Terms of reference and conduct of our investigation

Terms of reference

1. On 28 September 2012, the Office of Fair Trading (OFT) sent us the following reference:

A1. The OFT, in exercise of its powers under Section 131 and 133 of the EA02, hereby makes a reference to the CC for an investigation into the supply or acquisition of private motor insurance and related goods or services in the UK.

A2. The OFT has reasonable grounds for suspecting that a feature or a combination of features of the market or markets for the supply or acquisition of private motor insurance and related goods or services in the UK presents, restricts or distorts competition in connection with their supply or acquisition.

A3. For the purposes of this reference, 'private motor insurance' means insurance cover against damage to property and personal injury that is supplied to or acquired by drivers of privately owned motor cars designed and used for non-business (private) use. It excludes motorcycles.

Clive Maxwell
CEO
28 September 2012

Conduct of our investigation

2. On 1 October 2012, we published on our website an invitation to express views to us, and on 12 December 2012, we published an administrative timetable (since revised) for our investigation.

3. Since the reference from the OFT, we have gathered a wide range of information from relevant parties. We have:

- requested initial submissions from interested parties
- published an issues statement and received submissions on this document;

- held hearings with a number of parties;
- attended site visits;
- consulted on and commissioned a consumer survey from IFF;
- consulted on and commissioned a study involving post-repair vehicle inspections from MSXI;
- issued a number of information requests to parties; and
- held staff-level meetings with some parties on specific topics.

4. During July and August 2013, we published on our website a number of working papers, together with an annotated issues statement. These working papers addressed the following topics:
   - Overcosting and overprovision of repairs.
   - Overcosting and overprovision of temporary replacement vehicles.
   - Analysis of the results of the non-fault survey in relation to overprovision.
   - Statistical analysis of claims costs.
   - Vehicle write-offs.
   - Underprovision of repairs.
   - Underprovision of temporary replacement vehicles.
   - Analysis of the results of the non-fault survey in relation to underprovision.
   - Horizontal concentration in motor insurance providers in Northern Ireland.
   - Horizontal concentration in price comparison websites.
   - Horizontal concentration in repair cost estimation systems.
   - Obstacles to switching.
   - Analysis of add-ons.
   - Vertical relationships involving price comparison websites.
   - Impact of most-favoured-nation clauses in contracts between price comparison websites and motor insurance providers.
   - Analysis of vertical agreements for the supply of paint (excluding foreclosure).

- Analysis of potential foreclosure as a result of vertical relationships.
- Background to motor insurance (insurers, brokers and price comparison websites).
- Background to claims management process.
- Survey report.
- Vehicle assessments report prepared by MSXI (published October 2013).

5. We have published on our website non-confidential versions of the submissions we received in response to our annotated issues statement and our working papers, along with summaries and transcripts of the hearings.

6. We have published on our website a non-confidential version of our provisional findings.

7. We would like to thank all those who have assisted in our inquiry so far.

Industry background

Introduction

1. This appendix provides background information on:

   (a) the ten largest motor insurers (paragraphs 2 to 48);

   (b) selected PCWs (paragraphs 49 to 72); and

   (c) selected brokers (paragraphs 73 to 108).

The ten largest motor insurers

2. The ten largest motor insurers are: Admiral, Ageas, Aviva, AXA, CISGIL, DLG, esure, LV, RSA and Zurich.

3. Table 1 shows a summary of the companies owned by, or in the same group as, the ten largest motor insurers which provide services related to motor insurance.

TABLE 1 **Summary of companies owned by, or in the same group as, the ten largest motor insurers, which provide motor-insurance-related services**

Admiral	PCW: Confused.com (100 per cent)
Ageas	Brokers: Ageas 50 Limited (including the RIAS and Castle Cover brands), Kwik-Fit Insurance Services Limited, Express Insurance Services Limited, The Green Insurance Company Limited, and UKAIS Limited Ageas Law LLP. Ageas Services (UK) Limited
Aviva	Vehicle repairs: Solus
AXA	None
CISGIL	Co-operative Legal Services
DLG	Vehicle repairs: UKAARC
esure	PCW: Gocompare.com (50 per cent) Brokers: esure broker and Sheilas' Wheels Broker
LV	None
RSA	Vehicle repairs: RSAAR
Zurich	Broker: Endsleigh

Source: Responses from the insurers.

4. In the remainder of this section we present some brief details on each of the ten largest motor insurers: the type of company; its distribution channels and brands

used to sell motor insurance; the companies it owns which provide services related to motor insurance such as brokers, a PCW, etc; and its GWP. Annex A 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.

Admiral

5. Admiral launched in 1993 and floated on the London Stock Exchange in 2004 (it is currently a FTSE 100 company).

6. Admiral operates 13 brands in seven countries. In the UK its brands are Admiral, Bell, Diamond, and Elephant.co.uk.

7. Admiral also owns Confused.com, one of the four largest PCWs, which was launched in 2002.

8. In 2012, Admiral's total motor insurance GWP was over £1 billion, making it the fourth largest motor insurer in the UK. [A majority] of its sales are made via PCWs; its other sales channels are direct (own websites) and direct (own call centres).

Ageas

9. Ageas is an international insurance group ranked among the top 20 insurance companies in Europe. Its activities are grouped in four geographic segments: Belgium, the UK, Continental Europe and Asia. Ageas operates partnerships in Belgium, the UK, Luxembourg, Italy, Portugal, Turkey, China, Malaysia, India and Thailand and it has subsidiaries in France, Hong Kong and the UK. Ageas is the market leader in Belgium of individual life and employee benefits, as well as the leading non-life

insurer through AG Insurance. Ageas employs more than 13,000 staff and has annual revenues of more than €21 billion.

10. In the UK, Ageas (UK) Limited is a provider of life and non-life insurance products. Ageas (UK) Limited owns a 50.1 per cent shareholding in Tesco Underwriting Limited.

11. Ageas Insurance has a different business model from the other ten largest motor insurers as it does not have any of its own brands and does not sell directly to customers, typically selling through the brands of others. 89 per cent of its motor insurance policies are sold through brokers. It also sells through retailer partnerships (Age UK, General Motors, John Lewis, Lloyds Banking Group, Post Office Financial Services and Toyota). Ageas (UK) Limited owns a number of brokers: Ageas 50 Limited, Kwik-Fit Insurance Services Limited, Express Insurance Services Limited, The Green Insurance Company Limited, and UKAIS Limited.

12. In September 2012, Ageas (UK) Limited acquired Groupama Insurance Company Limited, boosting its presence in personal and commercial lines, and adding 1 million customers in the UK.

13. In 2012, Ageas Insurance's total motor insurance GWP was over £500 million, making it the sixth largest motor insurer in the UK.

Aviva

14. Aviva is the UK's largest insurer and one of Europe's leading providers of life and general insurance. In the UK it provides home, motor, life and health insurance and annuities. The group was formed by the merger of CGU and Norwich Union in 2000.

CGU came from the merger of Commercial Union and General Accident in 1998. It is a FTSE 100 company.

15. Aviva has three brands: Aviva, Quotemehappy (launched in August 2011) and General Accident (launched in April 2013). Aviva sells motor insurance via many distribution channels: direct, through brokers, corporate partners and PCWs (only using its Quotemehappy and General Accident brands). In 2012 approximately 50 per cent of its sales came from the broker channel.

16. Aviva also owns a vehicle repair company, Solus Accident Repair Centres (Solus), which carries out vehicle repairs, including collection and delivery, and the provision of courtesy cars.[1] Solus also has some arrangements to carry out fleet repairs for the police and other repair networks.

17. Until September 2011 Aviva was also the owner of the RAC,[2] which it sold to Carlyle Group, a private equity group. Aviva continues to sell RAC breakdown cover to its customers and is an underwriter on RAC's panel of motor insurers.

18. In 2012, Aviva's total motor insurance GWP was over £1.1 billion, making Aviva the second largest motor insurer in the UK.

AXA

19. AXA SA is a French global insurance group headquartered in Paris and quoted on the Euronext Stock Exchange. In the UK, AXA specializes in wealth management, insurance, and healthcare.

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[1] Aviva also had a salvage company, bluecycle.com, which was shut down in September 2013.
[2] The RAC motoring organization no longer has any connection to its previous owners, the Royal Automobile Club.

20. AXA sells motor insurance under two brands, AXA and Swiftcover, and through three channels: direct online (which is responsible for [✂]), via brokers (responsible for [✂]), and via PCWs (responsible for [✂]). It operates call centres but these are only to assist customers as it does not sell motor insurance by telephone.

21. In 2012, AXA's total motor insurance GWP was over £[✂] million, making it the fifth largest motor insurer in the UK.

CISGIL

22. The Co-operative Group is the UK's largest consumer cooperative. It is owned by over 7.2 million consumers and approximately 80 independent cooperative societies. The Co-operative Group includes The Co-operative Banking Group, which in turn includes The Co-operative Bank and CISGIL, the general insurance company within the group. On 4 November 2013 The Co-operative Group announced a restructuring plan under which, inter alia, its shareholding in The Co-operative Bank will be reduced to 30 per cent. It also stated that it was in discussions with various interested parties to sell CISGIL, but as at that date, no agreement to sell CISGIL had been entered into.[3]

23. CISGIL sells motor insurance under only one brand, The Co-operative Insurance, but it sells three different motor insurance products through different sales channels: 'Car Insurance' is sold direct, both online and via telephone, 'ecoinsurance' is only sold via PCWs, and 'Young Driver' is sold only direct online.

24. In 2012, CISGIL's total motor insurance GWP was over £[✂] million, making it the ninth largest motor insurer in the UK.

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[3] www.co-operativebankinggroup.co.uk/corp/pdf/recapitalisation-plan.pdf.

DLG

25. DLG is a leading general insurer and is the largest motor insurer in the UK. It also has businesses in Italy and Germany. Following an EU decision to separate DLG from the Royal Bank of Scotland Group plc as a condition of the bank receiving state aid, DLG floated on the London Stock Exchange in October 2012 and has a FTSE 250 position. DLG is still 48.5 per cent owned by RBS, although RBS has committed to selling its entire shareholding by December 2014.

26. In personal lines insurance, DLG sells home insurance, breakdown cover, pet insurance, travel insurance, motor and income insurance. Its commercial business also offers a range of products primarily targeted at small businesses.

27. DLG offers motor insurance through the Direct Line, Churchill and Privilege brands, and also through the brands of a range of partners, including Sainsbury's Bank, RBS Group, Prudential and PSA (Peugeot/Citroen).

28. DLG uses different channels for its different brands of motor insurance: Direct Line is available only over the telephone or online, not through PCWs; while Churchill and Privilege are sold through PCWs, as well as being available directly by telephone or online. DLG also uses its partnerships with retailers, banks, building societies and motor manufacturers. Across all its brands, over three-quarters of its sales are made direct (either online or by telephone).

29. DLG owns UK Assistance Accident Repair Centres Limited (UKAARC), which provides vehicle repair services exclusively to DLG through a network of 16 sites.

30. In 2012, DLG's total motor insurance GWP was over £1.6 billion, making it the largest motor insurance provider in the UK.

esure

31. esure only sells motor, home and travel insurance, and only to customers in England, Wales, Scotland and the Isle of Man. It was started in 2000 by the founder of Direct Line, and in 2010 was subject to a management buyout of the stake originally held by Halifax/HBOS and latterly Lloyds Banking Group. The company was floated on the London Stock Exchange in March 2013.

32. esure sells motor insurance under three brands: esure, Sheilas' Wheels (launched in 2005 to female drivers only) and First Alternative. It sells through PCWs (over [✂] per cent of its sales), and direct to customers via telephone and online. It does not distribute motor insurance through partnerships with retailers, banks/building societies or other distribution channels. In the past, esure provided motor insurance under the Sainsbury's and Halifax brands in partnership with these companies but new business under these arrangements has now ceased.

33. esure launched an insurance broker at the end of 2011 under two brands: esure broker and Sheilas' Wheels Broker. esure does not distribute motor insurance products through its insurance broking business but rather has a panel of other insurers which it believes complement esure's position in the market, enabling the group to offer services to customers who do not necessarily fit the underwriting footprint of esure, but nevertheless with to engage with the Group.

34. esure owns 50 per cent of Gocompare.com Holdings Limited, the parent company of Gocompare.com Limited, one of the four largest PCWs. It told us that Gocompare.com was independent and operationally separate from esure.

35. In 2012, esure's total motor insurance GWP was over £400 million, making it the seventh largest motor insurer in the UK.

LV

36. LV is the UK's largest friendly society[4] and a leading financial mutual. A mutual organization is owned by its members, with membership restricted to those who have certain types of policy, such as life insurance, or a retirement policy.

37. LV distributes car insurance through the full range of distribution channels: direct to customer (online or by telephone), affinity schemes, PCWs, corporate partners and brokers. [✂] It sells motor insurance only to customers in the UK.

38. LV sells motor insurance through three main brands: LV for direct sales, and both ABC Insurance and Highway Insurance for broker sales (Highway Insurance Group PLC was acquired by LV in 2008).

39. In 2012, LV's total motor insurance GWP was over £1.1 billion, making it the third largest motor insurer in the UK.

RSA

40. RSA is a leading global insurance group and a FTSE 100 company. In the UK it is the largest commercial insurer and one of the largest personal lines insurers.

41. RSA has three motor insurance brands. It sells motor insurance directly (through its More Th>n and eChoice brands) and also makes motor insurance sales through intermediaries including brokers (where some motor insurance will be sold under the RSA brand) and affinity partnerships. More Th>n is an online and telephone service provider which sells the full range of RSA's personal insurance products, including

[4] A friendly society is based on the principle of mutuality. Unlike a cooperative, members usually do not contribute to the capital of the organization by direct investment but derive their right to profits and votes through their customer relationship with the organization.

motor insurance, while eChoice is only sold online (through a dedicated website launched in 2010) and is only a motor insurance brand.

42. RSA sells motor insurance through a wide range of distribution channels: directly, either online or by telephone; online via PCWs (representing [✂] per cent of its sales); via brokers; and indirectly through affinity partnerships (Ford and Volvo). In 2012, [✂] per cent of its motor insurance sales were made direct and [✂] of sales were made via PCWs, with [✂] its sales made via brokers. However, RSA told us that, in 2013, it expected to write [✂]. RSA uses 'branded' and 'non-branded' brokers:[5] branded brokers include AA, Brightside, Budget, Castlecover, Endsleigh, Kwik Fit and Swinton; non-branded brokers tend to be RSA-branded, with the cover based on RSA's own policy wording.

43. RSA group owns RSA Accident Repairs Limited (RSAAR) which trades under the name of Motor Repair Network Management. RSAAR operates through a network of approved garages and carries out some repairs at garages which it owns and which are staffed by its employees, known as Quality Repair Centres (QRCs), and which undertake repair work solely for RSA.

44. In 2012, RSA's total motor insurance GWP was over £[✂] million, making it the eighth largest motor insurer in the UK.

Zurich

45. Zurich is one of the world's largest insurance groups and is listed on the SIX Swiss Stock Exchange. In the UK, Zurich sells a range of general insurance products,

[5] A branded broker leverages its brand name, customer loyalty and possession of customer data to obtain cheap quotations. The AA Insurance, part of the AA roadside breakdown organization, is the UK's leading branded broker of motor insurance. It uses a 'Motor Insurance Deal Checker' system to compare insurance policies from a selected panel of over 15 insurers (including RSA). Other branded brokers include Kwik Fit Insurance (owned by Ageas), Endsleigh (owned by Zurich), BGL and RAC.

including car, home, boat, and high-net-worth insurance, as well as life insurance products such as life cover, pensions and retirement products, and investments.

46. Zurich sells motor insurance through two main sales channels: nearly [✂] per cent of sales are made through brokers, with the remainder made through PCWs. It has not written new business through partnerships since 2010. A very small amount of motor insurance is sold directly online.

47. Zurich owns the broker Endsleigh Insurance (over which it acquired full control in 2007).

48. In 2012, Zurich's total motor insurance GWP was over £[✂] million, making it the tenth largest motor insurer in the UK.

PCWs

The four large PCWs

49. The four largest PCWs are:

(a) Comparethemarket.com;

(b) Confused.com;

(c) Gocompare.com; and

(d) Moneysupermarket.com.

50. Table 2 presents a summary of the financial results for the four large PCWs. Since all four companies promote other products in addition to motor insurance, the results do not reflect the size of their motor insurance business. Although none of the four companies publically discloses financial results for its motor insurance activities, the turnover related to motor insurance is shown in the bottom half of the table for each

PCW. None of the four PCWs discloses the operating profit related to motor insurance in its management accounts.

TABLE 2 **Summary financial results of the four largest PCWs**

Company	*Confused.com*		*Comparethe market.com*		*Gocompare.com*		*Moneysuper market.com*	
	2011	*2010*	*2011*	*2010*	*2011*	*2010*	*2011*	*2010*
Turnover (£m)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Op profit (£m)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Op profit (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Motor insurance only								
Turnover (£m)	[✂]		[✂]		[✂]		[✂]	
Turnover as a % of company turnover	[✂]		[✂]		[✂]		[✂]	

Source: PCWs' published reports and accounts, and management accounts.

51. Three of the four large PCWs were able to provide us with some of their key performance indicators (KPIs) for their motor insurance business on a similar basis, as shown in Table 3. Conversion is calculated as the ratio of motor insurance policies sold to the number of unique customer quotes.

TABLE 3 **KPIs for the three of the four largest PCWs**

	Confused.com	*Comparethe market.com*	*Gocompare. com*
Fee per policy sold (£)	[✂]	[✂]	[✂]
Unique customer quotes (m)	[✂]	[✂]	[✂]
Number of motor insurance policies sold	[✂]	[✂]	[✂]
Conversion (%)	[✂]	[✂]	[✂]

Source: PCWs' published reports and accounts, and management accounts.

Note: Moneysupermarket.com [✂].

52. We discuss the profitability of the PCW's motor insurance business further in Appendix 9.3, Annex I.

53. In the remainder of this section we provide some brief details on each of the four large PCWs.

Comparethemarket.com

54. Comparethemarket.com is an independent division of BISL Limited (BISL), which is part of the privately owned BGL Group.

55. Motor insurance makes up [✂] of Comparethemarket.com's PCW business [✂].

56. Comparethemarket.com is [✂] it generated turnover of £[✂] from motor insurance in 2011. Its average income per sale was £[✂].

57. Comparethemarket.com told us that it considered its closest competitors to be the other three large PCWs, plus Google and Tesco Compare which were of lesser but increasing significance.

Confused.com

58. Confused.com is a wholly-owned subsidiary of Admiral. It promotes and compares a wide range of general insurance and finance products. It was launched in 2002, starting with motor insurance, and added its home insurance comparison service in 2005.

59. On motor insurance turnover alone, Confused.com is the [✂] of the four large PCWs, having generated £[✂] turnover from motor insurance in 2011. This represented [✂] per cent of its total turnover. Its average income per sale was £[✂].

60. Confused.com told us that it considered its closest competitors to be the other three large PCWs, plus Google.

Gocompare.com

61. Gocompare.com is 50 per cent owned by esure.[6] Gocompare.com told us that it was operated independently of esure and no executive management was shared.

62. Gocompare.com provides comparison services for other insurance products including home, motorbike, van and pet. It also has a number of 'white label' agreements for the provision of other products, such as travel insurance, utilities, and business/ landlord insurance.

63. On motor insurance turnover alone, Gocompare.com is the [✂] of the four large PCWs, having generated £[✂] turnover from motor insurance in 2011. This represented [✂] per cent of its total turnover. Its average income per sale was £[✂].

64. Gocompare.com told us that it considered its closest PCW competitors to be the other three large PCWs, Tesco Compare and Google.

Moneysupermarket.com

65. Moneysupermarket.com was founded in 1999 and provides comparison services for a range of products including insurance, financial services and non-financial services. Moneysupermarket.com is wholly owned by Moneysupermarket.com Group Plc, which is a FTSE 250 listed company. The group also owns Moneysavingexpert.com which is a financial journalism website.

66. Moneysupermarket.com is structured into four 'verticals': money, insurance, home services and travel. Other than motor insurance, Moneysupermarket.com provides comparison services for a wide range of insurance products: home, travel, life, mortgage protection, income protection, breakdown, motorbike, business, and van.

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[6] Via GoCompare.com Holdings Limited.

Moneysupermarket.com also provides comparison services for a wide range of products, both financial and non-financial: travel, energy, mobile phones, shopping, and broadband, as well as offering promotional deals and vouchers. Moneysupermarket.com appears to offer the widest range of product comparisons of the four large PCWs.

67. On motor insurance turnover alone, Moneysupermarket.com is the [✂] of the four large PCWs, having generated £[✂] turnover from motor insurance in 2011. This represented [✂] per cent of its total PCW business.

68. Moneysupermarket.com told us that it considered its closest competitors to be the other three large PCWs, as well as Tesco Compare, Google, Tiger, Quotezone, Moneyexpert, Uswitch, Lovemoney, Quidco, and Soswitch. This longer list of competitors appears to be because of Moneysupermarket.com's wider product range than the other three large PCWs.

Other PCWs

Google and Tesco Compare

69. We asked the four large PCWs which PCWs they considered to be their closest competitors. All four cited the other three large PCWs but three out of the four PCWs also mentioned Google and Tesco Compare. Google launched its current motor insurance price comparison service in the UK in September 2012 following its acquisition of Beatthatquote in March 2011, a company which was founded in 2005. Tesco Compare launched its motor insurance price comparison service in September 2007, initially as a 50:50 joint venture with the Royal Bank of Scotland, though in 2008 Tesco bought the business in its entirety.

CompareNI

70. CompareNI is a PCW operating only in Northern Ireland. It is part of Seopa Ltd, founded in 2003, and is still owned 100 per cent by its founder. Although originally focusing mainly on search engine optimization for the insurance industry, Seopa Ltd began to expand into the creation of price comparison technologies soon after incorporation. The company started price comparison activities in the UK with Quotezone and developed CompareNI in 2008/09.

71. CompareNI's primary revenue stream is from motor insurance, where it earns commission fees and click-through fees generated from customers clicking on adverts placed on its website. The company includes links to others websites in order to give consumers a route to some of those motor insurers which do not participate on PCWs. Since 2008, CompareNI has also provided consumers with the telephone numbers of the brokers which quote on its site so that they can purchase their insurance over the phone or find out more details about the policy if they wish.

72. Table 4 summarizes CompareNI's financial performance [✂].

TABLE 4 **Summary financial results for CompareNI, [✂]**

	[✂]	*[✂]*	*[✂]*
Company			
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
Motor insurance only			
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]

Source: CompareNI management accounts.

Note: [✂].

Information on selected motor insurance brokers

73. In this section we provide information on six large motor insurance brokers, three of which are owned by insurance companies, two part of a group with includes an

insurance company and one is in the same group of companies as a PCW, as follows:

- AA and Saga—owned by Acromas Holdings (which owns an insurance company);
- Ageas Retail—owned by Ageas Group (an insurance group);
- BISL—owned by BGL Group, which owns CTM;
- Endsleigh—owned by Zurich (an insurance group); and
- Swinton—owned by Covéa (an insurance group).

74. Table 5 summarizes the motor insurance income of these six brokers.

TABLE 5 **Motor insurance income for selected brokers**

	Year ended	*£m*
AA	January 2012	[✂]
Saga	January 2012	[✂]
		[✂]
Ageas Retail	December 2012	[✂]
BISL (Frontline only)	[✂]	[✂]
Endsleigh	December 2012	[✂]
Swinton	December 2012	[✂]

Source: Parties' management accounts.

AA and Saga

75. The AA and Saga are insurance brokers owned by Acromas Holdings. They are managed separately so we discuss them in turn. Acromas Insurance Company Limited (AICL), part of the Acromas group, is one of the panel insurers for the AA and the sole provider of motor insurance to Saga.

AA

76. Automobile Association Insurance Services Limited (AAISL) brokers motor insurance through two brands: AA Car Insurance and AA Drivesafe Insurance (the latter being the AA's telematics offering).

77. The AA also sells and administers a range of general insurance products, including home and breakdown assistance.

78. For motor insurance, the AA [✂].

79. The AA told us that [✂].

Financials

80. Table 6 summarizes the financial performance of the AA's motor insurance broking business for the three years to January 2012.

81. Sales and GWP did [✂]. Commission and contribution per policy did [✂].

TABLE 6 **Summary financials, AA, for the three years ended January 2012—motor insurance only**

Motor insurance only	*Years ended January*		
	2012	*2011*	*2010*
Sales (£m)	[✂]	[✂]	[✂]
Contribution (£m)*	[✂]	[✂]	[✂]
Contribution (%)	[✂]	[✂]	[✂]
Marketing costs (£m)	[✂]	[✂]	[✂]
Total policies	[✂]	[✂]	[✂]
GWP (£m)	[✂]	[✂]	[✂]
Average per policy (£):			
GWP	[✂]	[✂]	[✂]
Commission	[✂]	[✂]	[✂]
Contribution*	[✂]	[✂]	[✂]
Marketing costs	[✂]	[✂]	[✂]

Source: AA management accounts.

*After marketing costs.

Saga

82. Saga Services Limited, trading as Saga, is a general insurance intermediary business which sells and administers a range of general insurance products including motor, home, travel and private medical insurance. Saga only offers motor insurance policies underwritten by AICL.

83. All of the broking activity, including the sale, renewal and administration of policies, is carried out by Saga; but all claims handling is carried out by AICL.

84. Saga offers motor insurance exclusively to the over-50s market in the UK.

85. Saga featured in Datamonitor's list of the top ten motor insurance advertisers (by expenditure) in 2011: it had the ninth biggest spend on advertising, with direct mail accounting for over 80 per cent of its advertising spend.[7]

Financials

86. Table 7 summarizes the financial performance of Saga's motor insurance broking business for the three years to January 2012.

87. [✂], sales and contribution [✂].

TABLE 7 **Summary financials, Saga, for the three years ended January 2012—motor insurance only**

Motor insurance only	*Years ended January*		
	2012	*2011*	*2010*
Sales (£m)	[✂]	[✂]	[✂]
Contribution (£m)	[✂]	[✂]	[✂]
Contribution (%)	[✂]	[✂]	[✂]
Marketing costs (£m)	[✂]	[✂]	[✂]
Total policies	[✂]	[✂]	[✂]
GWP (£m)	[✂]	[✂]	[✂]
Average per policy (£):			
GWP	[✂]	[✂]	[✂]
Commission	[✂]	[✂]	[✂]
Contribution	[✂]	[✂]	[✂]
Marketing costs	[✂]	[✂]	[✂]

Source: Saga management accounts.

Ageas Retail

88. Ageas Retail is the broking division of the Ageas group. Ageas Retail consists of the following companies which all sell motor insurance: Ageas 50 Limited; KwikFit

[7] [✂], DLG, [✂] in 2011, spent [✂] per cent of its advertising expenditure on direct mail and [✂] per cent on television advertising.

Insurance Services Limited (KFIS), Express Insurance Services Limited (EIS), The Green Insurance Company (TGIC); and UK Ageas Insurance Solutions (UKAIS). KFIS was acquired in 2010. KFIS is the parent company for EIS and TGIC and these three businesses are managed together. Ageas 50 Limited is the largest brand in the group, offering primarily motor and home insurance.

89. Ageas Retail's major specialisms are providing insurance to the over 50s, affinity partnerships and aggregator distribution.

Summary financials

90. Table 8 presents the limited financial information available for all the Ageas Retail businesses for the three years ended December 2012.

TABLE 8 **Summary financials, Ageas Retail, three years ended December 2012**

£

	Years ended December		
	2012	*2011*	*2010*
Whole business			
Income	[✂]	[✂]	[✂]
Operating profit	[✂]	[✂]	[✂]
Operating profit (%)	[✂]	[✂]	[✂]
Total motor insurance income	[✂]	[✂]	[✂]
Average premium	[✂]	[✂]	[✂]

Source: Ageas Insurance.

BISL

91. BISL is an insurance broker [✂].

92. BISL uses multiple distribution channels: its own website and call centre, and PCWs.[8]

[8] Another division of BISL is Comparethemarket.com, [✂].

93. BISL is owned by BGL Group, which was established in 1992 as an insurer but changed strategy in 1997 to become an insurance intermediary.

94. BISL manages its direct brands within its Frontline business and manages its affinity and partner brand relationships within its Junction business.

Financials

95. Table 9 summarizes the financial performance of Frontline's motor insurance business [✂].

TABLE 9 **Summary financial performance, [✂]—motor insurance only**

[✂]

Source: BGL management accounts.

96. In 2012, [✂].

Endsleigh

97. Endsleigh is a group of companies wholly owned by Zurich.

98. Endsleigh Insurance Services Limited (EIS) was originally founded by the National Union of Students (NUS) in 1965 and is a UK insurance intermediary specializing in the provision of personal insurance products for students, graduates and the education sector. EIS is the primary brand under which Endsleigh markets and sells motor insurance.

99. EIS sells general insurance products to retail customers online via a direct website and through PCWs, offline via a call centre, and via introducer networks and partnerships. These include affinity relationships, such as with the NUS and the National

Association of Schoolmasters Union of Women Teachers. EIS sells motor, home, travel and student possessions insurance.

100. EIS has delegated authority from its panel of insurers to sell and service insurance and, for most of the insurers on its panel, it also handles claims on their behalf.

101. Separate to this business, EIS also offers third party administration claims handling services to a number of insurers and insurance risk capacity providers. This is distinct from the main EIS panel business as it handles policyholders who did not buy their policies from EIS. EIS is paid a fee for these services by the relevant insurer.

102. EIS operates a panel of 13 motor insurers. Its [✂].

Financials

103. Table 10 summarizes Endsleigh's financial performance for the three years ended [✂]. The management accounts are based on an analysis of income by product type (eg motor, home, travel etc). However, expenditure is considered by category and is not linked back to the product to which it relates. As a result, although motor insurance [✂], Endsleigh was not able to estimate the profitability of this business. Turnover and profits [✂] over the three-year period to [✂].

TABLE 10 **Summary financial performance, Endsleigh, three years ended** [✂]

[✂]

Source: Endsleigh management accounts.

Swinton

104. Swinton is a part of the Covéa group.[9] Swinton's primary brands for retail motor insurance broking are Swinton in mainland UK, and Open & Direct Insurance in Northern Ireland. Swinton also brokers many other insurance products, including household insurance and commercial vehicle cover.

105. Swinton brokers the majority of its motor insurance sales through its network of branches,[10] as well as through its call centres and online (new policies only). It has 512 branches in Great Britain and 16 in Northern Ireland. Swinton has an inbound call centre which functions as an overflow unit in support of the branches and provides service outside branch opening hours. Swinton also has an outbound call centre which is used as a sales campaign unit, and sells core products, add-ons and monthly products.

106. Swinton has [✂] main insurers on its motor insurance panel. The top ten insurers on its panel represent [✂] per cent of Swinton's GWP, with the most important ([✂]) representing [✂] per cent of its GWP, and the second most important ([✂]) representing [✂] per cent of its GWP.

Financials

107. Swinton does not allocate either divisional costs or central overheads to individual products, and therefore financial data is only available at a high level. Table 11 shows the financial performance of the whole business for the three years ended December 2012. Income, contribution and operating profits [✂] in 2011 [✂] in 2012.

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[9] Swinton Holdings Limited is a sister company of Covéa Insurance plc. Covéa Insurance was created in the UK in October 2012 through the integration of three companies: Provident Insurance, MMA Insurance and Gateway, and is part of the French Covéa mutual insurance group.

[10] Approximately [✂] per cent of Swinton's overall business is generated through these branches (no figure provided for motor insurance specifically).

Motor insurance has been an increasing part of Swinton's business, and in 2012 constituted [✂] of its total business.

TABLE 11 **Summary financials, Swinton, for the three years ended December 2012**

£ million

	Years ended December		
	2012	*2011*	*2010*
Income	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
Operating profit	[✂]	[✂]	[✂]

Source: Swinton Holdings Limited statutory accounts and Swinton management accounts.

108. Swinton provided us with a split of its income by product for the three years ended 31 December 2012, which is shown in Table 12. Total income [✂] per cent over the three years, which appeared to be [✂].

TABLE 12 **Swinton, breakdown of motor insurance income, 2010 to 2012**

£ million

	2012	*2011*	*2010*
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]

Source: Swinton management accounts.

High-level analysis of profitability for the ten largest PMI insurers, 2008 to 2012

	Claims ratio (%)						*Expense ratio (%)*					
	2008	*2009*	*2010*	*2011*	*2012*	*Average*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average*
Admiral	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ageas	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Across all 10 providers	**78**	**89**	**98**	**78**	**75**	**84**	**32**	**30**	**24**	**27**	**29**	**28**

	COR (%)						*Underwriting result plus investment income (£m)*					
	2008	*2009*	*2010*	*2011*	*2012*	*Average*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average*
Admiral	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ageas	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Across all 10 providers	**110**	**119**	**123**	**105**	**104**	**112**	**596**	**–238**	**–334**	**888**	**984**	**377**

Source: CC calculations based on data from the ten largest insurers.

Note: [✂].

Measurement of profitability

1. We found that there are two key measures of profitability which are disclosed externally: the underwriting result and the combined operating ratio (COR):

   - The underwriting result is expressed as an absolute figure and is calculated as earned premiums (net of reinsurance),[1] plus other income (including referral fees), less incurred claims (usually net of any rebates), earned commission and expenses, and excludes investment income. As such, it is focused only on underwriting activities and not investment activities.
   - The COR expresses insurance outgoings as a percentage of premiums. Insurance outgoings are claims liabilities, commission payments and expenses. The lower the figure, the more profitable the business to the insurer, with any figure below 100 per cent meaning that the insurer is profitable on its underwriting activities (before investment income).

2. Other financial performance measures used by motor insurers are:

   - Based on premiums received: GWP, net written premium (NWP) and net earned premium (NEP). Each of these measures is expressed as an absolute figure. GWP is the amount of premium written in the year, gross of reinsurance, and regardless of when it was accrued; NWP is GWP net of reinsurance; NEP is the amount of premium accrued during the year, regardless of when it was written, net of reinsurance.
   - Based on profitability:
     - Return on capital/return on equity. This is typically profit after tax divided by total capital or equity capital, expressed as a ratio.

[1] 'Reinsurance' is insurance purchased by an insurance company from one or more other insurance companies as a means of risk management. The function of reinsurance is to reduce an insurer's exposure to loss by passing part of the risk of loss on to a reinsurer.

- Profit before tax (also called portfolio insurance result, or technical or operating result). This is the underwriting result plus investment income, thus measuring all activities in the insurance business.

- Based on claims costs:
  - Claims ratio (or loss ratio). This is the claims cost as a percentage of premiums.
  - Underlying or normalized measure of claims costs. This is claims costs excluding very large individual claims, over a certain amount, eg very large personal injury claims. This is generally then used in the calculation of a normalized claims ratio.
- Based on expenses: expense ratio. This is expenses as a percentage of premiums.

3. We also asked the insurers how they accounted for referral fees and rebates from other firms, and amendment and cancellation fees from customers. We found that rebates are generally credited against the cost of claims, while referral fees and amendment and cancellation fees are generally included in ‘other income’.

ToH 3: Horizontal concentration in repair cost estimation systems

Introduction

1. In this appendix we present the evidence we have received in relation to horizontal concentration in repair cost estimation systems.

Evidence

2. There are two main repair cost estimation systems in the market: Audatex and Glassmatix. A third system, offered by Inter-est, is also available.

3. Insurers and other work providers generally recommend or require their preferred repairers to use a specific repair cost estimation system. This makes their processes easier, with one consistent feed of data into their systems and a consistent process for their engineer assessors. We found that, of the ten largest insurers, only Ageas does not recommend or require a specific system to be used and the other nine insurers all recommend or require the use of Audatex.

4. Audatex charges a fee for several elements of the estimation process, including a per-estimate fee and a per-photograph fee. Audatex estimates that its average cost per estimate, charged to the repairer, is £[✂].

5. Glassmatix charges an annual subscription fee of £1,800 for a licence for up to five users. It does not charge a per-estimate fee but does charge a transmission fee if the estimate is sent to an insurer, which is between £[✂] and £[✂]. Glassmatix told us that its recent deals with repairers had been at the lower end of this range due to its weakened market position. Repairers told us that the Glassmatix price structure made Glassmatix the preferred option for repairers which undertook a substantial amount of work for retail customers (ie not through work providers), for whom

estimates were required but where there was no transmission, as such estimates could be generated in the Glassmatix system at zero marginal cost.

6. Glassmatix told us that it could not determine how many estimates were produced by its system as many were created without transmission. However, it has estimated the number of estimates produced on the basis of the number of online registration checks which are run through its system on the DVLA database (as almost all estimates will require such a check). On this basis, Glassmatix estimates that its system costs repairers about £[✂] per estimate (including subscription revenue).

7. In the last five years, Glassmatix has lost several contracts with work providers, including with Zurich, AXA, CISGIL and RSA. It told us that Zurich switched away from Glassmatix because it was already having to use Audatex for its work with fleet managers which meant that it was having to input Audatex outputs manually into its system. RSA told us that [✂].

8. Glassmatix told us that there were two principal reasons why it had lost contracts with work providers to Audatex. First, Glassmatix had [✂]. Glassmatix said that [✂]. Second, Glassmatix said that Audatex had offered work providers rebates for estimates submitted by their repair networks as a way of incentivizing work providers to mandate or to recommend strongly the adoption of Audatex by their repairers. Glassmatix said that the effect of these deals for work providers was to make the system approximately costless for them, with all the cost paid by repairers.

9. Glassmatix told us that it had lost market share to Audatex very quickly over a short period. In 2007, its revenue was £[✂], whilst in 2014 its projected revenue would be £[✂]. It said that Audatex had built its market share very quickly, almost entirely at the expense of Glassmatix.

10. Glassmatix told us that its market analysis suggested that there were 3,500 primary body shop outlets,[1] with around a further 2,500 businesses in the UK offering 'car body repairs'.[2] These sites provide repairs to insurance, CMC, fleet and retail customers. Glassmatix is used in approximately 650 sites and Audatex is used in approximately 2,200 sites. Glassmatix said that some small repairers which focused on retail customers did not use a repair cost estimation system at all.

11. Glassmatix said that it was now focusing its business on large repairers which targeted the retail market and on small repairers for which purchasing the Audatex system was inefficient. Glassmatix said that it believed Inter-est was targeting this same customer base, also recognizing that, in the short term at least, Audatex had an insurmountable position with work providers.

12. Glassmatix told us that the costs for an insurer in switching its repair cost estimation system would depend on the degree to which the system was integrated into the insurer's back office systems, and these costs could be high. However, we noted that there was now effectively an industry standard for the form of the input into back office systems, which meant that the cost of switching had reduced, at least for some insurers. Glassmatix said that the other principal cost of switching was training engineer staff on to the new system, which would require approximately two days for each engineer. However, as Glassmatix (or another repair cost estimating system provider) would usually provide this training at no cost to the insurer, it did not believe that the insurer would consider this alone as a major impediment to switching.

13. Glassmatix told us that the products its group offers are broadly the same across Europe, though sometimes under different brands. Glassmatix said that Audatex offered systems across Europe under the same brand and was now the undisputed

[1] Source: Trendtracker.
[2] Source: Auto Industry Insider website and Bodyshop Magazine circulation numbers.

European market leader. Glassmatix said that there were other ‘local’ vendors in some countries (such as Inter-est in the UK).

14. In our conversations with repairers, they told us consistently that Audatex was the best repair cost estimation system available, but that it was also the most expensive. Many told us that, if they were free to choose their repair cost estimation system (without the interference of work providers) they were likely still to choose Audatex.

Horizontal concentration in motor insurance in Northern Ireland: introduction

1. The purpose of this section is to assess the level of horizontal concentration in motor insurance providers in Northern Ireland, both overall and for specific types of driver. We consider to what extent the level of concentration of motor insurance providers in Northern Ireland may explain the profitability of insurers in Northern Ireland. In Annex A we present an analysis comparing motor insurance profitability in Northern Ireland with motor insurance profitability in Great Britain.

2. The appendix is structured as follows:

- background to the supply of motor insurance in Northern Ireland;
- horizontal concentration of motor insurance providers in Northern Ireland;
- why some motor insurance providers are not active in Northern Ireland or only to a limited extent;
- why there are fewer motor insurance providers offering policies for young and high-risk drivers;
- evidence of entry and expansion in motor insurance provision in Northern Ireland; and
- motor insurance profitability in Northern Ireland.

Background to the supply of motor insurance in Northern Ireland

Estimated market size

3. A number of motor insurance providers active in Northern Ireland provided us with estimates of the size of the motor insurance market in Northern Ireland. In terms of the number of private vehicles, these estimates ranged from 570,000 to 880,000, typically based on figures sourced from the Department for Regional Development Northern Ireland, although the estimates varied depending on the base year and the types of vehicles included. A number of the higher estimates included light goods

vehicles which were not included in this reference. Based on 2011 statistics provided by the Department for Regional Development, we estimate that around 610,000 to 650,000 vehicles are covered by motor insurance in Northern Ireland.[1]

4. In terms of the market value, motor insurance providers estimated that the total GWP of motor insurance in Northern Ireland is between £282 million and £500 million. However, some of the higher-end estimates either did not have a robust methodology supporting them, or they included light goods vehicles as well as private motor vehicles so we put less weight on these estimates. Several motor insurance providers estimated the market to be worth around £300 million. Based on our estimate of the number of vehicles covered by motor insurance in Northern Ireland (see paragraph 6.5) and the average GWP per policy in Northern Ireland,[2] it appeared to us that this estimate of around £300 million seemed reasonable.

Distribution of motor insurance in Northern Ireland

5. Consumers in Northern Ireland predominantly purchase motor insurance policies through brokers. RSA estimated that around 60 per cent of motor insurance sales were made through brokers in Northern Ireland and a number of other insurers estimated that the four or five leading brokers in Northern Ireland had a collective retail market share of between 40 and 60 per cent. Most of those broker sales are made by telephone through local branches rather than face-to-face interaction or online.

6. Several parties gave us reasons why brokers had such a significant role in the distribution of motor insurance in Northern Ireland:

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[1] 650,000 is based on the number of diesel cars and petrol cars in Northern Ireland (categories 48 and 49) found in Table 1.3 on p25 of www.drdni.gov.uk/ni_transport_statistics_annual_2011-12.pdf. However, some of these vehicles are likely to be fleet vehicles. [✂] However, due to information we have now received from all parties, we know there are at least 610,000 policies.
[2] In 2011, this was £[✂] per policy, based on information from motor insurance providers.

- RSA said that because claims rates in Northern Ireland were, on average, higher than Great Britain, motor insurance providers had felt more comfortable using the broker's personal relationship with their customers as a method of controlling fraud at the point of claim as well as at the point of sale.
- AXA told us that the three main brokers had branch networks which contributed to their brand strength.
- Allianz said that many Northern Ireland customers preferred to purchase motor insurance via intermediaries in person or over the phone and were less inclined (than in Great Britain) to buy insurance directly from insurers. They said that this was partly due to Northern Ireland having an abundance of small intermediaries.
- Several parties noted that PCWs had less of a presence in Northern Ireland compared with Great Britain. Allianz told us that some PCWs had only recently removed an exclusion relating to Northern Ireland, which had been in place because many insurers did not cover Northern Ireland. In addition, First Central (an insurer selling predominantly through PCWs) said that none of the PCWs included a list of the separate Northern Ireland driving endorsement codes and even the Northern Irish comparison website 'Compare Northern Ireland' did not cater for the Northern Ireland driving conviction codes.

7. Many motor insurance providers named Hughes, Open & Direct (Swinton) and Abbey as being the leading brokers in Northern Ireland. Several also named Autoline and three named Provincewide as being significant brokers in Northern Ireland.

8. We noted that PCWs appeared to be growing in importance as a sales channel in Northern Ireland. Both LV and RSA told us that sales via PCWs had increased over the last year, though RSA also told us that the use of PCWs in Northern Ireland had not grown as rapidly as in other parts of the UK.

9. Hughes told us that the introduction of PCWs had had a major impact on the supply of motor insurance in Northern Ireland. It told us that 61 per cent of its new business for drivers under 30 now began with an online quote. Hughes said that, although Northern Ireland consumers valued being 'local' as an important component of a motor insurance provider's brand, it believed this aspect to be weakening as the younger population became more confident about buying online.

10. However, we also noted that AXA Northern Ireland (the largest motor insurance provider in Northern Ireland) does not sell under the AXA brand via PCWs, and Allianz told us that any change in customer behaviour from buying via brokers was likely to be slow.

11. Overall, although the broker channel remains strong in Northern Ireland, the PCW channel is growing. We have UK-wide evidence that premium competition between insurers is intensified when sales are conducted through PCWs. We expect that the increasing adoption of PCWs in Northern Ireland, particularly among the young, will increase rivalry in the supply of car insurance.

Differences in legal structure

12. There are several important differences with relevance to motor insurance between the legal system in Northern Ireland compared with the legal systems which operate in England and Wales and Scotland. The OFT, in its summary of responses to its call for evidence, identified two aspects of the Northern Ireland legal system which may be responsible for motor insurance premiums being higher in Northern Ireland than in Great Britain, as follows:

- First, the levels of compensation for personal injury claims are higher in Northern Ireland than in Great Britain. Insurers pointed to differences in the levels of

compensation set out in the relevant guidelines[3] and told the OFT that, as a result, personal injury settlements were higher. The OFT heard that the gap between Northern Ireland and Great Britain had narrowed recently, although the submissions indicated that compensation levels continued to be higher in Northern Ireland than in England and Wales.

- Second, insurers told the OFT that differences in the legal processes also appeared to be leading to higher legal costs in Northern Ireland compared with Great Britain. In particular, the absence of a compulsory pre-action protocol in Northern Ireland[4] at the time of the OFT call for evidence was cited as potentially having the effect of making litigation more prevalent in Northern Ireland than in Great Britain as the applicable procedures did not appear to provide the same incentive to settle cases quickly.[5]

13. We note that on 18 January 2013, DK McFarland, Presiding Judge of the County Courts in Northern Ireland, issued a practice decision that came into operation on 25 February 2013—the 'Pre-Action Protocol for Personal Injury Litigation and Damage-only Road Traffic Accident Claims'.[6] However, as this protocol has only recently come into operation in Northern Ireland, we have not carried out any analysis of its impact on motor insurance.

14. Several motor insurance providers told us that the legal differences between Northern Ireland and the rest of the UK made very little difference in practice to the

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[3] Guidelines for compensation levels in Northern Ireland are set by the Judicial Studies Board for Northern Ireland. See: *Guidelines for the Assessment of General Damages in Personal Injury Cases in Northern Ireland* (Third Edition), Judicial Studies Board for Northern Ireland, 2008.
[4] The Civil Procedure Rules 1998 (SI 1998/3132 as amended) in force in England and Wales contain a Pre-Action Protocol for Low Value Personal Injury Claims in Road Traffic Accidents. The pre-action protocol for road traffic accidents is set by the Ministry of Justice. It describes the behaviour the court will normally expect of the parties prior to the start of proceedings where claims damages are valued at no more than £10,000.
[5] Respondents to the OFT call for evidence indicated that while claimant and defendant legal rates are not higher in Northern Ireland than in Great Britain, settlement often takes place close to a hearing, resulting in higher costs. The practice of retaining counsel for valuation and negotiation is apparently more prevalent in Northern Ireland than in Great Britain which adds to the overall litigation costs. However, in their submissions to the OFT, legal associations did not agree that the legal process in Northern Ireland was more expensive than in Great Britain.
[6] Accessible at: http://tinyurl.com/czh5zxh.

provision of motor insurance. However, we were told that there was a lower prevalence of CMCs and CHCs in Northern Ireland.

Insurers active in Northern Ireland

15. We asked both insurers and brokers for the main insurers active in Northern Ireland. AXA Northern Ireland, Allianz and Prestige Underwriting (Prestige)[7] were named by most motor insurance providers as being the main underwriters in Northern Ireland. Several third parties estimated AXA to have a [reasonably large] market share [✂]. Aviva, RSA and Zurich were also mentioned by some parties. DLG, Admiral, Liberty (formerly Quinn), NFU Mutual, Equity and Marker Study (Zenith) were mentioned by one or two providers. We are aware of at least 45 insurers which offered motor insurance policies in Northern Ireland in 2013, although most of these are estimated to have a share of supply under 5 per cent. The market shares for 18 of them, for which we have detailed data for 2011, are presented in Table 1.[8]

Concentration of motor insurance providers

16. We estimated shares of supply using both the volume and value of motor insurance policies underwritten in Northern Ireland in 2011, based on information supplied by motor insurance providers. Table 1 shows the results.

[7] Prestige Underwriting states on its website (www.prestigeunderwriting.co.uk) that it is a delegated underwriter 'acting on behalf of a number of large, financially strong insurance companies'.
[8] See paragraph 4.20. We did not reach a final view of whether there is a separate motor insurance market in Northern Ireland.

TABLE 1 **Market shares**

	GWP £'000	*Share of supply Value (%)*	*Number of policies active*	*Share of supply Volume (%)*
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]*	[✂]
[✂]	[✂]	[✂]	[✂]†	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]‡	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]§	[✂]
[✂]	[✂]¶	[✂]	[✂]#	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
Total (known)	c295,000		c610,000	
Market size (estimate)	295,000–315,000~		610,000–650,000★	

Source: motor insurance providers.

*CC estimate.
†CC estimate based on [✂] average GWP of £[✂].
‡[✂]
§CC estimate based on estimated average GWP of around £[✂].
¶CC estimate based on [✂] GWP for young drivers in Northern Ireland and proportion of motor insurance volume being from young drivers (4.5 per cent).
#CC estimate based on methodology in previous footnote.
~See paragraph 12.
★See paragraph 11.

17. In response to our survey of motor insurance policyholders[9], 19 per cent of Northern Ireland motor insurance policyholders said that their policy was underwritten by AXA. However, a very high proportion (around 45 per cent) of Northern Ireland respondents did not know which insurer had underwritten their motor insurance policy. Of those Northern Ireland respondents that did know which insurer had underwritten their policy, 35 per cent had a policy underwritten by AXA.[10] This result is [✂] the market share estimate shown in Table 1.

18. Based on the above market shares, we calculated the Herfindahl–Hirschman Index (HHI) for the supply of motor insurance in Northern Ireland to be between 2,000 and

[9] Customer Survey Tables.
[10] Responses to question S11 (see Customer Survey Tables), with broker responses and 'don't know' answers excluded.

2,200 (based on value) and 1,500 and 1,800 (based on volume). The CC's guidelines state that a market with an HHI over 1,000 is likely to be considered concentrated whilst a market with an HHI over 2,000 is likely to be considered highly concentrated.[11] On this basis, we noted that the HHI for motor insurance in Northern Ireland (when calculated on the basis of value) was indicative of a highly concentrated market.[12]

19. However, we find that this high concentration is largely the result of Axa's recent growth in the market, growth which even competitors appear to agree has been the result of Axa's competitive offering and well-managed strategy of expansion. [✂]

20. Furthermore, we noted that some motor insurance providers do not underwrite policies for certain types of driver in Northern Ireland. For example, Saga and Allianz told us that they did not underwrite policies for policyholders under 21 years old; and DLG and Zurich told us that they only wrote business for young drivers through certain brands and sales channels respectively. Some other insurers told us that they wrote few policies for young drivers. Tesco Underwriting, Groupama and AXA[13] told us that they would not underwrite policies for some high-risk drivers. This, however, is not a strategy that is specific to Northern Ireland—there is specialization in the types of risks that insurers seek in the entire UK market.

Why are some motor insurance providers not active in Northern Ireland or only to a limited extent?

21. A number of motor insurance providers active in the rest of the UK are not active in Northern Ireland, whilst others do not appear actively to seek business in Northern Ireland. Motor insurance providers cited three barriers to entering or expanding within Northern Ireland, which we discuss in turn.

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[11] See *CC3*, Annex A, paragraph 7.
[12] CC estimate based on data provided in Table 1.
[13] Although AXA told us that it provided quotes to the vast majority of consumers.

The Northern Ireland market is small

22. There are specific investments that an insurer may need to make in order to underwrite (or perhaps to underwrite significant numbers of) policies in Northern Ireland. For example, Allianz told us that an insurer might need a local approved repair network[14] and there was a need for local solicitors who knew the differences in the court system, Northern Ireland legislation and the level of personal injury awards. LV told us that, due to the legal differences, an insurer would need an effective claims network in order to control costs.

23. Allianz said that, while the hurdles to entering Northern Ireland were not difficult to overcome, because the market was small it might not be worth the investment. Similarly esure said that Northern Ireland was not considered to be economically viable for it to enter as a start-up insurer and, given the need to establish local infrastructure and esure's current business strategy, esure did not currently have any appetite to enter the Northern Ireland market.

24. Both LV and First Central told us that, because Northern Ireland was a small market, claims costs could be volatile. [✂] told us that its business in Northern Ireland had had unpredictable results, with some large claims.

25. It appeared to us that the size of the motor insurance market in Northern Ireland, and the fact that insurers may need to incur specific investments to operate (or perhaps to operate at significant scale) in the market, may inhibit new entry (or deter insurers from underwriting significant numbers of policies). However, we do not consider that the costs of entry are on a different scale from entering other regions of the UK. We note that there has been recent entry and expansion in Northern Ireland.

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[14] Allianz said that this type of investment was not critical where an insurer wished to underwrite young drivers whose decisions were more likely to be driven by, for example, the premium level rather than whether there was a local approved area network.

Lack of underwriting experience

26. We noted that some insurers might not be active in Northern Ireland due to a lack of claims experience within Northern Ireland on which to base their risk modelling. A few insurers told us that a lack of previous underwriting experience was a bigger barrier to entry in Northern Ireland than it was in the rest of the UK. For example, [✂] told us that some sources of third party socio-demographic data, which could be accessed in Great Britain to aid risk pricing, were not available in Northern Ireland.

27. However, RSA told us that a new entrant could choose to pay another party (eg a broker or another partner) which did possess learned experience within the market in terms of allocating risk and pricing to build up a body of knowledge within a shorter time frame. RSA told us that, alternatively, a new entrant could delegate underwriting authority to a broker or other partner in order to enter the market more quickly. LV told us that [✂]. Information obtained from brokers may not be a perfect substitute for the information gained from experience, but the barrier to entry appears reduced by the presence of broker networks in Northern Ireland.

28. esure said that an insurer required specialist underwriting and pricing knowledge of the Northern Ireland client base in order to operate in the market; and [✂] told us that the greater underwriting experience of AXA gave it a competitive advantage. We noted in some AXA internal documents that it recorded some UK competitors to be setting prices without reference to specific Northern Ireland factors.

29. It appears to us that motor insurance providers with little underwriting experience in Northern Ireland may be at some competitive disadvantage to those with more experience in the market, but we believe that broker-based information offers some reduction in this barrier to entry.

Strength of the broker channel

30. Some insurers indicated that the significance of brokers as a sales channel for motor insurance in Northern Ireland restricted entry. [✂] told us that expanding its market share beyond its broker business was harder in Northern Ireland than in other parts of the UK as customers in Northern Ireland had a stronger preference for buying through a broker. Covea told us that Northern Ireland was a broker-led market, which it was not focused on serving because the market was dominated by large insurers which had existing relationships with brokers.

31. On the other hand, RSA and AXA both argued that the predominance of the broker channel in Northern Ireland made entry easier, not harder. An insurer could get customer access and market information through agreements with brokers and did not have to develop their own direct sales channels. Thus, unless they were committed to a vertically integrated model, entry into Northern Ireland should be easier than entry into other areas that did not have such well-defined routes to market. It was important to consider the counterfactual in determining whether entry was made easier or harder by consumers' preferences for broker-based purchases. It made direct sales models harder, but intermediated sales models easier.

Why are there fewer motor insurance providers offering policies for young and high-risk drivers?

Young drivers

32. We found that not all motor insurance providers in Northern Ireland provide policies for young drivers (see paragraph 27), although the definition of 'young' varies slightly between insurers.

33. Saga told us that its decision not to underwrite policies for young drivers was related to its brand positioning rather than being an underwriting choice. Tesco Underwriting told us that [✂].

34. NFU Mutual, RSA, First Central and Zenith all told us that they wrote relatively few policies for young drivers. NFU Mutual told us that, in its experience, price was the major motivator for young drivers when selecting an insurance provider so fewer young drivers were attracted to its brand and customer proposition, which was focused on product and service quality. First Central said that its internal reinsurance costs were dependent on the proportion of young drivers underwritten, which caused it to keep this percentage low in order to maintain acceptable reinsurance costs. Zenith told us that it would be at a disadvantage writing motor insurance policies for younger drivers due to its lack of knowledge and experience in this area.

35. While acknowledging that there were fewer insurers actively underwriting motor insurance policies for young drivers in Northern Ireland, RSA told us that there were no specific barriers to insurers doing so. RSA said that, consequently, firms active in supplying policies to young drivers remained subject to potential competition from motor insurance providers not currently active in that segment.

'High-risk' drivers

36. We found that some motor insurance providers in Northern Ireland do not provide motor insurance policies to drivers considered to be 'high risk' (see paragraph 27). Motor insurance providers do not appear to have a specific definition of what constitutes a 'high-risk driver', although certain characteristics may contribute towards this assessment. These include drivers:

- with a poor credit history;
- who have been previously disqualified from driving;
- who have made multiple claims;
- with excess penalty points or Road Traffic Act convictions;
- in high-risk occupations; and/or
- previously convicted of drink-driving.

37. Both Tesco Underwriting and Groupama identified that some risks were outside their underwriting risk appetite and they would not write motor insurance policies for such drivers. AXA also said that drivers who had excessive claims, previous convictions or were employed in certain high-risk occupations might not represent an acceptable risk which it would be willing to underwrite.[15]

38. Allianz said that it would write motor insurance policies for some higher-risk drivers but they would be rated at a higher premium than the standard rating levels and might have bespoke terms and conditions applied. Similarly, [✂] identified drivers with poor driving records as a segment where it would not be able to offer competitively-priced policies.

39. It is not only in Northern Ireland that insurers choose the specific risk categories to whom they most wish to sell. Specialization in provision is a common form of market segmentation all over the UK. We have not identified any significant specific barriers to entry or expansion for any particular risk class in Northern Ireland.

Evidence of entry and expansion in motor insurance provision in Northern Ireland

40. We consider in this section evidence of recent expansion in Northern Ireland by [✂], [✂], Midas, Liberty and AXA.

41. AXA told us that, in the last six to nine months, [✂], Midas, Liberty and RSA had become much more active in the market. This activity involved offering new products, and pricing to gain market share. AXA said that both [✂] and RSA were gaining business and, [✂].

[15] Although AXA told us that it provided quotes to the vast majority of consumers.

42. [✂] Midas is a new entrant in the market, is to follow a similar penetration strategy and also expects to enter the top 10 in 2013.

43. [✂]

44. [✂]

45. Despite noting that both [✂] and AXA had recently gained business in Northern Ireland (see paragraph 47), Allianz told us that it did not believe it likely that the position of the three largest underwriters in Northern Ireland (Allianz, AXA and Prestige) would change significantly in the foreseeable future. However, it noted that the impact of the pending launch/relaunch of [✂] in the broker market was unknown.

46. We noted that AXA had achieved the most significant recent expansion in Northern Ireland, growing its Northern Ireland business from around [✂] policies in 2006 to [✂] policies in 2011. [✂] It appeared to us that there were a number of factors which had underpinned its previous growth, including:

- winning business as a result of Quinn going into administration in 2010;
- establishing a strong local focus, in part by transferring its business to be managed from the Republic of Ireland in 2007;
- successful branding and pricing; and
- some of its competitors being less focused on this market.

47. Thus, AXA's market share seems to be the result of a process of rivalry and seems to have arisen from AXA taking a number of risks over the past seven years. Its current position does not seem to be protected by significant barriers to entry or expansion.

Motor insurance profitability in Northern Ireland

Introduction

1. This annex presents an analysis of motor insurance profitability in Northern Ireland compared with motor insurance profitability in Great Britain.

Theoretical background

2. In our update to the statement of issues, published on 27 February 2013, we stated that under ToH 3: Harm due to horizontal effects (market concentration) in motor insurance we would focus our investigation solely on Northern Ireland, and we would investigate the profitability of insurers in Northern Ireland.

Why profitability is a useful indicator

3. The CC's Guidelines state that outcomes of the competitive process in their different forms in a market, eg prices and profitability, can provide evidence about its functioning.[1]

4. The Guidelines[2] state that, in practice, a competitive market would be expected to generate significant variations in profit levels both between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. The profitability of some firms may exceed what might be termed the 'normal' level, for example as a result of past innovation or superior efficiency, but a situation where the profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process.

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[1] *CC3*, paragraph 103.
[2] *CC3*, paragraphs 117 & 118.

Examples of these limitations could be the presence of entry barriers, or the existence of significant market power.

5. The Guidelines mention[3] four possible types of analysis of prices and profitability: pricing patterns; price cost margins; price comparisons; and profitability. Annex A of the Guidelines states[4] that where capital employed cannot be reliably valued, the CC may consider alternative measures, such as the return on sales or other relevant financial ratios.

Measures of profitability

6. We looked at the claims ratio and the combined operating ratio as basic measures of profitability.

7. The claims ratio is calculated as claims expense divided by NEP. Claims expense is the total of claims paid, net of any recoveries from reinsurers, and any change in provision for claims, net of reinsurance; NEP is GWP net of IPT, premiums ceded to reinsurers and any change in provision for unearned premiums. Thus, both parts of the calculation take into account the potential need to spread premiums and claims expenses over more than one period (that is, the amounts are accounted for on an accruals, not cash, basis (ie premiums received but not yet earned; and claims incurred but not yet paid out)).

8. The claims ratio, which is presented as a percentage, essentially measures the proportion of premiums paid out in claims. A low claims ratio indicates that only a small amount is paid out compared with the amount customers are charged in premiums; a high claims ratio would indicate that a large amount is paid out. All things being equal, a lower claims ratio indicates higher profitability.

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[3] *CC3*, paragraph 107.
[4] *CC3*, Annex A, paragraph 15.

9. However, the claims ratios does not take into account the expenses incurred in the sale of insurance such as commission paid to brokers, fees to PCWs, advertising costs, other customer acquisition costs and administration expenses. Therefore we also looked at

(a) the expenses ratio: total expenses divided by NEP; and

(b) the combined operating ratio: total claims costs and expenses divided by NEP.

10. We looked at weighted average claims ratio, expenses ratio and combined operating ratio over a five-year period. This was in order to smooth out most fluctuations in claims costs due to any build-up and subsequent release of provisions. We also thought that, given the smaller book size in Northern Ireland, a five-year period would be long enough for a representative number of large claims to occur, and thus reduce the amount of variability in claims costs and profitability.

The data

Data requested from the parties

11. We asked providers to complete a template spreadsheet for the five years 2008 to 2012, splitting their data between Great Britain and Northern Ireland. The spreadsheet was a standard profit and loss account for insurance providers, showing GWP, premiums written net of reinsurance, NEP, investment income, fee and commission income, and total income; claims paid and any movement in claims provision; and expenses such as fees and commissions to brokers, advertising costs, and administrative and finance costs. The template spreadsheet also asked for the number of policies, split by type of policy (comprehensive; third party, fire and theft; and third party).

Data provided

12. Of the ten largest insurers in the UK, seven were able to provide us with figures enabling us to compare claims ratios for Northern Ireland and Great Britain: [✂].[5] Five of these insurers provided us with figures enabling us to compare expenses ratios and combined operating ratios for Northern Ireland and Great Britain: [✂].

13. Of these five, we excluded [✂] figures for the reasons set out in paragraphs 17 to 23.

14. esure told us that it did not operate in Northern Ireland. Two insurers (Aviva and CISGIL) told us that they carried out a very small amount of business in Northern Ireland and did not provide us with any data on Northern Ireland. [✂] did not provide any data on broker commissions in Northern Ireland and [✂] did not provide a split of broker commissions between Northern Ireland and Great Britain.

15. We also asked the ABI to tell us which other insurers, outside of the ten largest insurers in the UK, were active in Northern Ireland. In response, the ABI said that Allianz, First Central, Groupama and Tesco Underwriting all operated in Northern Ireland.[6] We found that these insurers (in aggregate) made up approximately one-quarter of total NEP from motor insurance in Northern Ireland for the insurers in our analysis (ie the total for these insurers and the Northern Ireland businesses of the four large insurers who provided sufficient data). Although we recognized that these other insurers sold motor insurance in the rest of the UK, we called them the 'Northern Ireland-only insurers' to distinguish them from the 'large insurers'.

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[5] [✂]
[6] Tesco Underwriting started trading in October 2010. We included data for 2012 but not for 2010 or 2011 as Tesco Underwriting told us that its results in 2010 and 2011 were not representative of its current trading levels.

16. Some of the insurers provided us with commentary and explanations for the differences in profitability between the two territories, which we discuss below (see paragraphs 38 to 44).

Data provided by [✂]

17. [✂] provided us with data which enabled us to compare its profitability in Northern Ireland and Great Britain. [✂]

18. Overall, [✂] average claims ratio over the five-year period was [✂] per cent (with [✂] per cent for Great Britain and [✂] per cent for Northern Ireland). However, [✂] claims ratio for Northern Ireland over the five-year period fluctuated considerably [✂].

19. [✂] told us that [✂].

20. [✂] also told us that [✂].

21. We asked [✂] if it could suggest a method of 'smoothing' the large fluctuations in claims costs other than simply taking a five-year average. [✂] provided us with an analysis which showed the claims ratio split for both Northern Ireland and Great Britain by accident year rather than by financial year. This had the effect of removing the distortions to the results caused by movements in prior year claims and showed average claims ratios of [✂] per cent for Northern Ireland and [✂] per cent for Great Britain. We noted that these figures were [✂].

22. However, [✂] also told us that, [✂].

23. Because we considered [✂] data to be anomalous and because it made up only a small percentage of the total data provided, we decided to exclude [✂] original data from our analysis. We also did not include [✂] accident year data as it was not comparable with the data provided by the other large insurers.

Analysis of the data

Total NEP in our sample

24. Over the five years 2008 to 2012, the four large insurers and the Northern-Ireland-only insurers in our sample achieved an aggregate Northern Ireland motor insurance NEP of £732 million. Table 1 shows how this level of NEP was split between the insurers in the sample. [✂], while the Northern-Ireland-only insurers (in aggregate) were responsible for one-quarter.

TABLE 1 **Northern Ireland NEP, 2008 to 2012, four large insurers and Northern-Ireland-only insurers**

	per cent
	Northern Ireland NEP
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
	[✂]
Northern Ireland-only insurers	[✂]
Total	100

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

Claims ratios

25. Table 2 shows the claims ratios for the four large insurers and the Northern-Ireland-only insurers in our sample for Great Britain and Northern Ireland for 2008 to 2012.[7]

[7] The claims ratio is calculated as claims expense divided by NEP. Claims expense is the total of claims paid, net of any recoveries from reinsurers, and any change in provision for claims.

TABLE 2 **Claims ratios for Great Britain and Northern Ireland, 2008 to 2012**

per cent

	Total UK excluding Northern Ireland						*Northern Ireland only*					
	2008	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Northern-Ireland-only insurers							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
To note: [✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

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

26. Overall, for these insurers, the weighted average claims ratios over the five-year period was eight percentage points higher in Great Britain than in Northern Ireland ([✂] per cent compared with [✂] per cent). The average claims ratios of two of the four large insurers were lower in Great Britain than Northern Ireland [✂].[8]

27. The data also showed that:

- For the four large insurers, the weighted average claims ratios over the five-year period were [✂] per cent for Great Britain and [✂] per cent for Northern Ireland. In each of the five years except 2009, the weighted average claims ratio was higher in Great Britain than in Northern Ireland.
- For the Northern Ireland-only insurers, the weighted average claims ratio over the five-year period was [✂] per cent, ranging between [✂] per cent (2012) and [✂] per cent (2011).

28. We considered each of the four large insurers individually:

[8] We also calculated the weighted average claims ratio using data provided by the six large insurers noted in paragraph 12, excluding [✂]. For the six large insurers and the Northern-Ireland-only insurers, the weighted average claims ratio over the five-year period was 11 percentage points higher in Great Britain than in Northern Ireland ([✂] per cent compared with [✂] per cent).

- Two of the four large insurers had average claims ratios over the five-year period greater in Great Britain than in Northern Ireland ([✂] and [✂]).
- [✂]
- [✂]

Ratio of broker commission to NEP

29. One explanation given to us for the lower claims ratio in Northern Ireland was that more motor insurance business is written though brokers in Northern Ireland than Great Britain and that because distribution costs might be higher in Northern Ireland due to the payment of broker commissions, premiums might be higher to compensate for the higher cost, resulting in a lower claims ratio.

30. AXA Ireland told us that in Northern Ireland [✂]. AXA Ireland noted that in Northern Ireland:
    - brokers sold additional products such as motor legal expenses insurance and breakdown cover and had their own premium finance facilities and therefore the income from these products accrued to brokers rather than insurers; and
    - in addition to commission on policy sales, brokers could earn administration fees from customers for renewals, mid-term adjustments and from insurers for claims management.

31. [✂] told us that claims ratios in Northern Ireland might be lower than in Great Britain because most Northern Ireland business was written through brokers, where distribution costs might be higher due to the payment of broker commissions. [✂] said that, whilst commissions were generally paid in lieu of marketing and operational costs, there would be an element of broker margin which would result in an overall higher cost than if business were sold directly to a customer. As such, premiums may be slightly higher to incorporate the higher cost, resulting in a lower claims ratio.

32. In order to examine the explanation that claims ratios in Northern Ireland were lower because premiums are higher to compensate for the higher cost of the broker distribution channel we next looked at the ratio of broker commission to NEP for the insurers for which we have data. The results are shown in Table 3.

TABLE 3 **Broker commission/NEP for Great Britain and Northern Ireland, 2008 to 2012**

per cent

	Total UK excluding Northern Ireland						*Northern Ireland only*					
	2008	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Northern-Ireland-only insurers							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
To note: [✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

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

33. Table 3 appears to be consistent with the explanation. It shows that overall the average ratio of broker commission to NEP over the five-year period 2008 to 2012 was four percentage points higher in Northern Ireland than Great Britain and also that in Northern Ireland the ratio was similar for the large insurers and the Northern-Ireland-only insurers. [✂], while [✂], which in the UK sells most of its motor insurance policies through brokers, had a similar ratio in Northern Ireland and Great Britain.[9] [✂], which in the UK also sells the majority of its motor insurance policies through brokers, also had a similar level of broker commission to NEP in Northern Ireland and Great Britain.[10]

[9] Working paper 'Background to private motor insurance (insurers, brokers and PCWs)', paragraph 32.
[10] ibid, paragraph 67.

Expenses ratio

34. We next looked at the ratio of total expenses (including broker commission, fees paid to PCWs, advertising, other customer acquisition costs, administration and other expenses) to NEP. The results are shown in Table 4.

TABLE 4 **Expenses ratio for Great Britain and Northern Ireland, 2008 to 2012**

per cent

	Total UK excluding Northern Ireland						*Northern Ireland only*					
	2008	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Northern-Ireland-only insurers							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
To note: [✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

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

35. We found that the average ratio was similar in Great Britain and Northern Ireland, which indicated that if broker commission was higher in Northern Ireland than in Great Britain, other expenses were lower in Northern Ireland than in Great Britain (for example, PCW fees). This pattern was confirmed by examining individual insurer's data:

(a) In the financial information provided by [✂].

(b) Similarly, in Northern Ireland [✂] allocated [✂] to fees to PCWs or advertising and other customer acquisition costs, whereas in Great Britain these expenses amounted to an average of [✂] per cent of total NEP for Great Britain and Northern Ireland combined over the period 2008 to 2012.

Combined operating ratio

36. Finally we looked at the combined operating ratios for these insurers. This ratio expresses the total claims costs, commission payments and expenses as a

percentage of NEP. The lower the figure, the more profitable is the insurer, with any figure below 100 per cent meaning that the insurer is profitable on its underwriting activities (before investment income). The ratios are shown in Table 5.

TABLE 5 **Combined operating ratio for Great Britain and Northern Ireland, 2008 to 2012**

per cent

	Total UK excluding Northern Ireland						*Northern Ireland only*					
	2008	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average (weighted by NEP)*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Northern-Ireland-only insurers							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total							[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
To note: [✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

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

37. Overall, the weighted average combined operating ratio for this group of insurers over the five-year period 2008 to 2012 was nine percentage points lower in Northern Ireland than Great Britain ([✂] per cent compared with [✂] per cent) which indicates that motor insurance business was more profitable in Northern Ireland than Great Britain. However, the average combined operating ratio in Northern Ireland of [✂] per cent indicated that the underwriting activities (before investment income) only broke even over the five-year period.

Insurers' comments on profitability in Northern Ireland compared with Great Britain

38. [✂] AXA Ireland noted that [✂], which it cited as evidence of the competitive nature of the market.

39. [✂] told us that its profitability [✂]. In these years [✂] combined operating ratio in Great Britain was [✂], while in Northern Ireland it was [✂]. [✂] noted that its

combined operating ratios for Great Britain and Northern Ireland were similar in 2012 and suggested that the main reason for the difference we had found in the five-year averages was that the data for the period was not representative.

40. Table 5 supports the contention by [✂] and [✂] that the difference in profitability between Great Britain and Northern Ireland reduced in 2012. It shows that for the large insurers the weighted average combined operating ratio was higher in Great Britain than Northern Ireland by 14 percentage points in 2010 and 15 percentage points in 2011 and that the difference narrowed to seven percentage points in 2012.

41. [✂] told us that, anecdotally, it would not be surprised if direct insurers with no specialist knowledge of the market in Northern Ireland experienced lower claims ratios in Northern Ireland than in the rest of the UK as insurers with any disadvantage in risk pricing in Northern Ireland could not afford the risk of adverse selection which followed from being too price-competitive.

42. CISGIL [✂] told us that, based on its indirect assessment of market conditions rather than directly on data, it believed that claims costs had been historically higher in Northern Ireland than in Great Britain, primarily as a result of differences in the personal injury claims process, as a result of which premiums in Northern Ireland were typically higher than for the equivalent risks in Great Britain. However, CISGIL told us that claims ratios might be lower in Northern Ireland than Great Britain because:

(a) Over the last four years, personal injury claims costs in Great Britain had increased rapidly and to a large extent unexpectedly, driven by an increase in low-value whiplash-type claims and the prevalence of CMCs, which had caused claims ratios to rise, particularly in 2009 and 2010, before improving somewhat in 2011 and 2012 as premium increases caught up.

(b) The same rapid increase in claims costs had not been observed in Northern Ireland as CMCs did not exist in the same way, meaning that claims ratios in Northern Ireland had not seen the same increase and had remained at a more sustainable long-term level.

(c) Expense ratios were higher in Northern Ireland as insurers writing business in Northern Ireland would typically need to maintain some local infrastructure, such as claims repair networks, and would not achieve the same economies of scale as in Great Britain, due to the relatively small size of the Northern Ireland market, resulting in a relatively higher level of expense which would need to be covered by a lower claims ratio to achieve the same level of profitability.

43. RSA noted that there were several characteristics specific to the Northern Ireland market, as follows:

(a) Historically, there was a higher incidence of fraud at the point of claim in Northern Ireland than in Great Britain.

(b) Although the frequency of claims was low (due to Northern Ireland being largely a rural area with fewer road traffic accidents), the amounts paid out in claims was typically higher than in other UK regions, driven by higher payouts for personal injury and solicitors' fees relating to personal injury claims.

(c) Because Northern Ireland drivers tended to cross the border into the Republic of Ireland, RSA was frequently in a position of dealing with claims in a jurisdiction in which it did not operate which increased its overall costs of handling claims (and anecdotal evidence suggested that the average payout for personal injury claims was even higher in the Republic of Ireland than in Northern Ireland, with an average whiplash claim costing £3,500 in Great Britain, £5,000 in Northern Ireland and £10,000 in the Republic of Ireland).

44. Admiral told us that it aimed to price its policies to maintain a broadly consistent claims ratio across all segments in its portfolio. It said, however, that the underwriting result for Northern Ireland had been much more variable over the period as a result of the volatility which arose from a smaller book size.

Claims ratios for each insurer in our sample, split between Great Britain and Northern Ireland, five years 2008 to 2012

per cent

	Total UK						*Total UK excluding Northern Ireland*						*Northern Ireland only*					
	2008	*2009*	*2010*	*2011*	*2012*	*Average*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average*	*2008*	*2009*	*2010*	*2011*	*2012*	*Average*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Northern-Ireland-only insurers													[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
To note: [✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

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

Cost of replacement cars

Introduction

1. In this appendix, we assess the cost implications of separation of cost liability and cost control. As discussed in Section 6, this is the case when non-fault claims are managed by the non-fault insurer or by a CMC, rather than by the at-fault insurer itself.

2. The appendix is structured as follows:

   (a) comparison of credit hire and direct hire costs;

   (b) analysis of the cost of credit hire, including (i) the payment of referral fees by CMCs/CHCs to non-fault insurers and brokers (and others) in order to provide credit hire services; and (ii) the frictional costs incurred by both insurers (at-fault and non-fault) and CMCs/CHCs in relation to the provision of credit hire services; and

   (c) analysis of the duration of credit hire.

Credit hire

3. If a non-fault insurer or broker controls a non-fault driver's claim, the driver often receives a replacement car from a CMC/CHC under a credit hire agreement, following a referral to the CMC/CHC from the broker or insurer (for which the broker or insurer earns a fee). Assuming that 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 duty to mitigate their loss with consideration to their need, and will recover the cost from the at-fault insurer.

4. Nine of the ten motor insurers in our sample told us that they usually referred their non-fault drivers, with the driver's consent, to a CMC or CHC for the provision of replacement car services under a credit hire agreement.[1]

The GTA

5. Nine of the ten motor insurers in our sample subscribe to the GTA.[2]

6. The GTA is a voluntary non-binding protocol which sets out the arrangements between insurer and CMC/CHC subscribers for replacement car provision under credit hire to non-fault drivers. It was established with the intention of removing confrontation, avoiding costly litigation and encouraging collaboration in the management and settlement of credit hire claims.

7. Although subscription to the GTA is voluntary, the Credit Hire Organisation (CHO) told us that it estimated that the GTA was supported by CHCs/CMCs and insurers that accounted for about 90 per cent of the credit hire market in the UK. According to the CHO, about 77 per cent of credit hire and credit repair claims are settled under the GTA (see Table 2). The remaining cases are either handled outside the GTA from the outset, or are handled initially within the GTA but then 'fall out'. The latter are settled through negotiation and, often, litigation.[3]

[1] CISGIL told us that it did not refer its non-fault drivers directly to CHCs. However, it said that it referred its non-fault drivers with motor legal expenses insurance to Co-operative Legal Services (CLS) in respect of their uninsured losses. CLS managed these drivers' claims against the at-fault party, including the provision of a replacement car. CISGIL said that around [✂] per cent of these drivers were referred, on the basis of need, by CLS to [✂] for the provision of a replacement car on credit hire terms.
[2] [✂] told us that all but one of its brands subscribed to the GTA. [✂] did not.
[3] Under the GTA, a CMC/CHC can pursue payment outside the terms of the GTA for claims not settled within 90 days, ie through litigation.

TABLE 2 **Credit hire and credit repair claims settled under the GTA, 2009 to 2011**

	2009	*2010*	*2011*
Proportion of credit hire and credit repair claims settled under the GTA (%)	76	77	77
Credit hire and credit repair claims issued under the GTA	23,500	28,400	19,200
GTA claims resulting in a court case	2,290	2,270	1,590

Source: The CHO.

8. The GTA covers the terms, conditions and rates of credit hire for replacement cars provided to non-fault customers in the UK. The overriding principle of the GTA is that whoever is first to a customer and obtains their agreement should provide the service and no other subscriber should seek to intervene. 'First to a customer' is defined as the receipt and acceptance by the customer of a suitable and clear offer. The GTA also applies pre-agreed administrative processes and pre-agreed maximum daily hire rates.[4] The GTA hire rates are agreed between the insurance industry and the CMCs/CHCs by a technical committee, which is constituted with equal representation by insurers and CMCs/CHCs and an independent Chairman.

9. The GTA Technical Committee is currently conducting a feasibility study into the establishment of a GTA portal, which would be an online tool to improve the management of credit hire claims and reduce administrative and frictional costs for both insurers and CMCs/CHCs. The concept has received backing from both insurers and CMCs/CHCs. Insurer and CHO members of the GTA have, through the Technical Committee, prepared a detailed technical specification for the portal and conducted a competitive tendering process which is nearing completion. Tender responses are in the final stages of evaluation following which members will be asked to carry out a cost benefit analysis in respect of the proposed portal as it relates to their own

[4] The GTA is intended to apply to situations where a CMC/CHC feels the non-fault driver has the prospect of full recovery against the at-fault insurer and, in such cases, all subscribers are required to follow the GTA. In all other cases (ie where full recovery is not anticipated), subscribers may elect to follow the same principles, provided that they comply with the spirit and terms of the GTA, including by applying the relevant settlement rates.

organization. At present it is possible that the portal could commence operating towards the end of 2014.

Direct hire

10. Direct hire replacement cars are often supplied to non-fault drivers when the at-fault insurer captures and controls the non-fault claim or where there is a bilateral agreement in place between the at-fault insurer and the non-fault insurer or when the at-fault insurer is also the non-fault insurer.

11. Under a direct hire agreement, the insurer managing the claim arranges and pays for a replacement car through its contracted direct hire provider at pre-agreed rates. Six of the nine CMCs/CHCs in our sample (Accident Exchange, Ai Claims Solutions, Enterprise, Helphire, Kindertons and WNS Assistance) told us that, as well as providing credit hire services, they also provide direct hire services to at-fault customers and captured non-fault customers (following a referral from the at-fault insurer).

Non-fault party capture

12. Insurers told us that, when they were the at-fault insurer, they often attempted to capture the non-fault driver, in order to control the costs of the claim, including the cost of replacement car provision. Table 3 shows the varied success of insurers in capturing non-fault drivers.

TABLE 3 **Insurer non-fault driver capture rates, 2012**

	*Third party capture rate %**
Admiral	[✂]
Ageas Insurance	[✂]
Aviva	[✂]
AXA UK	[✂]
AXA Northern Ireland	[✂]
CISGIL	[✂]
DLG	[✂]
esure	[✂]
LV	[✂]
RSA	[✂]
Zurich	[✂]
Unweighted average	25

Source: Insurers.

*The third party capture rate is the proportion of successful captures (where the at-fault insurer captures at least one element of the non-fault party's claim) from all capture attempts. Therefore, in part, the different capture rates represent the different degrees to which at-fault insurers attempt to capture non-fault drivers.

13. At-fault insurers capture non-fault drivers by contacting them directly as early as possible following an accident where their customer appears to be at fault. They usually obtain the contact details of the non-fault driver from their customer during the FNOL process. Where the customer cannot provide full contact information, the insurer will use a range of easily available data sources to obtain or verify the details. For example, [✂].

14. The majority of the insurers in our sample told us that [✂].[5]

15. The main cost is from employing claims handlers to try to identify and contact these parties. esure told us that this claims handling cost was around £[✂] per claim. LV told us that it estimated it cost around £[✂] to capture a non-fault driver.

[5] [✂]

Bilateral agreements

16. Five of the ten motor insurers in our sample ([✂]) told us that they had bilateral agreements in relation to replacement car provision with one or more of the other motor insurers in our sample (see Table 4).

TABLE 4 **Motor insurer replacement car bilateral agreements**

[✂]

Source: Insurers.

