

CIS GENERAL INSURANCE LIMITED

Market Investigation into Private Motor Insurance

**Response
to the
Competition Commission's
Annotated Issues Statement
of 5 July 2013
and
Working Papers**

9 September 2013

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CIS GENERAL INSURANCE LIMITED

MARKET INVESTIGATION INTO PRIVATE MOTOR INSURANCE

RESPONSE TO ANNOTATED ISSUES STATEMENT AND WORKING PAPERS

1 INTRODUCTION

1.1 This Response is made by CIS General Insurance Limited ("**CISGIL**"). It contains CISGIL's observations on the matters considered by the Competition Commission (the "**Commission**") in the Annotated Issues Statement (the "**AIS**") published on 5 July 2013. Where relevant, observations are also provided on certain of the various Working Papers published subsequently by the Commission that relate to a specific Theory of Harm ("**ToH**") considered in the AIS. However, CISGIL does not, in this Response, comment in detail on every issue considered in the AIS or in a Working Paper.

1.2 CISGIL welcomes this opportunity to comment on the AIS and the Working Papers. CISGIL trusts that its observations will assist the Commission in finalising its provisional findings and in identifying possible remedies to those market features which it considers prevent, restrict or distort competition to the detriment of consumers and therefore lead to an adverse effect on competition ("**AEC**"). CISGIL looks forward to continuing to engage with the Commission throughout the remainder of its investigation.

2 EXECUTIVE SUMMARY

2.1 There is much in the AIS and Working Papers with which CISGIL agrees, although there are a small number of aspects of the Commission's 'emerging thinking', as set out in the AIS and Working Papers, with which CISGIL does not agree.

2.2 The market for private motor insurance ("**PMI**") is both highly competitive and efficient at the underwriting level. However, a number of market practices and features, identified in the AIS and relating Working Papers, lead to excessive claims costs as a result of insurers operating on an increased and inappropriate cost base when acting as the fault insurer. This has both affected underwriting profitability and led to increases in PMI premiums for motorists. A significant proportion of the excessive claims costs are due to the increasing costs of personal injury claims (including for whiplash) and fraud: recent legal changes have sought to address this. However, a proportion is the result of the separation of cost liability and cost control that arises from the system of motor insurance in the UK. This leads to inefficiency and fault insurers bearing inflated costs for repairs, temporary replacement vehicles ("**TRVs**") and vehicle write-offs.

2.3 CISGIL accordingly strongly agrees that a serious AEC plainly arises from the separation of cost liability and cost control in fault claims, which leads to the over-costing of repairs and the over-provisioning and over-costing of TRVs, as well as practices relating to over-costing of vehicle write-offs. This, together with overall impact on the consumer, should remain the principal focus of the Commission's investigation.

In summary:

- (a) this is the result of a combination of anti-competitive practices and features of the market for PMI and related markets (including for the provision of vehicle repairs, TRVs, vehicle salvage, claims management services and vehicle paint and parts) identified in ToH 1, ToH 2 and ToH 5, which exploit the separation of cost liability and cost control. Many of these practices are undertaken by parties other than insurers (in particular, claims management companies ("**CMCs**") and credit hire companies ("**CHCs**")), such that the excess profits generated by them permanently leave the PMI market altogether;
- (b) the Commission correctly identifies that these practices lead to increased costs for fault insurers, which in turn lead to increased PMI premiums for motorists. However, CISGIL considers that the Commission has underestimated the costs to fault insurers: CISGIL estimates that, for its own business, these practices increase repair costs by £[redacted] (as compared to captured third party repairs carried out by its authorised repair network) and TRV costs by £[redacted] (as compared to direct hire). In turn, credit repair and credit hire increases PMI premiums by an estimated £[redacted] (including related frictional costs) and £[redacted] (excluding frictional costs) respectively;¹ and
- (c) this persistent market failure is caused by the availability of credit for TRVs and repairs, and the exploitation of features of the legal systems of the United Kingdom that impose insufficient controls on the costs of non-fault claims, through allowing the recovery of excessive repair and TRV costs,² which are passed on to and borne by fault insurers. This provides many market participants (including CMCs, CHCs, brokers, repairers and some non-fault insurers) with the ability and incentive to improperly generate revenue through increasingly ingenious methods, without proper checks and balances, so raising the costs of insurers and ultimately consumers.

