COMPETITION COMMISSION
PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Notes of a hearing with DLG, NFU Mutual, Admiral, esure and AXA held at the Competition Commission, Southampton Row, London on Tuesday, 16 July 2013

PRESENT:

FOR THE COMPETITION COMMISSION

Alasdair Smith	- Chairman
Stephen Oram	- Member
Anthony Stern	- Member
Robin Aaronson	- Member

FOR THE STAFF

Andrew Wright	- Inquiry Director
Tony Curzon Price	- CC Economist

FOR THE PRIVATE MOTOR INSURANCE COMPANIES

Tom Woolgrove	- MD Personal Lines, Direct Line Group
Steve Maddock	- MD Claims, Direct Line Group
Emma Hopkinson	- Senior Legal Counsel, Competition & Anti Bribery, Group Legal, Direct Line Group
Mark Friend	- Partner, Allen & Overy
Reinder Van Dijk	- Associate Director, Oxera
David Stevens	- Chief Operating Officer, Admiral
Geraint Jones	- Deputy CFO, Admiral
Lorna Connelly	- Head of Claims, Admiral
Claire Beer	- Reinsurance Manager for Claims, Admiral
Ian Sinho	- Head of Technical Claims, AXA Insurance - Direct & Partnerships
Gareth Howell	- Product Director, AXA Insurance - Direct & Partnerships
Philip Bradley	- Executive Director, AXA Ireland
Claire Fletcher	- Trainee Solicitor, AXA UK plc
Alistair Mourdaunt	- Partner, Clifford Chance
Gordon Hannah	- Chief Operating Officer, esure
Bob Matwiejczyk	- Regional Claims Manager, esure
Graham Roberts	- National Technical Services Manager/Regional Manager, esure
Philippe Chappatte	- Partner, Slaughter and May
Christopher Graf	- Associate, Slaughter and May
Jeremy Charles Diston	- Chief UW Manager, NFUM
Matthew Leonard Scott	- Chief Claims Manager, NFUM
James Damian Creechan	- Company Secretary and General Counsel, NFUM
Rosemary Sara Choueka	- Partner, Lawrence Graham

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THE CHAIRMAN: Good morning. Thank you all very much for taking the time to come here to help us with this market investigation.

I want to start with introductions. Let us just do introductions round the central table. If at any point in the meeting, as I hope you will, those of you round the periphery are joining in the discussion, I would be grateful if you would then introduce yourselves for the transcript writer.

I am Alasdair Smith. I am a Deputy Chair of the Competition Commission and I am Chair of the group conducting this investigation.

Q. (Mr Oram) Steve Oram, panel member.

Q. (Mr Wright) I am Andrew Wright, the Inquiry Director.

Q. (Mr Stern) I am Anthony Stern. I am a panel member.

Q. (Mr Aaronson) Robin Aaronson, panel member.

A. (Mr Diston) I am Jeremy Diston, Chief Underwriting Manager of NFU Mutual.

A. (Mr Scott) Matthew Scott, Chief Claims Manager of NFU Mutual.

A. (Mr Howell) Gareth Howell, the Commercial and Product Director of AXA.

A. (Mr Sinho) Ian Sinho, Technical Claims Director at AXA.

A. (Mr Chappatte) Philippe Chappatte, Slaughter and May, acting for esure .

A. (Mr Hannah) Gordon Hannah, COO for esure .

A. (Mr Maddock) Steve Maddock, Managing Director for Claims, Direct Line Group.

A. (Mr Woolgrove) Tom Woolgrove. I am the Managing Director of UK Personal Lines, including motor insurance.

A. (Mr Stevens) David Stevens, Chief Operating Officer for Admiral.

A. (Ms Connelly) Lorna Connelly, Head of Claims, Admiral.

THE CHAIRMAN: Thanks. I have referred to the fact that we are taking a transcript of this meeting. Okay. Let me say a few things by way of introduction before we get underway. As you are aware, today's meeting is structured as a joint hearing. Given the number of parties affected by this market investigation, we thought that this was the most practical way of conducting consultations at this stage.

We are mindful of the constraints of a joint hearing. We have been mindful of that in setting the questions that we want to discuss today, but I want to remind all of you at the start that it is your responsibility to ensure that you do not provide information in this discussion that it would be inappropriate for you to discuss in front of your competitors in a forum like this.

If you do want to provide confidential information on views on any of the issues which we discuss today, then we would be very happy indeed to receive individual communications from you on these issues.

I am not going to take you through our rules and procedures of hearings, as we have sent you advice on that in writing. As I have already referred to, we are taking a transcript of this hearing. We will send a copy of the transcript to you, I hope, within the next week, and we would ask you to check the transcript for any obvious errors, either in the transcription or slips in what was said. If, on reflection, there are substantial corrections that you want to make to anything said today or issues on which you want to enlarge, then it would be helpful if you do that in a separate letter rather than as an amendment to the transcript.

We normally provide summaries of hearings like this on our website, but for these joint hearings we have decided that the most appropriate way of letting everyone know what is going on is simply to publish a transcript of the hearings, which we will do on the website. So when you get the copy of the draft transcript, we would be grateful if you would check it just in case anyone has said anything that is confidential and should not be published in the transcript, so that that can be excised before the transcript is published on the website.

Normally, I remind people of the legal requirement under the Enterprise Act 2002 which is to always to give truthful evidence to the Competition Commission. I feel slightly apologetic about it because reminding people that they are supposed to tell the truth feels not the sort of thing that well brought up people are meant to say to each other. But given the amount of time that I and everyone else in the room has spent hanging on phone lines while being earnestly enjoined to tell the truth in answering the questions about your motor insurance record, this is one occasion which I do not feel particularly apologetic about having to remind you of the importance of telling the truth.

On the conduct of hearings, what I am going to do is take us through a series of questions that we have prepared. I will take the lead on all of the questioning, but other members of the panel and members of the staff team will chip in with supplementary questions or follow-ups, as appropriate.

Apart from on the introductory questions, where I am keen to have each one of the parties give a brief response, on all of the other areas of questioning I am going to ask one of you to lead off with the responses. Given that we have quite a long agenda to get through, I would be grateful if we did not spend a lot of time agreeing with each other.

If you do agree with what has just been said then it is enough to say, I agree with what has just been said, and not spend two/three minutes expanding on your agreement with what has already been said. So we will be keen for the follow-ups to questions to expose areas where there are differences of sharing of opinion or where you want to raise further issues that have not been responded to in the first set of questions. So, let us not spend a lot of time on repetition, but if, on at least some of the questions, we do get a bit of interchange between you, we would regard that as a very good thing.

The last thing is just to make it clear where we are in this stage of our inquiry. We have published our Annotated Issues Statement which summarises where we are. We are about to publish a series of working papers. We are unambiguously still at the stage of developing our own understanding of how this complex market works. We have not arrived at any views on the legal question which we are asked, in a market investigation, to decide on, and therefore we have not started thinking about the hypothetical question of: If we do find that there are issues in the way this market operates, what should be done? We are still very much at the finding out stage, so please do not read anything into any of the questioning about making inferences about anything we have decided because we have not decided anything yet.

I want to start off with a general question for each of you to respond to, as briefly as possible, please, no more than five minutes, and then we will get into the detailed questioning.

Then the general question, I suppose, hangs on our annotated Issues Statement. You have all seen our Annotated Issues Statement that sets out the issues on which we are focusing. I would like to hear from you whether you think we have things right; whether we are in danger of getting things wrong, in the sense of missing out important issues or spending time on issues which are not important. If you do think we are in danger of getting anything wrong; why is that and what is it you think we are missing? Can I start with Direct Line?

A. (Mr Woolgrove) Sure. Sorry, Tom Woolgrove. First of all, we very much welcome the opportunity to attend this hearing with the Competition Commission.

There are four key points coming out of your statement that I would like to touch on briefly. I think the first one is unlike most of the markets that end up being referred to the Competition Commission, we see the private motor insurance market is actually highly competitive. There is very strong rivalry between insurers and we see that switching rates are much higher than many other retail markets. Our belief is that the consumer benefits from this, both in terms of the prices that are charged for insurance, but also the quality of service, and as a group with large established consumer brands, Direct Line Group has a strong incentive to meet customer's needs, to deliver high quality repairs and to drive customer satisfaction. That is what, for us, drives higher than average customer retention rates.

We are very pleased to see the positive evidence from your survey report that customers are happy with the quality of repairs and provision of TRVs, and our belief that that means that in this respect, the PMI market is delivering for customers.

I would like to restate that the biggest contributors to premium inflation in recent years have indeed been claims for whiplash injuries. However, that said, we do recognise that the separation of cost liability and cost control, your first theory of harm, does lead to market dysfunction, and we do support the

CC's investigation of this area. Specifically, we accept the misalignment of incentives that this produces may increase insurer's costs.

However, there are well established legal rights which enable both CMCs and CHCs to recover above cost and to generate a profit. We see that you have found that this can lead to higher costs and longer higher periods. It is important to state that we and other insurers have sought to challenge this, but have consistently failed.

So within this system, we do seek to control costs. This is beneficial to customers because in the context of a highly competitive market in which we operate, any such cost savings help us to offer customers more competitive premiums.

However, we would suggest caution here. It is a very complicated and complex market involving a mix of statutory provisions and many case law precedents. It is a natural consequence of the third party liability model. Any reforms of this model carry a high risk of unintended consequences, so we strongly believe that any changes that you might propose in this area should be very carefully considered and underpinned by a full cost benefit analysis.

Secondly, we strongly believe that it is important to note that insurers and other interested players do employ the same repair and quality methods for fault and non-fault claims and repair process. We believe that in the highly competitive environment in which we operate we, and not our less efficient competitors, should be able to benefit from economies of scale which we are able to generate through centralised procurement of parts and paint.

Thirdly, we strongly believe that insurers should be free to own and control repair networks, as indeed Direct Line Group currently does. Our network of repairers enables us to control the cost of repairs and to ensure the quality of our repair work. It is an important mitigant to the separation of cost liability and cost control that underpins your theory of harm one, and again any changes that you contemplate should not dis-incentivise insurers from making these investments.

Fourthly and finally, we welcome the fact that the CC is focusing its attention on price comparison websites. We agree with you that the so-called wider MFN clauses, which prohibit lower pricing across multi-sales channels, are anti-competitive. However, we disagree with your view that narrower MFN clauses which prohibit lower pricing on insurers' direct websites are unproblematic. Our strong view is that narrow MFNs can be anti-competitive, effectively creating a price floor and dampening price competition between insurers.

We look forward to your analysis of PCW profitability in due course, but our view is that PCWs do have considerable bargaining power against insurers. Insurers do not have much leverage when it comes to negotiations with PCWs. The threat to de-list a brand from a PCW does not carry much weight because of the large number of competing brands that are typically carried on any individual PCW. We also disagree with your findings to date that the PCWs’ commissions are below market inflation rates, and we are very happy to share data with you on this separately, as well as our experience of the competitive pressures from PCWs at contract renewals.

