Insurance Company Limited.' This description does not make it clear whether all passengers are covered by the product.¹⁰ We note that there is some variation in the coverage of this add-on. Some personal injury cover products provide cover for the customer and their

¹⁰ For example, in some cases only the spouse is covered as a passenger.

partner only, whereas other personal injury products also provide cover for named drivers and/or passengers.

8.31 The variation in the descriptions of add-ons provided by motor insurers is illustrated by comparing the descriptions of enhanced courtesy car cover provided by CISGIL and DLG. CISGIL describes the products as follows:

Could you manage without your car if it was written off or stolen?

Our motor policy will provide you with a standard courtesy car but only whilst yours is being repaired by one of our appointed repairers.

However if your car has been written off or stolen and not recovered then you could be left without a car.

Would our standard courtesy car meet your needs?

Our standard courtesy car is generally a small Class A vehicle, for example a Nissan Micra or Ford Ka and only provided whilst your vehicle is being repaired by one of our appointed repairers.

If your answer is “No” to one or both of the questions above, then our Enhanced Courtesy Car Cover may be for you.

Enhanced Courtesy Car cover ... would provide you with:

A saloon or hatchback vehicle of similar engine size to your own up to a maximum of 1,800cc (Van drivers can get a van up to a maximum of 3.5 tonne GVW).

For 14 consecutive days cover in the event that your vehicle is stolen and not recovered, unfit to drive as a result of a road traffic accident or written off.

You and up to 2 named drivers on your policy can drive the vehicle, provided you all hold full licences.

A vehicle that is fully insured, subject to a policy excess.

Possibility to extend the period beyond the 14 days. Whilst you will be responsible for paying the hire charges for the period in excess of 14 days, preferential rates are available to The Co-operative Insurance customers. (Minimum extension period is 7 days)

Please be aware:

The Enhanced Courtesy Car will be delivered to you with at least £15 worth of fuel, which will be payable by yourself upon return of the vehicle.

If your vehicle is a 4x4, MPV, Electric or a motor caravan, the Enhanced Courtesy Car provided will be a saloon or hatchback motor car of similar engine size to your own vehicle up to a maximum of 1,800cc.

The Enhanced Courtesy Car will not be provided in the event of your vehicle still being roadworthy following a road traffic accident.

If your vehicle has been adapted to accommodate a disabled driver or passenger, we cannot guarantee being able to provide a suitable replacement.

Buying Enhanced Courtesy Car Cover

You can add our Enhanced Courtesy Car optional extra (which is managed on our behalf by Albany Assistance Limited) when taking out your Co-operative car insurance online for £17.50 extra per year. When you have received your online car insurance quote simply select "Add" next to Enhanced Courtesy Car, then click on the recalculate button to view the updated price.

In contrast, DLG describes enhanced courtesy car cover as follows:

For a small extra premium, we'll supply a hire car for up to 21 days if your car is unusable or in for repair following a claim (excluding windscreen damage). This applies even if your car is stolen and not

recovered or written off as a total loss. Guaranteed Hire Car Plus can only be added to your policy if you have Comprehensive cover.

Our customer survey evidence

8.32 Our customer survey of motor insurance policyholders sought first to ascertain the take-up of different add-ons and then to assess the policyholders' understanding of a selection of add-ons. The approach for this assessment was first to ask consumers about their perceived level of understanding and then to ask one or more factual questions about the add-on to test their understanding.¹¹

8.33 The results of our customer survey showed that there was a limited understanding of the selected add-ons. For example:

(a) In relation to personal injury cover, only 17 per cent of respondents answered correctly that passengers, other than themselves and their spouse, were not covered by the add-on.¹² Only 5 per cent answered all three customer survey questions correctly.

(b) In relation to NCB protection, a high proportion of respondents (77 per cent) thought that they had a good understanding of this add-on. 59 per cent of those who claimed to understand it well wrongly thought that NCB protection would prevent their motor insurance premium going up as a result of a claim. 29 per cent of respondents who said that they had the add-on answered this question correctly. Our assessment of the descriptions of NCB protection provided by motor insurers on their websites revealed that none of the motor insurers explain

¹¹ The response rate to our survey was 5 per cent, giving rise to some concern about the potential for response bias in the results. We have no particular evidence of response bias, but we note that there was a slightly higher response rate among older policyholders. As only 5 per cent of the policyholders contacted were both available and willing to respond to the telephone interview, they are therefore unusual in this respect, which causes us to question the extent to which their survey answers can be considered to be representative of all motor insurance policyholders. The survey results have all been weighted to correct for oversampling in Wales, Scotland and Northern Ireland.

¹² We note that there is some variation in the coverage of this add-on. Some motor insurers provide personal injury cover for the driver, whereas other motor insurers provide cover for the driver, their partner and any named drivers. Although a few motor insurers might provide cover with a slightly different scope, we believe the market shares of such providers are insufficient to materially affect our results. See table 11 paragraph 79 appendix 8.1 (note to table)

that the effect of an accident typically increases the consumer's risk premium, irrespective of fault and regardless of their level of NCB.

(c) In relation to key loss cover, 67 per cent of respondents with key loss cover said that they had a good understanding of it. However, only 9 per cent correctly answered both the customer survey questions which tested their understanding of the add-on.¹³ Specifically, only 14 per cent correctly answered that it is the responsibility of the claimant (and not their motor insurer) to appoint a locksmith to resolve the problem. Our assessment of the descriptions of key loss cover provided by motor insurers on their websites revealed that none of the motor insurers explained this.

8.34 We note that any limitations in the understanding of a selected add-on may in part reflect the length of time elapsed since the respondent initially researched into and purchased that add-on. Therefore, the evidence above may not accurately represent consumers' understanding of the add-ons at the point of purchase. However, when matching the descriptions on the motor insurers' websites with the findings of the customer survey, we found that this tended to corroborate some of the customer survey findings.

Transparency of NCB scale

8.35 We considered further whether NCB scales are made transparent to consumers when purchasing NCB protection. NCB protection seemed to have potentially more severe informational asymmetries than the other add-ons we examined because the cover is in effect an option to protect future premiums. When purchasing NCB protection, a consumer is likely to want to understand the value of the protection in terms of the NCB they retain in future years as a result of purchasing NCB protection (ie the

¹³ The respondents were asked the following two questions: 'Will this (cover) pay for replacement keys and locks to your car if you lose your keys?' and 'Will someone appointed by the insurance company come out to you and fix the problem if you lose your keys?'

percentage discount earned by their existing NCB and the effect on this percentage discount of making a claim). Unless the impact on their premium of making a claim is clear, the consumer will be unable to assess the value of their NCB and, therefore, whether it is worthwhile to protect that discount by purchasing NCB protection.

- 8.36 We found that only one motor insurer (CISGIL) provides an NCB scale on its website. Six of the ten motor insurers in our sample (Admiral, Aviva, DLG,¹⁴ [X],¹⁵ RSA and Zurich) told us that the NCB scale was not available on their website and was not provided to staff for the purposes of explaining to consumers on the telephone. The remaining three motor insurers (Ageas, AXA and LV) told us that they did not display the NCB scales on their website but they did provide details of the current scale and the 'step-back' rules when requested.
- 8.37 The failure of the motor insurers in our sample (with the exception of CISGIL) to provide consumers with their NCB scale suggests a lack of transparency in relation to the sale of NCB protection. As set out above, it is difficult for consumers accurately to assess the value of NCB protection if they cannot understand the level of discount earned through their NCB and how this would decline in the event of a claim. The lack of transparency in relation to the sale of NCB protection is further compounded by the fact that the level of discount offered by the various motor insurers differs due to their use of different NCB scales.
- 8.38 Although the motor insurers' concerns regarding the accuracy of any such scale, given the complexities of the calculation required to produce a meaningful and current scale, appear plausible, the provision of some form of NCB scale with suit-

¹⁴ DLG told us that it did not publish the scale of NCB for number of claim-free years on either its website or over the phone for any of its brands.

¹⁵ [X] told us that the NCB scale was [X] and was therefore not available on its website and was not provided to its staff for the purposes of explaining to consumers on the telephone.

able explanation and appropriate caveats would assist consumers in making a more informed decision as to their need for NCB protection.

Possible point-of-sale advantages for motor insurers

8.39 In this section, we consider how add-ons are sold by examining:

- (a) the experience of comparing add-ons on a PCW; and
- (b) the experience of purchasing add-ons on a motor insurer's website following click-through from a PCW or by going direct to the motor insurer's website

Comparing add-ons on a PCW

8.40 Both the basic motor insurance policy and selected add-ons are not purchased on a PCW. The selection of the basic motor insurance policy and a review of some of the more commonly purchased add-ons (eg breakdown cover, courtesy car cover, MLEI, personal injury cover and windscreen cover) can be performed on a PCW. However, the purchase of the basic motor insurance policy and the selection and purchase of add-ons is completed on the motor insurer's website when a consumer clicks through from a PCW.¹⁶ The four largest PCWs (Comparethemarket.com, Confused.com, Gocompare.com and Moneysupermarket.com) told us that they were not incentivized to sell add-ons, as their fee was based upon the sale of the basic motor insurance policy only.

8.41 To the extent that consumers are unable to compare add-ons on PCWs, motor insurers have a point-of-sale advantage at the point when the consumer clicks through to the motor insurer's website to purchase their chosen add-ons.¹⁷ We therefore considered the extent to which add-ons can be compared on PCWs.

¹⁶ Some add-ons are included as standard in the quote returned by the PCW.

¹⁷ We have assumed at this stage that brokers do not have a similar point-of-sale advantage, as they are able to compare add-ons on behalf of their customers.

8.42 A PCW typically displays the most common add-ons that are available from a selected motor insurance provider, whether each add-on is included under the motor insurer's basic motor insurance policy or can be purchased separately and, if so, a representative or indicative price for each add-on.¹⁸ For example:

(a) Comparethemarket.com displays the following add-ons on its price page:

windscreen cover, courtesy car, breakdown cover and motor legal protection.

Each add-on is represented with a tick (if included under the basic motor insurance policy), an indicative price (if it is not included under the basic policy but can be purchased separately) or a cross (if it is not included under the basic policy and cannot be purchased separately).

