



Private Motor Insurance Market Investigation

Response to Issues Statement

Royal & Sun Alliance Insurance Plc

Chapters

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A. Executive Summary

- 1.1 Royal & Sun Alliance Insurance Plc ("RSA") welcomes the opportunity to participate in the Competition Commission's ("CC") market investigation into private motor insurance ("PMI") in the UK and welcomes the broad review undertaken by the CC and reflected in its subsequently comprehensive Statement of Issues ("SOI"). In particular, we endorse any approach which aims to ensure a sustainable, well-functioning and highly competitive market focused on delivering high quality PMI services to customers at competitive prices.
- 1.2 RSA supports the continued focus of the CC's investigation on the main issues identified previously by the OFT, namely the costs associated with credit hire and third party repairs which are detailed in the SOI, principally in Theory of Harm 1 ("TOH1") and also (although to a lesser extent) in Theory of Harm 2 ("TOH2"). However, as set out in more detail below, we would be concerned if Theories of Harm 3, 4 and 5 ("TOH3", "TOH4" and "TOH5") were not quickly dismissed by the CC. Such an approach will ensure a focused review on the core areas for concern, namely those identified by the OFT.
- 1.3 RSA also welcomes the recognition given by the CC to the on-going regulatory process undertaken by the Ministry of Justice ("MoJ") in respect of Bodily Injury ("BI") claims costs and the CC's decision not to intervene in this process. As will be clear from the submissions to the OFT (and indeed from the OFT's conclusions themselves), increased BI claims costs are the key driver behind increases in premiums. Whilst it is essential to ensure consistency with the MoJ review (given the need for a comprehensive solution), we agree with the CC that the MoJ process and timetable of reforms should be allowed to proceed as planned and without delay.
- 1.4 We believe that TOH1 and TOH2, concerning the costs and quality of credit hire and third party repair provision, should be the primary focus of the CC's investigation. The law permits insurers and non-insurers acting for not-at-fault ("NAF") drivers to earn a margin on credit hire and third party repair costs. Where insurers control the claims process, the benefit of such margins will ultimately be passed through to customers in the form of lower premiums. However, increased costs in the system are likely also to be passed through in the form of higher premiums. Overall, RSA agrees with the CC that the net effect on premiums of margins on credit hire and third party repair costs is likely to be upwards due to the increasing intervention of third parties (i.e. non-insurers) in the claims process. The potential harm arising from this mechanism, referred to as 'leakage', as well as via 'frictional costs' related to the available margins, is discussed in detail in Chapter B below.
- 1.5 Whilst RSA considers that the issues raised by TOH1 and, to a lesser extent, TOH2 are worthy of investigation by the CC, we do not believe that the focus of the CC's attention should be distracted further by any of the issues raised under TOH3, TOH4 and TOH5.
- 1.6 As the OFT has recognised, the PMI market is highly competitive and highly transparent. Customers can choose from a large number of PMI providers, and avail themselves of a number of tools to evaluate and switch between insurers. The market is working well in respect of providing customers with a wide choice of insurance products that can be tailored to their specific needs. Furthermore, given the absence of market power at any level of the PMI supply chain, there is no credible prospect (and no evidence) of vertical integration giving rise to adverse effects on competition (an "AEC").
- 1.7 As is explained in further detail in Chapter B below, the Financial Services Authority ("FSA") or its successor, the Financial Conduct Authority ("FCA"), are already considering many of the issues around transparency and consumer awareness the CC raises in TOH3, TOH4

and TOH5¹. As with BI, it is essential that consideration of these issues is consistent and joined-up and the FSA/FCA is best placed to consider all of the issues identified in these three theories of harm. We therefore believe that the FSA/FCA should be left to continue its important work of ensuring that insurers deliver clear, transparent, fair and not misleading communications to customers. Accordingly, RSA believes that the CC's investigation should focus only on those issues identified by TOH1 and TOH2.

- 1.8 Indeed, RSA believes that the core focus of the CC's investigation should be to understand, quantify and address the question of additional costs that have been created by the present claims process and which have resulted in upwards pressure on premiums and other inefficiencies that are detrimental to consumers. Even having excluded BI from the scope of its investigation, the OFT identified that these additional costs could be as high as £225 million per year in total².
- 1.9 RSA welcomes the CC's recognition of the steps the industry has taken to seek to resolve or mitigate the issues identified by the CC and the OFT (most notably, through bilateral agreements which seek to keep the costs of claims down, with the expectation that this will place downward pressure on premiums). Nonetheless, whilst RSA has actively participated in this process (having already entered into a number of bilateral agreements, with others under negotiation³), RSA accepts that there are limitations to what can be achieved through bilateral agreements alone.
- 1.10 At Chapter C below, we have identified the core issues which we believe should be addressed as a result of the CC's investigation, together with an assessment of the key principles which we consider must underpin any such outcome. We believe that this should be aimed at delivering a better result for customers. This requires a balancing of the need to reduce costs (and hence premiums) whilst maintaining service levels to ensure that customers receive appropriate redress consistent with their legal rights.
- 1.11 We believe that a package of remedies could be identified to deliver a sufficiently comprehensive solution. Such a package of remedies might include all or some of the following elements: judicial or legislative reform to lower the appropriate benchmark against which NAF claims are assessed for reasonableness; remedies aimed at raising consumer awareness of key rights; enhanced bilateral agreements between insurers.

Conclusion

1.12 In summary:

- We are generally supportive of the CC's approach in TOH1 and TOH2 and welcome any focus on the core issues of addressing the increased costs arising from third party intervention;
- We welcome the approach adopted by the CC with regards to BI and would like to see a consistent approach adopted with those areas currently the focus of FSA/FCA review;

¹ For example, see the FSA's statement published on 19 December 2012 which announces its add-on general insurance market study: <http://www.fsa.gov.uk/library/communication/statements/2012/gi-study>.

² OFT Report, 'Private Motor Insurance: Decision to make a market investigation reference' (September 2012), paragraphs 2.10, 2.20, 3.18 and 4.10.

³ A summary of the provisions of RSA's bilateral agreements, copies of those agreements and a list of the insurers with whom RSA is currently discussing bilateral arrangements are all provided in RSA's response to the CC's Initial Questions (see response to Question 15).

- We would be concerned if the CC's investigation were to become distracted by the issues identified in TOH3, TOH4 and TOH5 and hope that the CC moves swiftly to dismiss any concerns under these headings;
- We would like to see the CC's investigation focus on outcomes which will help to deliver value back to customers by removing many of the additional costs from the claims process, whilst ensuring a level playing field which protects what is a highly competitive and vibrant market for PMI; and
- Ultimately, we would like to see the outcome of the CC's investigation give rise to a comprehensive solution which:
 - Protects a NAF customer's legal entitlement to full rectification;
 - Maintains and enhances the service levels NAF customers receive when they make a claim, including speeding up the claims process and assessment of liability whilst reducing the scope for disputed claims;
 - Gives more control over cost to the AF insurer who will ultimately be liable for the final bill; and
 - Reduces the overall cost (including frictional costs), whilst protecting customer service levels.
- We consider that additional costs arising out of the provision of TRVs account for the majority of the costs identified by the OFT. One possible option the CC may wish to consider further is whether enshrining the legal entitlement of a NAF claimant to full rectification (which as regards a mobility solution will usually mean the provision of a like-for-like TRV) within the minimum policy benefits of all PMI policies in the UK might address many of the issues identified by the CC in TOH1 and TOH2 and by the OFT previously in its market study.

1.13 RSA looks forward to continuing to engage constructively with the CC over the course of its market investigation and wishes to help the CC to deliver a lasting and thorough industry-wide solution. Such a solution should seek to remove unnecessary and incidental costs and to increase the level of trust between the customer and PMI providers by protecting customer choice and to deliver the highest quality of services more simply, more transparently and at better prices.

B. Response to Theories of Harm

An overview of the routes to market for PMI products is set out in Annex 1 to RSA's response to the CC's Ten Priority Questions.

1. TOH 1: Potential harm arising from the separation of cost liability and cost control

1.1 TOH1 looks at issues arising from the separation of cost liability and cost control, with the CC first addressing the legal position and the interaction with BI claims.

1.2 As the CC will be aware from its submissions to the OFT, RSA supports the findings of the OFT that BI claims are the key factor in increased costs overall. However, reforms are in progress to address many of these issues and we believe that it is essential that this reform process is not delayed or otherwise inhibited by the CC's investigation. RSA consequently welcomes the consideration given by the CC to the on-going regulatory process undertaken by the MoJ. Whilst there will be a need to ensure consistency between the MoJ reforms and the CC's investigation, we therefore agree with and welcome the CC's proposal to exclude BI from the investigation.