We look forward to your questions. Thank you.

Q. Thanks. Admiral.

A. (Mr Stevens) We also very much welcome the opportunity to comment on your work. I should be very brief, just to say that we are pleased that you are coming to the conclusion that by and large the functions are reasonably healthy and the efficient manner and the competitive manner for the good of the customer, that there is clear exception in the contents of non-fault claims and the difference of cost control and cost liability, which clearly is dysfunctional and leads to an increase in premiums paid by motorists, although that increase is a relatively small percentage for total premiums, the absolute pound value is significant and therefore obviously will be something that we will be looking at in great depth.

The diagnosis is challenging and I think it is has been corrected as we read the papers to-date. The remedy is much more challenging. Some of the more radical suggestions leave us questioning whether the changes that would be imposed on the car insurance market and the possible side effects are proportionate to the problem identified. So, though it is too early to speculate on what the right remedy is in the absence of all the evidence that you have gathered to-date, which is relevant to us, our suspicion is that a more incremental reform that specifically focuses on the cost of credit hire is likely to the most effective outcome to partially mitigate the current problems in the market.

Q. Good. Thank you. esure ?

A. (Mr Hannah) esure too welcomes the CC's key conclusions in its annotated

Issue Statement.

In esure's view there are three main issues for the CC inquiry; the high cost of credit hire vehicles; the high cost of repair services and the use of wide MFNs by PCWs.

A bit of background information first: The context of the CC involvement stems from a referral from the OFT expressing concern about the rising cost of motor insurance. Increases in personal injury frequency and severity of both genuine and fraudulent claims have necessitated significant motor premium increases throughout the period of 2009 to 2011. The civil litigation costs reforms have, in esure's opinion, started to address the issue.   Maybe lessons can be learned when it is time for CC to consider solutions to the excessive costs of credit hire and credit repair, especially with regard to the possibility of banning referral fees for credit hire and repair as there are marked similarities with the issue of personal injury referral claims.

In terms of materiality, that is customer detriment and the direct impact of motor insurance premiums, then theory of harm number 1 seems the right place to focus and this brief opening statement will therefore concentrate on the area of both credit hire and credit repair.

Firstly, esure agrees with the CC that the areas of concern relate to the cost of credit hire and credit repair rather than the quality of service provision. Whilst esure understands that there is further work outstanding from the CC in this respect, it would be extremely surprised if the CC found that repair quality varied by the status of the claimant.

I now turn specifically to credit hire. In terms of both magnitude and the costs involved and the extent of the problem, esure considers that credit hire is the biggest area of concern. The industry has not been able to control effectively the cost of credit hire and there are a number of reasons for this. At-fault insurers have challenged excessive claims and more often than not the courts have not supported the at-fault insurer. There are some very high profile cases involving footballers, such as Darren Bent, where, for example, hire charges were agreed at £63,000 whilst the damage to the car was less than a third of that cost. So the cost of litigating with credit hire companies and the lack of success by at fault insurers in challenging the excessive credit hire claims led, initially, to the creation of GTA, which I think was of some benefit in the early days, but is increasingly not fit for purpose today as the bar has been set too high in terms of the daily rates, allowing excessive claims to be made. The use of unjustifiably large referral fees only serves to illustrate the scale of the problem.

I comment now on credit repair. The magnitude of the problem with credit repair is much less that in credit hire. Its frequency is lower and excessive claims narrower, largely due to the widespread use of cost effective estimation tools. However, we do believe that the credit repair is too expensive and drives up industry costs without any discernable benefit to the customers.

I now turn to the issue of insurer subrogated repair. Although by no means perfect, there is an efficient system for setting up and dealing with subrogated claims between insurers, which is largely paper free and preserves the ability of the at-fault insurer to contest excessive repair claims. esure, for example, has successfully challenged [✂] for excessive repair claims, albeit not through the courts. We believe that most subrogated repair claims made by insurers are reasonable.

As to the CC's finding that subrogated claims by one insurer to another are £200 on average more than when the repair is managed by the at-fault insurer, esure would suggest that the CC treats this analysis with some caution. There are a number of possible explanations for this difference. For example, in esure's experience, its direct claimant services - this is the capturing of a third party customer - tend to be more successful in capturing the lower cost damage vehicles rather than the higher cost, more substantially damaged, vehicles. Perhaps customers are more willing to allow a third party insurer to manage minor repairs, but prefer their own insurer, to whom they have paid premium, to deal with the bigger repair jobs. If this is reflected industry wide, this customer behaviour, then it would be a rational explanation for the differential. I give this example to illustrate the complexity and the difficulty in drawing conclusions from data extracts only.

Finally, on the subject of MFN clauses, esure's position on this can be summarised as follows: We believe the CC is correct in its view that wide MFNs could tend to stifle innovation and competition between PCWs which is not a good outcome. It also prevents insurers from proper risk pricing and cost allocation by a distribution channel, which could impact the provision of lower premiums for customers in that insurer's target market. However, the narrow MFNs are perhaps more justifiable since they are probably essential for the workings of a PCW business model. PCWs have brought many benefits to the industry, including fostering price competition and lowering the barriers to entry for insurers.

I look forward to debating these issues and answering any questions.

Q. Thanks. AXA.

A. (Mr Howell) Thank you, firstly, for this opportunity to give a short opening response to the panel today.

Before briefly expressing AXA's views on the Commission's Annotated Issues Statement, I would like to start by making a general observation about the market, and that is that AXA views the market as being extremely competitive. This is demonstrated, in particular, by the increasingly high levels of switching that we observe and the transparency of information for customers in the market and indeed the large number of providers. These market characteristics create a wide choice available to the consumer, and perhaps not surprisingly, therefore, consumer satisfaction levels are high, as shown in the Commission's own customer survey.

Now turning to the Annotated Issues Statement, I would like to make four brief comments. First in relation to the Commission's first two theories relating to repairs and temporary replacement vehicles. Our key concern here is to ensure a level playing field. Some players are currently taking greater advantage of the skewed incentive existing in the market than others. Also we note that there are certain practices that could be improved and, in particular, certain frictional costs which could be removed entirely from the market. We would, however, recommend that the Commission exercise extreme caution to avoid any unintended consequences when considering what action it might take in relation to these.

Secondly, in relation to Northern Ireland. We recognise that there are indeed some differences between this market and Great Britain, but we believe that it is also a highly competitive market. Phil Bradley, sitting behind me, is here to address any questions that you may have on this topic.

Third, we agree entirely with the Commission's view on the absence of barriers to switching for customers.

In relation to add-on products, we believe that these are of value to the customer and respond to consumer demand, in particular, no claims bonus protection, which seems to be of particular interest to the Commission. We are cooperating with the FCA and its ongoing market study on general insurance add-on products, which I am sure you are aware of.

Finally, we have noted, with interest, the Commission's possible concerns in relation to the most favoured nation clauses in contracts between price comparison websites and insurers, and we would be happy to elaborate further on the views which we have already expressed to the Commission in our previous submissions.

Thank you and we look forward to your questions.

Q. Thanks. Finally, NFU.

A. (Mr Scott) Good morning. Matthew Scott.

National Farmers Union Mutual Insurance has a proud heritage dating back over 100 years. We pride ourselves on the strength of our customer service delivery and our continued dedication to sustaining our brand, which is recognised as representing very high quality.

With regard to private motor insurance, we are a small player in a very competitive market focused on maintaining our brand proposition. Whilst our private motor insurance business continues to perform in accordance with expectations, we acknowledge there are features of the private motor sector which could be more efficient and which, if reformed, could result in lower premiums for the customer. Many of these have been addressed already, in particular, the work being done in relation to personal injury claims and whiplash and on the achievement of proportional legal expense costs. However, we accept that there are further aspects of the sector in which competition may not be working as well as it could. As a result of this, we welcome both the OFT market study and the Competition Commission market investigation. In particular, the moral hazard identified by the Competition Commission in its theory of harm one and the related issues encapsulated in the theory of harm two, may mean that some outcomes are not optimal for the consumer, thus for our members.

In line with our business focus, we strongly believe that the emphasis of the market investigation and any outcomes from it should be on removing cost to the consumer and creating a level playing field, both for the competition between insurers and for the consumer experience, regardless of whether or not a policy holder is the at-fault driver in any given situation. This is how we operate at NFU Mutual. We approach all claims alike, regardless of whether or not they are fault claims. We do not seek to derive a revenue stream from claims where our members are not at-fault and the cost will be paid for by our competitors.

Our business model is to manage our expense ratio to allow us to pay out a higher percentage in claims to our policy holders rather than driving up profitability for shareholders. Looking at the market as a whole, however, it is our view that the claims handling process could, in some situations, be made more efficient. The cost savings resulting from this efficiency should be passed onto the consumer. We recognise that price is not the only aspect of competition. As we have already acknowledged, we also strongly value quality of service. We consider that greater control over cost is in the interests of all concerned. We therefore support the Competition Commission's continued focus in your Annotated Issues Statement on the first two theories of harm, and consider that this is where most efforts should be directed going forward.

We consider that the scope of the Competition Commission's investigation to date has been correct and has neither missed out any important factors nor included any superfluous concerns.

Whilst there are several points remaining for the Competition Commission's consideration, which do not touch on NFU Mutual's business model, for example, price comparison websites, we are happy to take your questions during the hearing, and thank you for inviting us to attend.

Q. Thank you all for these very clear and helpful opening remarks.

I would like now to move on to more focused questions. The first group of question are on post-accident repair services, and I would like to start off with Direct Line Group on these questions.

The first one is: Why do you give non-fault customers the choice of claiming through their own insurance company or going through a claims management company when claiming on their own insurance company seems a much more costly option for the consumer?

A. (<u>Mr Maddock</u>) We encourage our customers to notify us directly. In terms of the broader market response - maybe that is best answered by those that outsource their FNOL processes.

A. (<u>Mr Woolgrove</u>) To be very specific, we do not refer any of our customers to claims management companies.

Q. Are there are any disadvantages to your customers for that, for example, do they worry about losing their no claims bonus, even if they are not at-fault because they are dealing with their own insurer?

A. (Mr Maddock) Specifically for us, we do not differentiate. We do not believe we have a problem with NCD. Where our customer clearly is not at-fault we waive the excess. Sorry, your question related to NCD?

Q. Yes.

A. (Mr Maddock) Yes, and they will have their bonus, allowed, and we will recover the excess on their behalf. I think as Gordon has rightly said, allow the NCD, and I think others could comment, but I think it is a pretty broad market.