(b) Confused.com displays the following add-ons on its price page: legal cover, courtesy car, breakdown cover and windscreen cover. As for Comparethemarket.com, each add-on is represented with a tick, an indicative price or a cross.

(c) Gocompare.com displays the following add-ons on its price page: legal assistance, courtesy car, windscreen cover, personal accident and breakdown cover. Each add-on is represented with a tick, a cross or a cross if it can be purchased separately with an indicative price if the cursor is held over the cross.

(d) Moneysupermarket.com displays the following add-ons on its price page: windscreen cover, courtesy car, breakdown cover, personal accident and legal cover. Again, each add-on is represented with a tick, an indicative price, or a cross.

8.43 In addition, the four largest PCWs (Comparethemarket.com, Confused.com, Gocompare.com and Moneysupermarket.com) allow the consumer to modify the quotes returned to include/exclude the price of NCB protection (ie the cost of the basic motor insurance policy with or without NCB protection is updated automatically).

¹⁸ A representative or indicative price provides the customer with an estimate of the likely price of an add-on (eg from £25) specific to that motor insurer, but not to an individual consumer's own risk profile. However, the actual price is only confirmed upon click-through from the PCW to the motor insurer's website.

8.44 The evidence above shows that on the four largest PCWs, consumers can compare whether the most common add-ons, with the exception of key loss cover and extended foreign use cover (which amounted to less than 0.1 per cent of total NEP generated in 2012), are included in the basic motor insurance policy and if not, whether or not they can be added to the basic motor insurance policy for an additional premium. However, the PCWs only provide a generic description and a representative price for each add-on (not the specific cover provided by each motor insurer and the actual price that is returned upon click-through to the motor insurer's website, which would allow them to understand the differences in the extent of cover offered by different motor insurers providing the same type of add-on). Further, the quotes returned by a PCW are ranked based on the price of the basic motor insurance policy, excluding the price for the selection of add-ons displayed by the PCW. This suggests that it is difficult for consumers to compare the combined price of basic motor insurance policies and add-ons across different motor insurers.

Purchasing add-ons on an insurer's website

8.45 We have considered what choices a consumer is given upon click-through from a PCW to a motor insurer's website or when they go to a motor insurer's website directly. [§<]

8.46 We found that the motor insurers in our sample have responded to the FCA's investigation into MLEI such that, with the exception of RSA's eChoice brand,¹⁹ add-ons are no longer automatically included in the price of the basic motor insurance policy and therefore consumers are no longer required to 'opt out' from purchasing them (where those add-ons are optional and not sold as an integral part of the basic motor insurance policy).

¹⁹ All eChoice add-ons are opt-in with the exception of courtesy cars and windscreen cover which are included in the initial price displayed on the PCW listing page. We note, however, that these are more typically included in the basic motor insurance policy. eChoice is therefore unusual in offering these as optional add-ons. MLEI cover has always been sold as an add-on to eChoice core cover on an opt-in basis.

8.47 Gocompare.com told us that upon click-through to a motor insurer's website add-ons could be added to the price and it was working closely with the providers to make sure that those were clear on click-through and that it was easy for the consumer to select or deselect the relevant add-ons.

8.48 Our customer survey of motor insurance policyholders found that most policyholders who said they had compared add-ons offered by different motor insurers believed that add-ons were easy to compare across motor insurers, in particular for windscreen cover and NCB protection (73 and 65 per cent of respondents respectively said that the comparison of windscreen cover and NCB protection was easy). However, the customer survey results also showed that, with the exception of NCB protection, almost half of respondents did not make any such comparison across motor insurers (see Table 8.2).

Outcomes of the sale of add-ons

Profitability of add-ons

8.49 Tables 8.1 and 8.3 respectively showed that add-ons tend to be relatively low-priced products compared with basic premiums (for example, MLEI is priced typically between £15 and £40 and courtesy car cover between £15 and £25) and that add-on premiums accounted for only 8 per cent of total premiums in 2012.

8.50 Table 8.4 shows a summary of our analysis of the profitability of certain add-ons. Further details of our analysis are in Appendix 8.1.

TABLE 8.4 Profitability of add-ons, 2012

	<i>Unweighted average claims ratio</i>
Basic cover	82
MLEI	7
Windscreen cover	84
Breakdown cover	38
Personal injury cover	5
Courtesy car cover	51
Key loss cover	25
Extended foreign use cover	29
NCB protection	Not available*

Source: CC calculations based on responses from the motor insurers in our sample.

*It has not been possible to assess the profitability of NCB protection because there is no clear cost of a 'claim' against this add-on.

8.51 Table 8.4 shows that, with the exception of windscreen cover, the unweighted average claims ratios were below that for basic motor insurance cover, some considerably below (MLEI and personal injury cover), suggesting that motor insurers generate greater profits from the sale of add-ons than from the sale of basic motor insurance policies.

8.52 The motor insurers in our sample told us that because the price of an add-on was much lower than the price of a basic motor insurance policy, the expense ratio of an add-on (eg the costs of selling the policy and administering claims, expressed as a proportion of the premium) was likely to be higher than for a basic motor insurance policy, meaning that the profitability of an add-on overall (taking into account both the cost of claims and the cost of expenses) might not be dissimilar to the profitability of a basic motor insurance policy. However, given that some of the claims ratios in Table 8.4 were extremely low (notably MLEI, personal injury cover, key loss cover and extended foreign use cover), we considered that this was unlikely to explain fully the difference we had observed.

Perceived value of add-ons

8.53 Our customer survey found that the majority of policyholders perceived most add-ons to be good value for money (see Table 8.2). Respondents to our customer survey perceived key loss cover and extended foreign use cover to be less good value than other add-ons and these products had the lowest take-up rates.

8.54 The motor insurers in our sample told us that because the cost of an add-on was low (relative to the cost of a basic motor insurance policy):

(a) some consumers might be willing to pay the price of the add-on to have 'peace of mind', in particular where the potential loss being covered could be very large; and

(b) some consumers might not consider it worthwhile comparing add-ons, in order to achieve, at most, a small saving and so they might be willing to pay a slightly higher price for the add-on.

Provisional conclusion

8.55 We have found that:

(a) Our review of the descriptions of add-ons provided by motor insurers on their websites suggests that the level of information provided to consumers varies significantly. Further, it appears that, overall, insufficient information is provided to consumers at the point of sale.

(b) The results of our customer survey suggest that consumers do not understand fully the cover which is provided by some add-ons. This lack of understanding would seem to be partly explained by the limitations of the descriptions of these add-ons provided by motor insurers.

(c) With the exception of CISGIL, the motor insurers in our sample do not provide consumers with an NCB scale at the point of sale of NCB protection. Further, our customer survey results showed that 59 per cent of those respondents who

claimed to understand NCB protection well wrongly thought that it would prevent their motor insurance premium going up as a result of a claim. We note that it is not made explicit by any of the ten motor insurers in our sample that NCB protection protects the driver's NCB but is not an absolute protection of his/her current premium (which can be affected by at-fault and non-fault claims even if a driver's NCB is maintained), and that there is a difference between an NCB and NCB protection.

- (d) The results of our customer survey suggest that most policyholders found that add-ons were easy to compare across motor insurers, although it appears that, with the exception of NCB protection, almost half of respondents did not make any such comparison.
- (e) PCWs allow consumers to compare whether the most common add-ons are included in a basic motor insurance policy or can be purchased on top of the basic policy for an additional premium, but the information provided when making comparisons is only a generic description of the add-on and a representative price of each add-on. Further, consumers are unable on PCWs to compare the total price of their preferred motor insurance policy if they choose to supplement a basic motor insurance policy with one or more add-ons.
- (f) The premiums that motor insurers earn in relation to the sale of add-ons account for less than 10 per cent of total premiums, in part due to add-ons being relatively low-priced products compared with basic premiums. However, motor insurers generate lower claims ratios (and hence greater profits) from the sale of add-ons than from the sale of basic motor insurance policies and in some cases claims ratios are extremely low.

8.56 Based on the evidence above, we have provisionally found that:

- (a) Insurers have a point-of-sale advantage when selling add-ons, because it is hard and costly in terms of time for consumers to compare the price of basic motor

insurance policies and add-ons together across different providers. The point-of-sale advantage is a source of market power for insurers. We have found that it is possible to compare on PCWs whether the most commonly purchased add-ons are part of a basic motor insurance policy or can be purchased as an add-on. However, this comparison is relatively limited because the PCWs only provide a generic description of each add-on and not one that explains how the products differ between motor insurers. In addition, the PCWs provide only an indicative price of each add-on rather than the actual price that is returned following click-through to the motor insurer's website. Further, the quotes returned by a PCW are ranked based on the price of the basic motor insurance policy, excluding the price for the selection of add-ons displayed by the PCW, thus restricting the ability of consumers to make comparisons across motor insurers of the total price of the motor insurance policy including add-ons. This suggests to us that a point-of-sale advantage exists when selling add-ons following a referral from a PCW. In addition, we note that a point-of-sale advantage may also be generally present for consumers who renew their policies or purchase through direct channels rather than through PCWs.

- (b) Consumers have limited understanding of add-ons based on the differences in the quality and quantity of information provided by different motor insurers, which overall appears, overall, insufficient for consumers to make informed decisions when purchasing add-ons. This leads to consumers demonstrating a willingness to pay prices for add-ons that are higher (or lower) than their value turns out to be. This informational asymmetry between insurers and consumers results in a weakening of competition, as it means it is more difficult for consumers to identify the best-value offers in the market. We note that, given the complexity of the add-ons offered by motor insurers, it is particularly difficult for them to strike an appropriate balance between providing the relevant information to the consumer and ensuring the information is understandable and not unnecessarily complex.

However, even taking this into account, our view is that the current level of detail provided to consumers is variable between motor insurers and overall appears to be insufficient. The problem is particularly acute for NCB protection, because of the nature of the product. A lack of transparency of NCB scales, the different NCBs applied by motor insurer due to the use of different NCB scales, and a lack of clarity on the difference between NCB and NCB protection and the fact that NCB protection does not provide an absolute protection of premiums means that consumers are unable to properly evaluate the protection on offer.

