

CIS GENERAL INSURANCE LIMITED

**Market Investigation
into
private motor insurance**

**Non-Confidential version of
Response
to the
Competition Commission
Issues Statement
of 12 December 2012**

14 January 2013

CIS GENERAL INSURANCE LIMITED

MARKET INVESTIGATION INTO PRIVATE MOTOR INSURANCE

RESPONSE TO ISSUES STATEMENT

1 INTRODUCTION

- 1.1 We refer to the Private Motor Insurance Issues Statement (the "**Issues Statement**") published by the Competition Commission (the "**Commission**") on 12 December 2012. This Response is made on behalf of CISGIL.
- 1.2 CISGIL welcomes the opportunity to comment on the Issues Statement. As the Commission's market investigation is very much in its preliminary stages and its thinking on the issues identified by it, and CISGIL's views upon those issues, will inevitably develop over the course of the investigation, CISGIL does not, in this Response, comment in detail on every potential issue identified in the Issues Statement.
- 1.3 In order to assist the Commission in determining those market features that it should investigate in more detail, by reference to the issues and theories of harm raised by it in the Issues Statement, CISGIL identifies the principal market features which it considers are market failures that distort or may distort competition, leading to detriment to consumers and which should therefore be the principal focus of the Commission's investigation. We also identify both a number of other issues not identified in the Issues Statement that we consider should be investigated in detail by the Commission, as well as a number of other issues considered in the Issues Statement that we consider do not justify further investigation by the Commission, in the absence of any adverse effects on competition or consumers' interests.
- 1.4 The absence of observations by CISGIL on any of the other points raised in the Issues Statement should not be taken to represent either CISGIL's agreement or disagreement on these other issues.
- 1.5 CISGIL looks forward to exploring these points and other aspects of the investigation over the coming months, and would be happy to elaborate on any of the issues raised in this Response, including in either a formal hearing with the Inquiry Group or an informal meeting with members of the Commission's staff.

2 EXECUTIVE SUMMARY

- 2.1 The Issues Statement addresses a much broader range of issues than those considered by the Office of Fair Trading ("**OFT**") in its Market Study. However, CISGIL considers that the Commission should limit the scope of its investigation to those features of the market for the supply of private motor insurance ("**PMI**") in the United Kingdom, and closely related markets, which represent a clear market failure, leading to increased costs to insurers and thus to increased premiums, resulting in consumer detriment relative to an efficient market structure.
- 2.2 The market for the supply of PMI in the United Kingdom is highly competitive. Indeed, it is one of the most competitive motor insurance markets in the world, with over 100 insurers competing to provide PMI to consumers through different sales channels, including direct sales and sales through brokers, price comparison websites ("**PCWs**") and other distributors. Consumers receive competitive and high quality service from insurers, both when purchasing insurance and when they need to make a claim, including when a vehicle needs to be repaired after an accident.
- 2.3 However, CISGIL also considers that there are a number of features of the PMI market, and markets related to it (such as repairs and the provision of replacement vehicles) that enable third parties and some insurers to engage in practices that unnecessarily lead to increased costs for insurers of at-fault drivers. These include the payment and receipt of referral fees, rebates and discounts; 'over-providing' services, such as replacement vehicles and unnecessarily prolonging repair times; and charging a higher cost for the same repair when it is for a "not-at-fault" driver. These are highlighted by the Commission in Theory of Harm 1. These features have allowed some industry participants to engage in practices that raise the costs to insurers. Whilst this allows some insurers to generate additional revenues (in addition to underwriting and investment income), there is no evidence that this ultimately lowers prices for consumers. Indeed, overall, all insurers (even those engaging in these practices) suffer increased claims costs, as many of the increased costs are generated by non-insurers, including credit hire and repair companies and claims management companies. These additional costs must ultimately be passed on to and be borne by consumers. This represents a clear and persistent market failure, which the normal competitive process has not been able to resolve and has allowed the establishment and growth of businesses that exist solely to exploit this failure. We therefore agree with the Commission's observation (at paragraph 30 of the Issues Statement) that "overall, each insurer is likely to be in the fault position for some claims and in the non-fault position for other claims, which is likely to result in all costs being pushed up despite this not being in the interest of most insurers". Whilst this can accurately be described as a "prisoner's dilemma", it is indeed actually a "race to the bottom".

- 2.4 In addition, certain features of the legal systems in the United Kingdom enable third parties (such as accident management companies, providers of replacement vehicles and not-at-fault insurers) to recover from at-fault insurers sums that are in excess of the actual costs incurred by them in repairing a damaged vehicle or in providing a replacement vehicle. The Courts have consistently allowed the recovery of high costs for, e.g. credit hire and credit repair, on the basis that the costs are "reasonable" and "not excessive", holding that – in these circumstances - the not-at-fault motorist has mitigated his or her loss, when in reality it is one or more third parties (e.g. his/her insurer, a credit hire provider, an accident management company or a repairer) that has both incurred those costs and benefitted from charging an excessive price, borne by the "at-fault" insurer. This has also encouraged and provided "legitimacy" for practices that - whilst lawful under the common law - are inefficient, not in the consumer interest and indeed cause economic harm. It is clear that there is a resulting "dislocation" of the proper functioning of the market, leading to inefficient outcomes for consumers.
- 2.5 A number of other features of the sector facilitate excessive and often fraudulent claims for both personal injury, particularly whiplash, and damage to property. Some, but not all, of these practices may be controlled - to at least some extent - with the forthcoming ban on the payment of referral fees in personal injury cases. However, this is not presently within the scope of the Commission's investigation, given that this is the subject of legislative changes and further on-going reforms by the Ministry of Justice ("**MOJ**").
- 2.6 The result of these features is that insurers' costs are increased above what might be considered the efficient level. This means that whilst the market for the supply of PMI is itself highly competitive, it is operating on the basis of an inflated cost base, which insurers themselves cannot control. As the PMI market is highly competitive, these costs must be passed through to consumers in terms of higher premiums. The consumer detriment is thus clear.
- 2.7 Over time, these practices may well affect competition in the actual provision of PMI itself. Many insurers and intermediaries seek to maximise their revenues from claims made by "not-at-fault" drivers, by engaging in the practices identified by both the OFT and the Commission. However, not all insurers engage in these practices; this includes CISGIL, which as an ethical insurer must: act in a way that is fair and does not disadvantage consumers or others, offer an excellent service to its customers, sell its products in a fair and honest way, and be committed to supporting communities. Such insurers are thereby placed at a considerable competitive disadvantage: their claims costs are rising (as for all insurers), but they do not benefit from increased revenues from inflated costs charged to at-fault insurers. [CONFIDENTIAL] The alternative would be that these insurers would also need to engage in these practices in order to maintain

their market position: this would exacerbate the current situation, leading to a "race to the bottom" in which consumers will suffer further harm.

2.8 In view of the above observations, CISGIL considers that certain of the features of the different markets relevant to the provision of PMI increase insurers' costs (and thus premiums paid by consumers) and should be investigated in detail by the Commission. A number of other features are being investigated by other public authorities (such as the Financial Services Authority ("FSA")/Financial Conduct Authority ("FCA")) and government departments (such as the MOJ) and it would therefore not be appropriate for these to also be investigated by the Commission. Furthermore, in view of the fact that the actual supply of PMI is itself highly competitive, CISGIL considers that there is no justification or need for the Commission to investigate the supply of PMI itself to consumers.

