

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Theory of harm 4: Obstacles to switching

Introduction

1. This working paper discusses whether certain clauses of private motor insurance (PMI) policies or add-on products often purchased with PMI are obstacles to switching between PMI providers. If so, it would imply that some customers do not switch even though they would benefit from doing so, which might have the effect of softening competition between PMI providers.

Summary

2. Overall, there is clear evidence that switching levels for PMI are high relative to comparable products. We commissioned a survey of PMI policyholders (see the working paper 'Survey report'). This survey found that 72 per cent of PMI policyholders previously insured their vehicle with another provider. An earlier Office of Fair Trading (OFT) study found that 61 per cent of car insurance customers had switched in the previous five years, which was the highest rate of switching in the markets the OFT considered.¹
3. Despite this, we considered whether there are any obstacles to switching PMI. We considered in particular whether automatic renewal, cancellation fees and no claim bonus (NCB) protection might be obstacles to switching. After an automatic renewal customers may not shop for alternative offers if they are unaware of the possibility to cancel. Cancellation fees may also mean that customers stay with the previous provider until the next renewal to avoid paying such a fee. With respect to NCB protection, we considered whether customers who bought this add-on might be concerned about losing the benefit were they to switch their PMI provider. (Please

¹ www.of.gov.uk/shared_of/reports/financial_products/OFT1005.pdf, July 2008, chart 3.8.

note that customers' understanding of NCB protection and the profitability of this product is discussed in a separate working paper 'Theory of harm 4: Transparency and complexity of add-ons'.)

4. In our survey we also included an open question regarding the important factors for the decision to stay with or switch PMI provider in order to identify if there are other obstacles to switching which might exist.
5. In our assessment we considered information provided by PMI providers and the responses to our consumer survey.²
6. On the basis of this evidence, it does not appear to us that automatic renewals and cancellation fees are obstacles to switching which could give rise to customer harm. We also found no evidence for further possible obstacles to switching which we had not previously considered. With regard to NCB protection, the findings were less clear-cut. Notably, the responses to an open question in our survey regarding important factors which determine customers' decisions to switch or stay with their current provider and the responses to a prompted question asking specifically about the importance of NCB protection in this respect differed considerably.
7. Responses to the unprompted question suggested that NCB protection is not an important factor in the decision and hence not an obstacle to switching. However, when prompted, 21 per cent of the respondents who said they had a protected NCB also said that they had been concerned at the time of their last PMI purchase decision that changing their PMI provider might affect their protected NCB, and 25 per cent said that it had been a very important factor in their decision to stay with their current insurer. In response to those two questions: 39 per cent in total said they

² We also looked at internal documents detailing providers' procedures on switching.

had been either very concerned or a little concerned that switching might affect their NCB, while 59 per cent said that they had been either not very concerned or not at all concerned; and 50 per cent said that it had been either a very important or fairly important factor in their decision to stay with their current insurer, while 36 per cent said either that it was not very important or not at all important.³

8. However, a significant caveat needs to be applied to these results, as the very high penetration of NCB protection suggested by the survey may indicate that respondents did not accurately distinguish between NCB and NCB protection when answering the questions. The survey results on NCB protection should therefore be taken with some caution.
9. Furthermore, a high proportion of respondents (63 per cent) stated that the NCB (rather than the NCB protection) had been a factor which particularly influenced their decision to stay with their PMI provider. Notably, 59 per cent of those not concerned that changing their PMI provider might affect their protected NCB said that the NCB had particularly influenced their decision to stay with or switch provider. Thus, the NCB itself may reduce customers' willingness to switch.
10. Moreover, we found that the majority of respondents said that they would compare PMI providers and policies every year at renewal (55 per cent), with 66 per cent spending one hour or more and 40 per cent two hours or more. This suggests that many customers spend time and effort to collect the information required for an informed decision which would counteract harm from obstacles to switching, while the inactive customers may be more prone to suffer harm.