- 8.57 We have identified two features of the supply of motor insurance²⁰ which we provisionally conclude have, in combination, an adverse effect on competition:
- (a) information asymmetries between motor insurers and consumers in relation to the sale of add-ons; and
 - (b) the point-of-sale advantage held by motor insurers when selling add-ons.
- 8.58 We provisionally conclude that these two features distort competition in the motor insurance market. This is because they mean it is more difficult for consumers to identify the best-value offers in the market and may lead to consumers purchasing products at an inflated price.
- 8.59 We note that the detriment arising from these features above is likely to be most significant in relation to the sale of the following commonly purchased add-ons: courtesy car cover, MLEI, NCB protection and personal injury cover. The detriment arising from these features is likely to be less significant for less commonly sold add-ons such as enhanced courtesy car cover (offered by only three of the ten motor insurers in our sample) and extended foreign use cover (explicitly offered as an add-

²⁰ The supply of motor insurance includes the supply of add-ons. For the reasons set out in Section 4—Market definition, we did not find it necessary to define a separate market for any add-on product and therefore include them in the motor insurance market.

on by only four of the ten motor insurers in our sample). We also noted that the features are less pronounced for breakdown cover (there are many stand-alone products available for this type of cover) and key loss cover and windscreen cover (typically included in the basic motor insurance policy).

- 8.60 The customer detriment arising from the AEC is particularly difficult to quantify. Add-ons generate an NEP of about £630 million a year. Excluding breakdown cover, windscreen cover and key loss cover (for the reasons given in paragraph 8.60), this amounts to an NEP of about £390 million a year. It is not yet clear what proportion of this NEP that may be the result of the sale of add-ons at an inflated price due to distorted competition. We note that, given the levels of understanding of add-ons from our customer survey, the level of consumer detriment could be significant even though these products are priced low compared with basic premiums. However, rivalry may mean that higher prices on add-ons enable motor insurers to offer lower prices on the basic motor insurance policy. We intend to carry out further work to ascertain the level of detriment caused by the features described above and the extent to which this impacts motor insurance premiums.

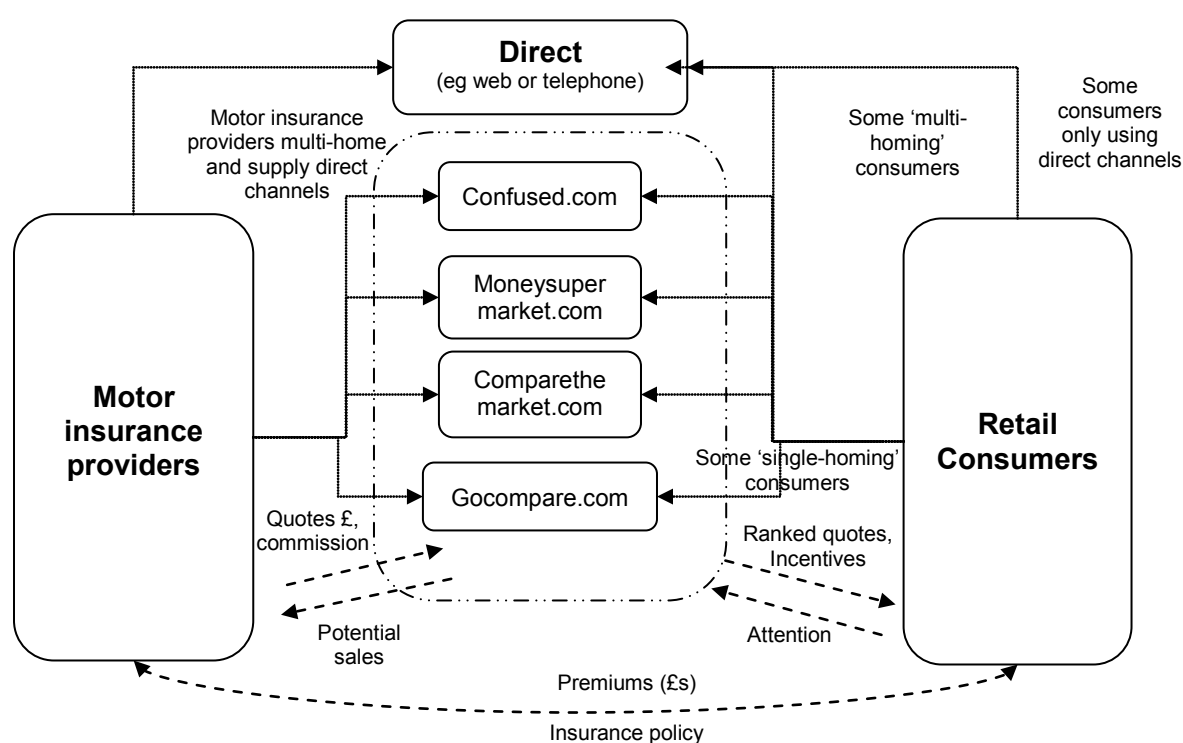
9. Price comparison websites and MFN clauses (theory of harm 5)

Background to PCWs

9.1 PCWs provide a platform for buying and selling car insurance. They are a ‘two-sided market’: one set of customers are the motor insurance providers (insurers and brokers) and the other are retail consumers. Their interactions are shown in Figure 9.1, with ‘attention’ (in the form of qualified sales leads¹) flowing from retail consumers to motor insurance providers, and quotes flowing from insurers to retail consumers. PCWs are paid by insurers—mostly on a commission basis—and some of them ‘pay’ retail consumers with loyalty gifts (like cuddly toys) when they purchase through their platform.

FIGURE 9.1

Interaction between PCWs and their customers



Source: CC.

¹ A 'qualified sales lead' is a potential customer who has been through some selection (or qualification) process that is meant to make it more likely that this potential customer is genuinely interested in purchasing the product.

- 9.2 Comparison sites perform a 'matching' service between the two sets of customers so seek to attract both sides to use their PCW. To attract motor insurance providers, PCWs need to bring consumer traffic to their websites. To attract retail consumers, PCWs need to advertise and have an attractive proposition including a wide portfolio of motor insurance providers for consumers to compare. PCWs do not charge retail consumers a fee for using the search services or purchasing a product through the PCW. Almost all insurers seek listings on all the major PCWs (they are said to 'multi-home'), while only some consumers use multiple PCWs in their search for insurance.
- 9.3 PCWs are not wholesalers of insurance. They do not buy the motor insurance policy and resell the policy to consumers; they do not set the retail price of policies. Rather, PCWs are intermediaries: typically they are paid a commission fee by motor insurance providers whenever a consumer buys a policy through the PCW.
- 9.4 PCWs have become an increasingly important sales channel for car insurance (see Figure 9.2). They now account for [55–65] per cent of all new business sales.

FIGURE 9.2

Distribution of motor insurance by origination channel (new business only)*

[✂]

Source: Ebenchmarkers.

*This data excludes branch sales, as Ebenchmarkers does not collect data on branch sales. But, other than Northern Ireland, only one of the motor insurance providers we contacted still made significant branch sales.

- 9.5 As PCWs have grown in importance and increased their advertising expenditure, some insurers have reduced their own advertising and become more focused on providing the best price through PCWs. New motor insurance providers have been able to enter the market and have attracted customers by posting competitive prices on PCWs rather than spending money on advertising. One can thus think of PCWs as a technological innovation in the advertising of insurance policies. It is potentially an efficient and competition-enhancing advertising medium.

- 9.6 Some motor insurance providers, in particular DLG [X], which we believe were leaders in direct telephone sales (the previously predominant sales technology), have chosen not to list some of their brands on PCWs. They continue to advertise [X] and sell significant volumes through their own websites and over the telephone.² Thus whilst PCWs advertise motor insurance products, PCWs are also in competition with some of those motor insurance providers who seek to attract customers to their own direct-sales channels.
- 9.7 We have found that PCWs increase the competition between insurers. Table 5.1 reports the price elasticities of demand for two large insurers through different channels. It shows that the volumes that these insurers sell are five to ten times more sensitive to price when they are selling through PCWs than through alternative channels. The profit margins that an insurer can earn are likely to be negatively related to the price sensitivity of demand,³ so, at these high levels of price sensitivity, PCWs can be expected to be reducing insurer margins.
- 9.8 However, we cannot conclude that the benefits of competition are being passed to consumers—that depends on the nature of competition in the PCW market itself. If the PCW market is competitive, then the benefits of increased insurer-to-insurer competition will flow through to retail consumers; but if it is not, the increased competition among insurers on PCWs is associated not with lower consumer prices but with higher commission fees, higher PCW profits, high levels of advertising and high premium levels. We have analysed PCW profitability (see Appendix 9.3, Annex H) and found that the [X] PCWs are highly profitable, with operating margins around 25 per cent and low capital costs.

² To a lesser extent, Saga and CISGIL (under the brand Co-operative Insurance) also advertise significantly off PCWs. [X]

³ The more sensitive demand is to price, the greater the sales lost from increasing prices; therefore the lower the margin that will maximize profits.

Competition on the two sides of the PCW market

9.9 In this subsection we examine the determinants of competitiveness on the two sides of the PCW market and find that the degree to which a PCW can provide exclusive access to a subset of retail consumers is a source of market power. We consider the degree to which entry and expansion in the PCW market is a threat to the exercise of market power.

Retail consumer behaviour on PCWs

9.10 In two-sided markets, an important determinant of competition is the degree to which customers ‘single-home’ or ‘multi-home’. ‘Single-homing’ occurs when a customer chooses a platform and tends not to switch between platforms. For example, the market for smartphone apps is characterized by single-homing. The owner of a smartphone with a particular operating system will be interested in buying apps only for that system. A consumer who wished to buy apps for a different operating system would have to take the costly step of switching phones. ‘Multi-homing’ is the phenomenon of consumers switching readily and easily between platforms. In the case of PCWs, there are some switching costs: a search on one PCW for motor insurance might take the user 10 to 20 minutes to complete. Another search on a different PCW would require the same time again. The repeated entry of data is the cost of multi-homing in PCWs.

9.11 Our evidence suggests that multi-homing in PCWs is relatively common—many consumers check several PCWs in their search for insurance. However, a material number of consumers appear to be accessible only through a single PCW. Our evidence is the following:

- (a) The CC consumer survey estimated that 33.5 per cent of consumers who use PCWs use only one PCW. This percentage amounts to 450,000 customers for the smallest of the ‘big four’ PCWs.