1.3 RSA also believes that the primary focus of the CC's investigation should be the incentives that arise to capture the margin available when controlling NAF claims. As the CC notes, this was the focus of the OFT's investigation. In making its reference, the OFT estimated that harm to consumers could be significant, with premiums potentially being £225 million higher overall than necessary as a result of additional costs in the claims process, principally through the provision of temporary replacement vehicles ("TRVs") and repairs⁴. There are therefore potentially significant savings to be made from addressing those areas of the claims process which are not currently functioning in the best interests of consumers.

Incentives arising in relation to NAF claims

1.4 The CC has recognised that NAF claims give rise to a separation between cost liability and cost control, and that this separation may give rise to distortions within the insurance industry. We agree that this is the nub of the problem. The key issue to address is how to ensure that at-fault ("AF") insurers (i.e. those ultimately responsible for paying the final bill) have appropriate incentives and sufficient control over claims costs whilst ensuring that NAF claimants receive the level of service they are legally entitled to expect when they are involved in an accident.

1.5 The law entitles a NAF claimant to be placed back into their pre-accident state, with the AF insurer being liable for the costs of rectifying the harm and compensating any losses suffered by the NAF claimant. In doing so, however, the AF insurer will (unless it is able to 'capture' the NAF claim) have little control⁵ over the means by which, and therefore the cost at which, the NAF claimant's losses are redressed. This lack of control may lead to the AF insurer paying a higher cost to address the NAF claimant's losses than would have been the case if the AF insurer had directly controlled the rectification of the loss.

1.6 The CC has suggested that this may give rise to two potentially negative effects:

⁴ OFT Report, '*Private Motor Insurance: Decision to make a market investigation reference*' (September 2012), paragraphs 2.10, 2.20, 3.18 and 4.10.

⁵ Any control is limited to the ultimate sanction of litigation in the courts to settle disputes over what amounts to a 'reasonable' claim.

- (i) There may be little incentive on service providers to a NAF claimant to compete on price and hence the costs of providing repair and TRV services could be higher than necessary ('over-pricing'); and
- (ii) There may be an incentive to 'over-provide' or 'gold plate' services (for example to provide higher specification TRVs than may be necessary or desired, to provide vehicles for longer than requested, or even to provide them when no vehicle was necessary or even desired)⁶.

- 1.7 It is essential that the CC considers the recovery of NAF claims in the context of the prevailing legal framework⁷. The law permits recovery at higher rates than actual costs, subject to the constraint that the total value of the claim must be 'reasonable'. Thus, under the current law, insurers (and other third parties) acting for NAF claimants are legally entitled to retain a margin on NAF claims if they are able to procure services for less than the reasonable amount that a consumer would have to pay for those services.
- 1.8 The CC has suggested that insurers may seek to gain a competitive advantage over rivals by increasing the costs of NAF claims⁸. RSA strongly disagrees that the observed margins on NAF claims reflect strategic behaviour by insurers attempting to disadvantage their rivals. As stated above, the margin on NAF claims is limited by the legal requirement that the claims value be 'reasonable'. Any entity controlling a NAF claim (whether an insurer or not) has a simple profit-seeking incentive to set the value of the claim at the defined 'reasonable' maximum. That being so, there is no additional scope for an insurer to increase the claim value further in order to raise its rivals' costs. The margins observed on NAF claims are therefore simply a reflection of the legal framework, not of strategic behaviour by insurers. Where we control the claim, we are able to deliver cost savings by managing the supply chain more effectively, whilst ensuring that customers receive better service.
- 1.9 In fact, the existence of a legally permitted margin between 'reasonable' and 'actual' costs is unlikely to have any AEC, subject to two exceptions (concerning 'leakage'⁹ and 'frictional costs'¹⁰) which are discussed below.
- 1.10 The existence of a margin between 'reasonable' and 'actual' NAF claims costs will increase the size of payments made from AF insurers to those parties controlling NAF claims (i.e. because the AF insurer is not simply paying the NAF claims controller's actual costs, but also their reasonable margin in addition). This increased cost of NAF claims will increase the marginal cost to insurers of underwriting customers who become AF drivers, which will, in turn, place upward pressure on customer premiums.
- 1.11 Critically, however, where an insurer's customers become involved in NAF incidents (and the insurer is able to retain control of the customer's claim), it will receive that same margin between 'reasonable' and 'actual' costs. This serves to reduce the marginal cost of underwriting customers who become NAF drivers, creating an incentive for insurers to reduce premiums.

⁶ SOI, paragraph 27.

⁷ *Coles v Hetherington*, [2012] EWHC 1599 (Comm).

⁸ SOI, paragraph 29.

⁹ References to 'leakage' refer to the margin that will be captured by any non-insurer third party who has successfully intervened in the claims process and captured one or more elements of the NAF claim. This margin will inevitably exit the market as a net cost to insurers where it is captured by a non-insurer (in contrast to the neutral impact observed where the claim is controlled entirely by an insurer).

¹⁰ References to 'frictional costs' refer to the additional costs incurred by insurers seeking to capture NAF claims (in order to capture the margin), including defending attempts by non-insurer third parties to intervene in the claims process and all costs of challenging inflated claims.

- 1.12 The existence of margins on NAF claims therefore has two offsetting effects on insurers' costs: an increase in insurers' costs where their customers are involved in AF incidents; and a decrease in their costs where they control their customers' NAF claims. Given the degree of competition observed in the supply of PMI (see further response to TOH3 below), both of these cost effects can be expected to be passed through to customers via higher and lower prices, respectively. Crucially, if only insurers are involved in the NAF claims recovery process, then the aggregate value of the increased costs faced by insurers will be exactly equal to the aggregate value of decreased costs. In this situation, the two effects will be likely to cancel out and have no net impact on costs and therefore PMI premiums¹¹.
- 1.13 In summary, the ability for insurers to make a margin on NAF claims is both enshrined in, and constrained by, the applicable legal framework. Furthermore, for so long as insurers are both bearing the cost and the benefit of that margin, this is unlikely to have any net effect on premiums.
- 1.14 However, RSA agrees with the CC that the current framework for the recovery of NAF claims may nonetheless give rise to distortions in practice. RSA believes that the CC should focus on two such distortions:
- (i) The 'leakage' that occurs when non-insurers intervene in the NAF claims process and are able to capture the available margin; and
 - (ii) The 'frictional costs' arising as a result of efforts to capture NAF claims in order to earn the available margin, to defend attempts by non-insurer third parties to take over claims and/or the costs of recovering disputed AF claims from other insurers¹².

Leakage of NAF claims margin

- 1.15 As explained above, insurers can expect to benefit from the permitted margin on NAF claims that they control to the same extent that they bear the cost of that margin where their customers are AF. Assuming that insurers are likely overall to be NAF (and therefore benefitting from the margin) at least as often as they are AF (and therefore paying the additional costs), this should have a neutral overall impact on costs and therefore prices¹³.
- 1.16 This can be contrasted to the situation where the NAF claims are captured by non-insurers. In these cases, the value of the permitted margin will 'leak' out of the insurance industry. Furthermore, whilst the highly competitive nature of the PMI market in the UK gives insurers an incentive to pass the value of these margins on to customers in the form of lower premiums, there are no such incentives or mechanisms for non-insurers to pass the value of those margins on to consumers.
- 1.17 In other words, where non-insurers have captured a NAF claim, the AF insurer will bear 100% of the cost of the permissible NAF margin, whilst receiving less (often significantly less) than 100% of the associated benefit. The cost and benefit of the NAF claim no longer cancel out, meaning that the net effect will be to raise insurers' costs, leading to a net incentive to raise PMI premiums.
- 1.18 Although focused on referral fees alone, the CC recognised the net upward impact on premiums of such 'leakage' via non-insurers at paragraph 32 of the SOI. In practice,

¹¹ See further section 6 to RSA's Overview Submission to the OFT (February 2012).

¹² OFT, 'Private Motor Insurance: Report on the market study and proposed decision to make a market investigation reference' (May 2012), paragraph 5.1 and see further section 5 of RSA's Response to the Proposed Market Investigation Reference (July 2012).