¹ [redacted]

² For example, through the application of the principles laid down in *Coles v. Hetherington* (concerning recovery of the 'reasonable costs of repair', which are considered in WP ToH 1: Over-costing and over-provision of repairs, paras. 30 to 33), *Bee v. Jenson* (concerning recovery of credit hire costs for TRVs), *Clarke v Ardington* (concerning the duration of the provision of a TRV on credit hire terms), *Rose v. Cooperative Insurance* (concerning recovery of credit hire costs for a TRV even though a courtesy car was provided under the insured's own policy) and *Sayce v. TNT* and *Copley v. Lawn* (concerning recovery of credit hire costs for a TRV notwithstanding the fault insurer offering a TRV without charge): the Commission is referred to CISGIL's Response to the Issues Statement (14 January 2013), paras. 4.17 to 4.28, for further discussion of how the common law is being exploited to generate excessive profits by increasing the costs borne by fault insurers.

- 2.4 Whilst the Commission may not itself be able to effect changes to either the common law or the legal systems of the United Kingdom (although it can make recommendations to Government in this respect, for example to legislate to correct features of the common law that allow the recovery of excessive costs and to clarify claimants' entitlements to credit and the 'quality' of TRV provided to them), it is submitted that it can and should control the anti-competitive practices and market features that lead to an AEC as a result of a combination of moral hazard, information asymmetries and vertical integration. In particular, there is no requirement for the use of credit for either repairs or TRVs, as the needs of non-fault claimants can be met fully without credit. In addition, parties managing a non-fault claim (such as a non-fault insurer, repairer, a CMC or a CHC) should be permitted to recover only the actual and efficient costs incurred by them, net of any discounts or rebates and without artificially transferring costs, revenues and profits within different parts of integrated groups. Again, this would have no negative impact upon the legitimate interests of non-fault claimants in being provided with their legal entitlement (including in respect of repairs and, where need is demonstrated, the provision of a TRV).
- 2.5 CISGIL considers that an AEC also arises from most favoured nation ("**MFN**") clauses imposed on insurers by operators of price comparison websites ("**PCWs**") (ToH 5), which in part arise because operators of PCWs have a degree of market power which insurers are unable to counteract (ToH 3). This is the case for both 'narrow' and 'broad' MFNs, which restrict both price and non-price competition and discourage innovation. Whilst PCWs clearly have benefits for consumers and are an important distribution channel for insurers, these benefits can be achieved without resorting to MFN clauses.
- 2.6 In relation to the other matters identified in the AIS, CISGIL considers that no AEC arises in respect of the following market features and that no further investigation is necessary:
- (a) possible information asymmetries from the beneficiary and procurer of post-accident services being different (ToH 2): there is no under-provision of either repairs or TRVs and both fault and non-fault claimants' legal entitlements are satisfied following an accident;
 - (b) the sale of 'add on' products (ToH 4): these products are generally provided for a small additional premium and provide significant additional protection and benefits to motorists, ensuring that they are appropriately insured. Whilst assessing the profitability of these products is not straightforward (due to difficulties in allocating costs), profitability does not appear to be excessive and there is effective competition in their provision. In addition, the Financial Conduct Authority ("**FCA**") is undertaking a review of 'add on' products generally, and motor legal expenses insurance ("**MLEI**") specifically. Therefore,

it is more appropriate for the FCA to continue its consideration of these issues rather than for two separate enquiries to be undertaken by the FCA and the Commission, given that the FCA has the necessary powers to take any action that might be needed to ensure the protection of consumers;

- (c) possible obstacles to customers switching PMI provider (ToH 4): as the Commission itself observes, switching (or 'churn') rates for PMI are extremely high, which is indicative of an absence of barriers to switching. Automatic renewals and cancellation fees are not barriers to switching. Equally, no claims bonus ("**NCB**") protection is not a barrier to switching; and
- (d) ownership of PCWs by insurers or brokers (ToH 5).

3 THEORY OF HARM 1 – MORAL HAZARD FROM SEPARATION OF COST CONTROL AND COST LIABILITY

Overview

- 3.1 CISGIL agrees that there is manifest over-costing of repairs, TRVs and vehicle write-offs. In addition, there is also manifest over-provisioning of TRVs. The practices identified by the Commission in ToH 1 lead to excessive and unnecessary costs for fault insurers and therefore lead to the prevention, restriction or distortion of competition to the detriment of consumers and thus to an AEC. This detriment is made worse by the information asymmetry identified under ToH 2: non-fault motorists are, unsurprisingly, either unaware of or indifferent to over-provision and over-costing. The harm caused by the separation of cost control and cost liability should remain the priority focus of the Commission's investigation. It would appear that a number of other insurers have expressed the same view to the Commission during recent hearings.³
- 3.2 CISGIL is, however, concerned that the Commission has underestimated the excessive costs being imposed on fault insurers: CISGIL estimates that, for its own business, these practices increase repair costs by £[redacted] (as compared to captured third party repairs carried out by its authorised repair network) and TRV costs by £[redacted] (as compared to direct hire). In turn, credit repair and credit hire increases PMI premiums by an estimated £[redacted] (including related frictional costs) and £[redacted] (excluding frictional costs) respectively.