*[✂] bilateral agreement with [✂] only applies to [✂] brand.

17. Where such bilateral agreements exist, at-fault insurers can avoid the referral of a non-fault driver to a CMC/CHC by the non-fault insurer and can reduce frictional costs by, typically, mutually agreeing to provide a replacement car to non-fault drivers at rates agreed between the at-fault insurer and non-fault insurer.[6]

Alternative model

18. Enterprise told us that it had recently entered the credit hire market with a subscriber model for the provision of replacement cars to non-fault drivers. Enterprise told us that, where both the at-fault and non-fault insurer were subscribers to its model, it would pay the non-fault insurer a referral fee for referring the non-fault driver to Enterprise and it would invoice the at-fault insurer for *(a)* the cost of the hire and *(b)* the referral fee it had paid. However, the cost of the hire would be at contracted direct hire rates rather than at credit hire rates. The at-fault insurer would be required to pay the invoice within [✂] days.

[6] We note that the rates of bilateral hire are based on agreement between the two insurers that are party to the bilateral agreement and this agreed rate is not necessarily the rate that has been agreed between the insurer and their chosen replacement car provider.

Northern Ireland

19. There are several commercial and legal differences between Northern Ireland and the rest of the UK in relation to replacement car provision. The main differences appear to be:

(a) CMCs/CHCs are less prevalent in Northern Ireland than in the rest of the UK. It has been put to us that this might be due to:

(i) The effective ban of the payment of referral fees by solicitors in Northern Ireland.[7]

(ii) Means-tested legal aid for personal injury cases.[8] The Belfast Solicitor's Association (BSA) told us that 45 per cent of people were financially entitled to legal aid in Northern Ireland (although we understand that this entitlement is currently under review). Consequently, non-fault drivers pursuing compensation were less likely to require the services of a CMC/CHC, in order to negate the risk of having to bear the costs should they be unsuccessful in their claim.

(b) The GTA is not used as much in Northern Ireland. For example, Crash Services, a leading CMC/CHC in Northern Ireland, does not subscribe to the GTA.

(c) The Ministry of Justice, which includes the Ministry of Justice's Claims Management Regulator, does not have jurisdiction in Northern Ireland, meaning that CMCs/CHCs in Northern Ireland are not regulated.

Comparison of the cost of credit hire and direct hire

20. We asked the ten largest motor insurance providers to provide us with data on replacement car costs between 2010 and 2012. Five of the ten insurers provided us with data which we could aggregate and compare. We compared 'third party non-

[7] Although referral fees are not explicitly prohibited in Northern Ireland, they are effectively banned by the operation of Article 28 of the Solicitors (NI) Order 1976, which prohibits the sharing of profits or fees with an unqualified person. In England and Wales, the growth of the claims management industry coincided with the lifting of the ban on referral fees to solicitors in 2004.
[8] We note that personal injury cases were within the scope of the England and Wales legal aid scheme prior to the introduction of Conditional Fee Agreements in 1998.

fault' data (ie the costs subrogated to at-fault insurers) with two benchmark scenarios: captured claims and claims where the at-fault and non-fault insurers were the same. Annex A explains the reasons for our choice of data.

21. Figure 1 shows the average replacement car costs by insurer and claim type in 2012.[9]

FIGURE 1

Average replacement car cost by claim category and insurer, 2012

[✂]

Source: Insurers and CC analysis.
Notes:
1. [✂] and [✂] number of observations for 'same insurer' costs are very low so these results should be interpreted with caution.
2. [✂] figures are for 2011 to enable better comparability.

22. Subtracting the average costs in the benchmarks without the separation ('captured' and 'same insurer') from the costs in the scenario with this separation ('third party non-fault'), we found that the average cost where there is the separation was higher than in the cases without. Figure 2 illustrates these differences.

FIGURE 2

Average cost difference, 2012

[✂]

Source: Insurers and CC analysis.
Notes:
1. [✂] and [✂] number of observations for replacement car costs and 'same insurer' are very low. Results should be interpreted with some caution.
2. [✂] figures are for 2011 to enable better comparability.

23. Figure 2 suggests that the average increase in replacement car costs arising from the separation is between £570 and £1,400. The result is broadly consistent across the two alternative benchmarks used. The data provided indicates a similar result for 2011 and 2010 (see Annex A).

[9] The third party non-fault category represents replacement car bills received by the five insurers from other parties.

24. There are two problems with using these values as estimates of the effects on credit hire's cost of the separation:

(a) the data on the 'captured' and 'same insurer' scenarios may include cases in which a courtesy car was provided; the comparison with credit hire may therefore not be 'like-for-like'; and

(b) the cars in captured claims may tend to have a lower level of damage than in non-captured claims (see Appendix 6.2, paragraph 26); this could suggest that captured claims may on average require the provision of a replacement car for shorter periods; again, the comparison with credit hire may therefore not be 'like-for-like'.

25. Given these caveats, we decided to look separately at hire duration and at the hire daily rates.[10]

Hire duration

26. Table 5 compares the average credit hire and direct hire duration. The evidence provided by the ten motor insurers in our sample suggests that the average credit hire duration is about 3.7 days longer than the average direct hire duration. Although the evidence provided by the nine CMCs/CHCs in our sample was limited, where figures were provided, the average credit hire duration was longer than the average direct hire duration.

[10] A detailed econometric analysis, which could have controlled for the differences in service, was not possible for lack of suitably disaggregated data.

TABLE 5 **Average credit hire and direct hire durations**

Motor insurer/CMC/CHC	*Average credit hire duration (days)*	*Average direct hire duration (days)**	*Difference (days)*
Motor insurer			
Admiral	[✂]	[✂]	[✂]
Ageas Insurance	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]
Unweighted average	15.5	11.8	3.7
CMC/CHC			
Accident Exchange	[✂]	[✂]	[✂]
ACM†	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]
ClaimFast‡	[✂]	[✂]	[✂]
Crash Services§	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]
Kindertons¶	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]
Unweighted average	18.5	13.5	5.0
Overall unweighted average	17.0	12.7	4.3

Source: Motor insurers and CMCs/CHCs.

*The direct hire data may include at-fault claims.
†ACM is a CMC and does not provide credit hire or direct hire services.
‡ClaimFast does not provide direct hire services, except as an outsourced function for [✂].
§Crash Services does not provide direct hire services.
¶Kindertons' average credit hire duration is based on the average time taken to complete a credit repair (performed by Kindertons) on a repairable and roadworthy car.

27. The difference between the average credit hire and direct hire duration could in principle be due to:

(a) the mix of claims, ie with replacement cars for more complex claims, which require longer repair periods, being provided under credit hire;

(b) the underprovision of replacement car services under a direct hire agreement in relation to duration (though we have not found any evidence to support this view); and/or

(c) unnecessarily lengthening credit hire durations (eg by disproportionately booking in cars for repair on Fridays or returning them on Mondays, or by extending repair durations).

28. The first hypothesis is consistent with our finding that the average level of damage is lower for captured claims than for non-captured ones. Since direct hire is mainly provided in the case of captured claims and credit hire for non-captured ones, it is reasonable to expect higher average duration for credit hire.

29. We decided, therefore, to exclude the difference in hire duration from our analysis of cost differences. If part of the difference in duration is due to hypothesis *(c)*, our estimate does not capture it and can therefore be considered a lower bound.

30. Evidence on point *(c)* is discussed more fully later in the appendix.

Daily rate

31. In estimating the cost difference between credit and direct hire, we focus on a comparison of daily rates. The daily rate is determined by the class of replacement car. For credit hire claims, the GTA sets the maximum daily rate for each car class. This, however, is not necessarily the rate charged to insurers. For claims settled under the terms of the GTA, a CHC may choose to apply a lower rate. On the other hand, at-fault insurers may pay more if they do not comply with the GTA timeline for payment. The GTA's guidelines specify that payment in settlement of a credit hire claim should be made within 30 days of the dispatch of the claim to the at-fault insurer. If payment is late, the outstanding amount incurs a late payment penalty at both 30 (12.5 per cent) and 60 days (20 per cent). A CMC/CHC is entitled to progress settlement outside the GTA (eg through litigation) if a claim has not been settled after 90 days from the dispatch of the claim to the at-fault insurer.[11] Finally, some hire claims are managed from the outset outside the GTA; in this case the daily rate is usually higher than the relevant GTA rate.

[11] Helphire told us that [✂] per cent of its credit hire claims were not settled within 90 days.

32. Table 6 presents three different rates:

(a) the GTA daily rate;

(b) an overall credit hire daily rate, calculated dividing the total revenues for seven large CHCs in 2012 by the number of hire days; this rate includes both GTA and non-GTA claims; and

(c) the average direct hire daily rate paid by three large insurers.[12]

The table compares the two credit hire rates with the direct hire rate.

[12] In a previously published working paper, we also presented the direct hire daily rates provided by two hire companies. We do not show them here because the sample of hire companies appears to be small and non representative.

TABLE 6 **Comparison of credit hire daily rates and insurer direct hire daily rates**

GTA car category	*Example car*	*GTA credit hire daily rate* £	*Overall credit hire daily rate* £	*Average insurer direct hire daily rate* £*	*Multiple of GTA rate over average insurer direct hire rate*	*Multiple of overall credit hire rate over average insurer direct hire rate*
Standard						
S1	Peugeot 107	30.28	39.79	14.18	2.1x	2.8x
S2	Ford Fiesta	34.33	43.09	14.95	2.3x	2.9x
S3	Ford Focus 1.4	36.62	46.63	17.83	2.1x	2.6x
S4	Ford Focus 1.6	39.26	48.49	19.55	2.0x	2.5x
S5	Ford Mondeo 1.8	41.54	50.81	21.93	1.9x	2.3x
S6	Ford Mondeo 2.0	44.25	54.76	23.52	1.9x	2.3x
S7	Peugeot 607	62.06	70.79	28.09	2.2x	2.5x
Weighted average					2.1x	2.6x
MPV						
M	Vauxhall Meriva	48.38	59.30	27.99	1.7x	2.1x
M1	Ford Focus C-Max 1.4/1.6	55.91	64.43	30.63	1.8x	2.1x
M2	Ford Focus C-Max 2.0	63.75	74.37	33.70	1.9x	2.2x
M3	Ford Galaxy	74.94	84.27	31.53	2.4x	2.7x
M4	Mercedes Benz Viano 2.0	95.07	101.29	44.90	2.1x	2.3x
M5	Mercedes Benz Viano 2.2	142.59	148.06	49.33	2.9x	3.0x
M6	Mercedes Benz Viano 3.5	180.62	162.92	55.87	3.2x	2.9x
Weighted average					1.9x	2.2x
4x4						
F1	Toyota RAV4 (2.0)	93.94	106.21	50.07	1.9x	2.1x
F2	Toyota RAV4 (2.2)	100.66	110.26	51.12	2.0x	2.2x
F3	BMW X3 (2.0)	108.49	130.09	52.30	2.1x	2.5x
F4	BMW X3 (2.5)	133.10	149.14	63.32	2.1x	2.4x
F5	BMW X5 (3.0)	178.93	196.22	67.72	2.6x	2.9x
F6	BMW X5 (Xdrive40d)	201.31	216.85	77.80	2.6x	2.8x
F7	BMW X5 (V8 4.4)	234.86	254.22	96.51	2.4x	2.6x
F8	BMW X5 (4.8 Sport 5 door auto)	251.64	265.22	89.37	2.8x	3.0x
F9	Porsche Cayenne Turbo (4.5)	307.56	310.01	141.49	2.2x	2.2x
Weighted average					2.2x	2.4x
Prestige						
P1	BMW 116 (1.6)	78.28	86.71	37.37	2.1x	2.3x
P2	BMW 118 (1.8)	87.24	94.82	40.39	2.2x	2.3x
P3	BMW 120 (2.0)	92.82	105.05	47.93	1.9x	2.2x
P4	BMW 320 (2.0)	112.95	126.19	54.32	2.1x	2.3x
P5	BMW 520 (2.0)	140.92	151.76	58.58	2.4x	2.6x
P6	BMW 525 (2.5)	167.76	174.79	70.28	2.4x	2.5x
P7	BMW 530 (3.0)	195.72	208.03	79.38	2.5x	2.6x
P8	BMW 730 (3.0)	223.66	235.04	104.62	2.1x	2.2x
P9	BMW 735/740 (3.5/4.0)	257.23	290.84	109.74	2.3x	2.7x
P10	BMW 750 (5.0)	316.51	249.53	118.78	2.7x	2.1x
P11	Bentley Continental	444.55	495.82	204.19	2.2x	2.4x
P12	Bentley Flying Spur	665.44	590.92	305.25	2.2x	1.9x
P13	Rolls Royce Phantom	964.88	1,050.81	N/A	N/A	N/A
Weighted average					2.2x	2.4x
Sports						
SP1	Mini Cooper (1.6)	75.36	88.87	33.76	2.2x	2.6x
SP2	Mini Cooper S (1.6)	88.08	97.25	39.97	2.2x	2.4x
SP3	Mini Cooper S (1.6) Cabriolet	98.41	107.50	58.80	1.7x	1.8x
SP4	Audi TT Coupe 1.8T	120.79	128.61	58.05	2.1x	2.2x
SP5	Audi TT Roadster 1.8T	131.97	149.60	60.61	2.2x	2.5x
SP6	Audi TT Roadster 1.8T Quattro	184.54	189.84	77.72	2.4x	2.4x
SP7	Audi TT Roadster 3.2T Quattro	206.91	216.82	93.41	2.2x	2.3x
SP8	BMW 325 Cabriolet	229.27	254.64	87.84	2.6x	2.9x
SP9	BMW 630	251.64	275.56	107.95	2.3x	2.6x
SP10	BMW M5	287.98	320.53	130.54	2.2x	2.5x
SP11	Aston Martin Vantage (6.0)	346.70	439.70	129.69	2.7x	3.4x
SP12	Aston Martin DB7 coupe	455.75	488.81	209.26	2.2x	2.3x
SP13	Aston Martin DBS Coupe V12 6L	665.44	728.75	305.09	2.2x	2.4x
Weighted average					2.2x	2.4x
Overall weighted av					2.1x	2.5x

Source: Insurers and CMCs/CHCS.

*The direct hire data may include at-fault claims.
Notes: 1. The weighted averages are based on revenues obtained by CHCs for each car category.
2. N/A = not available.

33. The average daily rates paid by insurers for credit hire are usually higher than the GTA rates. Our estimates are based on CHCs' revenues and they therefore take into account discounts offered to insurers, penalties paid by the insurers under the GTA when claims are not settled within 30 days, and the higher rates charged for hires handled outside the GTA.

34. Both the average direct hire and the average credit hire rates over multiple car categories are computed using as weights the relevant numbers of credit hire days in our sample of CHCs. This implies that the comparison between credit and direct hire rates is based on the assumption that claimants are provided in both cases with the same cars for the same period length. It is therefore a like-for-like comparison.

35. Table 6 shows that, on average, credit hire rates are 2.5 times higher than direct hire rates. Dividing the total revenues for the CHCs in our sample by the total number of credit hire claims managed by them, we estimated the average credit hire bill to be approximately £1,085.[13] Since credit hire rates are 2.5 times higher than direct hire rates, under direct hire the same services could be provided for about £445. We therefore estimate average cost difference due to the separation at approximately £640.

Analysis of the cost of credit hire

36. In seeking to analyse the higher daily hire rate of credit hire compared with direct hire, we considered the underlying costs borne by replacement car providers under the two models. In this section, we discuss the following costs, which contribute to and/or reflect the cost difference estimated in the previous section:

(a) referral fees; bad debt provision;

(b) credit risk; and

[13] This is somewhat lower than the average credit hire cost reported by a sample of five insurers (see Figure 1 above).

(c) administration costs (both duplicated costs and frictional costs).

37. Frictional costs are also borne by at-fault insurers when dealing with replacement car providers. These costs do not contribute to the cost difference we have estimated, but are in effect an additional source of cost to at-fault insurers.

Referral fees

38. A CMC/CHC usually pays a referral fee to the referring non-fault insurer or broker (or other party), in order to secure the provision of credit hire services to the non-fault driver.

39. Nine of the ten largest insurers told us that they received fees for credit hire referrals,[14] of which [✂].[15]

40. Table 7 shows the average referral fee for a credit hire replacement car paid by each of the nine CMCs/CHCs in our sample and received by each of the ten motor insurers and ten brokers in our sample. These averages are between £[✂] and £[✂].

[14] CISGIL told us that it did not refer its non-fault drivers directly to CHCs. However, it said that it referred its non-fault drivers with motor legal expenses insurance to CLS in respect of their uninsured losses. CLS managed these drivers' claims against the at-fault party, including the provision of a replacement car. CISGIL said that around [✂] per cent of these drivers were referred, on the basis of need, by CLS to [✂] for the provision of a replacement car on credit hire terms.
[15] [✂]

TABLE 7 **Credit hire referral fees received/paid by motor insurers/brokers/CMCs/CHCs**

Motor insurer/broker/CMC/CHC	*Average referral fee paid/received per referral* £
Motor insurers	
Admiral	[✂]
Ageas Insurance	[✂]
Aviva	[✂]
AXA UK	[✂]
AXA Northern Ireland*	[✂]
CISGIL	[✂]
DLG	[✂]
Esure	[✂]
LV	[✂]
RSA	[✂]
Zurich	[✂]
Unweighted average	249–358
CMCs/CHCs	
Accident Exchange	[✂]
ACM	[✂]
Ai Claims Solutions	[✂]
ClaimFast	[✂]
Crash Services	[✂]
Enterprise	[✂]
Helphire	[✂]
Kindertons	[✂]
WNS Assistance	[✂]
Unweighted average	247–310
Brokers	
AA	[✂]
Ageas Insurance 50†	[✂]
BISL‡	[✂]
Castle Cover†	[✂]
Endsleigh	[✂]
Express Insurance†	[✂]
Kwik Fit Insurance†	[✂]
Swinton	[✂]
The Green Insurance Company†	[✂]
UKAIS†	[✂]
Unweighted average	248–277
Overall unweighted average	248–315

Source: Motor insurers, CMCs/CHCs and brokers.

*AXA Northern Ireland [✂].
†Ageas Insurance had six broking companies at the date of responding to us: Ageas Insurance 50 (trading as RIAS), UKAIS, Castle Cover, Express Insurance Services, Kwik Fit Insurance Services and The Green Insurance Company.
‡BISL did not provide an indication of the average referral fee it receives from a referring party, but it told us that its credit hire referral fee income was £[✂] and £[✂].

41. The significant variation in the estimates of the referral fees paid by CMCs/CHCs and received by motor insurers and brokers provided in Table 7 reflects:

(a) the different forms in which referral fees can be structured;[16]

[16] Referral fees can take several forms, like *(a)* a flat fee per hire, *(b)* a variable fee depending on hire duration and on the class of the replacement car, or *(c)* a fee based on a percentage of the credit hire invoice recovered from the at-fault insurer.

(b) the importance of the referring party to the CMC/CHC in securing credit hire revenue (motor insurers typically handle more non-fault claims than brokers and therefore have more bargaining power against CMCs/CHCs); and

(c) the competitive pressure between CMCs/CHCs in securing referrals from all referring parties.[17]

Bad debt provision

42. Bad debts arise under credit hire when:

(a) there is a dispute over a credit hire bill;

(b) subsequent evidence suggests that the non-fault driver was at fault; and/or

(c) the non-fault driver is found to have submitted a fraudulent claim.

43. Under the terms of a credit hire agreement, the customer is ultimately liable for the costs of the provision of replacement car services should the CMC/CHC be unable to recover the costs from the at-fault insurer. However, the nine CMCs/CHCs in our sample told us that they rarely sought to recover costs from non-fault drivers.

Extent of bad debt write-off

44. The risk of non-recovery or only partial recovery of the costs incurred by CMCs/CHCs under credit hire is reflected in the high level of debt write-offs recognized by CMCs/CHCs. Table 8 shows the credit hire debt write-offs for the nine CMCs/CHCs in our sample. The table shows that, in 2012, CMCs/CHCs wrote off between [✂] and [✂] per cent of their gross revenue, with an unweighted average write-off of 20 per cent.

[17] Despite the considerable referral fees earned by almost all of the ten motor insurers in our sample, these motor insurers all told us that the size of the referral fee was only one of the factors they considered when establishing or renegotiating an agreement with a CMC/CHC for the provision of credit hire services, and that they also considered the quality of the services provided.

TABLE 8 **Credit hire debt write-offs, 2012**

CMC/CHC	*Write-offs £*			*Write-offs as proportion of gross revenue %*		
	*GTA**	*Non-GTA*	*Total*	*GTA**	*Non-GTA*	*Total*
Accident Exchange	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ACM†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Crash Services‡	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Enterprise§	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Unweighted average	9,356,973	3,393,580	12,750,553	18	30	20

Source: CMCs/CHCs.

*We note that, in relation to claims settled under the GTA, the difference between the gross commercial value of a hire and the amount settled under the GTA's discounted rates is often the result of a settlement discount rather than a write-off.
†ACM does not provide credit hire services.
‡Crash Services does not subscribe to the GTA.
§Enterprise's credit hire activity is all under the GTA.

45. [✂] told us that write-offs were driven by the severe cash flow pressures on CMCs/CHCs, caused by lengthy settlement periods, which often required them to accept lower settlement payments than were justifiable.

46. Table 8 also shows that, in 2012, the level of write-offs was significantly higher for credit hire claims outside the GTA than for claims within the GTA, which suggests that the GTA plays a significant role in providing a framework for the efficient negotiation and settlement of credit hire claims.[18]

47. [✂] told us that the likelihood of full recovery from the at-fault insurer fell as the size of claim increased, as shown in Table 9.

TABLE 9 [✂] **claims recovery (last three years)**

	Value of claim (£)			
	[✂]	[✂]	[✂]	[✂]
Cases where full recovery was made (%)	[✂]	[✂]	[✂]	[✂]

Source: [✂].

[18] However, since the 'non-GTA' category includes claims that fell out of the GTA because of litigation, part of the difference in write-offs may be due to selection bias.

48. Direct hire write-offs are less frequent than credit hire write-offs, as direct hire is usually arranged at pre-agreed rates with the party paying for it. For example, [✂] told us that, historically, it wrote off around [✂] to [✂] per cent of its non-credit hire revenue, and this was only if it failed to provide adequate services to the insurer or customer (eg relating to the delivery of the car, the billing process or the hire duration).

49. Table 10 shows the proportion of full and partial write-offs recorded by the CMCs/ CHCs in our sample in relation to credit hire bills in 2012.

TABLE 10 **Full and partial credit hire write-offs, 2012**

CMC/CHC	*Full write-offs* £	*Partial write-offs* £	*Total write-offs* £	*Full write-offs as a proportion of total write-offs* %	*Partial write-offs as a proportion of total write-offs* %
Accident Exchange	[✂]	[✂]	[✂]	[✂]	[✂]
ACM†	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]	[✂]
Crash Services‡	[✂]	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]	[✂]
Unweighted average	1,790,748	9,810,173	11,600,922	15	85

Source: CMCs/CHCs.

*We note that in relation to claims settled under the GTA, the difference between the gross commercial value of a hire and the amount settled under the GTA's discounted rates is often the result of a settlement discount rather than a write-off.
†ACM does not provide credit hire services.
‡Crash Services does not subscribe to the GTA.

50. The vast majority of debt written off by CMCs/CHCs in relation to credit hire is due to a partial write-off, ie a settlement discount being agreed with the at-fault insurer, rather than a full write-off, which only tends to occur where subsequent evidence suggests that the non-fault driver was actually at fault. Disputes in relation to credit hire (eg the customer's need for it, the class of car, the hire duration, and the daily rate) are much more common than disputes in relation to liability for the accident. We note that [✂].

Change in the initial assessment of liability and fraud

51. Table 11 shows that the termination of a credit hire claim due to a change in the initial assessment of liability (from non-fault to at-fault) only occurs, on average, in between [✂] and [✂] per cent of cases. This appears to be due to the significant time and resources spent by CMCs/CHCs in establishing liability.

TABLE 11 **Termination of credit hire claims due to a reassessment of liability, 2012**

CMC/CHC	*Proportion of credit hires claims terminated due to a reassessment of liability* *%*	*Proportion of credit hires claims terminated due to fraud* *%*
Accident Exchange	[✂]	[✂]
ACM	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]
ClaimFast	[✂]	[✂]
Crash Services	[✂]	[✂]
Enterprise	[✂]	[✂]
Helphire	[✂]	[✂]
Kindertons	[✂]	[✂]
WNS Assistance	[✂]	[✂]
Unweighted average	1.73	0.37

Source: CMCs/CHCs.

52. Accident Exchange told us that, in cases where the non-fault driver's car was not roadworthy as a result of an accident (and therefore, the driver required a replacement car immediately), it might make an initial assessment of liability and agree to provide hire on that basis pending further investigation. In cases where Accident Exchange subsequently changed its initial assessment, the hire might have to be terminated. Accident Exchange said that this was rare but, if it did happen, then it would bear the hire costs incurred up to that point. A similar service is offered by Kindertons.

53. [✂] told us that, if a CMC/CHC changed its initial assessment of liability, it could only recover its costs from the non-fault driver if the driver had deliberately misled it or made a fraudulent claim. It said that the costs of pursuing such drivers and the likelihood of not making any meaningful recovery meant that it would usually suffer the loss.

Cost of credit

54. A CMC/CHC incurs a working capital cost in providing credit hire services because it does not receive immediate payment.

55. The cost of credit incurred by CMCs/CHCs depends both on the cost of the service provided and the time taken to recover that cost from the at-fault insurer. CMCs/ CHCs told us that this time was often significant. For example, Helphire told us that its debtor days were around [✂] days, whereas its typical credit period under a direct hire agreement was [✂] days. Ai Claims Solutions told us that, although it recovered over [✂] per cent of its invoices in full, it took on average [✂] days to receive payment.

Administrative costs

56. Motor insurers and CMCs/CHCs incur administrative costs in the management of a credit hire claim, eg in the setting up of the claim, the assessment of liability and the processing and submission of documentation to the at-fault insurer (in line with GTA guidelines, such as the mitigation statement).[19]

57. We have considered two categories of administrative costs relevant to assessing the effects of the separation: *(a)* duplicated administrative costs, which arise from having two parties (rather than one) involved in the management of a non-fault claim; and *(b)* frictional costs, which arise from having two parties with different interests involved in a non-fault claim.

58. This section discusses both the costs borne by CMCs/CHCs and those borne by at-fault insurers. It must be kept in mind that while the former contribute to the differ-

[19] Under the terms of the GTA, a mitigation statement signed by the non-fault driver must be provided by the CMC/CHC to the at-fault insurer. This statement should set out the reasons why the non-fault driver requires a replacement car.

ence between credit hire and direct hire daily rates, the latter constitute an additional component of the costs to at-fault insurers not captured by the difference in rates.

Duplicated administrative costs

59. Duplicated administrative costs are those costs which arise from both the CMC/CHC managing the provision of replacement car and the at-fault insurer, which will ultimately pay for it, conducting similar activities. These costs primarily include the employment of claims handlers to:

(a) assess all circumstances relating to the provision of replacement car services, including the accident circumstances and the non-fault driver's need for a replacement car;

(b) assess (prior to the commencement of the hire period) whether the non-fault driver's car is roadworthy;

(c) assess whether the non-fault driver's car is economical to repair[20] and the repair methodology and cost is reasonable;

(d) ensure that the non-fault driver has entered into a binding and enforceable contract for the supply of replacement car services;

(e) monitor actively the repair of the non-fault driver's car during the hire period or the total loss settlement process (for write-offs), in order to keep the hire costs to a minimum; and

(f) manage the recovery/payment of claims.

Frictional costs

60. Frictional costs arise from the party controlling the replacement car provision under credit hire (the CMC/CHC) having a different interest from the party paying for it (the at-fault insurer). They are incurred by both the CMC/CHC and the at-fault insurer.[21]

[20] The assessment of whether a car is economical to repair is determined by comparing the likely cost of repair with the pre-accident value of the car.

Frictional costs incurred by CMCs/CHCs

61. The frictional costs incurred by a CMC/CHC in the provision of credit hire replacement car services to non-fault drivers include:

(a) administrative costs to increase the likelihood of the claim being settled by the at-fault insurer—these include the costs of complying with the obligations of the GTA; and

(b) costs of pursuing and recovering credit hire claims, including litigation.

62. Table 12 sets out the frictional costs incurred by the nine CMCs/CHCs in our sample. It suggests that a CMC/CHC incurs, on average, £[✂] to £[✂] of frictional costs per credit hire claim.[22]

TABLE 12 **Frictional costs incurred by CMCs/CHCs, 2012**

CMC/CHC	*GTA claims*		*Non-GTA claims*		*All claims*		
	Annual costs £	*Average costs per claim* £	*Annual costs* £	*Average costs per claim* £	*Annual costs* £	*Average costs per claim* £	*Frictional costs as a proportion of average credit hire bill* %
Accident Exchange	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ACM*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Crash Services†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Unweighted average							10

Source: CMCs/CHCs.

*ACM told us that [✂].
†Crash Services told us that [✂].

63. Five of the nine CMCs/CHCs in our sample were able to provide us with an estimate of their overall frictional costs. However, there was significant variation in these estimates, with these costs representing between [✂] and [✂] per cent of the average

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[21] We have not analysed in this appendix the frictional costs incurred by non-fault insurers, as non-fault insurers often refer their non-fault drivers to CMCs/CHCs for the provision of replacement car services under a credit hire agreement and therefore incur minimal frictional costs (though they do incur some small duplicated administrative costs).
[22] Many of the CMCs/CHCs in our sample found it difficult to distinguish between duplicated administrative costs (which relate to having two parties involved in managing a claim) and frictional costs (which relate to those two parties having different interests in the claim).

credit hire bill. It appeared to us that this reflected the difficulty for CMCs/CHCs to distinguish frictional costs from their general claims management costs.

64. In Annex B, we present an analysis of the different cost elements which are included within the frictional costs incurred by CMCs/CHCs. Administrative costs, in particular the cost of employing claims handlers to manage credit hire claims and to process documentation in line with the GTA, and litigation costs incurred in pursuing the at-fault insurer for settlement of credit hire claims are the largest elements of the frictional costs incurred by CMCs/CHCs.

65. The level of frictional costs incurred by CMCs/CHCs suggests that considerable resources are expended, in order to achieve settlement of credit hire claims. We also found that claims often lasted a long period. Accident Exchange told us that its debtor days were [✂] days and that it spent on average around [✂] resolving each claim.[23] Similarly, Ai Claims Solutions told us that its debtor days were over [✂] days and each claim required, on average, [✂] actions from the point of referral to the ultimate recovery of the claim.

66. Only two of the nine CMCs/CHCs in our sample ([✂] and [✂]) were able to provide a breakdown of their frictional costs between GTA and non-GTA credit hire claims. Based on [✂] evidence, frictional costs incurred in relation to non-GTA claims (£[✂] on average per claim) were significantly higher than those incurred in relation to GTA claims (£[✂] on average per claim). We noted that, although the GTA is not binding and is open to interpretation, it does provide a framework for the efficient negotiation and settlement of credit hire claims. However, we also noted that the large discrepancy between GTA and non-GTA claims was explained in part by many claims which

[23] Accident Exchange told us that this was a rough estimate based on the number of claims settled 'in-house' and the number of people employed exclusively in the settlement of claims. It excluded, for example, the time spent by external solicitors in settling claims.

were initially submitted under the GTA falling out of this system when they were not settled within 90 days. As these tended to be the claims which were most likely to be subject to dispute, they often required substantial cost in reaching settlement.

67. Ai Claims Solutions told us that the GTA facilitated a collaborative negotiation process and the GTA settlement guidelines were beneficial in providing higher industry standards, better relationships between CMCs/CHCs and motor insurers, and fewer frictional exchanges. Ai Claims Solutions told us that a claim process not under the GTA tended to be more combative. Accident Exchange told us that claims settled outside the GTA generally involved additional costs (such as legal costs, which were not usually fully recoverable) and took longer to settle, adversely impacting cash flow.

68. We note that the frictional costs incurred by CMCs/CHCs are to some extent offset by *(a)* late payment penalties paid by the at-fault insurer to the CMC/CHC in respect of GTA claims not settled within 30 days of the claim being submitted by the CMC/CHC to the at-fault insurer (as set out in the GTA); and *(b)* the reimbursement of legal fees by the at-fault insurer in relation to successfully litigated credit hire claims.

69. Table 13 sets out the extent of this offsetting income for CMCs/CHCs. In 2012, late payment penalties amounted to between [✂] and [✂] per cent of the frictional costs incurred by CMCs/CHCs.

TABLE 13 **Offsetting income received by CMCs/CHCs, 2012**

CMC/CHC	*Annual income*		*Income per claim*		*Income as proportion of frictional costs*	
	Late payment penalties £	*Reimburse-ment of legal fees* £	*Late payment penalties* £	*Reimburse-ment of legal fees* £	*Late payment penalties* %	*Reimburse-ment of legal fees* %
Accident Exchange*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ACM†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Crash Services‡	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMCs/CHCs.

*Accident Exchange's offsetting income relates to both credit hire and credit repair claims.
†ACM [✂].
‡Crash Services does not subscribe to the GTA and therefore is not entitled to late payment penalties under the GTA.

70. Table 14 sets out the frictional costs incurred by CMCs/CHCs net of offsetting income. It shows net frictional costs of £[✂] to £[✂] per credit hire claim, representing, on average, between [✂] and [✂] per cent of the average credit hire bill issued by a CMC/CHC to the at-fault insurer.

TABLE 14 **Net frictional costs incurred by CMCs/CHCs (net of offsetting income), 2012**

CMC/CHC	*Annual frictional costs* £	*Annual offsetting income* £	*Net frictional costs* £	*Net frictional costs per claim* £	*Net frictional costs as a proportion of average credit hire bill* %
Accident Exchange*	[✂]	[✂]	[✂]	[✂]	[✂]
ACM†	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]	[✂]
Crash Services‡	[✂]	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]	[✂]
Unweighted average					5
Unweighted average excl [✂]§					4

Source: CC analysis.

*Accident Exchange's offsetting income relates to both credit hire and credit repair claims.
†ACM [✂].
‡Crash Services does not subscribe to the GTA and therefore is not entitled to late payment penalties under the GTA.
§[✂] offsetting income appears to be higher than its frictional costs. Therefore, we have excluded this when calculating the average frictional costs as a proportion of the average credit hire bill.

Frictional costs incurred by at-fault insurers

71. An at-fault insurer incurs frictional costs in relation to the verification, negotiation and settlement of credit hire claims. These costs include:

(a) administrative costs to verify and negotiate credit hire claims;

(b) costs relating to the establishment and maintenance of mitigation strategies to reduce the cost of credit hire claims (eg non-fault party capture and bilateral agreements); and

(c) costs of challenging credit hire claims, including litigation.

72. Table 15 shows the frictional costs incurred by the ten motor insurers in our sample. The table suggests that an at-fault insurer incurs on average £[✂] to £[✂] of frictional costs per claim in verifying, negotiating, challenging (where necessary) and settling credit hire claims.

TABLE 15 **Frictional costs incurred by motor insurers, 2012**

Motor insurer	*GTA claims*		*Non-GTA claims*		*All claims*		
	Annual costs £	*Average costs per claim* £	*Annual costs* £	*Average costs per claim* £	*Annual costs* £	*Average costs per claim* £	*Frictional costs as a proportion of average credit hire bill* %
Admiral*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ageas Insurance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
DLG†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Unweighted average							10

Source: Insurers.

*Admiral's frictional costs include those incurred in relation to credit repair as well as credit hire. However, Admiral told us that it believed that the frictional costs associated with credit repair would be significantly lower than those associated with credit hire due to fewer areas of contention relating to credit repair.
†DLG was unable to provide the relevant data, [✂].

73. Nine of the ten motor insurers in our sample were able to provide us with an estimate of their overall frictional costs. However, there was significant variation in these estimates, with these costs representing between [✂] and [✂] per cent of the average

credit hire bill. For CMCs/CHCs, this reflected the difficulty for insurers to distinguish frictional costs from their general claims management costs. For example, CISGIL told us that it could not quantify the costs it incurred in setting up and maintaining bilateral and third party capture agreements, as these activities involved numerous CISGIL staff, who spent only a small amount of their time doing these things and the associated costs were therefore absorbed as part of their roles.

74. In Annex C we present an analysis of the different cost elements which are included within frictional costs for insurers. Administrative costs, in particular the cost of employing claims handlers to manage non-fault claims, and the payment of late payment penalties in relation to GTA credit hire claims are the largest elements of the frictional costs incurred by insurers.

75. Six of the ten motor insurers in our sample ([✂]) were able to provide a breakdown of their frictional costs between GTA and non-GTA credit hire claims, but only two were able to estimate a cost per claim. According to the evidence from these two motor insurers, frictional costs incurred in relation to non-GTA claims were higher than those incurred in relation to GTA claims for one motor insurer and they were almost identical between the two categories of claims for the other motor insurer.

76. Six of the ten motor insurers in our sample (Admiral, Ageas Insurance, Aviva, CISGIL, DLG and esure) told us that the level of disputes tended to be higher for non-GTA claims than for GTA claims.[24] For example, Aviva told us that it took about [✂] to handle a non-GTA claim than a GTA claim. CISGIL told us that CMCs/CHCs which did not subscribe to the GTA were more difficult to negotiate with and usually presented higher credit hire claims (CISGIL's experience was that the daily rates

[24] Of the remaining four motor insurers in our sample, AXA does not subscribe to the GTA, RSA told us that it was unable to compare the level of disputes in GTA and non-GTA cases, and both LV and Zurich told us that subscription to the GTA did not affect the level of disputes they experienced with CMCs/CHCs.

charged by non-GTA-subscribing CMCs/CHCs were typically [✂] per cent higher than the maximum GTA daily hire rates). In 2012, [✂] per cent of its credit hire claims were outside the GTA, but these claims accounted for [✂] per cent of its litigation costs.

77. Despite the significant frictional costs incurred by at-fault insurers, it appears that, overall, they achieve significant costs savings from challenging credit hire bills. On this issue:

(a) Admiral told us that it saved costs in [✂] per cent of credit hire claims settled in 2012 and the average saving was £[✂] per claim.

(b) Ageas Insurance told us that it saved around [✂] per cent on all credit hire bills in 2012, which equated to approximately £[✂] million.

(c) CISGIL told us that it saved about £[✂] million in 2012 as a result of challenging credit hire bills.

(d) Zurich told us that it achieved savings of £[✂] million against credit hire claims in 2012 through challenging bills (£[✂] million against GTA claims and £[✂] million against non-GTA claims).

78. Table 16 compares the total credit hire bills received by six of the ten insurers in our sample ([✂]) and the costs paid out in relation to these bills.

TABLE 16 **Credit hire bills received and costs paid out by motor insurers, 2012**

		GTA claims			*Non-GTA claims*		
Car type	*Example car*	*Total value of credit hire bills received* £	*Total credit hire costs paid out* £	*Difference* %	*Total value of credit hire bills received* £	*Total credit hire costs paid out* £	*Difference* %
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total		104,873,135	92,464,351	12	22,688,663	13,762,735	39

Source: Insurers.

79. Table 16 shows that the six motor insurers saved, on average, 12 per cent against credit hire claims within the GTA through challenging the bills they received, and 39 per cent against non-GTA claims. The significantly lower savings made against GTA claims compared with non-GTA claims suggests that:

(a) the GTA is effective to some extent in providing a framework for the efficient negotiation and settlement of credit hire claims, such that fewer disputes arise; and/or

(b) there is significant friction in non-GTA claims, in part because this category includes claims which began under the GTA but fell out of that system.

80. We note that the cost savings to motor insurers through challenging bills are partially offset by the payments made by insurers to CMCs/CHCs of late payment penalties under the GTA. For example, RSA told us that it achieved an average saving of [✂] per cent of the total credit hire bill through challenging the bill, but incurred an average late payment penalty of [✂] per cent under the terms of the GTA.

Mitigation strategies

81. We have seen that the GTA helps in reducing frictional costs for both insurers and CMCs/CHCs. However, the GTA does not eliminate friction. It is the continuing presence of frictional costs which explains the presence of other mitigation strategies, in particular of bilateral agreements between motor insurers and CMCs/CHCs.[25]

82. Bilateral agreements are typically in the spirit of but outside the GTA, specifying the terms of credit hire, including the daily hire rate, and the claims management and settlement process. Six of the nine CMCs/CHCs in our sample ([✂]) have such agreements or protocols in place. For example:

[25] Bilateral agreements may also include negotiated rates lower than the GTA rates, as the high GTA rates are a root cause of the adversarial relationship between insurers and CMCs/CHCs.

(a) Accident Exchange told us that it currently had a non-GTA protocol arrangement with [✂], whereby it accepted a fixed amount per claim, regardless of the recoverable value of each claim. This arrangement currently covered around [✂] per cent of Accident Exchange's credit hire revenue.

(b) Kindertons told us that it had 'specialised relationship' agreements with [✂], [✂] and [✂]. These agreements were inside the GTA but were in place to expedite payments, minimize frictional cost and reduce litigation. Kindertons said that it also had 'working benefit relationship' agreements with [✂], [✂] and [✂]. These agreements were outside the GTA and were created to remedy a past adverse relationship.

83. The benefits of these agreements to CMCs/CHCs are:

(a) fewer disputes and fewer claims requiring litigation, reducing frictional costs (eg Kindertons told us that, in 2012, only around [✂] per cent of its claims involving relationship motor insurers resulted in litigation, compared with around [✂] per cent of claims involving non-relationship motor insurers);

(b) faster settlement of claims (eg Kindertons told us that, in 2012, relationship motor insurers settled their invoices on average in [✂] days, whereas non-relationship motor insurers settled their invoices on average in [✂] days); and

(c) fewer resources required to comply with the obligations of the GTA and to pursue and recover claims.

84. Despite these benefits, Accident Exchange told us that [✂].

85. Six of the ten motor insurers in our sample ([✂]) have bilateral agreements with CMCs/CHCs. On this issue:

(a) AXA told us that, although the agreements took a number of months to set up, the work involved once the agreements were in force was minimal (ie the production of monthly management information to verify performance).

(b) esure told us that it had [✂] agreements with CHCs: [✂].

86. The benefits of these agreements to motor insurers are:

(a) fewer disputes and fewer claims requiring litigation, resulting in reduced frictional costs;

(b) fewer resources required to manage non-fault claims;

(c) discounted settlement rates (eg [✂]); and

(d) greater control and certainty over the cost of a credit hire claim (eg Admiral told us that, in 2012, [✂] per cent of the credit hire claims it received under fixed fee arrangements [✂] were settled at the negotiated flat rate, compared with only [✂] per cent of claims under the GTA).

Analysis of credit hire duration

87. Credit hire duration tends to be longer than direct hire duration (see paragraph 26 and Table 5). In this section, we consider the factors affecting credit hire duration.

Repair duration

88. Hire duration is largely determined by repair duration.[26] Table 17 sets out the average credit hire durations for the nine CMCs/CHCs in our sample under three scenarios: *(a)* where a car is repairable and roadworthy; *(b)* where a car is repairable but not roadworthy; and *(c)* where a car is not repairable (ie a write-off). The repair duration, and therefore the credit hire duration, is longer if a car is not roadworthy, as *(a)* the driver is likely to require a replacement car immediately (often before the

[26] Repair duration is the length of time taken to repair a car. The repair duration commences on the booking-in date and concludes when the car is returned to the customer. This is sometimes referred to as the 'key-to-key' period.

repair of their car has commenced); and *(b)* non-roadworthy cars typically have more significant damage than roadworthy cars and therefore require more extensive repair. Credit hire durations are longest where the car is a write-off, as a pre-accident valuation needs to be agreed and, under the GTA, the non-fault driver is entitled to a replacement for up to seven days following receipt of the settlement payment.

TABLE 17 **Average credit hire durations for repairable cars and write-offs, 2012**

CMC/CHC	*Average credit hire duration (days)*		
	Drivable car	*Non-drivable car*	*Write-off*
Accident Exchange	[✂]	[✂]	[✂]
ACM*	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]
Crash Services	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]
Unweighted average	10.3	19.8	29.8

Source: CMCs/CHCs.

*ACM does not provide credit hire or direct hire services.
†Enterprise told us that its average credit hire duration for non-drivable cars was likely to be lower than shown, as Enterprise's system recorded the drivability of the car at the time of the notification of the claim, and some repairable non-drivable claims became write-offs during the claim process.

89. Our survey of non-fault drivers found that 73 per cent of respondents who received a replacement car had the use of it for seven days or more, and 22 per cent had it for three weeks or more. The survey found that 41 per cent of respondents with a high level of damage to their car received a replacement car for three weeks or more compared with only 8 per cent of respondents with a low level of damage. This supports the view that credit hire durations are typically longer where the car has sustained more damage.

90. We asked repairers whether their processes for conducting repairs varied according to the work provider or the at-fault status of the driver. The majority of the repairers in our sample told us that they did not differentiate between at-fault, non-fault and captured claims in how they conducted repairs, including in the time taken to complete the repair. They told us that usually they did not know the at-fault status of

the driver. [✂] told us that it managed at-fault repairs to completion as quickly as possible but non-fault repairs were not as fast, as it was in the interest of the non-fault insurer or CMC/CHC to delay repair authorization and car inspection, in order to extend the hire period.

91. All of the ten motor insurers in our sample told us that a CMC/CHC could employ a number of methods in order to extend the credit hire period, including:

(a) Arranging for the collection and delivery of a roadworthy car to the repairer prior to either the authorization of the repair or the repairer being ready to perform the repair (eg on a Friday afternoon). However, [✂] told us that the practice of booking in non-fault repairs on a Friday was not now as common as it used to be. Table 18 presents the proportion of hire commencements by day of the week for the nine CMCs/CHCs in our sample and shows that, on average, 15 per cent of credit hires and direct hires commence on a Friday. This evidence supports the view that disproportionately booking in cars for repair on a Friday to extend a credit hire does not appear to be common.

TABLE 18 **Hire commencement, 2012**

Proportion of hires that commenced on each day (%)

	Monday	*Tuesday*	*Wednesday*	*Thursday*	*Friday*	*Saturday*	*Sunday*
Credit hire							
Accident Exchange				[✂]			
ACM*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast				[✂]			
Crash Services	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance				[✂]			
Unweighted average	23	20	19	17	15	6	0
Direct hire†							
Accident Exchange				[✂]			
ACM*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast‡				[✂]			
Crash Services§				[✂]			
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons				[✂]			
WNS Assistance				[✂]			
Unweighted average	22	20	19	17	15	7	0

Source: CMCs/CHCs.

*ACM does not provide credit hire or direct hire services.
†The direct hire data may include at-fault claims.
‡ClaimFast does not provide direct hire services, except as an outsourced function for [✂].
§Crash Services does not provide direct hire services.

(b) Delaying the process for the authorization and completion of the repair, eg by delaying the appointment of an engineer to inspect the car, delaying the submission of evidence to the at-fault party or sending it to the wrong address, and not monitoring the repair closely or resolving delays. [✂][27] told us that CHCs/CMCs could delay the start of the repair by instructing the engineer to wait up to five days before inspecting the car, and could delay the authorization of the repair once the engineer had provided a repair cost estimate.

(c) Delaying the return of a repaired car to the driver.

(d) Denying the at-fault insurer access to the car.

(e) Failing to monitor expeditiously and progress total loss claims.

92. The ten motor insurers in our sample told us that they monitored closely the hire and repair period (for repairable cars) or total loss settlement process (for write-offs) by:

[27] [✂]

(a) verifying with the repairer and/or non-fault insurer the date on which the non-fault driver lost use of their car;

(b) monitoring the progress of the repair against the estimated repair period;

(c) regularly communicating with the CMC/CHC in relation to the repair; and

(d) validating parts delays with the repairer and parts suppliers.

93. Five of the nine CMCs/CHCs in our sample ([✂]) told us that they could not influence the credit hire period, as the key determinant of the hire duration was the repair duration (if the car was repairable) or the time taken to remit the settlement payment to the non-fault driver (if the car was a total loss). They added that the commencement and termination of hire periods was governed by the GTA.[28]

94. Two of the nine CMCs/CHCs in our sample told us how they tried actively to minimize credit hire periods:

(a) [✂] told us that where a driver's car was not roadworthy, it would provide a replacement car immediately (subject to the driver meeting the relevant criteria); and, where a driver's car was roadworthy, it would look to provide a replacement car from the date the car was booked in for repairs. All scheduling of repairs was undertaken by the repairers. Where [✂] provided credit repair through its own repairer network, the selection of the repairer was based on geographical location and performance but, if the selected repairer was too busy, an alternative repairer was selected. [✂] said that it liaised with the repairer and/or engineer to ensure that the repair process was completed as quickly as possible, and it informed both the customer and the at-fault insurer of progress.

(b) [✂]

[28] The GTA states that the car requiring repair should be inspected and authorized for repair on day one of the hire period, repairs should commence on day two and the hire period must end not later than 24 hours after repairs to the car had been completed.

95. The nine CMCs/CHCs in our sample also mentioned the following as influencing the length of the repair period:

(a) the extent of the damage to the car;

(b) parts delays;

(c) the acceptance of liability by the at-fault insurer (as a failure to accept liability could lengthen the hire period by delaying the commencement of repairs);[29] and

(d) the speed with which repairs were authorized or the claim settled (where the car was a write-off) by the at-fault insurer.

Role of the GTA

96. Table 19 sets out the average credit hire durations for GTA and non-GTA claims for four of the ten motor insurers in our sample ([✂]) and seven of the nine CMCs/CHCs in our sample ([✂]). The average duration of a non-GTA credit hire claim is almost three times the average duration of a GTA credit hire claim when the claim has been referred to the CMC/CHC by a motor insurer. However, looking at credit hire services provided by CMCs/CHCs to all work providers, we note that the average hire duration is actually slightly lower for non-GTA claims than for GTA claims.

97. It must be noted that a comparison between GTA and non-GTA credit hire durations is affected by the composition of the two categories. The 'non-GTA' category includes not only the claims that are handled from the outset outside the GTA, but also those that fall out of the GTA because the bills are challenged by the at-fault insurers. In the second case, it is reasonable to expect higher average hire duration, because one of the most common circumstances in which insurers challenge a hire bill is when they perceive duration to be unjustifiably long.

[29] We note that under direct hire, the at-fault insurer accepts liability prior to the commencement of the hire period and therefore the repair and hire duration is not delayed by the replacement car provider awaiting acceptance of liability from the at-fault insurer prior to providing the replacement car to the driver.

TABLE 19 **Average credit hire durations for GTA and non-GTA claims, 2012**

Car type	*Example car*	*GTA claims*			*Non-GTA claims*		
		Hires	*Hire days*	*Average hire duration (days)*	*Hires*	*Hire days*	*Average hire duration (days)*
Credit hire services provided by CMC/CHC upon referral from insurers							
Standard	Peugeot 107	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
MPV	Vauxhall Meriva	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
4x4	Toyota RAV4 2.0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Prestige	BMW 116 1.6	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Sports	Mini Cooper 1.6	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total		71,442	1,173,343	16.4	4,911	215,068	43.8
Credit hire services provided by CMC/CHC to all work providers							
Standard	Peugeot 107	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
MPV	Vauxhall Meriva	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
4x4	Toyota RAV4 2.0	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Prestige	BMW 116 1.6	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Sports	Mini Cooper 1.6	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total		258,985	4,243,547	16.4	44,918	705,186	15.7

Source: Insurers and CMCs/CHCS.

98. CISGIL told us that, where a CMC/CHC was operating under the GTA, it was able to challenge excessive credit hire lengths wherever the CMC/CHC had failed to comply with its obligations under the GTA but, where a CMC/CHC was operating outside the GTA, challenging excessive credit hire lengths could be more difficult.

Notes and data tables on the statistical analysis of the cost of replacement cars

The choice of the appropriate scenario

1. There are various ways in which a non-fault claimant might receive a replacement car, eg on a credit hire basis, a direct basis, or as a courtesy car. Although concerns about differing levels of efficiency might suggest we should use first party non-fault costs for replacement cars (as we have done for repairs), we noted that this would risk giving a distorted view due to different insurers providing non-fault claimants with a replacement car in different ways. We were interested in the costs incurred across the industry, reflecting these different practices, as the choice of practice might itself be driven by the separation, and this concern outweighed our concern about efficiencies. For this reason, in this appendix we use third party non-fault replacement car costs to represent the scenario where there is the separation.

Other issues with the data

2. [✂] told us that, when it controlled both the at-fault and non-fault claims arising from an accident (ie in both of our two alternative benchmark scenarios), it did not record separately in its systems the costs of the two claims. Rather, it recorded the costs together. Therefore, to answer our data request, [✂] provided an estimate of its non-fault claims costs in our benchmark scenarios by allocating 53 per cent of its total costs in these scenarios to the non-fault party.

3. [✂] told us that it did not record claims data in its systems in such a way as to be able to identify which claims had been processed under the terms of a bilateral agreement. As such, its data for first party non-fault claims might be understated as some claims in this category might have been handled in a way to limit costs to some extent.

4. [✂] told us that some of its 'same insurer' claims might have included some elements which were managed, at least initially, by another party. As such, its costs in this category might be overstated since it might not have been able to exercise control over all areas.

5. Finally, the summary statistical analysis we have conducted does not control for all other possible factors which might give rise to differences in claims costs between the scenarios we have considered. Therefore, there may be other factors which explain some of the differences we have found, which we have not analysed.[30]

Data tables

TABLE 1 **Average replacement car costs by claim category and insurer, 2012**

	Third party non-fault	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
Average	1,413	N/A	478	369

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 2 **Average replacement car costs by claim category and insurer, 2011**

	Third party non-fault	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
Average	1,372	N/A	486	447

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

[30] We note also that summary statistical analysis can be sensitive to the techniques used to clean the data (ie removing mis-taken entries and outliers).

TABLE 3 **Average replacement car costs by claim category and insurer, 2010**

	Third party non-fault	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
Average	1,326	N/A	504	470

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 4 **Average cost of separation of liability and control—replacement cars, 2012**

Benchmark	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]
Esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
Average	N/A	934	1,044

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 5 **Average cost of separation of liability and control—replacement cars, 2011**

Benchmark	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]
Esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
Average	N/A	886	925

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 6 **Average cost of separation of liability and control—replacement cars, 2010**

Benchmark	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]
Esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
Average	N/A	822	856

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

Frictional costs incurred by CMCs/CHCs, 2012 (split by GTA and non-GTA claims)

£

CMC/CHC	*GTA claims*				*Non-GTA claims*			
	Admin costs	*Litigation costs*	*Annual costs*	*Average costs per claim*	*Admin costs*	*Litigation costs*	*Annual costs*	*Average costs per claim*
Accident Exchange	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ACM*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Crash Services†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMCs/CHCs.

*ACM [✂].
†Crash Services [✂].

Frictional costs incurred by CMCs/CHCs, 2012 (all claims)

CMC/CHC	*Admin costs* £	*Litigation costs* £	*Annual costs* £	*Average costs per claim* £	*Average credit hire bill issued* £	*Frictional costs as a proportion of average credit hire bill* %
Accident Exchange	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ACM*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Crash Services†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Unweighted average						10

Source: CMCs/CHCs.

*ACM [✂].
†Crash Services [✂].

Frictional costs incurred by motor insurers, 2012 (split by GTA and non-GTA claims)

Motor insurer	*GTA claims*					*Non-GTA claims*				
	Admin costs £	*Mitigation costs* £	*Litigation costs* £	*Annual costs* £	*Average costs per claim* £	*Admin costs* £	*Mitigation costs* £	*Litigation costs* £	*Annual costs* £	*Average costs per claim* £
Admiral*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ageas Insurance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
DLG†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Motor insurers.

*Admiral's frictional costs include frictional costs incurred in relation to credit repair as well as credit hire. However, Admiral estimated that the frictional costs associated with credit repair would be significantly lower than those associated with credit hire due to fewer areas of contention relating to credit repair.
†DLG was unable to provide the relevant data, [✂].

Frictional costs incurred by motor insurers, 2012 (all claims)

Motor insurer	*Admin costs* £	*Mitigation costs* £	*Litigation costs* £	*Annual costs* £	*Average costs per claim* £	*Average credit hire bill paid* £	*Frictional costs as a proportion of average credit hire bill* %
Admiral*	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Ageas Insurance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
DLG†	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Unweighted average							10

Source: Motor insurers.

*Admiral's frictional costs include frictional costs incurred in relation to credit repair as well as credit hire. However, Admiral estimated that the frictional costs associated with credit repair would be significantly lower than those associated with credit hire due to fewer areas of contention relating to credit repair.
†DLG was unable to provide the relevant data, [✂].

Cost of repairs

Introduction

1. This appendix discusses evidence on whether, as a result of the separation of cost liability and cost control, there is an increase in the cost of post-accident vehicle repair services.

2. This appendix sets out:
   (a) an overview of different approaches to managing vehicle repairs;
   (b) the differences in the cost of non-fault vehicle repairs depending on which party provides the repair service (ie captured non-fault repairs managed by at-fault insurers, credit repairs managed by CMCs and repairs managed by non-fault insurers); and
   (c) the cost of managing repair services.

Different approaches to managing repairs

3. Post-accident vehicle repairs are managed by a number of different accident management service providers. The most common providers are:
   (a) insurers (either as the non-fault or at-fault insurer); and
   (b) CMCs, which provide claims management services mostly to claimants who have been referred to them by insurers and brokers. CMCs can operate either as credit repairers or on behalf of an insurer (where the insurer has outsourced some or all of its claims management function). Some CMCs also provide credit repair services directly to non-fault claimants.

4. In some cases, repair services are also provided by a dealership or repairer directly to the customer without being managed by a CMC or insurer.

5. In most cases, non-fault claimants have the option either to use a repairer which is in the approved network of their repair services provider (ie an insurer or CMC) or to use a repairer of their own choice.[1]

At-fault and non-fault repairs

6. At-fault repairs are managed either by the insurer or by a CMC on an outsourced basis.

7. Non-fault repairs are usually managed by the non-fault claimant's insurer (the non-fault insurer), by a CMC or by the at-fault insurer (if the non-fault claimant is 'captured'). Where a CMC manages the repairs, this could be on a credit repair basis or on an outsourced basis where the CMC acts as the insurer would. Nine of the ten largest motor insurance providers ([✂], AXA, Aviva, DLG, esure, RSA, LV, CISGIL and Zurich) told us that they made no referrals to credit repairers and managed the repairs of their non-fault claimants themselves. Admiral told us that it referred its non-fault claimants to a CMC which then offered credit repair services (as part of a broader uninsured loss recovery service). esure told us that until [✂] it offered its non-fault claimants the option of being referred to a CMC which then provided credit repair services.

8. We found that brokers usually referred non-fault claimants either to the non-fault insurer or to a CMC which then provided credit repair services. For example, BGL told us that it referred its non-fault claimants to a CMC which might then offer credit repair. Swinton said that its non-fault claimants could have the repair managed by the non-fault insurer or through a credit repairer; similarly Endsleigh told us that non-fault claimants were offered the option either of a credit repair managed by a CMC or to

[1] Insurers and CMCs might encourage customers to use repairers within their networks, eg by not guaranteeing the repair if it is conducted by a non-approved repairer.

claim on their own policy, in which case the repairs would be managed by Endsleigh. Ageas Retail (ie the broking part of Ageas) said that its non-fault claimants [✂].

Managing non-fault repairs

9. Under tort law, a non-fault party is entitled to be put back into as good a position as they were in before the accident occurred and the at-fault party is therefore liable to cover the reasonable cost of repair.

10. Under the principle of subrogation, an insurer has a right to be subrogated to the rights of its insured (ie its policyholder) when the insurer indemnifies its policyholder pursuant to the policy of insurance. Essentially, this means that, once the non-fault insurer has put the non-fault party back into the position they were in before the accident, the non-fault insurer is able to exercise its policyholder's rights in relation to the underlying tort law claim. The non-fault insurer usually does this by pursuing the at-fault party's insurer in order to recover the costs that have been incurred. We understand that insurance policies (as well as contracts between CMCs and claimants) typically include a clause entitling the insurer (or CMC) to take control of the proceedings on indemnifying the non-fault driver.

11. The case of *Coles v Hetherton* (which at the date of this report was on appeal to the Court of Appeal[2]) considered subrogated claims brought by the non-fault insurer in the name of its policyholders. It was determined that where a vehicle is negligently damaged and reasonably repaired, the measure of the non-fault claimant's loss can be taken as the 'reasonable cost of repair'; and 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 by either the non-fault claimant or the non-fault insurer. It was noted that recovery is possible regardless of repair or pay-

[2] The Court of Appeal hearing was on 16 October 2013.

ment for repair; and that the 'reasonableness' of the repair charge is to be assessed from the position of the individual non-fault claimant (without reference to the non-fault insurer or to any benefits the claimant obtains under the 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.

12. The effect of this judgment, in practice, would appear to be that, where a non-fault insurer or CMC repairs the vehicle, that party has the opportunity to charge to the at-fault insurer more than the repair costs it actually incurred, provided the sum claimed does not exceed the reasonable cost of repair to the individual claimant (ie the cost that the non-fault driver would have reasonably incurred had he/she managed the repair).

13. The at-fault insurer can challenge the value of subrogated claims (eg if the costs are not related to the accident or are unreasonable).

Strategies for gaining value from non-fault repairs with the effect of inflating non-fault repair bills

14. We have identified a number of ways in which the non-fault repair charges subrogated by non-fault insurers and CMCs to at-fault insurers may be increased above the net costs they incur. These 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 ([✂]);[3]

(b) making an upward adjustment to the repair bill received from the repairer to inflate it above the costs incurred ([✂]);

[3] Three of the ten largest insurers have their own repair subsidiaries (DLG, Aviva and RSA). Total motor-insurance-related repairs performed by these subsidiaries generated around £[✂] million in revenues in 2012 (£[✂] million for QRC (RSA), £[✂] million for Solus (Aviva) and £112 million for UKAARC (DLG)). On the assumption that around [✂] per cent of repairs are non-fault repairs, these three repairers conducted non-fault repairs worth about £[✂] million in 2012.

(c) requiring approved repairers to discount the repair bill they charge (or to pay a parallel rebate), but not passing on this discount or rebate 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;[4] 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) ([✂]).

15. Table 1 summarizes our findings. This illustrates that there is considerable variation between insurers in the mark-ups that they earn from non-fault repairs. We calculated that the weighted average increase is about £95.

TABLE 1 **Average mark-up on non-fault repairs**

	Average mark-up (excluding referral fees)	*Method adopted*	*Referral fees for paint or parts*	*Total average mark-up*
Admiral	[✂]	[✂]	[✂]	[✂]
Ageas	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]
Average	[✂]		[✂]	£95

Source: Insurers.

16. Where non-fault brokers or insurers do not manage the repair but act as an intermediary, they can extract referral fees from the party managing the repair (usually a CMC performing a credit repair). Such payments are part of the costs incurred by a CMC in managing the repair (see paragraphs 66 to 74).

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

Differences in repair costs

17. We considered four different ways of assessing the cost increase for non-fault repairs managed by third parties (eg CMCs or non-fault insurers):

(a) average repair bills paid by insurers;

(b) discounts received by insurers in bilateral agreements;

(c) differences in the repair bill sent to the at-fault insurer and the actual repair costs incurred by CMCs providing credit repair; and

(d) repair bills from repairers.

We discuss each in turn.

Average repair bills paid by insurers

18. To test the presence of cost increases under ToH 1 and to estimate their extent, we need to compare the cost of post-accident services where there is the separation of cost liability and cost control (ie the more common situation) with the costs of these services in a scenario where there is no separation (ie our benchmark).

19. We noted that at-fault repairs were on average more expensive than non-fault repairs, which insurers told us was because at-fault damage was more often at the front of the vehicle and non-fault damage was more often at the rear of the vehicle, which was typically cheaper to repair. Also, we were told that there are more low-value claims for non-fault repairs than for at-fault repairs as non-fault drivers do not typically have to pay their excess, or can claim it back from the at-fault insurer. For these reasons, we decided that at-fault claims would not constitute an appropriate benchmark.

20. There are two conditions which need to be met for the benchmark:

(a) The claimant should receive post-accident services which are comparable with those which a non-fault claimant managed by a party which is not liable for the

cost (eg a non-fault insurer or CMC) would receive, assuming that there is neither overprovision nor underprovision in those services provided.

(b) The non-fault claim handler should have the incentive to keep the costs of post-accident services to a minimum.

21. There are three scenarios in which a non-fault claim might be managed by a party which satisfies condition *(b)*. These are: (i) where it is the at-fault insurer and has captured the non-fault claim; (ii) where it is both the at-fault insurer and the non-fault insurer; and (iii) where it is the non-fault insurer but has a bilateral agreement with the at-fault insurer. However, each of these possible benchmarks gives rise to some concerns. In particular, in all cases (especially scenario (i) where the claimant is not the at-fault insurer's motor insurance customer), there is a tension between conditions *(a)* and *(b)* such that condition *(a)* might not be satisfied. In addition, we note that, under scenario (iii), bilateral agreements are likely only to align imperfectly the interests of the at-fault and non-fault insurer so that there is likely to remain some scope for additional costs being incurred because of the separation of cost liability and cost control.

22. Since few insurers provided data for repairs managed under bilateral agreements, we considered only two possible benchmarks: captured claims and claims where the at-fault and non-fault insurers are the same. Table 2 summarizes the initial information we received from the ten largest insurers operating in the UK on the cost of different categories of non-fault repairs. The benchmark adopted was the average cost of captured repairs.

TABLE 2 **Average repair bills for non-fault repairs paid by the at-fault insurer**

Average repair bills, including VAT (2012)	*Average*	*Low*	*High*	*Number of insurers in sample*	*Versus base %*	*Difference £*
(a) Average captured non-fault repair cost, network repairer	1,174	[✂]	[✂]	7	Base	Base
(b) Average captured non-fault repair cost, non-network repairer	1,325	[✂]	[✂]	8	+13	151

The repair costs in *(a)* and *(b)* are the average repair bills that the at-fault insurer receives from repairers that have carried out its captured non-fault repairs, with subcategory *(a)* being those repairs that are done in the at-fault insurer's network of approved repairers and subcategory *(b)* being those that are done in a repairer of the customer's choice.

(c) Average credit repair bill received by at-fault insurer from CMCs	1,576	[✂]	[✂]	8	+34	402

The average repair bill in *(c)* covers those bills that the at-fault insurer has received from CMCs providing credit repair services to the non-fault driver.

(d) Average own non-fault repair costs incurred by non-fault insurer	1,169	[✂]	[✂]	7	0	–5

The average repair costs in *(d)* are the costs to the non-fault insurer in managing the repair. We note that if the non-fault insurer inflates the repair bill to market rates or adds a management or administration fee before passing it across to the at-fault insurer, the cost shown in this row may or may not be prior to this inflation or fee. Similarly, if the non-fault insurer receives a discount off the repair bill, this discount may or may not be reflected in the costs shown in this row.

(e) Average repair bill received by the at-fault insurer from other insurers (excl bilateral agreements)	1,347	[✂]	[✂]	7	+15	173

The average repair bill in *(e)* covers those bills received by the at-fault insurer from non-fault insurers that have managed the non-fault repair. These average bills exclude repair bills that have been settled under bilateral agreements. However, it appears that the overall prevalence of bilateral agreements is low (see paragraphs 34 and 35) so we do not think that including repairs performed under bilateral agreements would significantly change this number.

Source: CC.

23. As a cross-check to the figures in Table 2, Table 3 shows the average credit repair revenues per repair as provided to us by CMCs that provide credit repair services.

TABLE 3 **Average credit repair revenues**

Average repair revenues per repair, including VAT	*Average*	*Low*	*High*	*Number of replies*
Average credit repair revenue per repair, 2012	1,594	[✂]	[✂]	7
Average credit repair revenue per repair, 2011	1,515	[✂]	[✂]	7
Check: average credit repair bill received by at-fault insurers, 2012 (see Table 2, row *(c)*)	1,576	[✂]	[✂]	8

Source: CC.

24. Table 3 shows that the average credit repair bill reported to us by paying insurers (see Table 2, row *(c)*) is similar to the average credit repair revenue reported to us by CMCs.

25. The comparison between lines *(c)* and *(e)* provides an estimate of the average difference between costs subrogated by CMCs and by non-fault insurers (£229). Whatever the higher cost to at-fault insurers when repairs are managed by non-fault insurers, the table shows that the bills subrogated by CMCs are on average £229 higher than the bills subrogated by non-fault insurers. This estimate is lower than what some insurers told us. In particular, [✂] reported a value around £[✂], while CISGIL considered the total average cost increase in the case of credit repair to be £[✂].[5]

26. On the other hand, although some insurers (RSA and Zurich) generically supported our findings, lines *(a)* and *(d)* are problematic. First, we do not know whether the costs provided by the insurers include rebates from repairers and/or referral fees from suppliers. In addition, the fact that the figures in *(a)* and *(d)* are very similar contrasts with what three insurers (DLG, esure and RSA) told us, namely that captured claims tended to have a lower value than non-captured ones. Our consumer survey also shows that the level of damage is on average lower for captured claims.[6]

27. To get more robust information, we attempted an econometric analysis of claim costs. This turned out not to be feasible because of the different methods adopted by insurers in collecting and elaborating data. We therefore turned to an analysis of summary statistics. We asked the largest insurers to provide us with data on total repair costs over the past three years for three categories of non-fault claims: non-fault claims managed by the non-fault insurers ('first-party non-fault'), captured

[5] This value is close to our estimate. In fact, we estimated the average mark-up for directly managed repairs at £95, which gives a total higher cost to at-fault insurers in case of credit repair of £324 (£95 + £229) (see Appendix 6.6).
[6] Of the respondents whose claim was captured, 47 per cent reported low severity of damage, 35 per cent medium severity and 18 per cent high severity. For claims handled by non-fault insurers, these percentages become 31, 46 and 23 per cent respectively.

claims, and claims where the at-fault and non-fault insurers were the same.[7] Five out of the ten insurers provided us with data which we could aggregate and compare.

28. Figure 1 shows the average repair costs by insurer and claim type in 2012.

FIGURE 1

Average repair cost by claim category and insurer, 2012

[✂]

Source: Insurers and CC analysis.
Note: [✂] figures are for 2011 to enable better comparability.

29. Subtracting the average costs in the benchmarks without the separation of cost liability and cost control ('captured' and 'same insurer') from the costs in the scenario with this separation ('first party non-fault'), we found that the average cost where there is the separation is higher than in the cases without, in accordance with our hypothesis. Figure 2 illustrates these differences.

FIGURE 2

Average cost differences, 2012

[✂]

Source: Insurers and CC analysis.
Note: [✂] figures are for 2011 to enable better comparability.

30. Figure 2 shows that the average cost increase arising from the separation of cost liability and cost control in repairs is different according to the benchmark used. When compared with 'captured' claims, the cost increase ranges from £20 to £205; when compared with the 'same insurer', the cost increase ranges from £7 to £200. The data provided indicates similar ranges for 2011 and 2010 (see Annex A).

[7] We also asked for data on non-fault claims managed under bilateral agreements, but most insurers could not provide the data at the desired level of granularity.

31. These findings are compatible with the results of our consumer survey and with the insurers' view that it is generally harder to capture a non-fault claim when the damage incurred is substantial (which suggested that captured repair costs would, on average, be somewhat lower than first party non-fault repair costs). This effect results in an overstatement of the cost difference arising from the separation of cost liability and cost control for some insurers, and suggests that differences calculated against the same insurer benchmark might be more robust.

32. There is also some variation between insurers. Several factors may explain this variation, including differences in the customer bases and the typical accident damage their customers incur, differences in the insurers' claims handling efficiency, and various confounding factors. In particular, we note that, in all scenarios, some insurers may have netted off the referral fees, rebates and other sources of income which they receive in relation to repairs, while others may have provided us with the gross cost.[8] Other issues with the data are discussed in Annex A.

33. In the light of these points, we did not attach weight to the comparisons in Figures 1 and 2. Instead, we used the estimates of average mark-up set out above—see Table 1 and paragraph 15 (in effect a 'bottom-up' rather than 'top-down' approach to the estimation of cost differences).

Discounts received by insurers in bilateral agreements

34. We found that six of the ten largest insurers had bilateral agreements with at least one other insurer in relation to vehicle repairs. We found that these bilateral agreements usually operated by the parties continuing to pass on repair bills in the same

[8] Moreover, where an insurer is the first party non-fault insurer, it may or may not charge its customer their contractual excess, at least until liability is settled, and, where this is charged, the income may or may not be netted off the cost of the claim. [✂] and [✂] told us that their first party non-fault repair costs were stated net of the excess amount they received on some non-fault claims. As a result, we would expect some first party non-fault repair costs to be understated (resulting in an understatement of the cost difference arising from the separation of cost liability and cost control for some insurers).

way as prior to their agreement but, in addition, applying a discount. This discount would reflect the actual cost of the repair to the non-fault insurer, taking into account any referral fees, rebates and discounts. One insurer described this as effectively billing the wholesale cost of the repair.

35. Table 4 sets out the discounts off the repair bills insurers with bilateral agreements give to and receive from each other. [✂] and [✂] are not included as they were unable to provide this data. ([Four] do not have bilateral agreements with other insurers in relation to vehicle repairs.)

TABLE 4 **Discounts to repair bills passed on to at-fault insurers under bilateral agreements**

per cent

Discount from	*Discount to*				
	[✂]	*[✂]*	*[✂]*	*[✂]*	*[✂]*
[✂]		[✂]	[✂]	[✂]	[✂]
[✂]	[✂]		[✂]	[✂]	[✂]
[✂]	[✂]	[✂]		[✂]	[✂]
[✂]	[✂]	[✂]			[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	

Source: CC.

[✂]
Note: N/A = not applicable.

36. Table 4 shows that [✂].

Differences in the repair bill passed to the insurer and the actual credit repair costs incurred

37. We sought to identify the factors which contributed to the difference between the average credit repair bill charged to at-fault insurers and the cost of a non-fault captured repair. We looked at the additional charges CMCs added to the repair bill they received from their approved repairers before passing it on to the at-fault insurer, and we reviewed the discounts CMCs received from their approved repairers. We also considered the rebates some CMCs received from suppliers of inputs to their approved repairers (eg paint or parts suppliers).

38. Table 5 shows the additional charges CMCs add to their repair bills, the discounts CMCs receive off repair bills and the rebates they receive from repairers and suppliers to their repairers.

TABLE 5 **Discounts and additional charges for CMCs***

CMC	*[✂]*	*[✂]*	*[✂]*	*[✂]*	*[✂]*	*[✂]*	*[✂]*	*[✂]*
Average discount given to CMCs per repair	[✂]			[✂]	[✂]	[✂]	[✂]	[✂]
Discount given to CMCs as a % of repair bill	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Rebates and commissions (paint etc)	[✂]	[✂]		[✂]		[✂]	[✂]	[✂]
Admin and engineering fees		[✂]	[✂]				[✂]	[✂]

Source: CC.

*[✂]

39. All the CMCs which responded to our information request told us that they earned discounts from repairers, ranging from [✂] per cent of the repair bill to around [✂] per cent. These discounts allowed the credit repairer to pass on a higher bill to the at-fault insurer than the net bill incurred (see paragraph 14*(c)*).

40. Three of the eight CMCs in our sample ([✂]) told us that they charged the at-fault insurer an administration fee in addition to the repair bill, as permitted under the terms of the GTA. However, this fee varied from £[✂] ([✂]) to £[✂] ([✂]). One CMC ([✂]) said that it also added an engineering charge, which insurers told us was common practice among CMCs. Two CMCs ([✂] and [✂]) told us that they received a referral fee from [✂] (worth up to £[✂] per repair).

41. Five CMCs ([✂]) provided us with an analysis of how an average credit repair bill is made up. This showed that the invoice from the repairer accounted for around 90 to 95 per cent of the total repair bill (net of write-offs and discounts), engineering charges accounted for around 3 to 5 per cent and the remainder was made up mainly of administration charges, storage charges and penalty charges for late payment of invoices.

42. Four CMCs in our sample ([✂]) told us that they received rebates from paint suppliers of between £[✂] and £[✂] per repair; one CMC ([✂]) told us that it received rebates from parts suppliers ([✂]); and one CMC ([✂]) told us that it received a rebate from Audatex ([✂]). In all these cases, the rebate payment was likely to increase the cost of the repair to the repairer, and ultimately to the at-fault insurer.

43. Overall, taking all sources of income together, we found that the CMC with the highest income from the repair management process (ie through discounts and other rebates and charges) received around £300 per repair in 2012 ([✂]). We found that [✂] earned about £265 per repair, and both [✂] and [✂] earned about £[✂] per repair.

Referral fees

44. We found that CMCs typically paid referral fees to work providers (ie non-fault insurers or brokers) to gain referrals of non-fault claimants to whom they could then provide credit repair (and in most cases also replacement car) services. Table 6 summarizes the evidence we received from CMCs on the amounts paid in relation to credit repair.

TABLE 6 **Referral fees paid by CMCs for credit repair**

CMC	*[✂]*	*[✂]*	*[✂]*	*[✂]*	*[✂]*
Referral fee paid per repair	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC.

[✂]
Note: [✂] told us either that they did not pay referral fees to work providers in relation to credit repair services or that they did not pay referral fees directly related to credit repair.

45. From this data, it appears that the typical referral fee paid by a CMC in order to provide credit repair services is around £33 to £80. This represents a marketing cost for CMCs in order to win business but, as they compete by paying higher referral fees, it is also the means by which non-fault insurers and brokers, which 'control' the

claimant at the FNOL, can extract profits earned by CMCs through the credit repair process.

Repair bills from repairers

46. We looked at how repairers invoiced insurers and CMCs for repair work they performed. In particular, we looked at the agreements that repairers had with different work providers in order to consider how repair bills varied depending on the work provider.

47. Five repairers (three insurer-owned and two independent) provided us with data which enabled us to analyse repair bills by work provider.

48. Overall, we found that, on average, repair bills consisted of approximately 40 per cent labour costs, 40 per cent parts costs and 20 per cent paint costs. We first describe how these elements are negotiated and reflected in contracts before comparing repair bills between work providers.

Labour costs

49. Labour costs are calculated as the time taken for a repair multiplied by the labour rate per hour. Repairers told us that repair times were usually based on industry standards, set by reference to a cost estimation system (eg Audatex or Glassmatix), and were therefore generally the same irrespective of which party managed the repair or whether it was an at-fault or non-fault repair. Any differences in labour costs in vehicle repairs were principally a function of differences in the labour rate per hour.

Part and paint costs

50. We understand that, for most repairs, the repair cost estimation system will specify which parts are needed and will calculate a repair cost based on a recommended

retail price for each part. However, work providers and repairers, in reaching their agreements, will agree a discount off the recommended retail price for parts which is then reflected in the repair bill.

51. Similarly for paint, the repair cost estimation system will usually specify the quantity of paint and materials which are needed in a repair and will calculate an invoice value based on the price of paint in a paint basket. We understand that the paint basket in Audatex (the most commonly used repair cost estimation system) is based on the weighted average retail paint price for a range of brands of paint and, therefore, a work provider specifying the use of a certain paint will not be able to change the base price used in negotiations. Rather, work providers, in their contracts with repairers, will agree discounts off the paint basket (known as the paint index), which will be reflected in their repair bills.

Variables in a repair bill

52. The following elements of a repair bill therefore represent the key variables which create differences in repair bill prices between repairers: the labour rate per hour, the discount for parts and the paint index. We have seen no evidence to suggest that the time taken for a repair (ie the number of hours billed) and/or the amount of paint used varies according to which party manages the repair.

53. We have seen some evidence of differences in parts used. We found that some insurers stipulate the use of some non-OEM parts or sometimes require the repairing of a part rather than replacing it, while, in contrast, some CMCs use only OEM parts and, according to some repairers, are more inclined to replace parts. However, these differences appear small. We found that, across all post-accident repairs, the amount of non-OEM parts used is a small fraction of all parts, representing between 2 and 15 per cent of total parts costs (ie no more than 6 per cent of total repair costs); and

we did not receive evidence indicating a significant difference in the choice of replacement or repair between work providers. Therefore, in our analysis in Tables 7, 8 and 9, we have made the simplifying assumption that the parts and paint used for different work providers are the same.

Repairer data

54. [✂] provided us with an explanation of how it charges labour, parts and paint costs, which enabled us to calculate indicative differences in repair bills for at-fault and non-fault claims for different work providers, as set out in Table 7.

TABLE 7 **Repair costs by category: [✂]**

	Labour rate £/h A	*Parts discount % B*	*Paint index* % C*	*Indicative bill value† D*	*Difference to captured costs % E*
At-fault claims					
For repairs as an insurer's approved repairer	28	10	85	94	0
Dealership managed	28	10	100	97	4
For repairs as a non-approved repairer (ie customer choice)	30	5	90	100	6
Non-fault claims					
Captured non-fault (as approved repairer)	28	10	85	94	Base
Non-fault insurer managed (as approved repairer)	28	10	85	94	0
CMC managed (as approved repairer)	34	0	100	110	17
Dealership managed	28	10	100	97	4
Non-approved repairer (ie customer choice)	30	5	90	100	6

Source: Columns A to C: based on data from [✂]; columns D and E: CC analysis.

*The paint index can alternatively be expressed as a discount off the paint basket, ie a paint index of 85 per cent is the same as a 15 per cent discount off the paint basket.
†The indicative bill values are notional but represent relative differences, assuming 40 per cent of captured non-fault repair costs are for labour, 40 per cent are for parts and 20 per cent are for paint.

55. [✂] provided similar information, as set out in Table 8.

TABLE 8 **Repair costs by category: [✂]**

	Labour rate £/h A	*Parts discount % B*	*Paint index % C*	*Indicative bill value D*	*Difference to captured at-fault costs % E*
At-fault repairs as an insurer's approved repairer	23.5	10	65	100	
Non-fault insurer managed (as approved repairer)	23.5	10	65	100	
Credit repairs	33	0	0	131	31

Source: Columns A to C: based on data from [✂]; columns D and E: CC analysis.

Note: See notes to Table 7, which apply also to Table 8.

56. [✂] told us that, [✂].

57. We noted that, [✂], as shown in Table 9.

TABLE 9 **Repair costs by category: [✂]**

	Labour rate £/h A	*Parts discount % B*	*Paint index* % C*	*Indicative bill value† D*	*Difference to captured at-fault costs % E*
At-fault claims					
At-fault repairs	27	18	75	100	0
Non-fault claims					
Captured non-fault repairs	27	18	75	100	Base
Non-fault repairs	36	0	100	129	29

Source: Columns A to C: based on data from [✂]; columns D and E: CC analysis.

Note: See notes to Table 7, which apply also to Table 9.

58. The data provided by [✂], [✂] and [✂] shows that average repair bills can vary by up to around 30 per cent between a captured non-fault repair and a non-fault insurer or CMC-managed non-fault repair. The data submitted by [✂] suggests that, [✂], this equates to around £390 per repair.[9] However, repairers do not retain all the benefits of a higher repair bill as it appears that repairers pass most of the extra income back to the work provider in the form of a discount or referral fee (see paragraph 44). For example, [✂] told us that it discounted its repair bills [✂] per cent, [✂] told us that it discounted its repair bills by around [✂] per cent, and [✂] told us that it applied a discount of [✂] per cent. [✂] said that [✂].