Q. Are there comments? Yes, Robin.

Q. (Mr Aaronson) Can I say, you say very firmly you don't refer your claimants to CHCs and CMCs; why not?

A. (Mr Maddock) We do not. We believe that, you know, part of our customer proposition is to keep our customers mobile, so we will provide them with access to a hire vehicle, should they need one and their claim necessitate one.

A. (Mr Woolgrove) We own a network of repairers and we believe we can control the quality for our customers; we can provide timely repair services and we believe it is a good way of managing costs, so for us as a large player, we think managing our insured repairs and replacement vehicles is a strong customer proposition that allows us to manage the claimant cost as well.

THE CHAIRMAN: Clearly, different insurers have different practices in that respect. I would like to hear some other comments on this issue.

A. (<u>Ms Connelly</u>) We give our customers a choice and that has evolved over time. I take on board what Steve said and certainly the test that we did a few years ago on waiving excesses are becoming very short in the market and a number of insurers refused to pay back the excess and separate the claim, and that led us, along with the customer view of wanting to claim directly from the third party and put their bonus at risk to, in some situations, give our customer the option of referring to a partner accident management company.

With regard to the quality of the repairs; that is something that we monitor very closely. We monitor complaints and repairs. It is something that we stay very close to. Just like you have said, the customer services has very high importance to us also.

A. (<u>Mr Hannah</u>) esure runs a very similar model to Direct Line. The only comment I would add to that is the vast majority of our claims are reported directly to us. Those that are not are obviously those that can be captured by another insurance company for the repairs and hire to be completed.

Other than that, I think you will get commonality because we mainly have direct writers in the room. Where we will see marked differences in other models, I think, are with intermediated companies where there is a broker involvement and, therefore, the use of outsourced accident management services is probably more prevalent.

A. (<u>Mr Scott</u>) For NFU Mutual, our members would report their claim either to their local agent or through to the RAC, who handle our first notification of loss calls for us. That is partly because we also provide RAC breakdown cover as part of our motor policy. The claims are then all handled by our own in-house claims teams following the FNOL reporting and customers are advised of the benefits of our approved repairer network, but are free to choose a non-approved repairer without financial penalty, should they so wish, and either way our staff engineering team would manage the cost and the quality of the repair from that point forward. We make no distinction in the process as between fault and non-fault members.

A. (<u>Mr Sinho</u>) It is a very similar position in AXA; we do not differentiate between fault and non-fault. They would both be directed into our repairer network and we give customers options of going down that route but penetration is very high.

Q. Looking first at repairs, it appears to us from what we have looked at so far, that there are various ways in which non-fault insurers or claims management companies can increase repair costs, whether by allowing a repair subsidiary to charge high prices, getting referral fees from approved repairers, getting rebates from paint or parts suppliers, which are then not reflected in the invoices which are passed onto the at-fault insurers. How prevalent do you think that these opportunities are for repair costs to be increased to at fault insurers? Again, can I look at Direct Line first?

A. (<u>Mr Maddock</u>) In terms of repair costs I think there is arguably less scope for oversupply. Clearly, the repair damage is a matter of fact and I think readily challenged. I think our focus, specifically for the Direct Line Group, is making sure that we have an appropriate quality repair, so cheap does not always necessitate quality and a good outcome for our customers.

I think in terms of the rebates and referral fees, the way I would contextualise this is if you look, for reasons that Gordon stated, right across the market, a number of legal attempts to, in effect, control the impact of inflation, then rebates, discounts are a good offsetting mechanism to inflation for most insurers. I think the degree to which there is residual detriment or notional detriment to a customer really is the delta between the rebate that is received and actually flows through to the bottom line and, therefore, the premium for the end consumer and that element that is retained. I think I would argue that in a highly competitive market and exercising good procurement practice to get a rebate and discount, for example, where those are available, is exactly the good thing to be doing for consumers.

Q. Any other comments on that?

A. (<u>Mr Hannah</u>) esure would not know precisely the particular model another insurer deploys, but what we do have is management information which will look at our third party claims costs against repairs and highlight those insurers that are out of step with that. As I said in my earlier introductory statement, there are existing ways for insurers to challenge what they might deem to be excessive repair costs. It is unusual - the case in point, as I have mentioned with [✂] and that is being taken all the way through to litigation, but there are other ways. Bilaterals are certainly one way of addressing some of these problems.

Q. (<u>Mr Stern</u>) The problem with the industry is that not everybody is doing what you do. It is clear that by having bilaterals you can solve some of these problems, but not everybody has bilaterals with everybody else. The result is that you get a situation where certain costs within the industry will cost more because of the way that the thing has been done. I do not want to go into much more detail here, but we have had evidence that repairs, supply of raw materials and other supplies and services cost more when provided to one insurer, as opposed to another. So, the question is if you are not setting up a bilateral agreement, what other solution do you have to try and get round this particular problem? One solution would be to have banks and banks of people surveying every single invoice and challenging every single one, but that would be very expensive. So what is the practical solution to this problem?

A. (Mr Hannah) Well, like you say, bilaterals is one attempt at solving that. Technically, there is no reason why an insurer should remain unhappy with the amount that it is being asked to pay out in terms of a subrogated claim against them. They equally have a right to scrutinise the estimate and dispute that figure. I think the issue with repairs is not of the same magnitude as there is still a relatively small amount of cost to dispute if your average repair is £1,200 and you want to challenge a case because you think it might be £100 and £150 more than it should be. The issue is, is that really material, how do you best challenge it? If you went to court to challenge it, it is a very expensive way of doing that. Hence at esure, what we tend to do is to look in the round at those claims coming from different insurers and scrutinise those ones where the costs seem excessively high.

Q. (Mr Wright) Is that excessively high against other insurers or excessively high against retail rates?

A. (Mr Hannah) Against other insurers, yes. We rank them.

Q. (Mr Wright) So do you take the retail consumer rates into account for repair costs?

A. (Mr Hannah) We look at actually what we pay out. So that is the amount claimed and what we pay out. Just by way of background to show that whilst not perfect there is some efficiency in the process in that over a period of time instead of sending each other estimates and invoices, a lot of paper exchange, we have an agreement whereby we dispense with paper, so in terms of frictional costs of paying those claims, it is actually relatively efficient. I think the issues come when a particular insurer perhaps claims a lot more than the average of the rest of the insurers.

Q. (Mr Stern) So you know who the insurers are who are giving you higher invoices for the specific work?

A. (Mr Hannah) Yes, indeed we do, but the issue gets somewhat more complex because you could, from that, glean that perhaps they are inflating those costs, but the other side of the story you have to look at is they might underwrite a different type of portfolio. So the portfolio mix then comes into play.

THE CHAIRMAN: If bilaterals are an effective way of controlling those costs differentials, why do you think bilaterals are not more prevalent?

A. (Mr Hannah) A couple of reasons I think. A bilateral, by its nature, is an agreement between one insurer to another. It becomes ostensibly a problem when you have a lot of bilaterals with a lot of insurers, so there is a plethora of bilaterals. If the terms of each of those bilaterals are different then administratively it is very difficult to manage. I do not want to go into solution mode now, but the concept of an overarching multilateral bilateral with the same terms could be of benefit. It is certainly something to think about when it comes to solutions.

Q. So some of industry wide protocol? What do the rest of you think of that?

A. (Mr Stevens) Another complicating factor is that the effect of a bilateral requires both parties to have total control of their claims process and that tends to be the case with the direct operators. There are a number of operators who sell by a broker who do not have direct control of the claims process because the claim is only notified to the broker and therefore may not be able to deliver on their side of the bargain, which creates makes the bilateral harder.

Q. (Mr Oram) Would it really be so onerous for insurers to establish bilaterals? The top four cover a big percentage of the market. The top ten cover a very big percentage of the market. Is it as difficult as you say or are there other reasons for the bilaterals?

A. (Mr Hannah) I think one reason is the point I mentioned earlier about the plethora of different wordings for bilaterals, but I think David made a very good point. We, as direct writers, control virtually 100 per cent of our claims and then in terms of the bilateral with an intermediate company, it would not be on a like for like basis unless they could control 100 per cent of their claims.

A. (Mr Chappatte) The reason why they do not control - you probably know this, but just in case you do not - the reason why an insurer with a large brokerage network does not control their cost in the same way is because a broker network is highly dependent on referral companies, and each time they get a claim they will tend to pass it on to credit hire companies because that is a very important source of revenue for them.

There is asymmetry, as David has said, in terms of economic interest when you are dealing with direct insurers versus brokerage-dependant insurers.

Q. (Mr Stern) Could I ask one question? Gordon, in response to an earlier question you were saying that part of the problem within the industry is getting good data in order to work out exactly what the claims are and what you should be spending. It seems to me that the availability of data is a problem that we faced as a Commission looking at this market, and I guess that all of you sitting around the table represent the top echelons of the market. Is there some way that one can improve the quality of the data within the market? They say of the clearing banks, and I do not know whether this is true or not, that they have all inherited old fashioned systems and the result is they do not have as good an idea of what they are doing as they should have.

A. (Mr Hannah) I think precisely it is, yes.

A. (Mr Woolgrove) I think the second point is it is also a much more complicated web of repairers, small body shops under the arches all the way through to large scale, and so any vehicle can be repaired in a multitude of places. Clearly, the Audatex system is a way of looking at repair methods. It is used by many insurers to understand the method and costs, but there is a big complexity, and so how do you gather information from a wide web of actors within the system, so any insurer could have a bilateral, potentially a fraction of the repair solutions for customers.

A. (Mr Hannah) I think the other point is that, and it has been quite challenging within the data that you have requested in terms of its granularity in terms of either payments for paint or for parts. When you look at the whole cost of claims, then that is a very small part of our total claim spend and that is why our systems do not routinely drill down to the cost of paint on an individual repair basis.

A. (Mr Scott) I recognise the point that Gordon made at the outset, which is that it is not always that easy to understand or see what model or charging structure is present in a claim you receive from a not at fault insurer, who presents a repair cost to you.

We have fairly good data in terms of what we spend on our own repairs, but typically claim systems are good at capturing that, but would not necessarily be suited to capturing the claim as presented from the subrogating insurer. We follow a similar approach to one Gordon described in terms of tracking what we ultimately pay out to different insurers and then seek to address where we believe there may be excess charging of whatever nature going on. To discuss that, initially, with the individual insurer., We have a small number of bilaterals and in other cases we would challenge individual costs as they are presented, for example, on total loss if we felt that the amount being recovered there was excessive relative to the nature of the vehicle.

THE CHAIRMAN: I have a question about relations with repairers. We have had evidence from repairers and they have told us that they often make recommendations to insurers on how a repair should be conducted, then the insurer then pushes back on seeking to repair parts rather than replace them, for example. Sometimes they allege not fixing things that are hidden. Do you think your contracts with the repairers give them excessive incentives to cut costs?