(b) According to the CC consumer survey, consumers on average searched on 2.2 PCWs the last time they shopped around for motor insurance.

(c) Moneysupermarket.com told us that consumers searched on an average of 2.8 PCWs before making a purchase decision and its internal strategic plan noted that [X] per cent of enquirers compared two PCWs or more.

9.12 The CC consumer survey and Moneysupermarket.com suggest a single-homing rate of between [X] and [X] per cent. Some insurers have offered case-study evidence of higher single-homing rates of between 60 and 80 per cent. We put relatively more weight on the CC survey and the Moneysupermarket.com figure because these are more likely to be average rates rather than single specific cases. At 30 per cent single-homing, the fact that any one of the big four PCWs might provide exclusive access to around 8 per cent of PCW shoppers⁴ is a material source of power.

9.13 The relatively high degree of multi-homing suggests that there could be competition for retail consumers between PCWs. The platforms offer inducements to retail consumers in the form of free toys or loyalty card points, suggesting competition to gain their attention. The PCWs spend heavily on mass television advertising, again suggesting rivalry on the retail side of the market.

9.14 We found that the PCWs view themselves as being engaged in competition for customers who actively shop around and are not loyal to a particular PCW. For example, [X]. We also found that the target of instilling loyalty among customers [X]. For example, we saw in [X]—we might take this to be a target level of single-homing for [X].

⁴ This assumes that single-homing rates are approximately equal between the major PCWs.

- 9.15 In summary, we find that there is a significant degree of single-homing. Nevertheless many consumers seem able and willing to switch and to multi-home. Moreover, they do this despite the fact that there is very little premium variation between PCWs. Multi-homing rates would probably be higher if it were generally known that shopping around on different PCWs could often yield lower prices.

Insurer behaviour on PCWs

Listing and multi-homing

- 9.16 Most insurers seek to be listed on all four main PCWs—in other words, they tend to multi-home. One large insurer told us that to remain competitive, it was necessary to quote on a minimum of three of the four main PCWs but it was desirable to quote on all four. A small number of brands choose not to list on PCWs at all but instead to sell through their own direct channels (see Appendix 9.3, paragraph 12 and following for an analysis of this type of decision).
- 9.17 Most insurers have indicated to us that they believe that they must list on PCWs, and that each of the big four PCWs commands access to a number of retail consumers whom they could otherwise not reach. This is consistent with the discussion of single-homing rates in paragraphs 9.12 to 9.15 above. Single-homing, they believe, gives PCWs considerable negotiating power.
- 9.18 PCWs compete with other sales channels for retail consumers. To assess the importance of the different channels for the sale of motor insurance we looked at market research reports and responses to our survey. Respondents to our survey of motor insurance policyholders were asked what sales channel they used when they first purchased their motor insurance policy from their current provider (see the working paper ‘Survey report’). Responses included ‘over the phone’, which accounted for 42 per cent of sales; 33 per cent said that they purchased online via a

PCW; 9 per cent said they purchased through an insurer's or broker's website;⁵ and 7 per cent purchased the policy in person. Survey results presented in Moneysupermarket's Strategic Plan for 2012–2014 showed that among the most common reasons for people not buying through a PCW (despite using it to compare prices) was a preference for talking through options with someone and the possibility of discounts or cashback when contacting an insurer directly.⁶

- 9.19 An estimated 23 per cent of motor insurance policy sales are through PCWs. However, the total base from which this 23 per cent is derived includes sales to customers who opted to renew their policy with their current provider, and renewals account for about 59 per cent of all policies sold. PCWs account for a greater proportion of new business (ie customers purchasing motor insurance for the first time or switching from their previous provider). Figure 9.2 shows that [55–65] per cent of new motor insurance business was sourced through PCWs.
- 9.20 We examined the negotiating position of insurers and PCWs by looking at the quantity discounts that larger insurers were able to negotiate on the commission fees offered by PCWs. We found that larger insurers tend to negotiate lower commission fees. Appendix 9.3, Annex D provides the detailed results. This shows that not all of the market power is with PCWs: they are dependent on carrying important brands for the quality of their offering.⁷

Entry

- 9.21 Entry or the threat of expansion could restrict the market power that each PCW possesses by virtue of its single-homing retail consumers. We have examined the

⁵ In total, 46 per cent of respondents said that they first purchased their motor insurance policy from their current provider 'online'.

⁶ It should be noted that we understand that some PCWs have complained that cashback offers violate the terms of their MFN agreements.

⁷ We also examined the degree to which the ownership structure of PCWs may affect competition between motor insurance providers on PCWs. We did not find strong reasons to believe the ownership of a PCW currently affects competition between motor insurance providers. Appendix 9.3, Annex J provides the detailed results.

business plans of Tesco, Google and Covea SGAM. The first scaled back its involvement in the PCW market in the last five years; [REDACTED]; and [REDACTED] considered entry but decided not to do so. Tesco and Covea SGAM make it clear that advertising costs are a barrier to entry in the market. [REDACTED] Covea SGAM, in particular, noted that the major risk of entry would be the difficulty of differentiating their proposition where this was to be only on the basis of marketing.

9.22 PCWs invest heavily in advertising and marketing. Comparethemarket.com told us that [REDACTED]; and Moneysupermarket.com's 2011 annual report shows that its marketing investment amounted to £78 million, corresponding to around 43 per cent of its revenue in the same year.⁸

9.23 We conclude from our examination of business plans that the constraint on the big four PCWs from potential entry or expansion is present but nevertheless restricted by the need for high levels of mass advertising and the difficulty of entering with a differentiated offering.⁹

Conclusion on competition on the two sides of the PCW market

9.24 PCWs appear to enjoy a degree of market power by virtue of the number of single-homing consumers they have: on one side of the market, these consumers appear to be accessible to insurers on the other side of the market only through specific PCWs. Entry and expansion appear to be limited threats. In the remainder of this section, we consider in detail one use of this market power: the negotiation and enforcement of MFN clauses with insurers. We will consider briefly whether this market power could be used independently of the operation of MFNs.

⁸ We examine in Appendix 9.3 the suggestion that advertising may be excessive and used as a barrier to entry. We have not concluded on this possibility because of the difficulties of establishing a competitive benchmark for the level of advertising.

⁹ Paragraphs 9.56 to 9.57 note that the inability to enter with a differentiated offering is likely to be the result of the operation of wide MFN clauses.

MFNs

9.25 The four main PCWs constrain the prices that an insurer charges through alternative sales channels (including other PCWs) by using ‘most favoured nation’, or ‘price parity’ clauses (MFNs). We have observed two broad types of clauses and found them to have significantly different impacts on competition:¹⁰

(a) Narrow MFNs: These state that the price quoted through the PCW will always be competitive with the price on the insurer’s own website—that is, the price on the insurer’s own website will never be cheaper than the price on the PCW.

(b) Wide MFNs: These state that the price quoted through the PCW will always be competitive with any of the prices available online—be they on the insurer’s own website (as for the narrow MFNs) or on other PCWs.¹¹

9.26 Table 9.1 shows that of all the policies sold via the four largest PCWs in 2012, the vast majority ([redacted] per cent) were sold when there was one of the two types of MFN clause in the contract between the PCW and the motor insurance provider—less than half ([redacted] per cent) under narrow MFNs and slightly fewer ([redacted] per cent) under wide MFNs. However, [redacted] per cent is an underestimate of the impact of wide MFNs because a single wide MFN clause has a ‘network’ effect:¹² it stops any other PCW offering cheaper policies, so effectively excludes them as a source of price competition.¹³ A significant majority ([redacted] per cent) of policies sold through PCWs are covered by at least one wide MFN clause with one PCW.¹⁴

¹⁰ We have previously identified three types of MFNs, but the effects of online-sales and all-sales MFNs are considered under wide MFN clauses.

¹¹ Some MFNs are even wider than online channels and include all sales channels.

¹² If all PCWs have a wide MFN, the benefits of higher premiums are transferred to PCWs. If only one PCW has a wide MFN, that PCW and motor insurance providers share the benefit of higher premiums.

¹³ We consider in Appendix 9.3 whether this network effect is tantamount to coordination. We do not conclude on this question.

¹⁴ The difference between the 40 per cent of policies under wide MFNs and the 76 per cent of policies covered by at least one wide MFN comes from sales of those policies that are on at least one PCW not covered by a wide MFN but are covered by wide MFNs elsewhere.

TABLE 9.1 **Percentage of motor insurance policies sold under MFN clauses (2012)**

	<i>per cent</i>
<i>Sales by motor insurance providers with:</i>	<i>Sales volume</i>
An MFN	[X]
Narrow	[X]
Wide	[X]
At least one wide MFN	[X]

Source: CC calculation and parties' data.

9.27 PCWs' use of MFN clauses has evolved as the market has developed (see Figure 9.3). The first PCWs gathered prices by 'screen-scraping',¹⁵ from motor insurance providers' websites, which is equivalent to a narrow MFN: the price reported on the PCW is equal to the price that can be found by going directly to the motor insurance provider's website. As relationships with motor insurance providers developed, PCWs linked into the back office systems of motor insurance providers to obtain quotes. Narrow MFNs started to be introduced into standard contracts with motor insurance providers. As the market developed further MFN clauses were often widened¹⁶ to include sales through other PCWs and sometimes other sales channels. However, in late 2012, Confused.com narrowed its MFN clauses. Moreover, a small number of larger insurers negotiated a narrowing of clauses with Gocompare.com.