The costs of managing a repair

59. The average cost of a captured non-fault repair in Table 2 does not include the administrative cost incurred by the at-fault insurer in managing the repair (eg the need to record the claim, instruct the repairer, approve the repair cost estimate and deal with customer complaints). In most cases, other than where an administration or engineering fee has been added, these costs are also not recognized for non-fault

[9] [✂]

insurers or credit repairers. In this section, we examine the costs of managing repairs. We consider in turn the costs for at-fault insurers in managing captured non-fault repairs, the costs for non-fault insurers in managing non-fault repairs, and the costs for CMCs in managing credit repairs.

Captured non-fault repairs

60. CISGIL and esure provided us with their estimates of the costs of managing a captured non-fault repair. esure estimated these costs at £[✂] per repair and CISGIL estimated them at £[✂] per repair.

Own-insurer non-fault repairs

61. We considered the costs incurred by a non-fault insurer in managing a non-fault repair. In this scenario, the claimant will have claimed under his own insurance (possibly with payment of an excess), and the non-fault insurer will seek to recover the costs of the claim from the at-fault insurer (possibly repaying the excess to the claimant if successful).

62. The costs of managing a non-fault repair include:

(a) the cost of setting up a claim, paying independent engineers who provide repair cost estimates, monitoring the repair and liaising with the customer;

(b) the cost of administering and setting up a network of repairers, including monitoring quality; and

(c) the business overheads required to operate a repair business (rents, rates, utilities, management, etc).

63. The costs in *(a)* vary pro rata with the number of repairs managed, while *(b)* and *(c)* are less likely to do so. Generally, we are most interested in variable costs as these costs are most likely to be passed through into premiums (see Appendix 6.6).

64. Table 10 summarizes the evidence we received from insurers on the costs of managing a non-fault claim. These costs may include some non-repair elements (for example, costs of dealing with claimants), but we note that the repair element is likely to be large as the management costs to non-fault insurers of arranging provision of replacement cars are likely to be small.[10]

TABLE 10 **Cost of managing a non-fault claim**

	Cost of managing a non-fault claim £
Admiral	[✂]
Ageas	[✂]
Aviva	[✂]
AXA	[✂]
CISGIL	[✂]
DLG	[✂]
esure	[✂]
LV	[✂]
RSA	[✂]
Zurich	[✂]
Average	88

Source: Insurers.

65. We noted substantial variation in the quoted management costs between different insurers. This may reflect differences in the approach taken to estimating these costs, rather than differences in the underlying level of costs.

Credit repairs

66. Operating a credit repair business involves incurring various costs in addition to the cost of the repair, including:

(a) the cost of invoicing the repair bill to the at-fault insurer and recovering the repair costs from the at-fault insurer;

(b) the cost of unrecoverable repair bills;

(c) referral fees to gain work; and

[10] In our working paper on 'Overcosting and overprovision of TRVs' we estimated the costs of managing a repair to be £100 on the basis of information from a smaller group of insurers.

(d) some other costs.[11]

Invoicing and recovering repair bills

67. The costs of invoicing and recovering credit repair bills from the at-fault insurer include:

(a) the cost of liaising with the at-fault insurer about the repair;

(b) the cost of putting together the payment pack (ie the invoice and all supporting documentation); and

(c) the cost of chasing unpaid bills and litigation, and the costs to minimize collection costs (eg the cost of establishing and operating bilateral agreements and the cost of GTA membership).

68. None of the CMCs provided a direct estimate of these costs; however, [✂], and we estimated that [✂] incurred invoicing and recovery costs for credit repair in 2012 of about £[✂] per repair.

69. These invoicing and recovery costs include the frictional costs[12] associated with credit repair. Overall, we found that frictional costs (ie the costs of challenging and defending the repair claim, including related staff costs, legal costs and engineering costs), and the mitigation of these costs,[13] were low in relation to credit repair, for the following reasons:

(a) Six out of the seven CMCs in our sample said that credit repair bills were rarely disputed, except for liability issues. [✂] estimated that frictional costs for credit repair averaged about £[✂] per repair.

[11] This includes, for example, the cost of capital and overheads not captured in the other cost categories. We have not sought to estimate these other costs as it appears that they are unlikely to be significant.
[12] By frictional costs, we mean the costs that arise from both the monitoring and challenging by the at-fault insurer of non-fault claims which have been managed by non-fault insurers and CMCs, and the costs of defending and supporting claims by non-fault insurers and CMCs.
[13] Mitigation costs are costs incurred to mitigate frictional costs (eg through third party capture, bilateral agreements and litigation).

(b) At-fault insurers provided a wide range for their estimates of the frictional costs they incurred per credit repair; however, it appears that some included the cost of establishing liability disputes which was not related to the repair. Five insurers provided estimates of the total frictional costs they incurred in 2012 in relation to credit repair, which ranged from approximately £0.1 million to £1.2 million per insurer.

Non-recoverable bills

70. Non-recoverable bills arise most often in cases where the credit repair provider incorrectly assumes that the customer was not at fault (ie the driver turns out to be at fault or the claim is shown to be fraudulent). At-fault insurers also sometimes challenge credit repair bills with regard to particular costs incurred (eg if the insurer believes that there are excessive costs for valeting or vehicle collection and delivery), but both insurers and CMCs told us that successful challenges to credit repair bills for such reasons were rare. On the basis of estimates provided to us by CMCs, we estimate that the cost of unrecoverable bills is, on average, around £15 per repair, ie about 1 per cent of the average credit repair bill.

Referral fees

71. We found that referral fees paid by CMCs providing credit repair services were between £[✂] and £[✂] per repair (see Table 6). Endsleigh told us that it received referral fees from CMCs in relation to credit repair services of around £65 per repair, and [✂] told us that, [✂], it received [✂]. Admiral (the only insurer in our sample which told us that it made referrals to credit repairers) said that it received a referral fee of between £30 and £65 per credit repair.

Summary of credit repair costs

72. Table 11 summarizes our assessment of the costs of providing credit repair services.

TABLE 11 **Costs of providing credit repair services**

Cost category	*Estimated cost per credit repair* £
Managing the repair	53–71
Invoicing and recovering repair costs	42–90
Non-recoverable bills	15
Referral fees	33–80
Total	143–256

Source: CC.

73. In total, we estimate that the cost of managing a credit repair service is likely to be around £180 per repair. This figure is based, in particular, on evidence from [✂], [✂] and [✂], each of which indicated that the total cost of managing a repair and invoicing and recovering repair bills was around £100 per repair, together with the average cost of unrecoverable bills of £15 (see paragraph 70) and a typical referral fee of £65 (see paragraph 71).

74. However, we note that there are some uncertainties around these estimates, due principally to the wide range of figures provided by insurers and CMCs for some elements of the total cost. We note also that credit repair is usually not offered on a stand-alone basis but rather in conjunction with credit hire, which means that the costs of a stand-alone credit repair business may be higher.

Notes and data tables on the statistical analysis of repair costs

The choice of the appropriate scenario

1. We asked the insurers for data on the costs of non-fault repairs which they managed for their own customer, ie 'first party non-fault' repair costs, rather than the bills they received as the at-fault insurer, ie 'third party non-fault' repair costs. If we had used third party non-fault costs for repairs, these costs would aggregate the actual costs incurred by various parties (eg non-fault insurers, CMCs, car dealerships, etc), which could have differing levels of efficiency in handling repair claims. In seeking to identify the presence and extent of a cost increase arising due to the separation of cost liability and cost control, we would wish to compare equally efficient repair claims handlers, and this would not be the case if we used third party non-fault repair costs. For this reason, in this annex we use first party non-fault repair costs to represent the scenario where there is the separation of cost liability and cost control.

Other issues with the data

2. [✂] told us that, when it controlled both the at-fault and non-fault claims arising from an accident (ie in both of our two alternative benchmark scenarios), it did not record separately in its systems the costs of the two claims. Rather, it recorded the costs together. Therefore, to answer our data request, [✂] provided an estimate of its non-fault claims costs in our benchmark scenarios by allocating 53 per cent of its total costs in these scenarios to the non-fault party.

3. [✂] told us that it did not record claims data in its systems in such a way as to be able to identify which claims had been processed under the terms of a bilateral agreement. As such, its data for first party non-fault claims might be understated as

some claims in this category might have been handled in a way to limit costs to some extent.[14]

4. [✂] told us that some of its 'same insurer' claims might have included some elements which were managed, at least initially, by another party. As such, its costs in this category might be overstated since it might not have been able to exercise control over all areas.

5. Finally, the summary statistical analysis we have conducted does not control for all other possible factors which might give rise to differences in claims costs between the scenarios we have considered. Therefore, there may be other factors which explain some of the differences we have found, which we have not analysed.[15]

Data tables

TABLE 1 **Average repair costs by claim category and insurer, 2012**

	First party non-fault	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
Average	1,271	N/A	1,167	1,216

Source: Insurers.

Notes:
1. [✂] figures are for 2011 to enable better comparability.
2. The averages presented in the table are simple averages of the each insurer's individual average. We present this information for exposition purpose only.
3. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

[14] [✂] also told us that it had assumed that a non-fault claim was 'captured' if the replacement car element of the claim was captured. [✂] said that it believed this to be a good indicator of whether a claim was captured, despite not being accurate in all cases.
[15] We note also that summary statistical analysis can be sensitive to the techniques used to clean the data (ie removing mistaken entries and outliers).

TABLE 2 **Average repair costs by claim category and insurer, 2011**

	First party non-fault	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
Average	1,243	N/A	1,135	1,198

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of the each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 3 **Average repair costs by claim category and insurer, 2010**

	First party non-fault	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
Average	1,193	N/A	1,096	1,158

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of the each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 4 **Average cost of separation of liability and control—repairs, 2012**

Benchmark	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]
Esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
Average	N/A	104	55

Source: Insurers.

Notes:
1. [✂] figures are for 2011 to enable better comparability.
2. The averages presented in the table are simple averages of the each insurer's individual average. We present this information for exposition purpose only.
3. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 5 **Average cost of separation of liability and control—repairs, 2011**

Benchmark	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]
Esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
Average	N/A	108	45

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of the each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 6 **Average cost of separation of liability and control—repairs, 2010**

Benchmark	*Bilateral*	*Captured*	*Same insurer*
Admiral	[✂]	[✂]	[✂]
Esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
Average	N/A	97	35

Source: Insurers.

Notes:
1. The averages presented in the table are simple averages of the each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

Vehicle write-offs

Introduction

1. This appendix examines evidence concerning the impact of separation of cost liability and cost control on vehicle write-offs, ie when a vehicle is deemed uneconomical to repair following a road traffic accident. We assess whether at-fault insurers, which pay for the post-accident services received by non-fault claimants, pay higher prices when these services are managed by another party than when they manage them, and whether there are differences in the service received by claimants according to whether or not the at-fault insurer managed the write-off.

2. This appendix sets out:
   (a) the process for a vehicle write-off;
   (b) the differences in the cost of write-offs to the at-fault insurer depending on which party manages the write-off process; and
   (c) differences in the service received.

Vehicle write-offs

3. According to Trend Tracker,[1] around 600,000 cars were written off in 2012 (out of a total of around 4 million repair claims for private and fleet cars).

4. We gathered data in relation to vehicle write-offs from seven of the ten largest insurers, which together were responsible for around half of the GWP for motor insurance in 2012.[2] These insurers, in aggregate, managed in 2012 around 183,000 motor-insurance-related write-offs, made up of 106,000 write-offs for fault claimants, 56,000 for non-fault claimants managed by the non-fault insurer and 21,000 for

[1] *The Future of the Car Body Repair Market in the UK 2012–2017*.
[2] See Appendix 2.1.

captured non-fault claimants. This data would suggest that there were around 365,000 motor insurance-related write-offs in 2012 managed by insurers.[3]

5. Vehicle write-offs are classified into various categories under the ABI Code of Conduct. Categories A and B cannot be repaired or resold at all (and must be scrapped), whereas categories C and D are usually resold in car auctions and may subsequently be repaired or used for spare parts.

The write-off process

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

   (a) 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

   (b) where the vehicle is so significantly damaged to render the vehicle unable to be repaired (eg flood damage or in some cases where a vehicle has rolled over).

7. The pre-accident value is the cost of purchasing an equivalent vehicle of a similar age and condition at the time of the accident, which is usually based on published price guides.

8. However, some insurers use slightly different criteria. For example, [✂] told us that a vehicle was usually deemed a total loss if repair costs exceeded 80 per cent of the pre-accident value of the vehicle, and it would also take into account other factors and that each claim was treated on its own merits. DLG told us that it took into account the cost of replacement car hire when assessing whether a car should be written off or repaired in two circumstances: [✂].

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[3] We understand from data provided to us by CMCs that the number of write-offs managed by CMCs is small relative to the number managed by insurers.

9. Nine out of the ten largest insurers (Zurich, RSA, LV, esure, DLG, CISGIL, AXA, Aviva and Ageas) told us that they did not differentiate between fault and non-fault claims in how they determined whether a vehicle was a write-off.

10. However, most of the insurers[4] told us that they considered the cost of the replacement car provision when determining whether to repair or write off a non-fault driver's car in circumstances when:

(a) the repair duration was likely to be lengthy due to the vehicle having sustained significant damage or the repair was complex; or

(b) there was a significant extension to the repair duration (eg due to a delay in obtaining a replacement part).

Some of the insurers noted that these circumstances were more relevant when the non-fault claimant's car was a prestige car or a rare car, as the daily rate would be higher (particularly under credit hire).

11. AXA also noted that if the difference between the repair cost and market value of a car was less than the likely cost of hire taking into account the possible repair period, it would be in all parties' interests and in keeping with the claimant's duty to mitigate loss, to deal with the claim on a total loss basis. However, AXA told us that it did not insist that this approach was accepted by the non-fault driver, and that it would explain its approach and allow the non-fault driver to decide whether the vehicle was repaired or written off.

12. If a vehicle is being written off, a policyholder 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 policyholder by the

[4] RSA told us that it never took into account the cost of a temporary replacement vehicle when deciding whether to write off or repair any customer's car.

insurer or CMC differs according to whether or not the policyholder retains the written-off vehicle, as follows:

(a) If the policyholder gives up the vehicle, they will receive a payment of the agreed pre-accident value of the vehicle.

(b) If the policyholder chooses to retain the vehicle, they will receive a payment of the agreed pre-accident value of the vehicle less the estimated salvage value.

(c) In a fault claim (and in some non-fault claims managed by the non-fault insurer), they will receive either of the payments above, as appropriate, less the amount of the excess in their motor insurance policy (though in a non-fault claim claimants may then themselves recover their excess from the at-fault insurer).[5]

13. Non-fault insurers and CMCs will seek to recover from the at-fault insurer the pre-accident value and any other charges they incur (eg vehicle storage and collection costs), less the estimated salvage value. Practices vary as to what the insurer or CMC receives from the salvage company responsible for disposing of the vehicle, but typically it will be the estimated salvage value plus any commission or referral fee.

14. A salvage company's net income will be the actual salvage proceeds less the estimated salvage value paid to the insurer or CMC, any costs of disposal and any referral fees or rebates paid to the insurer or CMC which provided the work.

Evidence relating to claims costs

15. When a vehicle is written off the claim cost borne by a fault insurer may be higher when the write-off is managed by a non-fault insurer or CMC than when the write-off

[5] Where a driver involved in an accident says they are not at fault and asks their own insurer to manage the claim, the insurer may handle the claim in various ways: *(a)* it may indemnify the claimant for the insured losses only and seek to recover the costs of the losses from the at-fault insurer; *(b)* it may also indemnify the claimant for some uninsured losses (eg by waiving the excess) and seek to recover these losses from the at-fault insurer as well; or *(c)* the non-fault insurer may choose to indemnify only the insured losses (not uninsured losses) but nevertheless seek to recover uninsured losses as well (eg any excess that had been previously charged), either by virtue of the claimant having motor legal expenses insurance or as a service to its customer.

is managed by a fault insurer if the pre-accident value is set too high or the estimated salvage value is set too low.

16. In this section, we discuss:

(a) the average payments for vehicle write-offs for fault customers and non-fault customers;

(b) how the pre-accident value is agreed with claimants;

(c) incentives for insurers or CMCs to understate the estimated salvage value; and

(d) the payment and receipt of referral fees in relation to the salvage process.

Payments for vehicle write-offs

17. We received cost data from seven of the ten largest insurers in relation to vehicle write-offs, as summarized in Table 1.

TABLE 1 **Average payments for vehicle write-offs by insurers**

			£		
	*Unweighted average**	*Weighted average†*	*Low‡*	*High‡*	*Insurers providing estimates*
Fault write-offs	3,211	2,853	[✂]	[✂]	7
Captured non-fault write-offs	1,859	1,988	[✂]	[✂]	5
Non-fault insurer managed write-offs	2,240	2,292	[✂]	[✂]	6
Write-offs received from other parties	2,104	2,122	[✂]	[✂]	3

Source: CC.

*This is the average of the average write-off payouts provided to us by insurers (ie insurers which payout for few write-offs will be over-represented as each insurer's data is given equal weight).
†This is the average payout for all write-offs in the data, calculated as the total value of all write-offs (ie from all insurers in our sample) divided by the total number of write-offs in each category. These figures are more reliable than the unweighted figures as they give equal weight to each payout cost in the total sample.
‡This is the highest and lowest average write-off payment provided to us by insurers.

18. Only one insurer ([✂]) provided us with average write-off values where a claim was managed by a CMC. The average cost was £[✂], which was slightly higher than that insurer's average write-off value for captured non-fault claimants.

19. Table 1 shows that the weighted average payments for non-fault insurer-managed write-offs are 15 per cent (or around £300) more expensive than for captured non-

fault write-offs (ie where there is no separation of cost control and liability). However, eight out of ten of the large insurers told us that, in their write-off decision-making, they did not distinguish between at-fault, non-fault or captured non-fault customers (see paragraph 8).

20. DLG, esure and RSA told us that captured third party write-off payments were typically lower in value than other non-fault write-offs because a claimant was more likely to deal with a third party insurer (rather than their own insurer) where the claim involved a less valuable car (ie an older or smaller car).

21. Table 2 also shows that average write-off costs are significantly higher for fault write-offs.

Pre-accident value

22. Insurers told us that they usually used valuation guides (eg Glass's Guide) to establish a damaged vehicle's pre-accident value, though they might make adjustments to guide prices to take account of other factors, eg local market variations[6] or the condition of the damaged vehicle before the accident (eg its mileage, service history, pre-existing damage, etc). LV said that it would take into account where the customer would normally buy the vehicle (eg a main dealer or auction) when making a write-off decision.

23. [✂] told us that, where it was acting as the at-fault insurer, the estimated pre-accident value of a written-off vehicle from the non-fault insurer was rarely contested. esure said that, where it was the at-fault insurer and it received a claim for a vehicle write-off from a non-fault insurer or CMC, its internal engineers would review the estimate to ascertain that the costs reflected a fair market value. However, [✂] told

[6] Insurers told us, for example, that they sometimes checked vehicle values in Autotrader.

us that CMCs would often make it very difficult for [✂] to inspect the vehicle which they proposed to write off as the longer the CMCs could make the process last, the longer the credit hire would last. [✂] said that it therefore had to balance how much time it spent validating the cost of a claim.

24. It appears that non-fault insurers and CMCs managing a write-off have little incentive to inflate the pre-accident value in relation to the claim cost that is passed to the at-fault insurer for the following reasons:

(a) Given that the non-fault insurer or CMC managing a write-off pays the pre-accident value of the written-off vehicle to the claimant, it does not gain directly from setting a higher pre-accident value.

(b) As the pre-accident value is usually determined by reference to publicly available data such as used-car price guides and adverts for used cars, it is highly likely that the at-fault insurer would be able to challenge successfully any inflated valuation of the pre-accident value presented by a non-fault insurer or CMC managing a non-fault write-off claim.

Estimated salvage value

25. Ageas, [✂], [✂] and Zurich told us that when some non-fault insurers and CMCs calculated non-fault write-off claims they used estimated salvage values which were sometimes set artificially low, which then inflated the claims subrogated to fault insurers. Allianz told us that in its view, if this practice were allowed to continue, it would be adopted by others.

26. Seven of the ten largest insurers told us that they used actual salvage values when making non-fault write-off claims on other insurers.

27. The following arbitrary and unrepresentative numbers explain when there is an incentive for estimated salvage values to be set too low.

Assume:

- Pre-accident value = £30.
- Estimated salvage value = £10.
- Salvage proceeds = £17.

Flow of funds:

- The claimant receives the pre-accident value (£30) from the non-fault insurer or CMC.
- The at-fault insurer pays the non-fault insurer or CMC the difference between the pre-accident value and the estimated salvage value (£20).
- The salvage company pays the non-fault insurer or CMC the estimated salvage value (£10) of the vehicle.
- The salvage company receives the salvage proceeds (£17), which is £7 above the estimated salvage value it paid to the non-fault insurer or CMC. Of the £7 it retains say £3 (to cover its costs etc) and pays say £4 to the non-fault insurer or CMC as a rebate, referral fee or commission payment.
- The non-fault insurer or CMC receives net income from the claim of £4.

28. [✂] noted that some insurers received a fixed amount or a fixed percentage of pre-accident value for the sale of salvage. In non-fault claims, this value then became the estimated salvage value, which was deducted from the pre-accident value to give the settlement value to be paid by the at-fault insurer. However, when the salvaged vehicle was later sold at auction and if the amount realized was in excess of the fixed sum, a rebate was paid to the non-fault insurer.

Revenue earned from write-offs

29. We examined the amount of revenue earned by CMCs and insurers from salvage.

30. We found that most CMCs received a referral fee payment from salvage companies. [✂] and [✂] both received £[✂] a year from salvage companies and [✂] received £[✂]. This equates to on average between £[✂] and £[✂] per written-off vehicle. [✂]. However, the overall numbers of written-off vehicles managed by most CMCs is small (eg [✂] told us that it managed around 3,000 salvage cases in 2012). In aggregate, the seven CMCs in our sample received [✂] from salvage companies in 2012. We estimated that in 2012 CMCs earned average revenue of about £125 per write-off (see Appendix 6.6).

31. Three out of ten of the largest insurers ([✂][7]) told us that they earned income from salvage and, on the basis of the data they provided, we estimated this to be on average between £[✂] and £[✂] per written-off vehicle. [✂] One other insurer said it had earned income from write-offs in 2012 but had subsequently stopped doing so.[8] The other six insurers in our sample ([✂]) told us that they did not receive any commission or referral fee payments in relation to salvage. We estimated that revenue per write-off across all non-fault insurers averaged just over £50 (see Appendix 6.6).

32. We noted that CMCs and non-fault insurers may incur costs in managing claims for written-off cars.

33. [✂] told us that the amount obtained for salvage and the fees paid were frequently a cause of dispute.

[7] [✂] told us that, [✂].
[8] [✂] told us that, prior to May 2013 it obtained an average income per salvage of £[✂] in non-fault cases. However, as from May 2013, [✂] has changed its model so that it now does not receive any income from non-fault write-off claims. The proceeds of sale from salvage which [✂] receives are now the same as those credited in its non-fault recovery claims.

34. We also considered whether there were any payments made by salvage companies to non-fault insurers or CMCs with regard to vehicle recovery and storage. [✂] in relation to vehicle storage. [✂] in 2012.

Summary

35. When a non-fault insurer or CMC disposes of the vehicle the claimant neither gains nor loses out from a low estimated salvage value as they receive the pre-accident value. However, it does result in a transfer of value from the at-fault insurer to the non-fault insurer/CMC. CMCs and some non-fault insurers managing non-fault claims earn income from salvage companies in the form of rebates, referral fees and commission payment (though they may also incur costs managing non-fault claims for written-off vehicles).

36. In the event that the claimant chooses to retain the vehicle, a lower estimated salvage value would benefit the claimant rather than the non-fault insurer or CMC because the claimant would receive a higher payout (the pre-accident value less the estimated salvage value).

Services received by non-fault claimants

37. To the extent that CMCs and non-fault insurers earn revenue from write-offs, they may have an incentive to provide non-fault claimants with a better service than the at-fault insurer does when managing a captured write-off. We did not see evidence that at-fault insurers were providing captured non-fault claimants with compensation below the level to which they were entitled (see Appendix 7.2). However, there could still be a difference in service levels if CMCs and/or non-fault insurers provided non-fault claimants with better services than those to which they are entitled. This could be the case if the pre-accident value were set too high; if the estimated salvage value

were set too low when the claimant retains the vehicle; or if a replacement car was provided for too long during the write-off process.

38. On the basis of our assessment in paragraph 23*(b)*, it appears highly unlikely that pre-accident values would be systematically overstated. We did not find any other evidence of overprovision of services to claimants in the event of non-fault write-offs.

The effect on motor insurance premiums of changes in cost and revenue

Introduction

1. In this appendix we consider the pass-through of cost and revenue changes to premiums:

   (a) to what extent higher costs to at-fault insurers lead to higher premiums; and

   (b) to what extent the revenue stream to non-fault insurers and brokers leads to lower premiums.

   We are concerned specifically with the cost and revenue changes associated with the separation of cost liability and cost control (the separation). Our assessment of these cost and revenue changes is set out in Section 6 and the calculations are described in more detail in Appendix 6.6.

2. Our analysis follows several steps:

   (a) We first note that the separation affects the marginal cost of motor insurance policies. We can therefore apply the insights from the economic literature on the pass-through of changes in marginal costs.

   (b) We describe the model of competition we used to analyse the market, namely a Bertrand model with differentiated products.

   (c) We describe the incidence of the increase in costs to at-fault insurers and the revenue stream to non-fault insurers (and brokers) and show that the latter is more asymmetrically distributed than the former.

   (d) We analyse the pass-through of changes in at-fault insurers' costs. By presenting evidence on the relevant characteristics of demand and supply, we are able to reach a provisional view on the likely effect on premiums.

   (e) We consider the further issues involved in the determination of the pass-through of non-fault insurers' (and brokers') revenues and assess their impact on premiums.

(f) Finally, we discuss how the changes in premiums affect different groups of drivers in different ways.

Fixed and marginal costs

3. A standard assumption in economic analysis (including its application to competition issues) is that firms seek to maximize profits. We adopt that assumption here. When setting the prices of its products (in our case, motor insurance policies), a profit-maximizing firm does not take into account costs whose level does not depend on the quantity produced (fixed costs). These costs have an impact on the firm's profitability, but not on the optimal prices (and quantities). Therefore, changes in fixed costs do not have an effect on prices in the short run.[1] Changes in variable costs, on the other hand, do affect prices in the short run. Formally, the profit-maximizing price is the one at which marginal costs equal marginal revenue, ie the cost of producing an additional unit of output is equal to the additional revenue that would be gained. Marginal costs are clearly independent of fixed costs.

4. The costs and revenues we have identified as due to the separation constitute changes in marginal costs. The higher claim costs invoiced to at-fault insurers by non-fault rivals are clearly marginal costs; the same tends to be true for the revenue that accrues to non-fault insurers. These costs and revenues are not fixed, but depend on the number of at-fault or non-fault claims handled by the insurer. This, in turn, depends on the number of policies sold (and on customers' risk profile). An additional policy sold determines additional (expected) costs due to the increased cost of at-fault claims and additional revenues (or negative costs) due to the rebates and referral fees received if the new policyholder happens to be in a non-fault

[1] In the long run, however, there might be an impact, because the effect on profitability may determine the entry of new competitors or the exit of some firms from the market, with implications on equilibrium prices.

position. Similarly, the administrative and legal costs involved in the process of subrogation and in litigation are for the large part marginal costs.

5. We can therefore apply the insights from the economic literature on pass-through, which mostly deals with changes in marginal costs.

The model of competition

6. Drivers consider policies sold by different insurers as substitutes, but not perfect substitutes. Insurance policies are not a homogeneous good. They may differ in the level of cover offered and in the service provided in case of an accident; moreover, consumers may attach value to particular brands. As a result, price is not the only determinant of consumers' choices.

7. The motor insurance market can be described as one in which firms with similar, but not identical, products compete in prices. The market can therefore be analysed using a model of price competition (Bertrand model) with differentiated products. In our analysis, we have specifically considered the economic literature on pass-through in markets for differentiated products. The technical annex to this appendix includes a short review of the literature.

The incidence of higher costs and revenues among insurers

8. One of the factors affecting pass-through is how many firms are affected by the changes in costs and revenues, ie whether they are symmetrically or asymmetrically distributed. We have described in Section 6 how, because of the separation, insurers bear higher costs when they are at fault and earn revenues when their customers are non-fault. In this section, we discuss how far different insurers experience different changes in cost and revenue. We discuss costs first and then revenues. We then

discuss two other aspects of the market: the role of brokers and possible differences between insurers in their customer risk profiles.

Costs

9. 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. However, it is relevant that the subrogated bills for non-fault claims do not affect the non-fault 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 non-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.[2]

10. In relation to captured claims and bilateral agreements, we noted that:

(a) There were some differences in insurers' ability to capture non-fault claims (see Table 1). Since inflated costs are avoided when a non-fault claim is captured, a higher proportion of captured claims implies lower costs.

TABLE 1 **Proportion of captured claims**

per cent

	Admiral	*Ageas*	*Aviva*	*AXA*	*CISGIL*	*DLG*	*esure*	*LV*	*RSA*	*Zurich*
Some component is captured	[✂]	[✂]		[✂]	[✂]		[✂]	[✂]	[✂]	
Repair is captured	[✂]		[✂]		[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Replacement car is captured	[✂]		[✂]		[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Insurers.

(b) Some insurers have signed bilateral agreements with the aim of reducing the costs subrogated to each other. Insurers vary with respect to the number and

[2] 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.

nature of the agreements they are a party to (see Table 2). All other things being equal, insurers which are parties to bilateral agreement will receive subrogated bills that are on average lower than insurers without bilateral agreements.

TABLE 2 **Bilateral agreements**

[✂]

Source: Insurers.

Note: Replacement car (repair) indicates bilateral agreements relating to replacement car (repair) services. Some of the insurers in the table have also signed bilateral with smaller insurers.

11. We did not consider these differences to be of sufficient importance to lead to large differences between insurers in expected marginal costs.

Revenues

12. We now consider the effect of separation on revenues. Insurers' practices are quite similar for replacement cars, as all insurers (excluding CISGIL) receive fees for referring non-fault claimants to CMC/CHCs. Revenues from non-fault repairs, however, can exhibit large variations. In particular, there are differences in how non-fault repairs are handled and invoiced to at-fault insurers (see Appendix 6.2, Table 1). Moreover, the rebates that can be obtained from repairers, CMCs, and parts and paint manufacturers may depend on the bargaining power of the insurer. Larger insurers may be in a better position to extract revenues.

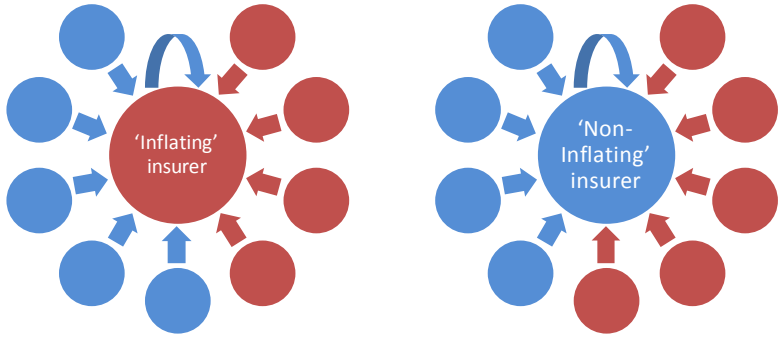
13. We can show that non-fault revenues are likely to be more asymmetric than at-fault costs using a simple example. Suppose for the moment that, out of ten insurers, five inflate claim costs while the others do not. For simplicity, if the ten insurers have the same market shares and their customer populations have the same distribution of risks, the asymmetry in revenues is evident. What about higher costs for at-fault claims? In any car accident, the non-fault party has the same probability of being a customer of each insurer. Therefore, as shown in Figure 1, when an insurer that does not inflate costs is in an at-fault position, it will receive an inflated invoice in 50 per

cent of the claims it handles (when the non-fault driver is insured by one of the five cost-inflating insurers). An at-fault cost-inflating insurer, on the other hand, will pay an inflated invoice in 40 per cent of the cases (when the non-fault driver is insured by one of the other four cost-inflating insurers). The asymmetry of costs is therefore much less pronounced than the asymmetry of revenues.[3]

FIGURE 1

Asymmetry of costs and revenues

	'Inflating' insurer	'Non-inflating' insurer
Percentage of non-fault claims handled with 'inflated' invoices	90%	0%
Percentage of fault claims paid with 'inflated' invoices	40%	50%



Source: CC analysis.
Note: We are assuming no cost inflation when the same insurer represents both the at-fault and the non-fault drivers.

14. Differences in practices between insurers are therefore more important for the pass-through into premiums of non-fault insurers' revenue stream than the pass-through of at-fault insurers' higher costs.

Possible differences between insurers in their customer risk profiles

15. Insurers may focus on different groups of drivers, with the result that one insurer's customers may be on average riskier than those of another. On an aggregate level,

[3] Cost asymmetry depends on the degree of market concentration. The more concentrated the market is, the higher the probability that the at-fault and non-fault parties are insured by the same insurer.

insurers with riskier customers will then be affected more by cost increases. Nevertheless, any such differences between insurers in the distribution of risks among their customers are of limited relevance to pass through as long as policies are priced according to a driver's risk profile. We can view policies associated with different levels of risk as different products, sold to mutually exclusive groups of customers. Therefore, when we consider changes in marginal costs, we can consider separately each risk profile. Given a driver's riskiness, the impact of the separation on their policy's marginal cost does not depend on the distribution of risks among the insurer's customers.

Role of brokers

16. In this section, we consider whether the distinction between insurers and brokers has an impact on pass-through. Both insurers and brokers can receive an income when handling non-fault claims. However, only insurers are affected by the additional costs associated with at-fault claims. At first sight, we might say that the cost increase for at-fault claims is more asymmetrically distributed than the revenue increase for non-fault claims. However, the gross premium that brokers' customers pay may be regarded as the sum of a 'net premium' received by the underwriting insurer and the brokers' commission. The gross premium is therefore potentially influenced by both higher costs and higher revenues, no matter whether a broker is involved or not.

17. 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);[4] and

[4] [✂] This is probably the case for other national brokers. We were told that, if brokers relied on add-ons or referral fees for their profits, commissions could even be negative.

(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).

18. In the case of larger national brokers effectively setting their own prices, both higher costs and revenue will affect premiums (similar to insurers selling directly). In the case of smaller regional brokers, higher costs will increase premiums and referral fee revenues will reduce premiums if lower commission rates are agreed and the underwriting insurers reflect these lower commission rates in lower gross premiums. Given that there was rivalry both between insurers and between brokers and direct-selling insurers, we considered that this condition was likely to be met, ie there was likely to be pass-through of both costs and revenue for regional brokers. We also noted that regional brokers were less likely to deal directly with a claim and therefore less likely to receive income from referral fees. Summing up, we considered that the distinction between brokers and direct-selling insurers was of limited importance to our analysis of pass-through, though it did introduce some additional uncertainty into the analysis.

Pass-through of the costs to at-fault insurers

19. We define pass-through as the ratio between a change in the price of a good and a change in its marginal cost. For example, if a £1 rise (fall) in marginal costs determines a £1 increase (decrease) in price, we say that pass-through is 1, or 100 per cent (we also say that the cost is fully passed through).

20. In a Bertrand model with differentiated goods, economic theory suggests that pass-through of a market-wide cost change depends on:[5]

[5] The analysis is based on Weyl, E G and M Fabinger (2013), 'Pass-through as an economic tool: Principles of incidence under imperfect competition', *Journal of Political Economy*, 121(3), 528–583.

(a) the elasticity of the firms' individual supply functions, ie the responsiveness of the quantity supplied by each firm to changes in its own price; pass-through is higher for higher levels of the elasticity of firms' supply;

(b) demand-side factors and competition:

(i) the elasticity of market demand, ie the responsiveness of the quantity demanded to changes in price; pass-through is higher for lower levels of the elasticity of market demand;

(ii) the curvature of demand; this is a description of how the slope of market demand changes at different price levels; and

(iii) the extent of the constraint firms within the market impose on each other, which depends on rivalry within the market and substitutability between the products of the different firms; in general, pass-through can either increase or decrease with the level of competition.

21. The technical annex to this appendix provides a more formal treatment of the determinants of pass-through under imperfect competition. In general, in a model of price competition with differentiated products, pass-through can be lower, equal or higher than 1.

22. However, if:

(a) firms can supply any quantity of the products at current prices (perfectly elastic individual supply functions); and

(b) rival products are good substitutes,

then pass-through approaches 1. A similar result is obtained if:

(c) firms can supply any quantity of the products at current prices; and

(d) market demand is very inelastic (the total quantity demanded does not change much with the overall price level).[6]

23. In relation to elasticity of supply, it is possible that, in the short run, a significant increase in the number of motor insurance policies supplied would be associated with a higher marginal cost. It might be necessary, in fact, to implement some organizational changes in order to deal with larger volumes. However, here 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. In our model, therefore, we can assume that firms can supply any quantity of the products at current prices. Moreover, empirical studies have suggested that most motor insurers in competitive regimes operate under increasing returns to scale.[7]

24. We believe that rivalry in the motor insurance market is strong. Switching between insurers is high relative to comparable products and there are no obvious obstacles to switching.[8] Moreover, there is evidence that each motor insurance provider faces a very elastic demand, ie sales volumes are very sensitive to price changes. All this suggests that consumers see the products of different providers as good substitutes.

25. The evidence comes from the assessments of demand elasticity that most of the large insurers periodically make. Although there are differences between insurers, all told us that elasticity was high. Elasticity depends on the strength of a brand and varies between different distribution channels, customer segments and price levels.

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[6] These results are linked because, if the products of the different firms within a market were weak substitutes and market demand was very inelastic, each firm would face inelastic demand for its own product—but in these circumstances profit maximization implies that each firm would increase its price up to the point where demand for its own product becomes elastic (in the absence of price regulation, profit maximization and marginal cost above zero imply a price elasticity of firm demand of more than 1). In other words, we would not observe a situation of weak competition within the market and price inelastic demand, except for instance when firms' prices are regulated to below the profit-maximizing price.

[7] See Weiss, M A and B P Choi (2008), 'State regulation and the structure, conduct, efficiency and performance of US auto insurers', *Journal of Banking & Finance*, 32(1), 134–156, and Fenn, P et al (2008), 'Market structure and the efficiency of European insurance companies: A stochastic frontier approach', *Journal of Banking & Finance*, 32(1), 86–100.

[8] See Section 4.

Demand on PCWs is characterized by very high levels of elasticity; the range of estimates goes from [✂]. Elasticity is lower on the insurers' own website or on call centres; estimates range between [✂] and [✂]. These are still relatively high figures and are indicative of strong rivalry. Reported elasticities are lower for renewals ([✂]).[9]

26. The low profitability of insurers is also consistent with a high level of rivalry. Profitability data does not suggest that car insurers 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 (see Appendix 2.1, Annex 1).

27. Although each insurance provider faces elastic demand, market demand is very price inelastic, ie the total number of policies sold in the market is not sensitive to changes in the overall prices. Third party car insurance is a legal requirement, and a change in average car insurance premiums can only affect market demand if it induces changes in the number of cars insured (eg a reduction in price might induce some young drivers to insure their own cars rather than use their parents' cars) or induces a change in the type of insurance taken by some drivers (eg a reduction in price might induce some drivers to take out comprehensive rather than third party, fire and theft insurance). However, for the majority of the population, the cost of motor insurance has little impact on demand, because, as Admiral and RSA suggested, this cost is small compared with the total cost of vehicle ownership. Admiral and DLG told us that elasticity might be somewhat higher for young drivers, although there was no firm evidence of this.

[9] Different insurers may adopt different estimation methods. Some compute the elasticity of demand in a channel to a change in price in all channels. Other may consider channel-specific price changes. The figures, therefore, may not be directly comparable. Moreover, all estimates are obtained through small price changes around current prices. Therefore, the values so determined have only local validity. At very different price levels, or for large price changes, elasticity may be different. Finally, some insurers told us that elasticity was higher for high-premium consumers.

28. As we have noted above, the combination of a high level of substitutability, inelastic market demand and highly elastic individual supply suggests a pass-through ratio close to 1.

Pass-through of the revenues to non-fault insurers and brokers

29. As a first approximation, the pass-through of the revenues to non-fault insurers and brokers depends on the same characteristics of demand and supply as the pass-through of the costs to at-fault insurers. Therefore, a high level of substitutability, inelastic market demand and highly elastic individual supply suggest a high pass-through ratio also for revenues.

30. However, we have seen in paragraph 13 that revenues to non-fault insurers and brokers resulting from the separation are more asymmetric than costs to at-fault insurers. In general, insurers that are in a better bargaining position with their suppliers can retain higher revenues. We now consider the effect of these asymmetries.

31. To study pass-through in this case, we need to take into account that changes are firm-specific and correlated with a firm's 'strength'. With asymmetric changes, the definition of pass-through must be modified. When a firm experiences a cost change, we must consider not only the direct effect of the change in the firm's own price, but also the indirect effect on the prices set by the other firms in the market. The sum of direct and indirect effects gives the total impact of the costs change on consumers.

32. Under the assumptions of inelastic market demand and constant marginal costs, our further analysis of pass-through with asymmetric firms and firm-specific cost changes (see the technical annex) suggests that:

(a) in the case of identical firms, pass-through of firm-specific cost changes is generally slightly higher than 1; and

(b) when firms are asymmetric, pass-through can exhibit significant variation; in general, cost changes are not fully passed through if they mostly affect firms with a stronger market position (less elastic individual demand), while they are potentially passed through more than fully when targeted on weaker firms.

33. Since we expect stronger firms to be in a better bargaining position and therefore to get higher revenue, we think pass-through is likely to be lower than 1. In other words, we expect the decrease of premiums to be somewhat smaller than the value of the revenues generated by the separation.

The impact on different groups of consumers and its relevance to pass-through

34. Since higher costs affect insurers only when at fault, while additional revenues accrue when insurers (or brokers) are in a non-fault position, the net change in expected costs depends on the risk profile of consumers. The higher costs are taken into account by insurers in their risk models and their impact on premiums depends on the risk profile of each customer, which seeks to reflect the likelihood of being at fault in accidents. The additional revenues, however, are allocated according to the estimated likelihood of being not at fault in accidents, or simply pro rata with overall revenue.[10] As a consequence, the harm from increased costs is likely to affect mostly high-risk drivers, while the benefit from additional revenues is likely to be distributed more widely across all customers (since all customers have some risk of being not at fault in accidents). The precise impact is likely to depend on the correlation between the probabilities of drivers being in a fault and in a non-fault position.[11]

[10] esure told us that '[✂],[✂] said that it did not consider claims-related income when estimating claims costs. RSA told us that it treated 'the income generated from not-at-fault customers [✂],' and that expenses were allocated '[✂]' [✂] told us that its statistical estimate of claims risk cost was augmented for any expected claim related income at a channel level. [✂]

[11] We do not have information on this, though we note that both at-fault and non-fault probabilities are likely to be correlated with the number of miles driven per year.

35. Pass-through should therefore be evaluated taking into account the characteristics of the consumers whose policies are likely to be affected by the cost changes. If, for example, demand elasticity for risky drivers is higher than the average (which seems plausible, given that they pay higher premiums for their policies), then, all other things being equal, pass-through of costs would be less complete than pass-through of revenues. However, in the case of highly elastic supply and strong rivalry, the impact of a difference in demand elasticities would be negligible and would not materially change the conclusion we have reached in paragraph 33.

Theoretical analysis of the determinants of pass-through

General framework

1. Although there is a rich economic literature on the pass-through of changes in marginal costs in imperfectly competitive markets with homogeneous products,[12] few authors have studied pass-through in markets with differentiated products. The question was first addressed by Anderson, de Palma and Keider.[13] Their results have been expanded and integrated within a general theoretical framework for the analysis of pass-through by Weyl and Fabinger.[14] In this annex we will draw extensively from their work.

2. We are interested in determining the ratio between marginal cost changes and price changes. For the moment we consider a market-wide cost change: the marginal costs of all the firms in the market change by the same amount. Formally, we want to find the determinants of the pass-through ratio $\equiv \frac{dp}{dmc}$, ie the derivative of price with respect to marginal costs. A pass-through ratio equal to 1 means that an increase (decrease) in marginal costs determines an equal increase (decrease) in price. When $\rho < 1$, pass-through is less complete: price changes less than marginal costs; if $\rho > 1$, a change in marginal costs implies an even larger change in price.

3. Under perfect competition, the pass-through ratio depends on the elasticities[15] of supply ϵ_S and demand ϵ_D according to the formula:

[12] For a non-technical review, see Keen, M (1998), 'The balance between specific and ad valorem taxation#, *Fiscal Studies*, 19(1), 1–37.
[13] Anderson, S P, A de Palma, and B Keider (2001), 'Tax incidence in differentiated product oligopoly', *Journal of Public Economics*, 81(2), 173–192.
[14] Weyl, E G and M Fabinger (2013), 'Pass-through as an economic tool: Principles of incidence under imperfect competition', *Journal of Political Economy*, 121(3), 528–583.
[15] The elasticity of supply is defined as the ratio between the percentage change in the quantity supplied and the percentage change in price. Similarly, the elasticity of demand is the ratio between the percentage change in the quantity demanded and the percentage change in price, with its sign changed.

$$\rho = \frac{1}{1 + \frac{\epsilon_D}{\epsilon_S}}.$$

Two things should be noticed. First, under perfect competition pass-through can never be larger than 1: the change in price is at most equal to the change in marginal costs. Second, a higher elasticity of demand determines, other things being equal, a lower pass-through ratio, while a higher elasticity of supply is associated with a higher pass-through ratio. In the limit, pass-through is complete ($\rho = 1$) when supply is perfectly elastic, which is the case, for example, when marginal costs do not depend on the quantity supplied.

4. When competition is imperfect, the determination of the pass-through ratio is in general more complicated, as it may depend on more subtle characteristics of the demand function. Weyl and Fabinger provide a general formulation that can be applied to a wide range of forms of competition between identical firms. In this section we will only present pass-through ratios in three special cases: Cournot competition (with homogeneous products), Bertrand competition (with homogeneous products), and Bertrand competition with differentiated products.[16] It will be apparent that the different expressions are special cases of a single general formula.

Cournot competition

5. In the Cournot model, firms produce a homogeneous product and compete by setting quantities. All firms simultaneously decide which quantity to produce and the equilibrium price is the one that clears the market. This is a widely used model of oligopoly. Although this is not the most appropriate framework to be used when modelling the motor insurance market, it is useful as a benchmark.

6. If there are *N* firms in the market, the pass-through ratio is given by:

[16] Under Cournot competition, firms set output levels (and prices emerge from competition in the market), while under Bertrand competition, firms set price levels (and outputs emerge from competition in the market).

$$\rho = \frac{1}{1 + \frac{\epsilon_D - 1/N}{\epsilon_S} + \frac{1/N}{\epsilon_{ms}}},$$

where ϵ_{ms}, formally defined as the inverse of the elasticity of marginal consumer surplus, is a measure of the curvature of the demand function. In particular, $\frac{1}{\epsilon_{ms}} < 1$ if demand is convex and $\frac{1}{\epsilon_{ms}} > 1$ if demand is concave.[17] To understand better the effect of the curvature of the demand function on pass-through, we consider the special case of constant marginal costs, ie perfectly elastic supply ($\epsilon_S = \infty$). In this case, the formula reduces to:

$$\rho = \frac{1}{1 + \frac{1/N}{\epsilon_{ms}}}.$$

If demand is linear (ie $\frac{1}{\epsilon_{ms}} = 1$), then pass-through is equal to $\frac{N}{N+1}$: it only depends on the number of firms and it is larger the more numerous the firms in the market are. In other words, pass-through increases with the level of competition. If the demand is convex, as is often assumed, pass-through is higher than $\frac{N}{N+1}$. Contrary to the case of perfect competition, pass-through can be larger than 1 if $\frac{1}{\epsilon_{ms}} < 0$. In that case, pass-through is decreasing in *N*, ie it decreases for higher levels of competition.

7. We can therefore draw two conclusions for the case of Cournot competition:

(a) pass-through can be larger than 1, ie price can change more than marginal costs; and

(b) there is no clear relationship between pass-through and the level of competition; however, in the special case of perfectly elastic supply, pass-through tends towards 1 as the level of competition increases.

[17] As the number of firms approaches infinity, the formula reduces to the one we have seen in the case of perfect competition (see paragraph 3), as is to be expected. The special case of $N = 1$ gives the pass-through ratio for a monopolist.

Bertrand competition with differentiated products

8. Another traditional model of oligopoly is the Bertrand model with homogeneous products, in which firms compete by simultaneously setting prices. In this case, it is possible to show that the pass-through ratio is the same as in a perfectly competitive market (see paragraph 3). In the standard Bertrand model, where marginal costs are assumed to be constant, pass-through is equal to 1.

9. In the motor insurance market, insurers compete in prices, as in the Bertrand model. However, products are not homogeneous, or are not perceived as such by consumers. The products of different firms are still substitutes, but not perfect substitutes. For the moment, we assume that firms have the same cost functions and face the same individual demands. We therefore look for a symmetric equilibrium in which all firms set the same price *p*.

10. In this case, pass-through for any firm *i* is given by:

$$\rho = \frac{1}{1 + \frac{\epsilon_D - \theta}{\epsilon_S} + \frac{\theta}{\epsilon_{ms}} + \frac{\theta}{\epsilon_\theta}},$$

where $\theta = 1 + \sum_{j \neq i} \frac{\partial q_j}{\partial p_i} \Big/ \frac{\partial q_i}{\partial p_i}$ and ϵ_θ is formally defined as the inverse of the elasticity of θ with respect to the quantity supplied by the firm. The first three components of the denominator are the same as in the Cournot case (see paragraph 7), with the difference that, instead of $1/N$, we now have θ (1 plus the aggregate diversion ratio for good *i*). The term $\sum_{j \neq i} \frac{\partial q_j}{\partial p_i} \Big/ \frac{\partial q_i}{\partial p_i}$, in fact, is the ratio between the cumulative change in the quantities supplied by all other firms and the change in the quantity supplied by firm *i* when the price for the product of firm *i* changes. This term is always negative: if the price of good *i* increases, the quantity of good *i* decreases, but the other firms will sell more, because their products are substitutes for *i*. Therefore, θ is always smaller than 1 (as was the case for the $1/N$ term in the Cournot case). The closer substitutes

the different goods are, the closer the diversion ratio approaches –1. In the limit, when goods are perfect substitutes ($\theta = 0$), we revert to the standard Bertrand case with homogeneous goods and the pass-through ratio is the same as in perfect competition. A similar result is obtained if market demand is highly inelastic, since in this case (almost) all sales lost by one firm are gained by its competitors (θ approaches 0).

11. Compared with the Cournot model, the new term is the last component of the denominator, $\frac{\theta}{\epsilon_\theta}$. Within this term, ϵ_θ measures how the diversion ratio changes if all quantities change by the same amount. It is possible to show that, under quite general conditions, this term is negative, so that pass-through is generally higher than it would be if the cumulative diversion ratio were constant.

12. Abstracting from the technicalities of the formula, we can reach some broad conclusions for the case of Bertrand competition with differentiated goods:

(a) The exact determination of pass-through involves a detailed analysis of the supply function, of the market demand function (elasticity and curvature) and of aggregate diversion ratios (and of how they change when all quantities, or all prices, change).

(b) Pass-through can be smaller or larger than 1 and there is no clear relationship between pass-through and level of competition; however, in the special case of perfectly elastic supply, pass-through tends towards 1 as the level of competition increases.

(c) When the different goods are very close substitutes, the pass-through ratio approaches that which emerges in the case of perfect competition; a similar result is obtained if market demand is highly inelastic.

Asymmetries

13. Allowing for asymmetric firms, ie firms with different marginal costs or facing different residual demands, or for firm-specific cost changes makes the model substantially more complicated. First of all, the definition of pass-through must be modified. There is no longer a single ρ, but each firm reacts to its own costs change and to the changes in the marginal costs of each other firm. The impact on consumers depends not only on the direct pass-through of a firm's own costs changes, but also on the indirect effect on the prices set by all other firms. Formally, pass-through ratios must be expressed as an $N \times N$ matrix P in which the generic element P_{ij} represent firm *i*'s response to a change in firm *j*'s costs.

14. As an example, we consider the case of Cournot competition with identical firms, constant marginal costs and linear demand introduced in paragraph 7.[18] We have seen that, in the case of an market-wide cost change, the pass-through ratio is $\frac{N}{N+1}$. If only one firm (firm *i*) experiences a change in marginal costs, it is possible to show that the impact on its own price is given by a pass-through ratio of $\frac{1}{N+1}$ (formally, $\mathrm{P}_{ii} = \frac{1}{N+1}$). However, all the other firms will react in a similar way, changing their prices by the same amount, even if they have not directly experienced any costs change (formally, $\mathrm{P}_{ji} = \frac{1}{N+1}$ for any *j*). The total fraction of firm *i*'s cost change that is passed to consumers is, therefore, $\frac{N}{N+1}$, which is the same ratio we have determined in the case of a market-wide change.

15. The equivalence between firm-specific and market-wide cost changes that emerges in the Cournot model does not hold for other models of competition. For example, in a Bertrand model with more than two identical firms, cost changes that affect only

[18] For a detailed analysis of this model, see Ten Kate, A and G Niels (2005), 'To what extent are cost savings passed on to consumers? An oligopoly approach', *European Journal of Law and Economics*, 20, 323–337.

one firm have no impact on prices.[19] In the next section, we consider pass-through in a market with differentiated products.

A duopoly model of Bertrand competition with differentiated goods

16. We consider a market in which two firms compete in prices. The products of the firms are substitutes, but not perfect substitutes. Demand for each good is decreasing in the price of the good and increasing in the price of the substitute. We assume demands are linear. Formally:

$$Q_1(p_1, p_2) = \alpha_1 - \beta p_1 + \gamma p_2$$

$$Q_2(p_1, p_2) = \alpha_2 - \gamma p_2 + \beta p_1$$

where Q_1 and Q_2 are the quantity demanded of good 1 and good 2 and p_1 and p_2 are the respective prices. We also assume that market demand is perfectly inelastic (it does not depend on prices): $Q_1 + Q_2 = \alpha_1 + \alpha_2$.

17. We assume that the firms have constant marginal costs (so that demand is perfectly elastic), denoted as c_1 and c_2. Each firm simultaneously chooses the price that maximizes its profits, taking the price of the rival firm as given. Solving for the equilibrium, we get:

$$p_1 = \frac{2\alpha_1 + \alpha_2 + 2\beta c_1 + \gamma c_2}{3\beta} \quad q_1 = \frac{2\alpha_1 + \alpha_2 + \gamma c_2 - \beta c_1}{3}$$

$$p_2 = \frac{2\alpha_2 + \alpha_1 + 2\gamma c_2 + \beta c_1}{3\gamma} \quad q_2 = \frac{2\alpha_2 + \alpha_1 + \beta c_1 - \gamma c_2}{3}$$

The effects of cost changes can be easily determined by changing the values of c_1 and c_2 in the formulas above.

18. We consider first the case of identical firms. In this case, $\alpha_1 = \alpha_2 = \alpha$, $\beta = \gamma$ and $c_1 = c_2 = c$. In equilibrium, $q_1 = q_2 = \alpha$ and $p_1 = p_2 = {}^{\alpha}/_{\beta} + c$. Identical firms charge

[19] There is no impact in the case of a cost increase, while for a cost decrease the impact is infinitesimal.

the same price and split demand equally between them. Moreover, if there is a market-wide cost change, the price changes by exactly the same amount, ie pass-through is 1. This is a result that we already know from the theory.

19. When the firms are not identical, pass-through can be different from 1. Before giving some examples, it is useful to specify what we mean by pass-through in this context. When firms are asymmetric or cost changes are firm-specific, the equilibrium after the changes will exhibit not only new prices but also new quantities. We need therefore to clarify the definitions of cost change and of impact on consumers. We define cost change as the difference between total production costs after and before the change in marginal costs. The total impact on consumers is given by the difference between the total amounts spent by consumers after and before the change. We define pass-through as the ratio between impact on consumers and cost change.

20. Table 3 show the results in two special cases. In both, firm 1 is in a stronger position than the rival: before the cost changes it produces a higher volume and gets higher profits. The demand it faces shows lower level of elasticities, both with respect to its own price and to the price of the substitute good. In the first case, a cost increase affects mostly the strong firm, while in the second the weak firm is affected most. As evident from the table, pass-through is incomplete in the first case, but higher than 1 in the second. This result is quite general and extends to the case of cost decreases.

TABLE 3 **Examples of pass-through**

α_1	400	α_2	400
β	10	γ	12
c_1	200	c_2	200
Initial p_1	253.33	Initial q_1	533.33
Initial p_2	222.22	Initial q_2	266.66

Price elasticity of good 1 at initial prices	4.75
Cross-price elasticity of good 1 at initial prices	5
Price elasticity of good 2 at initial prices	10
Cross-price elasticity of good 2 at initial prices	9.5

Case 1		*Case 2*	
Cost increase for firm 1	7	Cost increase for firm 1	2
Cost increase for firm 2	2	Cost increase for firm 2	7
Total cost increase	4190	Total cost increase	2826.66
Total impact for consumers	3279.02	Total impact for consumers	4237.51
Pass-through	0.783	Pass-through	1.499

Source: CC analysis.

21. This model suggests that, in a market with perfectly elastic supply and perfectly inelastic demand where asymmetric firms selling differentiated products compete in prices, costs are passed through less than fully if they mainly affect the strongest firms, but more than fully if they mainly affect the weakest firms.

Separation of cost liability and cost control and quality of services

Introduction

1. This appendix discusses evidence on the impact of separation of cost liability and cost control on the quality of service provided to non-fault claimants in relation to repairs and replacement cars. In particular, we consider the differences between services provided by parties liable for the costs (fault insurers) and without cost liability (eg non-fault insurers and CMCs/CHCs). Our evidence comes from:

   (a) responses to our survey of motor insurance policyholders who had been in a motor accident where they were found to be not at fault (see Survey report'[1]); and

   (b) evidence from insurers and repairers.

Presentation of the non-fault survey results

2. One of the factors which might affect the existence or the extent of any difference in terms of post-accident services could be the type of organization which was mainly responsible for managing the claim and the circumstances in which they are managing it. Therefore, we present the main analyses in this appendix detailing the organization mostly responsible for managing the respondent's claim. For both repair and replacement cars we considered the following situations:

   (a) non-fault insurer and at-fault insurer the same;

   (b) captured claims;

   (c) bilateral agreement between the non-fault and at-fault insurer;

   (d) non-fault insurer handled the claim;

   (e) CMC appointed by the non-fault insurer, the respondent or someone else (eg the garage the vehicle first went to, the other driver, a legal/solicitors firm);

   (f) other organization handled the claim; and

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

(g) don't know.

3. For claims dealt with under bilateral agreements, we considered separately the provision of repairs and the provision of replacement cars due to the different types of bilateral agreements in place between insurers.

4. In the table headings, we use the following shorthand to refer to these six groups (respectively): at-fault=non-fault, at-fault, bilateral, non-fault, CMC, other and don't know.[2]

5. Figures in this appendix have been weighted to correct for oversampling in Wales, Scotland and Northern Ireland. The response rate for our survey of non-fault claimants was 18 per cent. Survey responses are subject to error and some of the key questions asked in this survey depend on the subjective responses of respondents, for example the question asking respondents the condition of their vehicle after the repairs compared with before the accident. Responses are not based on an objective assessment of post-accident services and there may be other factors influencing responses.

Provision of repairs

6. In this section, we consider evidence from consumers and insurers on whether the repair services provided is different according to claims handlers.

Evidence from consumers

7. The following tables set out the key outcome measures which provide an indication of respondents' perceived quality in relation to repairs, each analysed by the main claims handler.

[2] If a respondent's claim was mostly handled by their own insurer (non-fault) but that insurer had a bilateral agreement with the other driver's insurer, the claim would be coded to the bilateral category.

8. Table 1 shows the proportions of claims by who handled the claim. Around 40 per cent of all claims were handled by the driver's own insurer and in 30 per cent[3] of cases the claim was captured by the at-fault insurer. In 13 per cent of claims a CMC was appointed by the respondent, the non-fault insurer or another organization (different from the at-fault insurer) to manage the claim. In 6 per cent of claims the non-fault driver and at-fault driver were insured by the same company—many of these cases were in Northern Ireland where AXA has a high motor insurance market share (see Appendix 5.2). 3 per cent of claims were handled under a bilateral agreement for repairs and 5 per cent were handled under a bilateral agreement for replacement cars.

TABLE 1 **Analysis variables for main organization handling the claim**

per cent

	Repairs	*Replacement cars*
Non-fault insurer handled the claim*	42	41
Claim captured by fault insurer†	30	30
CMC handled the claim‡	13	13
Non-fault and at-fault insurer the same	6	6
Bilateral agreement in place	3	5
Other	3	4
Don't know	2	1
Base (weighted)	1,500	1,500

Source: CC motor insurance Non-fault Survey, questions A16, A17 and additional information on bilateral agreements.

*Includes claims managed by the non-fault insurer and claims managed by other organizations (eg legal solicitors) where these were appointed by the non-fault insurer. It excludes claims managed by CMCs and claims where bilateral agreements were in place or claims where the non-fault and at-fault insurer were the same.
†Includes claims managed by the at-fault insurer and claims managed by CMCs, repairers, dealerships and other companies where these were appointed by the at-fault insurer. It excludes claims where the non-fault and at-fault insurer were the same.
‡Includes claims managed by CMCs where these were appointed by the non-fault insurer, the respondents or someone else (eg the garage the vehicle first went to, the other driver, a legal/solicitor firm).

9. Table 2 shows that the organization which first has contact with the claimant is most likely to handle the claim. Most drivers, 68 per cent, made first contact with their own insurer and, in these cases, the non-fault insurer went on to manage the claim in half of the cases. Of the 11 per cent of cases where first contact was with the at-fault insurer, this insurer went on to handle 80 per cent of cases.

[3] This is less than the 32 per cent quoted in paragraph 3.68 because it excludes captured claims where the at-fault insurer and the non-fault insurer were the same (see Table 1).

TABLE 2 **First contact analysed by who managed the claim**

per cent

	First contact		
	Non-fault insurer	*At-fault insurer*	*Other**
Main claim handler			
Non-fault and at-fault insurer the same	8	4	3
Fault insurer	22	79	28
Non-fault, bilateral agreement†	3	1	5
Non-fault insurer	51	10	32
CMC	13	5	19
Other	2	0	10
Don't know	1	0	3
Base (weighted)	1,022	170	308

Source: CC motor insurance Non-fault Survey, questions A10, A10a.

*Includes claims managed by legal firms, repairers, dealerships and CMCs appointed by the claimant.
†Includes bilateral agreements for repairs only.

10. The number of respondents falling into the 'at-fault=non-fault', 'bilateral' and 'other' categories are small. For this reason, we only show in the tables below comparisons between captured claims, claims handled by the non-fault insurer and claims handled by CMC. We benchmark figures against all claimants. Table 3 shows that for all claims where there was a repair, respondents said that all the damage to vehicles was repaired in 93 per cent of cases. In the remaining 7 per cent of cases, respondents said that some or most of the damage was repaired (but not all). This proportion is the same for captured claims and claims handled by the non-fault insurer or CMCs.

TABLE 3 **How much damage was repaired, analysed by who managed the claim**

per cent

	All	*At-fault*	*Non-fault*	*CMC*
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

Source: CC motor insurance Non-fault Survey, question C11.

11. Table 4 shows that the most commonly-stated reason for respondents saying that not all of the damage was repaired was that they did not think the repairs were carried out properly. Other cited reasons, in order of frequency, were: insurer refused to

make the repair; minor/cosmetic damage only; and respondents not wanting to pay further costs. The sample sizes for these responses were very small (which is why Table 4 shows the numbers of respondents rather than percentages).

TABLE 4 **Reason(s)* why not all damage repaired, analysed by who managed the claim**

	All	*At-fault*	*Non-fault*	*CMC*
Minor/cosmetic damage only	14	2	8	0
Respondent did not want to pay further costs	8	2	6	0
Repairs not carried out properly	31	12	11	2
Insurer refused to make repairs	16	5	3	2
Other/not stated	16	4	10	0
Base (weighted)	82	23	39	4

Source: CC motor insurance Non-fault Survey, question C12.

*Each respondent may give more than one reason.

12. Table 5 shows respondents' perception on how much damage was repaired according to who made the final decision as to who would carry out the repairs. The table shows that most respondents perceived that only part of the damage was repaired among those who chose a repairer they knew of. However, it is possible that some of the differences may be accounted for by respondents being more involved in the repair process when choosing their own repairer. These respondents may have a greater tendency to say that not all damage was repaired if they were not entirely satisfied by the services they received. The number of respondents falling into the 'other' category is small. For this reason, we do not show the result for such category in the table below.

TABLE 5 **How much damage was repaired split by who made the final decision as to who would carry out the repair and how such decision was taken**

per cent

	All	*Choice made by you: repairer you knew of*	*Choice made by you: options provided by insurers/CMC*	*Choice made by insurer/CMC*
How much damage was repaired				
All	93	81*	94	95*
Most	5	14*	5	4*
Some	2	5*	1	1*
Base (weighted)	1,159	148	121	797

Source: CC motor insurance Non-fault Survey, question C11.

*Difference is statistically significant.

13. Table 6 shows respondents' assessment of the condition of their vehicle after it had been repaired compared with prior to the accident. Most respondents (88 per cent) said that the condition was the same or better. Among captured claims, 13 per cent of respondents said that their vehicle was in a worse condition after repairs compared with before the accident, while the equivalent figure was 9 per cent for claims handled by the non-fault insurer and 10 per cent for claims handled by CMCs.

TABLE 6 **Condition of the vehicle after the repairs were made, analysed by who managed the claim**

per cent

	All	*At-fault*	*Non-fault*	*CMC*
Compared to before the accident				
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

Source: CC motor insurance Non-fault Survey, question C22.

*Difference is statistically significant.

14. The main reason for the vehicle being perceived to be in a worse condition was because not all the repairs were carried out (see Table 7). The second most cited reason was that the paintwork was not of the same colour or quality.

TABLE 7 **Reason(s)* why condition of the vehicle was worse, analysed by who managed the claim**

	All	*At-fault*	*Non-fault*	*CMC*
Reasons cited				
Paintwork not the same quality/colour	26	10	7	3
Not all damage repaired	98	34	34	9
Vehicle does not drive as well	6	4	2	0
Base (weighted)	130	48	43	12

Source: CC motor insurance Non-fault Survey, question C23.

*Each respondent may give more than one reason.

15. Table 8 shows that the main reasons for respondents perceiving their vehicle to be at least in the same condition as before the accident were because the vehicle returned to the original state and that the vehicle looks the same as before the accident.

TABLE 8 **Reason(s)* why repaired vehicle was at least in the same condition, analysed by who managed the claim**

	All	*At-fault*	*Non-fault*	*CMC*
Vehicle looks better than before the accident	32	12	15	5
Vehicle looks the same as before the accident	279	87	111	39
Vehicle returned to original state	310	86	157	34
Damage repaired	200	65	79	28
Damaged part(s) replaced	73	22	37	7
Vehicle drives as well as before the accident	40	6	20	9
Newer/better parts used in the repairs	59	15	30	6
Vehicle cleaned/polished	19	8	5	3
Vehicle resprayed/repainted	73	22	29	13
Scratches removed	19	6	11	0
Other	77	23	31	6
Don't know	9	2	3	0
Base (weighted)	1,156	364	491	141

Source: CC motor insurance Non-fault Survey, question C23.

*Each respondent may give more than one reason.

16. Table 9 shows respondents' perceptions of their ability to assess the repairs to their vehicle. Overall, respondents perceived themselves to be fairly or very confident of their ability to assess the condition of their vehicle following the repairs (85 per cent), but a higher proportion of those who said that their vehicle was in a better condition post-repair considered themselves able to assess this than those who said that their vehicle was in a worse condition (92 per cent and 60 per cent respectively).

TABLE 9 **How confident are respondents to be able to assess the repairs analysed by condition post-repair**

per cent

	Better condition	*Same condition*	*Worse condition*	*Total*
Confident	92*	87	60*	85
Indifferent	4*	7	13*	7
Not confident	4*	5	25*	7
Don't know	0	1	2	1
Base (weighted)	154	872	128	1,154

Source: CC motor insurance Non-fault Survey, question C25.

*Difference is statistically significant.

17. Table 10 shows that about a fifth of respondents' vehicles had been inspected for the quality of repair by a family member or friend and about one in ten by an independent inspector. The condition of the vehicle was more likely to have been assessed as worse if an inspection took place. However, these figures need to be interpreted

carefully as an inspection might only have been conducted because of concerns or a dispute about the repair work.

TABLE 10 **Condition of the vehicle by whether the repairs were assessed**

per cent

	All claims	*Inspected by: Family/ friends*	*Inde-pendent*
Compared to before the accident			
A lot better	5	4	5
Somewhat better	8	11	5
Same	75	71	70
Slightly worse	10	13	14
Much worse	1	1*	7*
Don't know	1	1	0
Base (weighted)	1,163	257	101

Source: CC motor insurance Non-fault Survey, question C21.

*Difference is statistically significant.

18. Table 11 shows the length of time taken to complete the repair work. To avoid mis-leading results driven by the mix of different types of damage across categories, rather than differences in the handling of the claim, we considered the average length of time taken to repair damage to the back of the vehicle as this was the damage most commonly reported by non-fault claimants in our survey. We conducted this analysis for high, medium and low levels of damage. In our view, this comparison of the average length of time to complete the repair work between captured and non-fault claims does not suggest a distinct pattern.

TABLE 11 **Average length of time (days) taken to repair a vehicle split by severity of damage**

number of days

	At-fault	*Non-fault*	*CMC*
Low damage	7	8	10
Medium damage	22	11	13
High damage	15	22	25
All types of damage*	14	11	13

Source: CC motor insurance Non-fault Survey, question C3.

*The average has been weighted by the number of claims for each type of damage.

19. Our non-fault survey asked respondents who made the final decision as to which repairer would carry out repairs to their vehicle. Table 12 shows the vehicle post-repair condition analysed by responses to this question. The table shows that a

greater proportion of those who chose the repairer considered the car in slightly worse condition compared with the situation in which the non-fault insurer chose the repairer.

TABLE 12 **Condition of the vehicle after repair by who decided who would carry out the repairs**

per cent

	All	*You*	*Non-fault*	*At-fault*	*Other**
Compared to before the accident					
A lot better	5	5	4	5	9
Somewhat better	8	11	8	9	3
Same	75	71†	78†	75	76
Slightly worse	10	13†	8†	10	8
Much worse	1	1	2	1	2
Don't know	1	0	1	1	3
Base (weighted)	1,163	299	439	306	119

Source: CC motor insurance Non-fault Survey, question C22.

*Includes claims where the final decision as to who would carry out the repair was taken by legal firms, repairers, dealerships and CMCs.
†Difference is statistically significant.

20. Our non-fault survey went on to ask those respondents who had chosen the repairer themselves to say how they chose who would carry out the repairs. Among these respondents, over half said that they had chosen from repairers they knew. Among this latter group of respondents, 16 per cent said that the condition of their vehicle was worse after repair, compared with 11 per cent who gave this answer across all respondents (see Table 13). We note that the caveat to the analysis of Table 5 in paragraph 12 applies equally to the analysis shown in Table 13.

TABLE 13 **Post-repair conditions split by who made the final decision as to who would carry out the repair and how such decision was taken**

per cent

	All	*Choice made by you: repairer you knew of*	*Choice made by you: options provided by insurers/CMC*	*Choice made by insurer/ CMC*
Post-repair conditions				
Better condition	5	5	6	5
Somewhat better	8	10	13	8
Same condition	75	69*	72	77*
Slightly worse	10	15*	8	9*
Much worse	1	1	1	2
Don't know	1	0	0	1
Base (weighted)	1,163	148	121	799

Source: CC motor insurance Non-fault Survey, question C22.

*Difference is statistically significant.

21. Table 14 shows respondents' perceptions of the value of their vehicle post-repair compared with prior to their accident. The table shows that 14 per cent of respondents said that they thought their vehicle was worth less. Whilst this appears higher among claims that had been captured, this difference is not statistically significant.

TABLE 14 **Value of the vehicle after the repairs were made, analysed by who managed the claim**

per cent

	All	*At-fault*	*Non-fault*	*CMC*
Compared to before the accident				
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 motor insurance Non-fault Survey, question C24.

22. Table 15 shows the respondents' degree of satisfaction split by who managed the claim. Non-fault claimants appear to have a higher degree of satisfaction in comparison with captured claims. For both types of claims, respondents appear to be fairly or very satisfied with the repair service provided, 93 per cent for non-fault claims versus 86 per cent for captured claims.

TABLE 15 **Satisfaction with the repair service analysed by who managed the claim**

per cent

	All	*At-fault (a)*	*Non-fault (b)*	*CMC (c)*
Very satisfied	61	56_{b}	66_{a}	63
Fairly satisfied	28	30	27	25
Neither satisfied nor dissatisfied	4	$6_{b,c}$	2_{a}	1_{a}
Fairly dissatisfied	3	4	2	6
Very dissatisfied	4	3_{c}	2	6_{a}
Base (weighted)	1,159	364	492	141

Source: CC motor insurance Non-fault Survey, questions C26.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

Nature of the accident

23. We considered whether the severity of the accident had any impact on the provision of services. Table 16 presents two outcome measures for repair services, as indicators of difference in service quality, and analyses them by three characteristics

of the accident: the severity of damage to the vehicle; whether the main damage to the vehicle was to the back of the vehicle; and whether the driver of the vehicle sustained an injury.

TABLE 16 **Stated quality of the repair services by nature of accident**

per cent

	All claims	*Severity of the accident*			*Damage mostly to back*	*Personal injury*
		Low (a)	*Medium (b)*	*High (c)*		
Repair						
Better condition	13	14	13	14	11	11
Worse condition	11	9_{c}	12	15_{a}	11	16*
Worth more	0	0	0	1	1	1
Worth less	14	$11_{b,c}$	18_{a}	18_{a}	14	21*
Average base (weighted)	1,123	498	472	148	537	271

Source: CC motor insurance Non-fault Survey, questions B1, C2, C3.

*Statistically different from claims where there was no injury incurred.
Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

24. The table shows that there appears to be more evidence of perceived poor quality in relation to repairs the more severe the damage to the vehicle (medium and high compared with low damage), although whether or not the main damage was to the back of the vehicle appears to make little difference. Among cases where the driver was injured in the accident, a particularly high proportion of respondents stated that they thought the vehicle was in a worse condition after repair.

Legal entitlement

25. There may be potential for differences in quality of goods and services when a claimant is unaware of their legal rights. Table 17 presents the same two outcome measures analysed by the extent to which the claimant said they had been made aware of their legal rights. The table shows that outcomes tended to be better among those who said that they had been informed of their legal rights in relation to their claim. However, we noted that it is possible that some of the differences may be accounted for by respondents having a greater tendency to say that they had been made aware of their legal rights if they were generally happy with the services they received.

TABLE 17 **Awareness of legal rights by stated quality of repair services**

per cent

	Were you made aware of your legal rights?				
	Yes, all	*Yes, some*	*No*	*Don't know*	*Total*
Repair					
Better condition	13	16	14	10	13
Worse condition	8*	8	14*	8	11
Worth more	1	0	1	0	1
Worth less	13	18	17	8	15
Average base (weighted)	1,127	269	86	626	146

Source: CC motor insurance Non-fault Survey, question D30.

*Differences are statistically significant.

Evidence from insurers

26. In this subsection we consider evidence from insurers and repairers on the repair services provided in different situations. As discussed in Appendix 7.3, we found that insurers did not differentiate significantly in how they managed repairs between fault and non-fault repairs.

27. We found that, to a limited extent, credit repairs were less likely to use non-OEM parts than insurer-managed repairs; and credit repairs had a higher proportion of replacement to repair than insurer-managed repairs. However, we were not able to quantify the impact on average repair costs of these differences. Also, we found no evidence to indicate that this additional level of service from credit repair was un-reasonable. We noted that the at-fault insurer can challenge inappropriate repair methods (eg the excessive use of replacement parts) through the scrutiny of its engineers.

28. We observed a few differences between non-fault insurer repair services, captured repair services and credit repair services, as follows:

(a) When repairs are handled by non-fault insurers, claimants are sometimes required to pay their insurance excess, in particular if liability is unclear or if claimants wish to use their own repairer. The claimant must then claim the

excess back from the at-fault insurer, sometimes with little assistance from the non-fault insurer. In contrast, for both credit repairs and captured non-fault repairs, no excesses are payable.

(b) Another consequence when repairs are managed by non-fault insurers is that claimants might lose their NCB. This should only be a temporary loss until liability is fully established or until the claim is settled but, again, this does not happen in credit repairs or captured non-fault repairs.

(c) In principle, credit repair customers may be exposed to the risk of being liable for the repair bill should the credit repairer not fully recover the cost from the at-fault insurer.[4] In practice, this risk appears small as some credit repairers offer insurance cover for this eventuality, and others told us that, although a customer might be legally liable, they would never expect a customer to pay. Captured claimants are not at such risk, but if there is doubt about who is at fault, a fault insurer is unlikely to wish to capture a claim in the first place.

(d) Captured non-fault claimants and CMC customers do not have access to the Financial Ombudsman Service in case of a dispute with the at-fault insurer (though CMCs are regulated by the Claims Management Regulator and customers can seek advice from the Claims Management Regulation Unit (part of the Ministry of Justice)).

29. We also noted that, alongside a credit repair service, a CMC often provided non-fault claimants with other services, which might not be provided to a captured non-fault claimant by a fault insurer, as follows:

(a) In addition to claiming for a repair, some CMCs will also claim, if appropriate, for a diminution in value of the vehicle as a result of the accident (ie due to a repaired car being worth less than the same car without an accident history).

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[4] Claimants with comprehensive cover would be able to make a claim on their own insurance, but would still be at risk of having to pay the repair before the claim under their own insurance had been dealt with. Claimants without comprehensive cover would be at risk of bearing the cost themselves.

None of the insurers which responded to our questionnaire offered their non-fault customers help with diminution claims. We found that, when such payments are made, they are typically for between 5 and 15 per cent of the pre-accident value of the vehicle, but that diminution payments are rare (ie they occur in less than 2 per cent of claims).

(b) Some CMCs also assist their non-fault customers in recovering uninsured losses, such as travel expenses, loss of earnings, recovery of insurance excesses and vehicle recovery costs. CMCs provided us with a wide range for the cost of providing these services, from £[✂] to £[✂] per repair. We found that some insurers only provided these services to their non-fault claimants if they had a motor legal expenses insurance policy.

30. When comparing the services (other than the repair itself) provided to credit repair customers and the services provided to own-insurer non-fault customers, it appears that credit repair services (and captured non-fault repair services) are slightly better. In particular, this is because credit repair providers do not require the payment of an excess and the claim does not affect the NCB of the claimant, albeit that these comparative benefits might be temporary as non-fault insurer claimants might be restored to their pre-accident condition in respect of these things subsequently.

31. With regard to the additional services provided by some CMCs, these would appear to be services provided to assist some claimants in pursuing their entitlements under tort law.

Replacement cars

31. In this section, we discuss responses to our non-fault survey as well as evidence from insurers and repairers and a review of electronic call records provided by

insurers and CMCs/CHCs in order to assess whether the level of replacement car services is different according to the claim handler.

Evidence from consumers

Perceived quality of replacement cars

32. The following tables set out the key outcome measures which provide an indication of respondents' perceived quality in relation to replacement cars, each analysed by the main claim handler.

33. About 80 per cent of the respondents to our non-fault survey were given access to a replacement car as part of their accident claim. Of the remainder, most were either offered a replacement vehicle and did not take up the offer or did not need a replacement vehicle. In only 1 per cent of all non-fault claims (22 unweighted cases) did the respondent ask for a replacement vehicle and not be given one.

34. Table 18 shows respondents' views on how well the replacement car they received met their needs. 85 per cent of respondents who received a replacement car said that it either met or exceeded their needs. This result does not appear to be different between claims handled by the non-fault insurer or CMC and claims handled by the at-fault insurer liable for the cost. The proportion of respondents who felt that the replacement vehicle fell short of their needs was slightly higher among captured claims than claims handled by the non-fault insurer and CMC.

TABLE 18 **How well the replacement vehicle met needs, analysed by who managed the claim**

per cent

	All	*At-fault (a)*	*Non-fault (b)*	*CMC (c)*
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	$14_{b,c}$	8_{a}	4_{a}
Fell well short of needs	5	5	5	7
Base (weighted)	1,191	345	487	170

Source: CC motor insurance Non-fault Survey, question D19.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

35. Table 19 shows the most stated reasons for the replacement car exceeding respondents' needs while Table 20 the most stated reasons for the replacement car falling short of needs. The most stated reason for the replacement car exceeding needs was that it was newer than the respondents' own vehicle while the most stated reason for the replacement car falling short of needs was that it was less spacious or smaller than their own vehicle.

TABLE 19 **Reason(s)* why the replacement vehicle exceeded needs, analysed by who managed the claim**

	All	*At-fault*	*Non-fault*	*CMC*
It was newer	79	27	24	12
It was more powerful / had a bigger engine	26	3	12	4
It was more spacious/bigger	62	12	24	12
It was less bulky/smaller	3	0	3	0
More economical	7	5	2	0
Higher specification	11	3	6	0
Low expectations/requirements	12	0	5	4
Was a good car (various)	4	2	2	0
Similar to my car/suitable to my needs	8	3	5	0
More expensive to run	4	0	0	2
Had vehicle for longer than was needed	2	0	0	0
Other	4	0	2	0
Don't know	0	0	0	0
Base (weighted)	205	51	83	28

Source: CC motor insurance Non-fault Survey, question D20.

*Each respondent may give more than one reason.

TABLE 20 **Reason(s)* why the replacement vehicle did not meet needs, analysed by who managed the claim**

	All	*At-fault*	*Non-fault*	*CMC*
Worse make/model	32	17	12	2
Method of pick-up/delivery	2	0	0	2
Older than own vehicle	2	2	0	0
Smaller engine than own vehicle	24	6	11	5
More bulky/bigger than own vehicle	11	5	4	0
Less spacious/smaller than own vehicle	97	35	40	12
Manual/automatic/diesel/petrol wanted	15	3	6	2
It was not clean	4	2	2	0
It was faulty	8	3	3	0
Fuel consumption too high	6	4	0	0
Unable to transport dog	4	2	2	0
Difficult/uncomfortable to drive	5	3	2	0
Not suitable for disabled people	5	3	2	0
Other	21	12	6	3
Don't know	2	0	2	0
Base (weighted)	171	67	67	19

Source: CC motor insurance Non-fault Survey, question D21.

*Each respondent may give more than one reason.

36. Table 21 shows respondents' views on whether they had their replacement car for the right length of time. Nine in ten customers said that they had the replacement car for at least as long as they needed it while 9 per cent of respondents said that they had the replacement car for a shorter time than needed.

TABLE 21 **Length of time had access to replacement car, analysed by who managed the claim**

per cent

	All	*At-fault*	*Non-fault*	*CMC*
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 motor insurance Non-fault Survey, question D23.

*Difference is statistically significant.

37. Table 22 shows the main reasons given for having had access for longer than needed while Table 23 the reasons for needing the replacement car longer. The main reason given by the small proportion of respondents who had their replacement car for longer than required was that they retained the vehicle for some time after the repair to their own vehicle was completed. Conversely, the reasons for needing the replacement car for longer were that they had no access to another suitable vehicle

for part of the time, or they needed time to finance the purchase or find another vehicle.

