COMPETITION COMMISSION

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Theory of harm 3: Horizontal concentration in PMI providers in Northern Ireland

Introduction

1. The average price of a PMI policy in Northern Ireland (NI) is higher than in Great Britain (GB). This may be the result of a number of differences between the two territories. One possible factor leading to higher prices in NI compared with GB is a higher level of concentration in PMI providers in NI than is the case in GB.

2. The purpose of this paper is to assess the level of horizontal concentration in PMI providers in NI, both overall and for specific types of driver. In Appendix 1 we present an analysis comparing PMI profitability in NI with PMI profitability in GB. We consider to what extent the level of concentration of PMI providers in NI may explain the profitability of insurers in NI.

Summary

3. There are several differences in how PMI is provided in NI compared with GB. For example, consumers in NI have a greater propensity to purchase PMI via a broker and a lower propensity to purchase via price comparison websites (PCWs). There are also some differences between the legal system in NI and the legal systems operating in England and Wales and Scotland. Each of these differences in the provision of PMI in NI compared with GB may be a contributing factor to differences in premiums between NI and GB.

4. Another possible factor is the level of concentration in providers. We found that PMI provision in NI is highly concentrated, particularly for young drivers and those classed

as high risk. A number of PMI providers active in the rest of the UK either do not supply PMI in NI or do not appear actively to seek business in NI.

5. PMI providers listed three main barriers to entry or expansion within NI:

- The NI market is small and it may not be economically viable for a new entrant to incur the necessary set-up costs or to operate at significant scale. Claims costs within a small market may also be volatile and make it more difficult to underwrite business profitably.
- A lack of underwriting experience places new entrants at a competitive disadvantage to incumbents with more experience. This is a bigger barrier to entry in NI than in the rest of the UK as some sources of socio-demographic data are unavailable in NI.
- The strong presence of brokers may inhibit entry.

6. Further, it appears that some PMI providers who operate in NI choose not to underwrite policies for young drivers and/or high-risk drivers. The two reasons given for this are a lack of underwriting experience and excessive claims volatility which increases the underwriting risk.

7. We found some evidence of PMI providers expanding in NI but in most cases this has been on a relatively limited scale. The exception is AXA NI, which has expanded significantly, from underwriting around [✂] PMI policies in 2006 to [✂] PMI policies in 2011. Evidence of entry and expansion by small insurers is limited.

8. We examined whether PMI providers in NI earned lower claims ratios than in the rest of the UK and found that, over the five-year period 2008 to 2012, weighted average claims ratios were approximately ten percentage points higher in GB than in NI, indicating a higher level of profitability in NI than in GB.

9. We have not conducted a full market definition assessment. Nevertheless, on the basis of the evidence we have seen it appears to us that consumers of PMI in NI face different purchasing conditions from consumers of PMI in the rest of the UK and, therefore, we consider that it is appropriate to consider the supply of PMI in NI separately from the rest of the UK for the purposes of our assessment of theory of harm (ToH) 3. There is a high level of concentration in PMI providers in NI which appears to be sustained by certain characteristics of the market. Some of these characteristics limit the incentive for entry (eg the limited size of the market in NI) while others may give large incumbent insurers an advantage over potential new entrants and smaller rivals and so limit competition. These characteristics may be a contributing factor to claims ratios being lower in NI than in GB and may also contribute to prices of PMI being on average higher in NI than in GB (though we recognize that the price differential is also likely to be due to several other factors unrelated to concentration).

10. The paper is structured as follows:

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

Background to the supply of PMI in NI

Estimated market size

11. A number of PMI providers active in NI provided us with estimates of the size of the PMI market in NI. 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 NI, although the year used and the types of vehicles included varied. A number of the higher estimates included light goods vehicles which we would not expect to be covered by PMI policies. Based on 2011 statistics provided by the Department for Regional Development, we estimate that around 600,000 to 650,000 vehicles are covered by PMI in NI.[1]

12. In terms of the market value, PMI providers estimated that the total gross written premium (GWP) of PMI in NI 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 PMI providers estimated the market to be worth around £300 million. Based on our estimate of the number of vehicles covered by PMI in NI (see paragraph 11) and the average GWP per policy in NI,[2] it appeared to us that this estimate of around £300 million seemed reasonable.