³ For the first questions, the remaining 2 per cent said 'don't know' and for the second question 11 per cent said 'neither important nor unimportant' and 3 per cent said 'don't know'.

11. The analysis in this working paper is structured as follows: First, we present some background on customers' search and switching behaviour and the factors which they take into account when deciding whether to switch. The subsequent sections then describe the potential obstacles to switching and present the findings from our consumer survey on the extent to which each feature actually affects customer switching. We discuss automatic renewal, cancellation fees and NCB protection in turn. With respect to automatic renewal and cancellation fees, we also briefly mention the work carried on by the Financial Conduct Authority (FCA) on these topics.

Consumers' willingness to switch

12. In order to provide benchmarks for comparing the extent to which obstacles to switching affect customers' decisions, we first summarize the key results of our survey on customer switching behaviour and the factors which influence it (see the working paper 'Survey report'). Tables presenting the key results of our survey are presented in the annex and referenced through the working paper.

Extent of switching and shopping around

13. Consumers have a high propensity to switch. According to our survey, 72 per cent of all respondents previously insured their vehicle with another PMI provider (see Table 1). This result is in line with findings from the OFT's market study on personal current accounts in the UK.⁴ This study showed that 61 per cent of people with car insurance had switched their provider in the previous five years. This propensity to switch is the highest of all markets considered by the OFT, followed by switching gas and electricity providers (54 per cent each) and switching home insurance provider (46 per cent).

⁴ www.of.gov.uk/shared_of/reports/financial_products/OFT1005.pdf, July 2008, chart 3.8.

14. Other findings from our survey support this conclusion. Table 2 shows that the majority of customers compare PMI policies every year at renewal, while 67 per cent compare either every year or most years. 66 per cent of those who compare prices or policies spend at least 1 hour doing so, while 40 per cent spend 2 or more hours and 18 per cent spend 3 hours or more (see Table 3). The mean number of hours spent comparing insurance provider is 2.2 hours.
15. Moreover, it appears that some customers have negotiating power at the time of renewal. Of the 35 per cent who paid a different price on renewal, 79 per cent obtained a cheaper price (accounting for 28 per cent of all respondents who have renewed their PMI policies (see Tables 4 and 5)).

Factors which drive the decision to stay with or switch the PMI provider

16. In response to the open question, with no prompt, regarding the most important reasons not to switch PMI provider on renewal, respondents who did not switch mentioned most often price/value (63 per cent), good experience with their current provider (15 per cent) and no time/less hassle (10 per cent). For those who did switch at their last PMI purchase, price/value was also the most important reason for their decision (85 per cent), followed by range of cover/suitable package (4 per cent) and dissatisfaction with the service from their previous provider (3 per cent) (see Table 6). However, if prompted on the importance of four specific factors, the ranking became price, reliability of the insurer, service quality and NCB (not NCB protection) (see Table 7).
17. In response to the question about which PMI provider respondents considered when last purchasing a policy, only 35 per cent said that they had not considered any other provider (though a further 17 per cent said 'don't know'). In line with the previous finding regarding the most important factors to stay with their current insurer or

switch, 48 per cent of the 35 per cent which did not consider any other insurer mentioned as one of their three most important reasons that the price was acceptable, 27 per cent mentioned convenience, and 26 per cent mentioned satisfaction with the service from their current insurer (see Figure 1 in the annex).

Obstacles to switching

18. There are various factors which might make it harder for consumers to switch their PMI provider. With the exception of our additional findings on NCB (rather than NCB protection), our customer research did not uncover any obstacles in addition to those set out in our issues statement, which we discuss below.

Automatic renewal and cancellation process

19. The FCA told us that the information provided to customers on automatic renewal, including the possibility to cancel, differed considerably between providers. The FCA is currently doing some work around automatic renewal for home and motor insurance. In particular it is considering the fairness of insurer's contracts and practices, how information about automatic renewal is disclosed to consumers and any discrepancies between contract terms and actual practices.