TABLE 22 **Reason(s)* why access was longer than needed, analysed by who managed the claim**

	All	*At-fault*	*Non-fault*	*CMC*
Had it for some time after the repairs had been completed	16	4	2	5
Did not use vehicle at beginning or end of period for which replacement vehicle was provided	6	2	2	0
Had access to another vehicle	5	2	1	0
Delays with the repair work	5	2	0	3
Told to keep hold of it longer	6	2	2	0
Did not use the vehicle	6	0	2	2
Other	1	1	0	0
Don't know/can't remember	2	0	0	0
Base (weighted)	41	12	7	10

Source: CC motor insurance Non-fault Survey, question D24.

*Each respondent may give more than one answer.

TABLE 23 **Reason(s)* why didn't have replacement vehicle long enough, analysed by who managed the claim**

per cent

	All	*At-fault*	*Non-fault*	*CMC*
Couldn't collect the replacement car straight away	17	3	4	2
Didn't have access to another vehicle for part of the time	40	7	23	4
Didn't have access to a suitable vehicle for part of the time	24	9	6	2
Car written off which caused delays	5	2	1	0
Needed time to find another car to purchase	28	8	13	3
Car had to go back for repairs	6	2	2	0
Needed time to finance purchase of another car	10	5	0	4
Needed car for commuting	4	2	0	0
Other	4	2	2	0
Base (weighted)	105	30	42	12

Source: CC motor insurance Non-fault Survey, question D25.

*Each respondent may give more than one answer.

38. Our non-fault survey asked respondents who had decided on the provider of the replacement car. Tables 24 and 25 show the proportion of replacement cars that met needs and the proportion of time replacement cars were provided analysed by the responses to this question.

TABLE 24 **How well replacement car met needs by who chose provider**

per cent

	All	*You (a)*	*Non-fault (b)*	*At-fault (c)*	*CMC (d)*
Far exceeded needs	11	12	10	12	12
Somewhat exceeded needs	6	4	8	5	9
Met needs	68	61	71	67	66
Fell slightly short of needs	9	16_d	8	11	6_a
Fell well short of needs	5	8_b	3_a	6	6
Don't know	0	0	0	0	1
Base (weighted)	1,191	44	464	375	161

Source: CC motor insurance Non-fault Survey, question D14.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

TABLE 25 **Length of time had access to replacement car by who chose provider**

per cent

	All	*You*	*Non-fault*	*At-fault*	*CMC*
A longer time than needed	3	4	3	4	6
As long as needed	88	77	87	86	88
A shorter time than needed	9	18*	10	10	6*
Base (weighted)	1,178	44	459	372	161

Source: CC motor insurance Non-fault Survey, question D14.

*Difference is statistically significant.

Awareness of replacement car costs

39. In our non-fault survey, we asked respondents whether they were made aware of the total hire cost of their replacement car and whether, given such cost, they would have been content with a lower-quality vehicle or having the vehicle for less time. 25 per cent of those that received a replacement car were aware of the total cost. Of these, 41 per cent said that they would have been content with a less good-quality replacement car and 21 per cent said that they would have been content with having the replacement car for less time. We noted that only 21 per cent of these respondents had said the replacement car provided exceeded their needs and only 5 per cent had said that they had it for longer than needed. In our working paper,[5] we suggested that knowledge of the actual replacement car cost might increase claimants' willingness to accept a lower-quality service. In its response, the CHO said

[5] ToH 1: Analysis of non-fault survey in relation to overprovision .

that the only cost that the consumer might have been aware of would have been the basic hire rate appearing on the face of the rental agreement with the credit hire operator and that the majority of hire claims were settled under the GTA (or bilateral agreements) at lower rates. We accept that this makes it more difficult to interpret responses to this question.

Nature of the accident

40. There may be potential for differences in quality of replacement car services according to the severity of the accident. Table 26 presents two outcome measures for replacement cars, as indicators of difference in service quality, and analyses them by three characteristics of the accident: the severity of damage to the vehicle; whether the main damage to the vehicle was to the back of the vehicle; and whether the driver of the vehicle sustained an injury.

TABLE 26 **Stated quality of the replacement cars by nature of accident**

per cent

	All claims	*Severity of the accident*			*Damage mostly to back*	*Personal injury*
		Low (a)	*Medium (b)*	*High (c)*		
Replacement car						
Exceeded needs	17	16	18	18	18	17
Fell short needs	15	18_{c}	14	10_{a}	14	12
Longer time than needed	3	5_{b}	2_{a}	3	3	3
Shorter time than needed	9	$3_{b,c}$	10_{a}	17_{a}	7	18*
Average base (weighted)	1,177	417	502	254	544	356

Source: CC motor insurance Non-fault Survey, questions B1, C2, C3.

*Statistically different from claims where there was no injury incurred.
Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

41. The table shows that, when damage to the vehicle was low, a greater proportion of respondents (compared with the base overall) said that the replacement car provided did not meet their needs but that they had it for long enough. When damage was more severe the opposite occurred, ie more said that the vehicle met their needs but they needed it for longer than it was supplied. Where the driver had sustained an injury during the accident, a significant minority (18 per cent) said that they did not have the replacement car for long enough.

Legal entitlement

42. Table 27 shows whether the awareness of legal rights has an impact on the quality of replacement car services. The table presents the same two outcome measures analysed by the extent to which the claimant said they had been made aware of their legal rights. The results tended to be better among those who said that they had been informed of their legal rights in relation to their claim. We note that the caveat to the analysis of Table 17 in paragraph 25 applies equally to the analysis shown in Table 27.

TABLE 27 **Awareness of legal rights by stated quality of replacement cars**

per cent

	Were you made aware of your legal rights?				
	Yes, all	*Yes, some*	*No*	*Don't know*	*Total*
Replacement car					
Exceeded needs	23*	22	14*	17	17
Fell short needs	9*	11	19*	8	14
Longer time than needed	4	1	4	4	3
Shorter time than needed	6*	13	10*	7	9
Average base (weighted)	1,188	286	103	640	159

Source: CC motor insurance Non-fault Survey, question D30.

*Differences are statistically significant.

Evidence from insurers and repairers

43. We considered evidence from insurers and repairers in order to assess whether there are differences in the quality of replacement car services provided to non-fault drivers. We consider the additional services received alongside credit hire. We make comparison against direct hire, though we recognize that this is an imperfect comparator as there could be underprovision to drivers who receive a replacement car under direct hire.

44. We present results for a sample of motor insurers (Admiral, Ageas, Aviva, AXA, CISGIL, DLG, esure, LV, RSA and Zurich) and CMCs (Accident Exchange, ACM, Ai Claims Solutions, ClaimFast, Crash Services, Enterprise, Helphire, Kindertons and WNS Assistance).

Additional services

45. We assess the additional services provided to non-fault drivers under credit hire, which are beyond the level of services provided to non-fault drivers under direct hire. We consider:

(a) the impact of credit hire on replacement car provision to non-fault drivers;

(b) the provision of replacement cars to non-fault drivers where liability is uncertain or disputed by the at-fault insurer;

(c) the speed of replacement car provision by CMCs/CHCs;

(d) the quality of the replacement car provided by CMCs/CHCs;

(e) the extent of the non-fault driver's liability in relation to any damage to the replacement car; and

(f) additional post-accident services provided by CMCs/CHCs under credit hire, such as after-the-event insurance and uninsured loss recovery.

Impact of credit hire on replacement car provision to non-fault drivers

46. The emergence of credit hire in the 1980s was in response to the limitations of the mobility provided by motor insurers to non-fault drivers following an accident. Prior to the advent of credit hire, non-fault drivers would in principle have had the following options in respect of replacement car provision:

(a) claim under their motor insurance policy (provided that they had comprehensive insurance and courtesy car cover included under their basic motor insurance policy or they had purchased suitable cover as an add-on to their basic policy);

(b) source a replacement car themselves and reclaim the hire costs from the at-fault insurer as an uninsured loss;

(c) secure alternative mobility (ie use public transport or rely on friends and family for transportation); or

(d) submit a claim for loss of use to the at-fault insurer.

47. Third party capture or intervention, the process whereby the at-fault insurer captures and manages the non-fault driver's claim, did not take place prior to the introduction of credit hire. Instead, the motor insurers in our sample told us that third party capture was in direct response to the increased non-fault mobility costs incurred by them (as the at-fault insurer) following the introduction of credit hire. By controlling the claim, the motor insurer is able to minimize hire costs by placing the non-fault driver in a direct hire replacement vehicle (secured at significantly lower rates than under a credit hire agreement).

48. The CMCs/CHCs in our sample told us that motor insurers minimized costs by providing a lower quality of replacement car under direct hire than they provided under credit hire. However, in response, esure told us that if a fault insurer underprovided replacement car services to a captured non-fault driver, there was a risk that the driver would accept the services of a CMC/CHC, thus increasing the hire costs incurred by the driver and payable by the at-fault insurer.

Replacement car provision where liability is uncertain or disputed by the at-fault insurer

49. CMCs/CHCs do not require upfront payment of their hire charges and provide interest-free credit against those charges, which are recovered from the at-fault insurer, thus effectively providing non-fault drivers with risk-free mobility.[6] This is of particular importance where liability is uncertain or disputed by the at-fault insurer,

[6] Although a CMC/CHC can only claim the costs of credit associated with credit hire if they can demonstrate that it was reasonable in the circumstances for the driver to hire the replacement car on credit (ie the customer was impecunious), the test for impecuniosity does not appear to be clear and, with the exception of WNS Assistance, the CMCs/CHCs on our sample do not appear to assess whether a driver requires a replacement car on credit terms. Under the terms of a credit hire agreement, the driver is ultimately liable for the costs of the provision of replacement car services should the CMC/CHC be unable to recover the costs from the at-fault insurer. However, the CMCs/CHCs in our sample told us that they rarely sought to recover costs from drivers.

because under this scenario, it is unlikely that the at-fault insurer will capture the non-fault driver and meet their mobility until liability has been formally settled.[7]

Determination of liability

50. Liability is only formally settled following an admission of liability from the at-fault insurer, which can take considerable time to achieve. For example:

(a) Ai Claims Solutions told us that on average liability was admitted by the at-fault insurer within seven days of the accident in 50 to 60 per cent of its claims and within 60 days of the accident in 80 to 90 per cent of its claims. 5 per cent of claims took up to a year to gain admission and 5 per cent of claims usually remained disputed.

(b) ClaimFast told us that a straightforward claim (ie where there was no dispute between the at-fault insurer and the CMC/CHC over the liability for the accident) could settle with an efficient insurer on average within two to four months of FNOL. Where liability is disputed and it is likely that litigation will be inevitable, this can extend timescales by three to twelve months (depending on the capacity of the courts and the complexity of the claim). This is illustrated by the information provided by Kindertons, where a greater proportion of straightforward cases were settled within 48 hours and seven days of FNOL (see Table 28 below).

TABLE 28 **Kindertons liability settlement, 2012**

per cent

Type of case	*Cases where liability settled within 48 hours of FNOL*	*Cases where liability settled within 7 days of FNOL*
Grade A (straightforward)	13.49	33.68
Grade B (uncertain)	11.12	29.06
All cases	12.47	31.71

Source: Kindertons.

[7] We found that, at FNOL, car 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 car insurers in our sample suggested that the categorization of a driver as non-fault changed following FNOL in between 2 and 12 per cent of cases.

(c) Table 29 shows that Helphire managed to settle liability within 90 days of FNOL [✂].

TABLE 29 [✂]

[✂]

Source: Helphire.

51. The CMCs/CHCs in our sample told us that the presence of credit hire caused liability to be resolved more often and more quickly. Given that CMCs/CHCs provide replacement car services on credit, a prompt and accurate assessment of liability is essential in reducing the risk of non-recovery or only partial recovery of the cost incurred in the provision of these services from the at-fault insurer.[8] For example, Accident Exchange told us that it sought to confirm liability within one working day of being contacted by a non-fault driver.

52. The motor insurers in our sample told us that the presence of credit hire had no impact upon the settlement of liability, because:

(a) The speed of the assessment of liability was very much dependent upon the nature of the accident rather than the presence of CMCs/CHCs. Admiral told us that liability could be assessed promptly where the accident circumstances were straightforward or where it was able to verify the version of events it held with all parties concerned and any independent witnesses.

(b) CMCs/CHCs typically provided mobility to non-fault drivers where liability was not disputed, in order to ensure that they had reasonable prospects of the recovery of the cost incurred in providing a replacement car under credit hire from the at-fault insurer. Admiral told us that although CMCs/CHCs were increasingly taking on

[8] Under the terms of a credit hire agreement, the non-fault driver was ultimately liable for the costs incurred by the CMC/CHC should the CMC/CHC be unable to recover the costs from the at-fault insurer. However, the CMCs/CHCs in our sample told us that they rarely sought to recover costs from non-fault drivers.

more disputed claims, the majority of the claims they accepted remain clear non-fault cases or those that had reasonable prospects of recovery.

53. However, the motor insurers are incentivized to settle liability promptly, in order to progress a non-fault claim to settlement and minimize the credit hire costs incurred. For example, CISGIL told us that motor insurers might admit liability (even where liability was uncertain or split), in order to mitigate or end the indefinite accrual of costs by CMCs/CHCs, which they were otherwise unable to control. Further, the application of GTA late payment penalties was punitive, which encouraged early resolution of claims.[9]

54. We note that the CMCs/CHCs in our sample also told us that the presence of a bilateral agreement covering replacement car provision between the at-fault insurer and non-fault insurer negatively impacted upon the determination of liability. However, the motor insurers in our sample who had such bilateral agreements in place ([✂], [✂], [✂], [✂] and [✂]) told us that the agreements applied only when liability had been settled and one party was deemed to be at fault and therefore liable for the costs of hire.

Replacement car provision

55. There is some variation among the CMCs/CHCs in our sample in relation to replacement car provision where liability is uncertain or disputed by the at-fault insurer:

(a) Four of the nine CMCs/CHCs in our sample ([✂]) provide replacement cars to non-fault drivers when liability is uncertain or disputed by the at-fault insurer. For example:

[9] The GTA's guidelines specify that payment in settlement of a credit hire or credit repair claim should be made within 30 days of the dispatch of the claim to the at-fault insurer. If payment is late, the outstanding amount incurs a late payment penalty at both 30 and 60 days. Under the terms of the GTA, a CMC/CHC is entitled to progress settlement outside the GTA (eg through litigation) if a claim has not been settled after 90 days from the dispatch of the claim to the at-fault insurer.

(i) [✂] told us that in complicated accident circumstances, it performed further investigations following FNOL, including calling the at-fault driver, calling the at-fault insurer, calling any independent witnesses, speaking to local shops and councils in relation to the availability of any relevant closed-circuit television (CCTV) footage, and liaising with the police (if necessary). In some cases, it might also engage its in-house investigation team to obtain a locus report to verify the accident circumstances. In some cases where a customer's car was not drivable as a result of the accident, [✂] might make an initial assessment of liability and provide hire on that basis, but then undertake investigations to verify that initial assessment. In the rare cases where it subsequently changed its initial assessment, it might terminate the hire, but did not pursue either the customer or the at-fault insurer for the costs of hire incurred up to that point.

(ii) [✂] told us that it attempted to seek an admission of liability from the at-fault insurer prior to providing a replacement car to a non-fault driver, although this was not always possible (eg due to an accident not being reported to the at-fault insurer or the at-fault insurer still investigating the accident circumstances). Where the driver's car was not roadworthy, it might provide hire without an admission of liability from the at-fault insurer. Ai Claims Solutions on average commenced hire without receiving an admission of liability from the at-fault insurer in around 25 per cent of cases.

(iii) [✂] told us that it routinely provided a replacement car where liability was unclear or disputed. If the non-fault driver's car was not roadworthy (and therefore they required immediate access to a replacement vehicle) [✂] might provide a replacement car on credit for up to seven days at no charge while it tried to establish liability. If the driver was later deemed to be at fault, [✂] did not seek to recover the costs of hire from the driver. [✂] told us that in 2012 only 12 per cent of its claims had liability admitted within 48 hours of

FNOL and 32 per cent of its claims within seven days of FNOL. For Grade B cases (ie where liability was uncertain), [✂] provided a replacement car on average within two days of FNOL, despite not receiving an admission of liability from the at-fault insurer on average until 25 days from FNOL.

(b) The remaining five CMCs/CHCs in our sample ([✂][10]) do not provide replacement cars where liability is uncertain or disputed by the at-fault insurer. A replacement car is provided once liability has been established or the CMC/CHC is confident that the driver is not at fault for the accident. For example:

(i) [✂] told us that it would not provide its services if, in its opinion, liability could not be assessed. Where liability could not be assessed at first contact due to incomplete information, it would carry out further investigations at its own expense. Customers were not placed into replacement cars whilst this additional investigation was performed.

(ii) [✂] told us that [✂].

Speed of replacement car provision

56. The CMCs/CHCs in our sample told us that they were usually able to provide non-fault drivers with a replacement car under credit hire within 1 to 4 hours of receipt of the mobility request (in line with their contractual stipulations).[11]

57. However, as many CMCs/CHCs provide replacement cars under both credit hire and direct hire terms and some motor insurers use the same CMC/CHC for both types of hire provision, a fault insurer (through its contracted direct hire provider) is also able to provide a replacement car to a captured non-fault driver promptly following the capture of the claim. For example, Admiral told us that its service levels with its direct

[10] [✂] told us that where the information captured during FNOL supported a decision to apportion primary liability with the third party insurer, it referred the customer to its outsourced service provider who would assess the customer's eligibility to receive a credit hire vehicle.

[11] We note that this applies to non-fault claims where the non-fault driver's car is not roadworthy (where the non-fault driver's car is roadworthy, delivery of the replacement car takes place upon commencement of the repair of the driver's car) and where liability has been established or the CMC/CHC is confident that it will be able to recover its costs from the at-fault insurer upon completion of the hire period and submission of the invoice to the at-fault insurer.

hire providers were designed to ensure that the providers did not prioritize credit hire instructions over and above direct hire instructions and that they were given equal merit in terms of speed of provision. Where there was an immediate request and requirement for hire, Admiral expected its providers to meet the contractual obligation of provision within 4 hours of instruction.

Replacement car quality

58. The CMCs/CHCs in our sample told us that they were more likely to provide non-fault drivers with a replacement car that met their legal entitlement (ie a broadly equivalent replacement car subject to the non-fault driver's duty to mitigate their loss with consideration to their need) than a fault insurer, who, as the payer of the replacement car services, is incentivized to minimize the cost of those services.

Replacement car upgrades

59. In practice, a non-fault driver is usually provided with a like-for-like replacement car for as long as is reasonably necessary, subject to their duty to mitigate their loss with consideration to their need.

60. Sometimes non-fault drivers receive a replacement car of a higher class than their own car (ie an upgrade) at no extra cost due to the unavailability of a like-for-like replacement car. In these cases, the CMC/CHC recovers from the at-fault insurer only the hire charges applicable to the class of the customer's own car. Table 30 shows the proportion of replacement car upgrades provided by the nine CMCs/CHCs in our sample to their credit hire and direct hire customers in 2012.

TABLE 30 **Provision of replacement car upgrades, 2012**

per cent

CMC/CHC	*Proportion of credit hire customers provided with free upgrades*	*Proportion of direct hire customers provided with free upgrades**
Accident Exchange	[✂]	[✂]
ACM†	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]
ClaimFast‡	[✂]	[✂]
Crash Services§	[✂]	[✂]
Enterprise	[✂]	[✂]
Helphire	[✂]	[✂]
Kindertons	[✂]	[✂]
WNS Assistance	[✂]	[✂]
Unweighted average	17	10

Source: CMCs/CHCs.

*The direct hire data may include fault claims.
†[✂]
‡ClaimFast does not provide direct hire services, except as an outsourced function for [✂].
§[✂]

61. Table 30 shows that between [✂] and [✂] per cent of credit hire customers were provided with upgrades (at an average of 17 per cent), compared with between [✂] and [✂] per cent of direct hire customers (at an average of 10 per cent). However, for two of the three CMCs/CHCs in our sample where figures were provided for both credit hire and direct hire ([✂] and [✂]), there was a greater proportion of upgrades for direct hire customers than credit hire customers, suggesting that there are no clear conclusions from this evidence. Given that upgrades are the result of operational issues and do not increase the bill to the at-fault insurer, we have not analysed this practice further.

Review of motor insurer and CMC/CHC electronic call records

62. We reviewed a sample of electronic call records provided by the ten motor insurers and the nine CMCs/CHCs in our sample, in order to assess whether there was any evidence of differences in the:

(a) type of replacement car provided to the driver by a non-fault insurer or CMC/CHC and a fault insurer; and/or

(b) assessment of the driver's need for that type of car,

and therefore, any indication that insurers or CMCs/CHCs provide non-fault drivers with replacement car services that exceed the services to which they are legally entitled.

63. We were aware that these call records reflected only one interaction between the claimant and the provider and there may have been other interactions.[12]

- *Claims managed by non-fault insurer or CMC/CHC*

64. We reviewed 56 electronic call records where the non-fault claim was managed by the non-fault insurer or a CMC/CHC:

(a) In 51 of the 56 records, the replacement car was provided under a credit hire agreement.

(b) In 4 of the 56 records, the replacement car was provided under a direct hire agreement, as the non-fault claim was subject to a bilateral agreement between the at-fault insurer and non-fault insurer.[13]

(c) In 1 of the 56 records, the driver received a courtesy car rather than a credit hire replacement car, as the non-fault insurer concerned does not refer its drivers who were not at fault to CMCs/CHCs for the provision of replacement cars under a credit hire agreement.

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[12] We note that the electronic call records provided by the ten motor insurers and the nine CMCs/CHCs in our samples enabled us to assess the type of replacement car provided to the driver, but not the driver's need for a replacement car or the driver's need for a replacement car on credit. We note that an assessment of the driver's need for a replacement car might have been carried out at a later stage in the process. Also, by focusing only on records where a replacement car was provided, we have not captured those cases where there was an assessment of the driver's need, which resulted in a replacement car not being provided. 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 driver 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 the driver requires a replacement car on credit. Under the terms of a credit hire agreement, the driver is ultimately liable for the costs of the provision of replacement car services should the non-fault insurer or CMC/CHC be unable to recover the costs from the at-fault insurer. However, the CMCs/CHCs told us that they rarely sought to recover costs from drivers who were not at fault. We do not consider credit further in this section.

[13] It appears that a low proportion of claims were subject to a bilateral agreement between the at-fault insurer and non-fault insurer. We note that the insurers concerned notified us that these claims were subject to a bilateral agreement (and therefore, the replacement car was provided under a direct hire agreement) and this was not disclosed in the calls.

65. In 19 of the 56 records, we were unable to compare the replacement car provided to the driver with the car requiring repair, in order to assess whether the replacement car was a like-for-like or a lower-class replacement, because the claims handler did not discuss the type of replacement car that was later provided to the driver (18 records) or the driver's car was not disclosed during the call (one record).

66. We were able to ascertain the type of replacement car provided to the driver in the remaining 37 records:

(a) In 34 of the 37 records (92 per cent of the sample), the driver was provided with a like-for-like replacement car. In 26 of the 34 records (76 per cent), the claims handler did not appear to assess whether the driver required a like-for-like replacement car or whether a replacement car of a lower class would have met their needs. In the remaining eight records (24 per cent), the driver demonstrated a genuine need for a like-for-like replacement car.

(b) In 3 of the 37 records (8 per cent), the driver was provided with a replacement car of a lower class than their own car. In these cases, the driver appeared to accept that a lower class of replacement car was sufficient for their needs.

- *Claims managed by fault insurer*

67. We reviewed 44 electronic call records where the driver who was not at fault was captured by the at-fault insurer, who subsequently provided a replacement car to the driver:

(a) In 35 of the 44 records, the replacement car was provided under a direct hire agreement.

(b) In 9 of the 44 records, the driver received a courtesy car rather than a direct hire replacement car.[14]

68. In 11 of the 44 records, we were unable to compare the replacement car provided to the driver with the car requiring repair, in order to assess whether the replacement car was a like-for-like or a lower-class replacement, because the claims handler did not discuss the type of replacement car that was later provided to the driver (eight records) or the driver's car was not disclosed during the call (three records).

69. We were able to ascertain the type of replacement car provided to the driver in the remaining 33 records:

(a) In 23 of the 33 records (70 per cent), the driver was provided with a like-for-like replacement car or courtesy car. In 19 of these 23 records (83 per cent), the claims handler did not appear to assess whether the driver required a like-for-like replacement car or whether a replacement car of a lower class would have met their needs. We note that, although an at-fault insurer has the incentive to minimize the cost of the replacement car provided to a captured driver who was not at fault, if it offers a poor quality of service, the driver may reject their services and accept the services of a CMC/CHC, which is likely to be more expensive for the at-fault insurer (due to higher daily rates and, possibly, a longer hire duration). In 3 of the 23 records (13 per cent), the driver demonstrated a genuine need for a like-for-like replacement car. In one of the 23 records (4 per cent), where the driver was provided with a courtesy car, the driver's own car was equivalent to the standard Class A courtesy typically provided by an insurer's approved repairer network.

[14] We note that only two insurers ([✂] and [✂]) in the sample of electronic call records reviewed engaged in the practice of providing a courtesy car through their approved repairer network rather than a direct hire replacement car to captured non-fault drivers.

(b) In 10 of the 33 records (30 per cent), the driver was provided with a replacement car or a courtesy car of a lower class than their own car. In these cases, the driver appeared to accept that a lower class of replacement car was sufficient for their needs.

Bilateral agreements

70. We note that the CMCs/CHCs in our sample also told us that bilateral agreements covering replacement car provision between insurers might suppress consumer entitlement, as they sought to control costs by, among other things, attempting to influence the type of replacement car provided to the non-fault driver. However, the motor insurers in our sample who have such bilateral agreements in place ([✂], [✂], [✂], [✂] and [✂]) told us that the agreements ensured that the replacement car was provided in line with the non-fault driver's legal entitlement. For example:

(a) [✂] told us that that its bilateral agreements contained provisions in relation to the type of replacement car to be provided, such as 'it is agreed that non-fault drivers will be offered a vehicle, subject to need, up to a class which is equivalent to their own vehicle (blanket provision on a like-for-like basis is not anticipated as there is a duty to mitigate loss wherever possible).' [✂] told us that, in practice, the needs were established with the customer and the right size car was provided.

(b) [✂]

(c) [✂] told us that [✂] its mobility bilateral agreements, [✂] (see Table 31 below). [✂]

TABLE 31 **[✂] replacement car provision in mobility bilateral agreements**

*Driver vehicle class**	*Minimum offer*	*Maximum offer*
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]

Source: [✂].

*These are the vehicle groups specified by [✂].

(d) [✂] told us that its [✂] bilateral agreements include obligations to ensure that any loss is mitigated and provide that a vehicle will be offered 'subject to need, up to a class which is equivalent to [the driver's] own vehicle.' [✂] agreements also include [✂].

(e) [✂]

Non-fault driver liability for damage to the replacement car

71. Non-fault drivers are provided with a comprehensively insured replacement car under both credit hire and direct hire. The excess typically matches the excess on the driver's motor insurance policy.[15] A CMC/CHC may provide drivers with a collision damage waiver, which reduces the amount payable to nil or to the excess on the driver's motor insurance policy as a result of theft of or damage to the replacement car.

72. Table 32 outlines the excess applied by the nine CMCs/CHCs in our sample to the replacement car under credit hire and direct hire:

(a) [✂] provides all of its credit hire customers with a collision damage waiver, which reduces the amount payable as a result of theft or damage to the replacement car to nil. In contrast, its direct hire customers would be liable for the excess under similar circumstances. [✂]

(b) [✂] provide their credit hire and direct hire customers with the same excess and collision damage waiver entitlement.

(c) [✂] do not provide replacement cars under direct hire, and therefore we cannot make a suitable comparison of credit hire and direct hire excess and collision damage waiver entitlement.

[15] Under clause 5.3 of the GTA, the credit hire daily hire rate includes full liability, theft and damage insurance subject to a £50 excess, unless the customer has a third party, fire and theft policy or their motor insurance policy excess exceeds this figure, when a higher excess can apply but with no compulsory additional charge to the customer.

TABLE 32 **Replacement car excess**

CMC/CHC	*Credit hire*		*Direct hire*	
	Excess	*Collision damage waiver*	*Excess*	*Collision damage waiver*
Accident Exchange	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]
ACM	[✂]	[✂]	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]	[✂]
Crash Services	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]

Source: CMC/CHC responses to October 2013 CMC/CHC questionnaire, questions 7 and 8.

[✂]

Additional post-accident services provided under credit hire

73. In addition to the provision of a replacement car, a number of the CMCs/CHCs in our sample provide additional post-accident services to non-fault drivers under credit hire at no extra cost to the driver, such as after-the-event insurance and uninsured loss recovery.[16]

After-the-event insurance

74. After-the-event 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.

75. Four of the nine CMCs/CHCs in our sample ([✂]) told us that they provided their credit hire customers with after-the-event insurance:

(a) [✂] told us that its after-the-event insurance covered the costs of hire, repair and legal expenses. The premium cost to it was £[✂] plus insurance premium tax per policy.

[16] The provision of these services may be part of a claimant's legal entitlement under tort law, depending on the circumstances of the claim.

(b) [✂] told us that the underlying cost of this service was around £[✂] per hire.

(c) [✂]

76. We understand that irrespective of whether a non-fault driver takes out after-the-event insurance, it is very rare for a CMC/CHC to pursue a driver for settlement of the costs of credit hire where the CMC/CHC cannot recover the costs from the at-fault insurer.[17] However, the driver may be liable for the costs incurred by the providers of any other post-accident services that they require.

77. We note that after-the-event 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.

Uninsured loss recovery

78. Under this service, the CMC/CHC pursues on behalf of the non-fault driver any uninsured losses which they might have suffered, such as:

(a) payment of their motor insurance policy excess;

(b) loss of earnings (eg if the customer could not work as a result of the accident);

(c) loss of personal effects (if any items were damaged in the accident);

(d) vehicle recovery charges (if incurred);

(e) vehicle storage charges (if incurred); and/or

(f) loss of value to their vehicle (ie a diminution claim).

[17] A CMC/CHC typically only pursues a driver for settlement of the costs of credit hire in relation to fraudulent claims and claims where there is a change in the initial assessment of liability (ie from non-fault to at-fault).

79. Six of the nine CMCs/CHCs in our sample ([✂][18]) told us that they provided uninsured loss recovery and that the recoveries formed part of the claim for recovery of credit hire and/or credit repair costs:

(a) [✂] told us that it incurred a cost of £[✂] per claim to provide uninsured loss recovery.

(b) [✂] told us that it provided uninsured loss recovery in around [✂] per cent of its credit hire cases.

(c) Table 33 outlines the breadth of the uninsured loss recovery services offered by [✂] in 2012 and shows that its customers, on the whole, receive a significant proportion of the costs submitted under their claims.

TABLE 33 **[✂] uninsured loss recovery, 2012**

Uninsured loss	*Number of claims*	*Amount claimed £*	*Amount paid £*	*Proportion of amount paid compared with amount claimed %*
[✂]	[✂]	[✂]	[✂]	[✂]

Source: [✂].

[✂]

80. We note that motor insurers do not typically provide uninsured loss recovery to captured non-fault drivers. However, the driver may be able to recover any uninsured losses if they have purchased motor legal expenses insurance as an add-on to their basic motor insurance policy or motor legal expenses insurance is included as standard under the policy.

Other aspects of quality relating to replacement car services

81. The ten motor insurers in our sample told us that they monitored the quality of the replacement car services provided to their customers by their credit hire and direct hire providers by:

[18] [✂] assists customers with the recovery of their uninsured losses if they have purchased a before-the-event policy (eg motor legal expenses insurance).

(a) monitoring customer complaints;

(b) reviewing performance against contracts or service level agreements;

(c) performing audits of the customer experience; and/or

(d) meeting regularly with providers to review performance.

82. For example, DLG told us that its direct hire and credit hire provider, [✂], must meet clear service standards, including in relation to quality and safety requirements and detailed performance measures and targets. DLG said that it monitored [✂] performance against these service levels and against customer metrics (eg satisfaction and complaint rates). They also had regular service reviews.

83. Table 34 presents customer complaint data for the ten motor insurers and nine CMCs/CHCs in our samples, relating to direct hire and credit hire. The table shows that there is no significant variation in the level of customer complaints received by the ten motor insurers and nine CMCs/CHCs in our samples in relation to credit hire and direct hire services, which suggests that there is no significant difference in customers' perceptions of these services. However, we note that this evidence is limited, as the majority of the parties do not record complaints relating to credit hire and direct hire separately and instead capture complaints data for all replacement cars provided, including courtesy cars.

TABLE 34 **Credit hire and direct hire customer complaints, 2012**

Motor insurer/CMC/CHC	*Credit hire*		*Direct hire**	
	Number of complaints	*Proportion of complaints in relation to total claims %*	*Number of complaints*	*Proportion of complaints in relation to total claims %*
Motor insurer				
Admiral	[✂]	[✂]	[✂]	[✂]
Ageas Insurance	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]
Unweighted average	43	0.4	24	0.6
CMC/CHC				
Accident Exchange	[✂]	[✂]	[✂]	[✂]
ACM†	[✂]	[✂]	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]	[✂]	[✂]
ClaimFast‡	[✂]	[✂]	[✂]	[✂]
Crash Services§	[✂]	[✂]	[✂]	[✂]
Enterprise	[✂]	[✂]	[✂]	[✂]
Helphire	[✂]	[✂]	[✂]	[✂]
Kindertons	[✂]	[✂]	[✂]	[✂]
WNS Assistance	[✂]	[✂]	[✂]	[✂]
Unweighted average	33	0.1		0.5
Overall unweighted average	38	0.3	24	0.5

Source: Motor insurers and CMCs/CHCs.

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*The direct hire data may include fault claims.
†[✂]
‡ClaimFast does not provide direct hire services, except as an outsourced function for [✂].
§Crash Services does not provide direct hire services.
Note: A number of the parties questioned do not separately record customer complaints in relation to the provision of credit hire and direct hire services.

The estimation of net effect on insurers' costs of the separation of cost liability and cost control

Introduction

1. This appendix describes how we estimated the effects on insurers' and brokers' costs of the separation of cost liability and cost control. We estimated both the higher costs faced by insurers when in a fault position (paragraphs 3 to 17) and the revenues they gain when not at-fault (paragraphs 18 to 24).

2. Our approach made use of data on claims numbers, average revenues and costs from the ten largest insurers operating in the UK (Admiral, Ageas, Aviva, AXA, CISGIL, DLG, esure, LV, RSA, and Zurich) and from several brokers (Acromas, BGL, Endsleigh, Hastings, and Swinton). Some of the figures exhibit a significant level of uncertainty. Moreover, the calculations are based on a number of assumptions which introduce further uncertainty. Therefore, our estimation must be seen as indicative of the scale of the detriment, not as an exact quantification of it.

Estimating higher costs to fault insurers

3. We estimated the higher cost separately for:

   (a) replacement vehicles;

   (b) repair; and

   (c) write-offs.

4. We consider each of these in turn, and then we discuss frictional and management costs.

Replacement vehicles

5. As discussed in Section 6 and Appendix 6.1 (paragraphs 31 to 35), we estimated the average additional cost of a credit hire to be £640. This was based on the difference between credit hire and direct hire daily rates. We then multiplied this figure by the estimated total number of credit hires in 2012. We estimated the total number of credit hires in 2012 by grossing up figures for the non-fault insurers and brokers in our sample for those providers' shares of supply—see Annex A. We noted that the resulting estimated total number of credit hires may be an underestimate because they did not take into account credit hire referrals by firms other than insurers and brokers, for example breakdown companies and repairers may also refer for credit hire.[1] Table 1 shows our resulting estimate of the total extra cost of credit over direct hire.

TABLE 1 **Estimated extra cost of credit hire**

	Our sample		*Estimated total number of credit hires '000*	*Average difference between credit and direct hire bills £*	*Estimated total difference between credit and direct hire bills £m*
	Number of credit hires '000	*Share of supply %*			
Referred by insurers	151	82	184		
Referred by brokers	76	65	117	640	193
Total			301		

Source: CC.

6. Some claims are managed by non-fault insurers which themselves provide a direct hire replacement vehicle (rather than referring for credit hire). We did not consider that such claims were likely to lead to material extra costs compared with claims where there was no separation of cost liability and cost control. This was for two reasons: first, there were few such claims because in most cases non-fault insurers referred for credit hire; second, we saw no evidence that direct hire costs were higher

[1] To obtain more comprehensive data, we sought information from fault insurers on the number of claims for which they had received subrogated bills from CMCs/CHCs and from other insurers. Unfortunately, a number of insurers were unable to provide the requested information and therefore it did not provide us with useful data on the total number of credit hires and credit repairs.

when the claim was managed by the non-fault insurer than when managed by the at-fault insurer.[2]

Repair

7. In this section we consider first repairs managed directly by non-fault insurers and then credit repairs.

Directly managed non-fault repair

8. We obtained from the non-fault insurers in our sample an estimate of the average rebate they received from approved repairers and/or of the profits they made when they owned a repairer network (see Annex B). We then computed the average mark-up for these ten insurers (see the first two columns in the table in Annex B). We then used this value (£95) as an estimate of the average repair cost increase to fault insurers. We noted that there was considerable variation in mark-up between insurers. Some insurers told us that they obtained large revenues for repairs; others that they did not retain any mark-up. However, we noted that the situation appeared to be fluid, with at least one insurer ([✂]) recently starting to retain a large mark-up, and another ([✂]) discontinuing that practice.

9. In estimating the total number of directly managed non-fault repairs, we excluded, when possible, those claims in which the same insurer was in both the at-fault and non-fault position, or in which a bilateral agreement on repairs existed between the two insurers. In these two cases we do not expect a mark-up to be retained.[3] Not all the insurers in our sample were able to identify the categories of claims to be excluded. However, the number of bilateral agreements involving repairs is small (see Appendix 6.2), so we expect the extent of overestimation to be very limited.

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[2] Typically a non-fault insurer would itself provide a direct hire replacement vehicle only when it had a bilateral agreement with the at-fault insurer or when the non-fault and at-fault insurers are the same.
[3] There may still be a small mark-up in the case of bilateral agreements, especially if the two insurers differ in size or in efficiency. In this case, an agreement may be reached in which the larger or more efficient insurer retains a mark-up.

10. Our approach is based on the implicit assumption that all non-fault repairs are made by repairers within the insurers' approved networks. In reality, some repairs are performed in body shops directly chosen by the driver. In these cases, the non-fault insurer does not get any rebates. These repairs should therefore be excluded when computing the higher cost due to the separation of cost liability and cost control. However, since we included them both here and when estimating non-fault insurers' revenues, the assumption has little impact on the net detriment, because both costs and revenues are similarly overestimated.[4]

11. The results of our estimate are shown in Table 2.[5]

TABLE 2 **The extra costs of directly managed non-fault repair**

Our sample				
Number of repairs '000	*Share of supply %*	*Average mark-up £*	*Estimated total number of repairs '000*	*Estimated total mark-up £m*
198	82	95	240	23

Source: CC.

Credit repairs

12. We estimated the average cost increase due to credit repair compared with a situation without separation of cost liability and cost control by summing two components:

(a) the estimated mark-up for repairs managed by non-fault insurers (£95)—see paragraph 8 above; and

(b) the average difference between credit repair bills and bills for non-fault repairs handled by non-fault insurers, as calculated in Appendix 6.2, paragraph 25 (£229).[6]

[4] The cost and revenue effects will offset each other unless the proportion of repairs in body shops chosen by the driver is affected by separation of cost liability and cost control or pass-through rates for costs and revenues differ (see the discussion in Appendix 6.4).
[5] We received from most of the insurers and brokers in our sample only the combined number of repairs and write-offs in 2012 and we estimated the fraction of claims in which repair took place using the split observed in our consumer survey.

The total difference is therefore approximately £324.

13. We estimated the number of credit repairs from converted referrals to CMCs by the insurers and brokers in our sample.[7] As the decision on whether to repair a car or to write it off is taken only after the referral, we used data from our consumer survey and estimated that a repair would take place in 80 per cent of the cases.[8] Table 3 summarizes our results.

TABLE 3 **The extra costs of credit repair**

	Our sample				
	Number of credit repairs '000	*Share of supply %*	*Estimated total number of credit repairs '000*	*Average difference between credit repair bills and at-fault insurers' costs £*	*Estimated total difference between credit repair bills and at-fault insurers' costs £m*
Referred by insurers	33	82	40		
Referred by brokers	30	65	46	324	28
Total			85		

Source: CC.

Write-offs

14. We followed a similar approach when estimating higher costs to fault insurers when cars are written-off. Results are summarized in Table 4, which distinguishes between write-offs handled by the non-fault insurers and write-offs handled by CMCs.

TABLE 4 **The extra costs of write-offs**

	Estimated total number of write-offs '000	*Average revenues £*	*Estimated total revenues £m*
Managed by non-fault insurers	64	53	3.4
Managed by CMCs	21	125	2.7

Source: CC.

Note: For the revenues obtained by insurers, see the third column in the table in Annex B. The average cost increase for write-offs managed by CMCs was obtained as a weighted average of the revenues for three large CMCs ([✂]).

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[6] This estimate does not control for differences in the mix of claims between credit repairs and repairs handled by non-fault insurers. However, we think differences are small, because the choice between credit and directly managed repair depends mostly on the identity of the non-fault party, ie whether it is an insurer or a broker.

[7] Consequently, the estimated number of credit repairs does not include referrals from firms other than insurers and brokers and may be an underestimate—see paragraph 5 and footnote 1.

[8] We assumed that the ratio of repairs to write-offs was the same for both insurers and CMCs.

Frictional/transactional costs and management costs

15. In addition to the cost increases computed so far, the separation of cost liability and cost control has two further implications, which have an impact on the costs borne by fault insurers:

(a) Fault insurers save on management costs. Repairs, write-offs and provisions of replacement vehicles that would be handled by the at-fault insurers without separation of liability and control are currently handled by non-fault insurers or CMCs, which bear the associated management costs. This is particularly significant for repairs and write-offs, where management costs are likely to be higher.

(b) Fault insurers incur frictional and transaction costs that would be absent without separation of liability and control. This is particularly the case for the provision of replacement vehicles, where fault insurers must verify that the hiring period is reasonable and where litigation is common.

16. We do not have data from most insurers on these costs and in our estimates we assumed that the frictional and transactional costs incurred by fault insurers (see paragraph 15*(b)*) offset the management costs saved (see paragraph 15*(a)*). We noted there was some evidence that frictional and transactional costs were larger than savings in management costs,[9] with the result that our calculation was likely to underestimate the total cost increase for fault insurers due to the separation of cost liability and cost control.

[9] One insurer said that the administration, mitigation and litigation costs of credit hire to a fault insurer were about £100 per claim and another said they were about £250 per GTA claim and £330 per non-GTA claim, and three insurers said the cost to a fault insurer of managing a credit repair was £95, £117 and £261 respectively (though this would be incurred for only a modest proportion of non-fault claims). By contrast, one insurer said its cost of managing captured non-fault repairs was £[✂] per repair, and another said it was £[✂]. We note also that the costs to a fault insurer of managing a captured non-fault claim are likely to be no more than the costs to a non-fault insurer of managing a non-fault claim, which average about £90—see Annex B. Indeed, the costs to a fault insurer of managing a captured non-fault claim are likely to be less than the costs to a non-fault insurer of managing a non-fault claim as in the former case the insurer only has to manage relationships with the repairer and replacement car provider, while in the latter case the insurer has to manage both these relationships and also has to manage the relationship with the at-fault insurer which ultimately pays the cost of the claim.

Summary of results

17. Our results on the higher costs faced by fault insurers are summarized in Table 5.

TABLE 5 **Total impact on fault insurers' costs**

	Replacement car		*Repair*		*Write-off*		
	£ per claim	*No of claims ('000)*	*£ per claim*	*No of claims ('000)*	*£ per claim*	*No of claims ('000)*	*Total cost increase*
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 offset the management costs saved with the result that our overall estimated cost increase is likely to be an underestimate—see paragraph 16. Also, since frictional and transactional are greatest for replacement cars and management costs are greatest for repairs and write-offs (see 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.

Estimating the revenue stream to non-fault insurers

18. In estimating revenues to non-fault insurers and brokers, our approach was similar to that followed for the estimation of costs.

Credit hire and credit repair

19. Non-fault insurers obtain revenue from credit hire and credit repair via referral fees. We estimated the average referral fees for credit hire and credit repair using data provided by the insurers and brokers in our sample, as reported in Table 6.

TABLE 6 **Referral fees for credit hire and credit repair**

£

	Credit hire	*Credit repair*
Insurers		
Admiral	[✂]	[✂]
Ageas	[✂]	[✂]
Aviva	[✂]	[✂]
AXA	[✂]	[✂]
CISGIL	[✂]	[✂]
DLG	[✂]	[✂]
esure	[✂]	[✂]
LV	[✂]	[✂]
RSA	[✂]	[✂]
Zurich	[✂]	[✂]
Average	339	53
Brokers		
Acromas	[✂]	[✂]
BGL	[✂]	[✂]
Endsleigh	[✂]	[✂]
Hastings	[✂]	[✂]
Swinton	[✂]	[✂]
Average	308	53

Source: Insurers and brokers.

Notes:
1. Most values are obtained by dividing the total amount of referral fees received by insurers and brokers in 2012 by the number of claims in the same year. There may be timing differences, as some claims referred in 2012 may not have been settled in the same year and vice versa. However, we believe any resulting error is small.
2. [✂]
3. [✂]
4. [✂]

20. Where claims are referred for credit hire and/or credit repair, insurers and brokers are unlikely to incur specific management costs, so we assume that their net revenue is equal to the total amount of referral fees, as shown in Tables 7 and 8.

TABLE 7 **Referral fees for credit hire**

	Estimated total number of credit hires '000	*Average referral fees £*	*Estimated total referral fees £m*
Referred by insurers	184	339	62
Referred by brokers	117	308	36
Total			98

Source: CC.

TABLE 8 **Referral fees for credit repair**

	Estimated total number of credit repairs '000	*Average referral fees £*	*Estimated total referral fees £m*
Referred by insurers	50	53	2.6
Referred by brokers	57	53	3.0
Total			5.7

Source: CC.

Directly managed non-fault repairs and write-offs

21. When a non-fault insurer manages a repair or write-off, it may earn revenue from charging the at-fault insurer more than the costs incurred. As set out in Tables 2 and 4 above, we estimated total such revenue in 2012 from repairs to be £23 million and from write-offs to be £3 million.

Net revenue stream to non-fault insurers and brokers

22. The net revenue stream to non-fault insurers and brokers comprises their revenue from referral fees plus any mark-up on directly managed repairs and write-offs, less the costs incurred in managing claims.

23. The costs to a non-fault insurer of managing a claim are principally the costs of dealing with the claimant, the repairer and the at-fault insurer. We estimated that the average cost of managing a claim in 2012 was £88—see Annex B. We considered that such management costs were likely to be incurred when a non-fault insurer managed the repair itself but not when a claim was referred for credit hire as the costs would then be borne by a CMC. We therefore estimated total costs to non-fault insurers of managing claims of £27 million.[10]

24. A summary of our estimates of the revenue stream to non-fault insurers and brokers is provided in Table 9.

[10] £88 per claim on 240,000 claims involving repairs and 64,000 claims involving write-offs.

TABLE 9 **Total impact on revenue of non-fault insurers and brokers**

	Referral fees from credit hire		*Referral fees from credit repair*		*Non-fault insurer mark-up on repair*		*Non-fault insurer mark-up on 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.

Data sources and weighting

1. We obtained data from the ten largest insurers in the market and from some of the largest brokers. However, we needed an estimate of the detriment for the entire market. In order to do so, we weighted the data based on the number of policies in force for each party in our sample. The total number of motor insurance policies in the UK is approximately 25 million,[1] of which around 35 per cent (or 8,750,000) have been sold through brokers.[2] We made the simplifying assumption that, if a policy is sold though a broker, first notification of loss would be to the broker. Given the average number of policies in force in 2012 for each of the brokers in our sample, we estimated the percentage of the brokers' market that our sample covers (see Table 1 below). We obtained estimates for the entire brokers' market by dividing the total number of claims handled or the total revenues received by the brokers in our samples by this percentage.

TABLE 1 **Weights for brokers' data**

	Number of policies in force (average in 2012) ('000s)	*Percentage of total brokers' policies (%)*
Acromas	[✂]	[✂]
BGL	[✂]	[✂]
Endsleigh	[✂]	[✂]
Hastings	[✂]	[✂]
Swinton	[✂]	[✂]
Total	5,650	65
Total for all brokers	8,750	

Source: Brokers.

2. We followed a similar approach for insurers. We collected the average numbers of policies in force in 2012 for each of them and we estimated the number of those policies which were sold through brokers. We used the number of policies not sold through brokers as the basis of our calculations, estimating the percentage of the

[1] Source: Datamonitor report on UK Private Motor Insurance 2010.
[2] ibid.

non-broker market covered by the insurers in our sample (see Table 2). Dividing the total number of claims, total cost increase or total revenues for these ten insurers by this percentage, we reached estimates for the entire non-broker market.

TABLE 2 **Weights for insurers' data**

	Number of policies in force (average in 2012) ('000s)	*Policies in force not sold through brokers ('000s)*	*Percentage of total policies (excluding brokers) (%)*
Admiral	[✂]	[✂]	[✂]
Ageas	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]
Total	18,791	13,361	82
Total for all insurers	25,000	16,250	

Source: Insurers.

3. We weighted the data based on the number of policies in force and not on the GWP because we used data from the non-fault insurers. Weighting the insurers by their GWP would mean linking the number of non-fault claims they receive to the riskiness of their customers, because premiums reflect the risk of a driver being at-fault in an accident. However, the probability that a customer will be the not-at-fault party in an accident is only weakly correlated with their risk of being at-fault. This implies that, once we control for the number of policies in force, the number of non-fault claims received by a non-fault insurer is only weakly correlated with its GWP. Therefore, the number of policies in force is likely to be a better weight.

Information obtained on repairs and write-offs from non-fault insurers

1. We obtained the information shown in the table below from non-fault insurers.

Revenues and management costs for repairs and write-offs

£

	Rebates from repairers or profits of integrated repairers	*Referral fees for paints or parts*	*Rebates or similar payments from salvage companies*	*Cost of managing a non-fault claim*
Admiral	[✂]	[✂]	[✂]	[✂]
Ageas	[✂]	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]
DLG	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]	[✂]
Average	82	14	53	88

Source: CC.

Notes:
1. When an insurer adopts multiple business models, rebates from repairers or profits of integrated repairers are computed as a weighted average of the revenues gained under the different models.
2. [✂]
3. [✂]
4. Most insurers found it very challenging to estimate the average cost of managing a non-fault claim. Moreover, they may not have interpreted the term 'management costs' in the same way. Some included overheads (which we would ideally exclude, being interested in changes in marginal costs); others may have adopted a very narrow definition. DLG did not provide an estimate at all. We therefore used a weighted average of all the other values.

Effects on consumer surplus of the separation of cost liability and cost control

1. Any change in car insurance premiums, for example associated with costs or revenue arising from the separation of cost liability and cost control, may affect demand for car insurance and consequently have effects on consumer surplus.

2. This is illustrated in Figure 1:[1]

   (a) The top chart illustrates that separation of cost liability and cost control leads to higher costs for fault insurers (rectangle X) and this increases premiums from m* to m. Associated with such higher premiums, separation of cost liability and cost control reduces demand for car insurance implying additional loss in consumer surplus for 'priced-off' drivers (triangle A).

   (b) The lower chart illustrates the effect of the offsetting revenue stream for non-fault insurers (rectangle Y), which is associated with an offsetting reduction in premiums from n* to n. Associated with such lower premiums, there is an offsetting increase in demand and further gain in consumer surplus (triangle B).

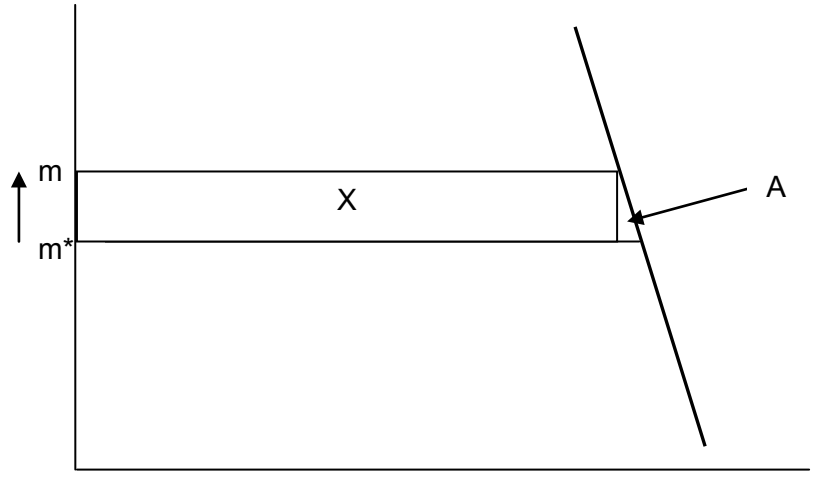
3. The consumer surplus effects in Figure 1 arise because changes in car insurance premiums are assumed to affect demand for car insurance, ie the demand curve is not vertical (demand is not completely price inelastic).

[1] The figure is intended to illustrate that the effect on premiums may be different for different drivers according to how likely they are to be at fault and non-fault in accidents. It is a simplification of reality in two important respects. First, the cost and offsetting revenue effects are shown as separate. However, in reality, they are interdependent, since all drivers have some probability both of being at fault and non-fault in accidents, albeit these probabilities differ between drivers; the result is that cost effects are likely to affect mostly the premiums of drivers with a high probability of being at fault in accidents, while revenue effects are likely to affect mostly the premiums of drivers with a high probability of being non-fault in accidents. Second, a change in the number of drivers of different types may change the number of accidents and hence the costs and revenue associated with separation of cost liability and cost control.

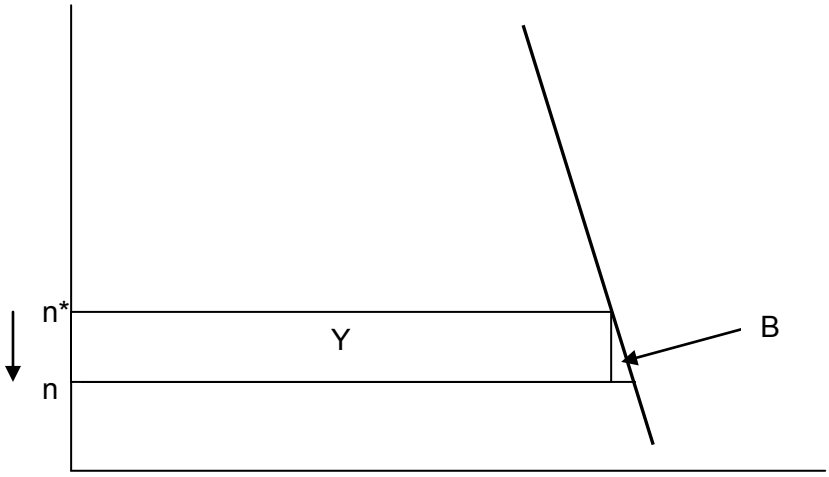
FIGURE 1

Effects on car insurance premiums of separation of cost liability and cost control

Fault insurers



Non-fault insurers



Source: CC analysis.

4. As drawn, Figure 1 assumes that the impact of the separation of cost liability and cost control on cost and on revenue is similar, and also that the slope of the demand curve is similar in both charts. Under these assumptions, the loss in consumer surplus in the top chart is offset by the gain in consumer surplus in the lower chart.

5. As set out in Section 6, however:

(a) Our assessment is that the effect of the separation of cost liability and cost control on costs (£249 million) exceeds the revenue stream (£104 million), implying area X exceeds area Y.

(b) It is plausible that demand from drivers most likely to be at fault in accidents is less price inelastic than the demand from other drivers (see Appendix 6.4).[2] Hence the slope of the demand curve in the top chart would be less steep than the slope of the demand curve in the lower chart.

Both these points would suggest that the loss in consumer surplus in the top chart (area A) would exceed the gain in consumer surplus in the lower chart (area B).

6. Nevertheless, as also noted in Appendix 6.4, demand even from drivers most likely to be at fault in accidents is likely to be price inelastic (even if not as price inelastic as demand from other drivers). Hence any consumer surplus effect is likely to be very small relative to the other effects of separation of cost liability and cost control. For example, assuming a straight line demand curve with an arc elasticity of –0.2 and total car insurance premiums of £10,000 million, the loss of consumer surplus would be no more than £{0.00001*$(249)^2$}million, that is £0.7 million.[3]

[2] Reasons for this include that the cost of car insurance for such drivers would be higher relative to the total cost of motoring and that such drivers may tend to be younger drivers with lower-than-average income for whom insuring their own car could become unaffordable.

[3] The estimated loss in consumer surplus ignores any gain associated with revenue from separation of cost liability and cost control (Y) and hence is an upper estimate of the net loss in consumer surplus.

Quality of service: replacement cars

Introduction

1. In this appendix, we summarize evidence on the quality of replacement car provision. We focus on the provision of replacement cars to non-fault drivers. We are concerned in this appendix with the overall quality of service received by claimants rather than the differences between captured and non-captured claimants.

2. We do not consider in this appendix the provision of replacement car services to fault drivers, as a fault driver's entitlement to a replacement car is based on their insurance policy. A fault driver is usually entitled to a courtesy car or, where the driver has purchased additional cover, a class of vehicle higher than a courtesy car or a like-for-like replacement car.

Outline

3. In this appendix, we examine:
   (a) non-fault drivers' views on the type of replacement car provided and the hire duration;
   (b) data on the provision of replacement car downgrades (where a non-fault driver receives a replacement car of a lower class than their own car); and
   (c) evidence from electronic call records provided to us by the ten motor insurers and nine CMCs/CHCs in our sample.

Non-fault drivers' views on the type of replacement car and the hire duration

4. Our survey of non-fault drivers investigated both the type of replacement car provided to non-fault drivers and the length of the hire duration. The results are set out in Appendix 6.5 but we summarize them here for convenience.

5. As shown in Table 1, 85 per cent of respondents to our survey who received a replacement car stated that it at least met their needs. Of these, 17 per cent said it exceeded their needs (of which 11 per cent said it far exceeded their needs). 14 per cent of respondents said that the replacement car fell short of their needs (9 per cent of respondents said that it fell slightly short of their needs and 5 per cent of respondents said that it fell well short of their needs). The main reasons why these respondents felt that the replacement car they received fell short of their needs were that it was less spacious or smaller than their own car, it was a worse make/model than their own car and/or it had a less powerful or smaller engine than their own car.

TABLE 1 **Non-fault claimants' experience of replacement cars**

	All claims
	%
How well the replacement car met respondents' needs	
Far exceeded needs	11
Somewhat exceeded needs	6
Met needs	68
Fell slightly short of needs	9
Fell well short of needs	5
base (weighted)	1,191
Length of time respondents had access to replacement car	
A longer time than needed	3
As long as needed	88
A shorter time than needed	9
base (weighted)	1,181

Source: CC motor insurance non-fault survey, questions D19 and D23.

6. As also shown in Table 1, 90 per cent of respondents to our survey who received a replacement car felt that they had access to the replacement car for at least as long as needed. Of these, 3 per cent felt that they had access to it for longer than needed, while 9 per cent of respondents felt they did not have the replacement car for long enough. The main reasons given by respondents for requiring the replacement car for longer than it was provided were that they did not have access to any other car or another suitable car during the repair and they needed time to find a car to purchase (ie where their car was written off).

7. Overall, we considered the survey results suggested that the vast majority of non-fault claimants were satisfied that the replacement car services they received following an accident met their needs (or exceeded them), both in terms of the quality of the replacement car provided and the hire duration.

Replacement car downgrades

8. A non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need for an alternative car can be established. In practice, this usually involves the provision of a 'like-for-like' replacement car for as long as is reasonably necessary, subject to the non-fault driver's duty to mitigate their loss with consideration to their need.

9. However, sometimes non-fault drivers receive a replacement car of a lower class than their own car (ie a downgrade). This can occur when:

   (a) The age of the driver's car does not justify a like-for-like replacement car. Where the driver's car is six years old or older, the GTA requires the CMC/CHC to provide a replacement car of a lower class than the driver's car (subject to the need for a replacement car at all). For example, [✂] told us that, in certain GTA car groups, where the driver's car is over ten years old, the replacement car provided was typically two vehicle groups lower than the driver's own vehicle, although the specific circumstances of a driver's need must also be considered.

   (b) The driver is encouraged to accept a lower class replacement car by the claim handler. [✂] told us that, when direct hire customers were provided with a downgrade, it was the at-fault insurer which determined the category of replacement car to be supplied to the customer.

10. Table 2 sets out the proportion of replacement car downgrades to non-fault drivers for the nine CMCs/CHCs in our sample, in relation to both credit hire and direct hire

customers in 2012. We note that the proportion of replacement car downgrades to non-fault claimants under a direct hire agreement may be inflated by the inclusion of some fault claims, as a fault driver may be entitled to a replacement car on a direct hire basis under their motor insurance policy (subject usually to them purchasing the appropriate additional cover).

TABLE 2 **Proportion of replacement car downgrades to non-fault drivers, 2012**

per cent

CMC/CHC	*Proportion of credit hire customers provided with downgrades*	*Proportion of direct hire customers provided with downgrades**
Accident Exchange	[✂]	[✂]
ACM†	[✂]	[✂]
Ai Claims Solutions	[✂]	[✂]
ClaimFast‡	[✂]	[✂]
Crash Services§	[✂]	[✂]
Enterprise	[✂]	[✂]
Helphire	[✂]	[✂]
Kindertons	[✂]	[✂]
WNS Assistance	[✂]	[✂]
Unweighted average	**15**	**30**

Source: CMCs/CHCs.

*The direct hire data may include fault claims.
†ACM does not provide credit hire or direct hire services.
‡ClaimFast does not provide direct hire services, except as an outsourced function for [✂].
§Crash Services does not record the proportion of downgrades to credit hire customers (as they are infrequent) and does not provide direct hire services.
N/A = Not applicable.

11. Table 2 shows that between [✂] and [✂] per cent of direct hire customers were downgraded and between [✂] and [✂] per cent of credit hire customers. We did not consider that the existence of downgrades indicated there was underprovision (because drivers may not have needed a like-for-like replacement and because of the difficulty of interpreting the data).

Review of motor insurer and CMC/CHC electronic call records

12. We reviewed a sample of electronic call records provided by the ten motor insurers and the nine CMCs/CHCs in our sample, in order to assess whether there was any evidence of differences in the:

(a) type of replacement car provided to the driver by a non-fault insurer or CMC/CHC and a fault insurer; and/or

(b) assessment of the driver's need for that type of car;

and therefore, any indication that insurers or CMCs/CHCs provide non-fault drivers with replacement car services that are inferior to the services to which they are legally entitled. The results are set out in Appendix 6.5.

13. Our review did not provide evidence that non-fault drivers were being underprovided with replacement cars (see Appendix 6.5). Nevertheless, we noted there was some variation in the quality and quantity of the information provided to non-fault drivers by claims handlers, irrespective of whether the claim was managed by the non-fault insurer or CMC/CHC or captured by the at-fault insurer. For example:

(a) the driver's need for a like-for-like replacement car was rarely assessed;

(b) the driver's duty to mitigate their losses was rarely explained in detail; and

(c) the complexities of credit hire, such as the driver's obligation to enter into a rental agreement and a credit agreement and to sign a mitigation statement to confirm that they have not received a suitable offer of a replacement car from the at-fault insurer, were only explained to drivers at a high level.

Quality of service: vehicle write-offs

Introduction

1. This appendix examines evidence on whether the compensation or quality of services provided to fault and/or non-fault claimants when their vehicle is a write-off is lower than that to which they are entitled (either under contract or tort law) due to a lack of alignment between their interests and those of the parties which procure services on their behalf.

2. The process relating to vehicle write-offs as a result of a road traffic accident is described in Appendix 6.3.

3. In this appendix we examine the following ways in which claimants might receive lower compensation or a lower service than that to which they are entitled following a vehicle write-off:
   (a) the pre-accident value being set too low;
   (b) a replacement vehicle being provided for an insufficient time;
   (c) a bias towards write-off rather than repair;
   (d) the estimated salvage value being set too high when a customer chooses to retain the vehicle; and
   (e) policy cancellation.

4. Some repairers told us that many of the vehicles which were written off and sold as salvage were then cheaply and badly repaired before re-entering the used car market. Although we have received some anecdotal evidence indicating that consumers of used cars are often unable to detect when a vehicle has been in an accident, or to assess the quality of the repairs which have been conducted, we judged that this was an issue relating to the supply of used cars and was not related to the

provision of motor insurance and related goods and services. Therefore we did not consider it further.

Pre-accident value

5. We found that information on the value of used vehicles is readily available to consumers, meaning that claimants are easily able to challenge a low pre-accident valuation of their vehicle.

6. Nine of the ten largest insurers told us that they gave their customers the opportunity to provide additional evidence in relation to the pre-accident value of the vehicle if they were not happy with the initial vehicle valuation and the evidence we have received indicates that customers frequently make use of this opportunity. For example:

   (a) Admiral said that its initial estimate of the write-off value was disputed in [✂] per cent of cases where it managed the write-off for its own customer, and in [✂] per cent of cases where it was a captured non-fault claim.

   (b) [✂] said that [✂].

   (c) [✂] said that [✂] per cent of its initial write-off estimates were rejected by the customer.

   (d) DLG said that [✂] per cent of its write-off decisions were disputed and [✂] per cent of its valuation disputes were unresolved.

7. Customers who are not happy with their insurer's final decision on the write-off value can complain to the Financial Ombudsman Service, except for captured non-fault drivers and non-fault drivers who claim through a CMC.[1] [✂] said that [✂].

[1] Captured non-fault claimants are not claiming under an insurance policy; CMCs are regulated by the Claims Management Regulator (within the Ministry of Justice) rather than by the FCA. For these reasons, captured non-fault claimants and customers of CMCs do not have access to the Financial Ombudsman Service.

8. We were told that:

(a) there was a limited period in which claimants could dispute the pre-accident valuation;

(b) some claimants might not want to delay the receipt of funds while a pre-accident valuation was being disputed;

(c) some customers may not be aware of the Financial Ombudsman Service; and

(d) captured non-fault customers and customers of CMCs did not have access to the Financial Ombudsman Service.

9. However, it appeared that these limitations for some consumers were unlikely to give rise to pre-accident valuations generally being too low given the ready availability of used vehicle valuations to claimants.

Estimated salvage value

10. We did not find any evidence that estimated salvage values were set too high. Indeed, the evidence we have received raises the opposite concern (see Appendix 6.3, paragraphs 25 to 28).

Replacement vehicles for insufficient time

11. We found that when at-fault customers' vehicles were written off following an accident, the provision of a replacement vehicle was often very limited. Zurich told us that it provided a replacement vehicle for up to five days; RSA told us it provided a replacement vehicle for up to three days; and esure, Admiral and Ageas Insurance said that no replacement vehicle was provided unless the customer had bought cover for a guaranteed courtesy car. RSA said that there was no contractual entitlement to a replacement vehicle on claims where the vehicle was a write-off, although, in practice, a courtesy vehicle was provided until the decision on write-off was finalized.

12. We found that guaranteed courtesy car cover typically guaranteed the provision of a replacement vehicle in the event of a vehicle write-off for a limited period, usually around 21 days.

13. We found that that there was also generally limited replacement vehicle provision for customers who were ultimately determined to be the non-fault party but whose liability had not been established at the time they needed the replacement vehicle and who therefore claimed on their own insurance.

14. We found that captured non-fault claimants and non-fault claimants managed by a CMC/CHC typically received a replacement vehicle for the entire period of the claim and for up to seven days after the funds were received from the insurer or CMC managing the claim.[2]

15. In relation to non-fault claimants whose claims were managed by their own insurers, AXA told us that its non-fault customers were allowed to retain the replacement vehicle until such time as an offer was made for the pre-accident value of the written-off vehicle; while Aviva and [✂] told us that its non-fault customers could keep the replacement vehicle for up to 14 days.

16. We asked insurers how long it typically took when they were managing the claim between agreeing the pre-accident value with the claimant and the claimant receiving the payment. RSA told us that, once settlement had been agreed with a claimant, the funds should be released within five days (in accordance with ABI requirements). [✂] said that on average it took ten days, [✂] said eight days, and DLG said 10 to 14 days. DLG said that the time frame could be influenced by factors such as delays by

[2] The duration of the replacement vehicle hire to which a claimant is entitled under tort law is assessed on the facts in the light of the circumstances of each case. However, the practice by some CMCs/CHCs of extending the period of replacement vehicle hire for up to seven days beyond the claim being settled appears to be intended to meet a customer's entitlement under tort law.

the customer in sending the required vehicle documentation or by outstanding settlement figures that needed to be provided by finance companies.

17. We also asked insurers how long it typically took between the first notification of loss and a write-off claimant receiving payment. Zurich told us that, in 2012, it took on average 37 days from the first notification of loss to send out the payment for a total loss; Ageas Insurance and esure said that in 70 per cent of cases its customer (whether fault or non-fault) would receive compensation within 21 days from the first notification of loss when their vehicle was a write-off; and Admiral told us that the average length of time between the report of the accident and payment in a vehicle write-off case was 20 days for fault claims and 19 days for non-fault claims.

18. Overall, we did not see clear evidence of underprovision against claimants' tort or contractual entitlement in regard to the length of time for which claimants had replacement cars.

Bias towards write-offs rather than repairs

19. We considered that insurers and CMCs might have an incentive to favour write-offs over repair, in particular in relation to non-fault claims, because of the referral fees that they might received from salvage companies (see Appendix 6.3, paragraphs 29 to 34.

20. We also considered that non-fault insurers and CMCs might also prefer write-offs to repairs in order to generate longer replacement vehicle hire durations and higher CHC referral fees.

21. However, we found no evidence to suggest that there is any preference for insurers or CMCs to write off rather than to repair vehicles. Rather, to the extent that salvage

values are underestimated (see Appendix 6.3, paragraphs 25 to 28), repairs may be more likely than write-offs because a low salvage value would increase the likelihood of the repair cost being less than the write-off claim cost (ie the pre-accident value minus the estimated salvage value).

22. We also found that customers generally appear to prefer repairs over write-offs. [✂] told us that customer satisfaction scores for repair claims were much higher than for write-offs and we noted that many repairers (in conjunction with insurers) offered their customers cheaper repair alternatives (eg by using recycled parts) in order to avoid a write-off.

23. Although we have found that there is a revenue opportunity for non-fault insurers and CMCs from a write-off, the amounts do not appear any greater than they would appear able to achieve through a repair (see Section 6). esure told us that the process of managing a non-fault write-off was only slightly longer than the process of managing a non-fault repair, which appeared to be likely to be due to write-offs attracting more scrutiny from insurers due to their higher average value.

24. In the case of a captured claim, the evidence we received suggested that the at-fault insurer would be unlikely to prefer a write-off over a repair as the replacement vehicle hire length was usually longer for write-offs than repairs.

25. Overall, it appears unlikely that the services received by claimants in relation to vehicle write-offs is lower than that to which they are entitled because of a preference by insurers or CMCs to write off rather than to repair a vehicle.

Policy cancellations

26. We found that some fault insurers cancel the at-fault driver's motor insurance policy when the policyholder's vehicle has been written off. Likewise, some non-fault insurers cancel the non-fault driver's policy if the claim was made under the customer's own policy.

27. However, most insurers told us either that they did not cancel policies or that the policy could be amended and remain in force if the customer replaced the vehicle within a reasonable period.

28. Overall, it does not appear to be common practice for insurers automatically to cancel policies following a write-off. Moreover, when cancellation does occur it is in accordance with the terms of the policy so any customer harm would be due to either *(a)* consumers not understanding and/or appropriately valuing the terms of their motor insurance policy at the point of purchase; or *(b)* not appreciating the implications of claiming under their own insurance or their alternative options at the time of their claim.

Quality of service: repairs

Introduction

1. In this appendix we consider the following points:

   (a) whether there are differences in how repairs are handled and performed depending on whether they are at-fault or non-fault, and if non-fault, which party manages the repair;

   (b) the strategies that at-fault and non-fault insurers and CMCs might take to reduce costs that would lead to lower repair quality;

   (c) quality standards and the monitoring of those standards; and

   (d) levels of customer satisfaction with regard to vehicle repairs.

2. We also commissioned inspections of repaired cars to see whether they had been repaired to the pre-accident standard. Appendix 7.4 summarizes the results of these inspections.

Differences in how repairs are handled and performed

Differences between at-fault and non-fault repairs

3. All of the ten largest insurers told us that their at-fault and non-fault repairs (including captured non-fault repairs) were managed in the same way and, if handled by the insurers' approved repair network, were performed in the same way. The only difference we found was that some insurers stipulated the use of non-OEM parts for some at-fault repairs and some own-insurer non-fault repairs (eg for certain parts in at-fault repairs of vehicles more than three years old), whilst on equivalent captured non-fault repairs, OEM parts were used. [✂], [✂] and [✂] each told us that they differentiated their handling of repair claims in this way. However, we found that the use of non-OEM parts in insurer-managed repairs was small (between 2 and 15 per cent of all parts used, by value).

4. All three of the large insurer-owned repairers confirmed that they repaired at-fault and non-fault vehicles in the same way.

5. Most of the largest insurers told us that they did not pay repairers differently for at-fault and non-fault repairs (eg in terms of the labour rate) and evidence from both insurer-owned and independent repairers confirmed this. The only exceptions we found were that one insurer used two different CMCs to handle separately some of its at-fault and non-fault claims and one insurer paid its repairers a higher labour rate for non-fault repairs.

6. Repairers told us that the time allowed for a repair was the same regardless of whether it was an at-fault or non-fault repair, as this was determined by the repair cost estimation system (usually Audatex). Repairers also told us that if insurers and CMCs (together referred to as 'work providers') stipulated the use of a certain brand of paint, the same brand of paint would be used in the at-fault and non-fault repairs for that work provider.

7. Overall, it appears that, for insurer-managed repairs, whether a repair was at-fault or non-fault made little difference to how it was performed.

Differences between insurer-managed repairs and credit repairs

8. We also considered whether there were any systematic differences between insurer-managed repairs and credit repairs. We asked both CMCs and insurers about the parts they used and the time they allowed for repairs.

9. We found that credit repairs were more likely than insurer-managed repairs to use OEM parts and more parts were likely to be replaced rather than repaired.[1] However, the use of non-OEM parts in insurer-managed repairs was small (see paragraph 4) so the effect from this difference is unlikely to be significant, and we did not receive evidence of a significant difference of replacement or repair depending on the work provider. We were also unable to assess whether the greater use by CMCs of OEM parts and replacement instead of repair was due to the repair being managed by a CMC rather than an insurer (as suggested to us by some repairers) or due to differences in the mix of repairs they handled (eg CMCs might handle on average more complex repairs).[2]

10. We did not find evidence of any difference in the time allowed for repairs as both insurers and CMCs told us that the time was determined by the repair cost estimation system (usually Audatex).

11. Kindertons, a CMC, told us that there was little difference between how it performed its credit repairs and how insurers performed their repairs, as both its repair network and those of insurers adhered to either PAS 125 (see paragraph 26) or manufacturer-approved guidelines.

12. Overall, it appears that there were no significant differences between credit repairs and insurer-managed repairs.

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[1] This difference is also discussed in the working paper 'ToH 1: Overcosting and overprovision of repairs'.
[2] [✂] noted that in most cases where a repair was possible, it was better to repair a part rather than replace it as replacement could mean cutting into the shell of the vehicle, while repair retains the original structural integrity of the vehicle.

Strategies that at-fault and non-fault insurers and CMCs might take to reduce costs that would lead to lower repair quality

13. We considered whether there were strategies that at-fault and non-fault insurers and CMCs might take to reduce costs that would lead to lower repair quality. We identified the following two possibilities:

(a) Work providers could require their approved repairers to conduct low-quality repairs. For example, one independent repairer told us that there was constant pressure from insurers to repair rather than to replace parts, even where replacement would provide a better repair; and another independent repairer told us that at-fault insurers often asked for cosmetic corners to be cut.

(b) Work providers could reduce the prices they pay to repairers to a level where the repairers could only afford substandard repairs. One party told us that the cost pressures on repairers could potentially lead to poor repairs.

14. In considering these possibilities we examined the relative bargaining positions of work providers and repairers. We found that repairers competed aggressively to become part of an insurers' network of approved repairers, which resulted in insurers and CMCs having a strong bargaining position relative to them. The National Association of Bodyshops (NAB) told us that repairers received about 80 per cent of their work from insurers, with the remainder made up of consumer retail work (which was increasing due to higher excesses in motor insurance policies), self-insured fleet work and credit repair work (for CMCs). NAB said that insurers typically tendered for repairers to become their preferred repairer in a defined geographic area (by post-code), and thereby established their approved networks. It told us that contracts were typically for five years but could be cancelled by the insurers at any time for many reasons. NAB said that tenders were usually awarded by reverse auction, focusing particularly on the labour rate. The result was that insurers, through their buying power, had squeezed labour rates to just £23 to £25 per hour, compared with £18 per hour in 1991 and the £45 to £50 per hour which garages could earn for

mechanical repair work. NAB said that the labour rate on credit hire repair work was generally higher (at £32 to £35 per hour), which meant that, even after paying a referral fee to a CMC to gain the work, credit repairs were usually more profitable for repairers than insurer work. NAB noted, though, that any repairer which took on more than a small amount of credit repair work was likely to be ostracized by insurers. NAB also told us that the body repair sector had been in decline for 20 years due to fewer accidents, safer cars and, more recently, reduced car usage.

15. WNS (a CMC) told us that there was some overcapacity in accident repairers, which had driven labour costs down; and Helphire (another CMC) said that it believed that the labour rates which insurers agreed with their network repairers were often so low as to be almost uneconomic for repairers.

16. We thought that the effect of such strong price competition between repairers might be a strong incentive for repairers to reduce their costs. We therefore considered whether this incentive might be offset by repairers having to satisfy the repair requirements of work providers and consumers and audits by work providers and standard monitors (eg in respect of PAS 125 accreditation) (see paragraphs 22 to 50).

17. We found also that some insurers had moved to agree repair bills with repairers on a fixed price average repair basis, whereby the repairer received the same income for each repair regardless of its costs in performing the repair. In our view, these arrangements give a greater incentive for repairers to cut corners where possible, particularly in relation to more expensive repairs. One repairer ([✂]) told us that fixed average price contracts (and also average repair cost penalty contracts) between insurers and repairers encouraged repairers to perform minimal repairs, which could compromise safety, quality and post-repair vehicle values. We also noted that *Post* (an insurance industry magazine), quoting an industry source, said that insurers were

unlikely to mandate an unsafe repair but unsafe repairs could happen if an approved repairer had to work to an average repair cost contract.[3]

18. On the other hand, both work providers and repairers told us that they were incentivized to conduct good-quality repairs. Work providers told us that they were keen to keep customer complaints low in order to retain customers and to build a good industry reputation for claims management; and repairers told us that they were keen to remain an approved repairer for work providers, not to have to carry out expensive post-repair remedial work, to sustain their reputations and not to lose any accreditations they may have (eg PAS 125 (see paragraphs 26 and 27) or manufacturer accreditations).

Quality standards in vehicle repair

19. We considered the quality of vehicle repairs, the standards applied by work providers and the monitoring of those standards. This section summarizes the evidence relating to insurers, brokers, CMCs and repairers and the evidence on the quality of materials used and the time taken for repairs; and we also set out the main relevant responses to our working paper on underprovision of repairs.

Insurers

20. We found that there were several ways in which insurers could seek to ensure that vehicle repairs were performed to certain standards:

(a) requiring repairers to have PAS 125 accreditation, or at least requiring them to aspire to this accreditation (in order to receive this accreditation, repairers need to demonstrate that they carry out vehicle repairs using certain processes and procedures);

[3] *Post* magazine, 28 February 2013.

(b) specifying the repair methods to be followed (eg manufacturer methods or Thatcham methods);

(c) monitoring repairers through audits (eg by the insurer's engineers), and setting performance targets (eg low levels of customer complaints, adherence to time-lines for repairs, etc);

(d) monitoring customer complaints and gathering evidence through customer surveys; and

(e) requiring repairers to provide a warranty for their repairs, putting the financial burden on repairers for any post-repair remedial work.

21. We considered each of these measures in turn.

PAS 125 and manufacturer approvals

22. [✂] of the ten largest insurers told us that they required repairers to have PAS 125 accreditation (or at least to be working towards this accreditation). [✂] insurers ([✂], [✂] and [✂]) said that they did not require their approved repairers to have PAS 125 accreditation.

23. The PAS 125 standard is owned and maintained by the British Standards Institution (BSI) as the National Standards Body of the UK.[4] BSI told us that PAS 125 was a technical specification, which provided repairers with the requirements for processes and procedures related to the safe repair of accident-damaged vehicles. PAS 125 details minimum requirements for:

(a) competent personnel;

(b) appropriate and well-maintained equipment;

(c) suitable repair methods; and

[4] www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/.

(d) the quality of repair materials.

24. In order to gain and retain PAS 125 accreditation, repairers must adhere to the PAS 125 repair standards and have this adherence certified by a provider of accreditation services. BSI is the largest provider of PAS 125 accreditation, in the form of a Kitemark (a mark owned by BSI), but other providers also offer accreditation. Once BSI has certified a provider, it will undertake two unannounced audits per year (or one for repairers with fewer than seven employees). Annex A provides more details on the PAS 125 standard and PAS 125 accreditation.

25. Some repairers have manufacturer approvals (either in addition to or instead of being PAS 125 accredited). When repairers have such approvals, they are required to adhere to the repair methods and standards set out in their agreements with the manufacturers (eg to use OEM parts and the manufacturers' recommended paint brand, and to comply with the manufacturers' warranty requirements). Aviva told us that it required some repairers to have manufacturer approvals in order to handle prestige vehicle repairs (eg Mercedes, BMW and Porsche). AXA GB told us that its approved repairers had to have either PAS 125 accreditation (or be working towards it) or equivalent manufacturer approvals. It said that manufacturer approvals would override PAS 125. The Institute of Automotive Engineer Assessors (IAEA) told us that, in practice, the requirements of PAS 125 and manufacturer approvals were quite similar.

Specifying repair methods

26. We found that PAS 125 and manufacturer approvals required repairers to adhere to certain vehicle repair methods. These methods were usually either Thatcham methods or manufacturer methods.

27. Thatcham is a not-for-profit organization, established in 1969. It is independently operated with a board of directors drawn from around 30 insurer members which fund its work. We were told that its main purpose was 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.

28. Manufacturer methods are similar to Thatcham methods in that they also prescribe the way in which each damaged part of a vehicle should be repaired.

29. We found that while some insurers did not stipulate that repairers needed to have PAS 125 accreditation or manufacturer approvals, they might specify in their repair contracts that repairers had to adhere to Thatcham or manufacturer methods. For example, Admiral told us that it required its approved repairers to adhere to manufacturer methods.

Monitoring the quality of repairs

30. All of the ten largest insurers told us that they monitored the performance of their approved repairers. For example, [✂] told us that it audited the compliance of its approved repairers with PAS 125. It said that in 2012 it performed more than [✂] audits and found that [✂] per cent of repairs were PAS 125 compliant. We found that most of the insurers carried out checks on a sample of vehicles at their repairers' premises (in addition to investigating specific customer complaints).