Distribution of PMI in NI

13. Consumers in NI predominantly purchase PMI policies through brokers. RSA estimated that around 60 per cent of PMI sales were made through brokers in NI and a number of other insurers estimated that the four or five leading brokers in NI had a collective retail market share of between 40 and 60 per cent.

14. Several parties gave us reasons why brokers had such a significant role in the distribution of PMI in NI:

- RSA said that because claims rates in NI were, on average, higher than GB, PMI providers had felt more comfortable using the broker's personal relationship with

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[1] 650,000 is based on the number of diesel cars and petrol cars in NI (categories 48 and 49) found in Table 1.3 on page 25 of www.drdni.gov.uk/ni_transport_statistics_annual_2011-12.pdf. However, some of these vehicles are likely to be fleet vehicles [✂].

[2] In 2011, this was £[✂] per policy, based on information from PMI providers.

his/her 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 NI customers preferred to purchase PMI via intermediaries in person or over the phone and were less inclined (than in GB) to buy insurance directly from insurers. They said that this was partly due to NI having an abundance of small intermediaries.
- Several parties noted that PCWs had less of a presence in NI compared with GB. Allianz told us that some PCWs had only recently removed an exclusion relating to NI, which had been in place because many insurers did not cover NI. In addition, First Central (an insurer selling predominantly through PCWs) said that none of the PCWs included a list of the separate NI driving endorsement codes and even the Northern Irish comparison website 'Compare NI' did not cater for the NI driving conviction codes.

15. Many PMI providers named Hughes, Open & Direct (Swinton) and Abbey as being the leading brokers in NI. Several also named Autoline and three named Provincewide as being significant brokers in NI.

16. We noted that PCWs appeared to be growing in importance as a sales channel in NI. 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 NI had not grown as rapidly as in other parts of the UK.

17. Hughes told us that the introduction of PCWs had had a major impact on the supply of PMI in NI. 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 NI consumers valued being

‘local’ as an important component of a PMI provider’s brand, it believed this aspect to be weakening as the younger population became more confident about buying online.

18. However, we also noted that AXA NI (the largest PMI insurer in NI) 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.

19. Overall, it appears to us that the broker channel is likely to account for a significant proportion of PMI sales in NI for the foreseeable future.

Differences in legal structure

20. There are several important differences with relevance to PMI between the legal system in NI 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 NI legal system which may be responsible for PMI premiums being higher in NI than in the rest of GB, as follows:

- First, the levels of compensation for personal injury claims are higher in NI than in GB. 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 NI and GB had narrowed recently, although the submissions indicated that compensation levels continued to be higher in NI 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 NI compared with GB. In particular,

[3] Guidelines for compensation levels in NI 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.

the absence of a compulsory pre-action protocol in NI[4] at the time of the OFT call for evidence was cited as potentially having the effect of making litigation more prevalent in NI than in GB as the applicable procedures did not appear to provide the same incentive to settle cases quickly.[5]

21. We note that on 18 January 2013, DK McFarland, Presiding Judge of the County Courts in NI, issued a practice decision that came into operation on 25 February 2013, which is 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 NI, we have not carried out any analysis of its impact on PMI.

22. Several PMI providers told us that the legal differences between NI and the rest of the UK made very little difference in practice to the provision of PMI. However, we were told that there was a lower prevalence of claims management companies (CMCs) and credit hire companies (CHCs) in NI, which was likely to be due to the effective ban on the payment of referral fees by solicitors in NI and the availability of legal aid for personal injury cases (see working paper 'ToH 2: Overcosting and overprovision of TRVs' for more discussion of this difference).

Insurers active in NI

23. We asked both insurers and brokers which were the main insurers active in NI. AXA NI, Allianz and Prestige Underwriting (Prestige)[7] were named by most PMI providers as being the main underwriters in NI. Several third parties estimated AXA to have a

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[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 NI than in GB, 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 NI than in GB which adds to the overall litigation costs. However, in their submissions to the OFT, legal associations did not agree that the legal process in NI was more expensive than in GB.
[6] Accessible at: http://tinyurl.com/czh5zxh.
[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'. For example, LV= told us that it operated a delegated authority scheme with Prestige.

market share of between 30 and 40 per cent. 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. As shown in Table 1, we are aware of at least 17 insurers who wrote PMI policies in NI in 2011, although most of these are estimated to have a share of supply under 5 per cent.