A. (Mr Maddock) I would totally disagree with that. At the end of the day, I can speak personally; most of us around this table are retail brands. I think one of the biggest PR disasters we all see is actually fixing a vehicle that ends up in a fatal accident. There is utterly no incentive at all to compromise on the quality of the repair.

Are alternative repair methods used? Yes. I believe they are probably not widely used in the market. From a Direct Line Group perspective I can say it is used where that repair has a utility and a customer. So this can be a marginal decision between actually repairing the vehicle or putting the vehicle into a total loss situation. What we find from a lot of our consumer feedback, our customers prefer their own vehicle. They can never replace a vehicle to the same sort of standard and quality than the one that we have, so I think alternative repair methods are used only when it is safe to do so, and sort of equally where there is a benefit to the consumer for doing so as well.

Q. I would like to come back on the general issue of repair costs in a minute, but we did want to get more information from you on this issue you have just mentioned of when you have a vehicle that is on the margin of being repaired or written off; you said the pressure from the consumer is generally to repair rather than write off. They prefer, if possible, to keep their vehicle, at least the pressure of your customer is not to write off. Is that the common experience?

A. (Mr Maddock) Sorry, could I just sort of define "pressure"? It is a conversation, but it is only repaired when it safe to do so. So, for example, for us, all of our repairs are PAS 125 accredited. They come with a five-year warranty, which either is greater than or at least matches the manufacturer guarantee. So, pressure only in terms of taking this into account as a consumer's preference, but never to compromise quality.

Q. No. That is the sense in which I meant the question.

A. (Mr Maddock) Just for the avoidance of any doubt.

Q. It is the consumer preference, yes. You are aware of that consumer preference and its effect; any other comments on that issue before I get back

[inaudible]

A. (Mr Sinho) Our contracts with our network repairers have no incentives which would require them to do anything other than give quality repair, so I would just like to cover that point. We do not own our own repairers, we have a network of repairers and a lot of things that have been spoken about in terms of the quality we expect of PAS 125 applied to those repairers as well.

In terms of discussion with customers over how to resolve a claim, there must be times when the correct thing to do is to write a vehicle off. There may be a number of reasons why a customer may not want that. I think we have a number of tools at our disposal there to come to an amicable outcome with the customer. We may use different types of parts. We may even, in rare cases, use recycled parts. This is all as part of a dialogue with the customer to achieve the right outcome. So if there is objection to writing off a vehicle it is not about saying that is what is going to happen and then there is a dialogue which tries to find the right outcome for both parties.

A. (Mr Scott) Yes, I would agree with that. I think it depends on the customer. There are some customers who are disappointed to learn that their vehicle is not going to be written off because they are worried about having it back after it has taken what they regard as major damage. So it depends entirely on the individual consumer and we would follow the same approach that Ian has outlined as to look at each case and be driven predominantly by what is safe and what is proper in terms of returning a vehicle onto the road to the standards that others have talked about.

A. (Ms Connelly) I would just agree with everything that everybody says here. With regard to quality of repairing, we again give a five-year guarantee on the repairs and to put things into context, it would be good for the Commission to understand the kind of headache that you get when you have a rectification complaint and the time and effort it takes to deal with it with a customer who is not happy with the style of repair to their car, and the cost that puts on your business is huge and is something we work particularly hard to avoid.

Q. (Mr Stern) What proportion of the repairs, roughly, do you get rectification complaints, if that is not sensitive?

A. (Ms Connelly) All of our garages have an SLA to keep complaints under a certain level and when rarely they do go above that then we act upon that and increase the audits and, if necessary, if that does improve, we take them off our network.

THE CHAIRMAN: Any other comments on controlling repair cost before I move on?

A. (Mr Maddock) I think the only point I would make is to really echo and reinforce something that Gordon said earlier. For me, the question is actually not looking at repair in isolation, total loss in isolation. What is the total average repair bill in the industry because clearly, you know, we will take a cosmetic repair, it is very, very easy to replace something than send something into a type of loss. It takes a few more hours, but it is ultimately more cost effective to repair something. So, for (a hypothetical) example, a wing mirror at £750 labour may be higher, more hours spent repairing it, but the overall repair bill is sort of cheaper, and I think it just reinforces a point that Gordon made.

A. (Ms Connelly) I think that is an education for our garages, is it not? We promote and repair and replace a lot, and this is an opportunity for the garage to actually make more money from the labour than it is from the parts. I think that is a challenge for us and to educate better on that front to understand it better.

THE CHAIRMAN: I would like to move onto post-accident TRVs. So thinking about temporary replacement vehicles, what role does the level of the referral fee play in choosing which party to provide post-accident TRV services to your customers? Let me look at Admiral on this first.

A. (Ms Connelly) Admiral has been with the same partner for TRV for as long as I can remember. We do not switch around because they give additional money, but the customer services element of it is the first and foremost thing and our working relationship with the partner that we work with.

Q. So I do not imagine that referral fees are irrelevant because of the part of the relationship, but what other factors do you consider? You may have had the same partner for a long time, but no doubt you will review whether that is the right partner to have.

A. (Ms Connelly) We do. We benchmark and we have tendered. It is quality services coverage. We need to make sure that their cars are available quickly for people that need them. Obviously, the fee does come into account, but it is not the only thing that we take into account.

Q. Can anyone else comment on that issue?

A. (Mr Sinho) I think for me the fee is probably secondary to the service irrespective of any fees which insurers will be getting. The key thing is to understand that what your customer is getting is a good quality service with a good quality product. So what really drives the selection of your partner has to be those considerations.

A. (Mr Stevens) I think it is important to perhaps - and maybe it is pre-empting a subsequent question - but slightly challenge the assumption underlying the question that actually referral fees are a cost in this context.

You could well argue that if you were to ban referral fees tomorrow, there is nothing as a result of that would lead to a reduction in car hire cost per case settled, because cost per case settled is driven by a combination of GTA and case law and things like that. So if you ban referral fees it is a major plus for claims management operations and car hire providers, but it is not clear it is a plus to the consumer. In fact, you could argue that referral fees slightly mitigate the horrendous cost to the industry as a whole for excess car hire. Some of that excess revenue, which is driven by inappropriate regulation, actually ends up with an insurer as opposed to the car provider.

A. (Mr Scott) I think again your question is predicated on the presumption that TRV solutions for customers are always linked to a referral fee but that is not the case. For NFU Mutual, if our policy holder is regarded to be not at-fault, they have the benefit of before the event legal expenses insurance within the motor product, through which we then provide a non-credit hire temporary replacement vehicle that is provided on day rates and then the cost of that is recovered from the at-fault insurer with no referral fee and no credit hire. If our member is at-fault and so there is no one to recover from, the vehicle is provided by our approved repairer network and again not on a credit hire basis. So there are models which do not involve referral fee at all.

A. (Mr Hannah) I think David has opened up a very interesting and complex argument on temporary replacement vehicles where the referral fees are part of the problem. They are symptomatic of the excessive costs of specifically credit hire costs. There are other bits of that jigsaw in addition to referral fees.

There are the GTA rates, that they are not fit for purpose. There is really the case law and the judicial guidance setting quite high benchmarks in terms of what is acceptable when mitigated on a challenged case.

I know you do not want to get into solutions now, but I think you have to think of those three elements together.

A. (Mr Scott) Yes. Despite what I have just said I would certainly agree that there are other factors and our view is the same as the one Gordon has expressed around GTA; it had its purpose at the time but is now not fit for purpose. The rates within it are too high.

Q. (Mr Aaronson) Could I follow up on what you said about using direct hire rather than credit hire. Given that other people in the industry are going for credit hire arrangements and gaining a referral fee, are you not passing up a profit opportunity by doing it that way?

A. (Mr Scott) The legal expenses component of our motor product used to provide the mobility solution for not at-fault customers on a credit hire basis. We changed that to an insured hire basis, so in other words, it is a policy benefit provided without the customer needing to sign up to credit hire. We made that choice partly because of the concern over our own members' dissatisfaction with the concept of referral fees when it started to become more prevalent in media publicity around personal injury claims, for example, but also because, for our members, it involved them signing up to a credit hire arrangement with concerns there in terms of possibly having to accept that they were ultimately financially responsible for that cost. If the credit hire claim could not be perused, they might have to go to court and had concerns about what they were actually signing up to. So there was a strong service component for us in changing that approach as well, to move it to a straightforward policy benefit insured hire.

Q. (<u>Mr Aaronson</u>) Can I just ask a question about the GTA. You say it is not fit for purpose, the levels are too high; what is stopping insurers influencing that to reduce the levels?

A. (<u>Mr Hannah</u>) It is a negotiated outcome. With the credit hire industry there are probably a number of competition aspects in terms of us doing anything other than what is a very open and transparent negotiation. But we are one half of the equation.

A. (<u>Mr Stevens</u>) Is it not worth saying in the context that any negotiations is about the reference of power.

A. (<u>Mr Hannah</u>) Exactly.

A. (<u>Mr Stevens</u>) If negotiations fall apart then you fall back on case law and GTA is a compromise that reflects the fact that case law perpetuates an efficient structure.

THE CHAIRMAN: Can I specifically ask, in relation to the GTA, on the issue of whether credit hire companies provide a vehicle which is better than the customer needs or longer than is really justified by the repair job being done or simply overcharging for the vehicle? How effective do you think the GTA is in controlling TRV costs in those respects?

A. (<u>Ms Connelly</u>) Probably a high percentage of claims that go to the GTA and are successful in doing that, whether it is on need or in length, we have a large team of people that is spending their time doing that.

I think all of us have tried to do something about unsavoury behaviour in typical examples of booking cars in when they are still roadworthy and booking them in on the weekend before, and talking people into hire cars is something that we have talked about on the committees and I kind of think we have failed to -- there is not teeth, as such, to be able to do anything about it.

Q. So you do find the GTA is effective on these issues?

A. (Ms Connelly) To an extent.

A. (Mr Stevens) To a lesser extent because it was still high frictional costs because of the need to challenge where the initial intention was that the GTA would remove frictional costs, but in the absence of sanction it is not necessarily fully functional to frictional costs, so we still have to invest a lot of money in actually challenging on a case by case basis.

A. (Mr Woolgrove) It is also voluntary and does not cover many of the most excessive case where again I think everybody will have experience of trying to challenge that legally.

Q. So why does everyone not sign up to the GTA?

A. (Mr Hannah) The reason why they do not sign up to the GTA is that even those that still remained subscribed to the GTA, which is most insurers, I think it will be common to find that they actually agree rates directly with the credit hire operators at a rate, which is lower than the GTA rates. That is why it is not fit for purpose.