³ See Notes of a hearing with DLG, NFU Mutual, Admiral, esure and AXA held on 16 July 2013, in particular the evidence of Direct Line (at page 7) and AXA (at page 12) and NFU Mutual (at page 16).

- 3.3 The separation of cost liability and cost control leads to inefficiency and inflated costs for repairs, replacement vehicles and vehicle write-offs. Numerous parties have the ability and incentive to engage in practices that generate unnecessary and excessive revenues, including:
- (a) the payment of referral fees to win business, which are recovered from the fault insurer;
 - (b) the recovery of repair, credit hire and other costs which are excessive and further inflated by referral fees;
 - (c) charging differential costs for fault and non-fault repairs that are otherwise identical in nature;
 - (d) failing to pass on to the fault insurer the benefit of discounts and rebates negotiated by the non-fault insurer;
 - (e) the recovery of repair and hire costs that are higher than the actual costs incurred by the non-fault insurer, on the basis that the higher subrogated cost is 'reasonable' by reference to what an individual motorist could obtain on the open market;
 - (f) excessive provision of TRVs on credit hire terms, through failing to identify and apply strict criteria for the 'need' for a TRV and permitting hire of unnecessarily expensive vehicles at hire rates double those for an equivalent direct hire;
 - (g) excessively long credit hire periods, through unnecessary extensions to repair periods and prolonging the time taken to agree a vehicle write-off; and
 - (h) failing to apply properly the legal obligation of a non-fault motorist to mitigate loss.
- 3.4 The parties engaged in these practices include some insurers, as well as brokers, repairers, CHCs and CMCs. Much of the excessive revenues (and profits) is generated by parties other than insurers and therefore permanently leaves the PMI sector altogether. The grossly inflated costs are borne by insurers and, ultimately, consumers through higher premiums. There is a clear consumer detriment. To the extent that some insurers benefit from engaging in these practices, by generating additional revenues (for example by accepting referral fees in respect of TRVs or by over-costing for repairs undertaken by their own or authorised repair networks),⁴ these insurers are put at a competitive advantage in providing PMI products as compared to those insurers (such

⁴ The observation that some of the benefits of over-costing and over-provision "flow back to non-fault insurers" (WP ToH 1: Over-costing and over-provision of repairs, para. 8) must be viewed with caution and be qualified by the fact that many insurers (including CISGIL) do not engage in these practices and therefore do not receive any of the 'benefits' of over-costing and over-provision.

as CISGIL⁵) that do not do so and seek to compete fairly. This further distorts competition in the provision of PMI, causing further consumer harm and thus a further AEC.

- 3.5 There are two principal reasons for this persistent market failure: (i) the existence of credit arrangements for TRVs and repairs; and (ii) exploitation of the legal system that does not impose sufficient controls on the costs of subrogated non-fault claims.
- 3.6 Whilst the Commission has correctly identified the AEC arising from the exploitation of the moral hazard opportunity afforded by the separation of cost-control and cost liability, CISGIL is concerned that the Commission has not fully understood and identified the AEC caused by the use of higher credit for both repairs and the provision of TRVs. Rather than attempting to explain the higher costs of credit repair and hire by reference to the higher costs of CHCs and CMCs, the Commission should consider whether credit is justified at all. It is plainly not: the use of credit is wholly unnecessary in order for non-fault motorists to be provided with appropriate mobility following an accident (whether their vehicle is being repaired or whilst it is being written-off) and for repairs to be carried out to damaged vehicles.
- 3.7 The fact that credit is not justified [redacted] is demonstrated by the following:
- (a) where a fault claim is 'captured' by the fault insurer, the motorist's vehicle is fully repaired and a TRV appropriate to their mobility needs is provided;
 - (b) as regards repairs, the majority of insurers (including nine of the 10 largest PMI insurers) do not make referrals to CMCs and manage the repair aspect of non-fault claims themselves, without using credit:⁶ the clear implication is that those insurers that do make such referrals do so to generate referral fee income and

⁵ As CISGIL has informed the Commission both in writing and at the hearing on 19 July 2013, CISGIL does not engage in any of the practices identified as raising the costs of fault insurers in respect of repairs, TRVs and vehicle write-offs:

- (i) it does not pay or receive referral fees or rebates for repairs, TRVs or vehicle write-offs;
- (ii) it does not directly refer customers to credit hire companies. Non-fault customers with MLEI (which is an additional cover) are referred to Co-operative Legal Services ("CLS"), which assists such customers in the recovery of uninsured losses, including TRVs. However, a TRV is provided on credit hire terms only where the customer can demonstrate a strict need for a vehicle of a higher specification than the courtesy car provided by CISGIL's authorised repairer (under the PMI policy) and no referral fee is paid or received. Therefore, only [redacted]% of those customers receive a TRV on credit hire terms;
- (iii) it does not refer customers to credit repairers. Non-fault repairs managed by CISGIL are undertaken by its approved repair network and are handled in exactly the same way and at the same cost as an equivalent fault repair;
- (iv) it charges the fault insurer in subrogation only the exact repair costs incurred by it, which involves it passing on negotiated discounts received from its authorised repairers and parts suppliers; and
- (vi) when writing-off a customer's vehicle, it does so on the basis of the actual salvage value and not an artificially low value, and it does not receive a referral fee from the salvage company.

⁶ WP ToH 1: Over-costing and over-provision of repairs, para. 28.

capture part of the excessive profits of the CHCs and CMCs which manage credit repairs;

- (c) almost all motorists have fully comprehensive cover and/or MLEI cover. Therefore, their repair and TRV requirements can be met by their own insurer, without the need for credit, with a TRV that is appropriate to their reasonable mobility needs being provided on a direct hire basis, should a TRV be necessary at all; and
- (d) the use, between certain insurers, of bilateral agreements (whether formal or informal) for both repairs and TRVs.

In all cases, repairs are undertaken and TRVs are provided without credit being provided to the non-fault motorist and at lower costs, without any negative impact upon the legitimate interests of non-fault claimants in being provided with their legal entitlement (including in respect of repairs and, where need is demonstrated, the provision of a TRV). It therefore also follows that the legitimate needs of non-fault claimants (as regards TRVs and vehicle repairs) can be met fully without the intervention of either a CMC or a CHO, as the non-fault claimant can be provided with repairs and a TRV by either his or her own insurer or the fault insurer. CMCs and CHCs are therefore providing a 'service' (such as providing repairs and a TRV) that is both unnecessary and inefficient, in that it can be provided by others at a considerably lower costs without any detriment to the non-fault claimant.

- 3.8 Whilst it is clear that the excessive costs incurred as a result of the inappropriate and unnecessary use of credit are most manifest in relation to the provision of TRVs on credit hire terms, they are still significant in relation to repairs on credit terms.⁷ Consumer detriment arises in relation to both repairs and the provision of TRVs and the two aspects of non-fault claims are closely linked, as most claims will involve both vehicle repair and the provision of a TRV. The detriment is particularly pronounced in those claims where the same CMC or CHC is managing both the vehicle repair and the provision of a TRV: in these cases, the CMC or CHC has a clear incentive to keep the vehicle off the road for as long as possible in order to extend the hire duration and thereby maximise vehicle hire charges.

Repairs

- 3.9 CISGIL agrees with the Commission's view that the market failures arising from the separation of cost control and cost liability lead to increased costs for fault insurers in respect of repairs. This clearly leads to over-costing of repairs. Non-fault motorists are

⁷ See WP ToH 1: Statistical analysis of claims costs.

unsurprisingly indifferent to over-provision and over-costing of repairs and replacement vehicles; this is because they have no responsibility for bearing any of the costs.

- 3.10 Credit repairs lead to higher costs through the greater use of OEM parts and more frequent replacement of parts (instead of parts being repaired). The Commission identifies this practice,⁸ but concludes that it is not "unreasonable or excessive" and therefore does not represent over-provisioning.⁹ CISGIL disagrees: organisations providing credit repair have an incentive to engage in these practices, which will generate additional income for them (for example in rebates or discounts, which are then retained). This, as the Commission recognises, leads to excessive repair costs.¹⁰
- 3.11 The Commission identifies over-costing of repairs where these are carried out by either a credit repairer or a non-fault insurer.¹¹ The sums identified by the Commission in the AIS and the associated working paper (ToH 1: Over-costing and over-provision of repairs) are themselves considerable. However, CISGIL is concerned that the Commission underestimates the excessive revenues generated and costs imposed. CISGIL estimates that, for its own business, credit repair leads to an additional £[redacted] per claim (when compared to captured third party repairs carried out by CISGIL's authorised repair network). This has added approximately £[redacted] (including related frictional costs) to the motor policies underwritten by CISGIL during 2012.¹²
- 3.12 In addition, it appears that some of the results of the non-fault survey in relation to overprovision are contradictory, with different amounts being stated for the difference in repair cost between a non-fault repair managed by the non-fault insurer and a non-fault repair captured by the fault insurer.¹³
- 3.13 CISGIL agrees with the Commission that a number of strategies are used to improperly generate additional revenues by inflating the costs of non-fault repairs, which are passed on to the fault insurers.¹⁴ In the case of insurers, these can include using either their integrated repair business (owned by them) or their authorised repairer network to recover in subrogation repair costs that are in excess of the net repair costs actually incurred by them, for example by inflating repair bills (through improperly including overhead costs) or by failing to account for discounts and/or retrospective rebates. CISGIL does not engage in any of these strategies, so neither generates excessive revenues from its own repair network nor extracts part of the excessive profits

⁸ WP ToH 1: Over-costing and over-provision of repairs, para 4 (a).