¹³ RSA's Overview Submission to the OFT (February 2012), paragraph 6.10.

however, this leakage will apply not only to referral fees, but more generally to the margins on NAF claims permitted by the prevailing legal framework. The value of such 'leakage' is far from trivial. At section 8 of its Overview Submission to the OFT, RSA sought to estimate the additional costs for both repairs and the provision of TRVs by estimating differences in RSA's actual costs (where it controls the claim) and average costs where RSA has insured the AF driver and NAF costs are subrogated back to it. This is summarised below:

- (i) For repairs, RSA estimated that the average mark-up on third party repair costs was around ~~XX~~% when comparing the average cost of a repair managed by a third party to the average cost of a repair managed by RSA;
- (ii) For TRVs, RSA estimated that the average mark-up on costs of providing TRVs was around ~~XX~~% when comparing the average daily charge rates for TRVs provided by RSA to the average daily rates subrogated to RSA. Similarly, GTA credit hire rates are on average just over 2.5 times higher for like-for-like vehicles compared to RSA's buy rates, with some classes of car as much as 4.5 times more expensive¹⁴; and
- (iii) Taking these figures as a proxy for the 'margin' which RSA is effectively paying in increased costs and applying them to RSA's cost of claims for 2011 suggested additional costs to RSA of ~~£XX~~, of which ~~£XX~~ was estimated to be paid out to non-insurer third parties¹⁵. Of this ~~£XX~~, an estimated ~~£XX~~ (that is, around 75%) was accounted for by TRV costs.

1.19 Reflecting RSA's c.5% share of the UK PMI market and looking only at margin not captured by insurers (and hence only those costs that place upwards pressure on premiums), this suggests a total margin earned by non-insurer third parties of around ~~£XX~~, of which just under ~~£XX~~ can be attributed to the additional margin earned in the provision of TRVs.

1.20 Whilst we recognise that not all of this estimated £332m will be retained by non-insurers (as a result of profit share arrangements, referral fees and other benefits in kind), we nevertheless believe that understanding and reducing these costs should be the CC's principal focus as this will have the biggest and most direct beneficial effect on customer premiums.

Frictional costs

1.21 The second potential distortion introduced by the prevailing legal framework for the recovery of NAF claims is the creation of 'frictional' costs associated with behaviour related to the legally permitted margins. This behaviour includes frictional costs associated with insurers trying to 'capture' claims early in the process, to defend attempts by non-insurer third parties to take over claims and/or the costs of recovering disputed AF claims from other insurers¹⁶.

1.22 Within RSA, the most obvious manifestation of frictional costs arising from non-insurer third party intervention, is our third party property damage team, which is tasked with identifying relevant NAF third parties and offering our services directly to them and managing our third party property damage costs. The RSA team is currently staffed by at least ~~XX~~ full time equivalent employees devoted to PMI, including fraud, at an annual cost of ~~£XX~~. Moreover, these figures do not reflect the costs of other staff involved in the capture, administrative management and dispute of claims.

¹⁴ See Table 1 at paragraph 1.10 of Chapter C.

¹⁵ Overview Submission to the OFT, paragraphs 8.12-8.15. This figure also reflected only the costs paid.

¹⁶ RSA's Response to the Proposed Market Investigation Reference (July 2012), paragraph 5.1.

- 1.23 More generally, the upper bound for the aggregate industry cost of efforts by insurers and non-insurers to capture NAF claims is likely to be the value of the margin available on those claims (i.e. the difference between actual and reasonable costs permitted under the prevailing legal framework). RSA's Overview Submission to the OFT estimated the value of the 'reasonable' NAF claim margin on repair costs to be around £[redacted] per incident, while the equivalent figure for TRV provision was around £[redacted] per incident¹⁷. RSA also estimated that around [redacted]% of third party claims made against it involved claims for TRVs¹⁸. Assuming that a similar ratio applies across the industry as a whole, this implies an average NAF 'reasonable' margin value, and therefore upper bound for the value of frictional costs related to NAF claims capture, of £[redacted] per incident.
- 1.24 Given the often significant variation between the sum claimed by the third party and the paying insurer's perception of actual cost, significant scope has also arisen for disputes on settlement of invoices. This results not only in frictional costs to pursue and defend claims (including the costs of challenging inflated claims), but delay and inefficiencies in the processing of claims and a significant additional burden on the Courts.

Mitigation measures

- 1.25 RSA agrees with the CC's assertion at paragraph 33 of the SOI that if the problem of separation of cost liability from cost control did not exist, there would be no need to consider alternative mitigation methods. However, short of mandating that AF insurers control 100% of all claims for which they are ultimately responsible (which would also require safeguards to ensure that NAF claimants receive the level and quality of service to which they are legally entitled), RSA sees mitigation measures as important steps taken by the industry to seek to lower claims costs. Indeed, RSA welcomes the CC's recognition of industry attempts to mitigate the impact of increased costs, including bilateral agreements, the GTA and claims capture.
- 1.26 A summary of the provisions of RSA's bilateral agreements, copies of those agreements and a list of the insurers with whom RSA is currently discussing bilateral arrangements are all provided in RSA's response to the CC's Initial Questions (see response to Question 15).
- 1.27 In addition, RSA has recently entered into a new arrangement with Enterprise Rent-a-Car ("ERAC") whereby ERAC has replaced Auto Indemnity Claims Solutions (UK) Ltd as RSA's exclusive provider of TRVs to NAF drivers. This arrangement also has a number of features similar to bilaterals aimed at reducing hire costs and reducing the potential for disputed TRV claims between insurers (and is discussed further in RSA's response to the CC's Initial Questions). RSA believes that this arrangement offers significant additional benefits over the GTA, delivering far lower hire costs¹⁹. Indeed, the GTA is a voluntary protocol which is not adopted by all insurers, making it both difficult to apply and not conducive to ensuring a level playing field for all market participants.
- 1.28 RSA considers that bilateral agreements play an important role in reducing costs and that they serve as a model for cost efficiency between insurers. They will also significantly reduce the prospect of litigation between participating insurers by effectively pre-agreeing the principles and in some cases maximum charges that can be recovered when claims are subrogated between participating insurers. There are therefore clear customer benefits

¹⁷ RSA's Overview Submission to the OFT (February 2012), paragraphs 8.6 and 8.10.

¹⁸ In 2011, [redacted] claims involving repairs were made against RSA and [redacted] claims involving TRVs. See RSA's response to question A1 of the OFT's Section 174 Notice.

¹⁹ RSA notes that some GTA charges are up to four and a half times the RSA buy-in price (see further Chapter C below). The GTA can therefore operate as a useful cap on excessive hire costs, but is not a viable long-term solution to eliminate additional costs.

from bilateral agreements, which offer security and quality of service and ultimately the potential for lower premiums as costs are reduced.

- 1.29 Although bilateral agreements between insurers cannot address the issue of margin 'leakage' via the intervention of non-insurers, RSA nevertheless considers that they represent an important means of reducing the frictional costs associated with disputing claims by minimising the scope for claims disputes between insurers²⁰. Nonetheless, RSA acknowledges that bilateral agreements are not a panacea. Only by focusing on reducing costs from the system can the CC achieve lasting reductions in consumer premiums (something which the MoJ has recognised in its reform proposals). RSA sees a role to be played by bilaterals in achieving that aim (see further Chapter C).

Conclusion on TOH1

- 1.30 RSA broadly agrees with the CC that there is potential for harm arising from the separation of cost liability and cost control and would like to see the CC focus its investigation on addressing these issues in order to lower costs and ultimately to deliver value back to customers in the form of lower premiums.

2. TOH 2: Potential harm arising from the beneficiary of post-accident services being different from the procurer of those services

- 2.1 TOH2 considers whether there is the potential for consumer harm to arise from the fact that the beneficiary of post-accident services is different from the procurer of those services. This may permit the party dealing with the claimant to provide a lower standard of service than that which the claimant ought to receive to ensure they are properly restituted in a reasonable manner.

- 2.2 The CC ultimately summarises the possible harm as arising out of two potential consequences of insufficient consumer awareness:

- (i) A lack of transparency resulting in consumers being unaware of their rights and therefore potentially making poor choices when selecting parties to provide post-accident services; and
- (ii) A restriction on consumer choice, for example a customer might be directed towards using the insurer's approved repairer rather than a repairer of the customer's choice by only guaranteeing repairs within that network, or by asking the customer to pay any excess up-front²¹ in respect of out-of-network repairs.

- 2.3 RSA notes that the CC does not provide any evidence of claimants being under-served or mis-served by either insurers or non-insurers (rather, TOH1 suggests that such claimants may in fact be over-provided for). Nonetheless, RSA acknowledges that, where insurers are not controlling the claim, there is a risk that claimants may not always receive the most appropriate service to which they are entitled and agrees that this is an area that the CC should investigate further, albeit with less focus than on TOH1. For our part, we are focused on providing services to all of our customers that maximise the speed, efficiency and overall cost management of a claim, ensuring that customers receive a service which meets or exceeds that to which they are entitled. However, it is essential that these issues are addressed as part of a comprehensive package.

²⁰ The bilateral agreements do not, however, reduce the costs to insurers of their efforts to capture claims.