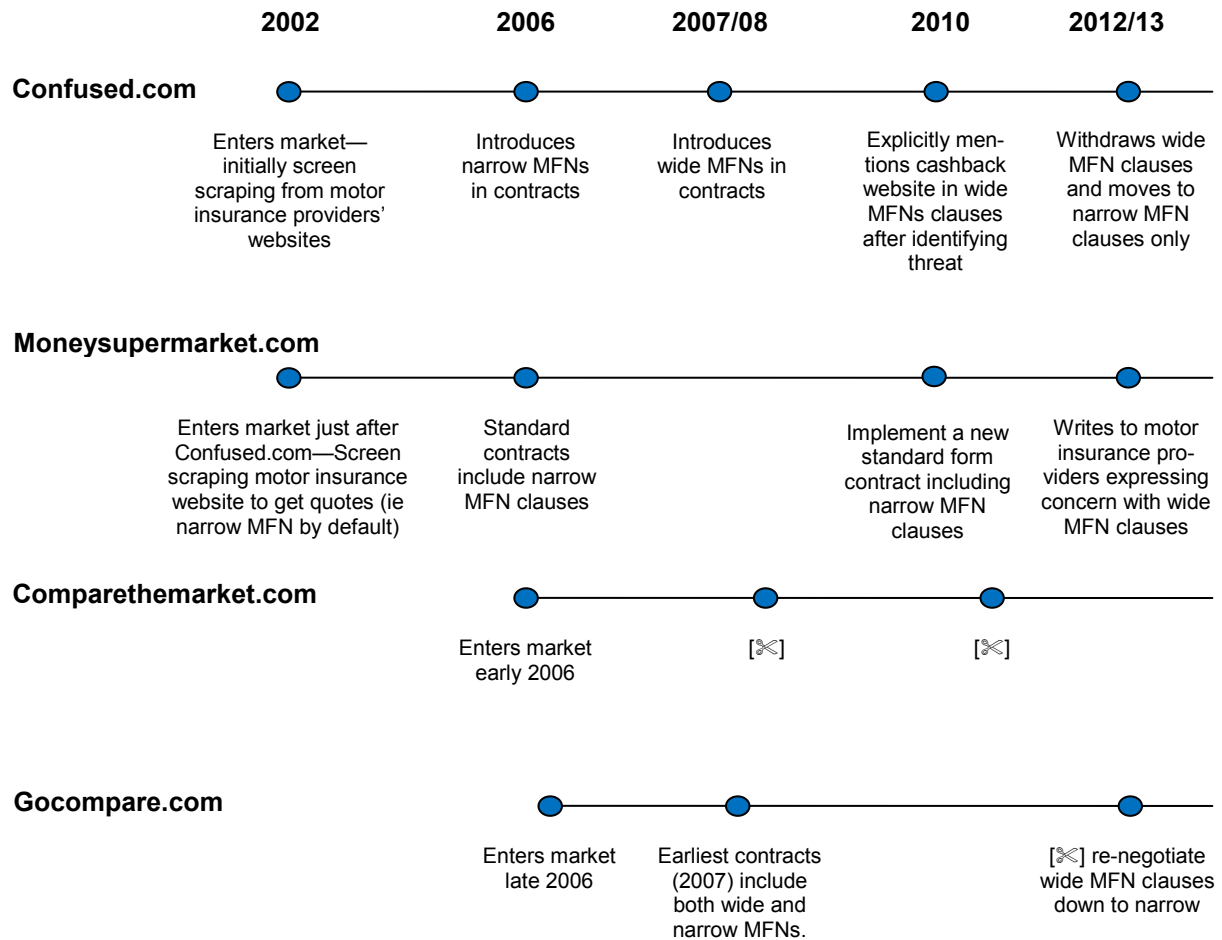
9.28 These recent moves towards narrowing do not, however, necessarily indicate that the market influence of wide MFNs is falling: a wide MFN with a single PCW constrains policy pricing on all PCWs.

¹⁵ 'Screen-scraping' is the term used for the practice of a server, or 'crawler' visiting a web page and extracting information from that page algorithmically.

¹⁶ Gocompare.com [X] had wide MFN clauses in their contracts from the earliest contracts with motor insurance providers.

FIGURE 9.3

Evolution of PCWs and MFNs



Source: PCWs.

Harm arising from incentives

Wide MFNs combined with the 'agency' pricing model softens competition between PCWs

9.29 The 'agency' pricing model which we observe with PCWs is where insurers set prices to final consumers while PCW-to-insurer negotiations set commission fees. Under this model, MFNs directly constrain the prices consumers pay. The agency model can be contrasted with a 'wholesale' model, under which MFNs might constrain the price to which insurers sold to intermediaries, but intermediaries would continue to be free to set different retail prices when competing for final consumers.

9.30 In this section we consider whether wide MFNs in combination with the agency model can harm competition between PCWs. We discuss two ways in which this might happen:

(a) by reducing entry and innovation; and

(b) by inflating policy premiums.

9.31 In our annotated issues statement, we considered the possibility that MFN clauses might reduce competition between insurers by providing them with an opportunity to make it more costly to reduce premiums. We have not pursued this line of investigation and have not concluded on whether or not MFN clauses might be used in this way. The generalized opposition to MFN clauses that we found among insurance providers suggested that insurers did not see this value.

Reduced entry and innovation

9.32 A common strategy for entry into many markets is for a new entrant to offer cheaper prices than incumbents. Evidence gathered by the CC supports the view that motor insurance consumers are price-sensitive, and those shopping through PCWs can be expected to be particularly price-sensitive. Therefore, we would expect that a new entrant PCW could grow its market share by offering lower premiums to consumers.

9.33 A new entrant PCW may be able to offer lower premiums by using one or a combination of strategies, such as:

(a) reducing the commission fee to a motor insurance provider in exchange for lower premiums; and/or

(b) providing more profitable business to motor insurance providers by, for example, offering better fraud prevention measures or reducing cancellation rates.

9.34 Entry and the threat of entry would have a number of pro-competitive consequences:

- potentially lower premiums (to the extent that lower prices are used to gain market share);
- increased consumer choice of platforms; and
- increased innovation (to the extent that competition is on features as well as on price).

9.35 However, a wide MFN clause undermines an entry strategy based on lower premiums. An entrant cannot offer consumers lower policy prices as long as those policies are covered by a wide MFN clause.¹⁷

9.36 In addition to reducing entry and the incentives to enter, wide MFN clauses can reduce the incentives for incumbents (and entrants) to innovate. PCWs could innovate in ways which lower the costs of business for an insurer selling through their PCW, for example by offering better fraud detection algorithms. Without MFN constraints, such innovation would lead to the motor insurance provider offering lower premiums through that PCW, reflecting the cost savings to the insurer of the PCW innovation. However, if the motor insurance providers cannot offer policies cheaper to innovative PCWs because of wide MFN clauses with other PCWs, this would reduce the incentive for a PCW to innovate as they would not receive a greater market share from offering cheaper policies relative to their competitors.¹⁸ (See Appendix 9.3, Annex C). Insurers could still reward innovative PCWs with higher commission fees in exchange for a better quality sales channel, but not with higher market share. Retail consumers would have no price inducement to using the better technology. The benefits of the innovation could be passed to the insurer but not the retail consumer.

¹⁷ We consider in Appendix x, Annex H whether PCWs could offer inducements, such as cashback, encouraging consumers to switch. We did not consider these inducements to be effective and sometimes, as in the case of cashback, they are covered by MFN clauses.

¹⁸ Comparethemarket.com told us that it had directly offered insurers the opportunity to review and improve fraud detection initiatives and controls in the past, although there had not been any substantive take-up of the opportunities and in fact the vast majority of underwriters did not respond to this approach. We take this as evidence that PCWs believe that it is possible to offer technological improvements.

Increased policy premiums

- 9.37 In the absence of wide MFNs, PCWs can compete with one another on the commission fees they charge to motor insurance providers. A PCW can offer to lower its commission fee to a motor insurance provider. The absence of wide MFN clauses would allow the insurer to offer lower premiums on the PCW, and, as a consequence, allow the PCW to grow its sales. Conversely, motor insurance providers can threaten to increase premiums to a PCW that increases its commission fees, leading to a potential loss of market share (and revenue) for the PCW. These are the competitive mechanisms that could be expected to restrain commission fee inflation.
- 9.38 When there is a wide MFN between a PCW and a motor insurance provider, the PCW does not face the same restrictions to increasing its commission fee. This is because the motor insurance provider cannot increase premiums on that PCW relative to premiums offered on other PCWs. In addition, other PCWs (without wide MFNs) no longer have the incentives to decrease their commission fees to motor insurance providers as doing so would not allow them to pass on savings and gain market share.
- 9.39 Generally, we expect that high commission fees will lead to higher policy premiums because there is likely to be some pass-through of costs to premiums.¹⁹ If commission fees rise on a PCW that has a wide MFN, it may be possible for the insurer to absorb a part of the increase through price rises on other sites, and therefore not to pass through the cost increase fully. However, irrespective of the rate of pass-through, the PCW with the wide MFN can continue to increase commission fees until the price of the policy is too high *from the point of view of the PCW*. Premiums across the market may increase up to the point at which insurers exercise

¹⁹ In Johnson, J, 'The Agency Model and MFN clauses' (2013), the author develops a formal model with many similarities to the current case in which wide MFN clauses in combination with the agency model lead to the emergence of high industry prices.

their ‘outside option’: withdrawing from any PCW with a wide MFN and drawing customers from other sources—either advertising to increase direct consumers, becoming more reliant on other PCWs or a combination of both strategies.²⁰

Narrow MFNs

9.40 In this subsection, we consider the ability and the incentives of insurers to behave in a way that fosters competition between PCWs under narrow MFNs. A narrow MFN ensures that the direct channel cannot undercut PCW channels. From a contractual point of view, a narrow MFN permits different prices on different PCWs and therefore should permit competition between PCWs. The exploration of that competition is the main aim of this subsection. However, before we address it directly we consider the incentive that motor insurance providers have to exercise their contractual freedom to price differentially on different PCWs.

The importance of the direct channel and possible network effects of narrow MFNs

9.41 If an insurer’s website is an important and attractive sales channel for the insurer, one or several narrow MFNs may have a wider impact. This subsection considers this special case in detail because it adds a general caveat to our main discussion on the impact of narrow MFNs.

9.42 Narrow MFNs could have wider impacts through a ‘network effect’: an insurer with a single narrow MFN (or possibly several narrow MFNs) may find that it wants to keep the price on its own website lower or equal than on any PCW to maintain its attractiveness; a narrow MFN would then force all prices to be at least equal to the price on the PCW with the narrow MFN.²¹ The insurer wants its own-website price to be lower than or equal to its price on any PCW; the narrow MFN clause requires its

²⁰ This point may be reached sooner for some motor insurance providers than for others, especially those with a strong existing brand.

²¹ This case has been argued by DLG.

own-website price to be higher than or equal to its price on each PCW with such a clause; from which it follows that its own-website price and its prices on each PCW must all be at least as high as the highest price covered by a narrow MFN clause.