Automatic renewal

20. Under the contractual terms of insurance policies, PMI policies are automatically renewed every year, unless one of the parties sends a termination notice before the insurance is due for renewal. A reminder is usually sent by the PMI provider before the renewal date and the consumer can decide whether to opt out of the automatic renewal following the procedure set by the policy.

Cancellation fees

21. In contrast to automatic renewal, cancellation fees might act as a barrier to switching every time customers do not consider the cancellation fees as a part of the effective price when buying a PMI policy. Consumers have the right to cancel their policy within 14 days of purchase, subject to no claim being made upon the policy, and a full refund will be provided in accordance with the terms of the policy. However, if the customer decides to cancel the policy after the initial 14-day period, typical terms and conditions specify administration charges that are payable to the PMI provider for the cost of arranging and handling the policy. Thus, cancellation fees are not charged when a PMI policy expires, but they may be payable for mid-term cancellation (which may be due to changes in the policyholder's circumstances, such as selling or changing the car or moving home).

22. With respect to cancellation fees, the FCA told us that it was not a price regulator and therefore it did not set prescriptive rules regarding the fees firms could charge. However, the FCA said that it would consider any barriers to consumers exiting a policy within its general requirement to industry participants to treat customers fairly and it would also look at the reasonableness of cancellation fees in the broader context of firms' business models.

23. Responses to an open question in our survey on which factors were important for respondents' decision to stay with or switch their PMI provider suggest that neither automatic renewal nor cancellation fees are significant obstacles to switching. Only five of the 1,102 respondents who recently renewed their PMI policy mentioned automatic renewal as a factor for not changing their insurance provider; and cancellation fees were not mentioned at all (see Table 6).

24. On the basis of this evidence, it does not appear to us that automatic renewal and cancellation fees are obstacles to switching which could give rise to customer harm.

NCB protection

25. Before we discuss whether NCB protection is an obstacle to switching, we first explain briefly how NCB and NCB protection typically work and summarize the evidence we have seen on their prevalence.

NCB

26. An NCB is a discount off the PMI premium which policyholders may obtain for not having had any claims in a certain number of years. As long as a consumer remains claims-free, they will ascend an 'NCB scale' where each step is associated with a different discount rate. The discount usually varies according to other risk characteristics, such as the customer's age, postcode, vehicle age or claim history. Two different policyholders each with the same number of NCB years (ie the number of years without having had a claim) are likely therefore to receive different NCB discounts.
27. In addition, the NCB scale is not the same for all PMI insurers and where insurance companies provide underwriting capacity to brokers or affiliated partners, there could be variation from one broker to another. Most PMI providers use a scale that ranges from 0 to 9+ years of NCB, but some consider a range between 0 and 5+ years of NCB. Exceptions are esure and [X], which use scales capped at 10 years and [X] years respectively.
28. When a claim is made, the policyholder may lose some or all NCB years accrued in accordance with the rules used by the PMI provider. However, while the customer is awarded with one year NCB for each year of claim-free driving, the step-back rule

usually penalizes the customer and reduces their NCB by two or more years (unless the customer has only one year of NCB). As an example, if a policyholder insured by LV has four years of NCB and makes a fault claim or a split liability claim against his/her policy, the NCB will be reduced to two years; if the policyholder has nine years of NCB, one claim would reduce this to four years of NCB.

29. However, not all claims affect the NCB. As an example, LV told us that the number of years NCB might be not affected by a claim (a) under legal expenses cover; (b) for fees for emergency treatment; (c) relating to a windscreen; or (d) under breakdown cover.
30. A PMI provider usually grants the number of years NCB claimed by a switching customer up to the maximum number of years on its 'discount scale'.