2.9 CISGIL's initial submissions in response to the Issues Statement can be summarised as follows:

- (a) the issues identified by the Commission in Theories of Harm 1 (moral hazard) and 2 (beneficiaries of post-accident services being different from the procurer – and also the ultimate payer - of those services) should be investigated by the Commission in detail because the market features identified by it have led to persistent market failure, to increased costs borne by insurers operating in a fiercely competitive market and to higher premiums for private motorists, and thus to significant consumer detriment, relative to the outcome in an efficient market;
- (b) as part of its investigation of Theory of Harm 1, we consider that the Commission should investigate how the application by the Courts of the common law to the subrogation of claims has resulted in the perpetuation by third parties of numerous inappropriate practices that unnecessarily and inefficiently increase the costs recovered from at-fault insurers, without providing any benefit at all to consumers;
- (c) insofar as issues identified by the Commission in Theory of Harm 5 (vertical integration) are also linked to those identified in Theories of Harm 1 and 2, in particular relationships between certain insurers and suppliers (notably repairers, parts and paint suppliers and replacement vehicle providers), it would be appropriate for the Commission to investigate further these issues. We consider that the Commission should also investigate further the use of "most favoured nation" clauses by PCWs; and

- (d) as the market for the supply of PMI is competitive throughout the United Kingdom, and in all segments, we consider that the Commission does not need to pursue further any of the issues identified in Theory of Harm 3 (horizontal effects arising from market concentration) or Theory of Harm 4 (strategies to soften competition). We also note that the FSA/FCA is already undertaking a study of "drip-in" pricing and whilst we consider that no consumer detriment exists from the use of "partitioned pricing", we consider that it would be unnecessarily duplicative for the Commission to also investigate the use of "drip-in" pricing.

3 CIS GENERAL INSURANCE LIMITED

- 3.1 CISGIL is part of the Co-operative Banking Group Limited ("**CBG**") and its ultimate parent is the Co-operative Group Limited.

Co-operative Group

- 3.2 The Co-operative Group is the United Kingdom's largest consumer cooperative. It is owned by over 7.2 million consumers and approximately 80 independent co-operative societies. It offers a broad range of products which include banking, insurance, other financial services, grocery and convenience store retailing, pharmacies and other healthcare services, legal services, funeral services, motor vehicles and electrical goods. It operates over 5,000 retail trading outlets, employs more than 102,000 people and has an annual turnover of more than £ 13 billion. Its purpose is to serve its members by carrying on business as a co-operative in accordance with co-operative values and principles. It aims to: be a commercially successful business that meets the needs of its customers and the communities it serves; respond to its members and share its profits; be an ethical leader; be an exemplary employer; and inspire others through co-operation.
- 3.3 Across all of its products, the Co-operative Group aims to build valued long lasting relationships with all of its customers whether they are members or not.
- 3.4 Further information on the Co-operative Group can be found on its website at: <http://www.co-operative.coop/corporate>.

Co-operative Banking Group

- 3.5 As noted above, CISGIL forms part of CBG, together with Co-operative Insurance Society Limited ("**CIS**") and The Co-operative Bank p.l.c. ("**Co-operative Bank**"), which are also separate corporate entities within CBG. The broad functions of these the corporate entities are:
- CISGIL: general insurance business;

- CIS: life and savings business;
 - Co-operative Bank: banking business, including under the brand names "Britannia" and "smile".
- 3.6 CBG provides financial services under a number of brand names including "The Co-operative Insurance", "The Co-operative Investments", "The Co-operative Bank", "Britannia" (part of the Co-operative Bank) and "smile". It has some 5.5 million customers. Its brands have developed a reputation for providing quality service and products, as well as leading the way on corporate and social responsibility matters. Further information on CBG can be found on its website at: <http://www.co-operativebank.co.uk>.
- 3.7 Through CIS and CISGIL, CBG provides a range of insurance and investment services, including motor insurance, home insurance, life assurance, and pensions, investments, protection products, unit trusts and ISAs.

CISGIL

- 3.8 CISGIL underwrites general insurance business in the United Kingdom, including home and motor insurance, using the brand name "The Co-operative Insurance". It distributes its insurance products on a direct basis (via telephone call centres and its own websites), through a number of PCWs (including confused.com, moneysupermarket.com, gocompare.com and comparethemarket.com) and via Co-operative Bank channels (e.g. branches). In addition, CISGIL also provides underwriting capacity for a number of brokers. Overall, across all its business, CISGIL's gross written premiums were £ [CONFIDENTIAL] million in 2011, of which gross written premiums for its overall motor account were £ [CONFIDENTIAL] million, and it had around [CONFIDENTIAL] million policies in force as at 31 December 2011. At an underwriting level (so not taking account of investment income), CISGIL's motor book has a combined ratio of [CONFIDENTIAL].
- 3.9 There are three "Co-operative Insurance" private motor insurance products that are currently available:
- the main "Co-operative Insurance" motor insurance policy, which is sold via telephone call centres and online;
 - a dedicated PCW product, called "Ecoinsurance", which is sold via PCWs; and
 - "Young Driver", a telematics-based product aimed at responsible young drivers and their parents. It is sold and serviced via a third party managed website.

- 3.10 In addition there is a legacy private motor insurance product, which is closed to new business. A range of additional services are offered alongside these products, including Breakdown Cover and Legal Expenses Insurance ("LEI") cover. LEI cover is provided as an embedded part of the product for CISGIL's legacy private motor insurance product and all of its home insurance policies, as part of a single premium.
- 3.11 Where CISGIL provides underwriting capacity to brokers, the "The Co-operative Insurance" brand name is not used and the product is sold under the broker's own brand. In these circumstances, the broker owns the customer relationship. If any additional services are provided with broker products, these are separately sourced by the broker, without the involvement of CISGIL. Broker policies represent approximately [CONFIDENTIAL] of CISGIL's current PMI book and [CONFIDENTIAL] of new PMI business in 2012.
- 3.12 As an ethical and co-operative insurer, CISGIL aims to create value for its customers and the Co-operative Group's members, to earn their loyalty and trust, so as to become a compelling customer-centric co-operative alternative to corporate insurers and thus be the natural choice for customers and members. It puts its members and customers first and takes social responsibility, so that it can deliver sustainable benefits to customers, members and communities through a commitment to value, fairness and social responsibility.
- 3.13 As part of the Co-operative Group, CISGIL must adhere to the Group's financial and operational objectives and its social and sustainability goals (which are set out in its ground-breaking Ethical Plan) which guide the way in which the Co-operative Group conducts its business. CISGIL must therefore: act in a way that is fair and does not disadvantage consumers or others, offer an excellent service to its customers, sell its products in a fair and honest way, and be committed to supporting communities.
- 3.14 As a result of its ethical commitment, CISGIL is not able to undertake certain commercial activities which others active in the motor insurance market and related markets (including some insurers, claims handling organisations, credit hire organisations and some personal injury lawyers) may undertake and which are not in the consumer interest.
- 3.15 As an ethical and consumer-focused insurer, CISGIL's objective is to minimise costs (including for replacement vehicles and repairs) in all claims handled by it, including those costs which are subsequently subrogated to the insurers of third party "at-fault" drivers. CISGIL does not engage in the practices identified by the OFT in its decision to make a market investigation reference and in the Commission's Theories of Harm 1 and 2. This is the case even if participating in such activities would be in accordance with CISGIL's broader commercial interests.

3.16 [CONFIDENTIAL]

3.17 Where CISGIL acts as underwriter and the broker “owns the customer” the broker will deal with “not-at-fault” claims without involving CISGIL and will sell its own legal expenses cover (if any). However, CISGIL will be responsible for meeting the costs of at-fault claims.

3.18 [CONFIDENTIAL]

Co-operative Legal Services

3.19 For completeness in the context of the Commission's market investigation, The Co-operative Group also includes Co-operative Legal Services (“**CLS**”), which provides a range of consumer legal services. CLS offers consumers high quality, low cost legal services in line with the Group's ethical and social principles. These include personal injury claims, probate and estate administration services. Further information on CLS can be found on its website at <http://www.co-operative.coop/legalservices>.