A. (Mr Sinho) I think, from my point of view, GTA is quite minimal in its impact. It needs so much still to be debated and which needs to be debated, although I think we still see credit hire companies which need challenge. That reality of the GTA does not remove a lot from the process. Once you take into account the concern over the rates and then you also take into account what still needs to be looked at and scrutinised in each individual claim, the GTA, to me, does not have a great deal to offer.

Now, GTA mark II, or something else like the multilateral bilateral, which I think was the MOU, which we were told was contrary to competition law , but I think looking again at GTA, multilateral bilateral, is something which the industry should do. We should not stand still. But I do agree with people that the GTA, as it currently is, is not the solution.

Q. What about bilaterals then; do you think bilaterals can help?

A. (Mr Sinho) We are perfectly happy with bilaterals. I think it was said earlier on that it is an enormous job to negotiate and put in place bilaterals across the industry to solve this issue. Could we ever move to a multilateral bilateral? Maybe we need to look at that again, but on an insurer to insurer basis I think bilaterals have a lot to offer.

A. (Mr Woolgrove) But they do not capture contract management companies who have quite significant incentives to try and capture claimants and drivers and put them into vehicles for longer than they might need at a higher costs, so bilaterals do not cover that. It is an insurers' solution that does not cover the whole market.

A. (Mr Scott) In considering whether to remain in the unsatisfactory, but partially effective GTA or come out of it and enter individual bilaterals, you are always left with the question: will I just spend as much time policing all those bilaterals as I am in policing the GTA? So what is the margin or benefit of moving from one to the other? We would need to see a more overarching solution to them.

Q. (Mr Stern) Could I be clear; you are saying you do not refer your customers to credit hire companies.

A. (Mr Scott) No.

Q. (<u>Mr Stern</u>) The reason you need to be in the GTA is because you were dealing with claims where other insurance companies or brokers have referred them to credit hire companies?
A. (<u>Mr Scott</u>) Yes, or whatever means a non-fault driver's mobility solution has been provided through a credit hire mechanism then that claim is presented to us by the credit hire company and, as with Admiral, we have a team of people who scrutinise those against the terms of the GTA and against what we believe to be reasonable, if it is outside the GTA, to keep the costs under as much control as we can.
Q. (<u>Mr Stern</u>) Thank you.
THE CHAIRMAN: Can I come back to the issue of repair duration because our survey results suggest that the average repair duration is higher for a non-fault insurer or claims management company managing non-fault claims than for captured non-fault claims. Why do you think this might be?
A. (<u>Ms Connelly</u>) I guess speaking for ourselves on capture claims, we have worked hard at controlling the repair times as far as we can, so we get the car booked in as soon as possible, we monitor it, we make sure parts are available and any delays are dealt with and we try to get the car back on the road as quickly as possible.
Q. Is there any scope for the credit hire companies to influence the length of the repair duration?
A. (<u>Ms Connelly</u>) I would have thought there were many opportunities for them to come into agreements with the repairers to extend repair times.
A. (<u>Mr Hannah</u>) I think particularly there is when the repair is done on a credit repair and then you have the credit repair and the credit hire together. Where

the credit hire is separate from the repair then we, as the insurer, have ways to try and ensure that the repair duration is kept to a minimum which then impacts the duration of the hire.

A. (<u>Ms Connelly</u>) I think we probably all work hard to even control the repair time when it is under a credit hire claimant time by monitoring the length of certain repairs and by trying to intervene. It is not unknown for us to source parts ourselves for a third-party credit hire repair just to bring the repair time down.

A. (<u>Mr Sinho</u>) And I think it is true that with the captured claimant we have to work hard to keep that person working with us, so we give them a very good service. The driver is not there for a credit hirer/repairer and they do things slightly more slowly than we would think is acceptable. There are steps in the process which are a bit more relaxed and I think they lead to an overall longer repair period and hence hire period, and I think that is what we see coming through in the data.

Q. Do you think that a captured non-fault claimant is likely to receive a lower level of TRV service than a non-fault claimant whose claim is managed by a party other than the fault insurer?

A. (<u>Mr Sinho</u>) I do not believe so. I know what is said in the Annotated Issues Statement, but I think the approach we take towards captured third parties is not going to lead to that result.

A. (<u>Mr Hannah</u>) I think, in our experience, a captured claimant will be given the opportunity, depending on their wishes. Sometimes a courtesy car they are perfectly happy with. Sometimes they do not want to hire at all, sometimes they want a like-for-like car. Really, our whole purpose on the whole claimant capture side is to keep our customer happy with good repairs, satisfy the need for hire, as that non-fault claimant is potentially someone who we might want to insure in the future. So there is every incentive to give very good service.

A. (Ms Connelly) I think you are right. You just risk losing them along the process if you do not give the car that they need or want because they will get captured by somebody else during the process. They will go to the garage or get approached by other people.

A. (Mr Hannah) If you under provide then the risks are that they will go to a credit hire company, which then you would incur the additional cost of that. So as Lorna was saying that there is every incentive to ensure that the customer is happy on a captured case.

A. (Mr Sinho) Just one thing, Gordon, I think the way we deal with captured claimants is there might be more of a dialogue about what the real need is. My feeling is that when it comes to the credit hire provision there is a perceived need delivered whenever a vehicle is delivered, sometimes whether the third party wants it or not.

So, I think the dialogue that we had with the captured claimants includes a greater understanding of what do they really want; what are they happy with. It is interesting to see the survey that some people felt they were over-provided. I think there is that closer connection with the captured claimant, the good service and there is a dialogue about what they actually need.

THE CHAIRMAN: I am looking to see whether we have any other questions, because I think we are at the end of the range of issues we wanted to raise with you on theories of harm one and two. But are there any final comments that you want to make on any of the issues we have covered?

A. (Mr Stevens) I have just one last point on that final conversation. I think it is clearly true that there is some extension of days on hire, there are some potential cases where there the key issue is the information of the daily rate, and the need to find a way of getting the daily rate so the insurers have to pay closer to the true cost of the product. It is much more achievable for car hire than it is for repair because it is a much simpler product.

THE CHAIRMAN: Thank you for that.

I suggest we take a five-minute break now, and we will then get into questions on a range of other issues we wanted to raise with you.

(short break)

THE CHAIRMAN: I want to move on and ask a couple of questions about Northern Ireland, and I will start off with AXA on Northern Ireland.

First of all, the basic question: Why do fewer insurers write private motor insurance in Northern Ireland than in the rest of the UK. If you can just introduce yourself for the sake of the transcript.

A. (Mr Bradley) Good morning. I am Philip Bradley. I am Executive Director of AXA Ireland, with responsibility for our business in Northern Ireland.

Q. Why do more companies not write insurance in Northern Ireland?

A. (Mr Bradley) There are a few reasons; it is a small market - it is less than 3 per cent of the UK market; geographically separate with a history of political unrest. There are some differences in the legal system, both in terms of process and in quantum and the way products are distributed is different. There is a desire, amongst Northern Ireland customers, to deal often face-to-face in branch locations.

There are quite a number of competitors in a small market. We know there are at least 38 insurers actively underwriting the market and more underwriting agencies.

Q. But it is still the case that AXA is in a very strong position in the Northern Ireland market?

A. (Mr Bradley) It is, we have developed a strong position since we entered the market in 1996.

Q. Why is the Northern Ireland market so broker led?

A. (Mr Bradley) I think two primary reasons. I think one is that a lot of insurers were reluctant to do business in Northern Ireland because of the size and political instability and also the claims process was different. So a lot of direct insurers do not write insurance in Northern Ireland. Secondly, the preference for people to deal face-to-face, all the major brokers in Northern Ireland have large numbers of branch networks in each town and city, as do we.

A. (Mr Howell) I think it is a cultural, social peculiarity - relative to GB mainland in terms of insurance issues. That is the preferred method of shopping for insurance.

Q. The lower presence of PCWs in the Northern Ireland market, is that part of the same story?

A. (Mr Bradley) The PCWs are all active in Northern Ireland. In fact, there is a special one devoted to Northern Ireland. I think your own research shows that only about 10 per cent of people have decided to buy through the price comparison sites. I think it is down to firstly that the intermediaries have good, strong customer relationships and there is a desire for people to deal locally.

People can access prices through the price comparison sites and they can access various company prices through the intermediaries.

A. (Mr Howell) The price comparison websites that exist and distribute have significant weight in terms of marketing, just as they do in Great Britain. The reality of the situation is they have not seemed to have offered the same perception of the value of that custom and proposition of price comparison all in one place compared to the public service or the nature and interaction that people will see through their local broker.

It is not that price comparison sites do not exist and it is not that they are not seeking to develop them, because they are, and they offer the equivalent propositions in Great Britain. It is just that it has not proved to be as popular from a purchasing perspective.

Q. Can I open that up to the rest of you; why is the Northern Ireland market different?

A. (Mr Hannah) I think Phil has identified certainly the major aspects that esure proffer up is: One, size; secondly, esure is a direct writer and not an intermediated company, the direct market is not strong; and thirdly, there is a different civil justice legal system and we do not have the experience, expertise or appetite to enter it based on those matters.

A. (Mr Woolgrove) Identical reason, and we also lack any experience and so again from the competitive advantage we would bring to that market. Direct Line Group does not sell through personal lines brokers in the UK and so we have no experience of that market.

A. (Mr Diston) Perhaps I'm just agreeing with what a lot of what has been said, but maybe I think there is still a legacy of the Troubles and the political unrest, as an insurer who has operated in Northern Ireland for a large part of its time. Whilst we are a direct writer we are a very different direct writer proposition perhaps to some of the people here today, but I think there is still a 'Troubles' legacy.

Q. Sorry, do you want to add anything?

A. (Mr Stevens) I think we have been operating in Northern Ireland for a decade and I think those points about its differentness are very valid. The only additional point I can bring to it is that we find our commercial movement on price comparison sites in Northern Ireland is considerably lower than in other parts of the country, which would be consistent with AXA's statement that people prefer to deal face-to-face and prefer to deal with the a local agency.

Q. Our analysis of costs and claims in Northern Ireland suggests that claims ratios are lower in Northern Ireland that the rest of the UK, which on the face of it might suggest that this is a more profitable market than the rest of the UK, which raises the obvious question: if it is a more profitable market why are more players not piling in, albeit it is small, but if it is small and profitable there ought to be an attractive opportunity.

A. (Mr Howell) I think profitability needs to be considered in aggregate and not just from a claims threshold prospective. Clearly, that is, albeit the most significant, that is only one component.

Q. What are the issues of the claims ratios missing that you would see as relevant for assessing profitability?

A. (Mr Bradley) I suppose there are three observations: Firstly, you need to look at the experience over a long period of time. The element that the claims ratio misses is the cost of distribution and expenses, but because the majority of the market is intermediated there is a substantial amount of money paid out in commissions to intermediaries and which obviously has to be funded.