Protected NCB

31. Consumers can protect their NCB with an optional insurance cover so that they do not lose years from their NCB in the event of a claim and continue to benefit from the discount off the premium corresponding to the number of NCB years accrued before their claim. Generally, a protected NCB allows the policyholder to make one claim in one year, or two claims in three consecutive years without losing their NCB. In case the claims limit is exceeded, the NCB protection no longer applies and any further claim could result in the loss of NCB years (according to a less punitive step-back rule compared with the unprotected NCB) and consequently to a reduction of the NCB discount.
32. Some PMI providers (Admiral, Aviva, esure and LV) offer a further option to protect NCB years: the guaranteed NCB. This form of protection allows the customer to retain the NCB regardless of the number of claims made against the policy. [X].

33. Both protected and guaranteed NCB policies preserve the customer's NCB entitlement, but they do not 'freeze' the premium. Therefore, a claim which increases the risk profile of the policyholder may still result in a higher premium, but with a protected/guaranteed NCB it will not affect the percentage NCB discount off the new higher premium. In the same way, notwithstanding the customer's NCB, the customer's claim record will affect the risk pricing and consequently the premium offered on switching. Years of NCB and claims history are two factors taken into account separately in the premium calculation.
34. Not all customers are eligible for NCB protection. Depending on the PMI provider, there could be more or less stringent 'admission criteria'. For instance, AXA requires the policyholder to have at least five or more years NCB, to be over 25, and neither the insured nor any named drivers to have claimed for an accident that was his or her fault. CISGIL requires the insured to be already entitled to a discount of 70 per cent or more and he/she should not have claimed more than once in the previous three years. esure offers a guaranteed NCB provided that customers have four or more years NCB, no at-fault claims in the previous two years and no more than one minor conviction in the previous two years.

NCB protection penetration

35. Despite these eligibility criteria, it appears to be very common for customers to protect their NCB. In response to our survey, 80 per cent of PMI policyholders said they currently had NCB protection. This percentage is higher for older drivers (85 per cent of the respondents aged 55 or more compared with 70 per cent of those aged 17 to 34 (see Table 8)).
36. We note that all of the ten largest PMI insurers offer NCB protection. However, only LV and Zurich said that it was their most sold add-on. AXA and DLG said that it was

their second most sold add-on.⁵ Jointly these four insurers account for [redacted] per cent of all PMI policies sold in 2011/12, which would suggest that the 80 per cent penetration rate indicated in our survey results is likely to be inaccurately high. Moreover, of the five brokers we contacted, only Endsleigh said that NCB protection was among its ten most-sold add-ons.

37. We note that it is possible that some survey respondents did not distinguish between NCB and NCB protection in their responses causing the percentage saying they had NCB protection to be overstated. For this reason, we believe that the results on NCB protection set out below should be interpreted with some caution.

NCB protection as a possible obstacle to switching

38. The importance of NCB protection as an obstacle to switching appears to be different depending on whether responses to an unprompted question or to a prompted question are considered.
39. Looking at the responses to the former open question, the survey responses suggest that NCB/NCB protection is not an important factor for the decision to stay with or switch PMI provider (see Table 6). Only 11 respondents of 1,102 customers responding to an unprompted question on why they decided to stay with or change their insurer said it was important for their decision. Moreover, given that these responses were coded as 'NCB/NCB protection', they give an upper bound on the number of respondents who considered that NCB protection was important in this respect.
40. However, these responses are inconsistent with responses to a direct question on whether respondents had been concerned that changing their insurance provider

⁵ [redacted].

might affect the NCB protection they had. In response to this question, 39 per cent said that they had been very concerned or a little concerned (21 per cent said that they had been very concerned), whereas 59 per cent said that they had been not very concerned or not at all concerned (45 per cent stated that they had been not at all concerned) (see Table 10).⁶