Horizontal concentration of PMI providers in NI

24. We estimated shares of supply using both the volume and value of PMI policies underwritten in NI in 2011, based on information supplied by PMI providers. Table 1 shows the results.

TABLE 1 **Market shares**

	GWP £'000	*Share of supply Value (%)*	*Number of policies active*	*Share of supply Volume (%)*
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]
Total (known)	c270,000		c550,000	
Market size (estimate)	275,000–300,000~		600,000–650,000★	

Source: PMI insurers.

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

25. In response to our survey of PMI policyholders (see working paper 'Survey report'), 19 per cent of NI PMI policyholders said that their policy was underwritten by AXA.

However, a very high proportion (around 45 per cent) of NI respondents did not know which insurer had underwritten their PMI policy. Of those NI respondents that did know which insurer had underwritten their policy, 35 per cent had a policy underwritten by AXA.[8] We noted that this result was [✂] the market share estimate shown in Table 1.

26. Based on the above market shares, we calculated the HHI index for the supply of PMI in NI to be between 2,091 and 2,488 (based on value) and 1,585 and 1,860 (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.[9] On this basis, we noted that the HHI for PMI in NI (when calculated on the basis of value) was indicative of a highly concentrated market.[10]

27. Furthermore, we noted that some PMI providers do not underwrite policies for certain types of driver in NI. 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[11] told us that they would not underwrite policies for some high-risk drivers.

28. In a highly concentrated market overall, this evidence suggests that the concentration of PMI providers active in the supply of PMI to certain types of driver is likely to be particularly high.

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[8] Responses to question S11 (see the working paper 'Survey Report'), with broker responses and 'don't know' answers excluded.
[9] See *Guidelines for market investigations: Their role, procedures, assessment and remedies*, *CC3 (Revised)* (the Guidelines), Annex A, paragraph 7.
[10] CC estimate based on data provided in Table 1.
[11] Although AXA told us that it provided quotes to the vast majority of consumers.

Why are some PMI providers not active in NI or only to a limited extent?

29. A number of PMI providers active in the rest of the UK are not active in NI, whilst others do not appear actively to seek business in NI. PMI providers cited three barriers to PMI providers entering or expanding within NI, which we discuss in turn.

The NI market is small

30. There are specific investments that an insurer may need to make in order to underwrite (or perhaps to underwrite significant numbers of) policies in NI. For example, Allianz told us that an insurer may need a local approved repair network[12] and there was a need for local solicitors who knew the differences in the court system, NI 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.

31. Allianz said that, while the hurdles to entering NI were not difficult to overcome, because the market was small it might not be worth the investment. Similarly esure said that NI 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 NI market.

32. Both LV= and First Central told us that, because NI was a small market, claims costs could be volatile. Aviva told us that its business in NI had had unpredictable results, with some large claims.

33. It appeared to us that the size of the PMI market in NI, and the fact that insurers may need to incur specific investments to operate (or perhaps to operate at significant

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

scale) in the market, may inhibit new entry (or deter insurers from underwriting significant numbers of policies).

Lack of underwriting experience

34. We noted that some insurers might not be active in NI due to a lack of claims experience within NI 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 NI than it was in the rest of the UK. For example, Aviva told us that some sources of third party socio-demographic data, which could be accessed in GB to aid risk pricing, were not available in NI.

35. 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. We noted that the information available from brokers may be limited as brokers often do not manage claims. LV= told us that it used Prestige, which was established in the market, to influence its rating model based on Prestige's prior experience.

36. esure said that an insurer required specialist underwriting and pricing knowledge of the NI client base in order to operate in the market; and Aviva 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 NI factors.

37. It appears to us that PMI providers with little underwriting experience in NI may be at a competitive disadvantage to those with more experience in the market.

Strength of the broker channel

38. Some insurers indicated that the significance of brokers as a sales channel for PMI in NI also restricted entry. Aviva told us that expanding its market share beyond its broker business was harder in NI than in other parts of the UK as customers in NI had a stronger preference for buying through a broker. Covea told us that NI 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.

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

Young drivers

39. We found that not all PMI providers in NI provide policies for young drivers (see paragraph 27), although the definition of 'young' varies slightly between insurers.