A. (Mr Howell) That is to fund their operating expense of branches and face-to-face interaction, which purely objectively is a more expensive way than interacting either entirely through an on-line centre or through a telephone based services. There are objectively higher distribution costs, which to insurers is purely seen, in the extent of the commission. We clearly do not have any control over those distribution costs and that is the function of the broker, but that is the biggest difference.

A. (Mr Diston) Can I just challenge. I am sure you will understand I am not able to share absolute details in this environment, but I would just like to challenge the premise of underlying profitability. I have to say that is not our experience, our Northern Ireland business typically performs less well than the balance of UK.

We operate the same product, the same business model, the same agency network. We don't approach Northern Ireland in a different way, but the outturn that we are seeing is different.

THE CHAIRMAN: Robin.

Q. (Mr Aaronson) Could I just follow up on what AXA said about entering the Northern Irish market. You said it was in 1996. Do you go back that far?

A. (Mr Bradley) I did. I managed the launch.

Q. (Mr Aaronson) That is great because I wanted to ask how easy that entry was and where there any particular problems you faced?

A. (Mr Bradley) It was slow. We launched the market from a call centre based in Dublin and it took us nearly 10 years to generate about 15 million in premium.

Only when we adapted our model with more business intermediaries, with branch network on the ground in the mid-2000s that we started to make significant progress.

Q. (Mr Aaronson) Do you run your Northern Irish operation as part of an all Ireland?

A. (Mr Bradley) The business model we have is more like our Irish operation. AXA and a number of others manage their operation out of Dublin, as do RSA now, as do Allianz. The reason we do that is that the Northern Ireland market is 40 per cent of the size of the Republic of Ireland market, so it is a bigger opportunity and therefore we devote more investment and attention to it.

Q. (Mr Aaronson) Are consumers in the Republic, do they have the similar characteristic of wanting face-to-face?

A. (Mr Bradley) They do. We have a branch network of 40 branches, with branches in most towns in Ireland. We are the leading motor insurer in the Republic of Ireland and there are similar characteristics.

Q. (Mr Aaronson) Thank you.

THE CHAIRMAN: Can I finish off on Northern Ireland just by asking a naïve question, and there is nothing behind it just other than to understand mechanically how things work. When a direct selling insurer chooses not to underwrite business in Northern Ireland, how do you manage that if a customer just calls you up and says I am interested in a motor insurance quote, and gives a Northern Ireland address; do you say, sorry we do not do business in Northern Ireland?

A. (Mr Woolgrove) Our rating is based on postcodes, so we will probably return a nil value for saying it is not necessarily right, and so we would manage that over the website or the phone.

There are some limited Direct Line Group brands that do write to them, some other brands do, so it would be about the rating structure, whether we return a quote or not. That is how we would manage it.

Just to pick up AXA's point, we have no experience of entering Northern Ireland, but certainly other European markets. It does take a significant amount of time to generate scale and returns and so corporately we would be looking at opportunities to deploy our cost and capital, and again given the relative size of Northern Ireland and the lack of experience, that is why we have not developed into the market. It is a very similar experience in other markets we have developed in.

Q. Thanks. I would like to move on to add ons, by which we mean things like motor legal expenses insurances, breakdown cover, windscreen cover, no claims bonus protection.

We did not say much in our annotated Issue Statement about our analysis of add ons and it is ongoing work, but it appears to us that the claims ratios for some of the most commonly sold add ons are generally very low, roughly below 50 per cent, sometimes well below 50 per cent. Why do you think this is the case; can I look to NFU first?

A. (Mr Diston) Again, we may be demonstrating our difference from some operators in the market. We don't start our product from a relatively paired down base and then seek to sell add ons. We include some roadside assistance, and as we mentioned in our provision of mobility solution, we provide inclusive motor legal expenses. Again, I am sure you will understand that I cannot share details of our margins, but we just factor that into our overall pricing and do not look to subsidise a technical insurance risk price with marginal performance with profit from other ‘add on’ lines.

Q. Any other comments about low claims ratios for add ons?

A. (<u>Mr Howell</u>) I think specifically in relation to your request, again that would depend on the period of time for which you were going to be looking at those type of metrics and performance. For some of them there will be a very, very relatively low factor and frequency, so the propensity to make a claim or the likelihood of making a claim would be very low, but actually when it happens the cost of it is very, very high and therefore it takes a significant period of aggregate time to be able to view these things in totality and for the large number of such add ons; how long they have been sold and how long they exist and that may not necessarily be the case. So I don't think it is an immediate logical conclusion to draw.

Q. So which add ons have the characteristic of having very infrequent, but potentially very high clearance?

A. (<u>Mr Howell</u>) [✂].

A. (<u>Mr Stevens</u>) One of the points to make is that some of the add ons in particular are not necessarily a true record of that. I think it is interesting in that context to read the conclusions of the FCA on legal expenses cover where they pointed to the benefits in terms of the value of recoveries achieved and the convenience to the customer.

On some of the add ons it can be very complicated. I think the Competition Commission may take comfort from the fact that the FCA is investigating in great depth on an add on by add on basis.

Q. We are certainly keeping in close touch with the FCA because we do not want unnecessary duplication between what we do and what they do.

Q. (Mr Oram) Can I just ask: you will have all read the FCA report on legal expenses and in there they cited a very limited case where penetration rate for opting out was 80 per cent and penetration rate for opting in was 40 per cent. Were those figures something you recognised or were they surprising to you?

A. (Mr Woolgrove) I think the experience of the data was pretty robust. I think the FCA has been pretty clear in its expectations now in terms of sales, conduct and process. I think the majority of the industry has now moved to that and I think it reflects their focus of good customer outcomes based on behavioural economics or anything else. Again, I think that for Direct Line Group, we probably have different commercial approaches. We believe customers do value the benefit to tailor their policy. We would try and present add ons clearly so that the customers understand them, and give customers real choice.

There is wide variation in the market in terms of cover and choices, but clearly from a conduct perspective, we have an obligation to make sure customers understand what they are buying, why they are buying it, the price they are paying and that is something the FCA has very clearly signalled as an area of focus for them. So actually that sales process predominantly was the core focus for their motor legal report. They didn't believe that opting out was an appropriate approach and I think the vast majority of the industry, if they did do it, have now moved away from it.

Q. (Mr Oram) To what extent do you think the industry does use profits from add ons to help hold down the cost of the core insurance product?

A. (Mr Woolgrove) For us as an organisation, we are clearly balancing three elements of income; one is underwriting profit, one is the investment income that we generate from our reserves and the third element is other income. The degree to which those offset each other will depend on macro economic conditions, so investment income is materially lower than it historically was - that would point to stronger underwriting discipline because they are writing profitable business. Certainly, other income is used to balance underwriting profit, but again I think each organisation will take an approach. We publically stated that our goal is to make an underwriting profit.

As an entity we think that is sustainable because we believe our shareholders value these are tradeoffs, but they will vary. Different customers have different behaviours, different channels have different economics, and so we will trade a portfolio of approaches with our different brands and our different brands and in our different channels.

Q. (Mr Oram) Going back to NFU, how well do you think consumers understand what they are actually buying when they are buying add ons. I specifically want to take no claims bonus protection and what are legal expenses as examples?

A. (Mr Diston) As I mentioned, our basic premise is to sell a single product with very little opportunity to add on. The covers we have mentioned are a standard part of our offering.

Nevertheless, as part of our sales process, we try very hard to make sure that our customer understands what they are getting so that they can hopefully avoid any duplication elsewhere.

As regards the very specific of protected no claims bonus, again we would make an effort to ensure that the customer understood the benefit that they were getting if they were buying that particular protection.

Q. (Mr Oram) In our survey when we asked specific questions about what protection consumers thought that they had from these elements, the answers did not align very strongly with the correct answer, to be kind. (Laughter)

A. (Mr Diston) I have absolutely no issue with when you referred to the FCA Legal Expenses report. I am sure it is an area that all insurers will be concentrating hard on. I think, as has been mentioned a few times this morning, we are all retail brands. We trade very heavily on brand value and service proposition and the quality proposition that we offer, as do all of the people represented here, and so we are reviewing and reacting to that process, but we believe that we started from a fairly robust place.

A. (Mr Hannah) To me, NCB and NCB protection are not so much an add on, but just an extension to a core policy, and people have been buying policies, either protected or unprotected, for a number of years, together with a working knowledge of NCB scales, but if your research shows that notwithstanding the operation in the market, customers still don't understand it then it is up to us as insurers to ensure that they do understand it. The same applies for legal expenses cover. It is not the easiest thing to explain to a customer, but insurers (if it is, which I believe it is, a useful product) need to be able to explain the cover perhaps better than they have done in the past. So the emphasis is on us to make sure the customer fully understands the product so they can make an informed choice about purchasing that product.

Q. (Mr Oram) The issue with NCB protection seems to be that consumers might think that if you have NCB protection and they have an accident, then the costs are not going to go up. But some of them might therefore have an unpleasant surprise when they find that they still have their NCB, but it is applied to a higher premium because of the accident. The suggestion is that --

A. (Mr Woolgrove) But it still delivers a benefit to them which is valuable relative to the cost (inaudible)

Q. (Mr Oram) But the survey results suggest that the benefit is different from the benefit that they thought they were paying for?

A. (Mr Woolgrove) Then I reinforce what Gordon said; that is a genuine challenge for all of us, together with the FCA, to try and help customers understand exactly what they are buying. The reality is for many insurers, motor insurance is a low engagement purchase. We all have an obligation to try and explain in straightforward, simple language, what every element of cover is.

I think this is a key area the FCA is going to work on to make sure customers do understand what they are buying and what they are paying. Where add ons are optional or otherwise, we have an obligation to do that. So I really would encourage you to work with the FCA to address this. It is in all of our interests. I do not think we are disagreeing this is a concern. We want our customers to understand what they are buying and why they are buying it. It is a competitive market.

A. (Mr Howell) I would probably add a couple of points. I think there are two key tenets to the FCA's thematic review on legal expenses; one was around certain selling practices and the other one was around the understanding of what legal expenses cover actually is and the adjustments. Others have said where there were outliers in terms of practice on both of those things, moving quite quickly in response to that. I can speak for AXA's perspective; the outcome of the FCA review was solely focused on legal expenses. We have taken some of the principles of that review to apply a magnifying glass to our other add-on sets so that we can apply those principles of clarity selling across the sector. Again, that is clearly the right thing to do.

I think a lot of this is a function of the general distribution shifts that has happened with motor insurance over the last 10 years, primarily done face-to-face or through telephone voice contact where there was a clear route to explain these types of things as part of the policy purchasing decision, and obviously the move into a slightly more detached customer/insurer/provider through one of the on-line price comparison websites creates a more difficult challenge for providers to maintain that level of clarity and transparency.

I think everybody here supports the work that both the Commission are looking at with regards to this and the FCA are helping us to take more incentives to the buying plan and the buying plan transparencies.