3.20 As noted above, CISGIL provides LEI cover to its customers, either as integral part of some policies (i.e. home insurance cover and legacy PMI cover) or an additional service for other currently available PMI products. LEI cover offered to PMI customers provides up to £100,000 cover for legal fees to help recover uninsured losses (such as the policy excess), loss of earnings or to pursue personal injury claims including medical bills, provided that the customer has a “non-fault” accident. The cover also provides a replacement vehicle at no extra cost to the customer, if the standard courtesy car offered by the repairer network is not suitable or not available, for example in case of a total loss.

3.21 CLS is not a direct or indirect subsidiary of CBG, CISGIL's immediate parent company. CLS provides claims management services to CISGIL in respect of CISGIL's LEI cover. [CONFIDENTIAL] If a customer with LEI cover has a “not-at-fault” accident, CLS handles the claim on CISGIL's behalf, including any recovery for personal injury and the provision of a replacement vehicle. [CONFIDENTIAL]

3.22 Subject to this exception (and unlike many of its insurer competitors), CISGIL does not provided replacement vehicles on credit hire terms to a “not-at-fault” driver insured by it. The vehicles provided by CISGIL to a “not-at-fault” driver are courtesy cars sourced from CISGIL's approved repairers at a considerably lower cost compared with the cost of credit hire vehicles. (The insured motorist can of course, if he or she wishes, source a replacement vehicle on credit hire terms using another provider.) This is consistent with CISGIL's objectives of minimising costs and ensuring that its customers' vehicles are repaired quickly, efficiently and safely.

4 THEORIES OF HARM

Observations on the market structure for private motor insurance

- 4.1 The market for the provision of PMI in the United Kingdom is large. In 2010, the Association of British Insurers estimated written premiums to be £ 10.7 billion. This market is highly competitive. Indeed, it is one of the most competitive motor insurance markets in the world, with over 100 insurers competing to provide PMI to consumers through different sales channels, including direct sales and sales through brokers, PCWs and other distributors. Consumers receive competitive and high quality service, both in purchasing insurance and when they need to make a claim, including when a vehicle needs to be repaired after an accident.
- 4.2 We therefore consider that there is no basis for a concern based upon consumers receiving an inferior or low quality of service. Equally, whilst insurance premiums have been rising over time, and this is naturally a concern to both consumers and public authorities (and also to insurers), this is not the result of a lack of competition between insurers in the underwriting of PMI: these rises are clearly caused by other factors, which are beyond the control of individual insurers. Indeed, the highly competitive nature of the PMI market is demonstrated by the fact that, [CONFIDENTIAL]. Data from the Association of British Insurers demonstrates that, at an industry level, providers of motor insurance have made an underwriting loss in each of the last 16 years.
- 4.3 PMI is a product that is readily understood by motorists: unlike other forms of insurance and other financial services, motorists are required by law to hold PMI and purchase it on an annual basis. This increases consumer awareness and familiarity. Regular, annual purchasing means that consumers are well able to identify the policy that they require and to compare the policies of different insurers and brokers. There is an extremely high degree of transparency through the widespread proliferation and use of PCWs (as well as insurers' and brokers' own websites), customers can compare both price and other key policy features (including, for example, excesses, replacement vehicle cover, legal expenses insurance cover, annual mileage limitations and restrictions on named drivers) and are able to make an informed choice as to which policy best meets their requirements. Indeed, most customers will purchase wholly or mainly on the basis of price. Indeed, low (or even no) barriers to switching provider are evidenced by the high rates of switching that occur, which ensures competitive market outcomes.
- 4.4 Therefore, we consider that there is no basis for concerns that the apparent "complexity" of PMI gives rise to consumer detriment. Indeed, the existence of strong rivalry between competing insurers, as identified in the OFT's call for evidence report, confirms that a

large proportion of consumers are "shopping around" to get the best cover for the best price, leading to strong price and product competition between PMI providers..

- 4.5 However, CISGIL also considers that there are a number of features of the PMI market, and markets related to it (such as repairs and the provision of replacement vehicles), and of the judicial systems of the different nations of the United Kingdom, that unnecessarily lead to increased costs for insurers of at-fault drivers. These features were identified by the OFT in its Decision to make a Market Investigation Reference to the Commission, in particular the persistent and unchecked inflation of costs of repairs and replacement vehicle claims made by the insurers of "not at fault" drivers which are recovered in subrogation from the insurers of "at fault" drivers, who have no effective means of controlling or challenging those costs.
- 4.6 These features and practices have allowed some industry participants to take advantage of excessive revenues whilst simultaneously raising the costs of insurers, which are then (because the market for underwriting PMI is so competitive) inevitably passed on to consumers in the form of higher premiums. This represents a clear and persistent market failure, with insurers competing on an inflated cost base, which the normal competitive process has not been able to resolve. As a result, we have seen the growth of businesses that exist solely to exploit this market failure, supported by the legal principle that, following an accident, a "not at fault" motorist is entitled to be restored to the pre-existing condition and that the insurer of the "at fault" motorist is required to meet all costs, subject only to a loosely defined and rarely applied duty to mitigate.
- 4.7 We therefore consider that the Commission's market investigation should focus on Theories of Harm 1 and 2 and certain aspects of Theory of Harm 5, as these address these practices which create and exploit market failures, so contributing to higher premiums for consumers and thus to consumer harm. They may also lead, over time, to a less competitive PMI market, if some insurers (which do not avail of these practices) are either no longer able to compete profitably or can only do so by themselves engaging in these costs, thus exacerbating an existing "race to the bottom".

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

- 4.8 The Commission's first theory of harm - that consumer harm arises from the separation of cost liability (borne by the insurer of the "at fault" motorist) and cost control (which is enjoyed by one or more other parties, such as the "not at fault" insurer, claims management companies, repairers and credit hire organisations) in respect of damage suffered by a "not at fault" motorist – was considered in detail by the OFT in its market study. CISGIL supported the making of the market investigation reference. CISGIL

would also refer the Commission to the Channel 4 *Dispatches* programme that was first broadcast on 7 January 2013.¹

Third parties have the ability and incentive to increase insurers' costs and that insurers cannot control these costs, leading to market failure

- 4.9 CISGIL is in full agreement with the OFT and the Commission that there are a number of features of the PMI market, and markets related to it (such as repairs and the provision of replacement vehicles) that facilitate anti-competitive practices that unjustifiably and unnecessarily lead to increased costs for insurers of at-fault drivers. At fault insurers have no means of controlling these practices and costs: "capturing" third party claims is effective only in a limited proportion of claims (CISGIL's experience is [CONFIDENTIAL] of third party claims can be "captured").
- 4.10 CISGIL agrees that third parties have the ability and incentive to increase their own revenues by engaging in the practices identified by both the OFT and the Commission, including: the payment and receipt of referral fees, rebates and discounts; 'over-providing' services, such as replacement vehicles and unnecessarily prolonging repair times; and charging a higher cost for the same repair when it is for a "non-at-fault" driver. The insured "not at fault" motorist is indifferent to this (since he or she does not have to pay the excessive costs of remedying an individual accident) and the "at fault" insurer has almost no means of controlling those costs and is essentially required to meet those costs, in view of the approach of the courts.
- 4.11 These features have allowed many intermediaries, insurers and other industry participants to engage in these practices, exploiting this ability to increase their own revenues on a persistent basis whilst simultaneously raising the costs to insurers as a whole. These parties have sought and continue to seek to maximise their revenues from claims made by "not-at-fault" drivers, by engaging in the practices identified by both the OFT and the Commission, including: payment and receipt of referral fees, rebates and discounts; 'over-providing' services, such as replacement vehicles and unnecessarily prolonging repair times; and charging a higher cost for the same repair when it is for a "non-at-fault" driver. In theory, where an insurer earns such revenues from claims it may assert that there are passed on to its customers in the form of lower premiums. This would be the case in a competitive market. However, even if this were to be the case, this justification is nevertheless flawed. First, even if an insurer does pass on such additional revenues to its own customers, the additional costs of managing this process increase the industry's overall claims cost base. Second, these practices may introduce inefficiency into the claims process, for example by increasing the time taken for a repair

¹ See <http://www.channel4.com/programmes/dispatches/4od>. Channel 4's website states that "*Dispatches reveals the secrets of car insurance that all drivers should know. Harry Wallop investigates claims that major insurers cash in when you have a crash, through maximising profits, lucrative referral fees and rebate deals, sometimes at the expense of doing what's best for you and your car.*"

(which unnecessarily allows additional credit hire revenues to be generated). As these additional costs are not borne by the non-fault insurer, it has no incentive to reduce these costs and indeed, in a worst-case scenario, may have the ability and incentive (in order to increase its own revenues) to increase competitors' costs: a clear "beggar thy neighbour" strategy. This means that the additional costs inflate the industry's overall cost base, which is ultimately passed through to consumers. In this way, these practices may distort competition by raising rival insurers' costs in respect of subrogated claims. Furthermore, where such practices are undertaken by parties that are not insurers (such as credit hire and credit repair providers, and claims management companies), the costs of *all insurers* are improperly raised.