40. 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 [✂].

41. 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 PMI policies for younger drivers due to its lack of knowledge and experience in this area.

42. While acknowledging that there were fewer insurers actively underwriting PMI policies for young drivers in NI, 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 PMI providers not currently active in that segment.

'High-risk' drivers

43. We found that some PMI providers in NI do not provide PMI policies to drivers considered to be 'high risk' (see paragraph 27). PMI 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.

44. Both Tesco Underwriting and Groupama identified that some risks were outside their underwriting risk appetite and they would not write PMI policies for such drivers. AXA also said that drivers who had excessive claims, previous convictions or were employed in certain high-risk occupations may not represent an acceptable risk which it would be willing to underwrite.[13]

45. Allianz said that it would write PMI policies for some higher-risk drivers but they would be rated at a higher premium than the standard rating levels and may have bespoke terms and conditions applied. Similarly, [✂] identified drivers with poor

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

driving records as a segment where it would not be able to offer competitively-priced policies.

Evidence of entry and expansion in PMI provision in NI

46. We consider in this section evidence of recent expansion in NI by [✂],[✂] and AXA.

47. Allianz told us that, in the last six to nine months, both [✂] and AXA had become much more active in the market. This activity involved offering new products, pricing to gain market share, etc. Allianz said that both [✂] and AXA were gaining business and, as a result, Allianz had seen its own new business rates fall. We noted in some internal documents from AXA that it had observed competitors reducing their rates, restructuring and replicating AXA's business model in NI.

48. [✂].

49. [✂].

50. Despite noting that both [✂] and AXA had recently gained business in NI (see paragraph 47), Allianz told us that it did not believe it likely that the position of the three largest underwriters in NI (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.

51. We noted that AXA had achieved the most significant recent expansion in NI, growing its NI business from around [✂] policies in 2006 to [✂] policies in 2011. It appeared to us that there were a number of factors which had underpinned this 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 ROI in 2007;
- successful branding and pricing; and
- some of its competitors being less focused on this market.

PMI profitability in NI

Introduction

1. This appendix presents an analysis of PMI profitability in NI compared with PMI profitability in GB.

Summary

2. As an indicator of profitability, we compared the weighted average PMI claims ratios (weighted by value of claims for each provider) between GB and NI over the five-year period 2008 to 2012. A lower claims ratio would indicate higher profitability, assuming that other elements of cost (eg distribution costs and overheads) are the same.

3. We found that, overall, for the six large insurers operating in NI and the NI-only insurers,[14] weighted average claims ratios over the five-year period were approximately ten percentage points higher in GB than in NI ([✂] per cent compared with [✂] per cent). More specifically, we found that:

   - For the six large insurers, weighted average claims ratios over the five-year period were [✂] per cent for GB and [✂] per cent for NI. In each of the five years, the weighted average claims ratio was higher in GB than in NI.
   - For the NI-only insurers, the weighted average claims ratio over the five-year period was [✂] per cent, ranging between [✂] per cent (2012) and [✂] per cent (2011).

4. We considered the following explanations as to why claims ratios might be higher in GB than in NI:

[14] See paragraph 18 of this appendix for a definition.

(a) Different and more expensive distribution model, ie more use of brokers in NI compared with cheaper methods of distribution in GB, such as PCWs. This would cause insurers in NI to charge higher premiums in order to cover the higher cost of distribution. In our view, although possibly a factor giving rise to lower claims ratios in NI, we have not seen evidence that broker commissions are likely to explain the whole difference.

(b) GB-specific, time-limited issues, ie an unexpectedly higher increase in claims costs in GB compared with NI in relation to personal injury. This would cause claims ratios to be high in GB. In our view, although this was a reasonable explanation for some difference in claims ratios for a couple of the years in the period, it did not appear relevant to the whole of the five-year period and was not likely to explain much of the difference we observed.

(c) Higher risks arising from greater claims volatility in NI (due to a smaller underwriting book), which would cause insurers in NI to charge higher premiums in order to cover higher possible claims. However, in our view, if the market in NI was competitive, large insurers would not price to provide themselves with a claims 'cushion' so we did not believe this to be a relevant explanation for much of the ten percentage point difference we observed.