41. Asked how important NCB protection was for their decision to stay with their current insurer, half of the respondents said this had been very important or fairly important (25 per cent each), while 36 per cent thought it was not very important or not at all important (11 per cent said 'neither important nor unimportant').⁷ We note that the proportion of those who said that NCB protection was very or fairly important is much higher for those who were concerned that switching provider might affect their protected NCB (73 per cent versus 35 per cent). Conversely, only 17 per cent of those who were concerned about this said that it had been not very or not at all important (compared with 49 per cent of those who were concerned that a change might affect their protected NCB) (see Table 11).
42. A high proportion of respondents said that their NCB had been a factor which had particularly influenced their decision to stay with or change their PMI provider. The share of respondents who stayed with their insurer and said that the NCB particularly influenced their decision to stay was 63 per cent, which was markedly higher than for those who decided to switch (29 per cent (see Table 7)).⁸ According to the results of our survey, only around 20 per cent of respondents have an unprotected NCB (see Table 8), which suggests that some respondents might have confused the effects of NCB and NCB protection. However, even 59 per cent of those respondents who said

⁶ Results are very similar if we consider only those who stayed with their current insurer at the last renewal. This is due to the fact that the vast majority of those who said they would have NCB protection stayed with their provider at the last renewal (only around 3 per cent of these respondents switched provider).

⁷ For the same reason as in the previous footnote, results are very similar if we consider only those who stayed with their current insurer at the last renewal.

⁸ The difference is statistically significant.

that they had not been concerned by how changing their PMI provider might affect their protected NCB also said that the NCB had particularly influenced their decision to stay with or switch provider (see Table 9). The corresponding proportion for those concerned about their NCB protection was 71 per cent. This suggests that not only concern about the effect on NCB protection but also concern about the effect on the NCB reduces customers' willingness to switch.

Survey results

TABLE 1 **Before this, did you insure your vehicle with another company or is this the only company you have used for insuring your current vehicle?**

	<i>No.</i>	<i>%</i>
Have previously insured vehicle with another insurance company	1,086	72
Only insurance company used	386	26
Don't know	28	2
Refused	0	0
Number of respondents	1,501	100

Source: Survey data.

Note: Base: all.

TABLE 2 **In general how much do you compare private motor insurers and policies?**

	<i>No.</i>	<i>%</i>
I compare every year at renewal	827	55
I compare most years at renewal	184	12
I compare some years at renewal	252	17
I never compare at renewal—I just let the policy continue	229	15
Don't know	10	1
Number of respondents	1,501	100

Source: Survey data.

Note: Base: all.

TABLE 3 **Approximately how many hours did you spend comparing different insurers and policies when you last compared them?**

<i>Hours spend</i>	<i>No.</i>	<i>%</i>
Less than 1	414	29
1	372	26
2	305	22
3	114	8
4	61	4
5	32	2
6	20	1
7	1	0
8	12	1
9	0	0
10	9	1
11+	12	1
Don't know	66	5
Refused	0	0
Number of respondents	1,420	100

Source: Survey data.

Note: Base: All those who have compared insurers or policies.

TABLE 4 At your last renewal, did you accept the renewal quote or was the price you paid different from the one you were initially quoted?

	<i>No.</i>	<i>%</i>
Accepted the renewal quote given	639	58
Paid a different price to one initially quoted	385	35
No/neither	41	4
Don't know	38	3
Number of respondents	1,102	100

Source: Survey data.

Note: Base: All who have renewed their PMI policy.

TABLE 5 And was this price due to ... ?

	<i>No.</i>	<i>%</i>
You negating a cheaper price—without comparing other options	98	25
You negating a cheaper price—after comparing other options	167	43
You changing some details on the policy so to make it cheaper	42	11
You changing some details on the policy so that it was more expensive	24	6
Insurer offered a lower price up front/loyalty discount	19	5
Negotiations (other)/broker/online mentions	10	3
Or some other reason	16	4
Don't know	10	3
Paid a cheaper price (subtotal)	307	79
Number of respondents	385	100

Source: Survey data.

Note: Base: All those who paid a different price to the one quoted at their last renewal. The line 'Paid a cheaper price shows a subtotal and was therefore not considered in the calculation of the total number and share of respondents. 'Don't know' responses are excluded in the calculation of that percentage.

TABLE 6 Last time your policy came up for renewal, which were the most important factors for your decision ... ?