- 9.43 Consider an insurer with a product, Brand A, which has 50 per cent sales on PCWs, 50 per cent direct sales, and is covered by at least one narrow MFN (but no wide MFNs). Recall that a narrow MFN prevents the direct channel from undercutting the PCW. The insurer wants to maintain the competitiveness of Brand A through its direct sales channels because these are the most profitable sales (it has no commission to pay and arguably might be better at fraud prevention on its own website). It also advertises significantly to consumers to encourage them to come directly to Brand A's website. Therefore, it does not want any PCW to offer Brand A's policies cheaper than available on its own website.
- 9.44 A single narrow MFN in this context imposes a floor price for Brand A's policies on any PCW that is **equal** to the own-website price, just as a wide MFN would. If a low-commission-fee entrant PCW wished to list Brand A's policies at a lower premium than other PCWs, the insurer would not want to reward the entrant PCW with lower premiums than on the other PCWs, because its MFN clause with the other PCWs would then require it to maintain its direct sales price above the price on the entrant PCW and that would take sales away from its own direct channel. Thus, through this 'network effect', low-commission-fee entry would have been discouraged much as it is under wide MFN clauses.
- 9.45 If there were a commission fee increase on the part of the PCW with the narrow MFN clause, then the insurer would want to increase premiums on that channel; but it would have to increase premiums on its own channel, and on any other PCWs that would otherwise be lower cost than the direct channel. Thus, the absence of

constraint on commission fees is similar to the case described in paragraphs 9.37 to 9.39 for wide MFN clauses.

9.46 Thus, Brand A's case does constitute a network effect for narrow MFNs. However, it does so only when direct sales are substantial. This applies to a few brands and we do not consider that it is generally the case that narrow MFNs substantially decrease competition between PCWs for reasons set out in Appendix 9.3, paragraph 12 and following).²²

9.47 In Appendix 9.3, we explore the parameters that are important in determining whether a brand will fall into the category of Brand A. The critical factor is whether the own website is worth protecting as much as in Brand A's case. This in turn depends on:

- (a) the strength of the brand—the stronger the brand, the higher the value of sales on the own website because they can be achieved at low incremental cost; and
- (b) the margins available on alternative PCWs with which the brand has no narrow or wide MFN—the lower the commission fees on these, the less worth protecting the own site becomes.

9.48 In examining empirically the importance of the direct channel, we find that the brands where the direct channel is dominant are not listed on PCWs. The question of whether narrow MFNs are harmful in this case does not arise. We examined the statements that insurers made about their advertising strategies in the light of their advertising expenditure and share of direct sales they achieved (see Appendix 9.3, paragraph 12 and following), and concluded that there are just four brands that have

²² Saga provided a different argument to the effect that MFNs substantially reduced competition, but this focused on the extent to which a narrow MFN eliminated competition between the PCW and the direct channel. While this is true, we do not believe that the constraint that PCWs exercise on premium pricing should be thought to be equivalent to the constraint imposed by direct channels. The evidence suggests that PCWs are very effective at increasing competition between insurers in the sense of increasing the rate of price-based switching. The evidence is that the competition between insurance brands is much more powerfully exercised on PCWs rather than between PCWs and direct sales sites. This argument is considered in more detail in Appendix 9.3, paragraph 5 to 7.

significant direct sales and which the insurers are trying to maintain both on PCWs and through their own sales channels. These are the cases where competition between the direct channel and the PCW is materially significant. It is a configuration in which narrow MFNs can lead to the same sort of harm to competition as we found with wide MFNs. These accounted for a small proportion ([X] per cent) of all policies sold on PCWs. However, one of the four brands is sold by an insurer with multiple brands, some of which would not be affected by narrow MFNs in the same way. Thus, in the vast majority of cases, narrow MFNs do not impose significant network effects.

Do narrow MFNs reduce entry and increase premiums?

9.49 In this section we consider whether narrow MFNs, in the absence of network effects, lead to harm to competition between PCWs. We consider both the effects of a single narrow MFN and the effect of a group of narrow MFNs on competition. We look at whether narrow MFNs:

- (a) reduce entry and innovation amongst PCWs; and
- (b) increase commission fees on PCWs and therefore premiums on policies.

- *Reduced entry*

9.50 As discussed above, a common entry strategy for a new entrant PCW would be to price lower than incumbents. Wide MFNs would in principle prevent this strategy. However, narrow MFNs would not prevent a low-priced PCW entering the market as they do not prevent motor insurance providers posting cheaper prices on other PCWs.²³ Moreover, several narrow MFNs together do not prevent a motor insurance provider quoting different prices on each PCW, provided that each price is no higher than that on the motor insurance provider's website.

²³ In this entire discussion, we are assuming that the 'network effect' described in paragraphs 9.41 to 9.49 does not apply.

9.51 Narrow MFN clauses ought to have no particular impact on entry by motor insurance providers into the motor insurance market. If narrow MFNs are the condition of listing on PCWs, the motor insurance provider may have to make a choice between listing on PCWs or primarily using its own direct channel (because a narrow MFN stops an insurer from making its own website the most competitive sales channel). However, entry into the insurance market is not itself restricted, even if narrow MFNs limit some sales options.

- *Reduced innovation*

9.52 A narrow MFN does not restrict a rival PCW from innovating. If innovations lead to an insurer preferring to sell through the innovative PCW, it can offer lower quotes on that PCW. This would increase competition between PCWs. Many narrow MFNs together will not prevent innovation by rival PCWs, as the price on each PCW can be different as long as each is no higher than the motor insurance provider's website.

9.53 A narrow MFN may, however, reduce an insurer's incentives to innovate on its own website, since it cannot attract a larger market share through lower prices.

- *Increased premiums*

9.54 Paragraphs 9.37 to 9.39 argued that wide MFNs reduce competition between PCWs leading to higher commission fees and ultimately higher premiums. Narrow MFNs do not, in general, prevent competition between PCWs since insurers can quote different prices on different PCWs. We therefore would expect competition between PCWs for market share to lead to them to seek to list lower-priced policies; this in turn will put pressure on them reducing their own commissions. Narrow MFNs therefore do not hinder competition between PCWs under most conditions, which we expect implies lower premiums to retail consumers.

Direct evidence

Entry and innovation

9.55 Our analysis suggests that wide MFNs will make it hard for an entrant to adopt a differentiated, low-premium entry strategy and that this will reduce consumer choice and competition in the market. In general, it is very hard to find direct evidence of entry having been restricted or of innovation not having occurred, because what is required is evidence of an absence. Nevertheless, we identified an instance of failed entry by Covea SGAM, which put effort into considering whether or not to enter the PCW market in 2012.

9.56 Covea SGAM's consultants concluded as follows:

Unless the [Covea SGAM] team can demonstrate tangible reasons that differentiate the business model from the existing players therefore allowing them to consistently beat the average over an extended period, then we see the downside risks as too high to justify the significant investment required to launch a full scale aggregator into the UK.

In other words, the difficulty of launching with a differentiated offering, as identified in our analysis in paragraphs 9.32 to 9.36 above, seems to have been the limitation on entry.

9.57 Covea SGAM informed us that the existence of MFNs prevented it from differentiating itself with a low-premium entry strategy. The entry strategy evaluated by Covea SGAM was entirely based on competing on marketing, not price. On this basis, Covea SGAM considered the venture too risky.

Higher premiums and commission fees

9.58 We have examined the relationship between commission fees, insurer size and the type of MFN.

- 9.59 There is some evidence that on average, wider MFNs are associated with higher commission fees (see Appendix 9.3, Annex D). However, we cannot exclude the possibility that this is mainly an effect due to the size of insurers that engage in these arrangements rather than contract type. The data seems consistent with the view that smaller insurers have less bargaining power, and this makes it more likely that they will sign wider MFNs *and* that they will pay higher commissions. We did not consider that it would be possible to separate the two effects because the data set is small and there is little variation in the bargaining strength of insurers over time.
- 9.60 Our analysis of incentives suggests that there ought to be cases of PCWs attempting to offer reduced premiums through reduced commissions but being thwarted by wide MFN clauses. We have collected direct evidence from motor insurance providers of specific instances in which exactly these behaviours can be found. These are cases in which commissions and premiums would have been lower had it not been for wide MFNs. A number of motor insurance providers told us that either they had entered these agreements and subsequently withdrew as they were warned they were in breach of their contractual (MFN) obligations with another PCW, or they did not consider these offers for fear of being in breach of their MFN clauses. One motor insurance provider stated that wide MFNs significantly reduce the incentives to engage in commission sacrifice offers and price promotions, as well as the incentives of other PCWs to offer them.
- 9.61 Moneysupermarket.com provided information about parties that had accepted and rejected commission sacrifice offers. The deals on offer were that Moneysupermarket.com would lower its fee, by, for example £5, and that the insurer might provide a matching price reduction (the ‘investment’). Overall, the fee sacrifice and the investment would be passed through to retail consumers in the form of lower prices.

9.62 Table 9.2 shows the number of insurers who agreed, did not agree and who agreed but then withdrew from these deals and the number of wide MFNs held, on average, by each group. [X] insurance providers who refused the deals had a wide MFN clause with [X]. [X] insurance providers initially agreed to reduce premiums but later withdrew. According to Moneysupermarket.com, this was because of wide MFN-related concerns. We found that these [X] insurance providers had a [X]. Two-thirds of the insurance providers who agreed to reduce premiums did so despite [X]. These tended to be larger insurers, and therefore ones with greater negotiating power.

TABLE 9.2 **Analysis of motor insurance providers who were offered a commission exchange by Moneysupermarket.com**

<i>Insurers who have: -></i>	<i>Agreed</i>	<i>Not agreed</i>	<i>Withdrawn</i>
Number	[X]	[X]	[X]
Average number of wide MFNs in place	[X]	[X]	[X]

Source: CC analysis and data from the parties.

*Confused.com told us that it had withdrawn the wide MFN clauses (or would not enforce these clauses), and we have calculated the average number of wide MFN clauses on this basis. However, some insurance providers told us that their contracts with Confused.com had not been adjusted.