Q. (Mr Oram) Last question on NCB protection: Do you think there is a risk that NCB protection inhibits consumer switching in the sense that a consumer who has had an accident, but still has their NCB, if they switch insurer they are going to lose their NCB because they disclose the accident to the potential new insurers, who then says, you are not going to…

A. (Mr Diston) NFU Mutual have had no experience to justify or support that observation at all.

A. (Mr Howell) From AXA's perspective, I would probably say the complete opposite. If they have had an accident and they have to fix the NCB we would, at the point of issuing the renewal invitation, they would have their NCB, which was protected, which they would then be able to use for proof and validation of NCB should they wish to.

Q. (Mr Oram) So they could switch their NCB to you? Is that the general practice?

A. (Mr Howell) As an existing customer of AXA, we would provide them with a new notification with the NCB, including the protection at the point of renewal, regardless of the fact that they had had a claim.

Q. (Mr Oram) Would there be any reference in the documentation to their having made a claim?

A. (Mr Diston) They would have to disclose that.

A. (Mr Hannah) They would have to disclose that, yes.

I would say that there is no barrier or no disincentive for them to switch whether they have had an accident or not had an accident.

THE CHAIRMAN: So the NCB is just as portable if they have had an accident?

Let us move on then to PCWs, because I am conscious of the fact that several of you in your opening statements made quite strong statements about the importance that you attach to this part of our work.

If I can direct questions in this section initially to esure. To what extent do you think the growth of PCWs has made the private motor insurance more competitive?

A. (Mr Hannah) I think simply it has allowed customers to research quotes and therefore for alternative suppliers it is much easier than in the past prior to the comparison websites. Really customers only means to get a better quote was to ring the individual providers, and after doing that on three or four occasions, taking about 20 minutes each. There is only a limit to which their endurance in terms of getting quoted can last, and therefore the aggregator is a breath of fresh air for the customer.

So I think it has helped, certainly the customer, to shop around to find the right provider, and clearly when, from an insurer's point of view, our rates are there ranked in order from top to bottom then, ,if we are to get whatever volumes of business that we want, it is very price sensitive. So, small movements in our pricing will make big differences to our conversion, more so with the advent of aggregators than prior to aggregators.

From that perspective, in terms of keeping premiums down and competitive, I would argue that price comparison websites are a good thing.

Q. Have they led to more switching by consumers?

A. (Mr Hannah) Probably switching is around about the same. It certainly gives them more opportunity in making it easier if they do want to switch. It really depends on the pricing of the individual insurer at renewal for the proportion of customers that do end up switching.

Q. What about on incentives for insurance companies to spend on advertising; does the existing of PCWs reduce the incentive to advertise directly?

A. (Mr Hannah) It depends on the business model of the insurer and to what extent they use different distribution channels will depend on their amount of direct brand spending.

A. (Mr Woolgrove) Speaking for Direct Line, we have brands with Direct Line that are not presently on PCWs and we have brands that are. That is based on customer insight, that there are different segments of customers, some of whom are very confident using PCWs; they are very happy to search, they are happy to buy. There are other groups of customers that would prefer to deal direct, and so we deploy a range of brands.

Certainly, the commission rates on a PCW do inform our spending on our direct acquisition. Those are tradeoffs that are constantly made in terms of the efficiency of our business, but it all starts from there are strong customer preferences who are using different brands, their level of confidence and trust, the importance they place on price verses cover to Direct Line Group, that is why we play with a portfolio of brands through different channels, it allows us to talk to more of the market, but it starts with understanding the customer.

Q. (Mr Curzon Price) Can I just step in and ask a question? If they are different segments, why do you decide to have different brands? You could use the same brand, couldn't you?

A. (Mr Woolgrove) The marketing theory people would say certain brands have different characteristics, why somebody appeals to Direct Line, which infers straightforward and self-control; versus Churchill the dog, reassuring will hold my hand through the process. The practical experience is that the Churchill customer is very, very different to a Direct Line customer. You can immediately tell when they are on the phone that they have different needs, different expectations and so it goes to marketing theory which is - can brands extend? But I think a range of other insurers would have different brands and different segments.

Q. (Mr Curzon Price) Just to pursue this a little bit; when you come in the PCW rankings if you had a brand that had been heavily advertised anyway, wouldn't it already be an advantage, wouldn't there be spill over advantage to using an existing brand with some recognition? So maybe have a click through, even if you came in at number 4 in the ranking rather than being at number 1?

A. (Mr Woolgrove) Clearly, there are commercial choices between the price you are able to offer, the investment you make in the marketing, the range and number of brands, the complexity that infers. That is a commercial choice. You could have a no name brand that would be at the top: you could have no investment in that brand, you may have a lower click through rate or the price might be so attractive it goes through.

Q. (Mr Curzon Price) So it has nothing to do with separating the prices out with the product?

A. (Mr Woolgrove) It is all commercial choice. The prices are clearly influenced by a range of customer experiences, investments, how much premium you would generate for a particular brand. So it is a commercial choice of different insurers to have either single brand or multiple brands. Clearly, we choose to have multiple brands.

THE CHAIRMAN: Would you say in general are PCWs expensive as a sales channel or economical as a sales channel?

A. (Mr Woolgrove) We would look at the commission payment and clearly would take choices around how much of that business we would write. We would write that up against the lifetime value of a customer generated through that channel, and we would compare that to any other brand or channel combination where we are investing a different amount in a different way in direct acquisition or a commission payment for an intermediary, and we would trade off all of those things.

The Direct Line Group focuses on the lifetime value of that customer, how long they stayed. Other factors are the profitability versus how much investment to acquire them. So it is a dynamic calculation of which simple acquisition cost is just one element.

Q. But is it possible to say that the simple acquisition cost is, on average, higher through PCWs or lower through PCWs than through other channels?

A. (Mr Woolgrove) A range of outcomes.

Q. Okay.

A. (Mr Woolgrove) Sorry to be flippant, but it is the commercial reality. Some direct campaigns are very, very efficient; you set that off against the cost of acquisition through a PCW.

Q. (Mr Stern) Do you experiment with your brands on PCWs such that you might pull out of nowhere a brand to which you put no marketing at all so that the customer does not know what is associated with that brand, but you give it an absolute rock bottom price so that it hits the top of the rankings, as opposed to one of your familiar brands, say it has a dog which people feel comfortable with, which does not have the finest pricing, but does have quite a bit of recognition and the rest of it. Do you use this as a marketing tool?

A. (Mr Woolgrove) I can't talk because we haven't introduced a new brand and it goes back to some of the constraints of our old systems in terms of that experience, so others might be better to comment.

We do constantly experiment with our brands - with different price points, with different offers. That is part of trading in this highly competitive market to try and balance profitability and volume.

Q. (Mr Stern) Does a PCW give you a particular window to do this in that you wouldn't otherwise have?

A. (Mr Woolgrove) It gives you some very direct and very prompt feedback about your competitiveness of other insurers, other brands. Different insurers will have different strategies about how they play on PCWs.

THE CHAIRMAN: I think one of you referred in the introductory remarks to the wealth of bargaining strengths of insurers and PCWs. Do you think that the relative bargaining power of the two sides has changed in recent years? I am looking at you, Gordon; do you have a view on that?

A. (Mr Hannah) I think it has taken some time for the PCWs to develop to such a stage now where there are effectively four major players in the market.

I guess the perspective that I would have would be that the balance is there or thereabouts. Customers can choose their route to market, as Tom has rightly told us about.

Q. Any other comments around the table?

A. (Mr Woolgrove) We would be very happy to share some experience of I guess their growing influence and power, and so we feel pressure now. The hypothesis of some of your data is some of these contracts are multi year. Certainly as they account for 60 per cent of new business distribution, we believe that the threat of not having our brand on there is pretty weak because obviously there are a significant number of brands in there, but we do have some examples we are happy to share with you of some of the renegotiation that we are currently undergoing and some of the pressures that the PCWs are placing on us as a business and the commercial choices we have had to make as we have done that, but probably not in this forum, if that is okay.

Q. Any of the rest of you able to make comments in this forum on how insurers bargain with PCWs; are there credible bargaining threats about delisting that can be made?

A. (<u>Mr Diston</u>) I am afraid we do not operate via PCWs, so I can't really comment.

Q. Let us move onto MFNs, which I gathered from the introductory remarks, some of you have quite strong views about.

Would you like to say what the broad effects of MFNs are?

A. (<u>Mr Hannah</u>) If I can start from the very simple view of it, as I understand the definition between wide and narrow, certainly we do take wide MFNs, then the absence of those, I think is helpful. It is helpful from the PCWs perspective in terms of an incentive to innovate and be creative and have more customers, and it is also good from an insurer's perspective, where it can better risk price, for example, and it can better allocate its acquisition costs by PCW.

So, in summary, a wide MFN is, from esure's perspective, not a good mechanism.

Then we move down to the narrower MFNs, this vertical MFN, then I think there are arguments to be made for the justification of one, simply on the basis that as part of the PCWs business model, they are investing in terms of acquiring clients and if those perspective clients use their PCW simply as a kind of shopping tool for cheapest prices in the knowledge that the one that comes to the top of the list, their direct price could be much cheaper, then it does to go to the root of the business model of the PCW.

By and large it is esure's view that PCW's are a good idea. A narrow MFN helps to support the business model of PCW.

Q. By "a narrow MFN" you are saying a restriction on the price on the insurer's own website, on-line sales by the insurers?

A. (<u>Mr Woolgrove</u>) Yes. So, as a company who has no relationship with the

PCW, we disagree with that point for narrow MFNs. We do believe that they present some challenges, but for us we have brands that we write both through a PCW and directly, so linking those two prices would mean that if a PCW did seek to raise its prices with higher commission, we would be obliged to do the same on direct. We do not believe that that is in the interest of customers and so we do think that there are issues of narrow MFNs that are worthy of looking at.

That is particularly true because some customer behaviour is becoming far more now bought through mobile devices, so the prevalence of web as a preference of acquisition is going to make this a growing issue, and so we do encourage you to look at this aspect because we think there is scope for levelling of prices and that leading to customer detriment, so we have a slightly different view to esure on that point.

A. (<u>Mr Howell</u>) I would echo, from AXA's perspective, around the narrow alternative. There is potential for constraint in the customer proposition, innovation that an insurer would wish to effect in the presence of narrower MFNs, so there is that potential.

There could be new elements to a proposition or new bits of information that we wish to ask customers, which just having the prevalence of narrower MFNs make the case to kind of explore those types of things much more difficult.

A. (<u>Mr Woolgrove</u>) Just to pick up on Gordon's concern, there are very clear contractual expectations in terms of "poaching." It is right that if a customer is starting on a PCW that they fulfil on the web, does the PCW get the commission? I think there are clear contractual ways for establishing that don't require narrow MFNs.