(d) Lower prevalence of CMCs/CHCs in NI (we were told that this might be due to the effective ban on the payment of referral fees by solicitors in NI and the availability of means-tested legal aid for personal injury cases). We were unclear whether these market characteristics would result in lower claims ratios, but we noted that none of the insurers mentioned these factors when we asked them to provide possible explanations for lower claims ratios in NI compared with GB.

5. Overall, although we recognized that both the different distribution model in NI compared with GB and the unanticipated increase in claims costs in GB for a couple of years in the period might have caused claims ratios in NI to be lower than GB, it did

not appear to us that these reasons were likely to explain all of the ten percentage point difference we observed.

Theoretical background

6. 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 PMI we would focus our investigation solely on NI, and we would investigate the profitability of insurers in NI.

Why profitability is a useful indicator

7. 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.[15]

8. The Guidelines[16] 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.

[15] *CC3*, paragraph 103.
[16] *CC3*, paragraphs 117–118.

9. The Guidelines mention[17] four possible types of analysis of prices and profitability: pricing patterns; price cost margins; price comparisons; and profitability. Annex A of the Guidelines states[18] 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.

Claims ratios as a measure of profitability

10. We looked at the claims ratio as a basic measure of profitability. It is calculated as claims expense divided by net earned premiums (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 Insurance Premium Tax (IPT)), net of 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)).

11. 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.

12. The claims ratios presented in this paper are based on total claims.

13. We looked at weighted average claims ratios over a five-year period in order to smooth out most fluctuations in claims costs due to any build-up and subsequent

[17] *CC3*, paragraph 107.
[18] CC3, Annex A, paragraph 15.

release of provisions. We also thought that, given the smaller book size in NI, 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.

The data

Data requested from the parties

14. We asked providers to complete a template spreadsheet for the five years 2008 to 2012, splitting their data between GB and NI. 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

15. Of the ten largest insurers in the UK, seven were able to provide us with figures enabling us to compare NI and GB profitability: [✂],[19][✂].

16. esure told us that it did not operate in NI. Two insurers (Aviva and CISGIL) told us that they carried out a very small amount of business in NI and did not provide us with data.

17. We also asked the ABI to tell us which other insurers, outside of the ten largest insurers in the UK, were active in NI. In response, the ABI said that Allianz, First Central, Groupama and Tesco Underwriting all operated in NI.[20] We found that these

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[19] [✂].
[20] 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.

insurers (in aggregate) made up almost one-quarter of total PMI sales in NI in our sample (ie the total sample includes the NI businesses of the six large insurers). Although we recognized that these other insurers sold PMI in the rest of the UK, we called them the 'NI-only insurers' to distinguish them from the 'large insurers'.

18. In our first analysis, as well as looking at claims ratios, we also looked at expense ratios (defined as expense costs divided by NEP) for each of the insurers able to provide us with financial data. We decided not to look at expense ratios in our updated analysis as the evidence considered in our first analysis did not appear to show a significant difference in expense ratios between GB and NI.

19. Some of the insurers provided us with commentary and explanations for the differences in claims ratios between the two territories, which we discuss below (see paragraph 34 onwards).

Data provided by [✂]

20. [✂] provided us with data which enabled us to compare its profitability in NI and GB. [✂].

21. Overall, [✂]'s average claims ratio over the five-year period was [✂] per cent (with [✂] per cent for GB and [✂] per cent for NI). However, [✂]'s claims ratio for NI over the five-year period fluctuated considerably [✂].

22. [✂] told us that [✂].

23. [✂] also told us that [✂].

24. 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 NI and GB 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 NI and [✂] per cent for GB. We noted that these figures were [✂].

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

26. Because we considered [✂]’s data to be anomalous and because it made up only a small percentage of the total data provided, we decided to exclude [✂]’s original data from our analysis. We also did not include [✂]’s accident year data as it was not comparable with the data provided by the other large insurers. However, we noted that the difference in [✂]’s claims ratios between NI and GB was similar to those of the other large insurers (see paragraphs 29 to 33).

Analysis of the data

Total GWP in our sample

27. Over the five years 2008 to 2012, the remaining six large insurers and the NI-only insurers in our sample were responsible for an aggregate NI PMI GWP of £850 million. Figure 1 shows how this level GWP was split between the insurers in the sample. [✂], while the NI-only insurers (in aggregate) were responsible for one-quarter.