⁹ WP ToH 1: Over-costing and over-provision of repairs, paras. 14 to 16.

¹⁰ *Id.*, para. 4.

¹¹ *Id.*, paras 4 to 7 (credit repairs), 9 to 11 (non-fault insurer repairs) and 12 (both).

¹² [redacted]

¹³ See, for example, *id.*, para. 12, where two different numbers are provided.

¹⁴ *Id.*, paras. 35 *et seq.* See also para 3.3 above.

generated by CMCs and CHCs. It is thereby at a competitive disadvantage to those insurers that do.

- 3.14 The impact of these strategies can be reduced, although not eliminated (due to differences in insurers' books of PMI business and bargaining strength), through the use of bilateral agreements, whether formal ([§]) or informal (such as 'RIPE' agreements) and 'knock for knock' arrangements. The existence of such agreements demonstrates that the identified strategies have no justification and are simply revenue raising initiatives. However, bilateral arrangements have had limited effectiveness, as they are not adopted industry-wide and [§]. Furthermore, bilateral agreements do not exist with CMCs and CHOs. Therefore, they are only limited means for individual insurers to counteract what are plainly unjustified and unnecessary strategies to generate excessive revenues.
- 3.15 The Commission correctly identifies that the costs of a credit repair are considerably higher than an insurer-managed repair (whether 'captured' or non-fault). However, in almost all cases it is unnecessary for the non-fault motorist to be provided with repairs on credit terms including because such motorists will almost always have fully comprehensive PMI cover (90 per cent)¹⁵ and/or MLEI cover,¹⁶ which can be used.¹⁷ In these circumstances, the non-fault motorist can use either its own insurer or the fault insurer to manage the repairs, without the use of credit and without consumers' needs and legal entitlement in respect of repairs being compromised, which are indeed protected where repairs are managed by an insurer (as the Commission itself has found when considering ToH 2¹⁸).
- 3.16 It therefore follows that whilst a CHC or CMC managing a repair claim may incur certain additional costs compared to an insurer (although it is by no means clear that these are justified), these arise because of the unnecessary and inefficient use of credit. These costs are a deadweight loss. The Commission should therefore be wary of seeking to explain and use these costs as being a justification for credit repairs being more expensive than insurer-managed repairs. This is even more the case for those CMCs which have their own repair networks and who can therefore (but choose not to) provide repair services on the same basis as insurers, without the use of consumer credit. The Commission should also consider whether it is appropriate for CHCs and CMCs to be able to recover the cost of credit, including for non-recoverable bills and referral fees:¹⁹ it plainly is not appropriate.

¹⁵ See WP Background to claims management process, para 19.

¹⁶ Around [§] per cent of CISGIL's customers take out MLEI. [§].

¹⁷ See paragraph 3.7 above.

¹⁸ See paragraph 4.4 below.

¹⁹ WP ToH 1: Over-costing and over-provision of repairs, paras 91 and 92.

- 3.17 CISGIL also makes the following observations in relation to the over-costing of repairs:
- (a) the GTA is ineffective in assisting fault insurers in challenging inappropriate repair methods used by credit repairers. In addition, scrutiny by independent engineers is also ineffective.²⁰ This is because any challenge can succeed only if the CHC/CMC or its repairer is in breach of the GTA,²¹ with the maximum repair costs allowable under the GTA being both very generous to the CHC or CMC and considerably in excess of the costs that an insurer would incur for the same repair.²²
 - (b) whilst the number of hours taken to implement a repair will be similar regardless of the party managing it²³ (due to industry standards developed by Thatcham and vehicle manufacturers and the use of repair cost estimation systems), it does not follow that the time that the vehicle is off the road and in the repair facility is the same: overall repair times (i.e. days the vehicle is off the road) are considerably longer when the repair is managed by a CHC or CMC, in order to maximise the provision of a TRV and thereby generate excessive hire revenues, particularly as credit repair is usually not offered on a standalone basis, but only together with credit hire.²⁴ CISGIL is therefore surprised by (and disagrees with) the Commission's statement that "it is not clear from the evidence that non-fault repair durations are longer when a non-fault claimant is provided with TRV services under credit hire than under direct hire",²⁵ as the evidence is clearly to the contrary;
 - (c) whilst a CMC or CHC will incur costs in managing a repair²⁶ (as does an insurer, albeit at a lower level²⁷), these are generally more than covered by the

²⁰ *Id.*, paras. 8 and 100.

