LLOYD'S MARKET ASSOCIATION

Suite 426
Gallery 4
One Lime Street
London EC3M 7DQ

Tel. 020 7327 3333
Fax. 020 7327 4443
lma@lmalloyds.com
www.lmalloyds.com

Inquiry Manager
PMI Market Investigation
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

9 January 2013

LMA response to Statement of Issues

The Lloyd's insurance market underwrites insurance business from over 200 countries and territories worldwide. In 2011, premium capacity was in excess of £23 billion.

The Lloyd's Market Association (LMA) represents all the managing agents at Lloyd's, which manage the syndicates underwriting in the market, and also the members' agents, which act for third party capital. We appreciate the opportunity given to us by the Competition Commission to respond to this important issue. Whilst this response is distilled from the views of our members, the views of individual members may differ.

Summary

We are supportive of this investigation, and are looking forward to cooperating with the Competition Commission's inquiry into this issue.

Our view is that the first Theory of Harm is the critical area; the separation of the liability for cost from the ability to control costs in motor claims. It is also our view that significant structural reform is necessary to remove the layer of unnecessary cost that has emerged in the PMI market over the last 10-15 years; the existing mitigations are helpful but ultimately inadequate in lowering costs faced by insurers.

Please see below for our views on the Theories of Harm set out below.

Theory of Harm 1: Separation of Cost Liability and Cost Control

ToH 1 addresses the main issue, and should receive the vast majority of resource in investigating.

Regarding mitigation of this harm, existing arrangements (such as bilateral agreements to reduce costs) are helpful but ultimately inadequate as mitigation *per se* can never remove a layer of unnecessary cost – significant structural reform is needed. Our initial preference (pending the outcome of this inquiry) is likely to be a compulsory 1st party cover for replacement vehicles, introduced via a change in primary legislation to the Road Traffic Act 1988.

We would like to highlight the potential for cost reduction arising from the recent LASPO Act may be circumvented by insurers and brokers adopting Alternative Business Structures (ABS) to own a solicitor, thereby continuing the separation of cost liability and cost control. The same issue could arise in respect of referral fees being preserved where a solicitor and an Accident Management Company form a joint ABS.

Payment of referral fees in non-PI cases (ref para 21, p5) is not desirable, for exactly the same reasons as it is not desirable in PI cases, and should also be banned. Our understanding is that this may be possible via secondary changes to the Civil Procedure Rules.

Theory of Harm 2:

Our assessment of ToH 2 is that it is largely an expanded restatement of ToH 1. It may well be true that customers are not aware when making a non-fault claim whether the party assisting them is seeking to minimise costs, or maximise costs. However this is essentially a symptom of the issues arising under ToH 1, and we suggest it can only be addressed by significant structural reform.

A key point for us is that the focus of investigation in this area should not solely be on service quality received by a claimant, given quality is, to a large extent, a function of cost, and also perception. Given the law requires motorists to insure their liabilities to others; surely it also ought to specify that systems designed to satisfy those liabilities ought to be made on a low-cost basis?

It is our view that the focus should really be on seeking ways to reduce costs, whilst providing a good standard of service. For example, take a scenario where a replacement car was not needed by a claimant, as the minor repair to their own vehicle could be done very quickly and they could easily manage without their car for a few days. An accident management company may well provide a replacement vehicle anyway, typically for c20 days. In this circumstance the claimant may feel that they have had an excellent service despite considerable unnecessary cost being incurred, ultimately falling to consumers in the form of higher premiums. For this reason it is essential that the control of costs is retained by the funding party.

NB We believe that that there is strong evidence of some insurers using separate repair processes for fault and non-fault claims, for example as evidenced in *Fallows v Harkers Transport*[1].

Theory of Harm 3:

It is our view that competition in general in the UK PMI market is intense, and that most customers can easily access an extremely wide a choice of provider, and also influence the coverage and cost of the product with the various buying options made available (setting of excess levels for example). In customer segments where choice is more restricted, this is generally a product of extremely poor historical performance of insurance products,

[1] [2011] EW Misc 16

forcing insurers to withdraw. This is a natural function of a market using risk-based pricing (which offers myriad benefits to consumers such as rewarding safe driving). Customers presenting very high risks (for example) can expect, in a free market, to face less choice and higher costs, reflecting their risk profile. The other side of the same coin is that customers presenting low risks can expect a high degree of choice and lower costs. Any adjustment to assist high-risk customers is likely to be made at the expense of low-risk customers, and may also damage the wider societal benefits of risk-pricing, such as compromising road safety leading to an increase in accidents.

Theory of Harm 4:

It is our view that the issues covered in ToH 4 are not likely to be creating harm to consumers. The degree of product differentiation in PMI is actually fairly narrow, given the basic structure of the contract is set out in statute, and as a result the product is largely commoditised.

There are a very large number of providers. Search costs for consumers are extremely low. Significant distribution is now managed via the internet, which is available 24 hours a day. Switching provider is easy and commonplace.

We agree that the FSA/FCA is best placed to consider complexity and transparency in the sale of PMI. We also feel that the FSA/FCA are best placed to consider other issues related to the sale of PMI and associated products, given these are primarily issues of conduct.

Theory of Harm 5:

i) **PCW market power**. PCWs are very popular with consumers. They now account for more than half of all new policies sold. They now outspend insurers on television and internet marketing and have established an extremely strong position in the distribution chain. As insurers effectively have to sell through PCWs in order to compete, they have very limited bargaining power over whatever Cost Per Acquisition (CPA) the PCW wants. This in turn will be passed on to the customer in their premiums and cancellation fees. As there are only four major PCWs there is not a great deal of competition between them in terms of CPA charges to insurers.

ii) **Vertical integration**. Although there may be no evidence that vertically integrated PCWs abuse their power to get information on competitors' quotes, there is evidence that PCW CPA fees vary significantly between insurance companies. If vertically integrated businesses offer lower CPAs to either their own brands or to large insurers with multiple brands, this will have the effect of limiting competition and artificially inflating some insurers' prices for customers (non vertically integrated insurers or smaller insurers). This has the effect of limiting competition.

iii) **MFN clauses.** These clauses seem problematic. Some PCWs insist on insurers signing a MFN clause. This means that where an insurer has lower costs due to a lower CPA fee (or as a result of customers coming directly to the insurer), the customer can end up paying more than they need to. This may harm competition between PCWs, by reducing their incentive to offer value. In fact, by charging a higher CPA, they can spend more on marketing, strengthen their power and then increase CPA fees more. There is no incentive for PCWs to not increase prices, as they face no competitive disadvantage by forcing up CPAs. Indeed the PCW with the highest CPA will become the market price setter because of the MFN clause.

iv) **Insurer-parts/paints manufacturer/distributor relationships.** We believe that the net cost is not always passed on to the at fault insurer. In effect any parts / paint rebate negotiated is driving cost into the claims process and as a result such agreements could be considered in the same terms as ToH 1.

Please contact:

David Powell
Manager - Underwriting
Lloyd's Market Association

0207 327 8399
david.powell@lmalloyds.com