9.63 We received information from insurance providers about the impact of wide MFN clauses on their ability to accept special offers from PCWs. [A motor insurance provider] was offered a commission sacrifice agreement by [one PCW]. [The motor insurance provider] described the commission sacrifice agreement as potentially incredibly desirable (only ‘potentially’, because negotiations over precise terms never properly got under way). It welcomed the opportunity to be able to offer lower premiums through [that PCW] and to win business, mainly, it said, from rival brands on that site rather than from consumers who would otherwise have purchased from [the motor insurance provider] through other sites. In other words, it expected the [X] offer to increase competition between insurers more than between PCWs. [The motor insurance provider] told us that it did not go on to negotiate a deal because of the wide MFN clause that it had with [other PCWs].

9.64 [Another motor insurance provider] told us that it had taken part in price-based offers with both [X] and [X] in the past. However, as these offers affected the price quoted on the relevant site, it received complaints from another PCW asserting that it was in breach of its MFN clause with that PCW and the offers were eventually removed. [X]

Summary of competitive effects

9.65 We have outlined the analysis of incentives that point to anticompetitive effects of both narrow and wide MFNs and assessed the analysis of incentives against direct evidence we collected.

9.66 For narrow MFNs, we find that under some conditions they may both reduce the incentives for a motor insurance provider to innovate on their own website and soften competition between PCWs. However, our analysis in paragraphs 9.41 to 9.48 found that there are very few insurance brands which meet the conditions where narrow MFNs reduce competition in the motor insurance market. If there are any anticompetitive effects from narrow MFNs, they are likely to be weak in the context of the whole motor insurance market.

9.67 For wide MFNs we find strong reasons why wide MFNs reduce entry, innovation and soften competition between PCWs leading to higher commission fees and premiums. We also find evidence that suggests that wide MFNs have indeed reduced entry and innovation and evidence that wide MFNs have prevented commission fees and premiums being lowered.

Are MFNs necessary for PCW survival?

9.68 We now assess whether MFNs are necessary for the survival of PCWs, whose activities have an overall positive effect on competition. As already highlighted in paragraph 9.7, PCWs have enhanced competition between insurers. PCWs have

argued that without MFNs PCWs would eventually be marginalized and the motor insurance market would be dominated by a few of the largest insurer brands. This, goes the argument, would eventually lead to higher premiums. If this were true, then MFN clauses would be seen as necessary for the existence of a competitive motor insurance market.

- 9.69 We consider below whether MFNs are necessary for PCWs to exist, looking firstly at narrow MFNs and then looking at the incremental effect of wide MFNs.

Narrow MFN clauses

- 9.70 All the PCWs have argued that narrow MFNs are essential to their business model, identifying two reasons for this:
- (a) First, narrow MFNs provide reassurance to retail consumers that the prices that they find on PCWs cannot be beaten by searching directly on insurers' websites. Without such reassurance, consumers would not use PCWs.
 - (b) Second, MFNs prevent a motor insurance provider free-riding on the advertising PCWs provide.

- 9.71 For each reason, we assess the strength of the argument and whether there are alternative, less restrictive, mechanisms that PCWs could use to achieve the same benefit for consumers.

Credibility

- 9.72 Narrow MFNs provide credibility to the PCW by allowing consumers to compare the prices that are actually available on a motor insurance provider's website. Without a narrow MFN, there is no guarantee that the insurer would truthfully answer the question asked by the PCW, which is: 'if this customer were to visit your own website, what price would they find there?' A truthful answer to this question means

that when consumers use PCWs, they can make considerable savings in search costs.

9.73 PCWs argue that if consumers did not have confidence in PCWs, consumers might stop using them altogether. This would lead to increased search costs for consumers and would eventually lead to motor insurance prices rising as motor insurance providers could extract the 'search rent'²⁴ from consumers.

9.74 We think this argument has merit. In Italy, the Autorità Garante della Concorrenza (Italian Competition Authority) investigated car insurance and found that PCWs had not been able to grow in Italy because, among other reasons, there were no mechanisms to ensure that the premiums quoted by PCWs were the same as the premiums quoted directly by each insurer.²⁵ As a consequence, PCWs had a lower-quality search experience. This provides an example of what might happen in a market with no narrow MFNs.

9.75 In addition, there does not appear to be an obvious alternative mechanism that a PCW could implement to ensure that the prices quoted reflect the price the motor insurance provider is offering to customers more generally.²⁶

Free-riding

9.76 Narrow MFNs prevent an insurer free-riding on the advertisement provided by the PCW. Currently, every time a quote is produced, it is accompanied by the logo of the insurer offering the quote. Moreover, brands and reputation are important in this market, with consumers often not choosing the cheapest quote. Thus, the logo of the insurer is an important piece of information in the consumer's search. If it were widely

²⁴ The search rent is the additional profit achievable due to consumer inertia because they stop shopping around before finding the best price available to them.

²⁵ Final Report of the Autorità Garante della Concorrenza (Italian Competition Authority), 22 February 2013.

²⁶ Arguably PCWs could revert to screen scraping, although this appears to be a regressive technological step and one which the insurers could block if they wanted to.

known that when shopping on a PCW you needed to visit the chosen website directly to get the best price, then the PCWs would be offering a service while often not being rewarded for it. The PCW might go out of business. As a result, good search solutions might not be offered to consumers.

9.77 Some degree of free-riding will not necessarily lead to the failure of the market, as the market can find other solutions to it (for example, more complex pricing structures which include a fixed element) or rely on loyal customers to cover fixed costs. In this market, there appear to be some alternative mechanisms for PCWs to use.

(a) PCWs could rely on single-homing customers to pay for the investment in the PCW.

(b) PCWs could provide anonymous quotes, which allow consumers to compare products and features without the motor insurance provider's brand.

(c) PCWs could move to an alternative charging model.

(d) PCW could implement quote-poaching clauses.

9.78 We assess these in detail in Appendix 9.3. We find that the alternative charging model and quote poaching clauses may provide a less restrictive mechanism for PCWs to overcome the problems of free-riding by insurers and consumers.

Summary

9.79 We have identified two ways in which narrow MFNs may be essential for a PCW and we have identified two potential alternative mechanisms by which a PCW might prevent an insurer from free-riding. However, we have not been able to identify an alternative mechanism for PCWs to provide customer reassurance on their truthfulness. We consider, therefore, that narrow MFNs may be necessary for PCWs to survive.

Wide MFN clauses

9.80 We now assess the arguments that wide MFNs are necessary to the existence of PCWs. We first look at the argument about credibility of the PCW and then look at free-riding, this time by other PCWs.

Credibility

9.81 [§] The fact that it does not prominently advertise the existence of the MFNs ('never knowingly undersold') does not seem consistent with this motivation.

9.82 [§] In other words, consumers do not typically behave like people who believe that a single PCW is sure to return the best quote. [§] Yet, despite this perception, PCWs have been very successful in establishing a market for their product. [§]

Free-riding

9.83 For narrow MFNs, free-riding by motor insurance providers is made possible by the branding of the quote, making it clear which motor insurance provider provided the quote. However, as PCWs do not provide a link to other PCWs when they produce their search results, it is unclear how another PCW would be free-riding on the first PCW's investment. Indeed, PCWs have argued that they all need to spend significant sums on advertising to keep bringing consumers back to their websites. This does not appear to support the argument that one PCW could free-ride on another PCW's investment by undercutting a rival. Moreover the main way for PCWs to bring more consumers to their website is to advertise more relative to their competitors, and if they could advertise that they could undercut another PCW, this would only likely enhance the attractiveness. This last claim cannot be made when a wide MFN is in place.

Summary

- 9.84 In the absence of wide MFNs, we find there is little danger of free-riding from other PCWs; and if competition were to make one PCW cheaper than another, that would not undermine credibility in PCWs in general, but just in the one relatively expensive PCW. We also note that Moneysupermarket.com and Confused.com have argued that they do not believe that wide MFNs are necessary for their business model and in fact interfere with their ability to compete with PCWs who have wide MFNs. Moreover, as we have noted above, neither Gocompare.com nor Comparethemarket.com actively advertise the existence of MFNs to retail consumers. As Moneysupermarket.com has never operated with wide MFNs, it does appear possible to operate successfully without them.

Summary on indispensability of MFNs for the survival of PCWs

- 9.85 We have assessed whether narrow and wide MFNs were necessary for PCWs to survive. We find that narrow MFN clauses may be necessary for PCWs to survive as they provide credibility to the business and enable retail customers on PCWs to compare insurers' actual prices. They also prevent insurers free-riding on the PCWs' investment. Although we find there may be other mechanisms to prevent free-riding, there are no clear mechanisms for ensuring that PCWs are able to compare insurers' prices. We also considered whether wide MFNs, over and above narrow MFNs, were necessary for PCWs to survive. The arguments about credibility and free-riding do not hold with respect to wide MFNs and we therefore do not believe that these are indispensable.

Non-contractual routes to price parity

- 9.86 We have found that the major PCWs have sufficient levels of single-homing and command sufficient market share to have negotiated MFN clauses. In the case of wide MFNs, we have found that this has had the effect of reducing competition

between PCWs. In this sub-section, we consider whether the effects of wide MFNs could be reproduced without resorting to contractual agreement—would it, for example, be possible to use the power derived from the number of single homers to achieve equivalent results?

9.87 Appendix 9.3, Annex I considers evidence of a specific alternative way to achieve the same results as MFNs. We focus on the tactic of using selective delisting as a means of reducing price competition between PCWs. We have four pieces of direct evidence that suggest that a PCW may have tried to use—or threaten to use—this tactic.

These are:

(a) [One motor insurance provider] indicated to us that when it asked [one PCW] about renegotiating its wide MFN clause, [the PCW] indicated in negotiation that even without MFNs, [the PCW] would expect to receive the best price.

(b) [REDACTED]

(c) [REDACTED]

(d) [REDACTED]

9.88 In conclusion, we see that [a PCW] has indicated to insurers that it could use selective delisting in order to achieve pricing behaviour equivalent to that achieved by wide MFN clauses. We also have evidence that it might have done so, although we place only a small weight on this.

Are MFNs and selective delistings equivalent?

9.89 If the threats were fully effective—for example, because of reputational effects—and price parity was maintained by this sort of mechanism, then the effect would be equivalent to that of a wide MFN. The power over single-homing retail consumers would have been extended to affect other retail consumers and the prices that they face.