	<i>Not to change insurer</i>		<i>To change insurer</i>	
	<i>No.</i>	<i>%</i>	<i>No.</i>	<i>%</i>
Price/value	689	63	288	85
good experience/dissatisfaction with provider	164	15	12	3
No time/can't be bothered/less hassle	114	10	-	-
Convenience	69	6	0	0
Range of cover/suitable package	68	6	15	4
NCB/NCB protection	11	1	2	1
Automatic renewal/rollover	5	0	-	-
Don't know	1	0	-	-
Not stated	20	2	6	2
Refused			2	0
Number of respondents	1,102	N/A	340	N/A

Source: Survey data.

Note: Base for non-switching customers: All who have renewed their insurance policy; base for switching customers: All those who changed insurer at their last renewal and have been insured with more than one. Multiple responses to this open question were possible. Other factors with a number of respondents smaller than 30 have been omitted.

TABLE 7 Which of these particularly influenced you to stay with/change your current insurer ...?

	Total		Not to change insurer		To change insurer	
	No.	%	No.	%	No.	%
<i>Price of policy</i>						
Yes	1,334	92	1,004	91	330	97
No	95	7	87	8	9	3
Don't know	14	1	12	1	2	1
<i>Reliability of insurer</i>						
Yes	944	65	797	72	147	43
No	318	22	171	16	147	43
Don't know	180	13	134	12	46	14
<i>Service quality</i>						
Yes	864	60	749	68	115	34
No	462	32	263	24	199	58
Don't know	116	8	90	8	26	8
<i>NCB</i>						
Yes	789	55	692	63	97	29
No	628	44	392	36	236	69
Don't know	25	2	18	2	7	2
<i>Time and effort required to find or switch insurer</i>						
Yes	734	51	617	56	117	34
No	660	46	450	41	210	62
Don't know	48	3	35	3	14	4
Number of respondents	1,442	N/A	1,102	N/A	340	N/A

Source: Survey data.

Note: Base for non-switching customers: All who have renewed their insurance policy; base for switching customers: All those who changed insurer at their last renewal and have been insured with more than one. Alternatives were read out and multiple responses were possible. Where shares of respondents apparently sum to 101 per cent this is due to rounding to a full percentage point.

TABLE 8 Features currently included in policy: No claims bonus protection (including age groups)

	Total		17-34		35-54		55+	
	No.	%	No.	%	No.	%	No.	%
Yes	1,194	80	144	70	468	77	582	85
No	251	17	56	27	116	19	79	11
Don't know	56	4	4	2	24	4	27	4
Number of respondents	1,501	100	204	100	608	100	689	100

Source: Survey data.

Note: Base: all. The differences between the group of 55+ year old persons and the remaining two age groups are statistically significant, but for the answer 'don't know'.

TABLE 9 Which of these particularly influenced you to stay with/change your current insurer—NCB

	Total		NCB-P Concerned		NCB-P Not concerned	
	No.	%	No.	%	No.	%
Yes	789	55	252	71	312	59
No	628	44	96	27	217	41
Don't know	25	2	6	2	3	1
Number of respondents	1,442	NA	354	NA	532	NA

Source: Survey data.

Note: Base for non-switching customers: All who have renewed their insurance policy; base for switching customers: All those who changed insurer at their last renewal and have been insured with more than one. Alternatives were read out and multiple responses were possible. NCB-P stands for NCB protection. Where shares of respondents apparently sum to 101 per cent this is due to rounding to a full percentage point. The difference between those who are concerned and those who are not concerned is statistically significant (except for the response 'don't know').

TABLE 10 How concerned were you that changing your insurance provider might affect any protected NBC you had?

	No.	%
VERY/A LITTLE CONCERNED	356	39
NOT VERY/NOT AT ALL CONCERNED	539	59
Very concerned	189	21
A little concerned	166	18
Not very concerned	128	14
Not at all concerned	411	45
Don't know	20	2
Number of respondents	914	100

Source: Survey data.