²¹ The GTA provides that: "The initial claim advice submitted by the CHO will identify the independent engineer who has been instructed and the location of the damaged vehicle. At the discretion of the at fault driver's insurer they may arrange their own inspection of the damaged vehicle to validate the costs involved. *Any adverse findings from such an inspection will be shared with the CHO but will not affect payments to be made to them unless they or their nominated repairer are shown to be implicated or are in breach of the terms of this protocol.*" (emphasis added)

²² For example, the GTA provides that "[the hourly labour rate shall be] A reasonable and appropriate figure based on geographic location and bodyshop facilities. The repair figure should not be influenced by who gave the instructions on the basis that the engineer is independent and not a representative of one or other party. The engineer should negotiate appropriate market discounts to the retail rates charged by a garage including ensuring that all standard market discounts and commissions are passed on to the insurer, including labour, parts, paint and materials and engineer's fee. The rates should not be out of line with the rates available in the locality in question."

²³ WP ToH 1: Over-costing and over-provision of repairs, para. 71.

²⁴ *Id.*, para. 95.

²⁵ See WP ToH 1: Over-costing and over-provision of TRVs, para. 165.

²⁶ WP ToH 1: Over-costing and over-provision of repairs, paras 92 to 95.

²⁷ *Id.*, para. 97. As the Commission identifies, the difference is almost entirely due to the costs of unrecovered repair bills (which should not in any event be borne by the fault insurer, but by the CHC or CMC which has incorrectly failed to identify a claim as non-fault and has then taken the business decision not to pursue the customer: see *id.*, para. 101(c)) and referral fees (which are entirely caused by the use of credit).

considerable excess revenues generated from the provision by it of a TRV on credit hire terms; and

- (d) CISGIL does not agree that credit repair services are "slightly better" (for the consumer) than repairs managed by the non-fault insurer.²⁸ It is common practice for insurers to waive the excess for non-fault customers that meet certain criteria and customers making a non-fault claim will usually retain their NCB. In making this assessment, the Commission would also appear to be confusing the provision of repairs with the provision of services for the recovery of uninsured losses (which include the excess, loss of NCB, diminution in vehicle value etc.) under tort law²⁹: these are additional services and should be charged for separately from the repair, where their provision is appropriate. However, CISGIL agrees with the finding that "these differences are [not] relevant to the difference in the costs of providing repair services".³⁰

Temporary replacement vehicles

- 3.18 CISGIL agrees with the Commission's view that the market failures arising from the separation of cost control and cost liability lead to increased costs for fault insurers in respect of TRVs: there is clear evidence of both over-costing and over-provisioning of TRVs. This is manifested in excess profits and the payment of very substantial referral fees by CHCs and CMCs to generate new business, as the Commission has rightly identified.³¹ However, CISGIL is concerned that the Commission has under-estimated the magnitude of the costs to fault insurers of this over-costing and over-provisioning. CISGIL estimates that, for its own business, credit hire leads to an additional £[~~£~~] per claim (when compared with direct hire). This in turn adds approximately £[~~£~~] (excluding frictional costs) to the motor policies underwritten by CISGIL during 2012.³²
- 3.19 Non-fault motorists are, unsurprisingly, indifferent to the over-provision and over-costing of TRVs, as they have no responsibility for bearing any of the costs: even in those circumstances in which their claim was not in fact a non-fault claim, the CHC or CMC managing the claim will take the commercial decision not to recover from the motorist the TRV (and repair) costs incurred by it.³³ Indeed, many motorists are likely to be unaware that they have in fact signed a consumer credit agreement when they are

²⁸ *Id.*, paras. 101 to 103.

²⁹ As is implicitly recognised in *id.*, para. 104.

³⁰ *Id.*, para. 103.

³¹ See WP ToH 1: Over-costing and over-provision of TRVs, paras. 62 to 63 and 118.

³² [~~£~~]

³³ This is confirmed by the high levels of bad debt write-off suffered by CHCs and CMCs, of an average 20%: see *id.*, paras. 104 *et seq.* CISGIL does not accept the assertion that this is due to "severe cash flow pressures on CMCs/CHCs, which often required them to accept lower settlement payments than were justifiable". Rather, these are due to CMCs and CHCs incurring unnecessary and excessive costs with a view to recovering them from fault insurers.

provided with a TRV by a CMC or CHC and will almost certainly not have read its terms.³⁴