31. We asked the insurers and some independent repairers what the insurers' repair quality checks involved and we found that these checks were typically part of repair audits, the main purpose of which was to control costs rather than to ensure a high

quality of vehicle repairs. Annex B sets out the extent of monitoring by each of the ten largest insurers. [✂] 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. [✂] told us that while post-repair audits focused on the accuracy of the assessment and invoice, it considered that repair quality was also at the forefront of its controls. [✂] told us that quality control was very much seen as a function that needed to be carried by the repairer and it required its network to implement quality processes adhering to PAS 125.

32. We found that insurers which referred non-fault repairs to CMCs monitored the performance of their preferred CMCs, and in some cases also monitored the quality of some of the repairs those CMCs handled (eg [✂] told us that it monitored the quality of repairs undertaken by its CMC partner).

Monitoring customer complaints and customer surveys

33. Eight out of the ten largest insurers told us that they monitored the level of customer complaints in order to identify any systematic problems with repair quality. Six of the ten insurers told us that they conducted customer surveys.

Requiring repairers to provide warranties

34. The insurers told us that they usually provided claimants with a warranty for vehicle repairs undertaken by their approved repairers. However, insurers usually required their approved repairers to carry out any rectification work in relation to repairs they had performed at their 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).

Brokers

35. All of the brokers in our sample told us that they either passed claimants to the underwriting insurer or to a CMC to manage vehicle repairs. None of the brokers which provided us with information had its own approved repairer network.

36. The brokers told us that they monitored the performance of the CMCs to which they referred claimants (eg in terms of call answer times, complaints, customer survey data) but they did not monitor the quality of repair services.

CMCs

37. Four of the seven CMCs in our sample told us that the majority or all of the repairers in their networks were PAS 125 accredited and/or had manufacturer approvals.

38. Five[5] out of the seven CMCs from which we gathered evidence said that they monitored the performance of their approved repairers. Four CMCs told us that they carried out audits of repairers, of which one told us that it did this solely through the appointment of independent engineers. Five CMCs told us that they reviewed or investigated complaints received and two CMCs told us that they solicited customer feedback on repairs.

39. Three CMCs told us that they provided a five-year warranty on the repairs they managed and another CMC said that it provided a three-year warranty.

Repairers

Insurer-owned repairers

40. Two of the three insurer-owned repairers in our sample either had PAS 125 accreditation or were working towards it, and one of them told us that it also had manu-

[5] [✂], [✂], [✂], [✂] and [✂], but not [✂] and [✂] which rely solely on independent engineers.

facturer approvals. Two of these repairers told us that they had service level agreements with their related insurers, against which each insurer monitored the repairer's performance, including through audits and inspections. Two of the three repairers told us that their related insurer also conducted customer surveys. All three of the repairers said that they were required to use Thatcham or manufacturers' methods. One of the repairers said that it was required to comply with manufacturers' warranty requirements.

41. UKAARC told us that its related insurer (DLG) was keen to ensure that costs were kept to a minimum, but not at the expense of repair quality or the safety of the customer. Solus (owned by Aviva) told us that it had never been asked by a work provider to carry out a repair in a way which would compromise vehicle safety and it would not allow this to occur.

Independent repairers

42. Nine independent repairers told us about the standards to which they conducted repairs and how they were monitored ([✂], [✂], [✂], [✂], [✂], [✂], [✂], [✂] and [✂]). Six of these repairers ([✂], [✂], [✂], [✂], [✂] and [✂]) told us that they performed repairs to PAS 125 or manufacturer standards, while two of the remaining three repairers ([✂] and [✂]) told us that all repairs were carried out in accordance with Thatcham methods.

43. Evidence from these nine repairers indicated that their repairs were monitored mostly through PAS 125 audits (for PAS 125 accredited repairers), internal checks and/or checks by work providers. They told us the following:

(a) [✂] said that the quality of its work was checked through PAS 125 biannual unannounced audits, manufacturer annual audits at approved sites, an internal audit performed quarterly, and work provider audits on an ad hoc basis.

(b) [✂] said that its repairs were all subject to internal quality control checks before the vehicle was released to the customer, and all its sites were subject to periodic audits by BSI to maintain their PAS 125 accreditation.

(c) [✂] said that it was audited by some insurers, but mainly for cost control purposes. [✂] said that insurers did very little monitoring of repairers' repair quality, giving, as an example, [✂].[6] However, [✂] added that the BSI PAS 125 Kitemark was a rigorous standard, with twice-yearly unannounced audits which drilled down into the repair process. [✂] said that credit repair work providers (CMCs) did not do any quality control checks.

(d) [✂] said that the quality of all the repairs it performed was checked internally, regardless of the source of work, through stage checks and final checks by a quality control manager. In addition, insurance repairs were subject to external audits by the insurers. [✂] said that BSI also audited its repair sites.

(e) [✂] said that the primary methods used by work providers to ensure repair quality were insisting on PAS 125 accreditation and analysing customer feedback.

(f) [✂] said that the quality of repair was self-monitored by repairers and that insurers and CMCs only became involved if there was a customer complaint.

(g) [✂] said that an insurer only found out about a repairer cutting corners if a customer complained. It said that the audits conducted by insurers were primarily desktop exercises which went through a repairer's files rather than involving any physical inspections looking at quality. [✂] said that [✂] did some inspections, but these were announced in advance and focused on an analysis of paperwork.[7] [✂] said that inspections by work providers did not focus on the quality of the vehicle repair and sometimes the inspectors were not even engineers.

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[6] [✂] told us that it did not agree with this view.
[7] [✂] told us that it did not agree with this view.

(h) [✂] said that the majority of insurers rarely came out to check on repair quality. It said that insurer audits were more about whether the assessment and invoice reflected the work carried out rather than the quality of the repair.

(i) National Accident Repair Group, a marketing association for repairers, said that larger insurers (eg [✂] and [✂]) had teams of engineers which audited repairs, though these audits were mainly either in relation to customer complaints or to check that a repair was done in line with the repair estimate.

44. [✂], [✂] and [✂] said that there was no difference in the monitoring of repairs between at-fault and non-fault repairs.

45. Five repairers ([✂], [✂], [✂], [✂] and [✂]) told us categorically that they would not compromise vehicle safety in any of their repairs. [✂] explained that it would not perform repairs which compromised vehicle safety, even if the alternative involved additional costs, as this would impact on its brand and reputation. Nevertheless, some repairers told us about poor-quality repairs, as follows:

(a) [✂] said that there was corner cutting by repairers and that this was increasing, as insurers wanted cars repaired as cheaply as possible. [✂] 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). [✂] said that some insurance repairs could compromise vehicle safety, but that the evidence on this was inconclusive.

(b) [✂] said that at-fault insurers sometimes asked for cosmetic corners to be cut.

(c) [✂] 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.

(d) [✂] said that insurers accepted repair proposals by repairers despite them failing to address properly all accident-related damage.

Summary of standards (insurers, brokers, CMCs and repairers)

46. The information provided by insurers, CMCs and repairers indicated that insurers often require repairers to adhere to an independently-audited PAS 125 quality standard and/or to manufacturer standards. [✂] 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.

47. Submissions from some parties suggest that insurers' incentives are to keep their costs as low as possible which can lead to 'corner cutting' in the repairs they approve. We also found that the main purpose of repair audits was to control costs rather than to ensure high-quality repair standards and noted that a number of repairers suggested that there was limited monitoring of actual repair quality.

Quality of materials used and time taken for repair

48. The principal inputs in vehicle repairs are labour, parts and paint. We considered whether the choice of parts and paint used in vehicle repairs and the time allowed for a repair gave rise to quality concerns.

Quality of parts

49. There are four types of parts used in vehicle repairs: OEM parts, original equipment supplier (OES) parts, non-OEM parts and recycled parts. OEM parts are manufactured and branded by the original vehicle manufacturer; OES parts are the same as OEM parts (ie produced by the same parts manufacturer), but are not branded by the

original vehicle manufacturer; non-OEM parts are copies of the OEM part; and recycled parts are parts taken from other vehicles (eg written-off vehicles).

50. We received no evidence of quality concerns in relation to OEM and OES parts. We were told that recycled parts were rarely used in insurer-funded post-accident vehicle repairs.

Non-OEM parts

51. Several repairers raised concerns about non-OEM parts, which mainly related to difficulties in fitting the parts. For example:

(a) [✂] said that the labour time required to fit non-OEM parts in order to achieve an acceptable fit and finish was typically longer than for OEM parts and hence resulted in a higher labour cost.

(b) [✂] said that non-OEM parts were cheaper than OEM parts but were often of poorer quality. [✂] said that this meant that additional time was required to make them fit, though insurers did not pay for this additional time.

(c) [✂] said that using non-OEM parts could reduce the cost of the repair, but could cause fitting difficulties.

52. 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) [✂] 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) [✂] said that panels which fitted poorly could reduce a car's value by 5 per cent.

(c) [✂] also said that the use of non-OEM parts could impact the resale price of a repaired vehicle.

53. We were also told that the use of non-OEM parts invalidated manufacturer warranties for repaired vehicles, though no party provided any evidence to indicate that this was a material issue in practice.

54. Both insurers and repairers told us that non-OEM parts were mainly used for the standardized, non-safety critical parts of a vehicle. For example:

(a) Aviva said that safety-related parts were often not available from non-OEM suppliers, due to the high development cost of these parts.

(b) QRC (owned by RSA) said that non-OEM parts accounted for [✂] per cent of the total number of parts it purchased, and were generally used only for non-structural elements of repair work.

(c) [✂]

55. We noted that insurers do not typically use non-OEM parts in repairs of vehicles less than three years old.

Repair or replace

56. Several repairers told us that there was often a tension between them and insurers in how a repair should be conducted and, in particular, whether a damaged part should be repaired or replaced. Repairers said that, due to low labour rates, insurers sometimes sought repair work to be performed when, in the repairer's opinion, the part needed to be replaced.

Quality of paint

57. We received no evidence to indicate that there was systematic use of poor-quality paint in vehicle repairs. We found that several insurers and some CMCs required repairers to use specific premium paint brands but we received no evidence to suggest that the use of non-premium paint brands had any detrimental effect on the quality of vehicle repairs. For example, [✂] told us that the quality of repair was more influenced by the preparation and application of the paint than by the paint itself.

Time taken for repairs

58. We found no evidence to suggest any difference in the time taken for repairs between at-fault and non-fault repairs or between insurer-managed and CMC-managed repairs. In all such repairs, we found that the allocated time was usually determined by the repair cost estimation system (ie usually Audatex).

Responses to our working paper

59. In response to our working paper on underprovision of repairs,[8] insurers said they did not consider that poor-quality repairs were a common practice in the market. Both insurers and CMCs said that they invested to provide high-quality repair services, as follows:

(a) Aviva said it endorsed PAS 125 standards with two unannounced BSI audits a year and also engaged in progress audit at intervals through the year. Aviva said that the combination of PAS 125 standards and each insurer's own audit functions mitigated the risk of lower repair quality.

(b) Zurich required its repairers to adhere to either PAS 125 or manufacturer-approved guidelines. Zurich said that it did not encourage or accept 'corner cutting' and it was not aware of this practice in the market as a whole.

[8] CC working paper, 'Theory of harm 2: Underprovision of repairs', 1 August 2013.

(c) DLG explained that its ability to own its repair network and control its approved network of third party repairers allowed it to provide customers with a high-quality repair service whilst ensuring that DLG could control costs. DLG was confident that any criticism in relation to DLG-managed repairs would be entirely un-justified.

(d) Zurich stated that its approved repairer network was required to provide a warranty for repairs. Similarly, RSA noted that repairs conducted by RSA's authorized repair network came with a lifetime guarantee. Allianz said that the fact that long-term warranties were provided on repairs performed via insurer networks was indicative that they had faith in the quality and longevity of the work.

(e) Allianz considered that substandard cosmetic repairs would be immediately obvious and would result in complaints, rework and significant frictional costs and cause reputational damage. Substandard mechanical repairs might result in an unsafe vehicle being returned to the road with potentially unthinkable conse-quences. Either way, the risks of systematically and consciously providing substandard repairs does not make any real sense from an insurer's perspective.

(f) Kindertons said that prior to being invited to join its network a repairer must have either PAS 125 or manufacturer approval. In addition, Kindertons said it monitored the repair process to ensure it was appropriate and efficient.

(g) WNS considered unsubstantiated the comment that CMCs did not monitor the quality of repairs.

60. In a response to our working paper on the vehicle inspection study, a manager of fleet repairs [✂] told us that, [✂] in 2012, it managed the post-accident repair of [more than 3,000] fleet vehicles. It said that the repairs [✂] went through rigorous de-fleet inspection. It said that, of those vehicles, [less than 10 per cent] failed. It added

that the main reasons for failure were cosmetic issues; some also failed due to the use of non-OEM parts [✂]; but no vehicle failed for a mechanical issue. [✂]

Customer complaints and satisfaction with vehicle repairs

61. We reviewed survey evidence relating to customers' satisfaction with the quality of vehicle repairs. We looked at the results of our survey of non-fault claimants and the GIMRA motor claims satisfaction survey, particularly with regard to at-fault claims. We also considered customer complaint evidence provided by some insurers, CMCs and repairers.

Our non-fault survey

62. The results of our survey of non-fault claimants in relation to repairs are set out in Appendix 6.5 and summarized in Section 7.

63. The vast majority of respondents to our survey (around 93 per cent) felt that all of their accident damage was repaired. Of the remaining 7 per cent, 31 respondents said that repairs were not carried out properly, and 14 respondents said that minor or cosmetic issues were not fixed.

64. Around 88 per cent of respondents felt that their vehicle was in the same or a better condition after the accident repair compared with its pre-accident condition. 10 per cent said that it was in a slightly worse condition, and 1 per cent said that it was in a much worse condition.

65. Overall, 89 per cent of respondents said that they were satisfied with the repair service, and only 7 per cent said that they were dissatisfied.

GIMRA survey

66. On behalf of a significant number of GIMRA members (about 14 insurers), research firm Harris Interactive contacts on a quarterly basis around 2,500 motor insurance claimants whose claims have settled in the last three months. Claimants must have had comprehensive cover and have claimed on their own insurance. Also, the claim must have been settled within six months of it being lodged, and no serious personal injury must have been involved.

67. We reviewed GIMRA's survey from December 2012, covering claims settled in the period of April to September 2012.

68. The results of the GIMRA survey indicated that the quality of repair was the second most important aspect of the claims-handling experience for claimants (with communication throughout the claim being the most important). The third most important aspect was the time taken from FNOL to the car being returned post-repair (or a cheque being received if the vehicle was written off).

69. [✂] per cent of respondents to the GIMRA survey said that the quality of the repair they received was at least of 'good' quality, ie it restored the vehicle to at least its pre-accident condition. [✂] per cent of respondents said that the repair left their vehicle in a better condition than prior to the accident.[9]

70. The GIMRA survey also found that only [✂] per cent of respondents were dissatisfied with the overall repair experience, compared with [✂] per cent who were either very satisfied or extremely satisfied.

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[9] It appears to us that the number of respondents stating that the repair left their vehicle in a better condition is high in comparison with both our survey results (see Appendix 6.5) and the results of surveys carried out by insurers and repairers. We note that the GIMRA survey appears to be mainly focused on the quality of customer communication and the customer service experience and it might be that responses to this question have to some extent reflected the overall customer service experience in relation to the repair.

71. [✂] per cent of respondents to the GIMRA survey made a complaint about their claim and, of these complaints, [✂] per cent were because of poor-quality repairs. This means that complaints in relation to the quality of repairs were made in less than [✂] per cent of claims.[10]

Customer complaint evidence from insurers, CMCs and repairers

72. The CMCs in our sample all told us that they received low levels of complaints in relation to vehicle repairs. For example, Quindell told us that it only received complaints in 1 per cent of its repair claims; and WNS said that it received justified complaints in relation to the quality of repairs performed by its approved repairer network in less than 1 per cent of cases. Claimfast said that it received complaints in less than 1 per cent of the claims it managed. Helphire, Enterprise and Accident Exchange all told us that they received complaints in less than 1 per cent of the claims they managed. [✂] said that it received complaints in 4 per cent of the claims it managed; and [✂] indicated that it received complaints in 6 per cent of the repairs it had managed in 2012.

73. Repairers also told us that complaint rates were low and generally in a range of between 1 and 5 per cent of repairs. For example:

(a) QRC (owned by RSA) said that it received complaints in 0.6 per cent of its repairs; and RSA told us that it received FSA-reportable complaints in 0.2 per cent of repairs carried out by QRC.

(b) Solus (owned by Aviva) said that it received complaints via Aviva in less than 1 per cent of its repairs (though we note that such complaints might only arise if earlier attempts to resolve issues have failed).

[10] Not all claims had an associated vehicle repair (the base for the total percentage of complaints was 2,512 claims, of which 1,708 claims involved a vehicle repair).

(c) UKAARC (owned by DLG) said that DLG had received complaints in [✂] per cent of its repairs in 2012 and, of these complaints, around half were in relation to [✂]. UKAARC said that, in addition, some customers complained directly to UKAARC.

(d) Independent repairers (eg [✂]) also told us that complaint rates were low. [✂] said that it received complaints in 3 per cent of its repairs; [✂] said 5 per cent of repairs, [✂] said 1 to 2 per cent of repairs and [✂] said in less than 1 per cent of repairs.

74. [✂], [✂] and [✂] provided data which showed that they received reportable customer complaints (ie complaints which have not been resolved by close of business on the business day following receipt of the complaint) with respect to between 1 and 4 per cent of total motor claims 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 motor insurance claims (although not all motor claims involve repairs, eg vehicle write-offs).

75. We noted that a 2 per cent complaint rate relating to repairs would equate to approximately 40,000 complaints a year (assuming a basis of around 2 million accident repairs paid for by insurers a year).

76. Repairers told us that customer complaints related mostly to:

(a) [✂];

(b) the scope of the service received (eg the exclusion of damage caused by wear and tear, additional work not being authorized, the courtesy car being insufficient, or the excess being higher than expected);

(c) delays in booking the repairs; and

(d) a lack of communication with the customer.

PAS 125 and the BSI Kitemark

1. In order to become part of an insurer's approved repair network, repairers are often required either to be PAS 125 accredited (eg through achieving the Kitemark) or to be working towards achieving this accreditation.

2. BSI owns both PAS 125 and the Kitemark. However, these are two different products, which we discuss in turn.[1]

PAS 125

3. BSI told us that, about six years ago, it was commissioned by Thatcham, insurers and insurance-related parties to set up PAS 125 as a publicly available standard. This was undertaken by BSI's standard-setting division, being the National Standards Body of the UK, which also maintains and updates this standard. QRC told us that the PAS 125 scheme was UKAS-accredited.[2]

4. BSI told us that the PAS 125 standard prescribed the process by which a vehicle was repaired, including requiring competent personnel, quality repair materials, appropriate and well-maintained equipment, and appropriate repair methods.

5. Aviva told us that the materials requirements in the original PAS 125 2009 standard were that parts, components and fasteners should be either:

   (a) OEM branded, with the vehicle manufacturer's trademark;

   (b) OEM branded, with the component manufacturer's trademark and independently certified under a recognized conformity certification scheme;

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[1] www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/.

[2] The United Kingdom Accreditation Service (UKAS) is the sole national accreditation body recognized by the Government to assess, against internationally agreed standards, organizations that provide certification, testing, inspection and calibration services: www.ukas.com/about-accreditation/about-ukas/.

(c) of matching quality independently certified under a recognized conformity certification scheme; or

(d) an alternative part (including recycled parts) of a non-safety-related status, supplied under a work provider agreement.

The BSI (PAS 125) Kitemark

6. BSI told us that, separately to setting the PAS 125 standard, it also provided certification of the PAS 125 standard in the form of a Kitemark pursuant to BSI's PAS 125 Kitemark scheme. The scheme was owned and operated by a separate company falling within the BSI group. BSI operated a strict observance of separation of business function between the National Standards Body and the company that promoted the Kitemark, enforced through law by agreement with HM Government. The Kitemark service was provided through BSI's certification division. BSI said that it competed for this work against other certifying organizations. It said that around 860 repairers had the BSI (PAS 125) Kitemark and this level had remained stable for the last three years.

7. BSI said that the difference between PAS 125 and the associated Kitemark was that the Kitemark was awarded to those repairers who were PAS 125 certified by BSI. BSI said that, to achieve this certification, PAS 125 had to be followed according to a scheme set down by BSI. BSI told us that other certifiers had their own schemes, but it believed that its scheme and its audit process were among the most robust.[3] For example, PAS 125 would set out that a repair needed to be done using appropriate methods but BSI would check what those appropriate methods were, eg to follow either manufacturer methods or Thatcham methods. BSI said that a repairer could follow PAS 125 without being certified by anyone.

[3] BSI said that its certification was the strongest, in part because, unlike the other certifiers, BSI did unannounced audits of repairers.

8. BSI said that, to be certified by BSI (and awarded the Kitemark), repairers were audited twice yearly through unannounced audits. In a typical audit, BSI would work back through a sample of repair records to check that the appropriate processes had been followed, and look at some vehicles (which included vehicles in various stages in the repair and finished vehicles). BSI said that quality was not audited directly (as the auditors were not usually engineers) but if the processes were being followed properly, repair quality should be maintained. BSI also said it checked that finished vehicles had been repaired as per the work instructions to identify whether vehicles had been repaired to the pre-damaged condition. BSI added that, during an audit, it would look at the complaints register of the repairer. It said that it would also consider any complaints it received directly from customers relating to vehicle repairs conducted by a BSI-certified repairer, though the number of such complaints was very low.

9. BSI said that, in addition, it performed in-depth audits of repairers, in particular where the initial audit indicated possible weaknesses. BSI said that non-compliance with the Kitemark requirements was usually higher when a repairer was seeking to gain the Kitemark for the first time rather than when it had become accustomed to the required processes.

10. We were told that if BSI found non-compliance through its audit processes, an agreed action plan was put in place, which was managed within certain service level agreement time frames. If the repairer did not respond with an acceptable action plan or keep to it, non-conformities could result in the repairer being suspended or, in more serious cases, removed from the Kitemark.

Insurer PAS 125 accreditation requirements and monitoring

1. [✂]

TABLE 1 **PAS 125 accreditation requirements and monitoring of repair quality**

Insurer	*PAS 125 accreditation requirements*	*Monitoring of repair quality through physical vehicle inspection*
Admiral	None	Yes ([✂])
Ageas	[✂]	[✂]
Aviva	Requires BSI PAS 125 Kitemark	Repairer audits have an element of repair quality checks of vehicles
AXA GB	[✂]	[✂]
AXA NI	None	Repair quality audits on vehicles since 2013. Prior to 2013, repair quality checks only done in response to customer complaints
CISGIL	Requires PAS 125 accreditation	Repairer audits have an element of repair quality checks on vehicles
DLG	Requires BSI PAS 125 Kitemark	Repairer audits include repair quality checks on vehicles
esure	Requires BSI PAS 125 Kitemark	Repairer audits include repair quality checks on vehicles
LV	[✂]	[✂]
RSA	Required PAS 125 accreditation (or be working towards it)	Repair quality checks on vehicles included in repairer audits, but quality is not an audit focus (but rather cost and process control)
Zurich	[✂]	[✂]

Source: Insurers.

2. The section below gives more details of the monitoring activity carried out by the ten insurers in relation to repair quality.

Admiral

3. [✂][1]

4. [✂]

Ageas

5. Ageas told us that its monitoring activity included the examination of repair charges, repair duration and any customer expression of dissatisfaction by root cause.

[1] [✂]

Ageas

5. Ageas told us that its monitoring activity included the examination of repair charges, repair duration and any customer expression of dissatisfaction by root cause.

6. The evidence gathered suggests that Ageas performed repair quality checks on vehicles, including in response to customer complaints. All other audits were related to the costs and the process of the repair service.

Aviva

7. Aviva told us that [✂].

8. [✂]

AXA GB

9. AXA GB told us that its engineering audit team carried out desktop audits each month. If these audits identified any discrepancies, the auditors considered conducting a physical 'on site' audit. This would involve looking at the paperwork trail and also the pre- and post-repair inspection on vehicles that were on site at the time of these visits.

10. The AXA Engineering Audit Team also carried out 'cold audit visits', where an engineer would turn up unannounced and would audit all paperwork relating to the claim repair being undertaken. These audits would also involve a review of Audatex Assessments in respect of vehicles on site that could be in various states of repair. This allowed checking the correct procedures and methodology had taken place.

AXA NI

11. AXA Ireland told us that since 2013[2] it had restructured its engineer team, piloted the use of an audit process within the Audatex system, revised processes and invested in additional resources to enable on-site audits to take place at various stages of repair. In December 2013, AXA Ireland said that it was completing regular monthly audits at both approved and non-approved garages.

12. AXA Ireland also told us that in cases where insured or third party customers had concerns over the quality of repairs, AXA Ireland would carry out a post-repair inspection. If the concern was legitimate, any faults would be rectified to the customer's satisfaction.

CISGIL

13. CISGIL told us that its audit team performed inspection on PAS 125 process requirements and the quality of the end-to-end repair process. Case-level audits were completed on site at the repairer's premises and also through retrospective and post-repair audits. Monitoring of the quality of vehicle repairs was carried out in all cases by:

    (a) engineering technical teams, which were responsible for assessing the repair methodology and any technical requirements in the repair process;

    (b) the repair audit team, which was a field-based audit team responsible for the on-site case-level audits and the management of any complaints; and

    (c) motor repair account managers, which were dedicated Approved Repairer account managers and responsible for supplier performance and acting on any feedback.

[2] AXA Ireland initially completed very basic audits of the approved garage network post-repair, primarily focusing on paperwork rather than physical inspection of a repaired vehicle.

14. Where a customer raised a complaint about the quality of the repairs, CISGIL's field-based repair audit team would physically inspect the vehicle. This not only included the aspect of the repair about which CISGIL's customer has raised dissatisfaction, but would involve a complete review of the repair in line with the expectations of the PAS 125 accreditation. Occasionally, CISGIL could also instruct an independent contractor to inspect vehicles where customers made complaints following repairs within CISGIL's Approved Repairer network.

DLG

15. DLG told us that it physically checked a sample of overall repair volume within its own UKAARCs, third party repairers and non-approved repairers on an ad hoc basis and monitored compliance against DLG's requirements. In addition, DLG used customer satisfaction and complaints data to identify any quality issues with its UKAARCs and third party repairers.

16. DLG told us that quality checks were undertaken in the following ways:

(a) Selective auditing in the form of post-repair inspections was carried out by DLG's engineering function at the end of the repair process. These checks used the original estimate as the basis of the audit.

(b) The engineer audited the method of repair to check that the original estimate was adhered to, and that all parts that had been estimated for had been fitted and that the overall quality met DLG's standards. These audits were carried out in a live environment (ie at the repair centres).

(c) Quality repair inspections were carried out to the same standard as the post-repair inspections during the repair process. These audits were carried out in a live environment.

(d) 'Tier A plus' audits were carried out remotely by DLG's engineers using imaging. These audits assessed repair methodology against the visible severity of the

damage. If these highlighted potential issues, then physical audits (as above) would be instructed.

17. [✂]

esure

18. esure told us that it undertook remote and physical audits via a team of external regional repair controllers. This entailed regular site visits with all repairers whereby reviews were carried out across all aspects of the customer journey and repair process. Quality, service and cost were central to all aspects of the audits completed.

19. [✂]

LV

20. [✂]

21. [✂]

RSA

22. RSA told us that the main way for RSAAR to review the quality of the repair performed was through 'open file review' audits conducted by the RSA Audit/ Performance Team on a needs basis. Audits were carried out at body shops by the performance team across the RSAAR network of repairers covering all aspects of the repair journey from customer communication to invoice validation and adherence to quality requirements. Although every audit included an audit of quality and the factors which may affect the quality of repairs, RSA noted that audits did not measure the quality of repair alone.

23. Quality processes within the body shops were the responsibility of the supplier. A work pack must be completed for each repair job which detailed the internal quality control checks for each stage of the repair process. RSAAR conducted reviews of complaints with each main supplier to identify areas of poor performance and implement any agreed countermeasures. Each supplier was required to give a lifetime guarantee for the repair.

24. In addition to the 'open file review' audits, RSAAR also sought to ensure the quality of repairs by mainly contracting only with body shops which operated quality standards based on PAS 125, Thatcham approved methodology, manufacturer approvals and networks.

Zurich

25. Zurich told us that field engineers were responsible for conducting post-repair inspections on a sample of vehicles repaired by the approved repairers. Post-repair inspections were undertaken when repairs were concluded and before vehicles were returned to the policyholder. Any defects or faults to the vehicle noted by the engineer at the time of the post-repair inspection were brought to the attention of a senior representative at the approved repairer location. These defects or faults were rectified prior to the vehicle being returned to the policyholder.

26. Zurich also told us that its auditors selected [✂] per cent of the monthly volume of repairs or a minimum of [✂] estimated repairs to inspect, either physically or by image, to ensure the process undertaken was in accordance with manufacturers' or Thatcham recommendations and the costs of the repair services were legitimate.

Responses to vehicle inspection working paper

1. The following main points were made about the MSXI results (Annex):

   (a) Sample sizes were small.

   (b) The sample was not designed to be random.

   (c) The sample was not representative in terms of the geographical spread.

   (d) The sample was not representative as to vehicle age.

   (e) Subjective inspection and no tolerance in determining whether a repair was or was not of sufficient quality.

   (f) Differences between the results and respondents' own experience.

   (g) Discrepancies between the results and the non-fault survey, and GIMRA survey.

2. Each of these is detailed below.

Sample sizes were small

3. Respondents said that the sample size appeared to be too small to allow for any reliable conclusions to be drawn in relation to systematic failings in repair standards.

The sample was not designed to be random

4. One insurer (esure) told us that there would be the potential for biases to have been introduced as a result of the process by which the sample was selected, and in particular that this might have biased the sample towards customers who were concerned about the quality of their repair. esure also pointed out that 11 per cent of the respondents to the non-fault survey found that their vehicle was in worse condition after the accident, but 20 per cent of the respondents who were selected for the MSXI report thought that their vehicle was in a worse condition.

5. Respondents noted that the vehicles had been selected based on MSXI's ability to assess pre-accident conditions, through prioritization of vehicles according to the type and scale of repairs and from documentation provided. Respondents said that repairs requiring more documentation were likely to be more complex and, therefore, more likely not to be returned in pre-accident condition (esure, ABI).

Sample not representative in terms of the geographical spread

6. CISGIL and AXA said that the sample showed a relative high number of repairs undertaken in Scotland and Wales and a disproportionately low number of repairs undertaken in London and Midlands. The National Association of Bodyshops noted that the West Midlands region had one of the highest concentrations of insurer-owned bodyshops in the country and yet was not represented in the MSXI study.

Sample not representative as to vehicle age

7. Respondents said that the sample may not be of representative vehicle age. [✂] and CISGIL told us that older vehicles were often more difficult to repair, particularly when a paint match was required.

Subjective inspection and no tolerance in determining whether a repair was or was not of sufficient quality

8. The ABI and esure said that the binary classification of 'pre-accident condition' and 'non-pre-accident condition' was less sophisticated than the standard industry approach. In the ABI's view it was inevitable that those vehicles deemed to be in non-pre-accident condition included vehicles where the difference between the actual repair and the pre-accident condition were minimal. The ABI said that other methods, for instance, classification on the basis of percentage 'deviation', would have been significantly more useful.

9. CISGIL and [✂] said that any assessment relying on opinion would inevitably involve a degree of subjectivity and, by the nature of the exercise, MSXI inspectors could not observe the actual pre-accident condition of the vehicles they inspected. CISGIL noted that no account appeared to have been taken of permitted repair tolerance in determining whether a repair was or was not of sufficient quality. For example, it said that, in the case of replacement panels being fitted, a tolerance for panel alignment was permitted by Thatcham. CISGIL said that it was not clear that these tolerances were taken into account by MSXI's inspectors, such that they might have found that a repair did not return a vehicle to its pre-accident condition (due to very slight panel misalignment) even if the repair was undertaken in accordance with the relevant repair specifications (including as to tolerances for panel alignment) and was therefore a 'commercially acceptable repair' in accordance with standards laid down by the motor industry, its trade bodies and insurers.

10. esure said its own inspections showed that [✂] of the repairs it inspected in 2012 were found to be outside its deviation limit. [✂] said it did not necessarily agree with the finding that all the defects found would have a negative effect on the car valuation should the customer decide, in the future, to sell. It said that its complaints data and market research had not highlighted any issues with valuations of vehicles following repairs.

11. AXA and the ABI said that it was not clear what safeguards were taken to ensure that any damaged sustained in the time between the completion of repairs and the MSXI inspection were disregarded.

Differences between MSXI results and respondents' own experience

12. esure told us that when it conducted inspections with a larger sample size ([✂]), the proportion of substandard repairs was significantly lower. In each of the last three

years, it said it had found that vehicles were not in a good post-repair condition in [✂] of the tests conducted. Helphire said that the level of rectification work shown in the MSXI results was very high and compared with a very low level (0.28 per cent) in its approved network.

Discrepancies between the MSXI results and the non-fault survey

13. CISGIL and esure noted that the results in the MSXI study were inconsistent with information from consumers including our non-fault survey. CISGIL pointed out that our non-fault survey showed that nine out of ten customers were satisfied with the repairs and that its own survey showed that [✂] per cent of CISGIL's customers considered that their vehicles were in the same or better condition than pre-accident.

14. Several insurers referred to their low level of complaints about repairs. The ABI noted the conclusions ran contrary to the findings in the GIMRA survey of 2,500 motor insurance claimants, which found that the number of claimants stating that the repair left their vehicle in a better condition was high in comparison with both the IFF survey and the results of surveys carried out by insurers and repairs.

Post-repair inspection programme

Background to vehicle inspection study

1. On 29 April 2013, as part of its investigation into private motor insurance, the Competition Commission (CC) issued a notice stating its intention to engage a company to carry out inspections of vehicles which have been involved in accidents and repaired. Party comments were received and noted. These primarily related to one party's involvement in the market (conflict of interest).

2. The three companies specified were sent a written brief and two written proposals for the inspection programme were received. Following internal review MSXI was chosen to carry out the inspection programme and a planning meeting with CC staff and MSXI was held on 14th June.

3. The intention of the vehicle assessments was to inform Theory of Harm 2, that of harm arising from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services.

4. The objectives of the assessments were stated as 'To look into the quality of repairs which have been made on vehicles which have been involved in accidents by comparing the pre-accident condition (evidenced through documentation) with the post-accident condition (evidenced through physical inspection) of the parts of the vehicle which have been repaired; and to identify any parts damaged through the accident which have not been repaired'.

5. Many Industry sources had suggested that quality standards in the repair industry had improved greatly over the years and evidence of poor standards of repair was unlikely. This thinking helped determine the sample specification (captured claims) as we felt if there was any incentive to under-repair this group were more likely to reflect this

6. The sample of vehicles to be inspected was derived from respondents to the Not at Fault consumer survey which was conducted by IFF Research. Within the total sample we had established a group of vehicle owners:

    a) not at fault for the incident in which their vehicle was damaged

    b) whose claim was handled by the other driver's insurer (ie the claim was captured)

    c) had said they were prepared to have their vehicle inspected by a professional assessor

Background to vehicle inspection study

7. A database of contact details of these owners together with repair estimate documentation were provided to MSXI for review. They were briefed to assess the information and set up inspections of 100 vehicles where they felt they would be able to assess pre-post repair most effectively, based on the type and scale of repairs undertaken. Only MSXI central office were able to access the complete database and they were not told that the contacts selected were captured claims.

8. Over the period from the end of June to the middle of August, 77 vehicles were inspected.

9. The findings from this initial stage of inspections were contrary to expectations, with nearly half of the vehicles being assessed as returned in non PAC.

10. As a result of this finding, a subsequent stage of inspections was commissioned. The process was identical to stage 1, but stage 2 contacts were those whose claim had been handled by their own insurer. Again MSXI were unaware of this specification until after the completion of the study.

11. Acquiring repair estimates was more problematic for stage 2 than stage 1 and so the database was smaller and only 27 vehicles were inspected. The inspections were carried out between mid-September and mid-October.

12. On receipt of the stage 2 findings it was clear that the proportion of vehicles which were not returned in PAC was similar to stage 1. The data was therefore amalgamated in order to produce a bigger base.

13. A further variable, whether or not the vehicle owner had claimed they were responsible for the final decision on who would carry out the repairs on the vehicle, was also available for analysis of the vehicle inspection data. This analysis is shown after the MSXI findings.

14. The results of the MSXI inspections need to be interpreted with care. The achieved sample may not be representative of the general population of non-fault claims because:

   i. The sample was small - only 104 cars were inspected in total.

   ii. The sample was not designed to be random; captured claims were over-represented and MSXI was instructed to select cases where they felt they would be able to assess pre versus post repair most effectively.

   iii. The 104 vehicles inspected are a sub-sample of the 13,000 in the original Non-fault Survey; and there may be sample selection biases in each of the several steps leading to the 104 inspections.

All responses to this working paper to be received by 21 November 2013. Non-confidential survey results from MSXI follow:

msx INTERNATIONAL

Post Repair Inspection Programme for the Competition Commission

msx INTERNATIONAL

Contents

Background

Consultant Profile

Team Leader

- Collision Industry Expert
- 46 years of experience in the automotive industry including:

3 industry experts

- Combined 40 + year experience in Collision Aftermarket
- Skills include
  - Motor vehicle technician
  - Estimator
  - Proprietor Body Shop / Workshop
  - Manager – Fleet Preparation and Collision Centre

Experts in consulting on:

- Whether work on repair estimate was actually completed
- Quality of panel fitment
- Quality of panels
- Paintwork – finish
- General quality of workmanship
- Anomalies pertaining to the repair
- Assessment of the pre-accident condition with the post-accident condition of the vehicle
- Identifying parts damaged through the accident which have not been repaired

Data Supplied by Insurance Companies

Insurance companies provided case data for each repair.
This generally included:

- Repair estimate
- Images
- Case History

Selection of Inspections

Selection of Inspections

The project manager used all the data available, with guidance from the Competition Commission, to decide on which repairs to select for inspection. MSXI was not made aware, before the completion of its inspection, of the difference between stage 1 (claim handled by At fault insurer) and stage 2 (claim handled by Non fault insurer) vehicles.

In order to provide the best cross section of available repairs to inspect, the data was prioritised according to;

- Type and scale of repairs undertaken,
- MSXI's opinion of the ability to assess the repairs (pre-post completion) from documentation provided.

Only MSXI central office had access to the complete database.

Once the databse had been prioritised, the inspection team then methodically contacted the owners in their regions in order to secure an inspection date.

Inspectors Reporting Sheet

Vehicle Inspection Sheet

Inspectors Name	
Reference number	
Date of Inspection	
County of Inspection	
Bodyshop Used	
Insured	
Vehicle Rectified?	
Registration Number	
Vehicle Make	
Model	
Type	
Mileage	
Paint Type	
Colour	
Ramp Used	
Area of Damage	
Severity of Damage	

The Owner agrees to the inspection of their vehicle and understands that the information is collected for the sole purpose of assisting the market investigation carried out by the Competition Commission in the private motor insurance industry, and is not to be used in any other context. The Inspection is opinion based, limited by the circumstances and location of the vehicle and does not constitute a full engineering report.	Owners Signature

Overview

Inspectors Opinion: Was the vehicle returned to the customer in pre accident condition Y/N?	

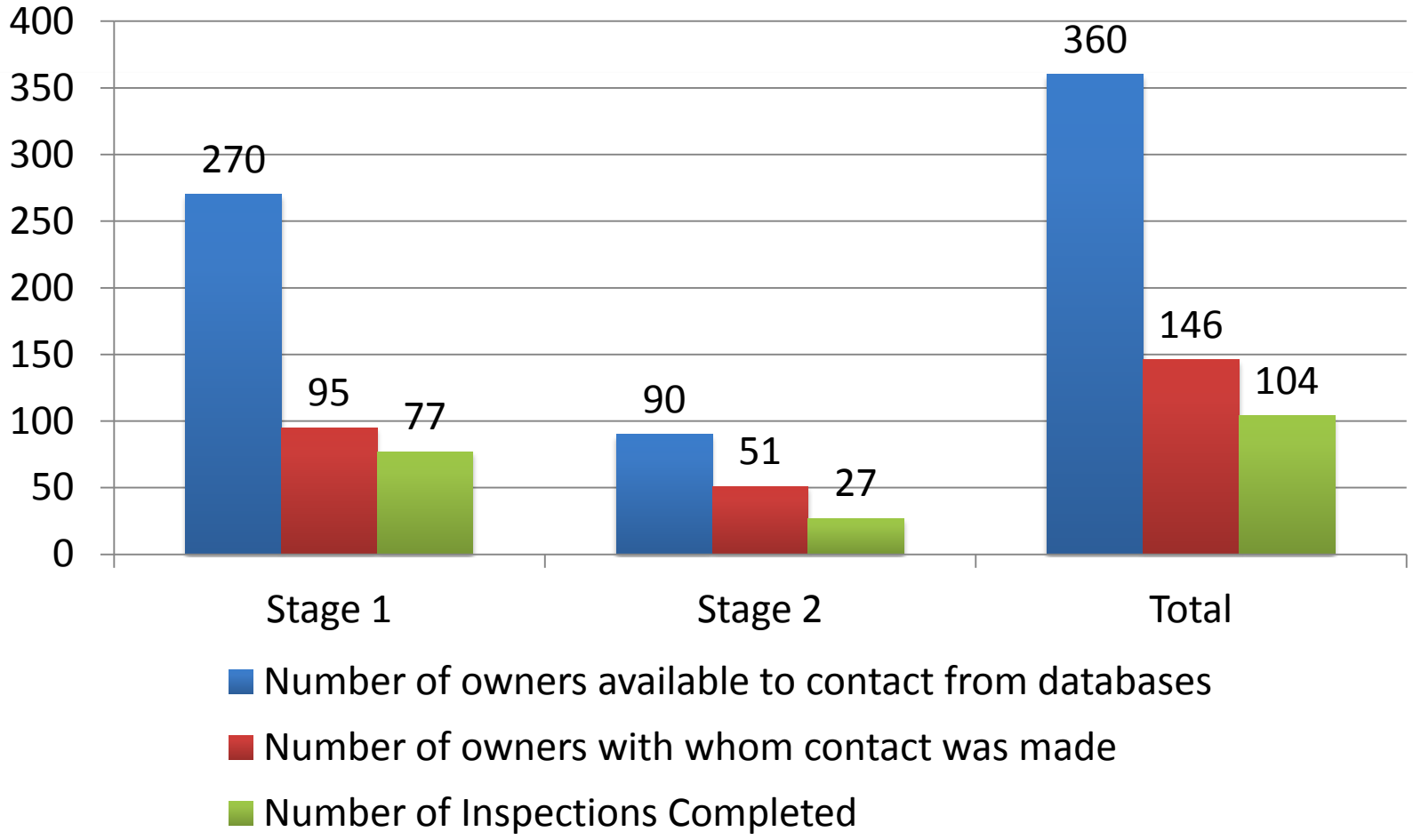
Reasons and supporting evidence for Vehicle not being considered repaired to pre accident condition – include Images

Reasons	
1	
2	
3	
4	
5	
6	
7	

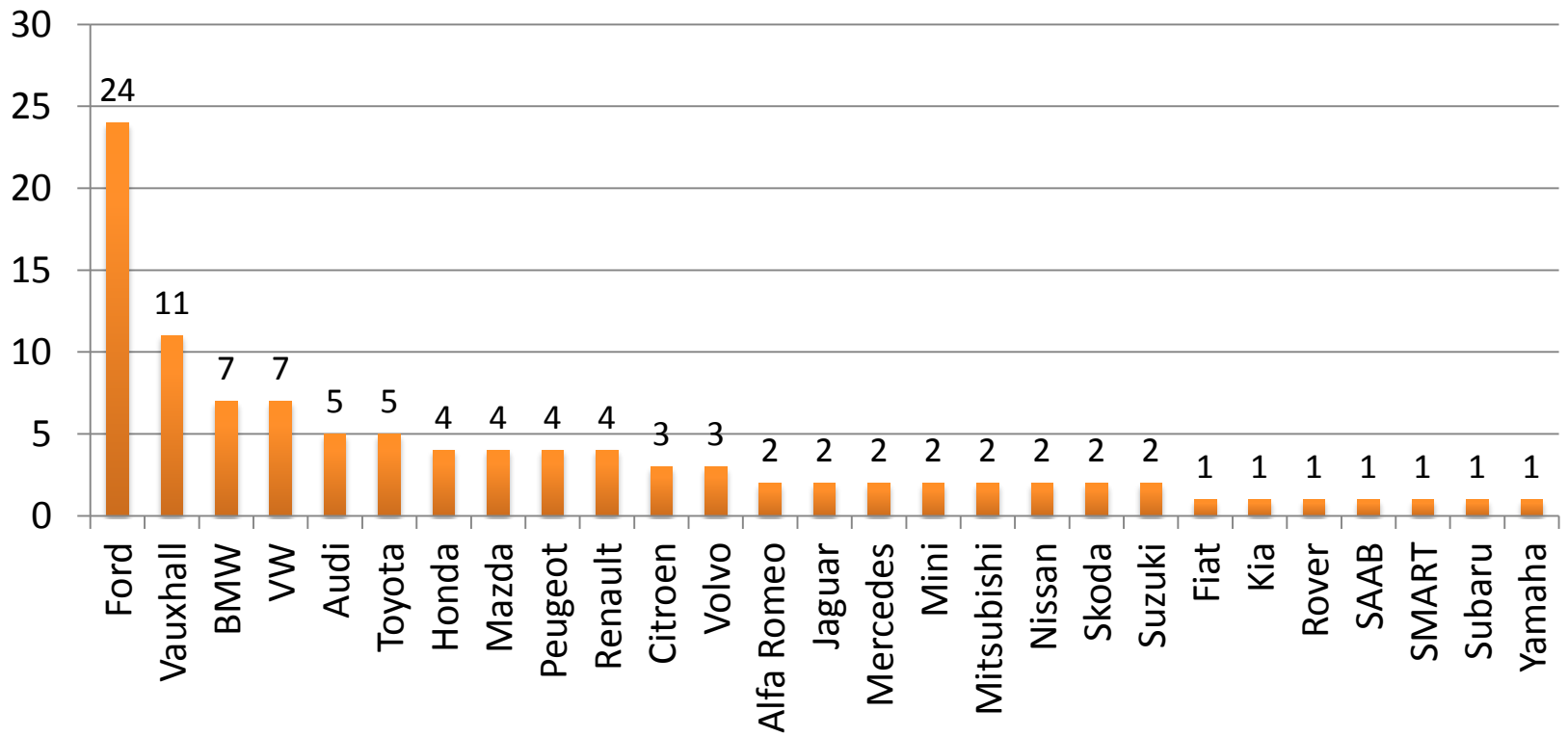
Results

Range of Inspections

Summary of Inspections Made



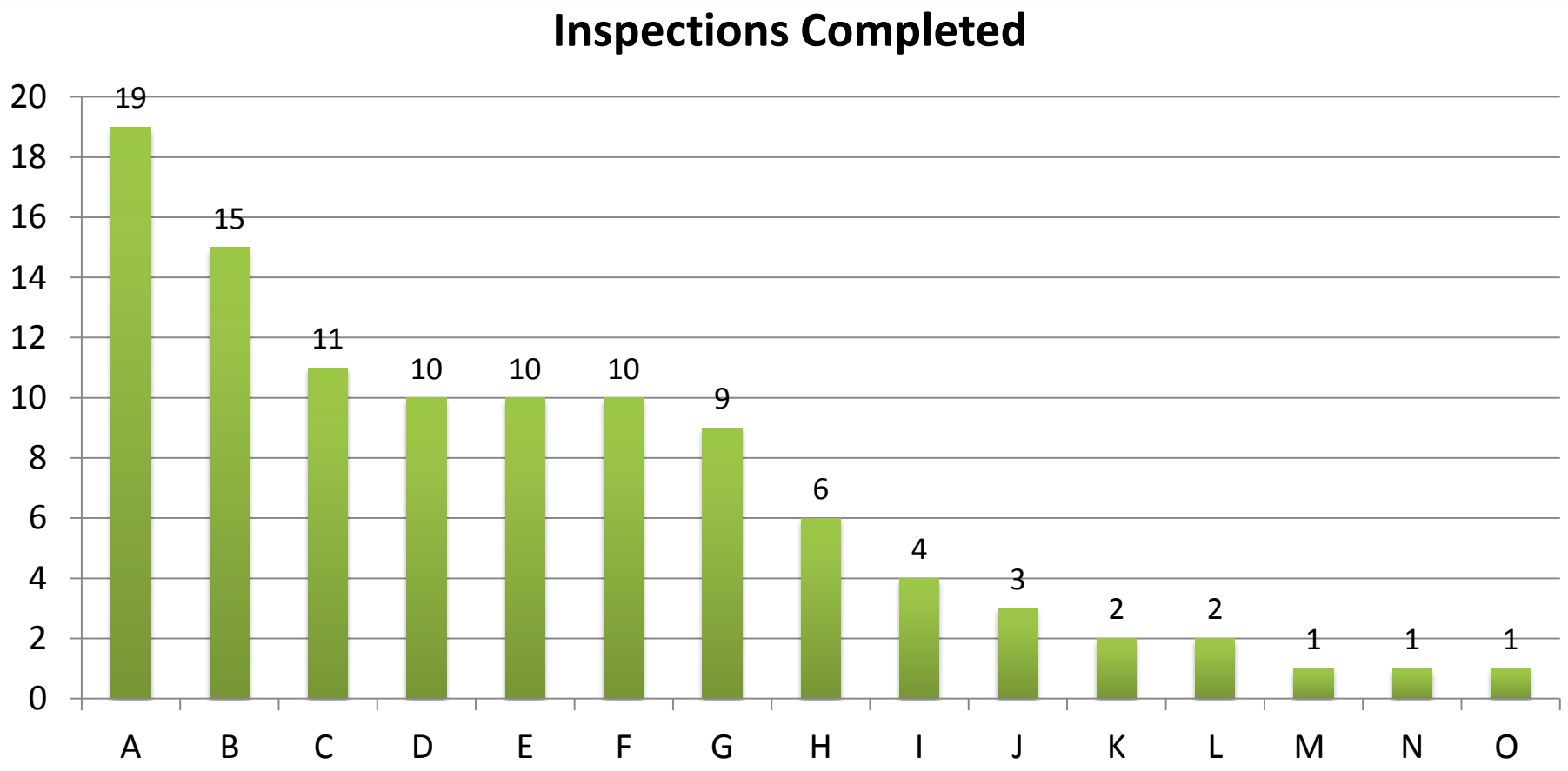
Range of Inspections Across Vehicle Models



The 104 inspections completed in stage 1 and stage 2 have provided a fair cross section of vehicle brands

Range of Inspections

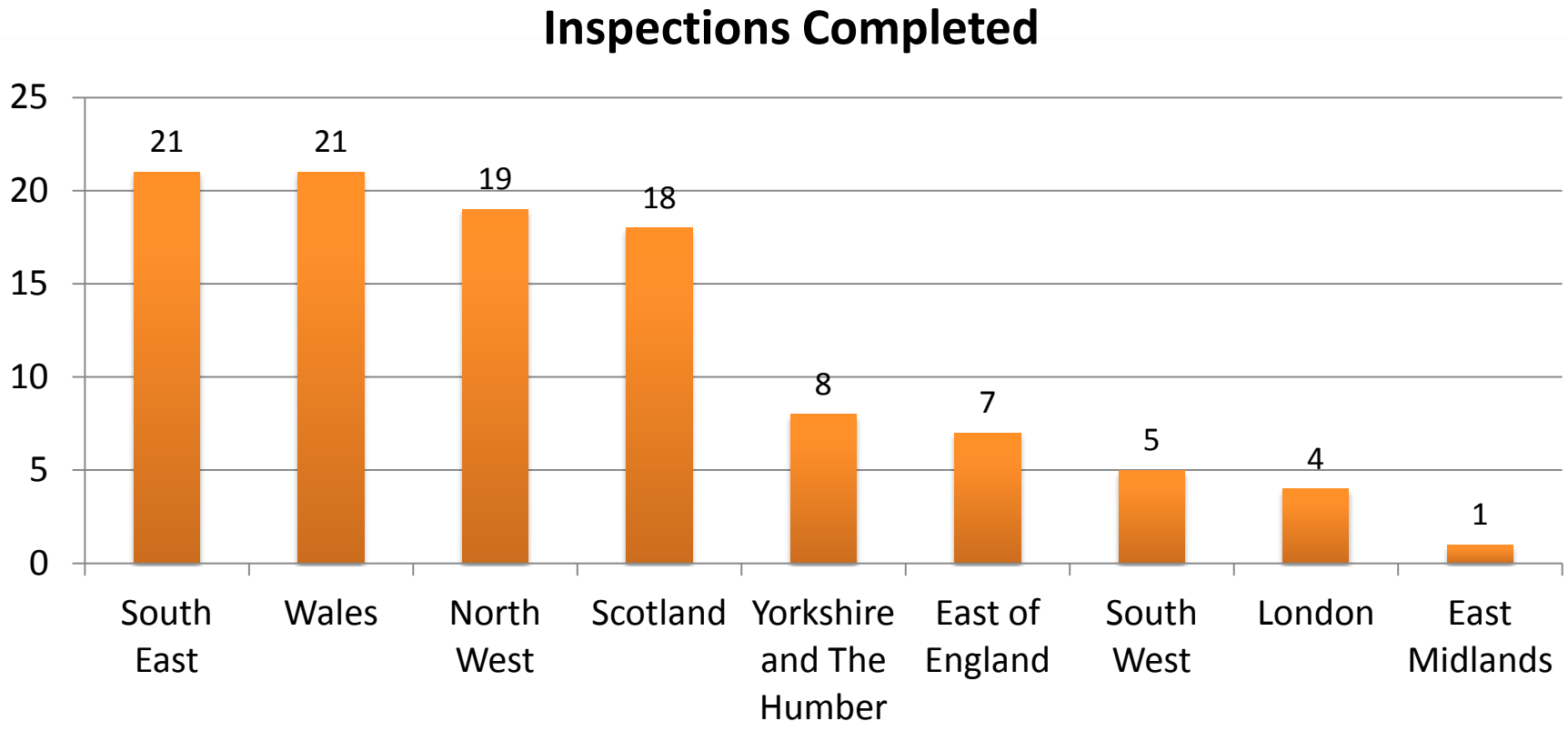
Across insurance providers



The 104 inspections completed in stage 1 and stage 2 have provided a fair cross section of providers of car insurance

Range of Inspections

Geographic Spread



The Inspections completed have provided a good National geographic spread, although availability of owners meant that some regions are not represented - N.I. proved particularly problematic in coordinating owners availability.

Return Condition

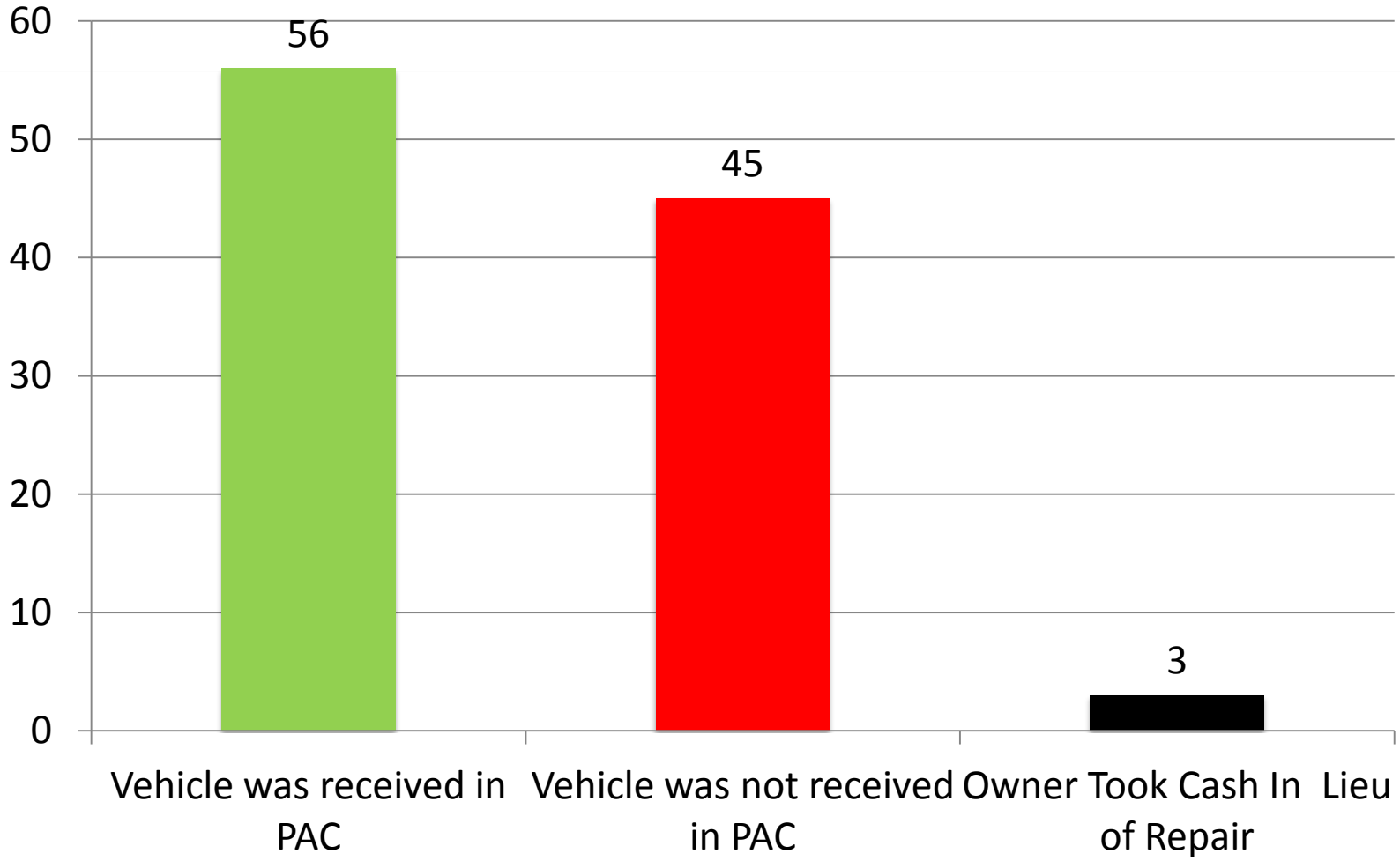
The investigation was carried out in two stages.

Stage 1 related to repairs managed by a fault insurer.

Stage 2 related to repairs managed by non-fault insurers or brokers.

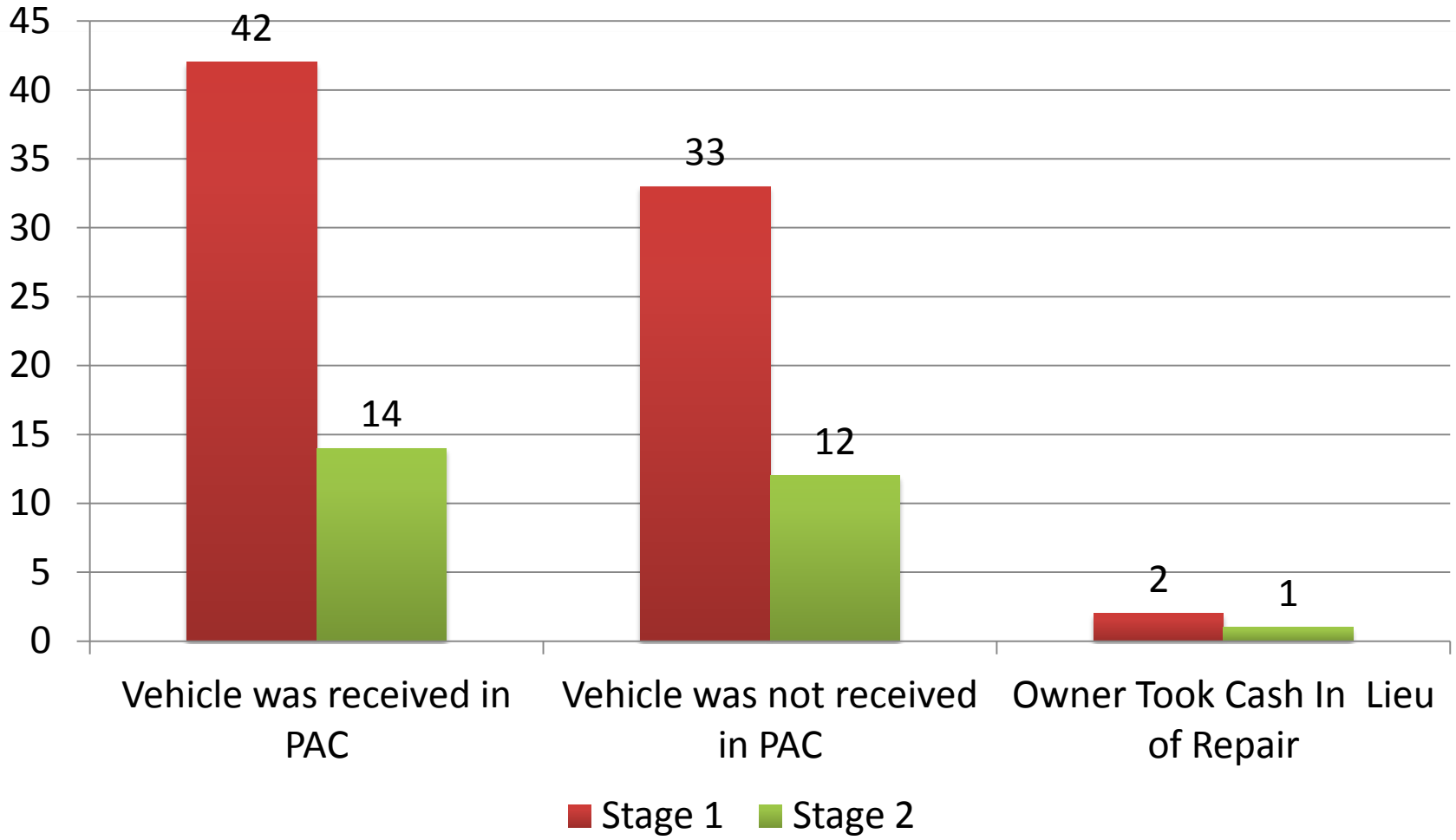
Inspectors View:

Was the Vehicle Returned in pre-accident Condition (PAC)?



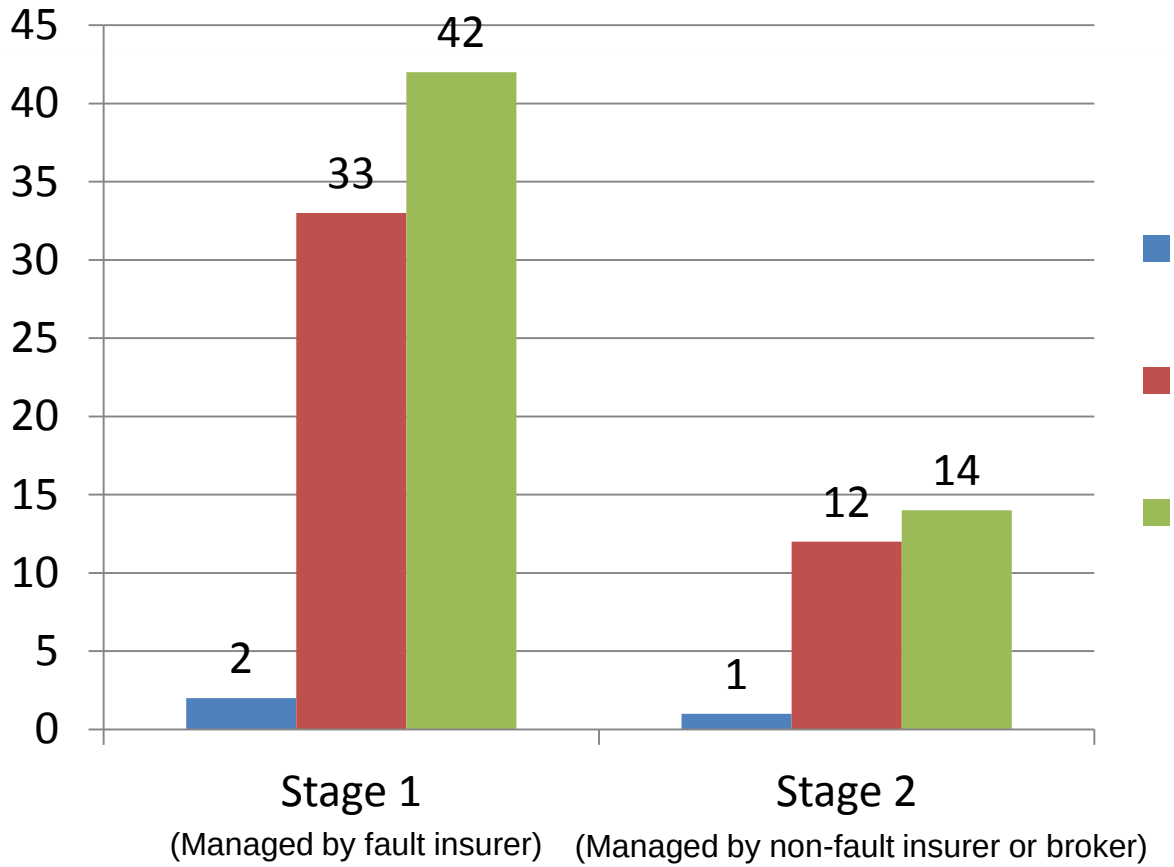
Return Condition - Inspectors View:

Was the Vehicle Returned in PAC by Stage?



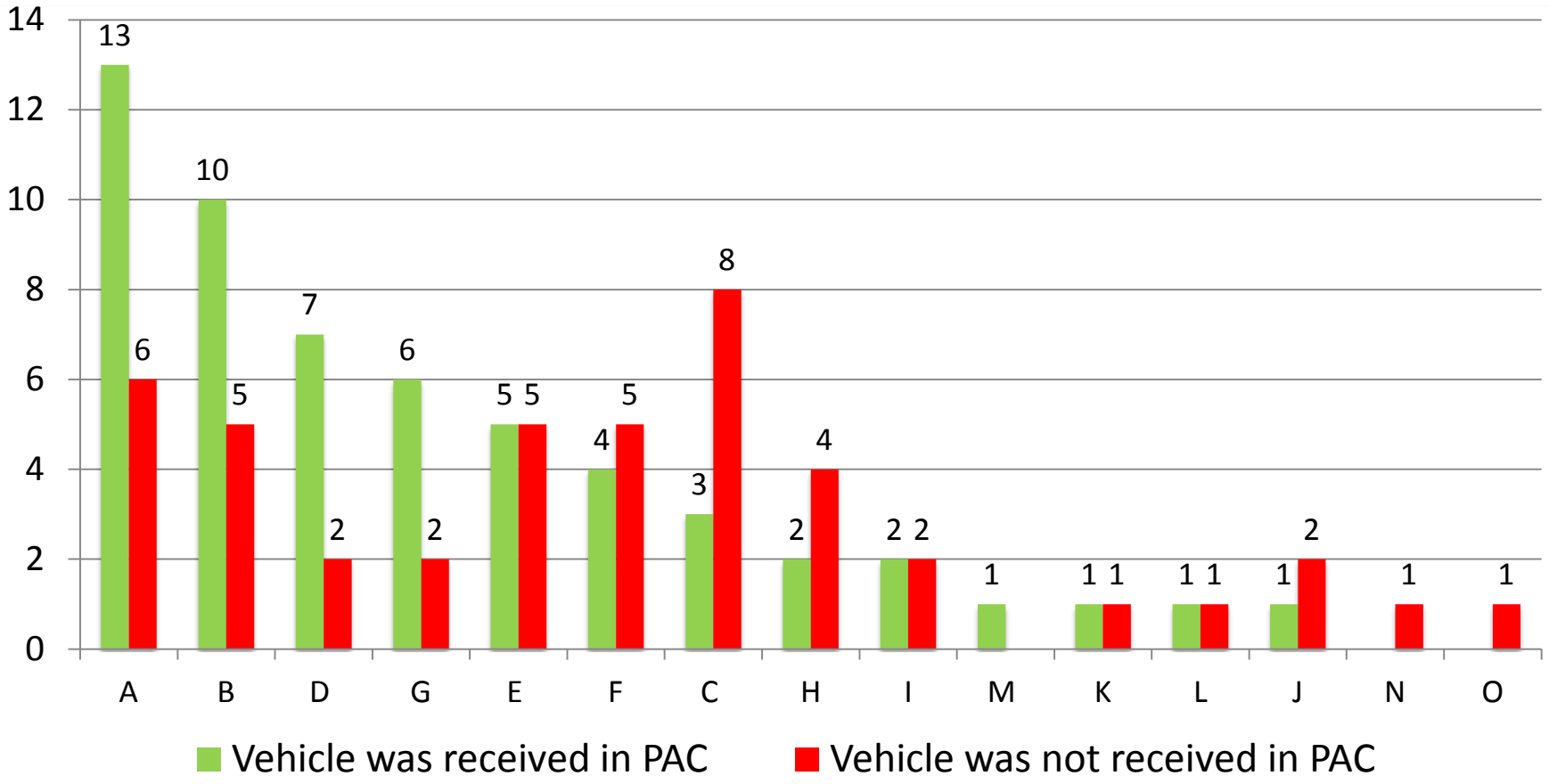
Return Condition - Inspectors View:

Was the Vehicle Returned in PAC by Stage?



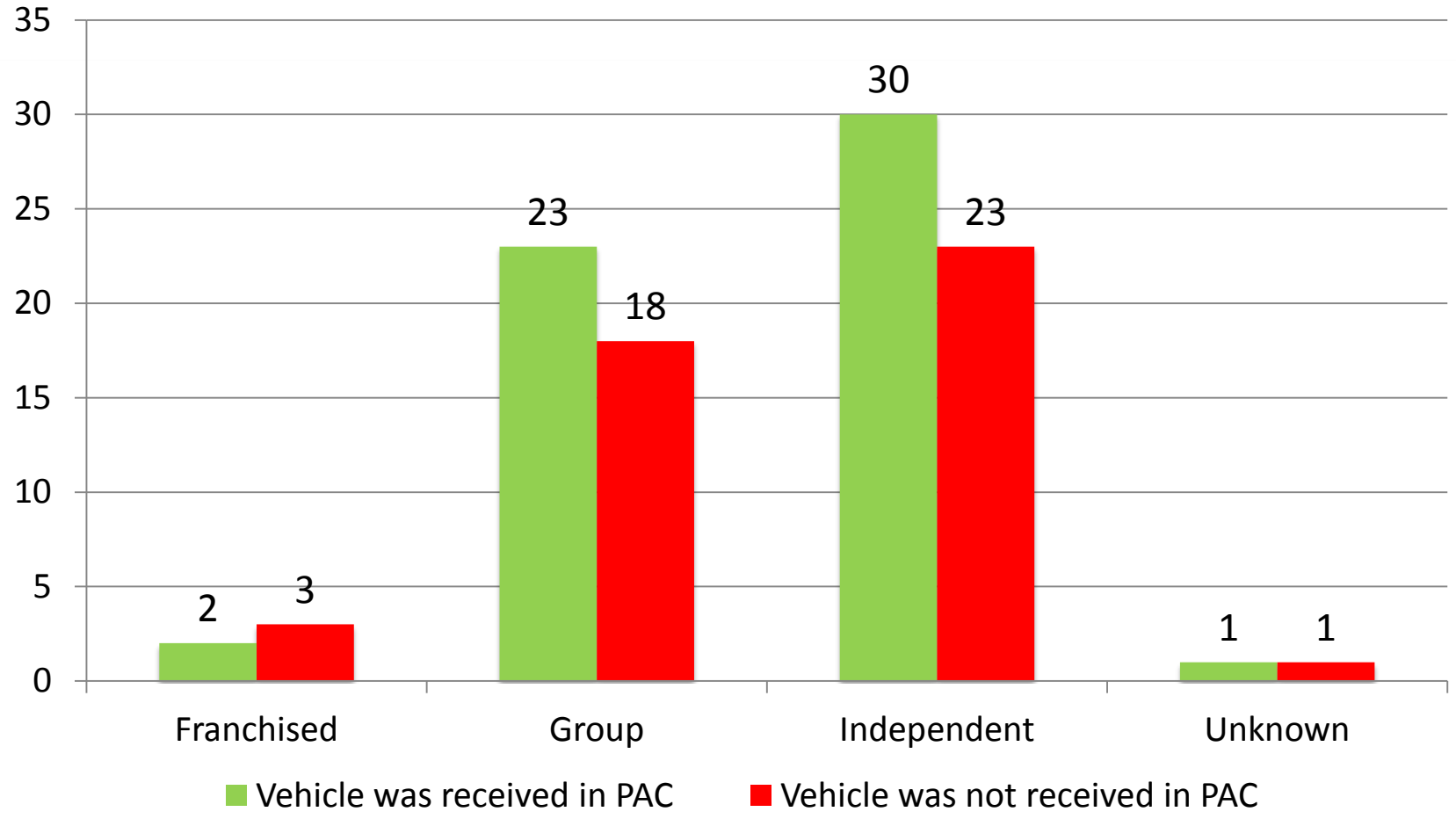
Return Condition:

By Insurer



Return Condition:

By Type of Bodyshop Used

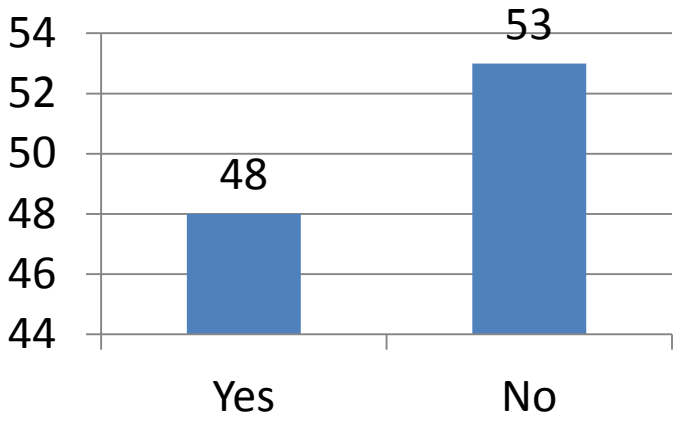


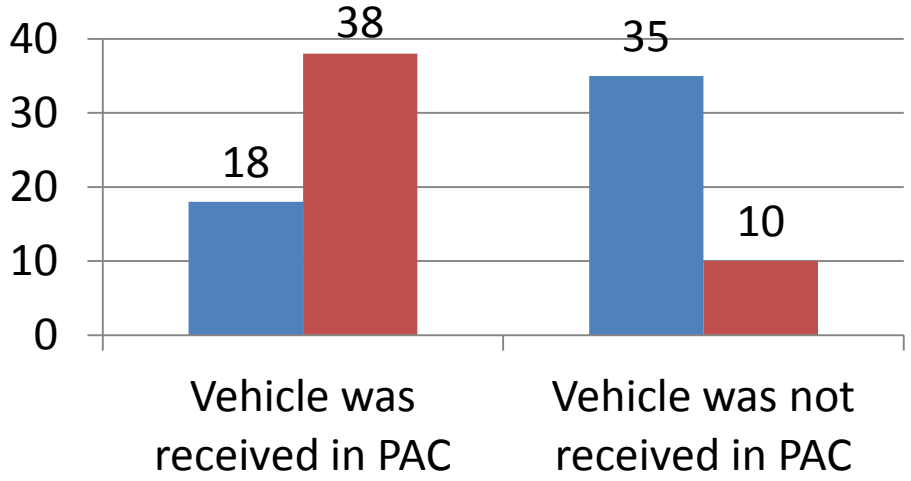
Franchised – Insurer owned or Manufacturer owned
Group – More than three sites
Independent – three sites or fewer

Return Condition:

Where a vehicle was rectified

Rectification –When, after the initial repair, the car owner highlighted ‘faults’ on its vehicle and returned the vehicle to the body shop in order to have these remedied.

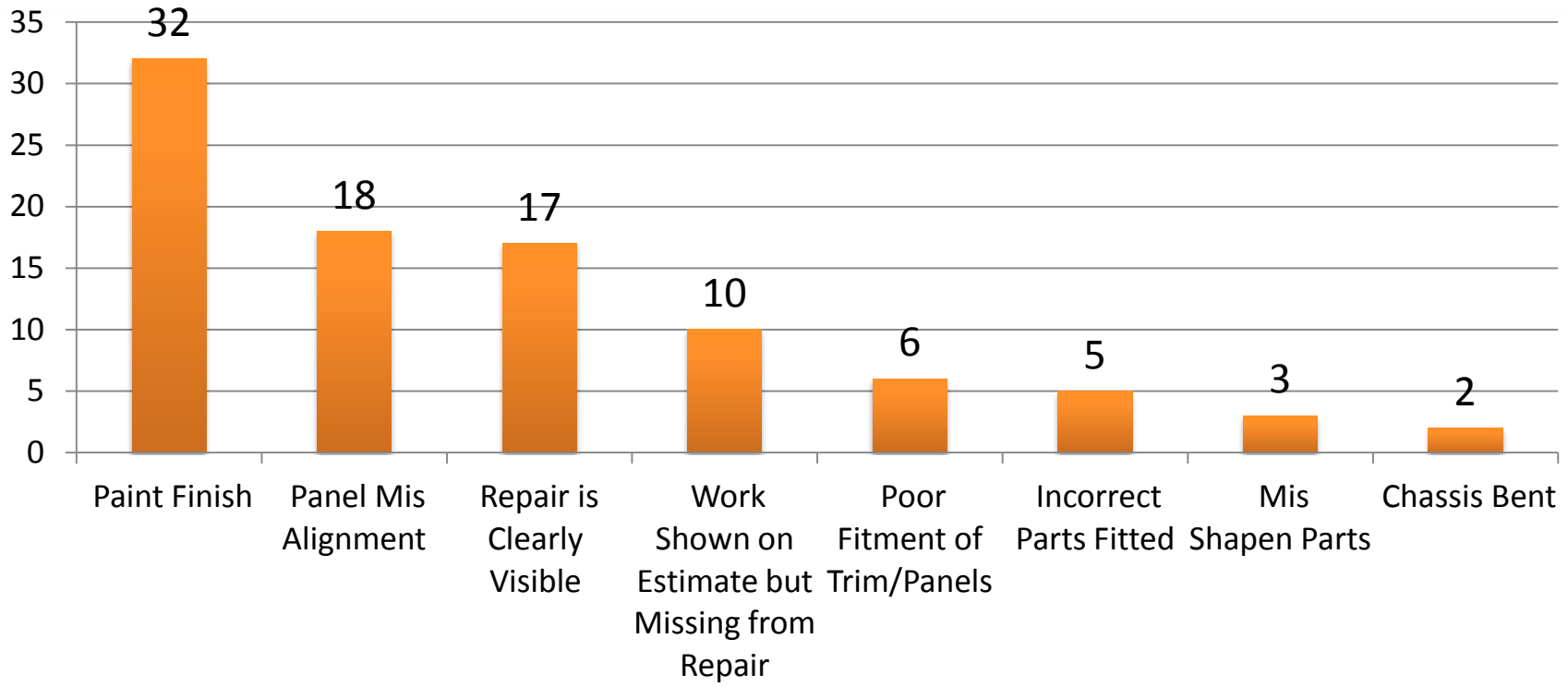




1. 18 of the 101 vehicles were returned to the owner in PAC without any need for rectification
2. 38 vehicles were returned to the owner in PAC after the vehicles had been further rectified
3. 10 vehicles were still not in PAC even after rectification

Consultants View:

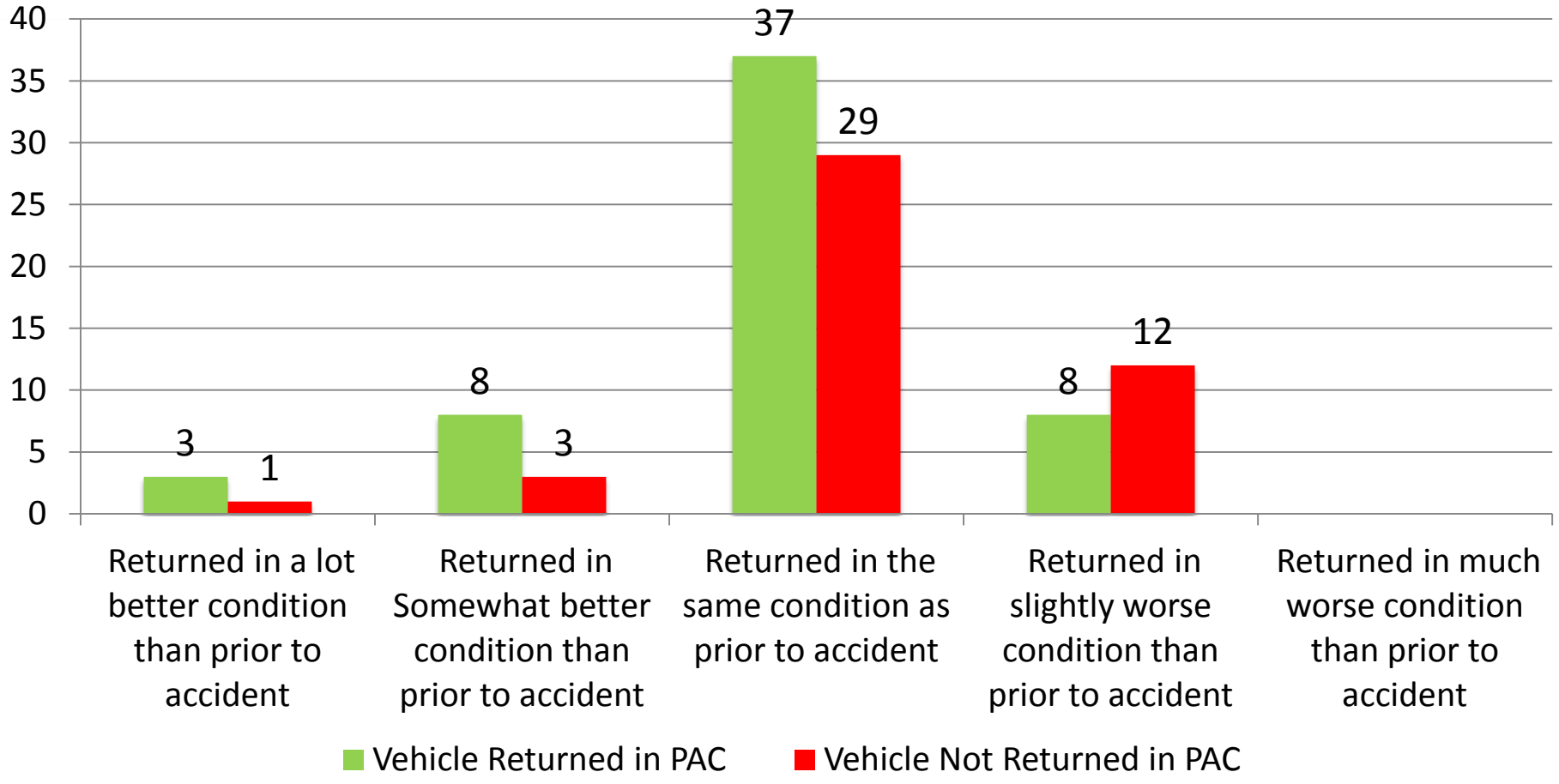
Reasons why the vehicle was considered **NOT** to have been returned in PAC



Of the 45 Vehicles deemed not to have been returned in pre-accident condition, many had multiple issues. The individual inspection reports have the full details.