²¹ At footnote 18 of its SOI, the CC observes that, "under the terms of some PMI policies, the non-fault driver might have to pay an amount which is twice the stated excess in order to use a repairer other than the insurer's preferred repairer".

- 2.4 Concerns around restrictions on customer choice are closely related to the issue identified in TOH1 where certain third parties could be incentivised to persuade NAF drivers to take additional services where these are not needed or even desired (for example, by maximising the right to a like-for-like TRV where a simple courtesy solution may be adequate, or even where no TRV is required, or by extending the hire period by delivering TRVs earlier and collecting later than the customer may otherwise desire). It is not clear that such conduct would constitute harm to the claimant in question, who may in fact receive a better service than that to which he or she is entitled. Nevertheless, consumer harm may arise in the longer term where such practices lead to a general increase in costs and therefore ultimately to upwards pressure on PMI premiums.
- 2.5 To the extent that there is confusion amongst customers as a result of a lack of transparency, RSA notes that the FSA/FCA are already considering these issues. Further, at least as regards the point of sale of insurance, insurers are under considerable FSA obligations to ensure that customers are provided with clear, transparent, fair and not misleading communications (see further the overview of the regulatory requirements on insurers at section 4 of Annex 1 to RSA's response to the CC's Ten Priority Questions). To the extent that more could be achieved (for example, by increasing awareness and transparency obligations on non-insurer third party providers of post-accident services), not only is the FSA/FCA well-placed to consider improvements (including appropriate consumer awareness and education initiatives), they are in any event already engaged with many of these issues.
- 2.6 RSA considers that the insurance industry is best placed to continue to work with the FSA/FCA to ensure sufficient transparency at the point of sale. Indeed, given that credit hire organisations ("CHOs") are also regulated by the FSA/FCA, the FSA/FCA would appear to be particularly well-placed to deliver a comprehensive solution on these aspects²².
- 2.7 As regards consumer choice as to where repairs are carried out, all our customers have a free choice either to use an approved RSA repairer, or a repairer of their choice. Clearly, RSA is only in a position to guarantee the quality of the repair for repairs conducted at pre-approved sites. By pre-approving repair sites, RSA is able to ensure that its customers receive higher service levels and better management of the overall claims journey in addition to guaranteeing the quality of the repairs.
- 2.8 In any event, we note that, as the CC itself recognises, NAF drivers are already adequately protected by the law: "*the fault party is required to put the non-fault party 'back into the position he would have been but for the accident', i.e. to compensate the non-fault party for any damage and/or injuries*²³". In the event of an accident, "*the non-fault party is entitled to have his or her car restored to its condition prior to the accident and, while it is being repaired, the non-fault party is entitled to the use of a temporary replacement car, on the basis of it being 'like for like, subject to need'*²⁴".

Conclusion on TOH2

- 2.9 RSA considers that TOH2 is closely related to TOH1 and that they should therefore be considered together.

²² Claims management companies ("CMCs") in England and Wales are regulated by the Claims Management Regulator which is a part of the MoJ, established under the Compensation Act 2006.

²³ SOI, paragraph 20.

²⁴ *Ibid.*

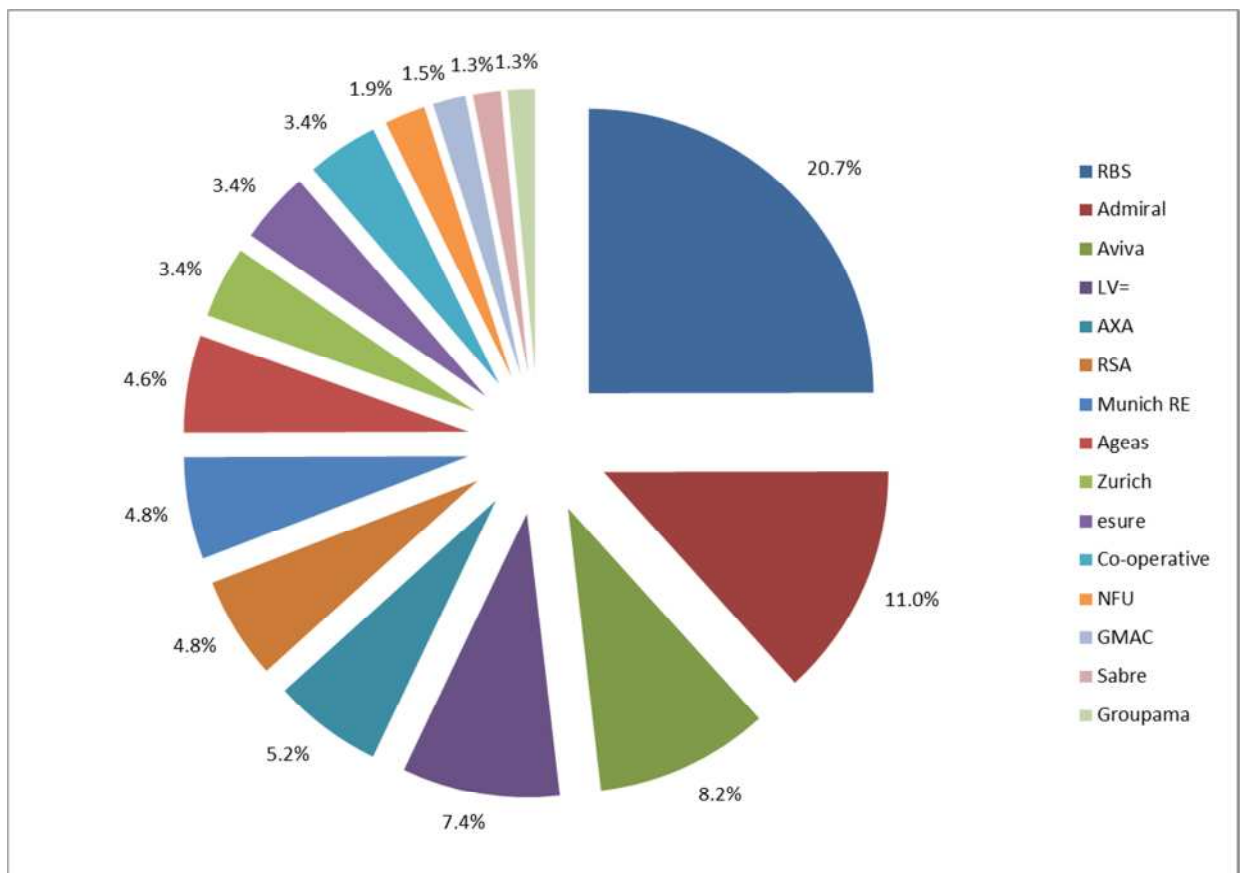
3. TOH 3: Potential harm due to horizontal effects

3.1 This TOH focuses on whether adverse effects on competition may arise from high levels of market concentration in the relevant markets. Specifically, the CC has questioned whether horizontal effects may exist between insurers, between price comparison websites ("PCWs") and between other sectors providing PMI services.

Insurers

3.2 RSA strongly disagrees with any suggestion that the market for the supply of PMI in the UK is anything other than vigorously competitive. As explained during the CC's site visit, RSA believes there to be at least 50 insurers active in the UK. Not all of these are domiciled in the UK – for example, Admiral is domiciled in Gibraltar, whilst Zurich writes UK insurance through its Dublin branch. The following chart summarises the market shares of the 15 leading UK insurers²⁵.

Chart 1: Top 15 UK PMI Providers



Source: Datamonitor, Admiral²⁶

3.3 As is clear from the chart, the largest UK insurer holds a market share of around 20%, while the top five players combined account for only around 52.5% of supply. On this basis the Herfindahl-Hirschman Index value for the PMI market in the UK is only 814, below the

²⁵ These insurers comprise the 14 leading UK domiciled insurers, as reported by Datamonitor, plus Admiral, which is domiciled in Gibraltar.

²⁶ Datamonitor UK General Insurance Database 2011; Admiral Group plc Annual Report 2011. The chart shows the top 15 insurance entities active in the UK, accounting for just over 80% of the UK PMI market.

threshold value of 1000 used by the Office of Fair Trading in merger assessment to identify 'concentrated' markets²⁷.