- 4.12 This represents a clear and persistent market failure, which the normal competitive process has not been able to resolve and has allowed the growth of businesses that exist solely to exploit this failure.

The harm to insurers, competition and consumers is clear

- 4.13 These practices, which, amongst other things, lead to inefficiencies in the market, increased subrogated claims costs and higher premiums to the detriment of consumers, should, as a priority, be fully investigated by the Commission to identify if they lead to market failure and to consumer harm. CISGIL considers that they do lead to consumer harm and that remedial action by the Commission is essential to control excessive costs. The result of these features is that insurers' costs are increased above what might be considered the efficient level. This means that whilst the market for the supply of PMI is itself highly competitive, it is operating on the basis of an inflated cost base, which insurers themselves cannot control. As the PMI market is highly competitive, these costs must be passed through to consumers in terms of high premiums. The consumer detriment is thus clear. Furthermore, we believe that this detriment is increasing as various industry participants identify new practices that can be employed to exploit market failures and so impose even higher excessive costs on insurers.
- 4.14 In accordance with its ethical principles, CISGIL itself does not pay or accept referral fees and does not use either credit repairs or credit hire vehicles in order to provide replacement vehicles to non-fault drivers (other than those customers with LEI cover, whose claims are handled on CISGIL's behalf by CLS, which procures vehicles from Helpfire Group). However, these and other practices are carried out by a wide range of other market participants: this has had a significant adverse economic effect on CISGIL, causing it to incur increased costs and placing it at a competitive disadvantage.
- 4.15 In 2011, CISGIL paid in the region of [CONFIDENTIAL] credit hire claims at a cost of approximately £ [CONFIDENTIAL]. Where replacement car hire is provided on a credit basis rather than directly sourced by the insurer itself, the hire periods tend to be longer

and the daily rate significantly higher. The average cost of a credit hire claim in CISGIL's experience is approximately £ [CONFIDENTIAL] whereas the average cost of direct hire is approximately £ [CONFIDENTIAL]. This is a clear example of an unjustifiable increase in costs, which has to be passed on to consumers. Given CISGIL's small market share in the PMI market, it is obvious that the adverse effects across the PMI market as a whole are considerable.

- 4.16 Over time, these practices may well affect competition in the actual provision of PMI itself. Not all insurers engage in these practices; this includes CISGIL, which as an ethical insurer must: act in a way that is fair and does not disadvantage consumers or others, offer an excellent service to its customers, sell its products in a fair and honest way, and be committed to supporting communities. Such insurers are thereby placed at a considerable competitive disadvantage: their claims costs are rising (as for all insurers), but they do not benefit from increased revenues from, for example, receipt of referral fees, rebates, discounts and inflated costs charged to at-fault insurers. [CONFIDENTIAL] The alternative would be that these insurers would also need to engage in these practices in order to maintain their profitability: this would only exacerbate a situation that can only be described as a "race to the bottom" in which consumers will suffer harm.

The judicial system and the common law promote and provide "legitimacy" for practices that are inefficient, distort competition and harm consumers

- 4.17 Whilst we agree with Theory of Harm 1, we consider that the Commission has omitted to identify an important feature of the PMI market from the scope of its Issues Statement: the fact that the common law system allows, and appears to condone, practices which inflate costs borne by a third party without providing any benefit to the innocent motorist or consumers generally.
- 4.18 We therefore consider that the Commission should also investigate the effect on competition of certain features of the legal systems in the United Kingdom which enable third parties (such as not-at-fault insurers, repairers and providers of replacement vehicles) to recover from at-fault insurers sums that are considerably in excess of the actual costs incurred by them in repairing a damaged vehicle or in providing a replacement vehicle: the Courts have consistently allowed the recovery of high costs for, e.g. credit hire and credit repair, on the basis that the costs are "reasonable" and "not excessive", holding that – in these circumstances - the not-at-fault motorist has mitigated his or her loss, when in reality it is one or more third parties (e.g. his/her insurer, a credit hire provider or a repairer) that has both incurred those costs and benefitted from charging an excessive price, borne by the "at-fault" insurer. Referral fees often make up the difference between the underlying costs actually incurred and the cost that may be legally recovered in subrogation: i.e. the excessive revenues are negated by "marketing

costs" (such as referral fees) which often do not add value and have clearly led to the consumerist challenge of industry practices.

- 4.19 The legal system has therefore encouraged and provided "legitimacy" for practices that - whilst lawful under the common law - are inefficient, not in the consumer interest and indeed cause economic harm. It is clear that there is a resulting "dislocation" of the proper functioning of the market.
- 4.20 Under the common law, the at-fault party is required to put the non-fault party 'back into the position he would have been but for the accident'. Whilst the non-fault party has a duty to mitigate, that party is still entitled to recover its "reasonable" costs in being restored to his or her original position. However, whilst, in law, the innocent party is the individual motorist, the reality is that it is his or her insurer (or another intermediary, such as an accident management company or credit hire provider) that meets and then recovers these costs and is the party behind any litigation that is, if necessary, brought in the motorist's name to establish liability and recover repair, replacement vehicle and other costs. Therefore, these parties are able to recover the hypothetical 'reasonable' costs of the individual motorist, and not those actually incurred by that party. In addition, the law applies a very flexible concept of what is "reasonable". This means that almost all costs, however high and potentially including referral fees incorporated into such costs, can be - and are - accepted as being "reasonable" and end up being borne by the at fault insurer.
- 4.21 The provision of replacement vehicles on a credit hire basis at high rates is but one example of these practices, and one which has withstood many and varied legal challenges over at least the last 15 years. Furthermore, the Royal Sun Alliance repair model litigated in *Harker v Fallows Transport*² and the recent case of *Coles v Hetherton*³ confirm that the Courts are reluctant to disallow high costs for repairs and replacement vehicles, provided that they are within the "reasonable range". Other leading cases in which the Courts have found in favour of the "not at fault" motorist in cases where costs for repairs and replacement vehicles have been disputed include:
- *Bee v Jenson* (2006), in which the Court of Appeal upheld the recovery of the full costs of a replacement hire car, even though the insurers of the claimant (Bee), who had arranged the hire, had obtained a discount from the car hire company by way of commercial inducement. The Court of Appeal held that Mr Bee could recover the reasonable hire of a replacement car even though the cost of that hire had been paid directly to the hire company by his insurers rather than by Mr Bee himself

² *Fallows v Harkers Transport* [2011] EW Misc 16.

³ *Coles v Hetherton* [2012] EWHC 2848.