Vehicle Condition:

Customer Perception/ Consultant Opinion



Evidence

The following slides provide some excerpts and pictures taken from individual reports

In the Inspectors Words

Example 1: Multiple Issues on a single repair

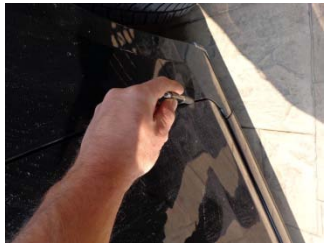
Reasons and supporting evidence for Vehicle not being considered repaired to pre-accident condition – include Images

Reasons

- Poor colour match charged for blending and only painted new wing
- Poor fitment to bonnet
- Paint on the edge of headlight rear
- Splash guard not fitted correctly
- Moulding not fitted back in place correctly
- Company has charged more than work carried out

Reasons and supporting evidence for Vehicle not being considered repaired to pre-accident condition – include Images

Reasons



- Chassis plate decal missing. Not replaced after repair
- Wind noise on Drivers front corner since repair
- Paint chipped of hinge bolts
- Paint sink marks on A Pillar / Sill area
- No paint on inner sill. Bare metal, see images
- Untidy flanges
- Mirror backing missing. Customer told by repairer it is on order ?
- Upper front door moulding badly distorted
- Door gap tight to front wing
- Door latch striker plate damaged and bolts rounded. (due to wrong tools being used)

Reasons and supporting evidence for Vehicle not being considered repaired to pre-accident condition – include Images

Reasons

- Evidence of damage still on bonnet. Bonnet frame still slightly distorted. Filler edge visible
- Dirt inclusions in bonnet have been partially removed but still visible
- Front bumper misaligned on passenger side. Rough edges on bumper edge under paint (see image)
- Issue over bonnet lock failing 3 months after repair. Garage said unrelated. I would personally disagree as it was hit on the lock. The lock failed the first time the customer opened his bonnet and used it. !

Reasons and supporting evidence for Vehicle not being considered repaired to pre-accident condition – include Images

Reasons

- Very Unsatisfactory Repair
- Parts on invoice have not been fitted. i.e. Grille, bonnet, arch moulding
- Damage parts still on vehicle
- Overspray on bumper trims
- Poor paintwork on bonnet

Reasons and supporting evidence for Vehicle not being considered repaired to pre-accident condition – include Images

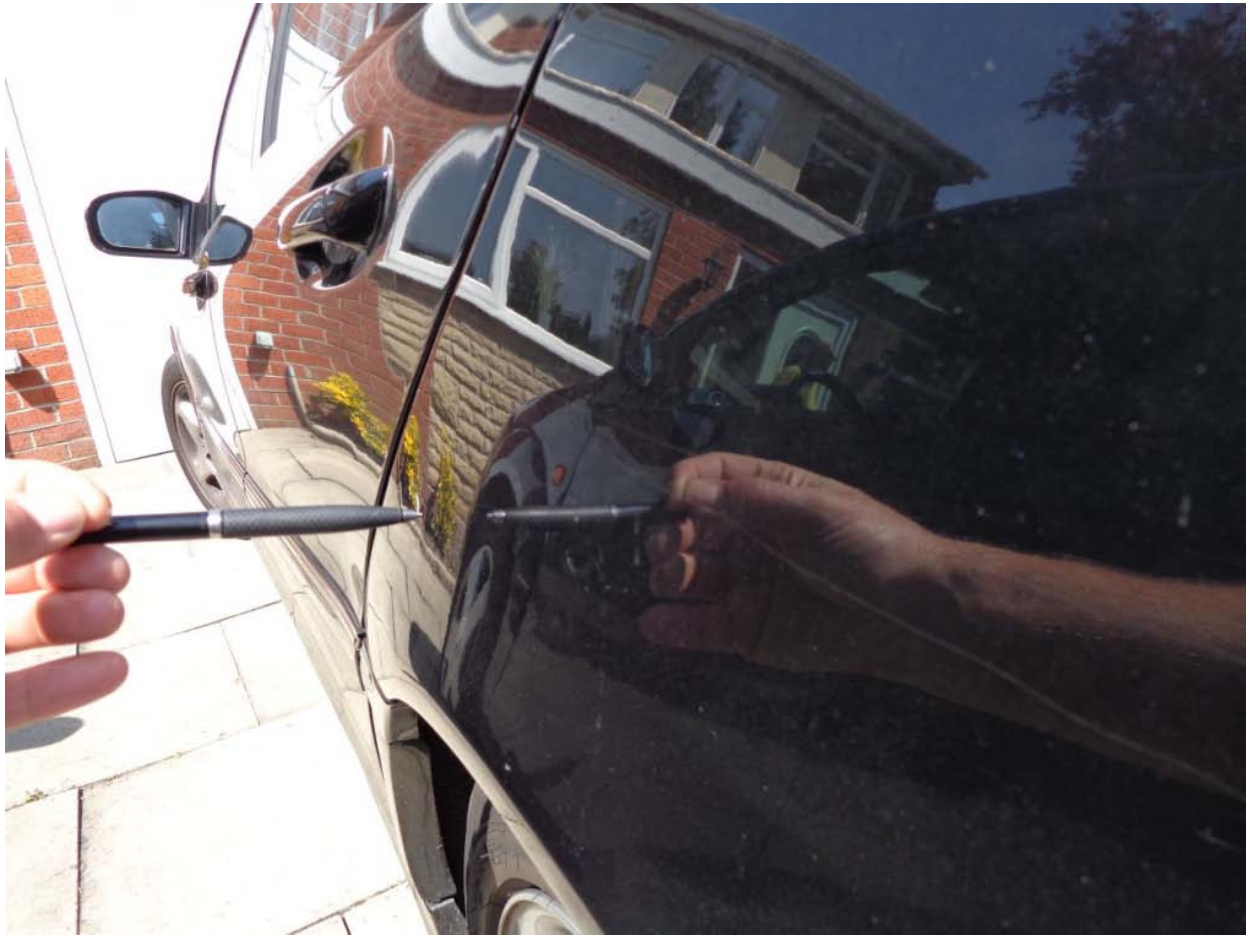
Reasons

- Colour slightly out
- Suspect non OE wing has been fitted. Poor pressing on front edge nr bonnet
- Poor alignment around rear of bonnet / A pillar

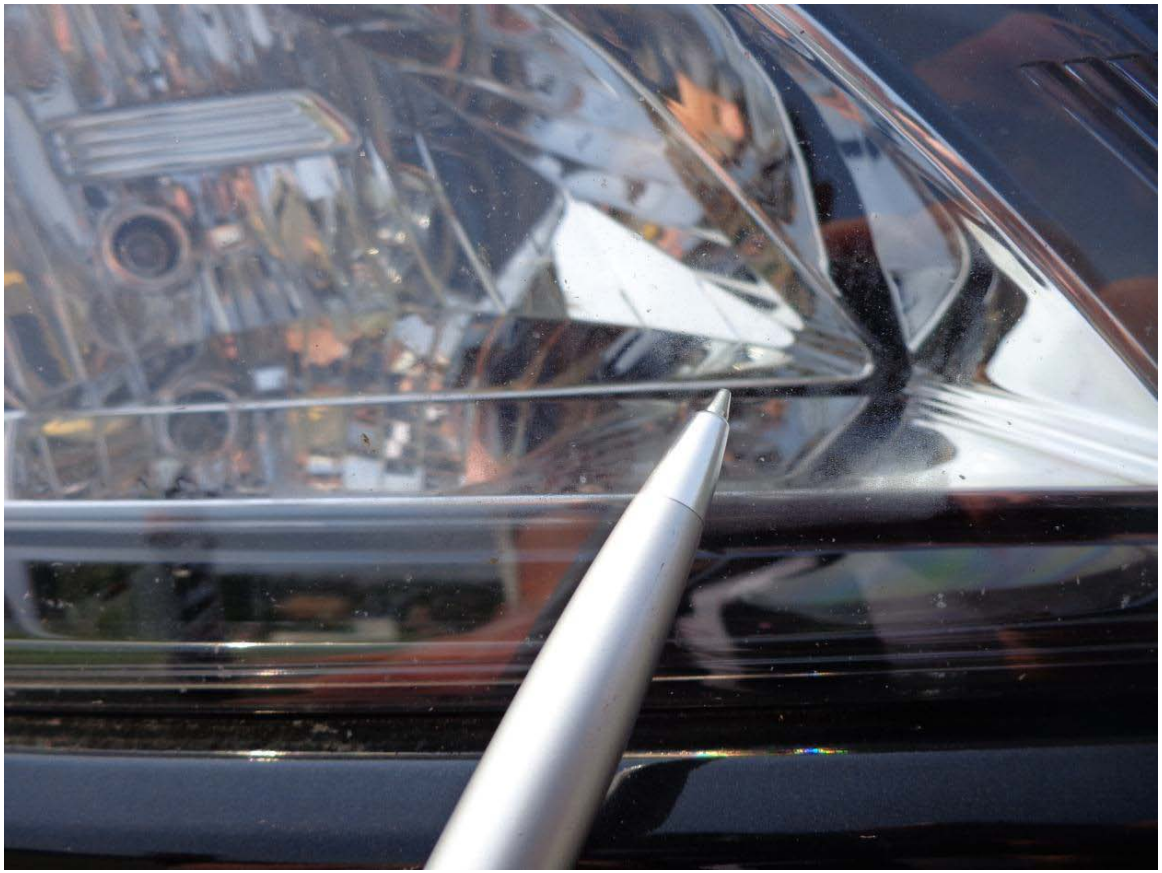
Paint colour mismatch

Trim misalignment

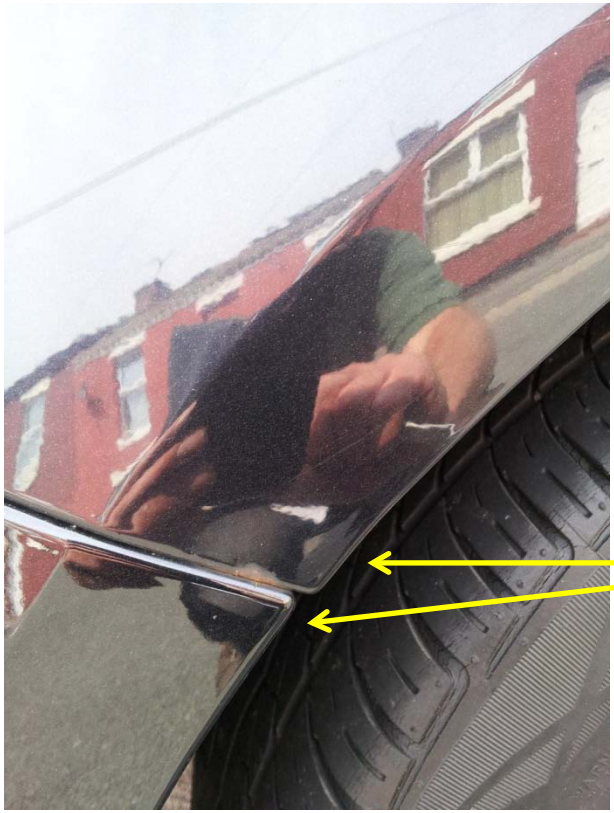
Repair visible (dent)



Damage not repaired



Misaligned part



Panel edges do not line up

Damage not repaired

Inner boot distorted, seam edge exposed

Misshapen parts & ‘orange peel’ paint finish

Part out of shape

‘Orange peel’ paint finish compared to original

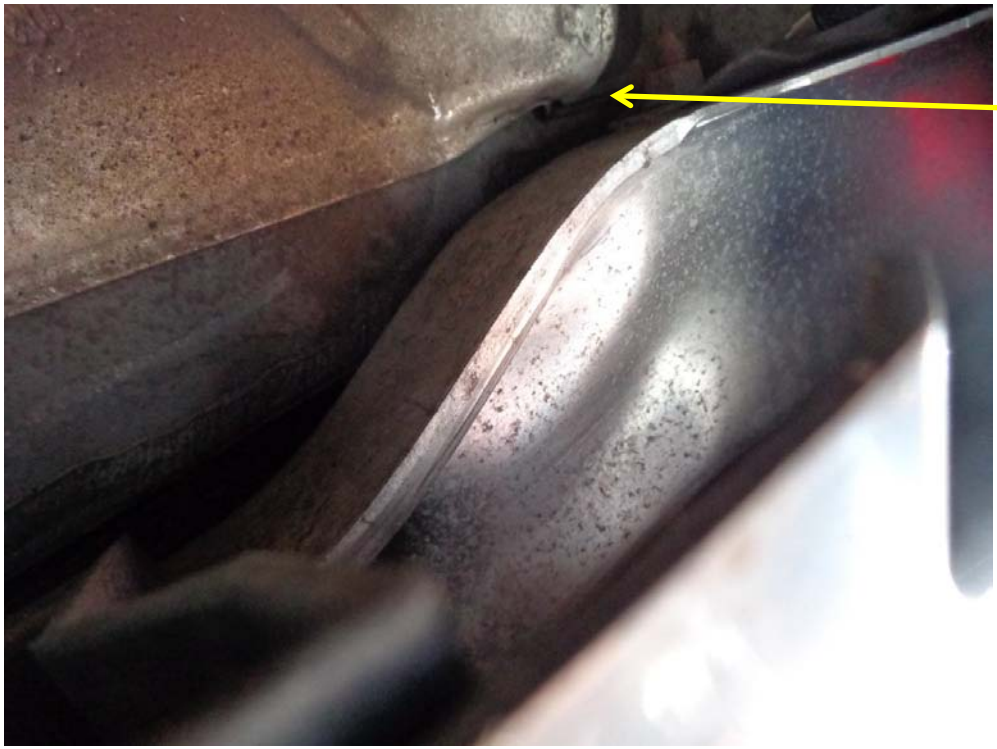
Wrong tool used

Rounded bolt – Suggesting wrong tool was used in the repair process

Fitment issues

Large gap between new and original parts

Repair not carried out



Damaged exhaust housing not repaired

Summary

Caveats

The following caveats need to be considered when analysing the results

- The inspection reports are opinion based – Our consultants are recognised experts in their field, but the inspections were not carried out under scientific or workshop conditions. Although the best efforts have been made to fulfil the programme criteria we can not guarantee that all defects were reported.
- The availability of the owner was the key factor in scheduling inspections

Conclusions

- Where the vehicle was considered not to have been returned to pre-accident condition the range of repairs did not show any particular trend towards vehicle model, the type of repairer, or insurance company.

- The most common causes for not meeting pre-accident conditions were
  - Paint finish,
  - Panel alignment
  - Repair work clearly visible

- Although limited by the parameters of the physical inspection, as far as the inspectors could tell none of the defects found could be seen as dangerous, but all would have had a negative effect on the car valuation

- In our opinion all of the issues found that resulted in a vehicle not being considered to have been returned to pre-accident condition, could have been detected during an efficient quality control process, prior to the car being handed back to the customer

%PAC based on who chose the repairer

Table 1: % PAC vehicle 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 insurer	Choice made by Insurer	Other*
Condition of the car after the repair:					
PAC	56	15	9	31	1
Not PAC	45	4	5	35	1
base (unweighted)	101	19	14	66	2

Source: CC PMI NAF Survey, questions C6, C8

* Two claims where “who made the final decision?” was reported as being “the repairer” and “don't know”.

Note: The version of this slide in the vehicle inspection working paper included reference to options provided by ‘insurer/CMC’ because, where decisions on repair were not made by the respondent, they could in principle have been made by either an insurer or a CMC.

Our review of the responses to the survey questions for the relevant individuals suggests in fact that the number of cases where a CMC was involved is small, if any.

The table shows that the proportion of non-PAC cases is much lower when the repairer is chosen by the customer than when the repairer is chosen by the insurer, but we are unable to attribute statistical significance to the difference since the small MSXI sub-sample of the survey may not be representative of the wider population.

Add-ons

Introduction

1. In this appendix, we consider:

   (a) the transparency and complexity of information provided to consumers when purchasing add-ons;

   (b) the possible point-of sale-advantages for motor insurers when selling add-ons;

   (c) the profitability of some add-ons; and

   (d) our customer survey results in relation to add-ons.

Transparency and complexity of information provided to consumers

2. In this section, we consider:

   (a) the descriptions of add-ons (sold separately from the basic motor insurance policy) provided by motor insurers to consumers at the point of sale; and

   (b) the transparency of the NCB scale used by motor insurers to calculate a customer's NCB.

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

3. The descriptions provided by the ten motor insurers in our sample for a selection of add-ons are presented in Annex A.

Personal injury cover

4. Personal injury cover typically provides cover in the event that a customer and/or their partner suffer injury or death as a result of an accident.[1] The cover provides compensation for injury or death and money towards the cost of medical treatment.

5. Five of the ten motor insurers in our sample (Admiral, Aviva, esure, LV and Zurich) offer personal injury cover as an add-on. Four motor insurers in our sample (Ageas, AXA,[2] DLG and RSA) provide this cover in their basic motor insurance policy. One motor insurer in our sample (CISGIL) does not offer personal injury cover as an add-on and does not include it in its basic motor insurance policy.

6. We would expect a description of personal injury cover to detail the parties included under the cover, the key features of the cover and the relevant compensation limits. The descriptions provided by the six motor insurers that offer personal injury cover as an add-on avoid the use of unnecessary complex language or terminology. However, there is considerable variation in the level of detail provided to consumers. For example, the descriptions provided by Admiral, Aviva and esure summarize the key features of the add-on. In contrast, the descriptions provided by LV and Zurich provide a high-level overview of the add-on without reference to its key features.

NCB protection

7. NCB protection ensures that a customer's NCB remains intact (subject to certain conditions) in the event of an accident where the customer is required to claim under their motor insurance policy. It does not protect a customer's motor insurance premium.

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[1] We note that there is some variation in the coverage of this add-on. Some personal injury cover products also provide cover for named drivers and/or passengers, in addition to cover for the customer and their partner..
[2] 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.

8. Six of the ten motor insurers in our sample (Admiral, Aviva, AXA, LV, RSA and Zurich) offer NCB protection as an add-on. Three motor insurers (Ageas, CISGIL and esure) 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). [✂] One motor insurer (DLG) does not treat NCB protection as a standard add-on, but as a variation to the pricing on the basic motor insurance policy.

9. We note that there is considerable variation in the level of detail provided to consumers in relation to NCB protection. For example, the description provided by Admiral explains clearly and concisely the conditions required to be considered eligible for NCB protection and the difference between protecting and guaranteeing an NCB. In contrast, the description provided by [✂] and Zurich is too short to provide the consumer with sufficient information about the product. In our view, the level of detail provided by the other motor insurers (Aviva, LV and RSA) is superior to that provided by [✂] and Zurich, but inferior to that provided by Admiral.

10. Further, none of the descriptions present comprehensively the complexities of the cover, notably that a driver's NCB protection is impacted if they submit too many claims in a specified period of time (typically more than one claim in a year or more than two claims over three years).

11. Further, it is not made explicit by any of the motor insurers that the add-on protects the driver's NCB but is not an absolute protection of their current premium (which can be impacted by claims independently of a driver's NCB), and that there is a difference between an NCB and NCB protection. This is a significant deficiency in the descriptions of NCB protection provided by the motor insurers in our sample.

Extended foreign use cover

12. Extended foreign use cover extends a customer's comprehensive motor insurance policy to any member country of the EU for up to 90 days per trip.

13. We note that the basic comprehensive motor insurance policies provided by all ten motor insurers in our sample provide the minimum cover required by law.[3] In addition, four of the ten motor insurers in our sample (Aviva, CISGIL,[4] LV, and RSA) offer extended foreign use cover as an add-on. Five of the ten motor insurers in our sample (Admiral, Ageas,[5] AXA, esure and Zurich) do not explicitly offer extended foreign use cover as an add-on, but may provide cover (at a cost) if requested. One motor insurer (DLG) does not offer extended foreign use cover as an add-on.

14. The descriptions provided by Aviva, CISGIL and LV are concise, comprehensible summaries of the key features of the extended foreign use add-on.[6] However, it would be useful if the difference between the add-on and coverage provided by the basic comprehensive motor insurance policy was made explicit in the description, in order for a consumer to accurately assess the suitability of the add-on for their needs.

Key loss cover

15. Key loss cover provides cover for replacement locks and keys in the event that the customer's car keys are lost or stolen.

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[3] The minimum legal cover (usually the equivalent of UK third-party-only cover) allows the customer to use the car in any member country of the EU and any other country that has agreed to follow Article 7(2) of the EU Directive on Insurance of Civil Liabilities arising from the use of motor vehicles (number 72/166/EEC) for up to 90 days in a year.
[4] 'CISGIL's extended foreign use is available as an add-on for the Co-operative Car Insurance product only.
[5] Ageas provides free EU cover for 90 days in its basic motor insurance policy. Extension to the 90 days or request for cover outside the EU may or may not be granted but would attract an additional charge if granted.
[6] RSA's Foreign Use Extension add-on can only be purchased on the telephone and therefore there is no description of the add-on the RSA website.

16. Four of the ten motor insurers in our sample (Admiral, AXA, esure and Zurich) offer key loss cover as an add-on. Five of the ten motor insurers (Ageas, Aviva, CISGIL, LV, and RSA) provide this cover in their basic motor insurance policy. The remaining motor insurer (DLG) does not provide this cover as an add-on and does not provide it in its basic motor insurance policy.

17. The descriptions provided by Admiral, [✂] and Zurich provide a high-level overview of the key features of the add-on in a comprehensible manner. However, the description provided by esure is far more substantial, providing a comprehensive summary of the scenarios under which the add-on can be utilized, thus better allowing the consumer to assess the suitability of the cover for their needs.

Courtesy car cover

18. Courtesy car cover typically provides the customer with a standard, Class A courtesy car in the event that their car is immobile following an accident, stolen and not recovered or declared a total loss.

19. Four of the ten motor insurers in our sample (Aviva, DLG,[7] LV and RSA[8]) offer courtesy car cover as an add-on. The remaining six motor insurers (Admiral, Ageas, AXA,[9] CISGIL,[10] esure and Zurich) provide this cover in their basic motor insurance policy.

[7] DLG offers (since 8 September 2013) 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. DLG offers Guaranteed Hire Car (GHC) and Guaranteed Hire Car Plus (GHC+) as optional add-ons, which enables customers to purchase hire car provision. 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 to14 consecutive days for GHC and 21 consecutive days for GHC+. Customers with GHC or GCH+ are not entitled to a courtesy car benefit. There are a very small number of DLG legacy policies that provide a courtesy car under the basic motor insurance policy.

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

[9] AXA provides courtesy car cover as standard under its basic motor insurance policy for its AXA Direct brand. Under its Swiftcover brand, courtesy car cover is offered as an add-on.

[10] This add-on is only applicable where the customer's car is repaired by a CISGIL-approved repairer.

20. We would expect a description of courtesy car cover to include the key features of the cover, such as the conditions under which the car would be provided, the type of car provided, the hire duration and any limitations of the cover. However, only Aviva's description summarizes all of these key features, thus allowing the consumer to make an accurate assessment of whether the add-on is suitable for their needs. The descriptions provided by the other three motor insurers, although comprehensible, do not detail the type of car provided under the cover.

21. We note that all four motor insurers do not explain to consumers that this add-on may not be necessary in circumstances when they are not at fault for an accident, because they are usually entitled to a like-for-like replacement car (subject to the driver's duty to mitigate their loss with consideration to their need) under a credit hire agreement (if referred to a CMC/CHC by the non-fault motor insurer) or a direct hire agreement (if captured by the at-fault motor insurer; or when a non-fault motor insurer is party to a bilateral agreement with the relevant at-fault motor insurer; or when the at-fault motor insurer and the non-fault motor insurer are the same), and therefore do not necessarily require the cover provided by the courtesy car add-on.[11]

Enhanced courtesy car cover

22. Enhanced courtesy car cover provides the customer with a like-for-like replacement car or a replacement car of a superior quality to the standard Class A courtesy car typically provided under courtesy car cover in the event that their car is immobile, stolen and not recovered or declared a total loss.

[11] CISGIL told us that it did not refer its non-fault drivers directly to CHCs. However, it said that it referred its non-fault claimants with MLEI to CLS in respect of their uninsured losses. CLS managed these claims against the fault party, including the provision of a replacement car. CISGIL said that around [✂] per cent of these claimants were referred, on the basis of need, by CLS to [✂] for the provision of a replacement car on credit hire terms. [✂]

23. Seven of the ten motor insurers in our sample (Admiral, Ageas, AXA,[12] esure, LV, RSA and Zurich[13]) told us that they did not offer enhanced courtesy car cover. Of the remaining three motor insurers:

(a) Aviva told us that it offered its Aviva customers an enhanced courtesy car add-on, which entitled them to a replacement car of a superior quality to a standard courtesy car (but not a like-for-like replacement car).

(b) CISGIL told us that it offered its Co-operative Motor Insurance customers an enhanced courtesy car add-on, which entitled them to a replacement car of a similar engine specification (up to a maximum engine size of 1800cc) and size to their vehicle for up to 14 days.

(c) DLG told us that it offered its customers a Guaranteed Hire Class Plus add-on, which entitled them to a replacement car of a similar physical size to their own car (although this is not guaranteed) for up to 21 consecutive days.

24. Table 1 below summarizes the proportion of Aviva, CISGIL and DLG customers that typically purchase the enhanced courtesy car add-on.

TABLE 1 **Enhanced courtesy car cover take up**

Motor insurer	*Proportion of customers who purchased add-on (%)*		
	2010	*2011*	*2012*
Aviva	[✂]	[✂]	[✂]
CISGIL*	[✂]	[✂]	[✂]
DLG†	[✂]	[✂]	[✂]

Source: Aviva, CISGIL and DLG.

*We note that CISGIL provides courtesy car cover as standard under its basic motor insurance policy (where any repair is undertaken by a CISGIL-approved repairer).
†These figures are in relation to the GHC+ add-on offered by DLG, which is its closest equivalent to offering policyholders 'a replacement vehicle similar to their own'.

[12] 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 that a courtesy car will be provided.
[13] Zurich told us that its policies included courtesy car as standard, and typically this would be a group A car (eg a small hatch-back), usually with a manual gearbox, and only available in the UK. On its high-net-worth product only, as standard, if the courtesy car provided does not meet the customer's requirements, it will provide a hire car of a similar specification to the vehicle which is the subject of the claim.

25. We note that the motor insurers do not explain to consumers that this add-on may not be necessary in circumstances when they are not at fault for an accident (see paragraph 21).

NCB scale

26. CISGIL told us that when a consumer purchases motor insurance on the telephone, it was not part of the standard sales script to describe the NCB scale. However, if the consumer asked for details then these would be provided by the adviser. In addition, the NCB scale is provided as part of the customer new business welcome and renewal packs.

27. Admiral told us that it did not have a scale available to share in a readable format and that its discount rates varied by a large number of factors, meaning that the rate applied for each level of NCB was not fixed.

28. [✂] told us that it did not publish the scales for NCB, as claim-free years were just one of the many factors it considered when calculating premiums.

29. [✂] told us that recent customer research indicated that customers were highly sceptical of advertised percentage discount scales, preferring instead to see how their driving history related to final premium.

30. AXA told us that it provided its NCB scales (in years only and not the discount provided to customers) in the policy wording and the step-back rules that applied should claims occur during a period of insurance. AXA told us that the actual discounts provided were commercially-sensitive information and therefore were not published where they were accessible to competitors.

Possible point-of-sale advantages for motor insurers

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

(a) the consumer experience of comparing add-ons on a PCW; and

(b) the consumer experience of buying add-ons on an insurer's website.

Comparing add-ons on a PCW

32. All ten motor insurers in our sample told us that consumers were provided with the same information in relation to add-ons regardless of whether they accessed the motor insurer's website directly or clicked through to the motor insurer's website from a PCW. The ten motor insurers in our sample re-offer add-ons to consumers upon click-through from the PCW to their website, because:

(a) PCWs do not offer the entire suite of add-ons provided by motor insurers; and

(b) the pricing of and the level of cover provided by add-ons can be variable, depending on the age of the vehicle and cover level selected (eg breakdown cover) or on the excess amount insured (eg excess protection) and PCWs are unable to match this functionality on their websites.

33. LV told us that to improve the consumer journey, it provided a range of offers on PCWs and consumers could select the most appropriate option to meet their needs. For example, as well as returning a quotation based on the information provided, additional offers were displayed, such as LV Plus, which included Guaranteed Courtesy Car; or LV Select, which included Guaranteed Courtesy Car and MLEI. These supplementary offers avoided the requirement to reselect relevant add-ons upon click-through to the LV website.

Buying add-ons on an insurer's website

34. RSA told us that its More Th>n customers could only choose to opt in to certain additional add-on products and could not opt out of any products contained within the

standard cover of a motor insurance policy (windscreen cover, personal items cover, emergency care cover, in-car entertainment cover and courtesy car cover). We note that this is different to requiring consumer to opt out of add-ons, because the add-ons are included as part of the basic motor insurance policy and therefore cannot be removed.

35. RSA told us that for its eChoice customers, windscreen cover and courtesy car cover were included as standard but, if desired, the customer could deselect these prior to purchase and therefore these add-ons were offered on an opt-out basis.

MFN clauses

36. [✂][14]

37. [✂]

38. [✂]

Profitability of add-ons

39. We looked at the claims ratio of some add-ons as a basic measure of their profit-ability. We could not review expense ratios as motor insurers did not allocate expenses between their add-on products.[15]

40. The claims ratio, which is presented as a percentage, measures the proportion of premiums paid out in claims. It is calculated as claims costs divided by NEP. Claims costs are the total of claims paid, net of any recoveries from motor insurers, and any changes in provisions for claims, net of reinsurance; NEP is GWP, net of IPT and premiums ceded to motor insurers and any changes in provisions for unearned

[14] [✂]
[15] The expense ratio is expenses expressed as a percentage of premiums.

premiums. All things being equal, a low claims ratio indicates higher profitability for a motor insurer than a high claims ratio.

Data requested from the parties

41. We asked motor insurers to complete a template spreadsheet containing a split of NEP and claims costs by type of risk covered. The template spreadsheet covered the five years 2008 to 2012. The types of risks covered were:

(a) basic cover;

(b) MLEI;

(c) NCB protection;

(d) windscreen;

(e) breakdown;

(f) personal injury;

(g) courtesy car; and

(h) other (including key loss and extended foreign use cover).

Data received

42. Of the ten large motor insurers, only seven were able to provide data splitting NEP and claims costs for some add-on products. No motor insurer was able to provide data on all the add-on products in our list (see paragraph 41). Motor insurers provided data on the following add-ons:

(a) Aviva: [✂];

(b) AXA: [✂];

(c) CISGIL: [✂];

(d) DLG: [✂];

(e) esure: [✂];

(f) LV: [✂]; and

(g) RSA: [✂].

43. Three motor insurers ([✂]) did not provide a split of NEP and claims costs by add-on product, for the following reasons:

(a) [✂] add-ons were all launched in the second half of 2012, so it had limited data.

(b) [✂] has a limited range of add-on products, which are mainly provided by third parties.

(c) [✂] add-on products are either included in its basic cover, or provided by third parties.

Analysis of the data

44. Table 2 shows which motor insurers provided data on which add-ons in order for us to be able to calculate claims ratios.

TABLE 2 **Data available for add-on products**

Add-on product	*Motor insurers providing suitable data*	*Number of parties with data compared with number offering add-on*
Breakdown	[✂]	3 out of 3
MLEI	[✂]	6 out of 8
NCB protection	None	0 out of 10
Windscreen	[✂]	2 out of 3
Personal injury	[✂]	1 out of 6
Courtesy car	[✂]	4 out of 5
Other: key loss	[✂]	1 out of 4
Other: extended foreign use	[✂]	2 out of 6

Source: CC based on responses from the parties.

NEP

45. Table 3 shows the aggregate NEP for basic cover and each add-on product for the five-year period for the seven motor insurers listed in paragraph 42.

TABLE 3 **Analysis of NEP by type of risk**

	2008	*2009*	*2010*	*2011*	*2012*	*2012 share to total NEP %*
Basic cover	5,302.7	5,285.6	5,558.9	5,699.5	5,176.7	91.5
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 [✂] which could not provide a figure for this year.

46. Table 3 shows that basic cover accounted for 91.5 per cent of total NEP in 2012. 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.

Claims ratios

47. Table 4 shows the claims ratios for basic cover and each add-on product for the five-year period. The averages are weighted according to the size of the motor insurer (based on NEP).

TABLE 4 **Claims ratios by type of risk covered, 2008 to 2012**

						per cent	
	2008	*2009*	*2010*	*2011*	*2012*	*Average*	*Parties providing data*
Basic cover	84	96	108	85	82	91	All 7
Breakdown	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	3: [✂]
MLEI	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	6: [✂]
Windscreen	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	2: [✂]
Personal injury	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	1: [✂]
Courtesy car	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	4: [✂]
Key loss	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	1: [✂]
Extended foreign use	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	2: [✂]
Overall	**80**	**90**	**102**	**80**	**77**	86	

Source: CC calculations based on responses from the parties.

Basic cover

48. The weighted average claims ratio for basic cover was 91 per cent over the five-year period, with consistency across the years except for 2010. [✂]

MLEI

49. The weighted average claims ratio for MLEI was extremely low at 5 to 10 per cent over the five-year period:

(a) [✂] showed [✂]. It told us that [✂].

(b) [✂] had [✂] claims ratio for MLEI, at an average of [✂] per cent over the five-year period.

(c) [✂] did not provide its claims ratio but told us that the claims cost for MLEI was very low as it usually sought to recover the costs incurred from the at-fault motor insurer. [✂] told us that this cover provided customers with valuable benefits, enabling them to recover uninsured losses or to pursue a personal injury claim following a non-fault accident.

Windscreen

50. Two motor insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 70 to 100 per cent over the five-year period, typically being only a little lower than the basic cover claims ratio.

Breakdown

51. Three motor insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 30 to 45 per cent over the five-year period. None of the motor insurers provided an explanation as to why its claims ratios were so low. We note that:

(a) [✂] claims ratio for each year was [✂] (between [✂] and [✂] per cent); and

(b) [✂] ratio fluctuated (being [✂] per cent in 2008 and [✂] per cent in 2009, probably due to a build-up and subsequent release of reserves), but averaged [✂] per cent.

Personal injury

52. Only [✂] was able to provide data on this add-on.

Courtesy car

53. Four motor insurers provided data on this add-on. The weighted average claims ratio ranged from 25 to 60 per cent over the five-year period. [✂] and [✂] showed [✂] claims ratios, of between [✂] and [✂] per cent, whereas [✂] showed [✂] ratios in 2009 and 2010 of [✂] and [✂] per cent respectively.

Other: key loss

54. Only [✂] provided data on this add-on. Its average claims ratio for the five-year period was [✂] per cent.

Other: extended foreign use

55. Two motor insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 20 to 40 per cent over the five-year period. [✂] average claims ratio for the five-year period was [✂] per cent, and [✂] was [✂] per cent.[16]

NCB protection

56. Although NCB protection insures a customer against a specific risk (ie losing NCB as a result of a claim) and a premium is charged for it, there is no claims cost clearly associated with it as it relates to the amount of premium payable by a customer on renewal. Consequently none of the motor insurers provided us with a claims ratio. However, the motor insurers told us how they priced the product (including whether it has a standard price or whether the price is dependent on the risk of the policy-holder), the costs associated with the product, and how those costs were accounted for. We set out this evidence below.

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[16] [✂] noted that its 'other' category of claims was mainly against foreign use cover but could include a small number of claims made against other covers.

Pricing of NCB protection

57. It appeared to us that all ten motor insurers took a risk-based approach to setting the price at which they offered NCB protection to policyholders:

(a) [✂], [✂] and [✂] noted that their pricing took account of customer profitability, which reflected claims performance. [✂] told us that, where protected NCB was available, the price was calculated as a percentage addition to the premium for basic cover and therefore reflected the overall risk of the individual policyholder. [✂] told us that the price was 14 per cent of the basic premium. [✂] told us that the price was up to 15 per cent of the basic premium.

(b) [✂] and [✂] told us that the selection of NCB protection was treated as a variable in the overall premium calculation, ie the total premium was adjusted if the customer selected NCB protection rather than there being a separate figure calculated to represent the cost of NCB protection. [✂] explained that this was because the benefit of NCB protection related to the cost of the basic cover whereas claiming under other add-ons did not affect the basic cover and its pricing. [✂] told us that the price was dependent on the number of claim-free years and was 2.5 per cent if the number of NCB years protected was five or more, and 10 per cent if four years' NCB was protected (and NCB protection was not offered for less than four years' NCB).

(c) [✂] and [✂] told us that NCB protection was priced in the same way as the basic motor insurance cover and was therefore based on the risk of the individual policyholder.

(d) [✂] and [✂] told us that NCB protection was priced as an additional percentage of the basic motor insurance cover premium and was therefore based on the risk of the individual policyholder. [✂] said that the price was currently 10 or 15 per cent of the basic premium for [✂]. [✂] told us that it charged an additional [✂] per cent of the basic premium for NCB protection.

(e) CISGIL told us that [✂].

The cost to motor insurers of NCB protection

58. Nine of the ten motor insurers told us that the cost to them of NCB protection was the income forgone from not reducing the discount applied to the premium at renewal (which would otherwise happen if the customer had made a claim).

59. [✂] estimated that the opportunity cost of not increasing the renewal premium was between 0.5 and 1 per cent of the NEP for basic cover plus the NCB protection add-on. [✂] noted that, for [✂] renewals in Q1 2013, for a customer who had nine years' NCB but had made at least one at-fault claim during the previous year, there was an average premium increase of over 60 per cent for customers without NCB protection and a significantly lower increase of below 15 per cent for customers with NCB protection.

60. [✂], AXA, [✂] and LV told us that an additional cost to the motor insurer was that customers with NCB protection were more likely to make small claims than customers without NCB protection (since the latter might decide not to make a claim in order to avoid an increase in premium due to losing their NCB). However, [✂] noted that, whilst in theory customers with NCB protection could be expected to make more small claims than customers without it, its experience was that overall the claims cost of customers with NCB protection was lower than for customers without it. Similarly, [✂] noted that its loss ratio was better (ie lower) on policies with protected NCBs. [✂] noted that customers with NCB protection who had made a claim were more likely to switch motor insurers at renewal than customers without NCB protection who had made a claim because they would be able to obtain more competitive renewal quotes.

61. One motor insurer ([✂]) told us that the additional claims cost associated with policyholders who had NCB protection was the only cost directly considered when it calculated premiums.

Accounting treatment

62. It appears to us that the extent to which renewal premiums are lower as a result of NCB protection than would have been the case otherwise is reflected in motor insurers' overall premium income. Similarly, the extent to which claims are higher than would have been the case is reflected in the overall claims cost. Two motor insurers, [✂] and Zurich, noted that the costs associated with NCB protection could not be separated from the overall claims cost as it was not possible to know which claims the customers with NCB protection had made which they would not have made had they not purchased it.

Add-on products supplied by third parties

63. The motor insurers in our sample were generally unable to supply us with data on the profitability of add-on products supplied by third parties. However, we received some data on selected add-ons from two motor insurers: CISGIL and esure.

64. CISGIL's breakdown cover and enhanced courtesy car cover add-ons are provided by a third party (so not included in the calculations above). Table 5 shows the maximum retail price and margin to CISGIL for each of these products (ie the retail price less the IPT (currently 6 per cent), the direct cost to CISGIL, allocated costs (such as marketing, sales staff, system expenses, etc), and a contribution towards indirect costs).

TABLE 5 **CISGIL breakdown and enhanced courtesy car cover add-on products**

	Breakdown	*Courtesy car*
Maximum retail price (£)	60	17.50
Margin (£)	[✂]	[✂]
Margin (%)	[✂]	[✂]

Source: CISGIL; CC calculations.

65. Since October 2010 CISGIL has also offered key loss cover from a third party supplier (Keycare).[17] CISGIL sets the retail price (currently £15) to cover the net rate payable to the claims administrators (currently £[✂] for each new business policy and £[✂] for each policy renewal (ie effectively the claims costs per policy)), direct and indirect CISGIL costs, IPT and its profit. The retail price net of IPT less the amounts payable to the claims administrators produces a margin of between £[✂] and £[✂] which cover CISGIL's costs of selling, allocated costs, indirect costs and profit.

66. esure's breakdown cover is provided by Green Flag. esure told us that [✂].

Our customer survey results in relation to add-ons

Take-up of add-ons

67. Table 6 shows respondents' stated take-up of add-ons.[18] Take-up is particularly high for windscreen cover at 85 per cent, though we note that this add-on is included in the basic motor insurance policy for seven of the ten car motor insurers in our sample. The majority of respondents said that they had NCB protection, legal cover, courtesy car cover and personal injury cover included in their policies. The high stated take-up of NCB protection suggests that some respondents may not be clear on the distinction between NCB and NCB protection, so we treat this result with some caution.

[17] CISGIL offers key loss cover as an add-on under its Ecoinsurance brand.
[18] Take-up means 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.

TABLE 6 **Products included in policy**

per cent

	Yes	*No*	*Don't know*
Windscreen cover	85	10	5
NCB protection	80	17	4
MLEI	76	18	6
Courtesy car cover	70	24	6
Personal injury cover	56	30	14
Breakdown cover	39	58	3
Extended foreign use cover	30	56	14
Key loss cover	24	54	22

Base (unweighted) = 1,501

Source: CC motor insurance customer survey, question B2.

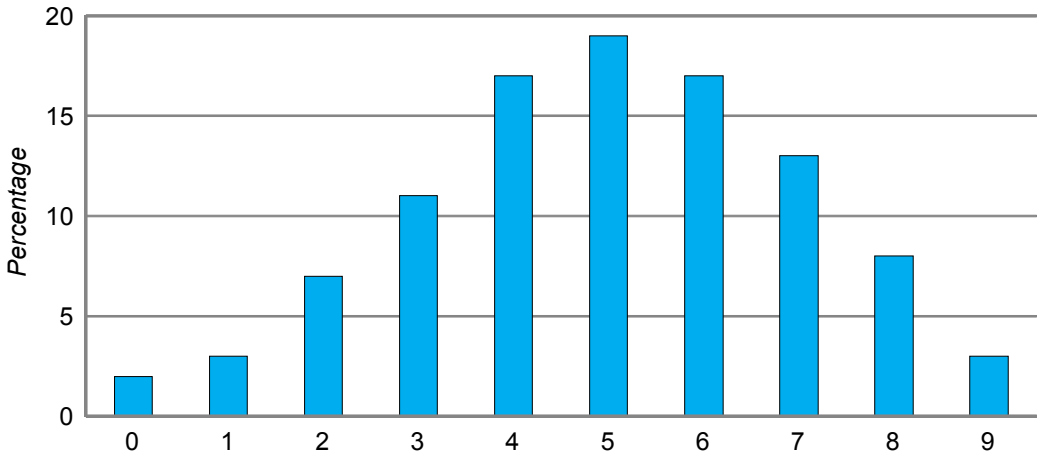
68. The final column of Table 6 shows that some policyholders were unsure about the content of their policy. The percentages of respondents who did not know whether they were protected by particular add-ons were 22 per cent for key loss cover, 14 per cent for extended foreign use cover and 14 per cent for personal injury cover.

69. Differences in the take-up rates between add-ons suggest *(a)* differences in the number and type of add-ons offered to consumers; *(b)* differences in how they are typically offered to consumers; and/or *(c)* the exercise of choice among consumers about which add-ons to purchase. We note that some motor insurers include certain add-ons (often windscreen cover and glass cover) in their basic motor insurance policy, such that a policyholder could not opt out from this protection (unless switching motor insurance provider). We also note that some add-ons are not offered by all motor insurance providers, such that if their policyholders wish to buy a specific protection they must do so from a different provider (or switch motor insurance provider).

70. Figure 1 shows the number of add-ons taken up by respondents. Only a very small proportion of respondents took up either all or none of the nine add-ons in our list, with the modal number being five.

FIGURE 1

Number of add-ons included in policy



Source: CC motor insurance customer survey, question B2.

71. Our customer 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 policy.

72. Table 7 shows that most people who considered an add-on at the time of purchase of their motor insurance policy went on to buy it (either within their basic motor insurance policy or separately). This is particularly true of windscreen cover, the most frequently taken-up add-on. In contrast, 23 per cent of those who considered breakdown cover did not take it up, which might be due to there being many stand-alone options for breakdown cover (eg from the AA or RAC).[19]

[19] We note that only 3 per cent of respondents said that they did not know whether breakdown cover was included in their motor insurance policy, suggesting a high level of customer awareness about this add-on (see Table 1).

TABLE 7 **Products considered by the policyholder**

per cent

	Considered	*Included*	*% who considered but did not include*
Windscreen cover	89	85	4
NCB protection	86	80	8
MLEI	83	76	9
Courtesy car cover	77	70	10
Personal injury cover	64	56	12
Breakdown cover	51	39	23
Extended foreign use cover	33	30	11
Key loss cover	29	24	18

Base (unweighted) = 1,501

Source: CC motor insurance customer survey questions B2, B3.

*Percentage of those who included this add-on in their policy.

73. Most respondents who had an add-on in their policy (either purchased separately or included in the basic cover) said that they compared that add-on across motor insurers the last time they compared motor insurance policies (see Table 9). Summing across the nine add-ons in our list, 52 per cent of add-ons included in policies were compared in this way. However, we note that different consumers might have meant different things in terms of the comparisons they made.

74. Most respondents who compared features of add-ons across motor insurers said that they found it easy to do so, in particular for windscreen cover and NCB protection (see Table 8). It appears that consumer purchasing behaviour is similar for personal injury cover, extended foreign use cover and key loss cover, with relatively little comparison of these add-ons across motor insurers.

TABLE 8 **Percentage of policyholders covered by the product who compared the product across motor insurers**

	Included	*of which:*	*of which: Comparison of feature was*		*Unweighted base*
		Compared motor insurers	*Easy*	*Difficult*	
	%	*%*	*%*	*%*	
Windscreen cover	85	52	73	9	653
NCB protection	80	62	65	12	735
MLEI	76	52	55	17	569
Courtesy car cover	69	53	59	14	539
Personal injury cover	56	47	53	17	399
Breakdown cover	39	52	59	13	355
Extended foreign use cover	30	26	59	18	114
Key loss cover	24	32	52	15	127

Source: CC motor insurance customer survey questions B2, B7, B8.

*'Easy' combines responses to B9 of; 'quite easy' and 'very easy'; 'difficult' combines 'quite difficult' and 'very difficult'.

75. Table 9 shows respondents' perceptions of the value for money of add-ons which they have taken up.

TABLE 9 **Perceived value for money among those that have the feature**

per cent

		*Value for money**		
	Included	*Good*	*Poor*	*Don't know*
Windscreen cover	85	65	8	7
NCB protection	80	69	6	7
MLEI	76	53	6	14
Courtesy car cover	69	54	7	14
Personal injury cover	56	51	7	12
Breakdown cover	39	64	7	9
Extended foreign use cover	30	38	16	23
Key loss cover	24	35	8	10

Source: CC motor insurance customer survey questions B2, B9.

*Question B9 of the customer survey asks 'On a five point scale where 5 is very good value and 1 is very poor value, how would you rate the value for money of the feature available to you'. Responses of 4 or 5 are categorized as 'good' for the purpose of this table, and responses of 1 or 2 are categorized as 'poor'.

76. Most respondents thought that the add-ons they had taken up were good value for money.[20] This was particularly true of NCB protection (69 per cent). For most add-ons, only a small percentage of respondents who had taken up an add-on regarded it as poor value for money (6 to 8 per cent for most add-ons). The proportions were higher for extended foreign use cover, which is discussed below.

[20] We note that, where an add-on was purchased as part of a basic motor insurance policy and without the payment of an additional premium, the 'cost' of the add-on might still have been assessed by comparison with the cost of the add-ons from another provider.

77. A relatively high proportion (23 per cent) of those respondents who said that they had extended foreign use cover said that they did not know whether it was good value. This suggests to us that many consumers of this add-on are unclear of the cover provided and whether or not it is needed in order to drive abroad.

Personal injury cover

78. The name of this add-on varies between motor insurers. Over half of the respondents to our customer survey of motor insurance policyholders (56 per cent) said that they had this add-on. We noted that there was also evidence of a seasonal effect with the add-on being taken up more often when policies were renewed in the first three months of the calendar year (60 per cent), possibly reflecting greater awareness of the risk of injury at that time of year.

79. Table 10 shows the extent to which respondents believed they understood the personal injury cover add-on,[21] analysed by their rating of its value for money. Half of respondents rated the add-on as good or very good value for money and these respondents tended to be those who claimed to understand it. This pattern applies to all nine add-ons, ie the more respondents believed they understood the add-ons, the better value for money they perceived the add-on to be.

[21] Question B10 of the customer survey asked the following: 'And still thinking about the last time you were considering which features to include in your Private Motor Insurance Policy, how well do you believe you understood what exactly the feature covered? Please answer on a scale of 1 to 5 where 5 is very well understood and 1 is not at all understood.' The results shown in this paper categorize respondents' perceived understanding into 'High' (a response of 4 or 5 to the question), 'Medium' (a response of 3) and 'Low' (a response of 1 or 2). The very small number of respondents who said they didn't know have been excluded from the analyses.

TABLE 10 **Perceived understanding compared with perceived value for money**

per cent

Personal injury cover	*How well the respondent believed they understood the feature*					
	Not at all				*Very well*	
	1	*2*	*3*	*4*	*5*	*All*
Poor or very poor value	21	28	10	6	3	9
Neither poor nor good value	28	30	41	29	19	30
Good or very good value	26	27	35	57	71	50
Don't know	26	16	14	8	8	11
Total	5	10	30	26	29	100
Base	43	90	279	244	266	922

Source: CC motor insurance customer survey questions B9, B10.

80. Table 11 shows the results of a suite of three questions designed to test actual understanding of personal injury benefits. The questions were asked of all those who had considered (most of whom also took up) personal injury cover. While most respondents said that they were covered by the add-on, only 17 per cent answered correctly that passengers, other than themselves and their spouse, were not covered by it. Only 5 per cent of respondents answered all three questions correctly.

TABLE 11 **Actual understanding of personal injury benefits**

per cent

	Do you think the following are covered?		
	You	*Your spouse*	*Any passengers*
Yes	84*	58*	56
No	6	22	17*
Don't know	9	20	27
% 'yes' by claimed understanding			
High	89*†	61*	59
Medium	83*	56*	53
Low	79*†	56*	50

Source: CC motor insurance customer survey, questions B10, B10a.

*Indicates the correct answer (although a few motor insurers might provide cover with a slightly different scope, we believe the market shares of such providers is insufficient to materially affect our results).
†Statistically significant difference.

81. The second part of Table 11 shows the percentage of respondents who said 'yes' to each of the questions asked broken down by their perceived level of understanding of the add-on. The table shows that the percentage of respondents who said 'yes' increases with their perceived level of understanding, though in the last case 'yes' is

the incorrect answer (59 per cent of those who thought that they understood the add-on well answered incorrectly).

82. Table 10 shows that the perception of understanding of an add-on tends to make a customer value it more. Table 11 suggests that this is because such customers think that the add-on offers wider cover than other customers, though sometimes they do so incorrectly. Subsequent tables in this section support this finding.

83. Table 12 shows the results of a similar set of questions for medical expenses. In this case the correct answer to all three questions was 'yes', and 40 per cent of those with the add-on answered all three questions correctly. Again, the perceived coverage of the add-on tended to increase with the perceived understanding (though in this case it was correct that coverage was wider).

TABLE 12 **Actual understanding of medical expenses**

per cent

	Do you think the following are covered?		
	You	*Your spouse*	*Any passengers*
Yes	84*	58*	50*
No	7	23	20
Don't know	10	19	30
% 'yes' by claimed understanding			
High	87*	62*	55*†
Medium	83*	54*	45*†
Low	80*	60*	45*

Source: CC motor insurance customer survey, questions B10, B10b.

*Indicates the correct answer.
†Statistically significant difference.

NCB protection

84. Our customer survey found a high stated take-up of NCB protection (80 per cent). However, this is likely to be an overstatement due to some customers confusing NCB and NCB protection. Data from five of the ten largest motor insurers suggests that actual take-up rates of NCB protection are between [✂] and [✂] per cent, with an

unweighted average of 49 per cent. This suggests that a significant proportion of consumers who think that they have the protection do not have it.

85. Nevertheless, a high proportion of respondents (77 per cent) thought that they had a good understanding of this add-on. Table 13 shows that 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, and only 29 per cent of respondents who said that they had the add-on answered this question correctly.[22] Respondents claiming a high level of understanding of NCB protection tended to be the most optimistic about the extent of its cover.

TABLE 13 **Actual understanding of NCB protection**

per cent

	Does the protection prevent your premium going up as a result of a claim?		
	Yes	*No*	*Don't know*
All with feature	56	29*	14
By claimed understanding			
High (base 991)	59†	29*	12†‡
Medium (base 182)	46†	31*	23†
Low (base 108)	50	27*	23‡

Source: CC motor insurance customer survey, questions B10, B10c.

*Indicates the correct answer.
† and ‡ indicate statistically significant differences.

86. 37 per cent of those who said that they had made a 'claim' against their NCB protection answered the question correctly. 47 per cent of those who had made a 'claim' said that they understood the add-on very well; with 48 per cent of respondents who had not made a 'claim' saying the same. This is different from all other add-ons (except extended foreign use travel where the number of claims is very low), where the experience of claiming against the add-on tends to increase both the stated and actual understanding.

[22] A motor insurance premium may rise following an accident, notwithstanding NCB protection, as a motorist involved in an accident (whether fault or non-fault) may be deemed by a motor insurer to be statistically more likely to have an accident in the future. NCB protection is also usually limited to a certain number of claims in a defined time period, such that if there are more accidents, the NCB will decrease.

Extended foreign use cover

87. Only 30 per cent of respondents said that they had extended foreign use cover. Among these, 60 per cent said that they had a good understanding of this add-on, but only 30 per cent of these correctly answered the question testing their understanding of it (see Table 14).[23] A higher proportion (42 per cent) of those who said they had a low understanding of the add-on gave the correct answer.

TABLE 14 **Actual understanding of extended foreign use cover**

per cent

	Do you need the feature to be able to drive your vehicle at all in continental Europe?		
	Yes	*No*	*Don't know*
All with feature	55	30*	16
By claimed understanding			
High (base 272)	61†	30*	9
Medium (base 108)	56	27*	17
Low (base 71)	42†	42*	15

Source: CC motor insurance customer survey, questions B10, B10d.

*Indicates the correct answer.
†Indicates statistically significant difference.

Key loss cover

88. Only 24 per cent of respondents said that they had key loss cover. Take-up was higher among the C2DE socioeconomic group (29 per cent) and much higher in Northern Ireland (38 per cent). It was also higher among those who had foreign travel cover (32 per cent).

89. Of respondents with key loss cover, 67 per cent 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 (see Table 15).[24] Those who thought that

[23] Foreign use cover is not necessary in order for the policyholder to drive their car in Europe (as a basic motor insurance policy provides at least third party cover abroad).
[24] Key loss cover insures for the replacement cost of locks and keys for the car if the policyholder loses the keys, but the insurance company will not send someone to sort out the problem. From the evidence we have seen, a very small proportion of key loss covers will include the motor insurer sending someone out.

they understood the add-on tended to be more optimistic about its coverage, though not always correctly.

TABLE 15 **Actual understanding of key loss cover**

per cent

	Will this pay for replacement keys and locks to your car if you lose your keys?		
	Yes	*No*	*Don't know*
all with feature	75*	6	18
By claimed understanding			
High (base 267)	86*†‡	3†‡	11†‡
Medium (base 86)	63*†	10†	27†
Low (base 47)	57*‡	15‡	28‡
	Will someone appointed by the insurance company come out to you and fix the problem if you lose your keys?		
	Yes	*No*	*Don't know*
All with feature	50	14*	37
By claimed understanding			
High (base 267)	55	12*	32
Medium (base 87)	43	17*	40
Low (base 48)	46	17*	38

Source: CC motor insurance customer survey, questions B10, B10e, B10f.

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*Indicates the correct answer.
†and ‡ indicate statistically significantly differences, eg in column 1, 86 per cent is statistically higher than 63 and 57 per cent but 63 per cent is not statistically higher than 57 per cent.

Descriptions of add-ons provided by motor insurers on their websites

Personal injury cover

Admiral

Personal Injury Cover provides cash when hospitalised after an accident, and up to £50,000 cover for serious injury or accidental death in your car. It also includes all the following benefits:

All named drivers are covered (under the age of 80)

Cover is extended for the policyholder travelling in any other privately insured car in the UK

You're covered whether the accident is your fault or not, and if you're hit by an uninsured driver

Please click here for full terms and conditions

Aviva

Regardless of who's to blame for an accident involving the insured vehicle, if the main driver is seriously injured, this cover helps to provide financial peace of mind.

£40,000 payment following death or permanent loss of a limb, sight or hearing within 3 months of an accident in the UK.

Or if you prefer choose joint cover for the main driver and their partner (£20,000 each).

esure

With our Personal Injury Benefit you get peace of mind in the knowledge from knowing that you'll get up to £30,000 worth of compensation if you, your partner and any named drivers or passengers suffer an injury in an accident -

regardless of who's to blame. Simply add Personal Injury Benefit to your car insurance policy and you also get the following:

All named drivers and passengers covered

Policyholder covered whilst travelling in any other private car in the UK

The cover applies regardless of whether the accident is your fault or not

Up to £30,000 worth of compensation

Plus these Cash Benefits if medical treatment is required:

£200 per night spent in hospital (10 days maximum)

£1,000 if you need an operation or surgical procedure

£500 if you need cosmetic dental work

£250 if you need physiotherapy

LV

With our standard comprehensive insurance, we'll pay you £10,000 if you or your husband, wife or civil partner is accidentally injured while travelling in, or getting into or out of, any car. For a small additional fee you can increase this cover to £100,000. This is only available with comprehensive cover.

Zurich

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.

NCB protection

Admiral

Please select the level of protection you would like for your No Claims Bonus from the available list

If you have 3 or fewer years No Claims Bonus you cannot choose to protect it. Please select the 'None' option

If you have 4 or more years No Claims Bonus, you can choose to protect it (subject to conditions). This means that you can have up to 2 claims in the next 3 years without losing your No Claims Bonus.

If you have 5 or more years No Claims Bonus, you can choose to guarantee it (subject to conditions). This means that you cannot lose your No Claims Bonus, regardless of the number and type of claims you may have.

Aviva

Protected no claim discount (NCD) protects you 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.

AXA

If you have five or more years no claims discount, why not protect it? This will allow you to have one claim in a year or two claims in a three year period without it affecting your no claims discount.

LV

If you protect your no claim discount it won't be reduced, regardless of the number of claims you make. If you don't protect your no claim discount, it could be reduced if you make a claim. W can only protect your no claim discount if you have four or more years.

RSA

With this protection if you make a claim on your policy we'll allow you to keep your No Claim Discount (providing no more than two claims occur within five consecutive years of insurance). If you need to make more than two claims, we'll only reduce your No Claim Discount in line with the scale described in your policy booklet.

Zurich

For a little extra, you can also:

Protect your no claims discount

Make 2 claims in 5 years without it affecting your overall bonus.

Extended foreign use cover

Aviva

Extended foreign use matches your UK cover and extends it whilst driving abroad in the countries listed below. Cover is valid for up to 90 days for one trip and up to 6 months during the year.

Andorra, Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France (inc Monaco), Germany, Gibraltar, Greece, Hungary, Iceland, Republic of Ireland, Italy, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, San Marino, Slovakia, Slovenia, Spain, Sweden, Switzerland, Vatican City.

If the country you want to travel in is not in the list above, we may still be able to offer cover. Please contact us to complete your quote.

Extended foreign use cover can also be extended to include European breakdown recovery, provided by the RAC.

CISGIL

Are you a frequent visitor to Europe, or do you like to escape to the Mediterranean to avoid the British winter?

With our motor policy you are covered to drive your vehicle abroad for up to 8 days in any policy year. However if you require an extension to this, then you should consider our Extended foreign use cover.

Our Extended foreign use would provide you with:

A similar level of car insurance cover as you have in the UK for 365 days a year, with a single trip limit of 90 days.

Cover whilst driving abroad in any country which is a member of the European Union.

Freedom to go on holiday without having to let us know.

Peace of mind that you have the backing of The Co-operative Insurance and its partners if you are involved in an accident abroad.

Please be aware:

A limit of 90 days per trip applies to this cover.

The £15 charge for this cover is a flat fee. This is irrespective as to when the cover is added to the policy or the number of trips taken.

LV

All of our policies meet the minimum compulsory insurance requirements in the European Union. However, this wouldn't cover damage to your car. For a small additional fee, you can choose to extend this minimum cover to get the full benefits of this insurance when you're travelling in EU countries up to 180 days in a policy year, including when your car is being transported. If your vehicle can't be driven or has been stolen and not recovered in one of the countries covered by the extended foreign use, one of the options available to

you is you could hire a vehicle. We will reimburse you on your return to the UK, up to a total of £1,000.

Key loss cover

Admiral

Keycare cover provides the protection of up to £1,500 for the costs of replacement locks and keys, if yours have been lost for 3 days or have been stolen.

Some of the other benefits include:

Cover for any of your keys, not just your car and your home, as long as they are attached to the Keycare fob (and the claim is reported to Keycare within 30 days)

Emergency helpline open 24 hours a day, 365 days a year

Access to a nationwide network of locksmiths

No excess to pay

You can also extend the policy to another set of keys belonging to someone else in your household, so their keys benefit from the same level of cover as well.

Please click here for full terms and conditions.

AXA

Up to £300 if your car key is lost or stolen, or £1,500 to replace the locks of your car.

esure

With our new 'Key Cover' we'll provide protection in the event of loss, damage to or theft of your car key. We will arrange to pay for:

- The cost of retrieving your car key if it is accidentally locked in your car; or

- Transport costs for you to collect a spare key from your home address if you do not have a spare car key with you at the time of the loss or damage or theft, if we consider the cost to be reasonable; or

- The cost of replacing the car key and for resetting or reprogramming your car's immobiliser and alarm system, up to a maximum of £300;

- The cost of replacing a lock if your car key breaks in the lock and cannot be removed; and

- Transporting you, your car and up to 8 passengers to the nearest suitable garage within the Green Flag network to obtain a replacement key or replace the locks.

- If your car key cannot be replaced, or we are satisfied that the identity or location of your car is known to any person who may have your car key, we will pay up to £1,500 for replacing the locks on your car and for resetting or reprogramming your car's immobiliser and alarm system or replacing the directly associated electronic control units.

Zurich

This cover provides up to £2,500 for replacing locks and keys for your car, home and office, including locksmith charges. You'll also receive three days of emergency car hire or the option to reclaim the cost of onward transport if your car keys are lost or stolen.

Courtesy car cover

Aviva

Relax with peace of mind that we'll keep you on the road if your car is written off or stolen. The package includes the following features:

Guaranteed replacement car* for the duration of repair if you use an approved repairer.

Guaranteed replacement car following a total loss, theft or fire claim for 14 days or on settlement of the claim (whichever is earliest), if you use an approved repairer.

If your vehicle is immobile or is not roadworthy the repairer can collect your vehicle and leave you with a courtesy vehicle.

* standard courtesy car – entitles you to a small three door hatchback vehicle with an engine size of 1 litre.

enhanced courtesy car – five door vehicle with an engine size of 1.6 litres, with room to seat five people.

DLG

For a small extra premium, we'll supply a hire car for up to 14 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 can only be added to your policy if you have Comprehensive cover.

LV

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.

RSA

We'll supply you with a courtesy car for up to 14 days whilst yours is either: -

being repaired at a repairer not recommended by ourselves – has been stolen

or – has been declared a total loss. Following an incident which is not covered under your policy. Click for more info.

Enhanced courtesy car cover

Aviva

Relax with peace of mind that we'll keep you on the road if your car is written off or stolen. The package includes the following features:

Guaranteed replacement car* for the duration of repair if you use an approved repairer.

Guaranteed replacement car following a total loss, theft or fire claim for 14 days or on settlement of the claim (whichever is earliest), if you use an approved repairer.

If your vehicle is immobile or is not roadworthy the repairer can collect your vehicle and leave you with a courtesy vehicle.

* standard courtesy car – entitles you to a small three door hatchback vehicle with an engine size of 1 litre.

enhanced courtesy car – five door vehicle with an engine size of 1.6 litre, with room to seat five people.

CISGIL

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 3.5tonne 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.

DLG

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.

Analysis of vertical agreements for the supply of paint (excluding foreclosure)

Introduction

1. This appendix considers the contracts between motor insurance providers and paint manufacturers or distributors, and their possible effects on competition. There is a range of such agreements. In general, the agreements provide for referral fees or rebates to be paid to insurers in return for them recommending (or mandating) the use of a particular paint brand to their network of approved repairers.

2. The main question we assess in this appendix is whether these contracts lead to an increase in the billed cost of paint, which may increase the cost of non-fault claims if the billed cost is passed to the at-fault insurer without taking into account the referral fee or rebate income received. This may harm final consumers through higher motor insurance premiums. This issue is part of our analysis of ToH 1, as it is a potential mechanism by which the separation of cost liability and cost control in the management of non-fault claims can lead to higher costs for fault insurers (see also Appendix 6.2. We also consider in this appendix some of the other concerns relating to the supply of paint which have been raised by various parties.

3. Another potential issue with paint supply contracts is whether they lead to vertical foreclosure, ie whether they provide a means for paint manufacturers or insurers to raise rivals' costs in a way that leads to a reduction in effective competition. We discuss this issue separately in Appendix 9.2.

Summary

4. The contracts between insurers and paint manufacturers can be divided into two groups:

(a) *Non-exclusive contracts:* Under these agreements, the insurer recommends a paint brand, and possibly a distributor, to its network of repairers and, in return, the paint manufacturer (and distributor) pays a fixed fee and/or per-repair fee to the insurer. The repairers retain some control over which paint to use. Such contracts exist between [✂], as well as between some CMCs and paint marketing associations (PMAs).

(b) *Exclusive contracts:* Under these agreements, the insurer mandates a paint brand, and possibly a distributor, to its network of repairers. [✂]

Non-exclusive contracts

5. It appears to us that repairers face slightly higher costs for paint as a result of the contracts between insurers and paint manufacturers. However, the evidence from repairers suggests that such cost increases are generally low, being not larger (and usually much smaller) than £18 per repair, which is a small percentage of the total cost of paint for insurers and around 1.5 per cent of the total cost of a repair. Moreover, we note that such cost increases are likely to be close to the level of rebates earned by insurers.

6. Since the rebates from paint manufacturers (and distributors) received by the non-fault insurer (in relation to non-fault claims) are not passed on to the at-fault insurer, the contracts lead to a difference between the effective cost of paint faced by the non-fault insurer (ie net of the rebate) and the cost incurred by the at-fault insurer (which pays the price which is higher than it otherwise would be). This difference is around £[✂] per repair. In Appendix 6.6 we estimate the total increase in subrogated repair costs arising from the separation of cost liability and cost control and this amount relating to paint supply contracts is one element of that increase.

Exclusive contracts: [✂]

7. [✂] This arrangement gives [✂] an incentive to set a high paint price for its repairers to pay to [✂], notwithstanding that this will result in a higher cost of paint in the repair bills it receives than would otherwise be the case.

8. When [✂] is the non-fault insurer, this structure of payments inflates the cost of repairs passed on to the at-fault insurer, as the costs passed on are those reflected in the billed cost of paint and do not take account of the rebates received. However, our assessment finds that the cost of paint charged to [✂] by its approved repairers is in line with the prices agreed between other insurers and their approved repairers, which suggests that [✂] does not lead to a greater increase of subrogated costs than non-exclusive paint contracts (see paragraph 6). Separately, we note that, [✂] and it appears to us that this is another mechanism by which non-fault repair costs can be inflated before they are passed to the at-fault insurer (see Appendix 6.2).

Other concerns

9. Currently, it appears to us that none of the other concerns which parties have raised in relation to paint supply contracts (eg loss of anti-corrosion warranty or higher prices due to reduced competition between distributors) are likely to give rise to competition problems in relation to the supply of motor insurance and related services.[1]

Structure of the appendix

10. In the first part of the appendix, we explain how the cost of paint is determined in the absence of vertical agreements between insurers and paint suppliers. We then describe such vertical agreements, distinguishing between non-exclusive contracts

[1] In our analysis we have considered whether such paint supply contracts might affect the provision of post-accident repair services covered by motor insurance. We have not considered whether such contracts might affect the conditions of competition in the paint market.

(with or without minimum volume requirements) and exclusive contracts (ie [✂]). We also discuss briefly agreements involving car manufacturers. We consider the implications of these agreements for repairs which are handled by other parties and non-insurance repairs. Finally, we consider to what extent the discounts and rebates stipulated in the contracts are passed on to fault insurers.

11. The second part of the appendix considers the rationale for such agreements, including possible efficiencies. We also discuss possible sources of harm for consumers arising from them. Here we discuss whether such contracts contribute to the increase of subrogated costs (ie our hypothesis under ToH 1). We consider whether payments to insurers have a significant effect on the cost of paint and the extent to which they generate differences between the costs faced by different insurers. Finally, we discuss briefly other concerns parties have raised.

Background

12. Refinish paint accounts for around 20 per cent of the average billed cost of a post-accident repair.[2] Its price is determined by complex interactions between paint manufacturers, distributors, repairers, insurers or CMCs, and car manufacturers. We can distinguish between:

(a) the trade price of paint (ie the published list price);

(b) the wholesale price paid by paint distributors to paint manufacturers;

(c) the retail price paid by repairers to paint distributors; and

(d) the billed price, charged by repairers to insurers or final customers.

13. In addition, rebates are sometimes paid by paint manufacturers or distributors to insurers, CMCs or car manufacturers (referred to by some parties as 'influencers') or to repairers.

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[2] See Appendix 9.2.

Paint sourcing in absence of vertical supply contracts

14. Although there is a published trade price for each paint product, repairers do not typically pay this price. Paint distributors commonly offer large discounts to repairers, either reducing the price or establishing a parallel rebate.[3]

15. The cost of paint charged by a repairer to an insurer is typically neither the trade price nor the price paid by the repairer but rather is based on the Audatex 'weighted average paint price'. This price is calculated by Audatex using a basket of trade prices and weighting them according to their respective market shares.[4] The repairer's price to the insurer is usually a percentage of this weighted average Audatex price, in particular where the repairer is part of the insurer's approved repair network (having had to compete to become part of this network).

16. We can illustrate the different prices for paint in an example.[5] If the paint needed for a repair has a trade price of £230 but the paint distributor charges a retail price to the repairer of £100, and if Audatex calculates that the cost of paint for the repair, based on the weighted average paint price, is £250, when billing the insurer, the repairer will use the Audatex paint price as a reference but will apply a discount of, say, 20 per cent, resulting in a price billed of £200 (with the repairer making a profit of £100).

17. It appears that the difference between retail prices and the prices billed to insurers is substantial. Repairers told us that the cost of paint was between 20 and 40 per cent of the Audatex weighted average paint price, while insurers were usually charged between 70 and 80 per cent of this price.[6] In absolute terms, it appears that repairers

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[3] [✂] told us that its approved repairers [✂] negotiated rebates with paint suppliers independently. The rebates earned by [✂] totalled just under £[✂] in 2012.
[4] The paint brands included in the Audatex paint basket are PPG, Nexa Autocolor, Sikkens, Standox, Spies Hecker, DuPont, Glasurit and R-M.
[5] The prices are illustrative only and are not meant to reflect real prices.
[6] [✂] told us that it paid 25 per cent of the Audatex price and received from insurers 70 per cent of this price. [✂] told us that it paid between 20 and 32 per cent of the Audatex price and usually charged 80 per cent of this price (although the amount could be as low as 50 per cent with some insurers). [✂] said that [✂].

spend, on average, around £80 to £90 on paint per repair (less when they are free to choose their supplier) but bill insurers, on average, around £200 to £350.[7] According to TrendTracker, repairers, constrained by low labour rates and narrow margins on replacement parts, rely on the high margin they achieve on paint.[8]

Vertical supply contracts to source paint

18. Currently, five of the ten largest insurers have contracts with paint manufacturers: [✂].

19. Some of these agreements also involve PMAs (see Annex A). In addition, some CMCs (eg [✂] and [✂]) have similar paint supply agreements.

20. Such contracts are not standard practice as five of the ten largest insurers do not have them and we have seen no evidence that other insurers (outside of the ten largest) have them. However, the five insurers with such agreements had, in 2012, a combined share of [✂] per cent of the motor insurance market in the UK.[9]

Structure of the contracts

21. Although each paint supply contract is different, they can be divided into three groups:

    (a) Non-exclusive contracts: an insurer (or CMC) recommends a paint brand to its approved repairers for use on its repairs in return for a rebate ([✂]).

    (b) Non-exclusive contracts with minimum volume requirements: an insurer (or CMC) recommends a paint brand for use on its repairs but the rebate is conditional on a minimum volume being purchased ([✂]).

---

[7] A repairer told us that it paid between £80 and £90, while charging around £180. It said that it would be able to save around £15 if it were free to choose its supplier. In [✂] if the repairer were free to decide on the paint used. [✂] seemed to suggest that average costs were even lower. For their average paint costs invoiced to insurers, repairers gave us the following values: [✂] (£243–£328), [✂] (£360), [✂] (£228), [✂] (£235–£250), [✂] (£275).
[8] *The Future of the Car Body Repair Market in the UK*, 2012–2017, p27.
[9] Based on data from the insurers. The estimated total market size is from Datamonitor report, p30, based on ABI data.

(c) Exclusive contracts: an insurer mandates a paint brand to its approved repairers for use on its repairs in return for a rebate ([✂]).

We discuss each in turn.

Non-exclusive contracts without volume restrictions

22. Table 1 summarizes the main characteristics of the [✂] non-exclusive contracts without volume requirements.

TABLE 1 **Paint supply contracts involving** [✂]

[✂]

23. The main characteristics of these contracts are:

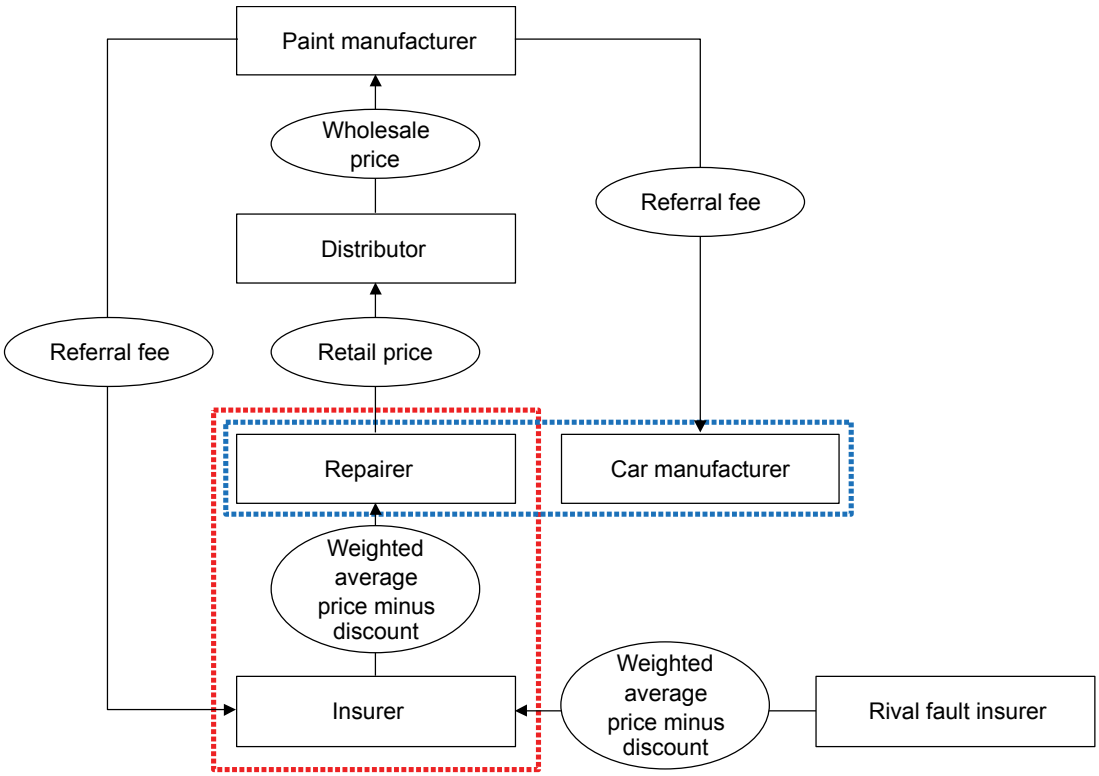
- Insurers recommend a paint manufacturer (and possibly a distributor) to their repairers but the repairers are free to choose from which supplier to buy their paint. A typical clause specifies that the insurer shall 'use its best endeavours to persuade its approved repair network to utilise the supplier's refinish materials'.[10] In practice, it could be that this recommendation is interpreted by repairers as an effective mandate.[11]
- There is typically a flat fee and/or a rebate paid [✂].
- The fee is [✂].

24. Figure 1 shows a stylized example of such a contract between a paint manufacturer and an insurer, and the resulting payments. It also shows a concurrent contract (and referral fee payment) between the paint manufacturer and a car manufacturer. Figure 2 represents the case in which an insurer has agreements with both a paint manufacturer and a PMA.

[10] [✂]
[11] For example, [✂] told us that [✂] mandated [✂] paint. [✂] said that 'often the recommendation is such that the business considers it to be mandated'.

FIGURE 1

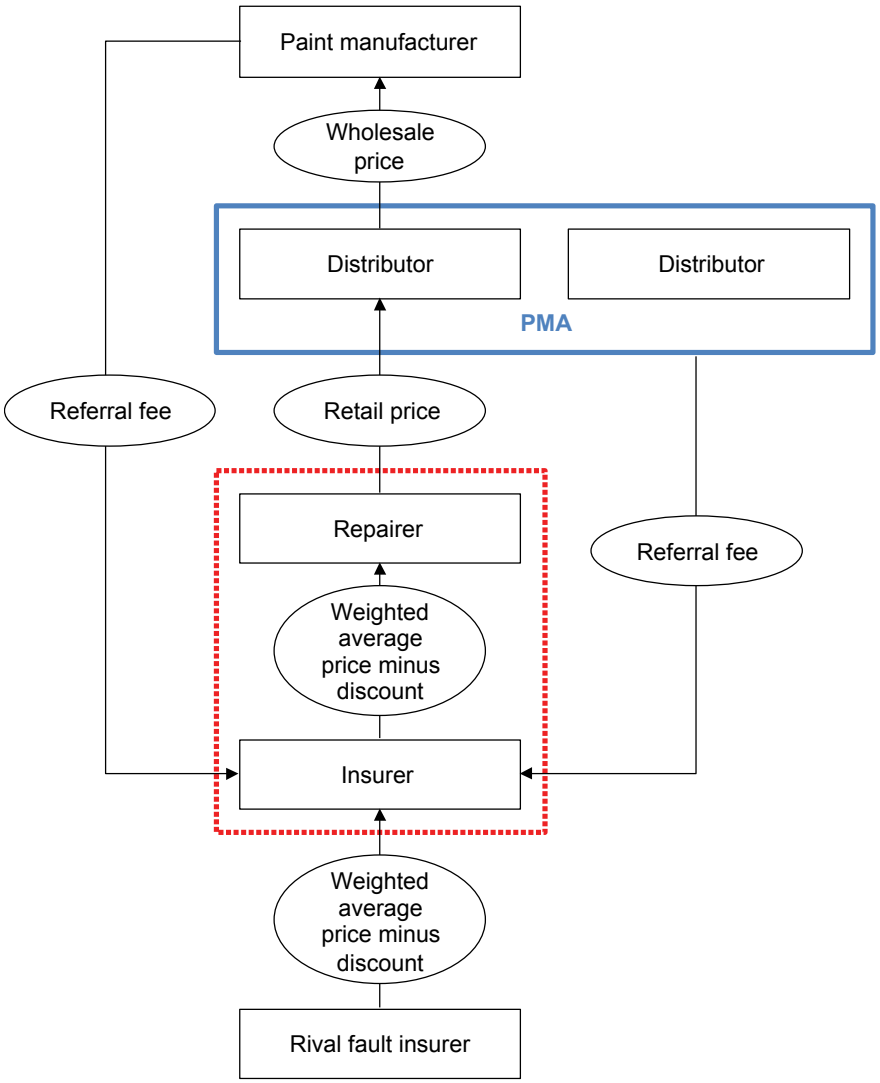
Contract between an insurer and a paint manufacturer



Source: CC analysis.
Note: The repairer in the figure is approved by both the insurer and the car manufacturer.

FIGURE 2

Contracts between an insurer and both a paint manufacturer and a PMA



Source: CC analysis.

25. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).[12] If, for each repair in which the recommended paint is used, the paint manufacturer pays a rebate of £5 to the insurer, when the insurer is in the at-fault position, the net cost of a repair is £195 (ie it pays £200 to the repairer but receives a rebate of £5 from the paint manufacturer); but when the insurer is in the non-fault

[12] The prices are illustrative only and are not meant to reflect real prices.

position, it still receives the £5 rebate but bills the at-fault insurer the full £200,[13] making a profit of £5.

Non-exclusive contracts with minimum volume requirements

26. [✂] similar to the non-exclusive contracts described above. However, [✂] the rebate is conditional on a minimum spend per repair on paint and related consumables. Table 2 summarizes [✂] characteristics. The table also shows, for comparison, details [✂].

TABLE 2 **Paint supply contracts involving** [✂]

[✂]

27. In the [✂].[14] This is equivalent to [✂]. One repairer told us that this minimum amount was in general substantially in excess of what it needed per repair.[15]

Exclusive contracts

28. The [✂] introduces a different system of rebates from the non-exclusive contracts discussed above.

29. [✂] Table 3 shows the [✂].

TABLE 3 [✂]

[✂]

30. [✂]

31. [✂] Figure 3 illustrates [✂].

[13] We note that there are some exceptions, for example when the at-fault and non-fault insurer have signed a bilateral agreement.
[14] [✂]
[15] [✂] told us that 'you need to commit to the volume of spend of 3 jobs to [✂] for every [✂] job repaired'. However, another repairer provided an estimate of the average cost of paint in the absence of vertical agreements, on the basis of which it seems that the minimum volume requirement set by [✂] would be sufficient for at most 1.5 repairs.

FIGURE 3

[✂]

Source: CC analysis.

32. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).[16] If the amount of paint required for a repair costs [✂], in this case, [✂].

33. Figure 4 illustrates [✂].

FIGURE 4

[✂]

Source: CC analysis.
Note: [✂]

34. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).[17] If the amount of paint required for a [✂]. Figure 5 illustrates this numerical example.

FIGURE 5

[✂]

Source: CC analysis.

35. [✂]

36. [✂]

Contracts involving car manufacturers

37. Contracts similar to those between paint suppliers and insurers (and CMCs) also exist between paint suppliers and car manufacturers. Car manufacturers have their

[16] The prices are illustrative only and are not meant to reflect real prices.
[17] The prices are illustrative only and are not meant to reflect real prices.

own networks of approved repairers to which they may recommend the use of specific paint brands, in return for a fee.