Note: Base: All those with NCB protection.

TABLE 11 How important was this to your decision to stay with the previous insurer?

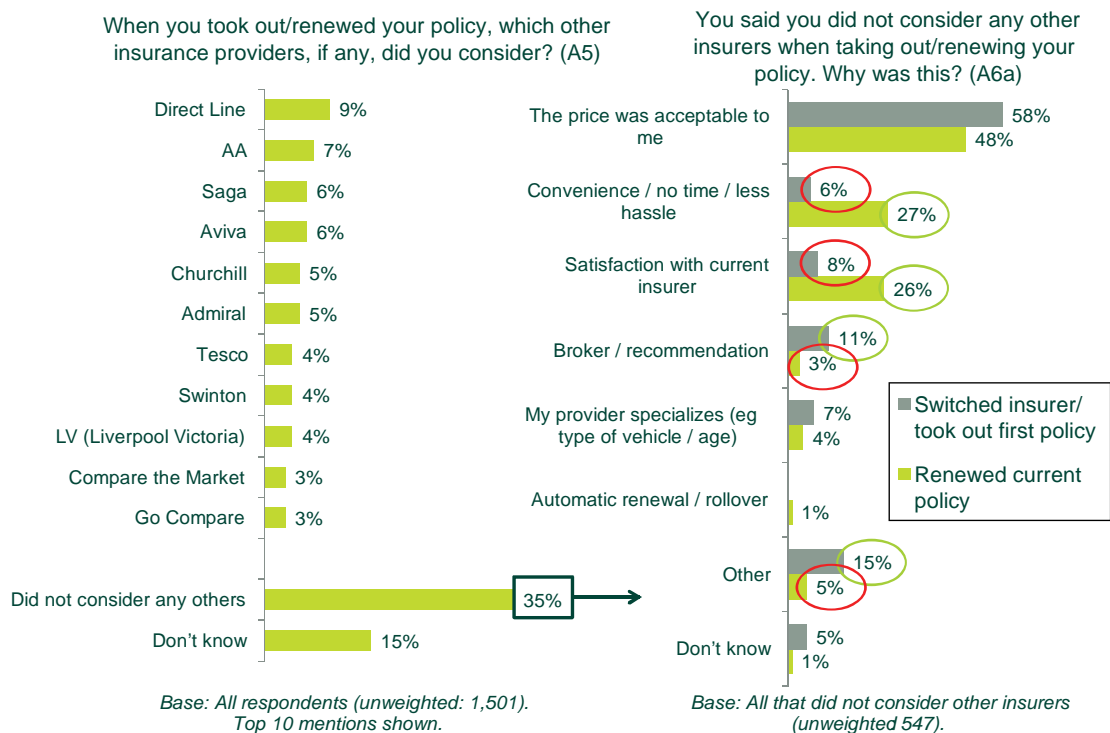
	<i>Total</i>		<i>NCB Concerned</i>		<i>NCB Not concerned</i>	
	<i>No.</i>	<i>%</i>	<i>No.</i>	<i>%</i>	<i>No.</i>	<i>%</i>
VERY/FAIRLY IMPORTANT	461	50	260	73	190	35
NOT VERY/NOT AT ALL IMPORTANT	327	36	60	17	262	49
Very important	229	25	136	38	89	17
Fairly important	232	25	125	35	101	19
Neither important nor unimportant	100	11	28	8	71	13
Not very important	147	16	39	11	105	19
Not at all important	180	20	21	6	157	29
Don't know	26	3	8	2	15	3
Number of respondents	914	N/A	356	N/A	539	N/A

Source: Survey data.

Note: Base: All those with NCB protection. The difference between those who are concerned and those who are not concerned regarding their NCB is statistically significant, for responses 'neither important nor unimportant only at the lower 10 per cent confidence level (except for the response 'don't know').

FIGURE 1

The insurance providers considered when taking out a policy



Source: Survey data, figure prepared by IFF.