- 3.20 The excessive costs incurred by fault insurers, which arise from both excessive hire rates and excessively long hire durations, are the direct consequence of the provision of credit to non-fault motorists for both repairs and TRVs. As has been explained above³⁵, the use of credit is entirely unnecessary in order for non-fault motorists to receive their legal entitlement to a TRV. Furthermore, it is CISGIL's experience that many non-fault claimants choose to enter into a credit hire agreement despite being offered a suitable (in relation to their established reasonable need) alternative vehicle by the fault insurer: this would appear to be because of the belief that they are entitled to a 'like for like' TRV, even where a lesser specification of vehicle would meet their reasonable mobility requirements.³⁶ This demonstrates both the absence of the need for credit and the over-provisioning of TRVs.
- 3.21 It is notable that the results of the Commission's own consumer survey show that when non-fault claimants were questioned about the costs of their TRV, of those who were aware of the costs, 41% would have been satisfied with a "less good quality" TRV and 21% would have been satisfied with having had it for less time.³⁷ It is submitted that this is clear evidence of over-provisioning of TRVs to non-fault claimants by CHCs and CMCs. CISGIL therefore agrees that if non-fault claimants knew the cost of credit hire and that they were entering into a credit hire agreement, it would influence their decisions both to accept a credit hire arrangement and to accept a particular make or model of TRV.
- 3.22 Whilst the results of the Commission's consumer survey show that non-fault claimants are generally satisfied with their TRVs, with 85% stating that it met or exceeded their needs,³⁸ this does not lead to the conclusion that the market is working effectively and

³⁴ Often the non-fault claimant does not realise that they have entered into a credit hire or credit repair arrangement, and are not aware of the daily rate or the expected duration of the TRV hire (which will depend on the duration of the vehicle repair, which is controlled by the CHC or CMC, not the motorist). Most claimants will not take note of the explanation provided to them of the basis on which a TRV is being provided to them and will sign the papers provided to them when the TRV is delivered, without having first read them: the claimant is concerned only with receiving a TRV as quickly as possible, without having to pay for it 'up-front'. In CISGIL's experience it is usual for the insurer or broker to 'warm transfer' non-fault customers to a CHC or CMC at FNOL stage using terminology such as "We will just put you through to somebody who can provide you with a replacement car". Therefore the customer will often be under the impression that it is their own insurer or broker which is providing the TRV and will have no visibility of the daily rate or the ultimate cost of the credit hire, or the fact that they would ultimately be liable to pay for it under the terms of the credit agreement.

³⁵ See paragraph 3.7.

³⁶ All customers whose vehicle is repaired by a CISGIL approved repairer are entitled to a courtesy car, regardless of fault. In the majority of cases, a standard courtesy vehicle, provided by the approved repairer, will be sufficient to meet the customer's needs. [§]. Non-fault customers with MLEI will be referred to CLS. In about [§]% of such referrals, the courtesy car is considered suitable to meet the customers' reasonable mobility needs, with only about [§]% of such referrals leading to a TRV being provided on a credit hire basis. By contrast a CMC or CHC will, by 'default', place almost all non-fault customers whose claims it handles into a 'like for like' TRV, irrespective of proven reasonable need: this is clear evidence of widespread over-provisioning of TRVs

³⁷ See WP ToH 1: Analysis of the results of the non-fault survey in relation to over-provision, para. 7.

³⁸ See WP ToH 1: Analysis of the results of the non-fault survey in relation to over-provision, paras. 25 et seq.

there is not over-provisioning of TRVs. 17% said that the TRV exceeded their needs: this is clear evidence of over-provisioning. In other cases, it would appear that a 'need' for mobility has been conflated with receiving a 'like for like' vehicle: the two concepts are not the same.

- 3.23 In addition, 87% of non-fault claimants said that they had a TRV for the "right" amount of time.³⁹ This time is presumably the same as the duration of the repair. However, the repair is not within the control of the vehicle owner and the claimant does not have visibility of how many days the repair should take, if undertaken promptly and efficiently. CMCs and CHCs have a very clear ability and incentive to prolong the number of days for which a vehicle is under repair (even if the actual number of man hours required to effect the repair is standardised) and use a number of strategies⁴⁰ to do so. That this is clearly the case is supported by evidence of both longer repair⁴¹ and hire⁴² durations when a TRV is provided on a credit hire basis, so contributing to higher TRV costs borne by the fault insurer.⁴³ Therefore, the results of the survey simply indicate that 91% of respondents were provided with a TRV whilst they were without their own car and that this 'met their needs', regardless of the duration of the repair and regardless of the party managing it, as is also clear from the fact that the involvement of the CMC has no impact on this.⁴⁴
- 3.24 Whilst the GTA provides a form of 'framework' for the resolution of claims between insurers and CHCs/CMCs that provide TRVs on credit hire terms, it is imperfect and is not effective in controlling TRV costs. The GTA does not set the daily hire rate, but merely a *maximum* daily rate: this has effectively become the default daily rate. In addition, as the GTA is voluntary, many TRV credit hires are provided by non-signatories to the GTA and, as the Commission has identified, these CHCs and CMCs generally charge the highest TRV costs.⁴⁵
- 3.25 The GTA has failed to control effectively credit hire rates for TRVs. In many cases, the GTA actually maintains hire rates at levels that are higher than they otherwise would be

³⁹ *Id.*, paras. 29 to 31.