38. Some car manufacturers have agreements with paint manufacturers (eg [✂]), some have agreements with paint distributors or PMAs (eg [✂]) and some have agreements [✂]. The fees earned may be either fixed or proportional to the value of the refinish paint sold to the manufacturer's approved repairers. In 2012, the fees received by [✂] from two paint manufacturers totalled £[✂], while [✂] received a total of £[✂] from [✂].

39. As these fees accrue to car manufacturers, the potential cost increases affect all insurers, irrespective of whether they are in the at-fault or non-fault position (ie the separation of cost liability and cost control applies to both at-fault and non-fault claims).

40. The same repairer can belong to the network of more than one insurer and car manufacturer, and different insurers/manufacturers might have agreements with the same paint supplier. In this case, a fee would be paid by the paint supplier to all the insurers and manufacturers entitled to it; however, some adjustments are usually applied to take into account the presence of multiple work providers. For example, [✂] records sales against each repairer and allocates them to different work providers in order to calculate a theoretical maximum number of paint jobs, which may be lower than the amount claimed by each insurer/manufacturer ([✂]). Similarly, [✂] crosschecks the number of repairs reported to it by work providers with the sales volumes to repairers communicated to it by its distributors. It appears to us that, due

to these controls, rebates are not usually paid to multiple insurers and manufacturers for a single repair.[18]

Implications for repairs handled by other insurers or non-insurance repairs

41. Although repairers are free to choose the paint they use for all repairs they conduct for parties which do not have paint supply contracts, an effect of the paint supply contracts which exist might be to restrict this choice in practice, especially if the repairer is small, for the following reasons:

(a) each paint requires the use of specific equipment so using multiple paint brands is costly (in terms of physical infrastructure and training);

(b) repairers can obtain better retail prices if they purchase larger volumes of paint so they would prefer to use a single brand;[19] and

(c) where there are volume requirements in a paint supply contract [✂], the paint purchased under the contract might be more than is needed, with the excess used in other repairs.

42. Different repairers adopt different strategies: some use only the brands which they are required (or encouraged) to use by some of their work providers; others use a different brand of paint when they are free to choose.

Costs passed on to fault insurers

43. In general, insurers told us that they passed on to the at-fault insurer the repair bill as they received it from the repairer. Moreover, repairers told us that when they were an approved repairer and they calculated a repair bill for their work provider, they did not take into account whether the customer was an at-fault or non-fault claimant. On the basis of this evidence, it appears to us that non-fault insurers generally pass on the

[18] We have received documental evidence that multiple influencers have been paid by [✂] in relation to the same repairs. However, this is not the general approach in the industry.
[19] In 2012, [✂] used paint only from those suppliers which were mandated by insurers, in order to achieve volume discounts. However, it told us that it was moving away from this model.

discounts (on invoice) they obtain from repairers but do not pass on the rebates they receive from paint manufacturers or distributors (or others, including the repairers themselves).[20]

Business rationale for paint supply contracts

44. We asked insurers about their incentives for entering into vertical paint supply contracts. All the insurers mentioned similar reasons:

(a) to ensure that the paint used is of an appropriate quality;[21] and

(b) to achieve cost savings.[22]

45. [✂] told us that, using its bargaining power, it believed it was able to negotiate better terms with suppliers than each repairer could gain individually. [✂] said that, moreover, it was confident that it was achieving the most competitive price that it could for the paint used [✂] added that there were also administrative efficiencies from using a single supplier, though it could not quantify these savings.

46. [✂] told us that it entered into an agreement with [✂] because [✂] could negotiate better discounts, due to its collective purchasing volume, and then pass on these discounts to [✂]. However, we noted that [✂] negotiates directly with individual distributors (not with [✂]). [✂] said that it estimated it saved [✂] per cent in its purchasing of certain non-paint goods due to using [✂] as its distributor, but it did not provide an estimate of its savings on paint costs from this agreement.

47. Paint manufacturers told us that their rationale for vertical supply contracts was to facilitate their access to large repair networks. Similarly, [✂].

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[20] We note that there are some exceptions, for example when the at-fault and non-fault insurer have signed a bilateral agreement (eg where [✂] is the non-fault insurer and [✂] is the at-fault insurer, [✂] passes on to [✂] (with which it has a bilateral agreement) the rebates it receives from [✂]).

[21] This rationale was mentioned by [✂].

[22] This rationale was mentioned by [✂].

48. We noted that [✂].

49. We did not see any efficiencies arising from minimum purchase volumes per repair (such as [✂]).

Allegation of raising costs for rival insurers

50. In this section, we discuss whether the vertical paint supply contracts might have the effect of raising costs billed to rival insurers. We consider non-exclusive and exclusive contracts separately.

Non-exclusive contracts

Reduced competition leads to higher costs for repairers

51. It appears to us that, as a result of the contracts between paint suppliers and insurers (and CMCs), repairers face higher retail prices for refinish paint than would otherwise be the case (see paragraph 59). One repairer told us that it could procure paint for around £15 less per repair if it were free to choose its supplier. [✂] made a similar remark.

52. It appears to us that the fact that repairers buy the brands of paint recommended to them by insurers (and CMCs), despite them being more expensive than the paint they would otherwise choose, is indicative of the pressure put on them by insurers. [✂] told us that 'often the recommendation is such that the business considers it to be mandated'.

53. We note that the contracts between insurers and paint suppliers reduce competition at the retail level, changing the relative bargaining power of repairers and paint suppliers in favour of the suppliers. In the contracts involving [✂], competition between distributors appears almost completely eliminated as repairers are recommended to

buy a specific brand through a specific distributor; however, the contracts involving [✂] appear to preserve competition between distributors, with only the paint brand being specified. The rebates paid to insurers could be seen as the way in which insurers extract from paint suppliers the additional profits they enable them to make.

Higher costs for repairers may be reflected in the bills invoiced to insurers

54. Higher paint costs for repairers may (or may not) be reflected in the bills they charge to insurers. At one extreme, if the higher cost is not passed on, paint suppliers and insurers (through the rebates they receive) may be benefiting from reducing repairers' profits. In this case, the contracts could be beneficial to motor insurance consumers, as insurers might be expected to pass on their additional income in lower motor insurance premiums. At the other extreme, if the higher cost is passed on, insurers' claims costs might be expected to increase by as much as they make from the paint supply contract, or possibly even more.[23,24] The reason why an insurer may prefer rebates from the manufacturer, notwithstanding a higher billed cost of paint from the repairer, is due to the separation of cost liability and cost control, as it achieves the benefit in all cases and only incurs the higher cost when it is liable for the cost of the claim.

55. The extent to which the increase in paint cost is extracted from the paint supplier by the insurer as a rebate depends on the relative bargaining power of insurers and paint suppliers. If paint suppliers are in a strong bargaining position, they will increase the retail price as much as possible and pay a small rebate; however, if insurers are in a stronger position, they will extract a high rebate. We note that if all of

[23] The increase in the cost of paint billed to an insurer might be higher than the rebate it receives from the paint supplier. For example: if a paint supply contract results in a £7 increase in the retail price of paint to a repairer and this higher cost is fully passed on, and if the paint supplier pays the insurer £5 for each repair conducted by one of the insurer's approved repairers, if the insurer is at fault, it then loses £2 per repair compared with the prior situation. However, in all other cases it gains £5. (These prices are illustrative only and are not meant to reflect real prices.)

[24] The extent to which costs are passed through the supply chain will depend on the relative bargaining power of paint suppliers, repairers and insurers, and the competitive pressure in the paint and repair markets. It will also depend on whether payments to insurers are fixed or on a per-repair basis ([✂]). Per-repair payments have a direct impact on the suppliers' marginal cost and a profit-maximizing supplier would respond by increasing its prices; fixed fees do not change the marginal cost of producing and distributing paint, so they are unlikely to determine price increases in the short term.

the higher cost to repairers is passed on to insurers and paint suppliers retain some of the additional revenue (ie it is not all extracted by insurers in rebates), then paint supply contracts are unlikely to be beneficial to motor insurance consumers overall as there is likely to be some 'leakage' of value to paint suppliers and claims costs overall are likely to have risen.

56. Overall, we note that the amount by which some insurers benefit when in the non-fault position due to their paint supply contracts (typically around £[✂] to £[✂] per repair) is small relative to the average billed cost of paint and even smaller relative to the average total cost of a non-fault repair.

Minimum volume requirements

57. The minimum volume clause in [✂] introduces an additional potential source of cost increase. This clause appears to set the sales volume higher than is needed, causing some of the paint bought under the agreement to be used on repairs for work providers other than [✂], including non-insurance repairs.[25] We note that the costs billed to insurers are related to the actual volume of paint used for the repair, and not the, potentially higher, minimum purchase level, but it appears to us that the surplus paint may lead to a higher paint cost for other repairs if the repairer would otherwise have sourced the required paint more cheaply (and the customer does not have the bargaining power to avoid the cost increase).

Direct effect of contracts on motor insurance consumers[26]

58. In order to estimate the direct effect of the paint supply contracts on consumers, we considered:

[25] A similar effect arises if repairers prefer to use only recommended brands because of the additional cost associated with the use of multiple brands (see paragraph 41).
[26] In our analysis we have considered whether such contracts might affect the provision of post-accident repair services covered by motor insurance. We have not considered whether such contracts might affect the conditions of competition in the paint market.

(a) the magnitude of the increase in the billed cost of paint;

(b) whether the increase in the billed cost of paint is higher than the rebates earned by insurers (to assess the extent of 'leakage' to paint manufacturers); and

(c) whether any saving to a repairer from not having the paint supply contract would be passed on to insurers.

59. Using the data from Tables 1 and 2, we estimate that rebates are, on average, between £[✂] and £[✂] per repair.[27] We asked repairers to estimate the effective cost increase due to the contracts and they told us that using a paint brand different from that recommended by insurers but of comparable quality could generate savings of up to between £[✂] and £[✂] per repair, or between [✂] and [✂] per cent of the cost of paint in a repair.[28,29] Repairers told us that the saving would be mostly due to higher volume discounts from using only one paint brand. Most repairers told us that using recommended distributors would not give rise to significant cost increases (and any cost increase would be difficult to quantify). However, one repairer told us that using different distributors could save it up to [✂] per cent of its total cost of paint.[30]

60. Overall, it appears to us that the cost increases due to the paint supply contracts are likely to be close to the level of rebates earned by the insurers which are party to those contracts. There might be cases in which the cost increase is higher than the rebate earned, but the difference is likely to be very small. In other words, it appears

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[27] [✂]

[28] For example, [✂] told us that it could save up to £18, corresponding to 30 per cent of its paint costs. [✂] estimated savings of £6.40, out of an average spend on paint of £80 per repair. [✂] and [✂] told us that no significant savings could be achieved.

[29] Hex and RML told us that these figures underestimated true potential savings. According to them, the comparison should be made between premium (recommended) brands and budget (non-recommended) brands, and between paint prices in the UK and in alternative markets. The first point has been addressed in our analysis, because we have asked repairers to compare paints of comparable quality. If they thought that budget brands had the same level of quality as premium brands, they must have considered budget brands' prices in their responses. As for the prices in alternative markets, the comparison would be meaningful only if there were an effective restriction on parallel trade in the paint market. This, however, does not fall within the focus of our inquiry (see paragraph 79).

[30] According to [✂], savings would not be significant. Similarly, [✂] was not able to quantify them. However, [✂] estimated that it could save up to [✂] per cent of costs were it not to use the distributors recommended to it [✂].

that insurers extract the vast majority of the additional profit generated by paint suppliers from the paint supply contracts.

61. We considered whether, were a repairer free to choose its paint supplier, and so generate a saving, it would pass on this cost saving to insurers. This would require insurers to renegotiate their repairer agreements, which we understand currently happens infrequently (see paragraph 72). Moreover, the fact that repairers usually make reasonable margins on paint (compared with labour and parts—see paragraph 17) suggests that insurers may not go to great lengths to appropriate the savings. One repairer told us that savings on paint would amount to an additional [✂] per cent profit, which seems to imply that gains would not be passed through.[31]

62. We also note that the contracts between paint suppliers and insurers may generate efficiencies along the supply chain (see paragraph 44), some of which might result in reduced costs to consumers.

63. Overall, since cost increases arising from paint supply contracts are small relative to the average repair bill, and similar to the level of the rebates paid to insurers,[32] and given that it seems unlikely that repairers would pass on fully to insurers any savings from not having these contracts, it appears to us that harm to motor insurance consumers is unlikely to arise directly from these contracts. We note that harm to consumers might still arise indirectly due to these contracts inflating non-fault repair costs (see paragraph 54).

[31] On the other hand, [✂] estimated that a potential £18 saving would translate into an average reduction in the invoiced bill of £[✂]. However, this was based on the assumption of a fixed percentage profit margin. [✂] recognized that this might not be the case.
[32] [✂]

Exclusive contracts (with a specific referral fee structure)

64. Under the [✂]. We have investigated whether this leads to an inflation of costs of repairs passed on to fault insurers [✂] over and above the effects identified in paragraphs 54 to 56. There are two ways [✂] might achieve this: *(a)* its repairers might give less of a discount off the Audatex weighted average paint price; and/or *(b)* it might 'inflate' the Audatex weighted average paint price. We discuss each in turn.

Raising costs to rivals through giving less of a discount off the Audatex weighted average paint price

65. One way to 'inflate' repair bills is to give less of a discount off the Audatex weighted average paint price. [✂][33]

66. Similarly, [✂].[34]

67. However, we also note that there may be reasons for [✂].

68. It appears to us that the data suggests that [✂].[35]

69. An analysis of billed paint costs [✂].

70. Overall, it appears to us that [✂] does not lead to [✂] repair bills from repairers which are significantly inflated compared with those where there is a non-exclusive contract through [✂] less of a discount off the Audatex weighted average paint price.

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[33] [✂]
[34] [✂]
[35] [✂]

Raising costs for rivals through manipulation of the Audatex weighted average paint price

71. An alternative way to 'inflate' repair bills is to increase the Audatex weighted average paint price. However, we note that this would only have an effect if insurers could not quickly renegotiate their contracts with repairers to take into account the new base price. Therefore we considered the nature of these negotiations.

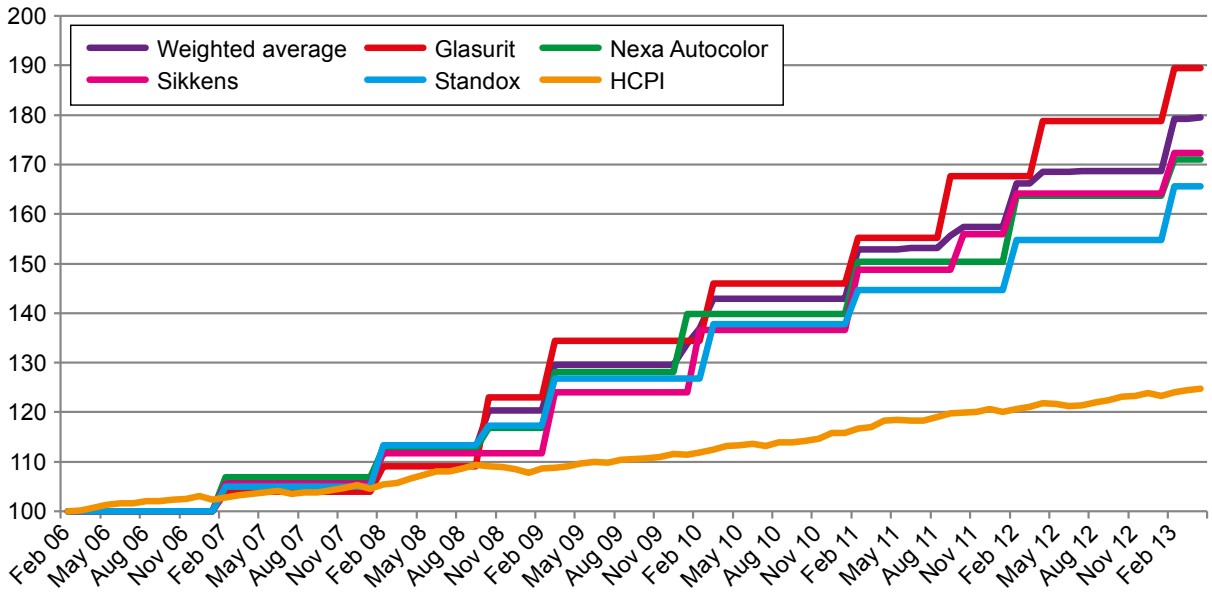
72. We found that insurer practice varied. Some insurers, like [✂] and [✂], told us that they would not renegotiate the discount in their contracts with repairs were there to be an increase in the Audatex weighted average price, assuming the increase was justifiable. Other insurers told us that they would consider renegotiation if it increased by 5 per cent. [✂] told us that, if there were a 10 per cent increase, it would immediately renegotiate its discount. In general, however, we found that renegotiations are infrequent. On this basis, the strategy of inflating rival costs through increasing the weighted average paint price could be effective, so we considered it further.

73. We noted that [✂].

74. However, we considered the change over time of the trade price [✂]. Figure 6 compares the trade prices of the bestselling brand of each of the four main paint manufacturers for the last seven years.

FIGURE 6

Increase in trade prices since 2006



Source: Audatex, Eurostat.

75. We recognized that the impact of the price increase of a given paint brand on the weighted average paint price did not depend on the percentage increase but on the absolute increase, as a similar percentage increase of a more expensive brand would have a greater effect. We noted that [✂].[36]

76. Overall, it appears to us that the change in trade price of [✂] and the impact of [✂] on the Audatex weighted average paint price has been similar to that of other leading paint brands.

Further concerns

77. Through the course of our inquiry so far, we have heard a number of other concerns in relation to paint supply contracts. In this section, we consider some of these concerns.

[36] [✂]

78. RML and the VBRA have argued that the DLG/Akzo paint supply agreement reduces competition between paint distributors, resulting in higher prices for repairers and to consumers. We have considered their concern from the perspective of any effect on the provision of post-accident repair services covered by motor insurance (we are not, in our investigation, examining the conditions of competition in the paint market). Within this context, it does not appear to us that a retail price negotiated directly between an insurer and a paint manufacturer will necessarily lead to higher prices compared with a situation where each repairer is free to choose a distributor from which to source a mandated paint brand (in particular, given the bargaining power of insurers).

79. Hex told us that paint manufacturers forbade distributors from purchasing paint from outside the UK, which, it said, amounted to a restriction on parallel trade. However, it appears to us that, if the case, this would be an issue relating to the supply of refinish paint overall, rather than one linked to post-accident repair services covered by motor insurance. Therefore, we did not believe that it would fall within the focus of our inquiry and did not consider it further.

80. RML and the VBRA raised an additional concern related to the DLG/Akzo agreement, saying that [✂] paint could cause customers to lose their car manufacturer's anti-corrosion warranty (if the warranty is linked to the use of other brands of paint). They told us that the warranty offered by [✂] might not be a reasonable substitute, as it would be underwritten by the repairer and not by [✂]. DLG told us that it offered a five-year guarantee on all repairs, or the manufacturer warranty period, whichever was longer, for all repair work carried out in its approved network, including in relation to captured claims. Therefore, it appears to us that if there is a problem it would relate to [✂]. However, we note that [✂]. In those cases, the repairer is free to

choose any paint brand so it is a matter for the repairer (and work provider) to agree with the customer the most appropriate paint to use.[37]

81. RML and the VBRA also said that a higher billed cost of paint may affect a customer's decision on whether to claim on their insurance or to pay for the repair themselves. They said that some customers, who might have preferred to meet the repair costs themselves, would end up claiming, so losing their NCB, resulting in a higher motor insurance renewal price. However, it appears to us that the small increase in the billed cost of paint because of vertical paint supply contracts is unlikely to 'tip the balance' of whether to claim or not in most cases. The increase in the cost of paint is a very small fraction of the average total repair cost (see paragraph 59).

82. NAB raised an additional concern, saying that the way in which Audatex established the weighted average paint price used for its cost estimates could skew paint manufacturers' pricing.[38] It said that every year the UK's four principal paint suppliers provided Audatex with details of their proposed price increases. This data was then embedded in the Audatex estimating system. NAB told us that these increases could often be significantly above the rate of inflation and that the insurers' use of the weighted average paint price led to large annual increases in the price of paint. However, repairers do not pay the Audatex price when sourcing paint, but receive large discounts from paint distributors (see paragraph 17). These discounts reflect the strong competition between paint manufacturers. Moreover, as far as we are aware, repairers do not usually charge the Audatex weighted average paint price to insurers, but use it as a reference point when agreeing a price (see paragraph 15). Also, although renegotiations are not frequent and there may be a lag between an

[37] In our analysis we have considered whether this agreement might affect the provision of post-accident repair services covered by motor insurance. We have not considered whether this agreement might affect the conditions of competition in the paint market.
[38] In our analysis we have considered whether this concern might affect the provision of post-accident repair services covered by motor insurance. We have not considered how this concern might affect the conditions of competition in the paint market.

increase in the Audatex price and a resetting of the discount, insurers told us that they would renegotiate discounts, especially if they considered an increase in the Audatex price to be unjustified (see paragraph 72). Moreover, we see no reason why insurers and repairers could not negotiate their paint prices without reference to an index at all, should that index become less helpful.[39]

[39] When customers use their own repairers, the full Audatex price is usually charged. However, this constitutes a small percentage of repairs. Our consumer survey suggests that only 11 per cent of drivers choose a repairer and, in those cases, more than 40 per cent of them choose one suggested by an insurer or CMC.

Paint marketing associations

1. PMAs are associations of paint distributors. There are four PMAs operating in the UK: ACIS, IRIS, NIBS and UPD. Table 1 shows the members of each PMA.

TABLE 1 **Members of PMAs**

Distributors	*ACIS*	*IRIS*	*NIBS*	*UPD*
Autotrade Centre		X		
BeeBee refinish supplies*		X		
Body & Paintshop supplies			X	
Carlac			X	
Coachfinish		X		
Cunbar			X	
Dingbro	X	X		
F&K Griffiths			X	
Fleet Factors				X
Gils			X	
Granlyn	X			
Grove Group (also known as G Mitchell)	X			X
Invicta paints		X		
JCA*	X	X	X	
JS Husseys & Co			X	
Karkraft	X	X	X	
MacGregor			X	
Mallaband			X	
MKPE*	X	X		
Movac	X		X	
Premier Paints*		X		
Rainbow Paints		X		
Sayers	X			X
Sinemaster*		X		
Supertune Automotive	X			
TRI			X	
Waregrain			X	
Wood Auto Supplies		X		

Source: PMA's websites.

*BeeBee refinish supplies, JCA, MKPE, Premier Parts and Sinemasters have been recently acquired by LKQ Corporation.

2. Each PMA has agreements with paint manufacturers to represent some or all of their brands. The PMA's members must be distributors of at least some of these brands. Table 2 shows the brands represented by each PMA.

TABLE 2 **Brands represented by PMAs**

Manufacturers	*Brands*	*ACIS*	*IRIS*	*NIBS*	*UPD*
PPG	PPG		X		
	Nexa Autocolor	X	X		
	Max Meyer (B)		X		
DuPont	Spies Hecker			X	
	Standox		X		
	Dupont				X
Akzo	Sikkens	X	X		X
	Lesonal (B)		X		X
BASF	Glasurit	X		X	
	RM		X		
Valspar	Octoral (B)		X		
	DeBeer (B)				
Lechler (B)					
Sherwin Williams (B)			X		

Source: ACIS; and the other PMAs' websites.

Note: B denotes a 'budget' brand. None of these are recommended by insurers or car manufacturers.

3. The same brand can be represented by more than one PMA. Also, paint manufacturers sell the same brands of paint to other distributors which are not members of PMAs. There are many more distributors which are not members of PMAs than distributors which are.

4. Paint manufacturers usually determine the terms of the supply of their products through agreements with individual distributors, not with PMAs. However, PMAs may receive marketing fees from manufacturers. For example, [✂]. Marketing fees are also paid by paint manufacturers directly to individual distributers.

5. The main purpose of a PMA is to negotiate a national paint supply contract with a repair network or a repair work provider. PMAs have negotiated a number of such agreements with insurers, CMCs and car manufacturers. [✂] has agreements with [✂]. [✂] has contracts with [✂] car manufacturers ([✂]), [✂] CMCs and a car dealership ([✂]) which [✂]. [✂] has agreements with [✂] and [✂], among others.

6. In most contracts, the PMA is given the status of a preferred distribution partner and it pays a rebate to the other party (ie the insurer, CMC, car manufacturer or dealership). In 2012, [✂]. However, paint prices are usually agreed between the repairer

and an individual distributor. Typically, the PMA will negotiate a maximum price to be paid by the repairer, but the repairer can negotiate a lower price with an individual distributor member of the PMA.

7. Members of a PMA are in theory free to compete against each other. However, in practice, competition might be limited, in particular by different members having a different geographic focus. For example, [✂] told us that it assigned each member a (non-exclusive) postcode area. Moreover, when [✂] was a preferred distributor partner, unless otherwise instructed by its client, it gave a repairer the contact details of the repairer's two closest distributors (though all of its members' contact details were published on its website). We also note that, as a result of membership, there could be an implicit threat that any member which acts to the detriment of its fellow members might be expelled. [✂] added, though, that all its members still competed for business against external competition.

Analysis of potential foreclosure as a result of vertical relationships

Introduction

1. We have considered whether the vertical relationships between parties involved in the provision of motor insurance and those supplying inputs for repair services might give rise to harm. This appendix presents our assessment of the foreclosure concerns that arise from these agreements, in particular in relation to the supply of paint,[1] parts (including glass) and repair cost estimation systems.[2] Other harm that might arise from the vertical relationships with respect to paint is discussed in Appendix 9.1.

2. The sourcing of inputs for insurance-related repair services is a vertical supply chain with three levels: the upstream input manufacturer supplies the repairer (downstream) which provides repair services for the motor insurance provider (further downstream). Foreclosure concerns may arise from vertical agreements within this supply chain either because they raise downstream rivals' costs (input foreclosure) or because they reduce upstream rivals' revenues (customer foreclosure), as set out in our Guidelines for Market Investigations.[3]

Summary

3. The general mechanism by which harm from vertical foreclosure may arise is the same for each of the inputs we considered: paint, parts (including glass) and repair

[1] Where we refer to paint, we mean paint used in vehicle repairs, as opposed to in the manufacture of vehicles. We understand that this type of paint, also known as 'refinish paint', is applied at much lower temperatures than paint used in car manufacture to avoid damage to parts which are not resistant to high temperatures. In addition, such paint must cover a wider colour range in order to replicate the colours used for different makes and models of cars and in order to match changes to the colour due to age (see, for example, the European Commission's decision in a related merger case (Case No IV/M.1363—DuPont/Hoechst/Herberts, paragraph 14)).
[2] We include in this analysis the supply of glass used in repairs where there is wider damage but exclude glass used in glass-only repairs. The supply of glass for glass-only repairs differs from the supply of glass used for the repair of wider damage.
[3] See *CC3*, paragraphs 268 & 269.

cost estimation systems. Therefore, in this appendix we often refer generally to 'inputs'.

4. Where the upstream party to the vertical relationship harms the ability of its downstream rivals to compete, for example by raising effective input prices to its rivals, or by refusing to supply them completely, such actions may harm the ability of the integrated firm's downstream rivals to provide a competitive constraint in the future (ie raising rivals' costs/input foreclosure). Similarly, if one or several rival input suppliers are materially disadvantaged because the vertical supply agreement(s) reduces their access to customers and thus their revenues, competition upstream may be reduced as these rivals, selling less, may face higher costs and may then be a less effective constraint on the integrated companies (ie reducing rivals' revenues/ customer foreclosure).

5. With respect to paint, parts (including glass) and repair cost estimation systems, we saw no reason for such harm to arise, as explained below.

   (a) For paint, the supply shares of paint manufacturers appear too low and expansion by rivals relatively easy (ie even the largest paint manufacturer appears constrained by competitors in its pricing). Moreover, the available customer base of repairers carrying out repairs for motor insurance providers appears large and is not consistent with paint distributors being foreclosed by paint supply contracts involving motor insurance providers because repairers working for those insurers are captive customers.

   (b) For both OEM parts and non-OEM parts we found that the proportion of costs of either type of part in the overall repair bill (and thus in insurers' claims costs) was very low and would not allow for harm either from 'raising rivals' costs (in motor insurance provision)' or 'reducing rivals' revenue (in providing the part)'. Glass

accounts for a share of parts used in the repair of wider damage to vehicles and therefore by extension could not give rise to such concerns.

(c) We ruled out concerns from contracts for the provision of repair cost estimation systems (eg by Audatex or Glassmatix) given the low share of the costs of such systems in the total repair bill.

6. This appendix discusses first the general characteristics of vertical supply contracts for these repair inputs, then briefly reviews the mechanism by which such agreements may 'raise rivals' costs' or 'reduce rivals' revenues'. We then present our findings for each of the inputs in turn (paint, parts/glass and repair cost estimation systems). We present some of the underlying evidence on which our analysis is based in Annex A.

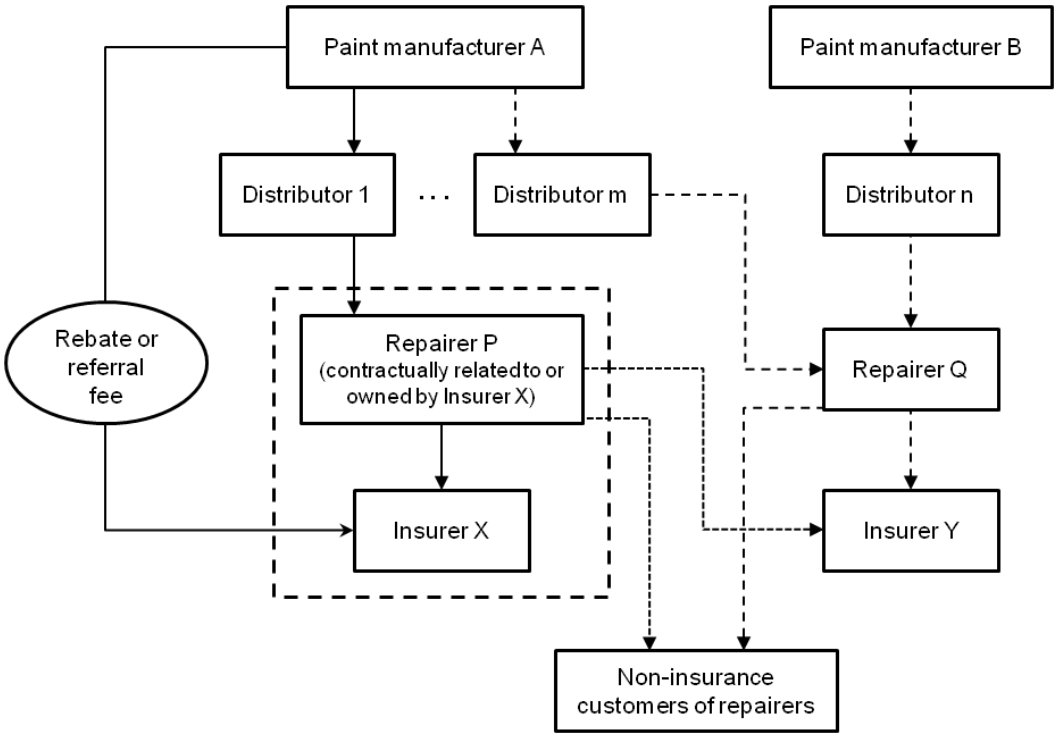
General characteristics of vertical supply contracts

7. Certain motor insurance providers (and other repair work providers, ie CMCs)[4] have contracts with some suppliers of goods used in vehicle repair, namely paint, parts (including glass) and repair cost estimation systems. Typically these contracts stipulate that the insurer will recommend the given supplier to its owned or approved repairers in return for per-repair referral fees and fixed fees (eg signing fees or annual fees). However, some repairers told us that they felt forced to use the 'recommended' supplier, such that use of the supplier was effectively mandated.[5,6] Figure 1 shows the interactions between the relevant parties.

[4] Since these agreements have the same structure as the agreements relating to motor insurance providers, we do not refer to them separately in this appendix.
[5] [✂]
[6] One independent repairer told us that 'there [was] some leeway in distributors though often the recommendation [was] such that the business consider[ed] it to be mandated.' Similarly, another repairer told us that [✂] would 'dictate' it to use [✂] for paint, [✂] for tyres and [✂] for windscreens and that 'commercial [✂] was used'.

FIGURE 1

Vertical supply contracts on the example of paint



Source: CC analysis.

8. This stylized figure shows an insurer X which has a paint supply contract with paint manufacturer A and recommends it to an owned or contractually-related network repairer P. Repairer Q is included to show that not all repairers which provide repair services covered by motor insurance policies are related to insurers (contractually or by ownership). In the illustration, repairer Q sources paint from paint manufacturer B, which is not involved in a contract with a rival insurer or another supplier.[7]

Raising rivals' costs downstream/input foreclosure

9. A vertical supply contract between an input supplier and a motor insurance provider could foreclose competing repairers which provide repair services covered by motor insurance policies either by reducing the supply of the input generally to achieve an increase in its market price or by increasing prices charged to repairers working for

[7] [✂]

rival insurers (partial foreclosure) or by ceasing to supply them with the input altogether (total foreclosure).

10. If foreclosure is successful, the input price paid by the integrated firm's[8] rivals would increase, putting its downstream rivals at a disadvantage. This might increase the integrated firm's profits downstream if its rivals have to increase their prices to cover their higher costs causing some customers to switch to the integrated firm. In the context of motor insurance repair work, if other repairers increase their prices to cover their higher input costs, some repair customers (insurers or end customers) might switch to the integrated repairer. To the extent that rival insurers increase their motor insurance premiums to cover their higher repair costs, they may lose customers to the integrated insurer. Alternatively, the integrated repairer or insurer might follow the price increase of its rivals and gain higher profits without increasing its market share.

11. When assessing the likelihood of harm from 'raising rivals' costs' the usual approach is to consider the issue under three headings:

- *Ability:* Would the companies involved in the vertical supply contract have the ability to harm rivals, for example by increasing price or by refusing to supply them in a way that significantly impacts the price the rivals have to pay?
- *Incentive:* Would it find it profitable to do so?
- *Effect:* Would the effect of this activity (either full or partial) be sufficient to reduce competition downstream to the extent that harm to end customers arises?

[8] We refer to an integrated firm even though the integration we are considering in this appendix is achieved by contracts between two firms.

Reducing rivals' revenues upstream/customer foreclosure

12. If the downstream companies (ie motor insurance providers and their repairers) which are parties to vertical supply contracts account for a large part of the total customer base, these contracts may have the effect of foreclosing access to a sufficient number of customers for the actual or potential rivals in the upstream input market such that their ability to compete is reduced. In turn, this may raise rival repairers' costs by making it harder for them to obtain supplies of the input under similar prices and conditions as in the absence of such supply contracts (because foreclosing rival input suppliers reduces competition upstream). As a consequence it may also raise rival insurers' costs if they consequently face higher repair bills. Vertical supply contracts which reduce rivals' revenues in an upstream input market may thus lead to higher prices in the downstream markets for both repair services and motor insurance. Efficiencies arising from such contracts, such as cost savings due to a better alignment of the supply chain, would at least partly offset any such negative effects if the parties pass on these savings as price reductions.

13. We assess the likelihood of harm from reducing rivals' revenues under the same three headings as we assess the likelihood of 'raising rivals' costs', as follows:

- *Ability:* Do the supply contracts lead to a situation where upstream rivals are foreclosed from a significant part of the customer base for the input so that they are less effective competitors than in the absence of these contracts?
- *Incentive and effect:* These questions are the same as for 'raising rivals' costs' (see paragraph 18).

Approach to assessing foreclosure

Raising rivals' costs

Ability

14. Our Guidelines,[9] and general economic theory, point to three conditions which are necessary for vertically integrated companies to have the ability to raise rivals' costs (input foreclosure), which we discuss in turn.

The importance of the input

15. All else being equal, if the input accounts for only a small part of the total repair costs incurred, the integrated firm will be less able to harm its downstream rival repairers' ability to compete than if the input accounts for a greater part of the total repair costs. This is the case since a small increase in a large total repair cost would have a small effect on rival repairers' costs.

The existence of market power

16. In the absence of market power, the input supplier would not be able to drive up the input price. Therefore, to identify whether any of the upstream companies involved in vertical supply contracts have sufficient market power, we used a filter based on market shares. We used 30 per cent as a threshold since our merger guidelines[10] suggest that a market share of 30 per cent or less would not usually give rise to concerns. In addition, we considered additional factors, such as the ease of entry and expansion, which may act as competitive constraints on input suppliers.

The absence of timely and effective counter strategies

17. Rival repairers (or motor insurance providers) downstream could avoid a price increase by switching away from the input. Therefore, if downstream rivals can turn

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[9] The joint CC/OFT *Merger Assessment Guidelines*, September 2010, paragraphs 5.6.6 & 5.6.10 and similarly *CC3*, paragraph 274.
[10] The *Merger Assessment Guidelines* say that 'a market share for the merged firm of less than 30 per cent will not often give the OFT cause for concern over input foreclosure', paragraph 5.3.5.

to many good substitutes for the input, the integrated companies will be unable to achieve an increase in the input price.

Incentive and effect

18. Since we concluded for all the inputs we considered that vertical supply contracts do not enable the parties involved to 'raise rivals' costs' we did not assess incentive or effect.

Reducing rivals' revenues

Ability

19. Two factors are important to determine whether the parties to a vertical supply contract can foreclose rivals from a sufficiently important part of the customer base, which we discuss in turn.

Large proportion of customer base

20. For customer foreclosure to be a concern, it must be the case that the vertical agreement(s) involves companies which (at least jointly) account for a large proportion of sales.

Reduced sales increases average costs

21. Furthermore, rival input suppliers' ability to compete can only be hampered by such foreclosure if reducing the production volume or reducing the number of different goods produced increases the average cost per unit (ie there are economies of scale or scope). In that case, foreclosure from a significant part of the customer base may make some suppliers less efficient competitors or may even force them to leave the market. If this is not the case, a reduction of the customer base available to upstream rivals would not increase the input price to downstream rivals.

Incentive

22. Since we could exclude harm from customer foreclosure either because the contracts did not foreclose rival input suppliers from a significant part of the customer base or based on the screening described under 'effects' below, we did not assess incentive.

Effect

23. We considered whether there were factors or circumstances relating to vertical supply contracts which would allow us to exclude harm due to customer foreclosure (ie which could serve as a screen or filter with respect to this concern).

24. We identified that in order for the vertical supply contracts to have negative effects for downstream rival repairers or motor insurance providers (and thus possibly for end customers) the input must represent an important part of the overall repair cost. If customer foreclosure reduced competition upstream and thus increased the cost of a supply input but this input was not an important part of repairers' costs then down-stream products would not be affected.[11]

25. For one input, paint, we based our view on the size of the available customer base of insurers (and thus repairers) not party to such contracts (see paragraph 27). For the remaining inputs we based our view on the importance of the input price (see paragraph 31). Therefore, we did not consider other aspects related to effects.

Findings for paint

Raising rivals' costs

26. To assess whether the vertical contracts for the supply of paint could give rise to harm, we considered first whether the cost of paint accounts for an important part of

[11] In this context, the importance of the input price is necessary in order for the harm upstream to be transmitted downstream; in the context of input foreclosure, the importance of the input price is necessary for harm to arise at all.

the overall repair bill. We found that the average paint cost represented about 20 per cent of the average repair bill. In our view this was too high to rule out such a concern. However, we noted that the amounts repairers actually paid for paint were significantly lower than the amounts shown on the bill. Some repairers told us that they would make a significant margin on paint because they would pay around 20 to 40 per cent of the Audatex paint basket price, but would charge 50 to 80 per cent of this price to insurers (see Annex A, in particular Table 3).

27. Since we could not rule out concerns on the basis of a low importance of paint in the total repair bill, we continued our assessment by considering the supply shares of paint providers.[12] We looked at the shares for refinish paint in the UK, as summarized in Table 1.

TABLE 1 **Supply shares of paint manufacturers for refinish paint in the UK in 2012**

	per cent	
	Volume share	*Value share*
PPG	[✂]	[✂]
DuPont*	[✂]	[✂]
Akzo Nobel	[✂]	[✂]
BASF	[✂]	[✂]
Lechler	[✂]	[✂]

Source: CC analysis.

*In June 2013 DuPont Performance Coatings (U.K.) Ltd. Changed its name to Axalta Coating Systems UK Ltd. Since we are using information and data for 2012, we use the former name in this appendix.
Note: The shares are adjusted to reflect the fact that [✂] per cent of paint is supplied by other paint manufacturers (ie the shares of the five companies shown sum to [✂] per cent). Volume and value figures were supplied by the paint manufacturers. The total market size is taken from the ABP UK body repair industry yearbook 2012.

28. We found that only PPG had a share of supply higher than the 30 per cent threshold suggested by our merger guidelines. Therefore, we considered whether other factors meant that PPG was constrained from profitably raising its paint price to repairers carrying out work for rival insurers.

[12] We understand that some 'budget' paint brands do not have the full colour range to enable the repairer to reproduce/match certain colours, may have less sales support and do not have manufacturer approval. However, we noted that the production process appears to be very similar and for this reason supply-side substitution between different brands is easy (see, for example, Case No IV/M.1363—DuPont/Hoechst/Herberts, paragraph 10). Submissions to us from paint manufacturers supported this view.

29. Paint manufacturers told us that paint supply deals were negotiated in a highly competitive environment, where customers could select from a wide range of choices from multiple suppliers. They said that they would expect their customers to compare their prices with those of competitors and would switch to an alternative supplier in the event of a 5 or 10 per cent price increase. Most of the paint manufacturers also said that they could increase production to accommodate an increase in demand. Akzo Nobel added that, in its view, 'the available capacity in the market adds to the already significant levels of competition between suppliers.'

30. Some of the large motor insurance providers confirmed this view, telling us that, in response to a 5 to 10 per cent increase in the paint price, they would consider switching to an alternative paint supplier. Other insurers told us that this would be a decision which they would make in consultation with their repairers, while others said that they would leave their repairers to decide.

31. The paint manufacturers also told us that barriers to entry were generally low. This was because a manufacturing presence in the UK was not required to enter the UK and there were no licensing or regulatory requirements for the supply of paint. We understand from information provided by one of the paint manufacturers that, in addition to smaller paint brands, PPG had started to sell its Novol brand and Valspar had started to sell its Octarol brand, but we noted that these were only new brands from existing suppliers and no new paint manufacturers had started to sell paint to motor insurance providers in the UK.

32. Given this evidence from paint manufacturers and insurers, it appears to us that, despite PPG's share of supply, competitive constraints in the paint market would imply that PPG would be unable to raise significantly its paint price to repairers of rival insurers (or the price for its paint brands generally).

33. We also considered the supply of paint by paint distributors. We found that there are at least 24 paint distributors and, although the largest group has a 25 per cent share of supply,[13] it appears to us that concentration in the market is not high enough to give real market power to any paint distributor. Therefore, no distributor can profitably achieve an increase in the paint price paid by rival repairers downstream.

34. Overall, in our view, the vertical supply contracts of motor insurance providers and CMCs for paint would not allow any of the paint suppliers involved to raise the paint price.

Reducing rivals' revenues

35. To come to a view on the likelihood that paint supply contracts would allow those paint manufacturers involved to 'reduce rivals' revenues' we looked at the potential customer base not involved in such contracts. In particular, we looked at the proportion of motor insurance policies written by those insurers without vertical supply contracts for paint. We found that, of the ten largest motor insurance providers, Ageas, Aviva, CISGIL, esure and [✂] did not have supply agreements, and these insurers accounted together for about 9 million motor insurance policies (ie 38 per cent of all motor insurance policies).[14] On the basis of around 23.8 million insured private vehicles and 3.2 million claims,[15] we estimated that around 1.2 million repairs were dealt with under motor insurance policies sold by insurers which do not have paint supply contracts ([✂]). We noted that this was a conservative estimate since it considered only the ten largest motor insurance providers and many smaller motor insurance providers also do not have paint supply contracts.[16]

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[13] LKQ Corporation has recently acquired BeeBee refinish supplies, JCA, MKPE, Premier Parts and Sinemasters, creating the largest paint distribution group in the UK.
[14] See UK Insurance – Key Facts, p 7 available on the ABI website.
[15] ibid.
[16] The five largest paint manufacturers did not tell us of any supply contracts they had with insurers outside of the top ten. However, some CMCs also have paint supply contracts and it is not clear how many of the claims in Table 2 they managed.

TABLE 2 **Policies sold and estimated number of claims for insurers in the UK in 2012**

£'000

	Average number of policies in year	*Estimated number of claims*
Insurers without paint contract		
Ageas	[✂]	[✂]
Aviva	[✂]	[✂]*
CISGIL	[✂]	[✂]
esure	[✂]	[✂]
LV*	[✂]	[✂]
Total without contracts	**8,969**	**1,202**
Insurers with paint contract		
DLG	[✂]	[✂]
Admiral	[✂]	[✂]
RSA	[✂]	[✂]
Zurich	[✂]	[✂]
AXA	[✂]	[✂]
Total with contracts	**9,819**	**1,316**
Total	**18,788**	**2,518**

Source: CC analysis.

*[✂]
Note: Based on the number of policies supplied by each insurer and the average number of claims per policy in the industry.

36. In our view, the size of the five insurers which are not party to vertical supply contracts for paint is a large enough potential customer base such that paint manufacturers are unlikely to be foreclosed from a significant part of the customer base by the contracts of other insurers.

37. Moreover, we noted that paint manufacturers produce paint not just for the UK, but for an international market. Therefore it appears unlikely that paint contracts involving motor insurance providers in the UK could prevent them from reaching an efficient scale of production such that harm from customer foreclosure could arise.

38. We also considered paint distributors but, given that at least five insurers accounting for 1.2 million claims ([✂] excluding [✂]) are not party to vertical agreements, it appears to us highly unlikely that paint distributors could be foreclosed from a significant customer base.

Findings for parts (including glass)

Raising rivals' costs

39. We looked at whether the cost of parts was sufficiently important to allow individual parts suppliers involved in vertical contracts with motor insurance providers to raise rival repairers' costs. For OEM parts produced by a car manufacturer we found that an upper bound of the share of their cost in the average repair bill was 6 per cent (see Annex A, paragraph 16). We found that the importance of non-OEM parts in the average repair bill was slightly lower at no more than 4 per cent (see Annex A, paragraph 19). We noted that, since glass is a subset of the parts used in repairing wider damage, the importance of its cost in the average repair bill could not be higher than for OEM or non-OEM parts.[17]

40. Given these average shares of parts costs or glass costs in the average repair bill (OEM, non-OEM and glass), it appears to us that vertical supply contracts for such parts could not raise rivals' costs.[18]

Reducing rivals' revenues

41. Vertical supply contracts which foreclose competitors might reduce upstream rivals' revenues but will only have an effect on downstream rivals (and thus end customers) if the given input accounts for a significant share of the overall repair cost (see paragraph 31). Since we found that this share was not important for OEM parts, non-OEM parts or glass, it appears to us that vertical supply contracts could not lead to harm for customers.

[17] The apparent discrepancy between these findings and the figure of 40 per cent for the cost of all parts in the overall repair bill (see Annex A, Table 2) is due to the fact that these findings are for individual providers of OEM parts (since we assume that input suppliers compete unilaterally), while the figure of 40 per cent applies for all parts jointly.
[18] As explained in the introduction the supply of glass for glass-only repair is different and glass supplied for such repairs is not considered here.

Findings for repair cost estimation systems

Raising rivals' costs/reducing rivals' revenues

42. The two largest suppliers of repair cost estimation systems are Audatex and Glassmatix and the cost of these systems account for at most around 2 per cent of the average repair bill (see Annex A, paragraph 3).

43. As for parts, we therefore see no reason to believe that vertical supply contracts between suppliers of repair cost estimation systems and motor insurance providers are likely to cause harm to end consumers.

Initial screen

1. In this annex we set out details of our initial screen considering the importance of the costs of the individual inputs in the overall repair bill.

Input prices for repair cost estimation systems in vehicle repairs

2. Table 1 presents information from four repairers on the cost of the Audatex system.

TABLE 1 **Cost of Audatex repair cost estimation system as part of costs of vehicle repair, 2012**

£

	[✂]	[✂]	[✂]	[✂]
Cost of Audatex estimate per repair	[✂]	[✂]	[✂]	[✂]

Source: Repairers.

3. Table 1 shows that Audatex costs around £[✂] per estimate. This amounts to less than 2 per cent of the average repair bill for at-fault and non-fault claims (which is generally in a range of £1,000 to £1,500).[1]

4. Based on information provided by Audatex, its cost per estimate (including subscription fees) is around £[✂] if only revenue from cost estimation software is included or £[✂] if all revenue is included. Both of these amounts are reduced by £[✂] if the rebates granted to insurers by Audatex are included. This is consistent with the repairers' estimates of the costs of the system.

5. Glassmatix told us that it charged an annual subscription fee which encompassed the creation of unlimited estimates, and a transmission fee for estimates which were sent to insurers through its communication systems. The licence fee was £1,800 for up to five users and the transmission fee was between £[✂] and £[✂], though Glassmatix

[1] See Appendix 6.2.

told us that its recent deals with repairers had been at the lower end of this range due to its weakened market position.

6. Glassmatix told us that it could not determine how many estimates were produced by its system as many were created without transmission. However, it has estimated the number of estimates produced on the basis of the number of online registration checks which are run through its system on the DVLA database (as almost all estimates will require such a check) and, on this basis, Glassmatix estimates that its system costs repairers about £[✂] per estimate (including subscription revenue). This suggests that the costs of Audatex's repair cost estimates are an upper bound of such costs in general.

7. Overall, the cost of repair cost estimation systems is less than 2 per cent of the average repair bill for motor insurance repairs.

Input prices for paint and parts in vehicle repairs

8. We looked at the importance of paint and parts in the provision of vehicle repairs. Table 2 presents information from four large insurers.

TABLE 2 **Cost of paint and parts as part of cost of mostly insurance-funded vehicle repairs, 2012**

					per cent
	Ageas	*Aviva*	*AXA*	*LV*	*Average*
Proportion of paint costs per repair	[✂]	[✂]	[✂]	[✂]	21
Proportion of part costs per repair	[✂]	[✂]	[✂]	[✂]	41

Source: Insurers.

9. Table 2 shows that paint accounts for approximately 20 per cent of repair costs and parts account for approximately 40 per cent of repair costs.

10. Trend Tracker reports that paint and materials as a percentage of the average repair job has increased from 14 per cent in 2002 to an estimated 22 per cent in 2012.

Labour as a percentage of the average repair job has been relatively stable at around 40 per cent, but parts have fallen from 45 per cent in 2002 to an estimated 38 per cent in 2012.[2]

11. However, repairers told us that the paint costs they incurred on an average repair were below the costs they charged for paint to the insurer. We found that the actual paint costs per repair were [✂] less than 20 per cent of the average repair. We note that Trend Tracker also reports that paint can be a significant contributor to the profitability of a repairer.[3] Table 3 summarizes evidence we received from five independent repairers about the paint prices they pay.

TABLE 3 **Use of paint in vehicle repair, 2012**

[✂]	[✂]	[✂]	[✂]	[✂]
Makes a margin of [✂]% on paint (it pays about [✂]% of the Audatex paint index and receives from insurers about [✂]% of the index).	Makes a margin of [✂] to [✂]% on paint (it pays about [✂]% of the Audatex paint index and receives from insurers about [✂]% of the index).	Pays around £[✂] per average paint job.	Pays around £[✂] to £[✂] per repair job (at about [✂]% of the trade price), with little difference between paint brands, and bills insurers about £[✂].	Makes a margin of [✂] to [✂]% on paint (it pays about [✂] to [✂]% of the Audatex paint index and receives from insurers about [✂]% of the index (though this can be as low as [✂]%).

Source: Repairers.

Additional considerations regarding parts

12. The parts used in vehicle repairs are either OEM parts or non-OEM parts.[4] OEM parts are supplied by the original manufacturer (often via an interim distributor); non-OEM parts are copies of the OEM parts and can be supplied by manufacturers that have no relationship with the original manufacturer.

[2] 2012–2017 Trend Tracker report, p3.
[3] ibid, p27.
[4] There are also original equipment supplier (OES) parts, which are made by the OEM but not sold under the vehicle manufacturer's brand. However, we were told by repairers and insurers that these parts constituted a very small proportion of all parts used in repairs, both by volume and value.

Original equipment manufacturer parts

13. OEM parts are usually distributed to repairers by franchised dealers of the car manufacturers. [✂] told us that competition between franchised dealers to supply parts to repairers was strong and margins were low (in particular when taking into account the credit risk). [✂] told us that it ordered OEM parts from local dealerships and some dealerships offered better discounts than others (eg [✂]). There are some distributors other than the franchised dealers but these are unlikely to have a significant share of supply.

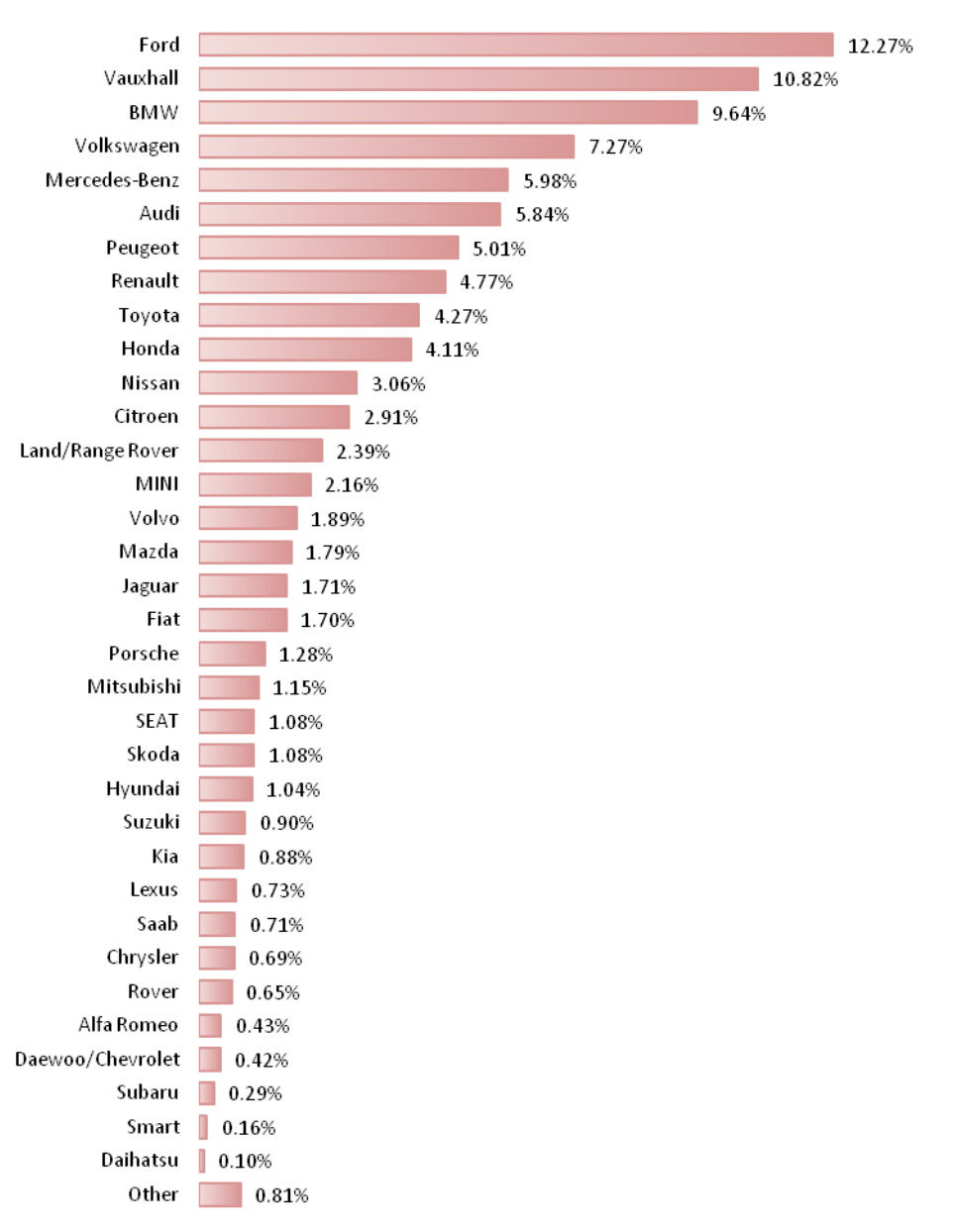
14. [✂] told us that there was, in practice, no alternative to using franchised dealers, as importers took too long to supply parts (because they lacked critical mass and could not stock a lot of product). [✂] said that franchised dealers competed with each other strongly on the popular brands (eg Ford and Vauxhall), but less so where there were fewer dealers around (eg Hyundai). [✂] told us that [✂] had centralized all its part supply operations into [✂] and no longer used the traditional franchised dealers for the majority of its parts supply. [✂] noted that the other vehicle manufacturers appeared to be considering similar structures. [✂] said that it received discounts off the Audatex list price of around [✂] per cent from Ford and Vauxhall, [✂] per cent on German vehicle manufacturer brands and as low as [✂] per cent on the far Eastern vehicle brands. It said that it gave insurers a [✂] per cent discount on the list price.

15. As OEM parts supply is ultimately controlled by the car manufacturers, we considered the shares of total parts costs according to the main car manufacturers. The values in Figure 1 are obtained from Trend Tracker's data.[5]

[5] 2012–2017 Trend Tracker report, pp40&48. Trend Tracker states that its estimate is based on Audatex data and covers 1.6 million repairs.

FIGURE 1

Percentage of total parts costs by vehicle manufacturer brands



Source: CC analysis from Trend Tracker data for 2011.

16. Figure 1 shows that the two largest manufacturers each accounted for around 11 to 13 per cent of total parts costs (ie Ford and Vauxhall). This suggests that no single manufacturer accounts for a significant part of the overall costs of repairers. For example, VW Group (which encompasses VW, Audi, Seat and Skoda) together account for less than 16 per cent of total parts costs, which means that they account for less than 6 per cent of the average repair bill (assuming that total parts costs are

40 per cent of total repair costs (see Table 2)). This can be considered as an upper bound of the importance of OEM parts costs in the repair bill since other makes account for a similar or smaller repair volume than VW Group.

17. We also note that *(a)* not all manufacturers have part rebate agreements with insurers; and *(b)* it does not appear that contracts with car manufacturers are exclusive (ie more than one insurer can have a contract with a car manufacturer).[6]

Non-OEM parts

18. Some repairers and insurers told us about the use of non-OEM parts in vehicle repairs:

(a) Aviva said that non-OEM parts were only available for around 5 to 15 per cent of all parts. In particular, safety-related parts were often not available other than from the OEM due to the high development cost.

(b) Three insurer-owned repairers told us about their use of non-OEM parts, with one repairer not using them at all and the other two repairers saying that they were responsible for between 2 and 3 per cent of all parts costs).

(c) The National Accident Repair Group, which is a marketing association for repairers, told us that there were only two or three large suppliers of non-OEM parts and the main products they supplied were external body panels, cooling systems, lights and bumpers. In value terms, only [✂] of parts that were used in vehicle repairs were non-OEM parts. It said that repairers were reluctant to use non-OEM parts as they were more difficult to fit than OEM parts and OEM parts could be pre-painted which reduced repair times.

(d) [✂] told us that in 35 per cent of repairs it fitted no non-OEM parts, while in the remaining 65 per cent of repairs non-OEM parts accounted for about 20 per cent of parts (ie non-OEM parts accounted for around 15 to 20 per cent of all parts

[6] [✂]

used). However, it added that, in terms of value, this percentage would be lower. It said that the cost saving from using non-OEM parts was about 35 to 40 per cent. [✂] also said that, if it had a choice, it would not fit non-OEM parts as there were sometimes delays in getting the parts and it had to use more than one supplier.

(e) [✂] told us that non-OEM parts accounted for around [✂] to [✂] per cent of all parts fitted (in volume terms) but there were no non-OEM parts for low volume parts. The main non-OEM parts fitted were headlamps, radiators and coolers.

(f) [✂] told us that 5 to 10 per cent of parts expenditure was on non-OEM parts, with an average saving of 30 per cent compared with the alternative OEM part.

(g) [✂] told us that non-OEM parts constituted around 35 per cent of all parts used. [✂] said that non-OEM parts tended to be fitted on cars older than three years, so for these cars the percentage of non-OEM parts used rose to about 60 per cent.

(h) [✂] said that non-OEM parts were responsible for around [✂] to [✂] per cent of its total parts costs, with the proportion of parts volumes attributable to non-OEM parts being slightly higher (due to the lower price of non-OEM parts than OEM parts). It said that the largest non-OEM parts suppliers were Eurocarparts/ Autoclimate, SEL and Direct Automotive. Other suppliers were smaller and generally did not offer a full range.

19. It appears to us that the use of non-OEM parts in motor-insurance-related vehicle repairs is typically up to around 20 per cent in terms of the volume of parts used and up to around 10 per cent in terms of value. Given that all parts (OEM and non-OEM) account for around 40 per cent of the total average repair bill to insurers, and less in terms of what repairers pay for parts (because repairers generally get more parts discounts from their suppliers than they invoice to insurers), non-OEM parts appear to account for no more than 4 per cent of the average repair bill invoiced to insurers.

Impact of most-favoured nation clauses on competition in the motor insurance market

Introduction

1. This appendix provides the supporting material to the findings in Section 9 of this report. It covers the following areas:

   - definition of MFN clauses in our investigation;
   - impact of narrow MFN clauses on competition;
   - MFN clauses as a coordination mechanism between PCWs;
   - ability of PCWs and insurance providers to circumvent MFN clauses;
   - evidence of the impact of wide MFN clauses; and
   - pro-competitive effects of PCWs and MFN clauses.

Definition of MFN clauses[1]

2. For the purpose of our assessment, we initially defined three MFN clauses with different scopes which broadly describe the main features of the majority of MFN clauses currently in force:

   (a) A motor insurance provider may not offer a particular policy on its own website for less than it is advertised on the PCW ('own-website MFN').

   (b) A motor insurance provider may not offer a particular policy on any online sales channel for less than it is advertised on the PCW ('online-sales MFN').

   (c) A motor insurance provider may not offer a particular policy on any sales channel for less than it is advertised on the PCW ('all-sales MFN').

[1] The term 'most-favoured nation' comes from multilateral trade negotiations, where one of the principles has been that a trading deal offered to one country (the most-favoured nation) must also be offered to all other nations. Its use has been expanded to cover commercial arrangements in which the terms negotiated with one party (the most favoured) automatically become a part of the deal with other parties.

3. In our analysis, however, we mainly discuss 'narrow' MFN clauses, referring to own-website MFN clauses and 'wide' MFN clauses, referring to online-sales and all-sale MFN clauses.

Impact of narrow MFN clauses on competition

4. Some insurers have argued that narrow MFN clauses reduce the competition in the motor insurance market. We look at the effects of narrow MFN clauses on premiums then innovation

Premiums

5. Saga argued that each direct channel provided a competitive constraint on PCW pricing, and that narrow MFN clauses undermined that source of pressure. Imagine a customer who can be competitively provided by ten insurers. Without any MFN clauses, that customer can be supplied through four competing PCWs and directly on ten competing own channels. Each narrow MFN that is entered into eliminates one potentially competing channel, and if all insurers have just one narrow MFN clause, competition in the market is entirely reduced to the competition between PCWs.

6. We accept Saga's analysis, but not the conclusion drawn. Policies are most in competition when listed on PCWs. As long as competition between PCWs is operating effectively, competition between policies is enhanced by being conducted through PCWs rather than on direct channels. Searching many direct channels is hard and that is the service that PCWs would perform for retail consumers in a competitive PCW market.

7. The constraint on commission fees from a motor insurance provider's website is unlikely to be significant. Therefore, a narrow MFN is unlikely to significantly alter any existing upward pricing pressure on commission fees. However, the constraint on

commission fees from other PCWs is likely to be significant. Therefore, a wide MFN is more likely to lead to substantial upward pricing pressure on commission fees.

Innovation

8. Many insurance providers have also argued that narrow MFN clauses restrict their ability to innovate. A recurring argument is that the insurance company would like more investment in fraud prevention—for example, the practice of retail consumers submitting many different versions of the information required in order to achieve lower premiums. Such investment is in the interest of the insurer, and the website could implement a technological solution to limit this sort of fraud. However, with a narrow MFN, if the insurer implements such measures on its own site, it cannot attract customers through the lower (non-fraudulent) premiums that the better fraud detection would allow.

9. Therefore, if the motor insurance provider's website is an important sales channel, then narrow MFN clauses may undermine a motor insurance provider's incentive to innovate. However, if the motor insurance provider's website is not an important sales channel, then there is unlikely to be any loss of innovation from the presence of narrow MFN clauses.[2] In addition, motor insurance providers still have incentives to innovate to lower the cost of their premiums relative to other motor insurance providers.

10. A second argument made by Saga is that consumers shopping directly have better risk profiles than those shopping through PCWs. DLG argued that consumers acquired direct (as opposed to through PCWs) could generate lower loss ratios as well as higher persistency. Ageas UK considered that the PCW channel was

[2] In addition, if PCWs have incentives to innovate, which they should still do with narrow MFN clauses, innovation will lead to lower prices for all consumers on the PCW rather than just the motor insurance provider's customers.

inherently more risky for insurers precisely because customers who used PCWs had a higher tendency to provide misleading information through the PCW channel, compared with other channels.

11. This would suggest that motor insurance providers should be putting their best prices through their own website. However, we considered whether the motor insurance provider's website will always have the lowest risk in Annex C. We rejected this argument, because we see no reason that a competitive PCW market would not offer all the plausible channel innovations and fraud detection capabilities of direct channels.

Is there a network effect from narrow MFN clauses?

Incentives analysis

12. Our analysis of incentives suggests that wide MFN clauses, in the context of commission-based pricing, will eliminate competition between downstream platforms. We hypothesize that this will lead to competition being lessened through:

(a) commission rate increases and therefore premium increase, limited only by the insurers' 'outside option' of delisting; and

(b) reduced entry and innovation into the PCW market based on strategies for acquiring market shares through offering low premiums.

13. DLG, in its response to our working papers, argued that a network of narrow MFN clauses would have the same damaging effects as a wide MFN because motor insurance providers had the incentive to keep their direct channels competitive.

14. DLG relies for its argument on the notion that any increases in premiums in a PCW channel due to commission increases would also lead to DLG being forced to increase its price in its direct channel in line with these changes. DLG would

consequently be unable to price its direct channel competitively. If this were the case, then we accept its argument that narrow MFN clauses will relieve the competitive constraint on PCWs' commission rates, as is shown by the following:

(a) A narrow MFN forces the direct channel price up to the price found on the PCW with the direct MFN.

(b) The requirement to keep the direct channel competitive forces up the price of channels that were previously lower-priced.

(c) This relieves the PCW with the narrow MFN of the competitive constraint of loss of market share.

(d) Therefore the PCW with the narrow MFN has an incentive to increase commission rates, leading to higher premiums, effectively, as do wide MFN clauses, as was argued in working paper 16.[3]

15. The step in the argument that we do not accept is the second. There is not always a requirement to maintain the direct channel as the most competitive if a narrow MFN has been signed—that depends on the size and attractiveness of the direct channel compared with PCW channels.

16. One way to think of narrow MFN clauses is that they tie channels together, so that the direct channel and the MFN channel enter the insurer's profitability calculations as a single, 'average' channel. Reducing the price on the own channel means reducing the price on the MFN channel, and the impact on profits will depend on the market shares and profitability of the average of the two channels.

17. Rather than always maintaining the direct channel as the most competitive, the profit-maximizing insurer will rebalance prices across all channels, and this will quite possibly involve lowering premiums on low-cost channels and raising premiums on

[3] CC, Theory of harm 5: Impact of MFN clauses in contracts between PCWs and PMI providers.

the own channel. For example, imagine a low-commission rate entrant PCW and a high-commission incumbent PCW that has a narrow MFN. The profit-maximizing insurer may offer lower premiums to the entrant because these are high margin rather than maintain the competitiveness of its own channel, since this will require a higher market share going to the low-profitability incumbent PCW with which they have an MFN.

18. Annex B provides a series of detailed numerical examples in which premiums are set optimally to show that narrow MFN clauses do not necessarily create the incentives to price equally across PCWs with a set of narrow MFN clauses. In Scenario 3, we show a case where narrow MFN clauses lead to the insurer pricing the same across all PCWs. This requires that the direct channel have a large, exogenous fixed preference—that it generates a large proportion of sales even without being price competitive with the PCW channels. This will happen in the case where loyal customers 'single-home' with an insurer. In such a situation, the insurer does not try to attract sales to the high-margin non-MFN PCWs (as in Scenario 2) because that would come at too great a cost in terms of lost sales on its own highly profitable own channel. In this special case, a narrow MFN has the same impact as a wide MFN. However, this is also the scenario in which an insurer is likely to find it most attractive not to list on a PCW at all to avoid the constraints of narrow MFN clauses.

19. Apart from this special case, however, a collection of narrow MFN clauses or a single narrow MFN does not have the same impact as a wide MFN. This is particularly clear in considering the entry-deterring detriment of wide MFN clauses. Someone wishing to enter the PCW market with a low premium offering may still be able to do so, even in the presence of a collection of narrow MFN clauses. As long as commission rates from the new entrant are low enough and the preference for the direct channel not too great, the insurer will wish to encourage low premium sales through the new

channel to some degree, even if its direct channel suffers. The narrow MFN clauses might even enhance the attractiveness of the low-price entrant because they force the direct channel to offer higher premiums than would be optimal without the narrow MFN clauses. Thus, the low-cost entry strategy is preserved and possibly even enhanced.

Summary of incentives

20. A collection of narrow MFN clauses will only impose the same constraints on a motor insurance provider (and thus incentives on PCWs) as a wide MFN when the following conditions hold:[4]

(a) the price-independent attractiveness of a brand is strong—the stronger the brand, the greater the likelihood that narrow MFN clauses will be a significant burden; and

(b) the margins that might be available for a motor insurance provider on low commission rate PCWs are low—the more attractive low-commission PCWs are, the greater the incentive to offer premiums on these that are lower than those offered on a direct channel constrained by a narrow MFN.

21. However, a collection of narrow MFN clauses does not usually have the same entry-deterrence or innovation-suppressing impact on PCWs as a wide MFN: profitable third party channels can usually be encouraged and rewarded with low premiums.

Extent of effect of narrow MFNs

22. In this subsection, we assess which providers are likely to be affected by narrow MFN clauses and the significance of these providers. For a provider to be affected by narrow MFN clauses in the same way as wide MFN clauses, all of the conditions in paragraph 20 need to hold as a motor insurance provider may, for example,

[4] Clearly, the insurance provider's brand will also have to be listed on a PCW to be affected by the MFN clause.

advertise heavily to drive higher sales through PCWs. Alternatively the motor insurance provider may have a significant online direct sales channel but not be featured on PCWs.

23. We first considered which brands are strong by looking firstly at advertising expenditure and then looking at the sales channel data. Figure 1 shows the advertising expenditure for a number of brands of motor insurance providers.

FIGURE 1

Motor insurance providers' advertising spend by brand (November 2011 to October 2012)

[✂]

Source: Ebenchmarkers.
Note: Red triangles represent brands that are not listed on PCWs; blue squares represent brands that are listed on PCWs.

24. [✂] We next looked at whether the motor insurance provider's website accounted for a large proportion of its online sales. Figure 2 shows the proportion of online sales made by brands that advertise significantly and appear on PCWs.

FIGURE 2

Motor insurance providers' expenditure on advertising and the proportion of sales on their website (November 2011 to October 2012)

[✂]

Source: Ebenchmarkers.
Note: Brands listed on PCWs are in blue; the brand not listed is in red.

25. Of the brands that advertise [✂], Churchill, Sainsbury's (both underwritten by UK Insurance[5]), Saga and Tesco all sell a significant proportion of their online sales on their own website as well as listing on PCWs.[6] The data in Figure 2 is consistent with

[5] UK Insurance is the underwriting arm of DLG.
[6] Although CISGIL also makes a significant proportion of its online sales on its own website, [✂].

the submissions from DLG and Saga about their view on narrow MFN clauses and their effect on pricing.[7]

26. A small number of brands [✂] appear to have characteristics which mean they could be affected by narrow MFN clauses. As highlighted in paragraphs 4 – 20 a motor insurance provider which operates on PCWs and also has a large direct sales channel might be affected by narrow MFN clauses by:

(a) lowering the incentives for the motor insurance provider to innovate on its own sales channel;

(b) losing a significant constraint on PCWs; and

(c) creating an inability for the motor insurance provider to price-differentiate across PCWs, leading to higher commission fees and premiums.

27. Data from PCWs suggests that these [✂] brands account for a small proportion ([✂]) of all policies sold on the largest four PCWs. In the case of Churchill, whilst DLG may find that it cannot innovate on the websites of this brand, DLG also operates the Direct Line brand which does not operate on PCWs, and would therefore still be free to innovate. In addition, the Direct Line brand is also still able to compete with PCWs to offer policies to consumers. Finally, whilst the Churchill brand may be affected by narrow MFN clauses, Privilege, another DLG brand, mainly operates on PCWs and should have the incentives to quote different prices on the various PCWs if commission fees changed. There should be no reduction in competition from DLG as a whole as a result of narrow MFN clauses, although narrow MFN clauses may affect the behaviour of one of its brands.

28. The case of Saga is slightly different as it sells significantly through its own sales channels as well as PCWs. Saga does not operate a multi-brand strategy and thus

[7] A fuller assessment of all the motor insurance providers and their advertising strategies appears in Annex F.

faces a lack of incentives to innovate on its own website. It is debatable, however, the degree to which Saga's direct channel competes with PCWs, given that Saga's total online sales[8] are a very small percentage (about [✂] per cent) of the big four PCWs' sales..With respect to the impact on commission fees, if Saga's website currently provides the most profitable business, under its current business strategy a series of narrow MFN clauses would have similar effects on Saga as a wide MFN as Saga may want to keep the price on its own website as low as on any of the PCWs.[9]

29. We note, however, that DLG has currently opted for a multi-brand strategy to distribute its insurance products, using its direct channels and also having a PCW-focused brand. DLG has pricing freedom on its direct-only brand, which is not available on PCWs, but not on its brands that are available both direct and on PCWs. [✂] has opted for a similar multi-brand strategy which enables it to have pricing freedom on its direct channels and also have a PCW-focused brand.[10] It is not clear why this strategy is not available to other providers with significant brands.

Summary

30. The solution to the business problem faced by an insurer that wants a healthy direct channel is not to sign narrow MFN agreements at all with PCWs. If insurers do sign narrow MFN agreements, we would expect both their direct channels to become less competitive *and* competition between PCWs to be strong. If PCWs insist on narrow MFN clauses, then non-listing, as practised by some DLG and [✂] brands, may be the way of preserving sales through a high-margin direct channel.

31. The number of brands and the number of policies sold by motor insurance providers with a substantial direct sales channel is small. On the one hand there are brands

[8] That is PCW and own-website sales.
[9] The arguments here would also apply to Tesco.
[10] CISGIL [✂].

with almost non-existent direct channels, for which narrow MFN clauses are not a significant pricing constraint. On the other hand, there are brands with very large direct channels (the main Direct Line brand, the [✂] brand, and [✂] main [✂] product) which are unaffected by MFN clauses because they are not listed on PCWs. It is only the brands in an intermediate position that face these incentives.[11] We estimate that they represent a small proportion ([✂] per cent) of the value of all policies sold on PCWs. They are, in a way, caught between two business models. We conclude that there is a substantial portion of the market that would not be affected by a series of narrow MFN clauses.

Coordination between PCWs

32. Coordination requires the simultaneous fulfilment of three conditions:[12]

(a) the ability to reach and monitor terms of coordination;

(b) internal sustainability, with it being in each firm's interest to maintain the coordinated outcome; and

(c) external sustainability, with the coordinating firms being able to exclude competition that could undermine the coordinated outcomes.

33. We considered the hypothesis that MFN clauses could enable coordination between PCWs by setting a floor price for the price of motor insurance policies.[13] We discuss each condition for this coordination in turn in relation to the operation of an MFN:

(a) If a policy is covered by a wide MFN, then the floor price of the policy is determined by its price on the PCW which has the wide MFN clause. Monitoring is effectively carried out through the monitoring of MFN clauses by the PCWs which have them.

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[11] [✂]
[12] See *CC3*, paragraph 250.
[13] It is possible that PCWs could try to coordinate over commission fee fees rather than final motor insurance prices. It is also possible that MFN clauses would help this task. We focus on coordination on motor insurance prices because this is the most direct way that MFN clauses might affect coordination. Our hypotheses on the effects of MFN clauses (commission fee upward price pressure, motor insurance upward premium price pressure, and restrictions on entry) all suggest that they could lead to an increase in motor insurance premiums.

(b) Internal sustainability requires that deviations from the coordinated outcome be punished. To the extent that deviation breaks the MFN clause, it is punishable in law and thus the MFN provides a very strong mechanism for internal sustainability.

34. External sustainability requires that entry be constrained or that fringe competitors who are not covered by the MFN be unable to disrupt coordination. The MFN helps to do this by softening the competitive constraint from other sales channels/PCWs and excluding a common entry strategy based on offering lower prices. Indeed, in the absence of price competition, entry requires substantial investment in advertising, which is likely to create a barrier to entry.

35. Overall, it appears to us that wide MFN clauses can be thought of as potentially reproducing conditions akin to coordination, but doing this in a fragmented market using bilateral contracts. We would usually think of coordination as involving the adjustment of the behaviour of each party in response to the history of the behaviour of all other parties to the coordinated outcome. However, wide MFN clauses do not require that sort of adjustment; they simply require that bilateral contracts be honoured. It appears that wide MFN clauses potentially replicate the outcomes of coordination, ie increased upward pressure on motor insurance premiums for all PCWs.

Advertising competition as a result of wide MFN clauses

36. If PCWs were competing to offer motor insurance policies at the best prices for the final consumer, we could expect them to use any negotiating strength they might have to put pressure on motor insurance providers to offer policies at lower premiums. A successful negotiation of a lower premium for a specific PCW would mean higher market share and higher revenues from commission fees.

37. However, in the presence of a wide MFN this strategy cannot work. As long as a policy is covered by even just one wide MFN, PCWs will not be able to negotiate a price advantage. Therefore, there is reduced pressure from the sales channel for lower motor insurance premium prices.

38. It appears that wide MFN clauses soften price competition between PCWs (see paragraphs 9.29 to 9.39). Without wide MFN clauses, we would expect to see more price competition and lower commission fees, and as a result we would expect lower commission fees to imply lower advertising expenditure. Hence, if we compare outcomes with and without wide MFN clauses, we would expect a market with lower commission fees and lower advertising in the no or narrow MFN case, and higher fees and higher advertising in the wide MFN case.

39. If the MFN is having the effect of channelling competitive pressures from price-based competition to non-price, advertising-based competition, the MFN may be creating a wasteful level of advertising. We do not suggest that the industry does not need advertising as there are clearly pro-competitive aspects to consumers being well informed about the availability of PCWs. However, wide MFN clauses may increase the level of advertising beyond this amount. In such a case, a combination of MFN clauses and increased advertising expenditure could be restricting competition through limiting entry.

40. Several motor insurance providers told us that PCWs had reached (or were near to reaching) saturation and that additional investment in advertising was only taking share from other PCWs rather than increasing the number of customers using PCWs as a whole. Indeed, motor insurance providers told us that additional expenditure on advertising and marketing had been the reason given by some PCWs for increases in commission fees. Swinton told us that additional volume from a PCW as a result of

advertising did not necessarily guarantee additional revenues for Swinton overall as, in many cases, it simply took business from another PCW. DLG said that the harmonizing effect of MFN clauses on prices across PCWs mitigated the risk of PCWs losing business to their competitors, with the result that PCWs competed more on the basis of non-price benefits to customers (eg cuddly toys or nectar points).

41. Evidence from Tesco and Covea SGAM is that advertising represents a substantial barrier to successful entry. Covea SGAM said that, in order to compete effectively with the big four PCWs, a new entrant would need to invest at least as much in advertising as the big four and probably more in the early stages as it sought to build a consumer brand. Similarly Tesco reported analysis it had commissioned estimating that it could have approximately 10 per cent of the motor insurance PCW market if it invested around £20 million a year in advertising—something which Tesco did not continue to do.

42. It is possible that the existence of wide MFN clauses increases the amount of advertising spending and therefore the size of the barrier to entry. By increasing commission rates, wide MFN clauses make advertising more profitable and therefore raise the amount that is done.

43. Although this is a plausible mechanism, we note that it is likely that the advertising barrier to entry would still exist without MFN clauses. Markets in which advertising is effective in adding to demand often maintain relatively high concentrations because it is profitable for incumbents to pay to grow their own demand through advertising rather than allowing new entrants to incur sunk costs to serve that demand. We would expect the PCW market to remain advertising-intensive and concentrated for that reason.

44. Figure 3 shows the evolution of aggregate advertising spend and total sales volume of the four biggest PCWs.

FIGURE 3

Advertising expenditure and sales volume by the big four PCWs

[✂]

Source: PCWs.
Note: Sales volume data for Comparethemarket.com is based on the closest accounting year rather than the calendar year.

45. Both advertising and the overall market are growing at broadly similar rates. Similarly, PCWs have increasingly become an important sales channel for new business.

46. Figure 4 shows the market shares of PCWs between November 2008 and October 2012. The CC considers that concentration in the PCW market has not changed significantly over the last three years.

FIGURE 4

PCW market shares

[✂]

Source: Ebenchmarkers.

47. This might suggest that motor insurance advertising spend by the big PCWs might be acting not just as a way of competing for new customers but also as a barrier to entry: the market is growing but the number of firms serving it is more or less constant. However, we do not find any evidence of the claim made by some insurers that PCW advertising spending is only reallocating market shares between the players rather than growing the market. It is possible that concentration has remained constant and the market has grown because the most efficient suppliers have advertised their platforms effectively. In other words, we have not excluded the alternative explanations to advertising being used as a barrier to entry.

Circumvention tactics

48. We briefly consider whether motor insurance providers (or PCWs) could circumvent the wide MFN clauses and still offer consumers a cheaper policy. If MFN clauses could easily be circumvented, then this would mean the MFN clauses are unlikely to, in the long run, lead to harmful effects on competition.

49. Some parties told us that it was possible to circumvent MFN clauses. We assess these potential circumvention strategies in Annex G. However, we considered that many of these strategies were likely to be costly (eg a multi-brand strategy) or in fact restricted by MFN clauses (eg time-limited price-based offers and cashback offers). We therefore consider that the harm identified above could not be easily avoided.

Evidence of incentives of wide MFN clauses

Commission fees

50. In Annex D, we present analysis that looks at the relationships between MFN clauses and commission fees by looking at a group of large insurers and a group of small insurers. Insurance providers within each group should have approximately equal bargaining power with the PCWs.

51. In the case of the largest insurers, we found very little difference between commission rates on policies that are covered by wide or narrow MFN clauses. Large insurers tend to enjoy lower commission rates and also tend to enjoy a larger number of narrow MFN schemes than do the smaller insurers. BGL, the owner of Comparethemarket.com, argued that there were a number of factors, including differences in insurer size and sales volumes, that lay behind differences in commission rates rather than differences in MFN status. This appears to be true for

the largest insurers.[14] In the case of the smaller insurers, commission rates are lower for those that enjoy narrow MFN clauses. The evidence here is consistent with the incentive-based logic that suggests higher commission fees for wide MFN clauses.