9.90 There are three clear differences between the operation of MFNs and of selective delistings:

- (a) When a delisting has to be carried out, it will harm the PCW that is delisting in the form of lost sales and commissions. A wide MFN, on the other hand, does not require costly behaviour (beyond monitoring). We can expect delisting to be a less efficient mechanism for maintaining price parities because of its costliness. However, a reputation for delisting might be established by a PCW and would reduce the cost difference with wide MFN clauses.
- (b) When an insurer cuts its retail price through one PCW, consumer incentives would move in the direction of reducing single-homing rates across PCWs—the incentive to search several sites increases with the frequency of price cuts; moreover, delistings are also likely to reduce single-homing rates since they worsen the quality of the search results returned by the PCW. A wide MFN, however, by maintaining price parities, is likely to increase single-homing rates (because there is little point to multi-homing if prices are all the same). Therefore, MFNs are likely to maintain market power, whereas selective delisting may reduce it.
- (c) In the case of delisting or its threat, insurers are free to negotiate a case-by-case settlement, whereas the only way out of an MFN is to renegotiate the entire clause. We have evidence of one instance in which an insurer [X].²⁷ This is an example of the threat of delisting leading to competition over commission fees with the PCWs—a scenario which would not have arisen with a wide MFN because the initial price cut would have been impossible.

9.91 The prevalence of single-homing allows selective delisting to be used to reduce price competition between PCWs. Wide MFN clauses operate differently than would selective delisting. We have not found that delisting practices are prevalent.

²⁷ [X]

However, we note that one reason for this could be because wide MFNs are currently a more effective mechanism. It is possible that selective delisting by PCWs with sufficient numbers of single-homing retail customers could in some circumstances come close to replicating the effects of wide MFNs.

Do MFNs lead to an AEC?

9.92 We have considered in this section the pro- and anticompetitive effects of both narrow and wide MFNs. For narrow MFNs we find that:

- (a) there may be some limited anticompetitive effects, although any effects are likely to be weak;
- (b) they may be necessary for PCWs to survive as they both provide credibility to PCWs and prevent free-riding by motor insurance providers;
- (c) competition in the motor insurance market would be weaker without PCWs. We have found evidence that price elasticity of demand is five to ten times greater on PCWs than on direct channels; and
- (d) therefore, on balance, we do not consider there to be an AEC from narrow MFNs.

9.93 For wide MFNs we find that:

- (a) Our analysis of incentives and evidence demonstrates that wide MFNs reduce entry, innovation and competition between PCWs.

- (b) There is direct evidence that wide MFNs harm competition between PCWs.

Notably, one PCW has tried to reduce its commission fees with motor insurance providers in exchange for lower premiums. However, motor insurance providers were unable to accept the offer due to the presence of wide MFNs in their contracts with other PCWs. A number of motor insurers also told us they had, as a result of wide MFNs, withdrawn from, or did not consider, such offers from PCWs.

- (c) Selective delisting of insurers, or its threat, by PCWs with sufficient numbers of single-homing retail customers could in some circumstances approximate the effects of wide MFNs.
- (d) The implementation of wide MFNs over and above narrow MFN clauses is not necessary for the survival of PCWs.

Provisional conclusion

- 9.94 We have identified a feature in the supply of motor insurance and related services²⁸ which we have provisionally conclude has an adverse effect on competition: wide MFN clauses in contracts between motor insurance providers and PCWs, and practices having equivalent effect where a PCW takes advantage of single-homing to prevent a provider of motor insurance and PCWs from competing on price.
- 9.95 We provisionally conclude that this feature distorts competition between PCWs, and thus ultimately restricts entry to the PCW market, reduces innovation by PCWs and increases premiums for motor insurance to the retail customer.

²⁸ The PCW market is a two-sided market where PCWs provide motor insurance price comparisons to consumers and sales opportunities to insurers and brokers. Both services are directly related to the supply of motor insurance to consumers.

10. Overall provisional finding

The statutory question

- 10.1 Under [section 134](#)(1) of the Act, we are required to decide whether ‘any feature, or combination of features, of each relevant market 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’. A feature, for the purposes of [section 134](#)(1) of the Act, can relate to the structure of the market and/or the conduct of market participants, including customers.¹ ‘Conduct’ includes any failure to act (whether or not intentional) and any other unintentional conduct.² There is an AEC if any individual feature or a combination of features 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.
- 10.2 The OFT referred to the CC the supply or acquisition of private motor insurance and related goods or services in the UK.
- 10.3 In this section we set out our provisional findings on whether there are features of the supply of motor insurance and related goods or services giving rise to an AEC.
- 10.4 For the reasons given in Section 5 we did not find any features giving rise to an AEC in relation to the supply of motor insurance in Northern Ireland or the supply of cost estimation systems. We considered whether there were significant obstacles to switching—especially in the form of automatic renewal, cancellation fees and NCB protection—which might give rise to competition concerns, but concluded that none of these features were giving rise to an AEC for the reasons set out in paragraph 5.14. We have noted that there are a number of industries that provide inputs to the claims management process (vehicle hire, repair, salvage and claims management

¹ See [section 131](#)(2) of the Act.

² See [section 131](#)(3) of the Act.

itself) but concluded that these relationships did not in themselves give rise to an AEC in the motor insurance market (see Appendices 9.1 and 9.2).

10.5 We provisionally found a number of AECs and each AEC is set out below along with our current thinking in relation to related customer detriment. We expect to develop and refine our analysis of the customer detriment in the context of our work on remedies.

10.6 We identified the following two features of the supply of motor insurance and related services³ which we provisionally concluded have, in combination, an AEC:

- (a) separation—that is, that the insurer liable for the non-fault driver’s claim, ie the insurer to the at-fault driver, is often not the party controlling the costs; and
- (b) various practices and conduct of the other parties managing such non-fault drivers’ claims which (i) were focused on earning a rent from control of claims rather than competing on the merits; and (ii) gave rise to an inefficient supply chain involving excessive frictional and transactional costs.

We provisionally concluded that these features distorted competition in the motor insurance market. Our reasons are set out in Section 6.

10.7 The effect of this AEC is higher motor insurance premiums than would otherwise be the case. Our current estimate of the customer detriment in terms of higher premiums for consumers is set out in paragraphs 6.79 to 6.82 and amounts to £150–£200 million per year. As noted in paragraph 6.84, not all drivers are affected in the same way by the issues we have identified associated with separation. Premium increases are likely to be higher for drivers with a higher probability of being at fault, while

³ The provision of claims services to non-fault drivers is related to the supply of motor insurance in a number of ways. It is the insurer to the at-fault driver who ultimately bears the costs of providing these services. Further, the party managing the provision of these services is often the insurer to the non-fault driver or a third party the non-fault driver is referred to by their own insurer or broker.

premium increases for less risky drivers will be smaller and premiums may even be lower for least risky drivers.

10.8 We noted (see paragraph 6.86) that the effects we identified were greatest in the provision of replacement vehicles and that the effects are currently smaller in repairs and write-offs, though ongoing litigation⁴ on repairs may impact on the position on repairs.

10.9 We identified the following features of the supply of motor insurance and related services⁵ which we provisionally concluded have, in combination, an AEC:

- (a) insurers and CMCs do not monitor effectively the quality of repairs; and
- (b) there are significant limitations to claimants' ability to assess the quality of car repairs.

We provisionally concluded that these features distorted competition between repairers to obtain business from insurers and other managers of drivers' claims. Our reasons are set out in Section 7.

10.10 The effect of this AEC is that some claimants would receive a lower value for their cars when they sold them (paragraph 7.48). Further, for those claimants who were immediately aware of issues with the repair done to their car they would be likely to experience some detriment. This would come from being aware their car was in a poorer condition and/or in having to seek rectification (paragraph 7.49). The net customer detriment associated with the AEC is the total detriment to customers whose cars are not repaired to their pre-accident condition less any savings to

⁴ *Coles and Others v Hetherton and Others*, [2012] EWHC 1599 (Comm) see paragraph 3.11.

⁵ The procurement of repair services by parties managing claims on behalf of drivers is related to the supply of motor insurance in a number of ways. It is an insurer who ultimately bears the costs of providing these services—either the driver's own insurer or the insurer of the at-fault driver involved in the accident. Further, the party managing the provision of these services is typically the insurer of the claimant or the insurer of the at-fault driver who has 'captured' their claim or a third party the claimant is referred to by their own insurer or broker.

insurers that are passed through to customers in lower motor insurance premiums (paragraphs 7.50 and 7.51).

10.11 We identified the following two features of the supply of motor insurance⁶ which we provisionally concluded have, in combination, an AEC:

(a) information asymmetries between motor insurers and consumers in relation to the sale of add-ons; and

(b) the point-of-sale advantage held by motor insurers when selling add-ons.

We provisionally concluded that these two features distorted competition in the motor insurance market. This is because they mean it is more difficult for consumers to identify the best-value offers in the market and may lead to consumers purchasing products at an inflated price. Our reasons are set out in Section 8.

10.12 We noted (paragraph 8.62) that the NEP of those add-ons which caused us concern was about £390 million a year. In calculating the customer detriment arising from this AEC it is not yet clear the proportion of this NEP that may be the result of the sale of add-ons at an inflated price but we intend to carry out further work to understand the level of detriment.

10.13 We identified the following feature in the supply of motor insurance and related services⁷ which we provisionally concluded has an AEC: wide MFN clauses in contracts between motor insurance providers and PCWs, and practices having equivalent effect where a PCW takes advantage of single-homing to prevent a provider of motor insurance and PCWs from competing on price.

⁶ The supply of motor insurance includes the supply of add-ons. We did not find it necessary to define a separate market for any add-on product and therefore include them in the motor insurance market.

⁷ The PCW market is a two-sided market where PCWs provide motor insurance price comparisons to consumers and sales opportunities to insurers and brokers. Both services are directly related to the supply of motor insurance to consumers.

10.14 We provisionally concluded that this feature distorted competition between PCWs, and thus ultimately restricted entry to the PCW market, reduced innovation by PCWs and increased premiums for motor insurance to the retail customer. Our reasons are set out in Section 9.

10.15 The effect of this AEC is higher premiums on motor insurance and possibly less choice from entry and innovation by PCWs (see paragraph 9.95).