- *Clarke v Ardington*, in which the Court of Appeal held that the credit hire cost could not be reduced due to delays unless those delays were the fault of the claimant. This has created a situation in many cases where the beneficiary of any delay is the company managing the claim, i.e. the credit hire organisation or the accident management company. However, the "at fault" insurer cannot reduce the cost of the claim because of any delays on the part of the credit hire organisation or the accident management company unless it can prove they were the fault of the claimant. Thus the CHO or AMC benefits the more delays that there are in the process and has every incentive to cause such delays.
- *Rose v Co-operative Insurance*, in which it was held that the claimant was entitled to recover the costs of a replacement vehicle obtained from a credit hire company, even though he was entitled to a free courtesy car under the terms of his own insurance policy. The Court held that the claimant had not failed to mitigate his loss, as his entitlement under his insurance policy should not be taken into account and he was entitled to hire a vehicle on credit terms despite the availability of a courtesy car.
- *Sayce v TNT* and *Copley v Lawn*, which both concerned a situation in which the at fault party offered to provide a "free of charge" replacement vehicle, but the claimant nevertheless hired a vehicle on credit terms. In *Copley*, which was heard first, the Court of Appeal held that whilst the claimant could not claim for the costs of hiring the replacement vehicle (as, acting reasonably, she would have accepted the offer of a free vehicle and avoided the hire costs completely), she was entitled to recover the costs that the defendant would have incurred in sourcing the offered replacement vehicle. In the later case of *Sayce*, the Court of Appeal followed *Copley* and rejected TNT's claims that Mrs Sayce had failed to mitigate her loss, so allowing partial recovery by her. However, the Court expressed misgivings about the law as expressed in *Copley*, particularly as the claimant should, acting reasonably, have avoided the loss (i.e. the hire costs) altogether. Lord Justice Moore-Bick suggested that the principle laid down in *Copley* should be considered by the Supreme Court once a suitable case arose.

4.22 These judgments encourage and indeed support inappropriate behaviour amongst credit hire organisations and accident management companies, as well as insurers: they are incentivised by the current state of the common law to provide alternative transport to a claimant and to unjustifiably increase further the already excessive costs of doing so, and to recover the costs of doing so, even where a claimant has not acted reasonably in mitigating his or her losses and where the claimant has not in fact incurred all of the costs claimed in subrogation.

- 4.23 As the Court held in *Coles v Hetherton*, the "reasonableness" of a claimant's conduct and the costs incurred by him or her will be judged by what could have been obtained on the open market: "*the reasonable cost of repair is the reasonable cost to the insured and whether or not the cost of repair is lower because of RSA's bargaining power is nothing to the point*".⁴ Of course, in reality, the insured has no interest or even say in those costs, since he or she is indemnified by the insurer of the "at fault" motorist and it is plain that, in commercial reality, his or her insurer would never seek to recover those costs from the innocent motorist in the unlikely event that they were to be successfully challenged by the at-fault insurer.⁵
- 4.24 So long as the Courts continue to find that the recovery of high costs for repairs and replacement vehicles is lawful, even if they are found to be at the high end of the range of "reasonable" costs and may not reflect the actual costs incurred, there will remain no incentive for market participants including insurers, brokers, claims management companies, repairers and credit hire companies to revise their practices. Indeed, they have every incentive to continue exploiting these market failures so that they can continue generating excessive profits. Whilst all market participants should be encouraged to operate efficiently, and thereby minimise their costs, a market failure arises and leads to a distortion of competition when they are able to increase their rivals' costs. Thus, whilst a larger insurer can justifiably benefit from economies of scale that it can generate from negotiating, for example, lower repair rates, so as to reduce the costs borne by it when repairing vehicles of its own at fault insureds, it should not be permitted to raise the costs of its rival insurers in subrogating to those rivals claims of its not at fault insureds. CISGIL considers that where a subrogated claim is made for an amount in excess of the actual costs incurred, this puts the at fault insurer at a competitive disadvantage (as it pays more than the true costs of its liability) and indeed represents an implicit cross-subsidy to the non-fault insurer. Furthermore, *all insurers* are harmed when these practices are undertaken by non-insurers. We therefore agree with the Commission's observation (at paragraph 30 of the Issues Statement) that "overall, each insurer is likely to be in the fault position for some claims and in the non-fault position for other claims, which is likely to result in all costs being pushed up despite this not being in the interest of most insurers". Whilst it can accurately be described as a "prisoner's dilemma", it is indeed actually a "race to the bottom".
- 4.25 The common law principle that a not-at-fault victim of a road accident is entitled to be restored to his/her pre-accident situation is therefore being exploited - albeit in a manner

⁴ *Ibid.*, at paragraph 59.

⁵ The same is also the case in respect of credit hire vehicles. Whilst credit hire vehicles are in theory only made available to innocent motorists once it is apparent that they are not liable for the accident, there are many instances in which replacement vehicles have been made available to motorists that have in due course been found to have been "at fault" to at least some degree, so preventing recovery of the hire costs in subrogation. However, credit hire companies have - to CISGIL's knowledge - never sought to recover those costs from the motorist in question.

found by the Courts to be lawful under the common law of insurance. This results in market inefficiencies and a loss of consumer welfare. This allows for the recovery of claim costs, greatly in excess of the actual costs incurred, enhancing the revenues of those parties handling the “not-at-fault” claim, at a direct financial cost to the “at-fault” insurer and an indirect cost to all motorists. In addition, as the difference between the costs actually incurred in the management of the claim (i.e. repair and replacement vehicle) and the cost that may legally be recovered in subrogation may often reflect the referral fee paid, it is clear that third parties are recovering costs (such as referral fees) that should not in fact have been incurred in any event.

- 4.26 This feature of the PMI market and related markets means that market participants are able to generate additional revenue which supports inefficient market structures, with business models designed to generate and increase these revenue opportunities. It may also lead to excessive revenues and/or inflated costs for some market participants. It is the competitive process that exacerbates this market failure, as businesses develop purely to capture this revenue.
- 4.27 The current market structure, therefore, does not promote efficiency but instead has resulted in rising costs both for market participants and the consumer. These practices suggest a market failure that distorts and unjustifiably increases costs, distorts competition and harms consumers.
- 4.28 However, the common law system is at the very heart of the market failure that leads to consumer detriment – the courts allow excessive prices to be set. CISGIL considers that, if the courts are unable or unwilling to control these practices (as appears to be the case), it is appropriate for them to be investigated by the Commission and, if consumer harm is identified by it, to impose appropriate remedies. CISGIL would urge the Commission, therefore, to expand the issues considered under Theory of Harm 1 and to consider the role and impact of the common law system on the practices which are leading to over-pricing and over-providing.

These market features and practices have a disproportionate impact on certain geographic areas

- 4.29 The Commission should also be aware that these market features and practices are leading to disproportionate harm in certain geographical areas and consumer groups across the United Kingdom.
- 4.30 Market participants are encouraged, due to the inherent inefficiencies in the system, to exploit certain practices in certain areas and in relation to certain groups of consumers. It is clear that claims management companies focus their efforts upon economically

disadvantaged areas, in which third parties may be more likely to be persuaded to make excessive or even fraudulent claims following a road traffic accident.

- 4.31 There is significant evidence that the incidence of personal injury claims following motor accidents is higher in some areas, which are mainly areas of relatively high social deprivation. The same is true of other claims made, including for vehicle repairs and replacement vehicles. These are undoubtedly influenced by the existence of referral fees: in Scotland (where the payment of referral fees by solicitors is prohibited by the Law Society of Scotland), the incidence of whiplash claims is considerably lower than in England and Wales.
- 4.32 Independent research, published in October 2011, by the Institute and Faculty of Actuaries has shown the considerable regional variations in the proportion of private car insurance claims involving bodily injury. The leading "hot spot" is the North West of England where 43% of third party claims in 2010 involved bodily injury, with significant concentrations also in North East England and West London. The lowest region was North East Scotland where 13% of third party claims involved bodily injury. According to the Institute and Faculty of Actuaries, these "claims hotspot areas" match areas with the highest concentration and activity of claims management companies: in general, more claims management companies means more personal injury claims. They found that Scotland has the lowest proportion of private motor insurance claims involving injury to third parties, with 20% of claims in the Central Belt involving a claim for injury against a United Kingdom average of 29%. Scotland has stricter controls on referral fees, with the amounts paid being less than the rest of mainland UK, and so has far lower numbers of claims management companies operating.⁶ Other research, by the Insurance Fraud Bureau, shows that the incidence of fraudulent claims (whether for accidents that did not exist or which are "staged" for insurance fraud purposes (so-called "crash for cash") or exaggerated claims arising from genuine accidents) is also highest in these areas.
- 4.33 If personal injury claims are highest in these areas, it is also the case that other claims – e.g. for damage to property - are also highest in these areas and are being driven by the activities of claims management companies, which are incentivised by the receipt of referral fees by other companies that are able to exploit the market structure and legal system to make excessive charges by providing services that are either overpriced, unnecessary and/or overprovided. In addition, many such claims may be fraudulent and/or exaggerated.