- 3.4 In other words, it is clear that, far from being unduly concentrated, the provision of PMI in the UK is exceptionally competitive. Moreover, and as explained in RSA's Overview Submission to the OFT and during the CC's site visit, the PMI industry has made an annual underwriting loss in each of the last 17 years - in 2011, the industry average combined operating ratio was 106% and it has been above 100% (i.e. denoting total expenses and claims incurred exceeding total income) since 1994²⁸. These sustained losses are not consistent with a market in which an absence of competition permits suppliers to earn excess profits²⁹.
- 3.5 The intensity of competition in the PMI market was reflected in the evidence provided to the OFT during its market study. The OFT reported that there was "*a reasonable degree of consensus amongst respondents [...] that the private motor insurance market is strongly competitive*" and acknowledged that "*there appears to be a high degree of competitive rivalry between insurers*", reflected in sales volatility and the entry and exit of PMI suppliers³⁰.
- 3.6 The CC has acknowledged the large number of insurers acting in the UK as a whole, but has suggested that there may exist some product segments or geographic regions in which competition is less effective³¹. In particular, the CC has noted that there may be relatively few insurers competing for business in Northern Ireland, for young and inexperienced drivers, and possibly for elderly drivers.
- 3.7 RSA would not expect competition to be inadequate in any segment of the UK insurance industry. In the case of Northern Ireland, for instance, while there are fewer insurers active than there are in Great Britain, the presence of 15 alternative suppliers indicates substantial consumer choice³².
- 3.8 Moreover, RSA agrees with the CC's suggestion that there are no material barriers preventing insurers competing in one segment of the UK insurance market from moving into other segments³³. The same core assets and skills are required to supply PMI in each product area and geographic region. An insurer with the means to supply PMI to one group of customers is therefore able to serve other types of customer, while, with respect to geographic regions, an insurer that has met the regulatory requirements to operate in one part of the UK³⁴ is able to supply customers in any other part of the UK (indeed, RSA offers PMI cover throughout the UK). Consequently, even in segments in which relatively few insurers are active, suppliers are not insulated from the competition provided by the wide variety of PMI suppliers active across the overall market³⁵.

²⁷ OFT/CC Joint Merger Guidelines, September 2010, paragraph 5.3.5.

²⁸ At this point, commercial and personal underwriting profits were not separated in FSA returns.

²⁹ Historically, underwriting losses would, to some extent, be offset by strong performance from an insurer's investment income. The global economic downturn has had a significant and prolonged impact on investment returns, heightening the concerns caused by underwriting losses.

³⁰ Private Motor Insurance: Summary of responses to the OFT's call for evidence, December 2011, paragraphs 3.3, 3.5 and 3.6.

³¹ SOI, paragraph 47.

³² In any event, there will be particular postcodes within Great Britain where choice is similarly restricted as compared to the total market.

³³ SOI, paragraph 48.

³⁴ Defined as Wales, England, Scotland and Northern Ireland.

³⁵ Note however that, to the extent that an insurer is currently not active within a particular market segment, that insurer would have more limited pricing data at the point of entry and would be reliant on third party data (for example via Experian) on more general local characteristics.

3.9 Given the above, RSA agrees with the CC that a review of horizontal concentration within the supply of insurance should not be a focus of its investigation. Indeed, RSA would be concerned if a high level review were to detract from an assessment of the key issues identified in TOH1 and TOH2 and would expect the CC to dismiss any concerns under TOH3 very quickly.

Price comparison websites

3.10 The CC has noted that there is a greater degree of concentration in the supply of PCWs, with only four large providers offering quotes for PMI³⁶.

3.11 RSA does not operate a PCW and so has no direct experience as a supplier within this market.

3.12 RSA's PMI products appear on six PCWs, although around X% of RSA's PCW sales are generated through the four largest PCWs. Initially, as the PCW channel grew quickly with no clear market leaders, RSA's strategy was to maintain a presence across all PCWs. RSA is not aware of any major PCW new entrants in the past four years³⁷.

3.13 RSA estimates that its More Th>n brand will provide somewhere in the region of X million PMI quotes through PCWs each year (compared to around 30 million licensed cars in Great Britain). However, given the highly competitive nature of the channel, conversion rates for MoreTh>n are low (around X%). Overall, we estimate that just over X% of More Th>n's new business will come through the PCW channel in 2012, up from around a third in 2010.

3.14 RSA has not removed any of its brands from a PCW in protest at the levels of a cost-per-acquisition ("CPA") fee – given the importance of the PCW channel, there is limited (if any) scope for RSA to withdraw its brands from a PCW. X of More TH>n's annual new business sales are made through PCWs, which therefore represents a very important route to market for direct sales.

Other sectors

3.15 The CC has questioned whether horizontal concentration may give rise to adverse effects on competition in other areas of the insurance industry. The CC has, however, found that there is a large number of competing brokers, CHOs, direct hire companies, repairers, CMCs, parts and paint suppliers and solicitors, both nationally and within narrower geographic regions³⁸.

3.16 RSA agrees, and does not believe that there is any deficiency in competition for the supply of these services. We therefore agree with the CC's suggestion that there is no cause for concern arising from horizontal concentration in the supply of auxiliary services to the insurance industry.

Conclusion on TOH3

3.17 Given the above, RSA would expect the CC to be able swiftly to dismiss any concerns under TOH3 and to ensure that the main focus of the investigation is on TOH1 and TOH2.

³⁶ SOI, paragraphs 49 et seq. RSA notes that, although the Direct Line brand does not sell PMI through PCWs, the Direct Line Group's Churchill brand is a key player in the PCW space (as, for example, is Aviva's Quotemehappy brand, although the Aviva brand itself does not sell PMI through PCWs).

³⁷ Google has recently set up its own PCW, although it is yet to launch its new service officially (<https://www.google.co.uk/compare/carinsurance/form>). RSA is a panel member as it previously operated on BeatthatQuote before its acquisition by Google.

³⁸ SOI, paragraph 53.

4. TOH 4: Potential harm arising from providers' strategies to soften competition

4.1 The CC's fourth TOH relates to the possibility that participants in the PMI industry may have engaged in strategic behaviour aimed at softening competition. The CC suggests that insurers may engage in a number of strategies intended to lessen competition, discussed in turn below.

Strategic product differentiation of PMI

4.2 The CC has suggested that insurers (and brokers) may seek to differentiate their products excessively in order to increase consumers' search and switching costs, thereby increasing insurers' market power³⁹.

4.3 We strongly disagree that product differentiation in the supply of PMI represents a strategic measure by which insurers seek to lessen competition. The observed variety of PMI policies available in the UK reflects both the inherent complexity of insurance products but also the industry's response to heterogeneous consumer requirements.

4.4 The scope for consumers to choose between alternative bundles of services and product characteristics, and to choose from a range of product qualities, is a direct result of the intense competition that drives firms to seek innovative ways to tailor their offerings to consumers' needs. This is something which has been broadly supported by the FSA and RSA considers that the FSA/FCA are best placed to intervene should they have concerns that product differentiation was causing consumer confusion.

4.5 Indeed, with over 50 competing PMI providers it is hard to see how insurers could successfully strategically target different customer bases such that there was reduced competition between them due to their different focus. On the contrary, to the extent that one insurer is able to steal a march on its rivals (e.g. by developing a more innovative approach), others soon follow with similar developments (and face no barriers in so doing)⁴⁰.

4.6 Moreover, the market evidence contradicts the CC's suggestion that strategic product differentiation serves to lessen competition by increasing consumers' switching costs.

4.7 First, the insurance industry's profitability does not exhibit signs of market power sustained by switching costs. As noted above, the motor insurance industry as a whole has exhibited combined operating ratios in excess of 100% since 1994 (see further paragraph 3.4 above).

4.8 Second, far from reflecting barriers to consumer switching, the insurance industry in fact exhibits high levels of switching. A consumer survey conducted for the OFT's 2008 market study into personal current accounts in the UK found that 61% of respondents had switched car insurance provider in the last five years⁴¹. This was the highest switching rate amongst the products covered by the survey, which included gas and electricity, mobile and fixed line telephone services, mortgages, and savings and current accounts. That market study also cited a study by the Department of Trade and Industry in 2000, which found that 53% of consumers had switched their car insurance provider in the previous year. More recently, a survey undertaken by the OFT during its market study found that 73% of PMI

³⁹ SOI, paragraphs 55 et seq.

⁴⁰ For example a number of insurers followed Admiral's lead in offering multicar insurance policies whilst products targeted at a particular segment (e.g. Sheila's Wheels and Diamond which focused on offering lower premiums to female drivers) were also swiftly followed. Although no longer possible to offer differential pricing based on gender, products can still be marketed to appeal to a particular demographic.

⁴¹ Available at http://www.of.gov.uk/shared_of/reports/financial_products/OFT1005.pdf. See also Annex 1, paragraph 1.4 of RSA's response to the CC's Ten Priority Questions.

policy holders in Great Britain, and 54% in Northern Ireland, shopped around at their last renewal⁴².

- 4.9 Taking these facts together, it is clear that any perceived complexity of PMI products does not serve to prevent customers from moving between providers. Consequently, it follows that the benefits from product differentiation of PMI products being tailored to consumers' requirements far outweigh any costs in terms of increased switching and search costs.
- 4.10 RSA consequently disagrees with the CC that strategic product differentiation should be a focus of the CC's review.