Q. Admiral.

A. (<u>Mr Stevens</u>) I think we would certainly endorse the concern about the wide MFNs. In your earlier comments and questioning about the negotiating power, at the moment we are in a situation where you can be in a situation where it is all mutual instruction; either I come off and don't pay or I stay on and pay. The removal of MFNs gives a intermediate option which is, fine you want to charge me a lot more, my price could be more expensive than yours as a result.

That, I think, is an important discipline that we can reflect the underlying cost in our pricing of PCW, so we would entirely endorse the wide MFN.

The narrow MFN is going to be a choice for you because on the one hand, I 100 per cent agree with Gordon that you have a freeloader problem that might undermine price comparison's long term health, and it has been good for the consumer. On the other hand, I think there is - this my point about negotiating power - the ability to say not only are you risking making yourself more expensive versus all the price comparison sites competition, you are also risking making yourself expensive versus my own activity and you are making it potentially the case that it becomes more worthwhile needing to advertise direct that I have a better product on the site. So you have a real trade off and it is a very difficult call as to what the best outcome is.

Q. I think you have all been clear on what you have said there, but can I press a little bit further on the issue of broader MFNs and their effect on competition between PCWs. Do you think that the broader MFNs are a disincentive to innovation; can you say a bit more about that?

A. (Mr Hannah) I think if they could only portray the same price then there would be no incentive for PCWs possibly to innovate and to make their sites more attractive, to maybe add some other risk assessment work to get a better risk through that. It is going to stifle both competition and innovation.
A. (Mr Stevens) It is not so much innovation as competition. It reduces the PCWs option of going for a low cost, low price to the consumer because if they go to their pal and say, I will give you a lower cost percentage and give you a lower price, that option is constrained if the panel has to say I cannot give you a lower price because I have signed MFN clauses to put on the PCW. So it sort of closes out that option for a price comparison site.
Q. Can I ask about cash back websites; to what extent has the emergence of cash back websites challenged the position of PCWs?
A. (Mr Stevens) I think the data on that suggests that almost to no extent. I think there was a belief about two or three years ago that that they may emerge as a really important distribution channel but I think the characteristics of a cash back customer have been such that they are not really that attractive and they have not become major competitors.
Q. What about Google and Tesco because some people thought that the price comparison market would be a market in which these new players might be very successful?
A. (Mr Woolgrove) The evidence, I guess, for Tesco Compare, is it is the fifth and hasn't really had experience and it shows the importance to the PCWs of advertising and attracting customers to their site. I am sure we all watch Google with some concern in terms of the data and the access to customers they have. We wait to see how they develop. There is a trade off for them in

terms of some of the other revenue sources versus the business model. It is not necessary for us to talk about their commercial strategy.

Q. Anyone else have views?

A. (<u>Mr Stevens</u>) I think Google bought a competitor in the market a year and a half or so ago and have not -- sorry, Google brought a price comparison player a year and a half or so back, I forget the exact time, and are yet to make a big impact, but what will be very interesting to see is whether in fact a few years hence this Commission is convening on Google and whether its entering into price comparison has been done in a way that is strictly competitive with them but that is perhaps early to comment on whether that is the case.

A. (<u>Mr Woolgrove</u>) I think David is volunteering for a front row seat.

Q. I would like to move on then finally to supplier relationships and here I will direct the initial question to Direct Line Group. We are aware that many insurers have contracts with suppliers of paint or parts to the repair process, and these contracts generate rebates. What efficiency do you think this kind of relationship achieves, do you think the buying power of insurers is significant compared with what repairers would achieve if they did their own negotiating on paint and parts?

A. (<u>Mr Maddock</u>) I think, from a DLG perspective, we see these as an unambiguously good thing. I think, for customers, it is inconceivable to think that with an element of scale that quality and cost would come down where you weren't exercising appropriate and good procurement practice. That clearly benefits the customer both in terms of the quality of the procurement decisions that we make and ultimately the cost.

Q. Anyone else have comments on that issue?

Some of our analysis of relationships between insurers and repairers suggests that insurers contracts with repairers gives the repairers a reasonable margin on paint, but squeezed them pretty hard on labour costs.

Can you comment on that; can you say why that might be a sensible way to manage the relationship with the repairers?

A. (Mr Maddock) I would argue that is probably a question that is probably best directed to the repair industry. I think whenever you are procuring sensibly and appropriately it is a balance between cost and quality and I think for the reason that I have stated before, clearly I think none of us with strong retail brands would compromise the latter, i.e. the quality.

I cannot clearly go into specifics around our particular relationship, but happy to do on a bilateral basis. But from a market stand point that would be certainly my experience.

Q. But the question is not about costs versus quality, but it was a sense from a number of players in the repair industry that they are under very, very strong pressure from the insurers on labour costs, but not such strong cost pressures on other elements, but somehow in this overall relationship their allowed labour costs have been squeezed to the bone, but other costs, other channels of the costs of where they are allowed to make their profits. We are trying to understand, if that is true, why that might be a sensible way to manage the relationship. [inaudible]

A. (Mr Maddock) I guess I would probably make two points there: Firstly, labour is a big component of our spend and therefore receives an appropriate amount of attention. I would reiterate again it is around an acceptable rate, not one that compromises the quality. Secondly, I guess I am somewhat confused by your second point because I don't feel that, certainly from our perspective, they would necessarily see through, certainly through legitimate means, into how we procure our claims or indeed parts. They may gather information from illegitimate means, but that is probably a question that is best directed to the repair industry.

Q. Any one else have comments?

A. (Mr Scott) We do not have any direct price relationships with paint manufacturers or parts manufacturers, and we follow the approach of looking at what an appropriate balance rate for labour and for parts and materials should be for the quality of the work that we want to do.

From past experience, if you squeeze rates on labour down you just end up policing hours more carefully. So, what matters is: what is the necessary work for the repair; how long should it take; and what is a fair price for the length of time it needs to take? We review that regularly with our group repairer partner and we have an interest in ensuring that they can make an appropriate margin so that they can deliver quality and stay in business.

A. (Mr Sinho) I agree with Matthew. These contracts are negotiated, the repairers are happy to enter into them. We monitor the quality, the quality is not suffering. I have not heard any complaints of the like that may have been made to you, so I do not have an issue.

We do not mandate parts. That is down to the repairer, so I do not hear any of those sorts of comments come through from our group repairer network.

Q. (Mr Stern) Do you mandate the paint that your repairers need?

A. (Mr Sinho) We don't. There is a fairly loose relationship with a paint supplier, but to our entire group network we do not mandate to them that they must use that.

Q. (<u>Mr Stern</u>) One of the issues we have heard is that some repairers say that they could get paint cheaper, the same paint cheaper if they were not getting it through a supply network. Obviously, some of you would say they should not be getting it elsewhere with good reasons, and that would be useful, but that is not a restriction that you impose?

A. (<u>Mr Sinho</u>) No we don't. Some of the things I have seen referred to about minimum volumes, about mandating of the provider and of the paint, that does not appear in our relationship with our repairers.

Q. (<u>Mr Stern</u>) Is there anybody who would like to give the contrary view?

A. (<u>Mr Maddock</u>) Certainly. I mean, from our perspective we do not mandate minimum volume; it is an appropriate amount of paint for the job.

We do have a paint relationship. You can get cheaper paint on the market, but it is of a lower quality and is not supported by a manufacturer's warranty, so therefore it is around getting an appropriate price for and an appropriate quality.

I think again I would reiterate most supply relationships are a matter of the privilege between the buyer and the supplier, and I am struggling to see how a third party can legitimately see through that type of relationship.

Q. (<u>Mr Stern</u>) So if someone says that they can get the same paint that you have specified and an insurer has mandated we should regard that claim with suspicion?

A. (<u>Mr Maddock</u>) I would suggest that.

A. (<u>Mr Hannah</u>) esure has been silent on the issue It is something we have no real experience of in terms of mandating paint or parts.

As regards the repair rate and labour rates, they would say that wouldn't they, but we have no strong views about mandating.

A. (Ms Connelly) Admiral is the same. It does not mandate labour paint or parts.

THE CHAIRMAN: Any other questions on this.

We have come to the end of the range of issues we wish to raise with you, but there may be issues that you wish we had covered, because you were dying to say something, so this is your opportunity, before I wind up, if there is anything that we have somehow missed that you have been keen to put across and this meeting, i.e. any final takeaway message; is there anything that you would want to say?

A. (Mr Woolgrove) For Direct Line Group, I think you have covered all the issues from your annotated issue statement and clearly we are interested in your working papers and some of your analysis, which we do think there is insight that we can share with you on that. This hearing has covered a level of detail which we would welcome.

I think the critical point is, as you hear from other parties that you do remember that this is a complicated industry and insurers have a huge incentive to try and manage the claims cost, but our ability to do so is limited by case law and precedent and the wide range of actors. So, as Gordon says, repairers would complain about the labour rates, wouldn't they? I am sure you are going to hear that going forward.

The most important thing for us is customers do benefit from a switching market, premiums that are very transparent and that claims costs do directly feed into premiums, so our incentive is to manage these costs as best we can.

I think that is the critical point that you remember going forward in terms of our businesses, our franchises and that we manage that going forward.

A. (Mr Hannah) The only thing I would suggest to bear in mind is this matter of keeping in perspective that the overall investigation is looking at customer detriment and at the impact of any theories of harm actually on the prices that the consumer is paying. In that respect, clearly your focus on credit hire is absolutely the key to this.

Q. If I can, in conclusion, just pick up one point which Tom just made. I can assure you that one thing that we have learned so far is that this is a very complicated industry. I did also note the message that several of you put across in your introductory statements, but if we do find issues that we wish to make recommendations about, we are very conscious of the fact that in a very complex market, changes are likely to have unintended consequences and therefore need to be approached in a spirit that respects that risk very carefully. That is an issue we are very conscious of.

I think that this has been an extremely helpful session for us. We have covered a wide range of issues. We have had very clear views expressed by you, so let me close by once again thanking you for the time that you have taken today in coming and participating in this session; for the time that I know will have gone on behind the scenes in preparing for it; and more broadly, for all the work that you are doing to help us with this very important market investigation, so thank you all very much.

Key to punctuation used in transcript

--	Double dashes are used at the end of a line to indicate that the person’s speech was cut off by someone else speaking
…	Ellipsis is used at the end of a line to indicate that the person tailed off their speech and didn’t finish the sentence.
- xx xx xx -	A pair of single dashes are used to separate strong interruptions from the rest of the sentence e.g. An honest politician – if such a creature exists – would never agree to such a plan. These are unlike commas, which only separate off a weak interruption.
-	Single dashes are used when the strong interruption comes at the end of the sentence, e.g. There was no other way – or was there?