⁶ See *New research shows wide regional variations in bodily injury claims, with North-West England the top hot spot* (19 October 2011), available at: <http://www.actuaries.org.uk/news/press-releases/articles/new-research-shows-wide-regional-variations-bodily-injury-claims-north>. The report of the Institute and Faculty of Actuaries, *Motor Third Party Working Party 2011*, is available at: <http://www.actuaries.org.uk/research-and-resources/documents/motor-third-party-working-party-2011-communications-pack>.

- 4.34 As insurance is risk based and reflects claims patterns in both geographic areas and driver groups, the increase in claims costs in these areas inevitably leads to considerably higher insurance costs for motorists in these areas (who are themselves likely to be economically disadvantaged), since most accidents occur in the insured motorist's local area. It is also a contributory cause of uninsured driving, as motorists in some areas may be 'economically uninsurable' because the insurers' risks are so considerable that the premiums are too high for motorists to afford: this in itself causes other societal issues, arising from uninsured drivers, including claims against the Motor Insurer's Bureau and unrecovered losses for property damage.
- 4.35 The Commission should take these wider effects into account when examining distortions to competition and consumer harm under Theory of Harm 1.

Role of brokers in these anti-competitive practices

- 4.36 Many PMI policies are sold through brokers. A broker will generally own the customer relationship, as the policy will be sold under its brand name, even if it is underwritten by a third party insurer. This means that the broker will usually be responsible for managing any claim, including a "non-fault" claim. Through the management of the claim, the broker is able to itself generate referral fee payments, as well as discounts and rebates, so generating additional revenues.
- 4.37 PCWs offer a low cost outlet for insurance brokers to present their products to the consumer and allow them access to a wider customer base. Insurers on a broker's panel compete against one another almost entirely on price and provide the broker with rates which are net of the broker commission. Through the use of credit hire income and referral fees, some brokers have been able to reduce their commission from policy sales and therefore reduce the retail price of their product enabling them to capture more market share.
- 4.38 In CISGIL's experience, insurers that underwrite the policies sold by brokers will only be notified where a claim is made against an at fault driver insured via a broker relationship. Often the underwriting insurer will have no control over the level of the costs of such claims and the extent to which these costs may have been raised by the payment of referral fees or credit hire schemes, some of which may have benefited the broker. The underwriting insurer will however remain liable to meet these costs. This inevitably leads to an increase PMI premiums as a whole.
- 4.39 Whilst brokers may justifiably argue that engaging in these practices simply levels the playing field and allows them to compete with direct insurers, they do raise the industry's cost level. Therefore, should the Commission identify any adverse effect on competition

from industry-wide practices, any solution or remedy must therefore encompass all market players, including brokers.

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

- 4.40 In Theory of Harm 2, the Commission is expressing the concern that the fact that the beneficiary of post-accident services is different from the party that procures those services may mean that the "not at fault" motorist is disadvantaged by being required to use a repairer or other provider other than that which he or she would choose or is receiving an inadequate service. This concern appears to extend also to at fault motorists, in both cases due to a misalignment of incentives between the procurer (i.e. the insurer) and the end consumer (i.e. the motorist) and an asymmetry of information between these parties.
- 4.41 The particular concerns identified by the Commission are that customers may not be aware of their rights in choosing the party to provide post-accident services or are directed towards services they might not ordinarily choose because the insurer states that the work will not be guaranteed or the customer must pay an excess in order to do so. For the avoidance of doubt, CISGIL's PMI policies do not require the payment of an excess in circumstances where a customer chooses not to use one of CISGIL's network of approved repairers, although the repair work undertaken by the non-approved repairer would not be guaranteed by CISGIL in those circumstances (although the consumer may still benefit from any guarantee or warranty provided by a third party, as well as protection under consumer legislation).
- 4.42 Whilst CISGIL shares the Commission's concern, it considers that the concern should not be directed at the consumer harm identified in the Issues Statement. We consider that motorists generally receive high quality repairs, particularly when using the guaranteed services of an approved repairer. The auto repair industry has - as with the auto servicing industry - historically been characterised by many "cowboy" operators, low standards of workmanship and safety, and low customer service. The use of approved repairers is designed to ensure that motorists receive high quality repair services in a sector where safety is of paramount importance and cannot be compromised.
- 4.43 As a general point, CISGIL therefore would note that insurers have played a key role in ensuring that customers involved in accidents receive, for reasons of health and safety, the best quality repairs possible to their vehicles. It is important, therefore, that insurers enter into trusted relationships with their repairers, and that they have control of these relationships in order to ensure the high quality service that is expected and required by

consumers. Approved repairer networks are one way of ensuring this. Whilst some market participants might be involved in practices that are exploiting this system and potentially leading to a poorer quality of service, CISGIL considers that in general the presence of repair networks is to the advantage of consumers. In the case of CISGIL, by operating an approved repair network, CISGIL is able to ensure that its customers (who may also be members of the Co-operative Group) receive a consistent and high-level service.

- 4.44 In relation to the Commission's comments (at paragraph 42) that consumers may be deterred from using their preferred repairer because the work may not be guaranteed under the insurance policy, CISGIL does not consider that this is an issue leading to consumer harm, at least for the individual motorist whose vehicle is being repaired (other associated practices, such as rebates, referral fees and inflated costs may do so for at-fault insurers and their insurers, as identified in Theory of Harm 1).
- 4.45 Where an insurer has an established relationship with an approved repair network it is able to offer a guarantee on that repair work. Where a consumer chooses a repairer unknown to the insurer, it follows that the insurer will be unable to guarantee the quality of that work as there will be no knowledge of the repairer or direct contractual relationship with the insurer (which is necessary both to ensure quality of the repairs and to provide protection to the insurer in the event that it is required to honour the guarantee). Where repairs are undertaken by CISGIL's approved repair network then CISGIL is able to guarantee the repairs.
- 4.46 The existence of an insurer approved repair network, therefore, adds to customer welfare as it provides an additional guarantee that would not be available if repairs were undertaken by a third party unknown to CISGIL.
- 4.47 CISGIL also notes the apparent overlap between Theory of Harm 2 and the on-going FSA/FCA "Treating Customers Fairly" initiatives to which CISGIL is fully participating and responding. In particular, CBG is currently conducting a broader review of all its processes as part of its conduct risk initiatives, including its PMI products.
- 4.48 CISGIL does, however, consider that Theory of Harm 2 should be investigated further, although not for the reason identified by the Commission. We consider that the harm does indeed arise from the beneficiary being different from the procurer of post-accident services. This is because, additionally, the procurer of post-accident services will often be different from the party (the at-fault insurer) which bears responsibility for, but cannot control, the costs incurred. As with Theory of Harm 1, this leads to unnecessary and excessive costs and to higher premiums.

Theory of Harm 3: harm due to horizontal effects (market concentration)

- 4.49 The Commission identifies possible competition concerns arising from concentration amongst insurers (in some segments) and PCWs. We consider that the overall PMI market, and its different segments are all competitive, as is competition between PCWs. We agree that no concentration concerns arise in other segments. Therefore, CISGIL is firmly of the view that there is no basis for further investigation of Theory of Harm 3.