Drip-in pricing and the transparency and complexity of add-on products and services

- 4.11 The CC has queried whether the use of drip-in pricing may lead to consumers paying higher PMI prices than would otherwise be the case⁴³. While acknowledging that the terms on which some add-on products are sold may be within the remit of the FSA/FCA, the CC has indicated that it will consider the complexity of those products with respect to drip-in pricing⁴⁴.
- 4.12 For its part, RSA does not use drip-in prices (as that term is understood in respect of e.g. airline sales) to introduce unavoidable options as a means of increasing price during the purchase process. The price quoted at the outset of an application will always be available to purchase, with the price increasing only if the customer chooses to take additional paid-for services.
- 4.13 RSA offers eight add-ons for eChoice customers to select, as well as the option to protect no-claims bonuses ("NCBs"). Of those eight, only two (courtesy cars and windscreen cover) are included in the initial price displayed on the PCW listing page and, in any event, the customer sees this price from the start. The customer can then opt out if desired by simply clicking on the tick box to remove it, and it is explicitly clear to the customer that these add-ons are optional. Legal expenses cover is sold through eChoice on an opt-in basis. For More Than, five add-ons are offered for customers to select online with all (including legal expenses) offered on an opt-in basis⁴⁵.
- 4.14 Moreover, the add-ons used by RSA (e.g. the option to pay by monthly instalments rather than a single annual payment) represent genuine choices offered to consumers to increase the flexibility of the PMI product; as explained above, the use of such add-ons reflects the industry's competitive response to differing customer needs. Preventing customers from choosing whether they wish to take add-ons such as windscreen cover, breakdown cover and protected NCBs would only diminish the utility of the product offered.
- 4.15 To the extent that concerns around customer confusion persist, these could be readily and easily addressed by ensuring that PCWs asked customers specific questions on which add-on products they would like to purchase. If this were accompanied by a clearer and more transparent ordering of results to reflect these choices (i.e. ordering by total price for the package of products requested by the customer), this may deliver significant benefits to customers.

⁴² Private Motor Insurance: Summary of responses to the OFT's call for evidence, December 2011, paragraph 3.7.

⁴³ SOI, paragraphs 59 et seq.

⁴⁴ SOI, paragraph 68.

⁴⁵ RSA met with the FSA in December 2012, when the FSA recognised RSA's stance in offering legal expenses on an opt-in basis as being best practice and RSA are now making changes to ensure that all legal expenses products are sold on an opt-in basis going forwards.

- 4.16 In any case, RSA believes that any measures towards the standardisation of the process by which insurers and PCWs communicate PMI policy terms to customers falls more naturally into the FSA/FCA's remit and should not be the central focus of the current competition investigation. Indeed, RSA notes that the FSA has recently announced its intention to conduct a study into how competition operates in the general insurance add-on market⁴⁶. RSA welcomes this review and is already cooperating with the FSA to help inform its investigation. It is anticipated that the FSA will specifically consider PMI add-ons such as windscreen cover, breakdown cover and NCBs and that the FSA will intervene if it identifies common features of the PMI add-on market that weaken competition and drive poor consumer outcomes.
- 4.17 As with the MoJ's review into BI, RSA would be concerned to see any unnecessary duplication between this review and the CC's investigation. For the same reason, RSA considers that issues relating to drip-in pricing and add-ons should be excluded from the CC's investigation, except to the extent it has a direct impact on the key issues of identifying and addressing the causes of excess additional costs in the system.

Obstacles to switching

- 4.18 The CC has identified a number of additional factors that it believes may increase consumers' switching costs. As discussed above, RSA considers the evidence to be compelling that there are high rates of switching across the PMI industry in the UK which strongly suggests that the factors identified by the CC are not giving rise to an adverse effect on competition ("AEC") by preventing consumers from switching between PMI suppliers.
- 4.19 Turning to the three issues raised by the CC, the CC first questions whether insurers' use of *automatic renewals* might raise switching costs. RSA (like many insurers) offers automatic policy renewals to its customers who pay either by monthly direct debit or by continuous authority credit card payment in order to eliminate the risk that they become inadvertently uninsured. There are additionally wider public policy benefits to society generally by seeking to reduce the risk of drivers unintentionally driving without insurance.
- 4.20 In addition, as with the sale of all insurance policies, insurers are already governed by FSA rules and regulations on automatic renewals (see further section 4 of Annex 1 to RSA's response to the CC's Ten Priority Questions). For example, we write to all our MoreTh>n customers at least 21 days prior to their renewal date to inform them of the date on which the policy will automatically renew and giving clear instructions on how to cancel the policy in the event that they wish to switch supplier⁴⁷. Those customers who need to make a payment are then sent a renewal reminder letter 10 days before the renewal date, confirming the policy's renewal and informing the customer of their right to cancel within the cooling off period of 14 days. Customers who wish to cancel policies during the cooling off period are subject to a administration charge of £25 under both MORE TH>N and eChoice policies (see further section 4 of Annex 1 to RSA's response to the CC's Ten Priority Questions).

⁴⁶ See <http://www.fsa.gov.uk/library/communication/statements/2012/gi-study>.

⁴⁷ Online customers are sent an email 21 days before renewal to inform them that their renewal documents are in their web account for review and for payment of the renewal premium. This is followed by a reminder email to remind customers of their renewal, that payment needs to be made before the renewal date and of the consequences of not renewing. For affinity schemes, the initial payment request forms part of the renewal letter sent to the customer when the renewal is generated. If payment is not received, a final reminder is issued 10 working days prior to the renewal date.

- 4.21 Second, the CC has questioned whether *cancellation fees* might increase switching costs, although no distinction is made between cancellation fees applied at the end of a policy and fees which may apply in the event of early termination of a policy mid-term.
- 4.22 We do not charge cancellation fees at the end of our policies. Our customers therefore face no financial barrier against switching to alternative providers at the end of their contracts. Like most insurers, RSA does however charge an administration fee to customers wishing to terminate their policies early. The fee is currently set at a flat rate of £50 for MORE THAN policies and between £50-£70 for eChoice policies, depending on the premium. These cancellation fees reflect the cost of administration, plus a small uplift for any extra claims risks associated with short-term rates. In the absence of such cancellation fees, the charges would simply be reflected across all PMI premiums with the consequence that customers who do not cancel their policies would suffer an additional cost as part of their premium. They also play an important role in helping to reduce insurance fraud – a common tactic adopted by fraudsters is to take out insurance to ensure a vehicle is listed on the motor insurance database ("MID") before cancelling within the initial cooling-off period. As they do not affect customers' ability to switch at the point of deciding between insurers, (i.e. between the end of one insurance contract and the beginning of the next), these cancellation fees clearly do not harm competition. The fees are also entirely consistent with RSA's FSA obligations.
- 4.23 Third, the CC has questioned whether the use of *protected NCBs* may represent a barrier to switching. The CC has suggested that the varying methodologies used by insurers to administer protected and/or guaranteed NCBs may distort the information available to insurers regarding applicants' risk levels, thereby preventing insurers from competing effectively for rivals' existing customers.
- 4.24 We do not believe that NCBs unfairly increase consumers' switching costs at the point of deciding between insurers. We allow new customers to transfer their full NCB years earned with a rival insurer when they take out RSA policies.
- 4.25 In any case, RSA believes that any measures towards the standardisation of the terms on which protected NCBs are offered and explained to customers would fall more naturally into the FSA/FCA's remit and should not be the central focus of the current competition investigation.

Conclusion on TOH4

- 4.26 As with TOH3, RSA expects the CC to be able swiftly to dismiss any concerns under TOH4 and/or to liaise closely with the FSA/FCA to ensure that there is no unnecessary duplication.

5. TOH 5: Potential harm arising from vertical relationships

- 5.1 The CC's fifth and final TOH relates to the vertical links and relationships between insurers and PCWs, insurers and brokers, and insurers and parts/paint suppliers. At the outset, RSA would highlight that PMI insurers do not have market power (as explained above); further, in the absence of market power, vertical agreements and vertical integration can be considered either benign or pro-competitive.

PCW integration

- 5.2 The CC has questioned whether insurers that fully or partly own PCWs might be able to gain a competitive advantage over non-integrated rival insurers via their operation of that PCW⁴⁸.
- 5.3 RSA does not itself have links with any PCWs and so cannot comment directly (i.e. from the perspective of an integrated service provider) on the use of the strategies hypothesised by the CC.
- 5.4 As regards integrated rivals, RSA has no experience or evidence of such rivals using PCWs to gain a competitive advantage over rival insurers and as such we do not consider that vertical integration of PCWs causes a problem *per se*. However, we would be concerned were sufficiently robust information barriers not in place and would expect the CC to confirm that adequate safeguards are in place.