FIGURE 1

Share within the sample of aggregate NI GWP, 2008 to 2012, six large insurers and NI-only insurers

[✂]

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

Claims ratios

28. We calculated weighted average claims ratios for the six large insurers and the NI-only insurers in our sample. Table 2 presents the results.

TABLE 2 **Weighted average claims ratios for GB and NI, 2008 to 2012**

	GB	*NI*
All insurers	84	73
Six large insurers	84	73
NI-only insurers	N/A	71

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

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29. Overall, when considering both the six large insurers and the NI-only insurers, weighted average claims ratios over the five-year period were approximately ten percentage points higher in GB than in NI ([✂] per cent compared with [✂] per cent). Although not the case across our sample overall, we noted that the claims ratios of some parties were higher in NI than GB, indicating for some parties higher profitability in GB than in NI.

30. The data also showed that:

- For the six large insurers, weighted average claims ratios over the five-year period were [✂] per cent for GB and [✂] per cent for NI. In each of the five years, the weighted average claims ratio was higher in GB than in NI.
- For the NI-only insurers, the weighted average claims ratio over the five-year period was [✂] per cent, ranging between [✂] per cent (2012) and [✂] per cent (2011).

31. We considered each of the six large insurers individually:

- Three of the six large insurers had average claims ratios over the five-year period greater in GB than in NI ([✂],[✂] and [✂]).

- [✂].
- [✂].
- [✂].

32. The average claims ratio in GB for each of the six large insurers over the five-year period was between [✂] and [✂] per cent ([✂] and [✂] respectively), while the average claims ratio in NI for each insurer over this period was between [✂] and [✂] per cent ([✂] and [✂] respectively).

33. The annex to this appendix shows the claims ratios for each of the six large insurers split between GB and NI for each of the five years 2008 to 2012.

Reasons for the difference in claims ratios between GB and NI

Higher claims ratios in GB than NI

34. Some insurers provided reasons for claims ratios being lower in NI than in GB, as follows:

    (a) Aviva [✂] told us that claims ratios in NI might be lower than in GB because most NI business was written through brokers, where distribution costs might be higher due to the payment of broker commissions. Aviva 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.

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

(c) Zurich told us that the difference in claims ratios was driven by [✄]. It said that the average difference was driven primarily [✄].

(d) 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 NI than in GB, primarily as a result of differences in the personal injury claims process, as a result of which premiums in NI were typically higher than for the equivalent risks in GB. However, claims ratios might be lower in NI than GB because:

(i) Over the last four years, personal injury claims costs in GB had increased rapidly and to a large extent unexpectedly, driven by an increase in low-value whiplash-type claims and fuelled by 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.

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

(iii) Expense ratios were higher in NI as insurers writing business in NI would typically need to maintain some local infrastructure, such as claims repair networks, and would not achieve the same economies of scale as in GB, due to the relatively small size of the NI 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.

(e) RSA noted that there were several characteristics specific to the NI market, as follows:

(i) Historically, there was a higher incidence of fraud at the point of claim in NI than in GB.

(ii) Although the frequency of claims was low (due to NI 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.

(iii) Because NI 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 NI, with an average whiplash claim costing £3,500 in GB, £5,000 in NI and £10,000 in the Republic).

(f) 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 NI had been much more variable over the period as a result of the volatility which arose from a smaller book size.

35. In addition to these points, we also considered two further possible explanations for claims ratios in NI being lower than in GB:

(a) Higher risks arising from greater claims volatility in NI (due to a smaller underwriting book), which might cause insurers in NI to charge higher premiums in order to cover higher possible claims. However, in our view, if the market in NI was competitive, large insurers would not be able profitably to price at rates which provided them with a claims ‘cushion’. Therefore, we did not believe this to be a relevant explanation for much of the ten percentage point difference we observed.

(b) Lower prevalence of CMCs/CHCs in NI (we were told that this might be due to the effective ban on the payment of referral fees by solicitors in NI and the availability of means-tested legal aid for personal injury cases). We were unclear

whether these market characteristics would result in lower claims ratios, but we noted that none of the insurers mentioned these factors when we asked them to provide possible explanations for lower claims ratios in NI compared with GB.

Claims ratios for each insurer in our sample, split between GB and NI, five years 2008 to 2012

per cent

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

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