No undue concentration between insurers

- 4.50 Although the Commission recognises that there are a considerable number of insurers providing PMI and that the market for PMI is not concentrated, it has identified a potential concerns in certain segments of the overall market, notably in Northern Ireland and for younger drivers.

Young drivers

- 4.51 CISGIL accepts that insurance premiums may appear to be higher in some market segments than others. However, this reflects the underlying risk which is naturally greater in some segments than others, for example young drivers versus more experienced drivers. This is not because of a limit in the number of insurers willing to write policies, but reflects the fact that young drivers (particularly men) have more, and more severe and thus costly, accidents than other groups. Indeed, there is no evidence of a shortage of insurers willing to insure young drivers for an appropriate, risk-based premium (which may, of course, be very high, reflecting the risk underwritten).
- 4.52 [CONFIDENTIAL] CISGIL has examined its range of products and tailored these to the different risk profiles. In particular, CISGIL has developed an innovative new product, known as the Young Driver Product, which is specifically tailored to meet the needs of CISGIL's young driver customers and, by encouraging safer driving (monitored through the use of telematics products) is designed to reduce considerably their premiums. This was introduced to the market in 2011.
- 4.53 When reviewing the performance of young drivers and the factors that impact on their level of risk CISGIL is aware that key to understanding the risk associated with this age group is their attitude to risk and their driving behaviours. It is the recognition of these factors that led CISGIL to develop the new Young Driver Product (launched in March 2011) utilising telematics technology and enabling CISGIL to measure aspects of risk previously unavailable. [CONFIDENTIAL] The product has allowed CISGIL to demonstrate, however, that it is possible to influence driving behaviour through a combination of incentives (e.g. safer driving discounts) and deterrents (e.g. penalties for dangerous driving). CISGIL considers that this is a good example of how the market can respond to market issues with new and innovative product designs.

Northern Ireland and other regions

- 4.54 CISGIL writes PMI business throughout the United Kingdom, the Channel Islands and the Isle of Man, including Northern Ireland. [CONFIDENTIAL]
- 4.55 Whilst there are a number of market participants who are active in Northern Ireland (the Issues Statement itself refers to at least 15) [CONFIDENTIAL].
- 4.56 [CONFIDENTIAL]. However, there does not appear to be any lack of competition between other insurers active in Northern Ireland.
- 4.57 CISGIL acknowledges that there is also variation in claims costs between many different geographical areas of the United Kingdom. Many claims costs increase with urban density, for example, the likelihood of having an accident and hitting another vehicle is much higher in urban towns than on rural roads or in the Scottish Islands. Northern Ireland is an exception to this general rule, and 315 road traffic injury collisions were reported per 100,000 of the population in 2010, compared to 263 in England, 197 in Scotland and 228 in Wales.⁷
- 4.58 Together within an increased cost of small personal injury claims, this in itself is likely to be a reason why insurance premiums have historically been higher than in the rest of the United Kingdom, reflecting insurers' view of risk, rather than an ability to generate excessive profits. Indeed, the small size and low profitability of the Northern Irish market may mean it is not attractive to many insurers.

PCWs

- 4.59 The United Kingdom PMI market is one of the most competitive financial services markets in the world. Aggregators, such as PCWs, help to provide a highly transparent market in which consumers can freely compare the premiums and policies offered by many PMI providers. This ability to access, view and compare a number of premiums simultaneously is a clear benefit to consumers and promotes price competition, as the OFT recently found in its study into PCWs. PCWs are thus good for competition and for consumers, even those that may decide to ultimately purchase PMI through another channel and/or from an insurer that does not list on any PCWs (such as the Direct Line brand).
- 4.60 PMI providers also benefit from PCWs, as this enables them to access customers to whom they might not ordinarily otherwise have access. There are over 100 PCWs in the United Kingdom, although there are five main ones. Google has also recently entered the market, with its acquisition of "Beat That Quote" and the subsequent launch of a price comparison service for PMI. [CONFIDENTIAL] Google's recent market entry

⁷ Department for Regional Development Northern Ireland Transport Statistics 2010-2011.

demonstrates that new entry by PCW providers is feasible and CISGIL expects that competition between PCWs will increase as a result.

- 4.61 We consider that there is not undue concentration between PCWs. They provide an important route to market and are valued by consumers. They also broke the "stranglehold" on the United Kingdom PMI market that had historically been enjoyed by a small group of large insurers and reducing barriers to entry for brokers and smaller insurers by creating a new route to access customers. However, no PCW is an essential trading partner of any insurer: all can compete effectively without being listed on a particular PCW and indeed PCWs require a broad range of product offerings in order themselves to be competitive. Therefore, cost-per-acquisition fees are established on a competitive basis.
- 4.62 CISGIL's only concerns regarding PCWs are that they encourage comparison of products solely or predominantly on price, rather than on other features such as the level of cover or service, and can also facilitate fraud. PCWs enable consumers to provide altered or manipulated information in order to secure cheaper premiums than would be justified by their correct risk profile. As price is the main factor taken into account by customers using PCWs, this means that it is important that premiums offered by insurers closely reflect the underlying risk and do not rely on cross-subsidies from one customer group to another. The focus on price - and the use of MFN clauses in this regard (which is considered in Theory of Harm 5) - may therefore stifle product innovation and lead to competition solely on price for increasingly standardised products; however, this is not the result of market concentration between PCWs, but rather their overall significance as a distribution channel for PMI in the United Kingdom.
- 4.63 Provided that PCWs are correctly and adequately regulated, CISGIL does not consider that the issues raised by the Commission in relation to PCWs in Theory of Harm 3 warrant any further investigation, especially given the obvious consumer benefits that flow from the service provided by PCWs.

Theory of Harm 4: harm arising from providers' strategies to soften competition

- 4.64 CISGIL is aware of the practices identified by the Commission in Theory of Harm 4 (i.e. strategic product differentiation, partitioned pricing and the sale of "add ons"). However, it is by no means obvious that these practices lead to a less competitive market or otherwise harm the interests of consumers. CISGIL considers that the differentiation of insurance products and the sale of 'add-ons' does not lead to a lack of transparency and excessive complexity in the sale of PMI. Therefore, there is no reason why these market features should be of particular concern to the Commission and be the subject of further detailed investigation.

- 4.65 Furthermore, CISGIL does not agree that there are significant obstacles to switching PMI provider. As noted above, the supply of PMI in the United Kingdom is highly competitive and consumers are free to change provider each year and large numbers do so, in search of the most competitive premium. This is inconsistent with the existence either of excessive pricing of certain products or barriers to switching.
- 4.66 Indeed, CISGIL considers that differentiated products, partitioned pricing and the separate sale of "add ons" benefits consumers by enabling them to purchase the combination of insurance products that best meet their needs while allowing them to benefit from the economies of scale that insurers can generate in the manufacturing, acquisition, distribution and management of different products.
- 4.67 In the specific case of sales through PCWs, PMI policies offered on PCWs are by necessity 'stripped down' products with standard features that allow easy comparison of the cover provided by different insurers and brokers, essentially by price. This has led to providers also offering 'add-on' products or services (e.g. LEI cover and breakdown cover) alongside the 'basic' insurance offering in order to provide the full choice of services and product features that consumers require.
- 4.68 Whilst the description of the cover provided by add-ons will be determined by the retailer (e.g. a PCW or a direct insurer), once the product is selected, information about the nature and cost of each of the add-ons is readily available (e.g. in a pop-up window), allowing comparison and an informed choice to be made. In CISGIL's case, all the add-on products are also sold on an "opt in" basis over the phone. [CONFIDENTIAL].
- 4.69 Furthermore, there are already extensive regulatory initiatives aimed at increasing transparency and consumer choice, which ensure that consumers are not disadvantaged. In particular, the on-going work of the FSA/FCA in this area means that the websites of both insurers and PCWs are in fact increasingly transparent, allowing customers to "shop around" and determine which products are most appropriate. These developments need time to have a positive impact and should not be overlooked by the Commission.
- 4.70 We also note that on 19 December 2012 the FSA/FCA announced the launch of a separate study into general insurance products sold as add-ons.⁸ The FCA will look at whether there are common features of the add-on markets that weaken competition and/or drive poor consumer outcomes. We expect that the motor insurance aspects of the FSA's study are likely to overlap considerably with Theory of Harm 4 and that regulatory overlap should be avoided by the Commission.