PCWs' use of MFN clauses

- 5.5 The CC has questioned whether PCWs may require insurers and brokers to accept MFN clauses, and whether such clauses may dampen competition between insurers⁴⁹.
- 5.6 RSA agrees with the CC that it was common for PCWs to require insurers to quote the same price for a given policy on the PCW as for sales through other online distribution channels. RSA also agrees with the information provided to the OFT by insurers, that the risk profile of customers acquired through PCWs may differ systematically from that of customers using other distribution channels (and indeed the risk profile as between different PCWs may also differ). The majority of RSA's PCW contracts will contain a commitment on RSA not to price more cheaply on its own direct website for the same product on the same risk than the price offered to the PCW. We would expect the CC to be concerned if it found evidence of MFNs being used to deliver pricing alignment between PCWs. The CC should also be concerned if the effect of any MFNs led to an increase in the prices that insurers can offer on their own sites, either as a result of price alignment or as a result of an increase in charges by any one PCW.

Insurer-broker relationships

- 5.7 The CC has suggested that insurers with vertically integrated brokers may be able to foreclose rival brokers by worsening the terms on which the vertically integrated firm supplies PMI to those brokers⁵⁰. The CC has also suggested that vertically integrated brokers could foreclose rival insurers' access to market by worsening the terms on which they distribute those rivals' PMI products⁵¹.
- 5.8 RSA is not itself vertically integrated with any brokers and so cannot comment directly (i.e. from the perspective of an integrated provider) on the use of the strategies hypothesised by the CC.
- 5.9 RSA agrees with the CC's view that vertical relationships between insurers and brokers are highly unlikely to give rise to competition issues. RSA notes that market power does not exist at either the insurer or the broker level of the industry. As the CC acknowledges, there are over 50 PMI underwriters active in the UK, and, as explained above, there are no

⁴⁸ SOI, paragraphs 78 et seq.

⁴⁹ SOI, paragraph 90 et seq.

⁵⁰ SOI, paragraph 97.

⁵¹ SOI, paragraph 98.

barriers to insurers moving between segments that might give rise to market power. Equally, RSA estimates that there are around 3,500 to 5,000 brokers operating in the UK⁵², and that brokerage is just one channel through which PMI is supplied.

- 5.10 Consequently, it is clear that foreclosure has not occurred in recent times, and that there is no scope for integrated insurer-brokers to pursue strategies of either input foreclosure or customer foreclosure. RSA therefore agrees with the CC's proposal that it should not consider this issue in detail.

Insurer-repairer relationships

- 5.11 The CC has questioned whether insurers may be able to use ownership of or contractual relationships with vehicle repairers to foreclose rival insurers by preventing them from accessing repairs⁵³. However, with more than 50 insurers already competing in the market, it is clear that foreclosure has not occurred. It would therefore seem speculative to consider the issue further.
- 5.12 RSA, through its RSAAR subsidiary (RSA Accident Repairs Limited), undertakes some repairs at its own garages, referred to as 'Quality Repair Centres' ("QRCs"). In other cases, RSA/RSAAR will subcontract repair jobs to outside garages. Some of those garages ("Dedicated Repair Centres") perform a large volume of work for RSA/RSAAR. Other garages (the "Priority Repair Network") are pre-approved by RSA but perform a lower volume of work. Others are not approved, and these are known as "Non-Recommended Garages".
- 5.13 The QRCs and Dedicated Repair Centres are in essence dedicated sites working exclusively with RSA rather than carrying out work for other insurers or intermediaries (although dedicated repairers may carry out work for other insurers from any non-dedicated sites they have). Garages in the Priority Repair Network are free to contract with other insurers provided that does not impact upon their ability to perform their contractual obligations to RSA. Where we control the repair network, we are able to ensure that customers receive high quality service and an efficient and speedy repair experience, enabling us to offer lifetime guarantees for the quality of the repair. RSA has no such control over non-recommended garages and hence no ability to verify the quality of the repairs or the service provided to the customer.
- 5.14 We agree with the CC's expectation that there are no areas of the country in which there is sufficient concentration in car repairers that insurers might be able to raise rival insurers' repair costs via garages which it owns or with which it has contractual relationships. We note that the OFT acknowledged during its market study⁵⁴ that the accident repair market appeared to be diverse and fragmented.

Insurer-parts/paint supplier relationships

- 5.15 The CC has questioned whether contracts between insurers and parts and paint manufacturers or distributors might give rise to consumer harm⁵⁵.
- 5.16 The CC acknowledges that these contracts are not generally exclusive, and that insurers do not seek to prevent parts and paint manufacturers from serving rival insurers⁵⁶. RSA does

⁵² BIBA alone accounts for just under 2,000 general insurance brokers.

⁵³ SOI, paragraphs 100 et seq.

⁵⁴ OFT, 'Private Motor Insurance: Report on the market study and proposed decision to make a market investigation reference' (May 2012), paragraph 2.15.

⁵⁵ SOI, paragraphs 103 et seq.

not have any exclusive deals with paints and parts suppliers, leaving all its suppliers free to deal with other insurers.

- 5.17 Repairers that form part of the RSA network (through the RSAAR model) are required to use specific paint suppliers exclusively (to ensure quality and to enable RSA to negotiate better volume rates from its suppliers – see paragraph 5.20 below).
- 5.18 However, as the CC has found, insurers and repairers do not hold sufficient market power to use vertical relationships with preferred parts/paints suppliers to foreclose other parts/paints suppliers⁵⁷. Moreover, RSA notes that it would not be in insurers' or repairers' interests to undertake measures that might lessen competition amongst their suppliers.
- 5.19 The CC has also noted that some insurers have negotiated volume discounts with suppliers based upon the volume of parts/paint used in repair work undertaken for the insurer⁵⁸. The CC has suggested that such arrangements may give larger insurers a competitive advantage over smaller insurers.
- 5.20 As explained in its Overview Submission to the OFT, RSA has established such relationships (known as “product mandating”) with a number of parts and paint manufacturers⁵⁹. RSA disagrees that the existence of volume discounts in contracts between insurers and parts/paint suppliers constitutes an AEC. On the contrary, the pursuit of efficiency is normally encouraged and the scale economies achieved by larger insurers benefit consumers via lower expected repair costs for insurers, and therefore lower premiums. The lower premiums resulting from large insurers' scale economies increase competitive pressure across the industry, to the benefit of all customers.
- 5.21 Moreover, as noted by the CC, smaller insurers are able to enjoy economies of scale in the procurement of paint and parts by using third party repairers⁶⁰.

Conclusion on TOH5

- 5.22 RSA agrees with the CC's proposal to review the impact of vertical relations between insurers and parts/paint suppliers only at a high level and would expect the CC to dismiss any foreclosure concerns under TOH5 very quickly.

⁵⁶ SOI, paragraph 104.

⁵⁷ SOI, paragraph 107.

⁵⁸ SOI, paragraph 104.

⁵⁹ RSA's Overview Submission to the OFT (February 2012), paragraph 5.9.

⁶⁰ SOI, paragraph 106.

C. Possible Solutions

Issues to be addressed

- 1.1 Both the OFT and the CC (in TOH1) have identified the potential for harm to arise as a result of the separation of cost liability from cost control. RSA agrees that a lack of control over costs by AF (i.e. paying) insurers is a key factor in the increase in additional costs in the claims process which the OFT identified as potentially adding as much as £225m to customer premiums. We explain below our belief that the majority of these additional costs relate to the increasing use of credit hire, driving up the costs of providing TRVs to NAF customers.
- 1.2 When considering how to address this concern, we believe that this lack of control on costs by the AF insurer must however be balanced with a NAF customer's existing legal rights to full restitution in the event of a claim (as explained in TOH2). In the context of TRVs, this means a NAF customer's expectation that a like-for-like TRV will be provided when his or her vehicle is temporarily off the road following an accident.