Entry and innovation

52. We considered above that a common route to establishing a new competitor in a market is to arrive as a low-cost alternative to the incumbents, and we noted that wide MFN clauses preclude this entry strategy.

53. We have received direct evidence that entry has been deterred in this way in the past. Covea SGAM, which was considering a launch of a new PCW, stated that it considered that MFN clauses prevented a new entrant from differentiating itself in the market through the offer of cheaper insurance premiums. It ought to be possible to achieve this through offering discounted commission fees to insurance providers, but the existence of MFN clauses prevented this.

54. An example of attempted entry of this sort is that of some cashback websites. An internal document from [✂] identified the threat posed from cashback sites such as Quidco, which, it noted, if they continued to grow, could erode [✂] profits. The document mentioned using a 'best price guarantee' (among other things) to achieve a competitive advantage over cashback websites, and we noted that the contracts that [✂] with a number of motor insurance providers specifically mentioned cashback websites being within the scope of the MFN clause. The inclusion of cashback websites [✂].

[14] However, we note that the mechanism described above whereby narrow MFN clauses de facto have the same impact on behaviour as wide MFN clauses for insurers with large direct business may account for some part of this absence of a result—if wide and narrow MFN clauses have effectively the same impact on incentives, there ought to be no difference in the commission fees observed.

55. As against this evidence, however, Tesco and Google—both smaller players in the market—stated that MFN clauses could help an entrant PCW by providing credibility to customers that the policies they offered were genuinely good value. However, it seems possible for a new entrant to offer a price-matching guarantee to retail consumers without requiring a formal MFN. John Lewis, for example, does this in the retail sphere—an offer to consumers which is not necessarily reflected in supplier agreements.

56. There is potential in such a young market for much innovation. Cashback websites were one example of a sales channel innovation that has not worked to date in selling motor insurance. Other innovations that have been mentioned to us are sales strategies through social media platforms. The potential for new entrants to gain a foothold is probably made harder by their inability to differentiate on price. However, evidence of an absence is a hard thing to come by, and we have no direct evidence of innovative entry being restricted.

Pro-competitive effects

57. In this section we outline some of the evidence on the pro-competitive effects of PCWs and MFN clauses. We first assess whether PCWs make the motor insurance market more competitive before we assess alternative mechanisms to narrow MFN clauses to counteract free-riding by consumers and motor insurance providers.

PCWs make the motor insurance market more competitive

58. We think that the evidence that PCWs have made the motor insurance market more competitive is strong. It is also hardly disputed by any parties.

59. Annex F highlights evidence from the CC's consumer survey that shows that consumers on PCWs shop around more and receive cheaper premiums in return. In

addition, evidence from [✂] (in Table 5.1 of Section 5) shows that consumers on PCWs are much more price-sensitive, which means that motor insurance providers know a small change in price can make a large difference to the number of customers.

60. The only caveat that some insurers have made is that competition has increased so much that consumers may be buying too much on price grounds and ignoring other attributes of the purchase. The argument is that achieving a high ranking in the price comparison results is such a high business priority that the product offering becomes distorted. Against this, we know that many consumers typically do not pick the very cheapest policy but choose instead from the top ranked policies.

Free-riding

61. Narrow MFN clauses 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 choosing not the absolute cheapest offering. Thus, the logo of the insurer is an important piece of information in the consumer's search. If it were widely known that when shopping on a PCW, to get the best price you needed to visit the chosen website directly, 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.

62. Free-riding can be an issue in many markets but will not necessarily lead to the failure of the market, as the market may evolve other solutions to it or rely on loyal customers. 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.

Single-homing

63. It has been argued[15] that PCWs do not need even narrow MFN clauses to sustain their current business models as they could rely on single-homing customers to provide revenues to cover their fixed costs. Motor insurance providers estimate single-homing rates of between 60 and 80 per cent.

64. [✂] This would imply an ability to earn substantial revenues from these captured retail customers even if a better deal was a click away.[16]

65. The CC consumer survey estimated that 33.5 per cent of consumers who use PCWs use only one PCW. This is another measure of the possible number of 'captured' or 'single-homing' consumers whom PCWs might be able to rely on to provide revenues even if cheaper policies were only a few clicks away.[17] This percentage amounts to [✂] customers for the smallest of the big four PCWs, or an income of around £[✂].

66. Submissions from PCWs suggest that the annual fixed costs of operation are between £[✂] and £[✂] excluding advertising. Under current single-homing rates,

[15] Most notably by Saga.
[16] The case study is not a perfect analogy to being without a narrow MFN: by being delisted, the [✂] policies were no longer 'a click away' on the motor insurer's site, but hidden in the haystack of the Internet.
[17] If the PCW business were sustained in this kind of way, it would imply that one set of retail consumers—the single-homing ones—would effectively be subsidising those who optimized and used the PCW for reference purposes only.

PCWs could conceivably recover their fixed costs of operating through single-homing customers, although it may mean a reduction in advertising expenditure.

67. However, the data on single-homing retail customers needs to be treated with caution, given that the reward to retail customers for visiting multiple PCWs is limited due to the prevalence of wide MFN clauses. If there were no wide MFN clauses, we might expect more retail customers to shop around and the number of single-homers to fall considerably. Therefore, cost recovery through reliance on single-homers may not be a credible alternative.

Anonymous quotes

68. Another alternative mechanism for PCWs is to offer consumers anonymized search results in which the identity of the motor insurance provider would only be revealed by clicking through to the destination site. Some online services for ordering taxi cabs, for example, operate on this model—they return cab quotes without the identity of the cab company.

69. However, in the case of motor insurance, we know that retail consumers often do not pick the cheapest quote, and that non-price considerations enter their choices. If the insurance brand is essential to the consumer choice because, for example, the insurer's reputation of dealing with claims is important, any system which restricts the visibility of that brand in the search result would imply a worse product for consumers. In addition, if a sale is completed on the insurance provider's website, the identity of the provider will eventually be disclosed. This does not appear to be a credible alternative.

Charging model

70. PCWs could change their current charging model from the commission fee model[18] to a pay-per-click model or listing fee model.

71. BGL stated in its response to WP16 that

> there are ways other than commission fees supported by MFN clauses to cover … costs; however, in [our] view, these alternatives are not practicable or, indeed, are likely to give rise to more adverse outcomes. For example, upfront fees or annual subscriptions would create greater barriers to entry for newer or smaller motor insurance providers and a cost per click model would take away the direct correlation between policy sales and acquisition costs which contributes so significantly to the efficiency of the PCW model.

72. BGL does not develop its claims that non-commission-based business models would increase barriers to entry, nor that there is some special efficiency in the commission model.

73. Listing fees, conversion floors[19] or cookie-based affiliate marketing fees could be used to reward PCWs irrespective of their sales-conversion rates. As PCWs provide a service to motor insurance providers irrespective of the sales they generate (ie by informing consumers that a given policy is reasonably good value), motor insurance providers could pay for this service directly.

74. However, we also note that some PCWs (including [✂]) have introduced conversion floors for some motor insurance providers, which suggests that they are already

[18] The commission fee model means that motor insurance providers only pay the PCW if a sale is completed.
[19] A conversion floor of 20 per cent means that a motor insurance provider pays the PCW as if 20 per cent of the clicks through to the motor insurance provider's website were converted into a sale. If the conversion rate is above 20 per cent, the motor insurance provider just pays the usual commission fee.

moving away from the pure commission-based model.[20] Whilst there may be benefits to the commission model, the survival of PCWs does not rely on staying with this model and PCWs could (and do) raise revenue through other charging models. This does appear to be a credible alternative.

Quote poaching clauses

75. PCWs have argued that motor insurance providers could avoid paying commission fees by encouraging customers to come to them direct after having used a PCW.

76. We have been told that there are already other mechanisms in place which do not require physical click-throughs and sales completion. For example, data audits could keep track of where a retail consumer had found information about a policy and could reward sites accordingly. Some car insurers already operate 'click poaching' agreements with PCWs that are of this form.

77. On the technical feasibility of basing referral payments on other mechanisms apart from completion, [✂], for example, told us: 'There is no practical obstacle to be able to marry those things [a customer visit on a price comparison site and an eventual sale of a policy] up. It is data.' [✂] told us: 'If [the customer] effectively transact a policy with us very soon [seeing our policy on a PCW] then we will have sensible conversations about the attribution of that cost. That is available now and part of the audit process.'

78. This appears to be a potential mechanism for PCWs to overcome free-riding.

[20] [✂]

Annex A: Prevalence and characteristics of MFN clauses

Annex B: Channel pricing model

Annex C: Rewarding channels with low risk

Annex D: Analysis of the effects of MFN clauses on commission fees

Annex E: Analysis of insurers advertising strategies

Annex F: Evidence from CC consumer survey on PCWs' impact on motor insurance market

Annex G: Effectiveness of counter strategies

Annex H: Profitability of the four large PCWs

Annex I: Evidence of the exercise of market power without MFNs

Annex J: Effect of PCW ownership structure on competition between motor insurance providers

Prevalence and characteristics of MFN clauses in contracts between PCWs and motor insurance providers

Introduction

1. This annex discusses the prevalence of the different types of MFN clauses in contracts between motor insurance providers and PCWs.

Background

2. The vast majority of contracts signed by motor insurance providers and PCWs have an MFN clause which prevents the motor insurance provider offering the same policy at a cheaper price via some other channel(s).

3. PCWs present consumers with quotes provided by motor insurance providers. PCWs ask consumers questions and the answers are passed on to motor insurance providers, which they map on to variables to enable them to assess risk. The MFN applies to prices that are quoted for identical inputs to the motor insurance provider risk model, with each different set of variables effectively being a different product.

4. The four large PCWs (Confused.com, Comparethemarket.com, Gocompare.com and Moneysupermarket.com) all use MFN clauses in at least some of their contracts and some of the smaller PCWs [✂] do as well.

Prevalence of MFN clauses

5. All the insurers and brokers from which we gathered evidence have MFN clauses in almost all of their PCW contracts.[1]

[1] Ageas Insurance is an exception because it does not sell policies directly through PCWs. Ageas Insurance's motor insurance policies are available through brokers (including Ageas Retail (its wholly-owned broking business)), many of which sell through PCWs, and through 'affinity' brands.

6. Table 1 summarizes the type of MFN clause for each motor insurance provider in each of its contracts with a PCW in 2012. We classify MFN clauses according to three categories: 'own website', 'online' and 'all sales'.[2] We note that this classification may not be fully reflective of pricing constraints because some MFN clauses are informal agreements. For example, [✂].

TABLE 1 **Type of MFN clause with the four largest PCWs for each motor insurance provider in 2012**

	Comparethemarket.com	*Confused.com*	*Gocompare.com*	*Moneysupermarket.com*
[✂]	[✂]	[✂]	[✂]	[✂]

Source: CC.

[✂]

7. Table 2 shows the number of policies sold under narrow, wide or no MFN through the four biggest PCWs in 2012. The least restrictive type of MFN, the narrow MFN, is currently the most frequently used MFN with less than half ([✂] per cent) of motor insurance policies sold through PCWs covered by a narrow MFN clause. The most restrictive, the wide MFN, is less frequent with ([✂] per cent) of motor insurance policies sold through PCWs covered by a narrow MFN clause. Otherwise, there are a significant minority ([✂] per cent) of policies which are not covered by any MFN clause.

TABLE 2 **Policies volume under MFN type for the four biggest PCWs (2012)**

MFN	*Comparethemarket.com*	*Confused.com*	*Gocompare.com*	*Moneysupermarket.com*	*Total*
Wide	[✂]	[✂]	[✂]	[✂]	[✂]
Narrow	[✂]	[✂]	[✂]	[✂]	[✂]
None	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]

Source: PCWs.

8. However, an insurer having in place at least one wide MFN with one PCW constrains the rest of the PCWs even if they are under a narrow MFN or do not have any MFN

[2] Narrow MFN clauses are the same as 'own website' MFN clauses. Wide MFN clauses include both 'online' all sales' MFN clauses.

clause in place. Table 3 shows that the number of policies under a wide MFN or constrained by at least one wide MFN represents a significant majority ([✂] per cent) of the total number of policies sold through the four biggest PCWs. The number of policies that are narrow or none across the four insurers is in the minority ([✂] per cent). The number of policies that are not under any MFN across the four PCWs represents very little ([✂] per cent) of the total sales volume.

TABLE 3 **Volume of policies taking into account the MFN clauses across the four biggest PCWs (2012)**

Insurers' policies under:	*Total number of policies*	*per cent*
At least one wide MFN	[✂]	[✂]
One wide MFN	[✂]	[✂]
Two wide MFN clauses	[✂]	[✂]
Three wide MFN clauses	[✂]	[✂]
At least one narrow MFN clauses (with no wide MFN clauses)	[✂]	[✂]
Only narrow MFN clauses	[✂]	[✂]
Mix of narrow and no MFN clauses	[✂]	[✂]
No MFN (only)	[✂]	[✂]
Total	[✂]	

Source: PCWs.

9. We note that PCWs do offer policies from some motor insurance providers without an MFN in place. However, motor insurance providers told us that they did not believe they had sufficient bargaining power against the PCWs to resist an MFN clause where a PCW insisted on it. Motor insurance providers said that they felt obliged to accept MFN clauses if they wanted to sell their products on PCWs.

10. Although these are the current proportions, we note that the use of MFN clauses seems to be a point of current discussion between some PCWs and motor insurance providers. We found that a recent request by some PCWs to extend the scope of their MFN clauses was strongly resisted by motor insurance providers. We also found that some PCWs had relaxed their MFN clauses, possibly due to increased interest by competition authorities in these clauses.

An illustrative channel pricing model

1. It has been argued that narrow MFN clauses force motor insurance providers to post the same price on all PCWs.

2. Consider, for example, an insurer with a brand, 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 MFN clauses). Recall that a narrow MFN prevents the price on the direct sales channel being lower than on the PCW although the insurer is permitted to set a higher price on the direct sales channel than on the PCW.

   (a) 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 direct to Brand A's website.

   (b) It therefore does not want any PCW to offer Brand A's policies cheaper than its own website.

   (c) 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.

   (d) Imagine a low-commission-rate entrant PCW wishing 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 clauses 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. Low-commission-rate entry would have been discouraged just as it is for wide MFN clauses.

   (e) Imagine also a commission rate increase on the part of the PCW with the narrow MFN. The insurer would want to increase premiums on that channel, 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 rates is identical to the case described for wide MFN clauses.

3. In the absence of the narrow MFN, the direct channel could be the cheapest and the prices of policies on PCWs would be in relation to their costs (a combination of commission rates and the risk profiles of the business they brought).

4. In this annex we describe a few simple numerical examples of channel choice. The purpose is not to produce an accurate forecast of the premiums that an insurer will charge under different MFN regimes, but rather to isolate and illustrate the incentives that the insurers face and the impact of these on premium pricing. The structure of the channel choice problem has been captured in the model, but not the magnitudes of any parameters.

5. Our simplified model has the following structure:

(a) An insurer chooses the premium at which a policy will be offered through its own channel, through each of four PCWs and, in some examples, through an entrant channel.

(b) Each channel has a cost associated to it which we can think of as being the average cost of sales through that channel—commission rates in the case of PCWs and consumer acquisition costs (mainly advertising) in the case of the direct channel.

(c) There is a maximum price that the insurer cannot exceed—we can think of this as the price at which the policy becomes uncompetitive and ceases to sell. Below that price, we assume that total demand for the policy through all channels is fixed. This is clearly a simplification of the usual price sensitivity of demand, but it helps to isolate between-channel effects.

(d) We model MFN clauses as constraints on the premiums at which the insurer can offer policies.

(e) We model consumers as switching channels in response to the price differences between the channels. We use a Dixit-Stiglitz Constant Elasticity of Demand specification for the consumer choice. We assume that consumers have some fixed channel-specific preference over and above price differences—a strong fixed preference makes it harder for any price difference to shift consumers. In all scenarios, we assume that consumers are very price-sensitive, although fixed preferences eventually limit that price sensitivity. Our assumption of great price sensitivity up to some point is intended to capture the behaviour that we see in the market whereby many consumers check many channels before making a purchase, but a core of consumers are 'single-homers' who do not seem to search actively through many channels. The exact specification of the demand model is not considered to be critical in this exercise: we are not so concerned with the magnitude of different effects as with illustrating the existence and direction of different effects.

(f) The decision that the insurer makes is to maximize profits (premium minus channel cost) subject to premium not exceeding the allowed maximum and subject to any MFN constraints. We use Excel's non-linear constrained optimization routines to simulate the insurer's profit-maximizing decision.

(g) The scenario variables that we consider with this model are:

(i) Degree and scope of MFN coverage (none/narrow/wide, and the number of such clauses).

(ii) Profitability of the direct channel (profitable versus unprofitable)—we take this to characterize the difference between those insurers who have substantial branding goodwill invested in their policies and can therefore attract attention to their direct sales channel at a relatively low average cost, versus those who do not have strong brands and for whom attracting

attention to their website is expensive relative to doing so through PCW listings.

(iii) The price-independent preference for the direct channel—its degree of 'single-homing'.

6. The rest of this annex describes specific illustrative examples of channel choice. We present three scenarios that gradually build up to establishing the parameters needed to establish where narrow MFN clauses act like wide MFN clauses so that the insurer tries to maintain the own-channel competitiveness and so raises all premiums to the level of the premium covered by an MFN.

7. The progression in the scenarios we explore is the following:

(a) A profitable direct channel with no special price-independent attractiveness to consumers and no MFN clauses. We consider this to be a 'benchmark' case for insurers with attractive direct channels.

(b) We add a narrow MFN to the above and show a set of parameters under which the narrow MFN clauses are not like wide MFN clauses—the impact of the MFN is to increase the premium offered on the direct channel, but to keep the premiums available on high-margin channels low.

(c) We increase the price-independent attractiveness of the direct channel to show that this has the effect of making narrow MFN clauses like wide MFN clauses. The insurer has the incentive to minimize sales on all channels except its own, and it does so by raising prices on all channels. The model does not allow a 'delisting' choice, but a useful interpretation of the result that PCW channels' market shares are minimized is that this would, in practice, mean a delisting.

Scenario descriptions

8. In all cases, we assume that consumers switch readily between channels in response to premium differences, although we vary the premium-independent preference level for channels in the last scenario. In all the numerical examples, the maximum price before demand disappears completely is 10, and below that price, 100 policies are spread between the channels. In the scenarios where premium-independent channel preferences are equal (1 and 2), the lower premium channels receive higher market shares.

Scenario 1: Channel choice with no MFN clauses and a profitable direct channel

9. The table below summarizes the numerical example.

TABLE 1 **Channel choice with no MFN clauses and a profitable direct channel**

Channel	*Channel preference*	*Average channel cost*	*Premium*	*Sales*	*Market share (%)*	*Total cost*	*Total revenue*	*Profit*
Own	0.18	3.5	**8.34**	5.17	46	18.08	3.11	25.02
PCW1	0.18	7	**10.00**	0.84	8	5.91	8.45	2.53
PCW2	0.18	6.5	**10.00**	0.84	8	5.49	8.45	2.96
PCW3	0.18	4.6	**10.00**	0.84	8	3.89	8.45	4.56
PCW4	0.18	4	**9.54**	1.36	12	5.44	12.96	7.52
Entrant	0.10	3.6	**8.58**	2.17	19	7.80	18.59	10.79
	Total profit	53.39	Weighted average price	9.19				

Source: CC analysis.

10. The important features of the scenario construction are the following:

(a) Channels vary in their average costs and therefore their profitability for the insurer. There is an entrant channel offering a low-cost option for the insurer; this entrant has a low channel preference parameter, reflecting the difficulty any entrant faces in gathering attention, regardless of premiums offered.

(b) We have made the own channel the most profitable of all the channels on offer—just slightly more profitable than the entrant's offering. This reflects the fact that there are no commissions payable on the own channel.

11. The important features of the optimal channel pricing solution—highlighted in bold—are the following:

(a) The insurer's interest is to divert a great deal of sales to its own website—the most profitable for it—and to do this it reduces prices there to the lowest of all channels.

(b) The insurer has some interest in selling more than the minimum through the next two highest margin channels because encouraging further sales through the own channel would reduce prices too far and hence reduce margins on own sales.

(c) The more expensive PCW channels are unattractive and the insurer offers premiums at the maximum price through them to minimize their market share.

Discussion of the scenario

12. With no MFN clauses in place, the direct sales channel is treated as any other—it is the lowest cost of all the channels and therefore the insurer seeks to maximize sales through it. It has equal 'visibility' (premium-independent preference) as the incumbent PCW channels, so sales maximization implies giving the own channel a price advantage.

Scenario 2: Channel choice with one narrow MFN clause and a profitable direct channel

13. The table below summarizes the numerical example.

TABLE 2 **Channel choice with one narrow MFN clause and a profitable direct channel**

Channel	*Channel preference*	*Average channel cost*	*Premium*	*Sales*	*Market share (%)*	*Total cost*	*Total revenue*	*Profit*
Own	0.18	3.5	**10.00**	1.12	10	3.92	11.20	7.28
PCW1	0.18	7	**10.00**	1.12	10	7.84	11.20	3.36
PCW2	0.18	6.5	**10.00**	1.12	10	7.28	11.20	3.92
PCW3	0.18	4.6	**10.00**	1.12	10	5.15	11.20	6.05
PCW4	0.18	4	**9.25**	2.45	23	9.82	22.69	12.87
Entrant	0.10	3.6	**8.32**	3.91	36	14.07	32.53	8.46
	Total profit	51.93	Weighted average price	9.49				

Source: CC analysis.

14. The scenario is identical to Scenario 1 except that PCW1 is assumed to have a narrow MFN with the insurer—the insurer's price cannot be cheaper than PCW1's.

15. The important features of the optimal channel pricing solution are the following:

(a) The insurer prices in order to shift demand to the two lowest-cost, highest-margin channels.

(b) The own-channel price rises to its maximum level to match the maximum that PCW1 was already being priced at, to satisfy the narrow MFN constraint.

Discussion of the scenario

16. Although the own channel is the most profitable, the imposition of a narrow MFN leads to sales being diverted to the next best alternatives. The insurer does not, in this case, find it profitable to maintain the share of its own channel when that means increasing the share of the least profitable of all channels, PCW1. This is thus an example of a parameter set that goes against narrow MFN clauses acting like wide MFN clauses.

17. The DLG argument relies on the assumption that an insurer will want to maintain the profitability of its direct channel. This scenario shows that even when the direct channel is the most profitable, there are cases where the insurer sacrifices that channel and does not maintain its competitiveness. The imperative to maintain competitiveness is not so strong as to eliminate the incentive to increase sales through the next most competitive channels.

18. The implication of the DLG argument is that in order to maintain the competitiveness of its brands on the direct sales channels, the price of other cheaper PCWs must also be increased. This is not profit-maximizing behaviour under these parameters. There is a general point which is not linked to the specifics of the channel choice model

here: it does not make sense in general for an insurer always to maintain the profitability of its own channel, when doing so would imply losing market share through attractive channels.

19. DLG stated in its response to WP16 that: [✂].

20. In the scenario below, we demonstrate what is needed to make this not just a possible strategy, but a profit-maximizing strategy.

Scenario 3: Channel choice with one narrow MFN clause and a strong direct channel preference

21. The table below summarizes the numerical example.

TABLE 3 **Channel choice with one narrow MFN clause and a strong direct channel preference**

Channel	*Channel preference*	*Average channel cost*	*Premium*	*Sales*	*Market share (%)*	*Total cost*	*Total revenue*	*Profit*
Own	0.70	3.5	**10.00**	7.00	70	24.50	70.00	45.50
PCW1	0.06	7	**10.00**	0.60	6	4.20	6.00	1.80
PCW2	0.06	6.5	**10.00**	0.60	6	3.90	6.00	2.10
PCW3	0.06	4.6	**10.00**	0.60	6	2.76	6.00	3.24
PCW4	0.06	4	**10.00**	0.60	6	2.40	6.00	3.60
Entrant	0.06	3.6	**10.00**	0.60	6	2.16	6.00	3.84
	Total profit	60.08	Weighted average price	10.00				

Source: CC analysis.

22. The important features of the scenario construction are the following:

(a) The scenario is as for 2, with PCW1 having a narrow MFN clause.

(b) The direct channel is given a very strong exogenous preference. The way to read this is to say that without making any effort on prices, the direct channel attracts most sales. This represents the case of a brand with a great deal of past advertising investment and high visibility.

Discussion of the scenario

23. The MFN forces the price of the own channel up to the maximum level, as it does in Scenario 2.

24. The premiums on PCW4 and the entrant channel are also raised to the maximum level. This happens because any price reduction on those channels which aims to take sales away from less profitable channels ends up taking more sales away from the direct channel.

25. This scenario appears to be the case where an important direct channel and a single narrow MFN lead to price equalization across all channels. DLG [✂], and this is consistent with its describing its incentives as in this scenario.

Rewarding channels with lower risk

1. Saga and DLG have pointed out that the risk profiles that channels attract are different. The efficient channel pricing model, outlined above, would imply the ability to reward those channels that attract lower-risk consumers with lower premiums. Insurers usually cite their own direct channel as being superior to PCW channels, specifically because of relatively higher fraud levels on PCW sites—for example, through consumers submitting repeatedly different answers in an attempt to lower quotes.

2. BGL considered that insurers did not pass on cost savings of cheap channels: the cheapest channel was renewals, and renewals were also offered the highest premiums. BGL also claimed that it had offered the insurers various fraud detection innovations but found very little interest among insurers.

3. In this annex, we consider the question of whether we would expect competing PCWs to have an incentive to offer fraud detection and other risk-lowering innovations.

4. The channel choice model presented in Annex B shows that, in general, lower-cost channels should be rewarded with lower premiums and higher market shares. A normal competitive process ought to make genuine improvements in channel technology spread through the PCW market. If wide MFN clauses are preventing between-channel competition, this would include the limited spread of cost-reducing technology across the sector.

5. The only case in which a direct channel would have an absolute advantage over a PCW in risk-filtering would be if the very fact of using a PCW were an indicator of

high risk. This has not been the argument of insurers and seems implausible, especially as a high and growing percentage of the market uses PCWs. If PCWs implemented the fraud detection regimes that insurers claim are available on their own websites—for example, limiting questionnaire resubmissions—then we would not expect their effects to be different on one website rather than the other.

Analysis on effects of MFN clauses on commission fees

1. In this annex we set out the CC's analysis on the effects of MFN clauses on commission fees by using cross-sectional averages.[1]

2. In order to explore the link between the scope of MFN clauses and the commission fees paid to comparison websites, we have divided insurers into the 'largest' and 'smallest'. It is likely that negotiating strength plays a role both in determining the scope of the MFN entered into and the level of commissions paid.

3. In the data below, we use only information from motor insurers which had brands on all four major PCWs in 2012.[2] Whilst there is a danger of missing some information, Figure 1 shows that we are capturing over 90 per cent of sales.[3]

FIGURE 1

Proportion of sales that largest and smallest insurers account for on each PCW

[✂]

Source: CC analysis of PCWs' data.

4. We see in Figure 1 that the proportion of sales that the largest 50 per cent of car insurers account for is above 80 per cent on average across the four PCWs. Some motor insurers, and particularly brokers, have a multi-brand strategy on PCWs so the sales of an individual brand may not be as high.

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[1] [✂]
[2] If a motor insurance brand appears on three out of four major PCWs and the motor insurance provider has another brand featuring on the other PCW, it has been included in our calculations below.
[3] [✂]

FIGURE 2

Commission fees for largest and smallest insurers

[✂]

Source: CC analysis of PCWs' data.

5. Figure 2 shows the commission fees that the largest and smallest 50 per cent of motor insurance providers pay to each PCW. As can be seen, the largest insurers are able to negotiate much better rates than the smallest insurers, with the difference being about £4.

FIGURE 3

Proportion of sales under wide MFN clauses

[✂]

Source: CC analysis of PCWs' data.

6. Figure 3 shows the proportion of sales that take place under the wider MFN clauses for each PCW. Moneysupermarket.com has no wide MFN clauses in place with car insurers so appears as 0. We can also see that the smallest 50 per cent of motor insurers [✂]. Larger insurers have wide MFN clauses in their contracts much less than the smallest motor insurers.

FIGURE 4

Commission fees for large and small insurers by type of MFN

[✂]

Source: CC analysis of PCWs' data.

7. Figure 4 shows the difference in commission fees for car insurers with wide MFN clauses, narrow MFN clauses and none at all.[4] We can see that commission fees are higher when there is a wide MFN in place. The difference in commission fees between narrow MFN clauses and none is ambiguous as there are some examples

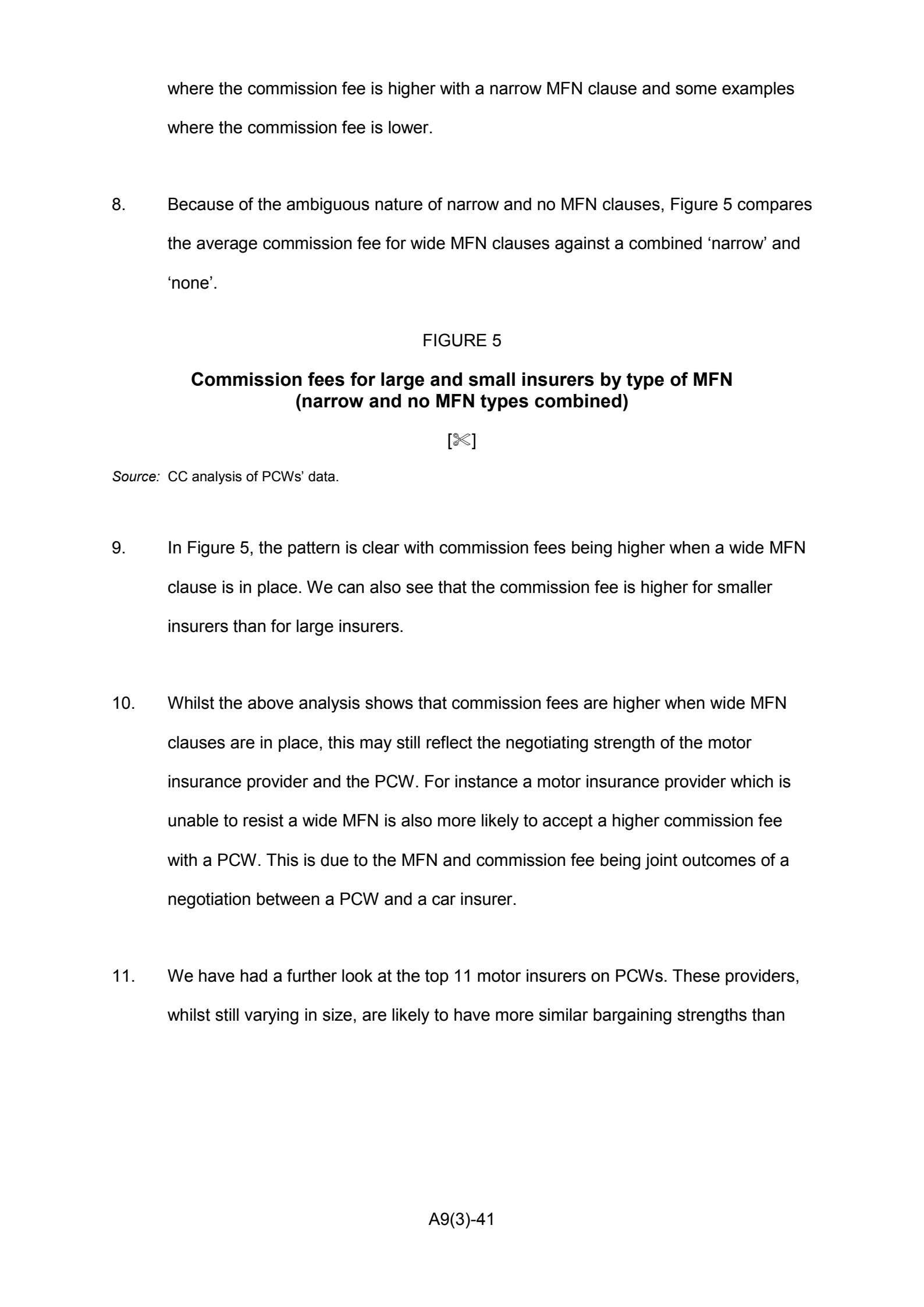
[4] Where there are missing columns, this is due to PCW not having those types of MFN clauses with this type of insurer.

where the commission fee is higher with a narrow MFN clause and some examples where the commission fee is lower.

8. Because of the ambiguous nature of narrow and no MFN clauses, Figure 5 compares the average commission fee for wide MFN clauses against a combined 'narrow' and 'none'.

FIGURE 5

Commission fees for large and small insurers by type of MFN (narrow and no MFN types combined)



Source: CC analysis of PCWs' data.

9. In Figure 5, the pattern is clear with commission fees being higher when a wide MFN clause is in place. We can also see that the commission fee is higher for smaller insurers than for large insurers.

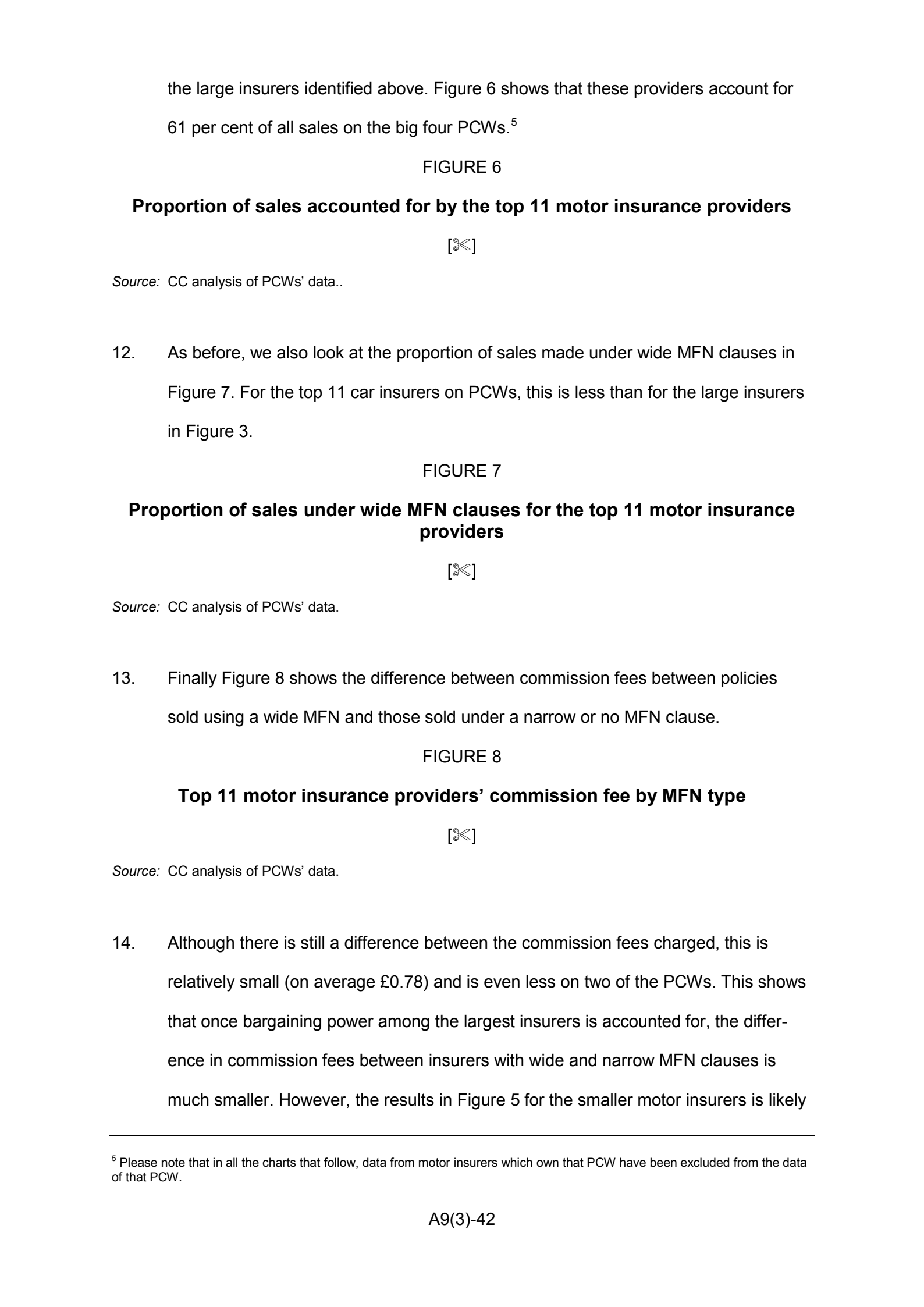
10. Whilst the above analysis shows that commission fees are higher when wide MFN clauses are in place, this may still reflect the negotiating strength of the motor insurance provider and the PCW. For instance a motor insurance provider which is unable to resist a wide MFN is also more likely to accept a higher commission fee with a PCW. This is due to the MFN and commission fee being joint outcomes of a negotiation between a PCW and a car insurer.

11. We have had a further look at the top 11 motor insurers on PCWs. These providers, whilst still varying in size, are likely to have more similar bargaining strengths than

the large insurers identified above. Figure 6 shows that these providers account for 61 per cent of all sales on the big four PCWs.[5]

FIGURE 6

Proportion of sales accounted for by the top 11 motor insurance providers



Source: CC analysis of PCWs' data..

12. As before, we also look at the proportion of sales made under wide MFN clauses in Figure 7. For the top 11 car insurers on PCWs, this is less than for the large insurers in Figure 3.

FIGURE 7

Proportion of sales under wide MFN clauses for the top 11 motor insurance providers

Source: CC analysis of PCWs' data.

13. Finally Figure 8 shows the difference between commission fees between policies sold using a wide MFN and those sold under a narrow or no MFN clause.

FIGURE 8

Top 11 motor insurance providers' commission fee by MFN type

Source: CC analysis of PCWs' data.

14. Although there is still a difference between the commission fees charged, this is relatively small (on average £0.78) and is even less on two of the PCWs. This shows that once bargaining power among the largest insurers is accounted for, the difference in commission fees between insurers with wide and narrow MFN clauses is much smaller. However, the results in Figure 5 for the smaller motor insurers is likely

[5] Please note that in all the charts that follow, data from motor insurers which own that PCW have been excluded from the data of that PCW.

still to hold as the smaller motor insurers appear to hold similar levels of bargaining power with PCWs.

Analysis of insurers' advertising strategies and use of PCWs

1. In this annex we assess motor insurance providers' advertising strategies, especially in the context of PCWs. This supports the analysis on which motor insurance brands are likely to be affected by narrow MFN clauses in a similar way to wide MFN clauses.

2. Figure 1 shows insurers' own website sales as a proportion of all online sales. We find out that the vast majority of insurers are selling substantially more through PCWs than through their online direct channel. [✂] The direct channel represents 26 per cent of sales on average.

FIGURE 1

Proportion of insurance providers' direct online sales volumes in 2012

[✂]

Source: Motor insurance providers.

3. Figure 2 shows advertising expenditure by brand. The chart shows that advertising expenditure varies by brand and reflects the multi-brand segmentation strategy adopted by some insurers.

FIGURE 2

Insurers' marketing spend by brand (November 2011 to October 2012)

[✂]

Source: Ebenchmarkers.
Note: Red triangles represent brands that are not available on PCWs. Blue squares are available on PCWs and through direct channels.

4. We are able to reconcile each insurer's advertising expenditure with its comments on their multi-brand strategies:

(a) Acromas—[✂]. Its sales for each brand are positively related with its marketing spend: [✂], which is in line with a strategy that PCW sales require less advertising.

(b) Admiral—Admiral, Diamond, Elephant and Bell Direct: Admiral's expenditure on advertising is focused [✂].

(c) Ageas—UKAIS, Kwik Fit Insurance Services, Express Insurance Services and The Green Insurance Company: These brands rely either entirely or mostly on PCWs and advertising expenditure is very low or nil.

(d) Aviva[6]—Aviva Direct represents most of the advertising expenditure. It is [✂] advertising expenditure is related to the sales volume through its direct online channel.

(e) BGL has low advertising expenditure for its motor insurance brands, which is in line with the strategy of focusing on PCWs and reducing advertising expenditure.

(f) CISGIL also has [✂], 'ecoinsurance'. [✂][7]

(g) DLG—Churchill, Direct Line and Privilege:[8] it is probably the best example of brand segmentation. Direct Line is not sold through PCWs and [✂].

(h) esure—esure commented that [✂].[9]

(i) LV—LV= and [✂]: LV commented that it still promoted itself directly despite the fact that PCWs generated around [✂] per cent of its direct new business sales.

(j) RSA—MoreThan: RSA explained that it had [✂]. eChoice (not shown in Figure 2) is its online brand selling predominantly through PCWs.

(k) Swinton—Swinton, The Insurance Line, Bullseye, Diva, Its4me and MIW: The Swinton brand is heavily promoted, to support its offline operations, while the rest of its brands are focused on PCWs and promotional spend is limited.

(l) Zurich—[✂].

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[6] Advertising expenditure in Figure 2 does not include the [✂] brand that is advertised principally through PCWs.
[7] [✂]
[8] Sainsbury's is a partner brand of DLG.
[9] esure noted that it believed that the introduction of PCWs had resulted in the shift of advertising spending from motor insurance providers to PCWs, which now generally did the advertising themselves.

5. Figure 1 on the proportion of direct online sales is broadly consistent with the insurers' responses and strategies concerning how much weight they give to their own channel. There has been a reduction in advertising expenditure because most of the insurers say they do not see a clear causal link between direct advertising and increases in sales. This is because of the predominance of PCWs in the volume of new sales. However, most insurers keep a certain amount of direct advertising spend, possibly attracting those customers who can be reached at low cost but also enhancing click-through rates from PCWs.

6. Figure 3 shows insurers' advertising expenditure in the period between May 2009 and April 2013. Advertising expenditure is split in two parts: online and offline (mainly television) expenditure. [✂] Both online and offline trends are consistent with insurers' comments about reducing offline advertising and relying more on PCWs while keeping online advertising to maintain existing customers. The amount of money that insurers spend on advertising remains very high, although some insurers say that they have drastically reduced their advertising spend. [✂], [✂] and DLG, have brands that they do not list on PCWs.

FIGURE 3

Motor insurance providers' advertising expenditure (May 2009 to April 2013)

[✂]

Source: Ebenchmarkers.

7. Figure 4 is a scatter plot showing the insurers' advertising spend on the x-axis and the percentage of insurers' own online sales on the y-axis. Many insurers argue that one of the reasons for reducing their advertising spend is that advertising is inefficient in increasing sales through the insurers' direct channel. Nevertheless, it appears from the larger motor insurance advertisers that sufficient spending will maintain a large direct channel.

FIGURE 4

Motor insurance providers' website sales and marketing spend (November 2011 to October 2012)

Source: Ebenchmarkers.

8. The insurers which state that direct advertising investment is not—or no longer—an efficient way of attracting new customers are effectively saying that, for incremental sales, the direct channel is a low-margin (or even loss-making) channel. For these insurers, wide and narrow MFN clauses have very different incentive effects, as described in working paper 16. Saga seems to be in a midway position: it appears to have a relatively small, loyal direct channel. However, it lists on PCWs [✂]. Whether a move to narrow MFN clauses across the market would lead to platform competition is going to depend on the incremental cost of direct sales and the sensitivity of direct sales volumes to price differences with PCWs. [✂] is in a similar midway position. [✂] It therefore has been able to combine flexible optimal pricing on its own channel with MFN-constrained pricing on PCWs.

9. [✂] DLG has chosen not to list its 'Direct Line' brand on PCWs but to list the 'Churchill' and 'Privilege' brands on PCWs. [✂] This approach would be consistent with short-term profit maximization if the fixed preference for the non-PCW brand is high enough to encourage the corner solution of Scenario 3, while the other brands fall below the threshold required. One way of interpreting Scenario 3 is that the insurer has an interest in minimizing the sales through the PCWs with which it has MFN clauses. Our model does not allow delisting as an option. Not listing on PCWs is effectively the choice taken by DLG on its non-PCW brand.

10. The only other insurer that comes close to having a similarly important direct channel is [✂]. [✂] does not list its [✂] brand on any PCW and so does not have any MFN

agreements for that brand. The decision to avoid listing on PCWs and avoid any MFN makes sense if that allows the company freedom to set the price on its large direct channel consistent with profit maximization.

11. In its response to working paper 16, [✂] objected to narrow MFN clauses on the grounds that it 'believes these could suppress the growth in market sales for lower cost distribution channels such as digital and social media and could restrict competition'. As we have seen in the discussion of Scenario 2, this is not generally the case, but it might be true in [✂] case. However, [✂] does not describe its own incentives in the same way as DLG does and does not argue that narrow MFN clauses will have the same effects as wide ones.

12. Our channel pricing model suggests a different but closely related point: that if an insurer does have a strategic goal of maintaining a strong direct sales channel, then it may not be a good idea to enter into narrow MFN agreements. The reason for this is precisely that in such a case, profit maximization will tend to increase the price and reduce the market share of the direct channel relative to attractive untied channels. Thus, it is true that narrow MFN clauses tend to undermine direct channels; but it is not true, as claimed by DLG, that narrow MFN clauses necessarily undermine competition between PCWs, as happens with wide MFN clauses.

13. The solution to the business problem faced by an insurer who wants a healthy direct channel is not to sign narrow MFN agreements at all with PCWs. If insurers do sign narrow MFN agreements, we would expect both their direct channels to become less competitive *and* competition between PCWs to be strong. If PCWs insist on narrow MFN clauses, then non-listing, as practised by some motor insurance providers, may be the way of preserving sales through a high-margin direct channel.

14. When insurers do not consider their direct channel to be important, channel optimization is simpler. This might arise if there is little goodwill invested in the insurers' brands through past advertising. In this case, getting sales from the direct channel requires a high incremental cost (for the purchase of attention) compared with sales through PCWs.

15. In this case, the insurer will optimize premiums to the various PCWs in relation to the attractiveness of sales through each of them—PCWs with lower commission rates will be offered lower premiums. The narrow MFN constraint will not have any impact on the pricing of the direct channel because sales through this unattractive channel are already minimized—it is not a burden on the insurer to maintain own-channel premiums at or above the maximum of all the PCW premiums.

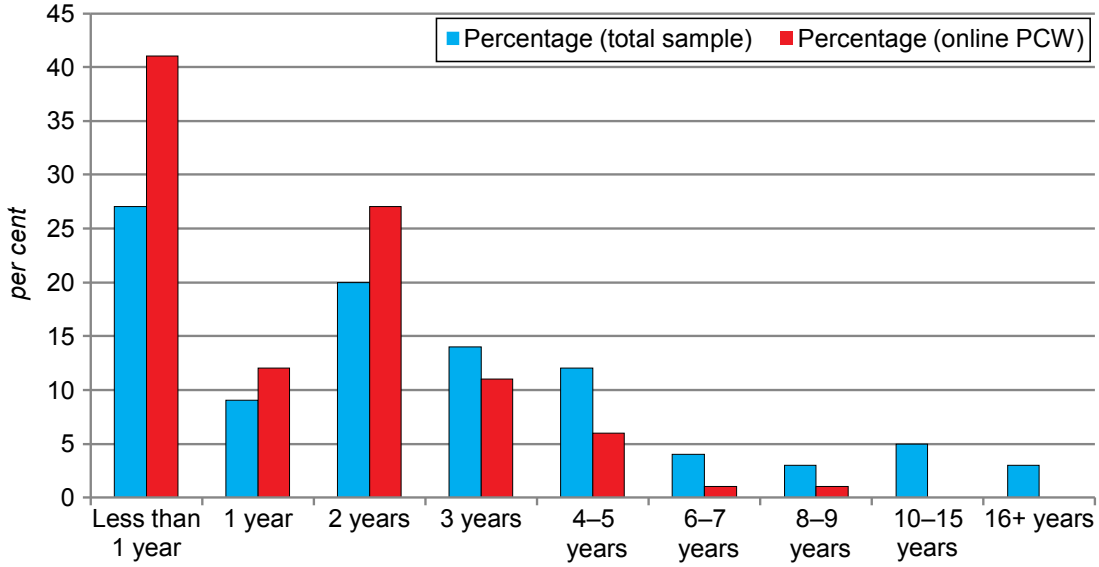
CC consumer survey: do PCWs make the motor insurance market more competitive

1. In this annex we look at evidence from the CC consumer survey into the degree to which PCWs make the market more competitive.

2. Purchasers through PCWs are significantly less likely to stay with the same insurer for many years. This can be seen in Figure 1: 79 per cent of purchasers through PCWs have renewed for two years or less compared with 56 per cent of the total sample.

FIGURE 1

Length of time consumers have stayed with their current insurer

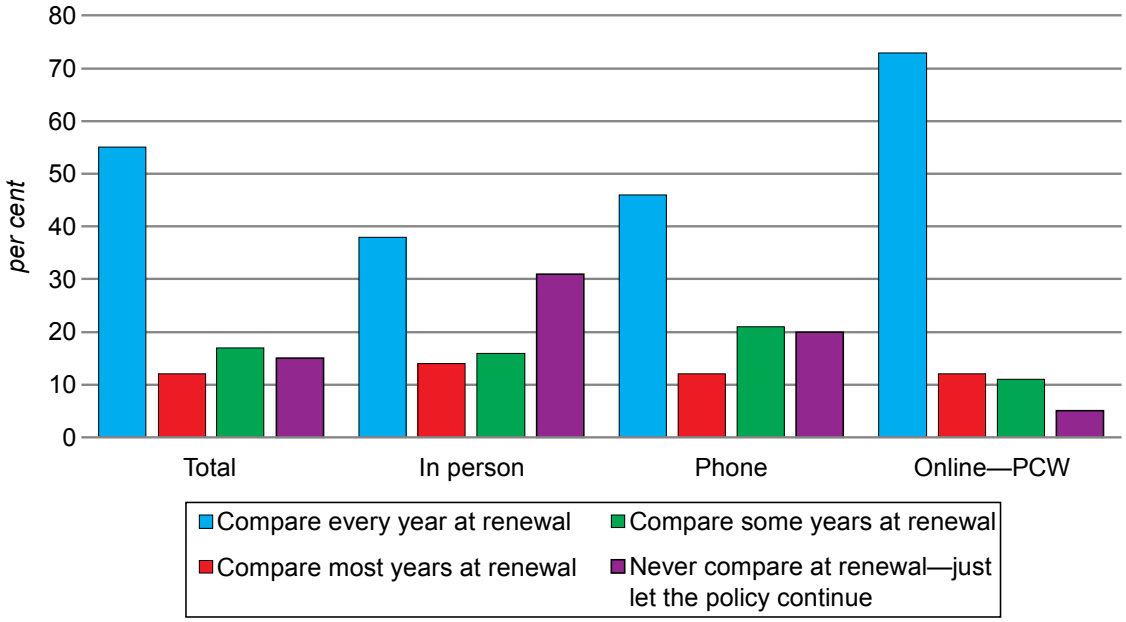


Source: CC consumer survey.

3. PCW users are also more likely to compare their insurance policies each year at renewal compared with those individuals who compare policies in person or by using the phone (see Figure 2).

FIGURE 2

Percentage of consumers who compare insurance policies each year

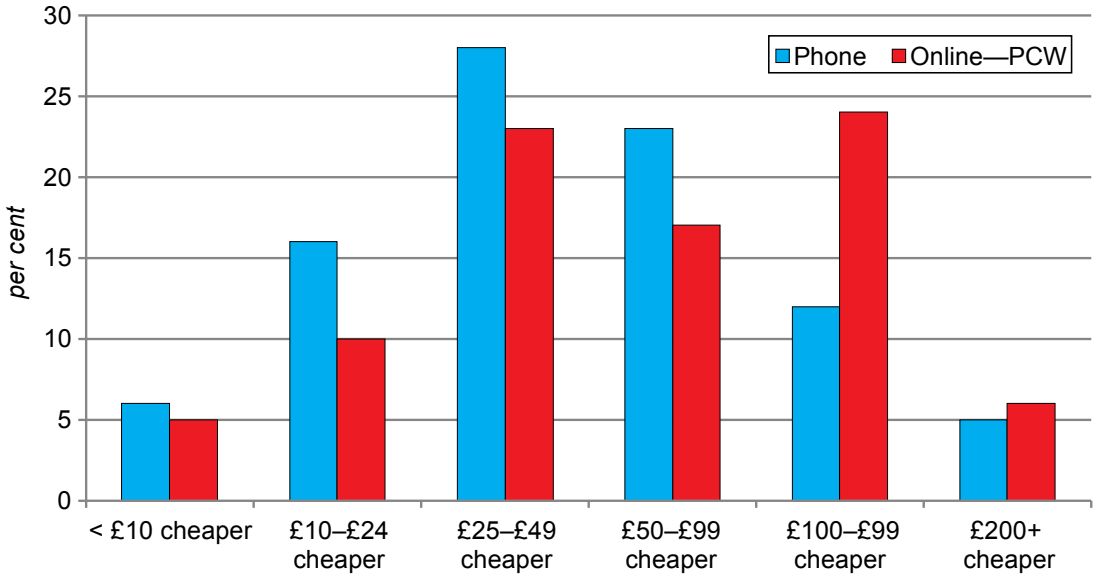


Source: CC consumer survey.

4. For those who paid a cheaper price compared with the renewal price quoted, Figure 3 shows that the price paid through PCWs is considerably cheaper than by phone.

FIGURE 3

How much cheaper was consumer's insurance policy compared with the renewal price



Source: CC consumer survey.

5. The general picture that emerges from the survey is that PCW users are less loyal and more likely to switch, and they are rewarded with more money off their premiums. This suggests that PCWs are overall a pro-competitive force.

Effectiveness of counter strategies

1. The potential harm to competition arising from MFN clauses described in the theory of harm section may be negated if motor insurance providers and PCWs can pursue strategies that circumvent the pricing restrictions. In this annex, we outline the potential counter strategies that motor insurance providers and PCWs have put forward as well as evidence on their effectiveness.

2. The potential strategies a motor insurance provider might use are to:
   - offer customers who purchase from its website a cashback guarantee at the end of the policy period if the pricing restriction only applies to the initial premium paid;
   - differentiate its policies slightly between different channels (for example, by including ancillary items of cover as part of the product sold like free legal cover); and
   - sell very similar policies through different brands (assuming the MFN only applies to one brand).

3. Similarly, PCWs may engage in strategies to help counter the effects of MFN clauses, by engaging in various strategies, including:
   - offering customers who purchase from its website a cashback guarantee at the end of the policy period if the pricing restriction only applies to the initial premium paid; or
   - offering other non-cash incentives to purchase through the PCW;
   - offering insurers short-term reductions in commission fee in return for lower premiums (‘exclusive offers’); and
   - using a different set of questions to other PCWs.

4. These strategies, if successful, could limit the incentive of the PCW to raise its commission fees.

Motor insurance counter strategies

Cashback

5. A number of motor insurance providers have engaged in the use of cashback websites and the use of cashback on their own websites. In particular, [✂] and this is one way in which it circumvents the effects of the MFN clauses.

6. The use of cashback sites by consumers in relation to motor insurance has been very limited with the volumes involved generally very low compared with the volumes achieved through PCWs. DLG stated that [✂]. As a mechanism for enabling insurers to price appropriately across channels, the use of cashback or other incentives is inefficient and ineffective, as well as unnecessarily elaborate.

7. In addition, Confused.com has (at least until it revised its contracts in light of the competition concerns with MFN clauses) included the use of cashback sites within the scope of a number of its MFN clauses. Moneysupermarket.com also said that its standard MFN clause would, in principle, prevent a motor insurer with which Moneysupermarket.com had a signed contract offering cashback or a free gift in relation to a policy available through its website.

8. Considering both the limited use of cashback by insurers, the convoluted nature of the offer and the inclusion of cashback websites in the scope of Confused.com's previous MFN clauses, the use of cashback does not appear to be an effective strategy to circumvent the MFN clauses.

Differentiated policies

9. Another way of circumventing the MFN clauses is by including ancillary covers (such as legal expenses cover) as a way of improving the products available, either through the provider's own website or through particular PCWs or sales channels.

10. Comparethemarket.com has also highlighted a number of special offers that insurers have run:

- esure/Sheilas Wheels free spa day;
- Octagon's insurance premium prize draw or rewards scheme;
- Kwik Fit's free MOT; and
- Hastings Essential's half-price MOT.

11. Both Comparethemarket.com and Confused.com mentioned motor insurance providers introducing free legal expenses cover for a period of time. [✂] DLG similarly considered such strategies as acceptable as these offers did not represent part of the premium.

12. However, these strategies do not adjust the price which motor insurance policies are available for and similar to the use of cashback. In addition, the reasons for using these strategies may be related to competition between motor insurance providers on a particular PCW rather than motor insurance providers seeking ways to circumvent the MFN clauses. It therefore seems unlikely that this is an effective or efficient counter strategy to MFN clauses.

Multi-brand strategy

13. One way of a motor insurance provider circumventing the MFN clauses (and certainly the wider MFN clauses) is to use different brands for different sales channels. DLG, [✂] and [✂] are to some extent now doing this, with DLG keeping the Direct Line

brand off PCWs but including Churchill and Privilege brands on the various PCWs. [✂] Finally, [✂] launched the [✂] brand specifically for PCWs. [✂]

14. A50 also said that it had launched an aggregator-specific product, and due to the highly price-sensitive nature of the PCW channel, pricing was managed in a highly dynamic way in order to attract the planned volume of customers.

15. Whilst the multi-brand strategy may be one way of avoiding the effects of the MFN clauses, it has not been utilized by many motor insurance providers and it is also notable that two of these providers, [✂] ([✂]) and [✂] focus their advertising budget on the non-PCW brand, reflecting that this may not be a strategy that all insurers can necessarily follow. It thus may not be an effective counter strategy for all motor insurance providers.

PCW counter strategies

16. Similar to motor insurance providers, rival PCWs may also engage in strategies to circumvent the effects of various MFN clauses. In the cases outlined below, these would be strategies to circumvent the effects of the online sales MFN and all-sales channel MFN, both of which have the potential to directly affect the competition between PCWs.

Cashback

17. As outlined in the section above, whilst cashback can be a way of circumventing the effects of MFN clauses, this strategy has not been widely used by motor insurance providers on PCWs. In addition, we noted that Confused.com included cashback as part of the MFN clause and thus motor insurance providers who had this version of the MFN clause would not be able to use cashback as a way of circumventing the MFN clause.

Non-cash incentives

18. Another way of countering the MFN clauses is to offer consumers non-cash incentives. Recently Comparethemarket.com has offered free meerkat toys when a policy is sold through its PCW, and Confused.com has offered free nectar points when purchasing through its PCW.

19. The Comparethemarket.com offer has had an effect on the market with [✂] Confused.com board minutes say that 'The CTM promotion to give away a free Meerkat with every sale made via CTM continued to be successful and had led to CTM increasing market share by 6/7% despite making a net loss given the cost of the campaign.' Gocompare.com mentions in its internal documents that 'comparison sites broadly competed on 3 things: (1) TV creative; (2) online management and (3) incentive offerings.' However, Moneysupermarket.com's board noted that the meerkat offer appeared to be focused on retention of customers, and DLG considered that PCWs also made extensive use of such promotions (eg meerkats, nectar points) to support their own sales.

20. Whilst the free toy offer from Comparethemarket.com has clearly had an effect on the market, it is debatable whether this is a circumvention effort by Comparethemarket.com of the MFN clauses. Rather it may be evidence of increased advertising investment aimed at improving consumer retention. These strategies, however, do not affect the pressure on commission fees and therefore premiums.

Exclusive offers

21. Finally, PCWs may seek to encourage motor insurance providers to provide exclusive offers to the PCW in return for a reduction in the commission fee charged.

22. A number of motor insurance providers and PCWs have sought to engage in exclusive offers by way of a reduction in commission fees.

23. We collected evidence from a number of motor insurance providers who had been offered exclusive deals by PCWs. A quarter of these insurance providers had not considered the deals because of wide MFN clauses in their contracts with other PCWs, whilst another was worried about damaging relationships with other PCWs if they did accept the offer.

24. The remaining providers contacted (three-quarters) had accepted the deals but over half of them were later put under pressure from another PCW for providing a lower price on another PCW—some even being threatened with suspension or delisting. For example, [✂] has taken part in price-based offers with both [✂] and [✂] in the past. However, as the offers mentioned above affected the price quoted on the relevant site, [✂] received complaints asserting that they were in breach of the MFN clause and the offers were eventually removed. [✂] Another provider said that wide MFN clauses inevitably reduced its incentives to engage in commission sacrifice offers and price promotions.

25. [✂] Other motor insurance providers have also been challenged when the prices on other PCWs are lower, even when this is not due to a commission sacrifice offer. This may indicate that PCWs may seek to achieve similar outcomes to wide MFNs, even if they were removed.

26. The scope of the MFN clauses can vary even between what appear to be similarly scoped clauses with the exceptions allowing motor insurance providers the ability to run time-limited promotions. However, as is clear from correspondence between [✂] and [✂], these offers can be in breach of the MFN clauses imposed and thus PCWs

with MFN clauses will object to them. Therefore, this does not appear to be an effective counter strategy.

Different question sets

27. PCWs state that the MFN clauses apply to consumers with identical risk profiles. Therefore, PCWs could set different question sets on their websites to circumvent the MFN clauses. We have seen evidence that PCWs seek to minimize the price differences with other PCWs so it seems unlikely that this would provide a significant difference in the prices between PCWs and thus may be an ineffective strategy.

Profitability of [✂] PCWs

1. This appendix examines the profitability of [✂] PCWs.

Why we look at profitability in market investigations

2. The CC's market guidelines state that outcomes of the competitive process in their different forms in a market, eg prices and profitability, can provide evidence about its functioning.[1]

3. The guidelines[2] state that, in practice, a competitive market would be expected to generate significant variations in profit levels both between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. The profitability of some firms may exceed what might be termed the 'normal' level, for example as a result of past innovation or superior efficiency, but a situation where the profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process. Examples of these limitations could be the presence of entry barriers, or the existence of significant market power.

4. The guidelines[3] mention four possible types of analysis of prices and profitability: pricing patterns; price cost margins; price comparisons; and profitability. Annex A of the guidelines (Market characteristics and outcomes) states[4] that where capital employed cannot be reliably valued, the CC may consider alternative measures, such as the return on sales or other relevant financial ratios.

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[1] Paragraph 103.
[2] Paragraphs 117 & 118.
[3] Paragraph 107.
[4] Paragraph 15.

Analysis

5. The [✂] PCWs were not able to provide figures from their management accounts for motor-insurance-only profit because they did not allocate costs to motor insurance sales. Therefore, we asked the [✂] PCWs to provide us with an analysis which would identify the operating profit for the motor insurance part of their business for the last five years. We did not look at other measures of profitability such as return on assets or return on capital as we considered that it would be very difficult for the PCWs to calculate an appropriate asset base and cost of capital for the motor insurance part of their business only. We asked the PCWs to set out clearly their approach for allocating both their direct and indirect costs to the motor insurance part of their business, if necessary differentiating between divisional, group and holding company overheads. We said that we expected to see at least the following headings in their analysis: turnover/income, cost of sales, gross profit, expenses, contribution, allocation of shared costs, operating profit, interest, and profit before tax.

6. [✂] PCWs [✂] provided us with a profitability analysis.

7. Table 1 shows the combined turnover, operating profit and operating margin for [✂] PCWs for the three years 2010 to 2012 for the motor insurance part of their business.

TABLE 1 **Summary of total motor insurance profitability, 2010 to 2012**

	£ million		
	2010	*2011*	*2012*
Turnover	[✂]	[✂]	[✂]
Operating profit	[✂]	[✂]	[✂]
			per cent
Operating profit margin	[✂]	[✂]	[✂]

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

8. Turnover [✂] by [✂] over the three-year period; operating profit [✂] by [✂]; and the operating profit margin [✂].

9. Overall, we noted that, in aggregate, [✂] PCWs had achieved an operating profit margin of around [✂] per cent over the last three years. We did not conduct a more detailed analysis of their profitability but, in our view, this finding is consistent with [✂] PCWs having some bargaining power against motor insurance providers.

10. In the rest of this appendix [✂].

[✂]

Evidence of the exercise of market power without wide MFNs

1. This annex describes in more detail the two pieces of suggestive but inconclusive evidence of the exercise of market power by a PCW without wide MFNs. These are:

   (a) [✂]; and

   (b) [A motor insurance provider's] account of its conversations with [one PCW] about MFN clauses.

[✂]

2. Figure 1 shows [✂].

FIGURE 1

[✂]

Source: [✂].

3. [✂]

4. We consider two explanations of this pattern of sales, the first based on 'diversion', the second on 'tit-for-tat':

   (a) Diversion: it could be that consumers search on both [✂]; when they find [✂] policies cheaper on [✂], they switch their custom from [✂] to [✂]. Hence, [✂] sales of [✂] fall and [✂] sales of [✂] rise.

   (b) 'Tit-for-Tat': when [✂] discovers lower [✂] prices [✂], it actively degrades [✂] search results on [✂] to reduce sales there and render the price reduction on [✂] unattractive.

5. We have not collected the evidence to strictly be able to tell apart the two explanations. [✂], although it had no specific evidence for this. In favour of 'diversion' is the fact that we are not aware of any mechanism for search degradation

that could be used. [✂] In favour of 'Tit-for-Tat' is the fact that we would expect 'diversion' to apply to all PCWs, and yet [✂] seem to have been largely immune to any diversionary effect.

6. The ambiguity of the data means that we do not conclude on the explanation for the [✂]. However, it alerts us to the possibility that strategies like 'tit-for-tat' might be used to replicate the effects of wide MFNs even in their absence.

[✂]

7. This section summarizes a conversation that the CC has had with [a motor insurance provider] about a commission sacrifice offer made by [a PCW]. [✂]

8. [A motor insurance provider] described the commission sacrifice offer from [one PCW] as being, in the ordinary course of business, incredibly desirable. However, [the motor insurance provider] commented that whilst this would ordinarily be viewed as an interesting commercial proposition, it felt that due to certain MFN clauses it would be unable to explore the offer further. [✂] When the commission sacrifice offer came in, therefore, it found itself 'regrettably declining' to pursue it.

9. [The motor insurance provider] expected that if the deal had gone through—which would have involved a price reduction on [the relevant PCW] of between £5 and £10—then most of the increment in sales would have come from sales competed away from other brands on [the relevant PCW], and very little would have come from 'diversion' from others.

10. [✂]

11. Most of this account describes the operation of a wide MFN and its impact on curtailing the ability of a provider to reduce prices. However, the final statement could be interpreted as an indication that a ‘tit-for-tat’ strategy could be pursued even without MFNs. This evidence is once again inconclusive. However, we take it as an indication that an exercise of market power through such strategies might be possible without wide MFNs.

Effect of PCW ownership structure on competition between motor insurance providers

Introduction

1. In this annex we consider whether a motor insurance provider integrated with a PCW might use the information obtained through the services offered by its PCW to *(a)* undercut rival motor insurance providers' quotes or *(b)* to manipulate their quotes (eg by including features (such as a lower excess) not requested by the customer). In this appendix we discuss these two issues.

PCW/motor insurance providers

2. PCWs are a major sales channel for motor insurance. Many insurers and brokers told us that it was important, or even essential, to sell on a range of PCWs in order to compete effectively in the motor insurance sector. In fact, the majority of customers search on multiple PCWs. We found that, on average, customers used 2.2 PCWs the last time they shopped around for motor insurance.

3. Among the four large PCWs, there are three which are fully or partly owned by a provider of motor insurance (insurer or broker), as follows:[1]
   (a) Comparethemarket.com, [✂], is an independent division of BISL Limited, which is part of the privately-owned BGL Group (BGL) (a large broker);
   (b) Confused.com is a wholly-owned subsidiary of Admiral (an insurer); and
   (c) Gocompare.com is 50 per cent owned by esure (an insurer).

Price undercutting

4. We considered whether an integrated PCW/motor insurance provider could operate the PCW such that rivals' quotes were gathered before it quoted, so that it could

[1] We provide more information on insurers, brokers and PCWs in Section 2.

ensure that its price for a policy was slightly cheaper. We noted that this could be done in real time just before the quotes were made available to the consumer.

5. However, price undercutting would be harmful for consumers only if the price quoted by the PCW/motor insurance provider would have been lower absent the information on its rivals' prices. If, on the other hand, the price would have been higher, customers would benefit from the provider's price-undercutting behaviour, at least in the short term (for an assessment of long-term effects, see paragraph 14 below).

6. The process of undercutting would rely on having a continuous flow of quoting information within the structure of the integrated PCW/motor insurance provider. However, this appears to be possible as both Admiral and BGL told us that their integrated PCW could provide them with aggregated statistical data. Admiral explained that it had access to similar statistics/KPIs from other PCWs with which it worked and that it also made occasional ad hoc data requests to other PCWs.

7. Admiral told us that it had a contract with Confused.com (its integrated PCW) under which Admiral might ask Confused.com to provide daily/monthly KPI statistics and, from time to time, it might also submit ad hoc data requests. Admiral said, however, that it also had access to similar statistics/KPIs from other PCWs with which it worked and it made occasional ad hoc data requests to them. Confused.com told us that its contract with Admiral was based on a standard template and the same information would be available to its other motor insurance providers. Confused.com said that all its motor insurance providers would be treated equally. It told us that the results displayed on its website would be based on premiums and would not be influenced by relationships or agreements with any motor insurance provider.

8. Admiral told us that it was unaware of any computer software (or other mechanism) which would allow a motor insurance provider to access a rival's price. Although it would probably be possible for a motor insurance provider and a PCW operating together to build the necessary software, Admiral said that it had never been party to such an agreement and it was not aware of any PCW/motor insurance provider with such an agreement. We noted that Admiral had told the OFT that having Confused.com granting Admiral access to the real-time data of its motor insurance rivals would be 'commercial suicide' for Confused.com as it needed to offer the broadest range of coverage in terms of motor insurance providers and such behaviour would make rival motor insurance providers run away.

9. BGL told us that its motor insurance intermediary business (IB) and Comparethemarket.com operated within one legal entity but as distinct business units, with processes and procedures in place to prevent the sharing of customer data and quote data between them. BGL told us that Comparethemarket.com provided BGL's IB business simple data that the IB business then analysed in order to identify trends, but this was aggregated statistical data, not customer or quote data, and it was data which was also made available to other motor insurance providers using Comparethemarket.com. BGL noted that other PCWs offered access to similar information.

10. esure told us that its participation as a panel member of Gocompare.com was on a strictly arm's length commercial basis. esure said that Gocompare.com was independent and operationally separate from esure, and esure received no information different from that provided to it by other PCWs in which it had no equity stake. Moreover, esure said that it was not aware of any software or other method that would allow a motor insurance provider to analyse rivals' prices through any PCW in order to provide a lower quote.

11. Although both Admiral and esure told us that they were unaware of any software or other method which would enable the undercutting of rivals' prices, we reviewed some of the internal documents of a number of parties and found that [✂]. These internal documents suggested to us that suitable software might be available or, at least, feasible.

Direct manipulation of quotes

12. Gocompare.com told us that motor insurance quotes were generally displayed first to consumers ranked by price, with the cheapest premium at the top. Customers could then re-sort the order according to other criteria or preferences. Customers could also select add-ons, which were usually added prior to the search. However, where the customer left questions relating to add-ons unanswered, it was up to the motor insurance provider to determine whether to include add-ons in the policy search or not. This choice could clearly affect the resulting ranking.

13. Integrated PCW/motor insurance providers could have the incentive to manipulate rivals' quotes to ensure that their motor insurance policies appear at the top of the ranking. This could be achieved, for example, by including in rivals' motor insurance products some add-on services (eg windscreen cover, breakdown cover, etc) which make them appear more expensive.

Possible consequences for competition in motor insurance provision

14. In the long term, an integrated PCW/motor insurance provider might benefit from the additional sales achieved through either the undercutting of rivals' quotes or the direct manipulation of search results to increase its market share to the detriment of its competitors. However, we noted that the ability of the integrated PCW/motor insurance provider to use its improved market position to increase its prices would still be constrained by the presence of other motor insurance providers in the market.

Moreover, the integrated PCW-motor insurance provider would be constrained by other motor insurance providers delisting from its PCW if the benefit of being quoted on the PCW became lower than the detriment incurred.

Sales volumes of large motor insurance providers on the top four PCWs

15. We asked some of the largest insurers and brokers to tell us the proportion of their motor insurance sales through PCWs by each of the large PCWs. Table 1 shows the results.

TABLE 1 **Proportion of policies sold through PCWs by each PCW for each motor insurance provider in 2012**

[✂]

16. Table 1 suggests that [✂].

17. We also collected data from PCWs on the number of sales made by each motor insurance provider. In Table 2, we show the proportion of sales that each motor insurance provider accounts for on each PCW.

TABLE 2 **Proportion of PCWs sales accounted for by the largest selling motor insurance providers on PCWs (2012)**

per cent

	Comparethe market.com	*Confused. com*	*Gocompare. com*	*Moneysuper market.com*
[✂]	[✂]	[✂]	[✂]	[✂]

Source: PCWs' data.

18. [✂]

19. However, we note that, [✂].

20. Overall, the information provided by the large motor insurance providers gives no indication that the integration of some PCWs with motor insurance providers gives rise either to the undercutting of quotes or the manipulation of quotes.

Consumer awareness of vertically integrated PCW-motor insurance providers

21. The OFT has considered the importance of disclosing to consumers clear information about the identity of the business operating a PCW, and information regarding the commercial relationships it has with providers of the products it offers. To inform its analysis, the OFT conducted an online consumer survey.[2] The survey covered a wide range of products and services offered by PCWs, one of which was motor insurance.

22. The survey showed that, of all consumers who used PCWs in all markets surveyed, a substantial majority (81 per cent) did not always purchase through a PCW. When asked why, 17 per cent gave the reason that they were not independent, and 13 per cent said it was because some PCWs were owned by the suppliers of the products being compared. Among consumers that used PCWs in 2010,[3] a substantial majority, 76 per cent (75 per cent for car insurance only), considered them to have at least some drawbacks, and 'not being independent or impartial' was a drawback reported by 39 per cent. Of these consumers who did not consider PCWs to be independent or impartial, 41 per cent (44 per cent for car insurance only) said that this was because 'some of the PCWs are run by the suppliers listed on the site'. Only a small minority (11 per cent)[4] of those consumers who said that they were aware of the vertical integration between some PCWs and some motor insurance providers said that they would use the PCW both to compare and to purchase, as opposed to the

[2] www.oft.gov.uk/OFTwork/markets-work/advertising-prices/#named4.
[3] This period represented the last 12 months at the time of the study.
[4] The number of responses for this question was very small so this result should be interpreted with some caution.

majority who said that they would use the PCW to compare products or services but would not always purchase on the PCW.

23. Unfortunately, we do not have data on the purchase behaviour of informed consumers specific for motor insurance. However, shoppers for motor insurance through a PCW constituted around half of the respondents to the OFT's survey (49 per cent) and we know from our customer survey[5] that, among those who compare policies online, the vast majority used one or more PCWs (87 per cent). Moreover, we see no reason why consumers' general behaviour (ie whether they would purchase through a PCW in the knowledge of vertical integration) would vary depending on the product for which they are using the PCW.

24. In our view, the OFT's survey provides a useful insight into consumer awareness of PCWs' vertical integration. However, it does not allow us to assess whether choices by informed consumers could limit or exclude any undercutting or quote manipulation by PCWs. In particular, we do not know the proportion of informed consumers which would not buy a motor insurance policy from a vertically-integrated PCW.[6]

Third parties' views regarding such behaviour

25. Non-integrated motor insurance providers are aware of the conflict of interest faced by PCWs which are owned by rival motor insurance providers and, for this reason, we would expect most non-integrated motor insurance providers to monitor closely their sales performance on each PCW in order to identify any unexpected changes (eg a decrease in sales volumes).

[5] See Appendix 2.2 'Survey report'.
[6] The share of consumers, in the OFT's survey results, that did not purchase through a PCW because they had concerns about integration, was derived from too small a base to infer general results.

Price undercutting

26. [✂]

Direct manipulation of quotes

27. [✂]

28. [✂] told us that its ability to identify any manipulation of the quotes it offered was limited. It said that, more generally, non-integrated insurers/brokers had no evidence that their products were not being quoted fairly on PCWs, though they were acutely aware that integrated PCW-motor insurance providers had both the incentive and the ability to do so.

29. Most non-integrated motor insurance providers told us that they would consider delisting from a PCW if they believed that they were not being quoted fairly on it. However, it appears that this option is typically considered as a last resort and the motor insurance provider would prefer to rely on good relationship management to resolve any issues, or would consider other options to protect its business and to mitigate any negative impact. As an example, [✂]. We recognized that the decision to delist from a PCW might result in a significant loss of sales for a motor insurance provider though we noted that many customers visit more than one PCW before making a purchase. We also noted that price is not the sole consideration for consumers when selecting policies on PCWs. We found that, to date, none of the motor insurance providers which provided us with information had ever delisted from a PCW due to a fear of quote manipulation.

30. RSA told us that it [✂].

Glossary

The ABI	The Association of British Insurers.
The Act	The Enterprise Act 2002.
Add-ons	Additional products that are typically offered on top of the basic motor insurance policy for an additional premium.
Admiral	Admiral Group plc. In the UK its brands are Admiral, Bell, Diamond and Elephant.co.uk. Admiral also owns Confused.com
AEC	Adverse effect on competition.
Ageas	Ageas NV/SA, an international insurance group ranked among the top 20 insurance companies in Europe. Ageas (UK) Limited is a provider of life and non-life insurance products. Ageas (UK) Limited owns a 50.1 per cent shareholding in Tesco Underwriting Limited. The CC has also used 'Ageas' to refer to Ageas UK, Ageas Insurance and Ageas Retail unless specified otherwise.
Approved repairer	A garage approved by the insurance company for car repairs covered by the insurance policy.
Aviva	Aviva plc, the UK's largest insurer and one of Europe's leading providers of life and general insurance. Aviva has three brands: Aviva, Quotemehappy and General Accident.
AXA	AXA SA, a French global insurance group headquartered in Paris which sells motor insurance under two brands, AXA and Swiftcover.
CC	Competition Commission.
CHC	Credit hire company, a provider of **temporary replacement vehicles** which may also be commissioned by insurers or brokers to conduct credit repairs to vehicles.
CISGIL	The CIS General Insurance Limited, part of the Co-operative Group which is the UK's largest consumer co-operative.
CMC	Claims management company, appointed directly by a consumer or by an insurer or broker to handle a claim. This may include managing all aspects of a repair, providing **temporary replacement vehicle**s and recovering costs from the fault insurer.
Commission fee	See **CPA**.
Comprehensive insurance	The highest level of cover a policyholder can have if they take out motor insurance. By taking out comprehensive insurance, policyholders are not only covered for third party claims after an incident, they are also covered for damage caused to their own vehicle.
CPA fee	Cost per acquisition fee, the charge levied by comparison sites (see **PCW**) to insurers for matching consumers with the insurers'

	policy based on mutually compatible criteria between consumer and insurer. Referred to by the **CC** as a commission fee.
DLG	Direct Line Insurance Group, one of the largest motor insurers in the UK offering motor insurance through the Direct Line, Churchill and Privilege brands.
esure	esure sells only motor, home and travel insurance, and only to customers in England, Wales, Scotland and the Isle of Man under three brands: esure, Sheilas' Wheels and First Alternative. esure owns 50 per cent of the parent company of GoCompare.com Limited.
Fault claim	An accident or loss where an individual is considered to be responsible for the accident or where the individual responsible for the accident or loss cannot be traced or is uninsured.
FCA	Financial Conduct Authority, which regulates insurance firms for conduct purposes. This includes the authority to ensure that regulated firms treat customers fairly as well as to investigate marketing, sales, claims and complaint-handling practices (conduct of business supervision).
FNOL	First notification of loss, the point at which the policyholder notifies their own or the third party's insurer of the fact of an accident.
FSA	Financial Services Authority. Until 31 March 2013, regulation of the insurance industry in the UK was carried out by the FSA under the Financial Services and Markets Act 2000. From 1 April 2013, the FSA was abolished and, under the terms of the Financial Services Act 2012, insurance companies are now regulated by two new regulatory institutions (**PRA** and **FCA**).
GTA	**The ABI**'s general terms of the agreement between subscribing insurers and credit hire organisations, a voluntary non-binding protocol which sets out the arrangements between insurer and **CMC**/**CHC** subscribers for replacement car provision under credit hire to non-fault drivers.
GWP	Gross written premiums, the total premiums paid for insurance policies written during an accounting period before deducting reinsurance costs.
LV	Liverpool Victoria/LV=, the UK's largest friendly society and a leading financial mutual, which sells motor insurance through three main brands: LV=, ABC Insurance and Highway Insurance.
MFN	Most-favoured nation, a clause that may exist within a contract between a motor insurance provider and a **PCW** that determines the price exclusivity of the product being carried by the **PCW**. These can be narrow (ensuring that the product is not cheaper on the motor insurance providers' own channels) or wide (covering the price of the product across other **PCW**s).
NAB	The National Association of Bodyshops, the leading not-for-profit

	trade association representing the UK body repair sector.
NCB	No claims bonus. For each year driven without making an insurance claim, a customer gets a year's NCB, subject to a maximum. This bonus reduces the cost of a car insurance premium for the following year (also known as 'no-claims discount').
NEP	Net Earned Premium, the **GWP**, net of Insurance Premium Tax and premiums ceded to re-insurers and any changes in provisions for unearned premiums.
Non-fault claim	A claim submitted by a driver who is deemed to be not responsible for the accident.
OFT	Office of Fair Trading.
PCW	Price comparison websites, websites that collate insurance premium data from a variety of insurers which pay an acquisition fee (see **CPA fee**) to source new customers.
PMAs	Paint marketing associations, associations of paint distributors. Their main purpose is to negotiate national paint supply contracts with repair networks or repair work providers.
PRA	The Prudential Regulation Authority, part of the Bank of England, responsible for the prudential regulation and supervision of insurers, which 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).
Pre-accident value	The value of the vehicle in the state immediately before the accident.
Replacement car	See **temporary replacement vehicle**.
RIPE	Reduction in paper exchange, a voluntary agreement between some participating insurers designed to provide a cost-effective means of settling at-fault/**non-fault claim**s respectively.
RSA	RSA Insurance Group plc, a leading global insurance group with three motor insurance brands: More Th>n, eChoice and RSA.
Settlement	What an insurer pays out for a claim.
Temporary replacement vehicle	A vehicle issued to a **non-fault claim**ant in line with their tort law entitlement in the event that their own vehicle is not in a fit state for use during the period of repair following a car accident. Referred to by the **CC** as a replacement car.
Third party fire and theft	Provides the same level of cover as third party cover, but also protects against damage to a vehicle from fire, or theft of the vehicle, as long as the policyholder is not at fault.
Third party insurance	An insurance policy purchased for protection against the actions of another party, purchased by the insured (first party) from an insurance company (second party) for protection against another

	party's claims (third party). It is the minimum level of insurance cover required by law and contains no cover for damage to the policyholder's vehicle.
ToH	Theory of harm.
Underwriter	An underwriter decides whether to accept a customer as an insurance risk and then calculates the car insurance premium.
Zurich	Zurich Insurance Group Ltd, one of the world's largest insurance groups, and in the UK owns the broker, Endsleigh Insurance.