⁸ See <http://www.fsa.gov.uk/library/communication/statements/2012/gi-study>.

- 4.71 In addition, CISGIL believes that add-ons at the point at which PMI policies are sold can actually be good value for money for consumers as the incremental cost of the 'add-on' product will generally be cheaper than if it were to be sold separately on a standalone basis, due to economies of scale in in the manufacturing, acquisition, distribution and management of different products. For example, CISGIL offers breakdown cover on both a standalone and an add-on basis, with a lower price for the "add on" product as compared to the price of the standalone product, which reflects the economies of scale associated with lower policy sales and administration costs.
- 4.72 In relation to obstacles to switching, CISGIL acknowledges that automatic renewal is a feature of the PMI market (as it is for home insurance). This is, however, a benefit to many consumers as it ensures that there is no gap in insurance cover and prevents consumers (inadvertently or not) becoming uninsured. CISGIL does not consider that automatic renewal is a real point of concern that should be investigated further by the Commission, as it is not in fact a barrier to switching, as a customer is always free to cancel the automatic renewal. Similarly, CISGIL does not consider that cancellation fees (whether mid-term or end of term) or protected no claims discounts prevent customers from switching PMI provider.
- 4.73 Many customers re-assess their PMI policy at the point of renewal and decide to switch to an alternative supplier. However, the fact that customers decide to remain with a particular insurer at the point of renewal should not be seen as evidence that there are barriers to switching. High retention rates can also be explained by both competitive pricing and customer loyalty and satisfaction, and are not evidence of market failure and rigidity. In CISGIL's case, it works hard to develop a life-relationship with its customers, which can only be achieved with high levels of customer service and satisfaction, as well as competitive pricing. The high rate of renewals of CISGIL's PMI policies reflects high levels of customer satisfaction with claims handling, including the use of guaranteed repairers. Therefore, when offered with a value and service proposition, customers will positively decide to remain with their existing insurer.
- 4.74 For the reasons set out above, CISGIL does not believe that the Commission should investigate Theory of Harm 4 any further.

Theory of Harm 5: harm arising from vertical relationships (vertical integration)

- 4.75 The Commission identifies a number of possible vertical relationships that might give rise to competition concerns. In general terms, CISGIL is not unduly concerned by vertical integration in the PMI market and related markets and does not consider that vertical integration should be a particular focus of the Commission's investigation.

4.76 However, CISGIL has two concerns that it considers should be investigated in more detail by the Commission. First, CISGIL is concerned by the commercial practices of certain PCWs which require insurers to accept MFN or "best price contracts". Second, CISGIL is concerned that vertical relationships between insurers and repairers and other participants (whether by equity or contract) may facilitate and indeed exacerbate many of the anti-competitive and inefficient practices identified in respect of Theories of Harm 1 and 2.

PCWs' use of MFN and "best price" clauses

4.77 CISGIL disagrees with the Commission's indication that there is no basis for it to consider further PCWs' use of MFN and "best price" clauses. We consider that these may lead - in at least some cases - to higher prices than would otherwise be the case.

4.78 As a result of the use of MFN and "best price" clauses, PCWs have little or no incentive to innovate or differentiate between the products or services they offer on their website. For example, CISGIL is not able to agree different pricing models with PCWs depending upon the services offered by the PCW to the insurer. For instance, if a PCW developed innovative fraud controls which resulted in the risk profiling of potential customers being more firmly established, CISGIL would be interested in reaching a separate commercial agreement on price with that PCW. Currently, this is not possible – where an MFN exists, CISGIL must offer its best price to the PCW. This is not a hypothetical issue. As the Commission correctly identifies, there is a greater risk of fraud in an insurance contract concluded using a PCW. However, that risk varies according to the different PCWs. If a PCW has higher fraud detection standards than other PCWs, then this would justify a lower premium for consumers using that PCW than if they used another PCW.

4.79 MFN clauses also harm competition by preventing an insurer from offering a lower premium on its own direct sales website, even though the risks incurred (e.g. as to fraud) could be identified more precisely on the insurer's own website, thus leading to a lower premium.

4.80 The effect of the MFN clause is therefore to dampen competition between PCWs and also between PCWs and insurers' own websites and other direct sales channels, to the detriment of consumers. For this reason, CISGIL would encourage the Commission to continue its investigation into MFN clauses.

Vertical integration between insurers and repairers and other service providers

4.81 CISGIL further notes that under Theory of Harm 5 the Commission proposes to investigate the vertical relationships between repairers and insurers. CISGIL notes that the matters discussed under this section are also connected to issues to be investigated under Theories of Harm 1 and 2, as these vertical relationships increase the insurer's

control over the value chain and in some circumstances may be used to generate excess revenues and pass the related costs on to another insurer in subrogation. CISGIL's approach of treating both fault and non-fault claims equally avoids such issues. We also note that the Commission should also investigate vertical relationships between insurers and other participants, including vehicle providers and claims management organisations.

- 4.82 Vertical relationships can be established either by insurers acquiring repairer businesses (for example the Royal Sun Alliance and Direct Line model) or through a series of vertical contractual relationships. CISGIL is not concerned about market participants establishing repairer networks, which can have quality and service benefits for consumers (in terms of vehicle repairs and the overall "claims experience") and allow insurers to actively control and minimise repair costs, and benefit from exploiting economics of scale, thus promoting efficiency. This may then be passed on to their own insureds through lower premiums.
- 4.83 However, ownership or control of such networks could lead to competition issues where insurers can use the vertical relationship to increase subrogated claims costs borne by rival insurers, not least because vertically integrated insurers have the ability and may have the incentive to include unjustified and unnecessary overheads or cost inefficiencies (so increasing their revenues), which it would be difficult or even impossible for a third party at fault insurer to challenge. The same concerns can, in principle, arise from other vertical relationships.
- 4.84 CISGIL considers that a market failure arises and leads to a distortion of competition when insurers (and other intermediaries) are able to increase their rivals' costs. Whilst a larger insurer can justifiably benefit from economies of scale that it can generate from negotiating lower repair rates, so as to reduce the costs borne by it when repairing vehicles of its own at fault insureds, it should not be permitted to raise the costs of its rival insurers in subrogating to those rivals claims of its not at fault insureds. Where a subrogated claim is made for an amount in excess of the actual costs incurred by the non-fault insurer, this puts the at fault insurer at a competitive disadvantage (as it pays more than the true costs of its liability) and indeed represents an implicit cross-subsidy to the non-fault insurer. Indeed, these practices are likely to disadvantage *all insurers*, since each insurer will be the at fault insurer for some claims and the non-fault insurer for other claims. Instead of seeking to generate a short-term increase in revenues by disadvantaging other insurers, all insurers should look to minimise costs across the industry as a whole by only subrogating the net costs actually incurred by them (as is CISGIL's practice). The alternative is a perpetuation and indeed acceleration of the current "race to the bottom" in which individual insurers seek to maximise individual

revenues, even though this inflates overall costs at the industry level, distorts competition between individual insurers and harms consumers' interests.

- 4.85 CISGIL would therefore encourage the Commission to investigate further these practices, and the potential for vertical relationships to facilitate anti-competitive practices, as part of its investigation into Theory of Harm 1.

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