Key principles that must underpin any solution

- 1.3 Given the above, RSA would like to see the outcome of the CC's investigation giving rise to a comprehensive solution which:
 - (i) Protects a NAF customer's legal entitlement to full rectification;
 - (ii) Maintains and enhances the service levels NAF customers receive when they make a claim, including speeding up the claims process and assessment of liability whilst reducing the scope for disputed claims;
 - (iii) Gives more control over cost to the AF insurer who will ultimately be liable for the final bill; and
 - (iv) Reduces the overall cost (including frictional costs), whilst protecting customer service levels.
- 1.4 These are clearly complex issues which will require a comprehensive and thoroughly tested solution. Indeed, we continue to believe that short-term fixes which deliver an incomplete solution could ultimately lead to increased consumer detriment. However, we believe that a package of remedies could be identified to deliver a sufficiently comprehensive solution. Such a package of remedies might include all or some of the following elements: judicial or legislative reform to lower the appropriate benchmark against which NAF claims are assessed for reasonableness; remedies aimed at raising consumer awareness of key rights; enhanced bilateral agreements between insurers.
- 1.5 Looking at the issue of like-for-like TRV provision to NAF claimants (as explained below, we believe this accounts for as much as ~~8~~% of the additional costs identified by the OFT), one possible option the CC might wish to consider further is whether enshrining the legal entitlement to a like-for-like TRV within the minimum policy benefits of all PMI policies in the UK might address many of the issues identified.
- 1.6 The aim of any such mandatory NAF like-for-like mobility cover would be to give customers the confidence and certainty that they will have an appropriate TRV, consistent with their legal rights, in the event that they are involved in an accident which was not their fault. If this were included as an integral policy benefit, it would also ensure that an appropriate

mobility solution was available at no-cost to the NAF claimant, removing the need to enter into credit arrangements. Furthermore, it would ensure that customer service and management of that aspect of the claim remains in the hands of the customer's insurer of choice (i.e. the insurer of their vehicle).

- 1.7 There would also be scope for underpinning the arrangements with appropriate judicial guidance and/or legislative change. This would aim at placing downward pressure on how the Courts assess what is 'reasonable' by seeking to establish a lower benchmark. Insofar as it is possible to reduce TRV costs this would reduce the value of leakage where non-insurers intervene in the claims process.
- 1.8 On its own, such a solution would not address the question of control of costs by the AF insurer who remains responsible for these costs. However, this could potentially be addressed by expanding bilateral agreements between insurers to ensure that TRV claims were paid at pre-agreed rates. This would also have the effect of ensuring that claims are dealt with more swiftly, in particular leading to a speedy assessment of liability.
- 1.9 We recognise that these are only initial thoughts on the possible shape that a package of remedies could take and that they will require extensive consultation and testing from a number of stakeholders, including industry participants, customers and the FSA/FCA.

Credit hire rates

- 1.10 We have focused in this section on additional costs associated with TRVs. This is because addressing the higher costs that arise in the provision of TRVs, particularly as a result of credit hire, should address the majority of the issues and costs identified by both the CC in TOH1 and the OFT in its earlier review. Indeed, TRV provision is the area in which the majority of leakage to non-insurers arises and hence the area where there is the most scope for reducing costs and putting downward pressure on premiums.
- 1.11 In its response to the OFT, RSA estimated that:
 - (i) Around 40% of its total claims costs in 2011 related to repair and TRV costs;
 - (ii) Mark-ups on TRV costs were significantly greater than mark-ups on repairs (with margins on repairs estimated to be around ~~XX~~%, compared to ~~XX~~% for TRVs); and
 - (iii) The great majority of RSA's TRV costs (~~XX~~%) were third party costs⁶¹.
- 1.12 In section 8 of that response⁶², RSA estimated that additional costs for the provision of TRVs account for around ~~XX~~% of total additional costs for repairs and TRVs combined, reflecting both far higher mark-ups and far greater penetration from non-insurer third party interveners. Bearing in mind the OFT's estimate that total additional costs for repair and TRVs could be adding £225m to customer premiums, a solution addressing additional TRV costs could therefore reduce leakage by more than £150m⁶³, which given the highly competitive nature of the PMI market would be expected to feed through into lower premiums.
- 1.13 Much of the impact of these higher additional costs has arisen as a result of the proliferation of credit hire charges in the market. In short, credit hire rates will tend to be higher than

⁶¹ Response to OFT Question A2 and section 8 of RSA's Overview Submission to the OFT (February 2012).

⁶² See paragraphs 8.15 and 8.17-8.18 of RSA's Overview Submission to the OFT (February 2012).

⁶³ This is consistent with RSA's own estimates at paragraph 8.16 of the Overview Submission to the OFT (February 2012) which would suggest reductions of around £~~XX~~.

equivalent direct hire rates (i.e. those that could be negotiated by an insurer direct) as they will reflect both a hire element and a credit element which incorporates the risk to the CHO that hire charges may not ultimately be recoverable (or not recoverable in full). The credit hire process can be summarised as follows:

- (i) The CHO (acting on behalf of the insurer or in its own capacity) will contact the driver upon notification of the claim (whether notification came direct from the NAF driver or following a referral from another third party) to take necessary details (name, address, type of vehicle etc), which enables the CHO to deliver a like-for-like replacement vehicle that meets or exceeds the NAF driver's need; and
- (ii) A like-for-like (normally) TRV is then provided on a credit basis (i.e. the NAF driver is not required to pay for the hire immediately) and the CHO will then seek to recover its costs from the AF insurer.

1.14 Crucially, however, under the terms of the credit agreement, the NAF driver is ultimately responsible for the costs incurred. Hence if there is a dispute as to liability or some other dispute which results in no, reduced or delayed payment to the CHO, the CHO will be entitled to recover its costs direct from the NAF driver⁶⁴.

1.15 It follows that part of the reason that credit hire charges tend to be higher is to reflect the credit element of the agreement. In its evidence to the OFT, RSA found that the average daily charge for a TRV subrogated to RSA amounted to £~~XX~~ as compared to an average daily charge of around £~~XX~~ for equivalent like-for-like vehicles provided by RSA.

1.16 The table below breaks this out in more detail, setting out average daily hire buy rates for RSA (i.e. where RSA is the AF insurer and providing a mobility solution direct to the NAF driver) and the rates which RSA must pay for provision of the same vehicle class under the GTA⁶⁵.

Table 1: Indicative Average Daily Hire Charges

Class of Car	GTA Daily Rate	RSA Daily Buy Rate	Difference (%)
<i>Standard</i>			
S1	£30.28	XX	XX
S2	£34.33	XX	XX
S3	£36.62	XX	XX
S4	£39.26	XX	XX
S5	£41.54	XX	XX
S6	£44.25	XX	XX
S7	£62.06	XX	XX
<i>MPV</i>			
M	£48.38	XX	XX
M1	£55.91	XX	XX
M2	£63.75	XX	XX
M3	£74.94	XX	XX

⁶⁴ Although in practice, RSA expects that these charges would be waived in the majority of cases.

⁶⁵ The table covers the most frequently hired categories of vehicle. However, variations for less frequently hired vehicles (e.g. more prestige models) will be similar to those in the table.

Class of Car	GTA Daily Rate	RSA Daily Buy Rate	Difference (%)
M4	£95.07	✘	✘
M5	£142.59	✘	✘
M6	£180.62	✘	✘
4 x 4			
F1	£93.94	✘	✘
F2	£100.66	✘	✘
F3	£108.49	✘	✘
F4	£133.10	✘	✘
F5	£178.93	✘	✘
F6	£201.31	✘	✘
F7	£234.86	✘	✘
Prestige			
P1	£78.28	✘	✘
P2	£87.24	✘	✘
P3	£92.82	✘	✘
P4	£112.95	✘	✘
P5	£140.92	✘	✘
P6	£167.76	✘	✘
P7	£195.72	✘	✘
P8	£223.66	✘	✘
P9	£257.23	✘	✘
P10	£316.51	✘	✘
Sports			
SP1	£75.36	✘	✘
SP2	£88.08	✘	✘
SP3	£98.41	✘	✘
SP4	£120.79	✘	✘
SP5	£131.97	✘	✘
SP6	£184.54	✘	✘
SP7	£206.91	✘	✘
SP8	£229.27	✘	✘
SP9	£251.64	✘	✘
SP10	£287.98	✘	✘
SP11	£346.70	✘	✘
Average	£135.61	£51.87	261%

Source: GTA and RSA actuals



1.17 As is clear from the above, GTA credit hire rates are on average just under 3 times more expensive (261%) than the rates that RSA would expect to negotiate on a like-for-like basis, but in some cases the mark up is as high as 450%+⁶⁶.

Conclusion

1.18 In conclusion, we believe that the outcome of the CC's review should be aimed at delivering a better result for customers. This requires a balancing of the need to reduce costs (and hence premiums) whilst maintaining service levels for customers in a way that meets their needs.

1.19 We would be happy to meet with the CC as appropriate to discuss any of the issues raised in this Response and we look forward to working with the CC constructively with a view to delivering a lasting industry-wide solution which has the support and confidence of our customers.



Neville Howe

General Counsel, UK & Western Europe

⁶⁶ Note that CHOs who are not within the GTA may even charge higher rates, although these may be more susceptible to challenge.