⁴⁰ See WP ToH 1: Over-costing and over-provision of TRVs, para. 127. An additional strategy used by CMCs and CHCs is to require their repairers to strip down a roadworthy vehicle on the pretext of inspecting for non-visible damage, which makes the vehicle undriveable. This immediately necessitates the use of a TRV, even if the repair does not then commence for several days.

⁴¹ The average repair duration when a CMC or CHC is managing the claim (on a credit basis) is longer than when an insurer manages the claim (on a direct hire basis): *id.*, para. 126. In addition, the duration more frequently takes longer than initially advised by the repairer when a TRV is required, again suggesting delays in the repair process: *id.*

⁴² The average hire duration when a CMC or CHC is managing the claim (on a credit basis) is 3.7 days longer than when an insurer manages the claim (on a direct hire basis): *id.*, para. 49.

⁴³ *Id.*, para. 53.

⁴⁴ See WP ToH 1: Analysis of the results of the non-fault survey in relation to over-provision, paras. 25 *et seq.*, paras 32 and 33.

⁴⁵ See WP ToH 1: Over-costing and over-provision of TRVs, para 8

as CMCs and CHCs will seek to recover the very maximum rate permitted under the GTA.⁴⁶ On average, the GTA rates are approximately [X]% higher than CISGIL's direct hire rates and the daily rate charged by CMCs and CHCs which do not subscribe to the GTA tend to be [X]% higher than the GTA rate.⁴⁷ Therefore, the GTA alone cannot control credit hire costs: [X].

3.26 CISGIL has the following additional observations on the Commission's Working Paper ToH 1: Over-costing and over-provision of TRVs:

- (a) whilst some CMCs/CHCs provide "some additional services" to non-fault claimants,⁴⁸ these may also be provided by insurers to captured claimants (including delivery and collection of the TRV) and others clearly increase costs and should not - as services for the recovery of uninsured losses - be included in the costs of providing the TRV. Therefore, these "additional services" do not justify either the use of credit hire or daily rates that are higher than equivalent direct hire rates;
- (b) not all insurers refer their non-fault customers to a CMC or CHC in return for a referral fee.⁴⁹ CISGIL does not do so, and therefore - unlike many of its competitors - is not "extracting" part of the excess profits generated by CMCs and CHCs in providing TRVs on a credit hire basis. Indeed, CISGIL is being forced to contribute to the generation of excessive profits through paying excessive TRV hire costs;
- (c) late payment penalties (under the GTA) are a further frictional cost borne by fault insurers in settling credit hire claims.⁵⁰ As the Commission itself observes, credit hirers are very quick to avail of such penalties,⁵¹ further increasing hire costs and also forcing insurers to settle claims quickly, even at excessive hire rates;
- (d) whilst, despite the frictional costs incurred, insurers may achieve cost savings in challenging credit hire bills,⁵² this merely demonstrates that TRV providers are engaged in practices that lead to the over-provisioning and/or over-costing of TRVs. This is driven by the unnecessary use of credit. If TRV providers did not

⁴⁶ As the Commission itself correctly identifies in WP ToH 1: Over-costing and over-provision of TRVs, para. 48.

⁴⁷ [X]

⁴⁸ See WP ToH 1: Over-costing and over-provisioning of TRVs, para. 15

⁴⁹ *Id.*, para. 62. See also para. 118

⁵⁰ *Id.*, para. 80

⁵¹ *Id.*, para. 83

⁵² *Id.*, paras. 86 to 90.

engage in these strategies, the counter-response by insurers would not be necessary and frictional costs would either not be incurred or be significantly reduced. Therefore, the existence of the GTA and insurers' other counter-strategies are evidence of a clear market failure. Furthermore, insurers are often unsuccessful in challenging credit hire bills and, as the Commission itself observed, the GTA has not eliminated "friction" and indeed may itself generate further "friction" between insurers and CHCs/CMCs.⁵³

- (e) CISGIL is not aware of "bilateral agreements" between insurers and CHCs/CMCs to reduce claims costs for TRVs.⁵⁴ Under bilateral agreements, insurers agree to treat each other in the same way when they represent the non-fault or the fault party. A number of 'protocols' have been put in place between insurers and CMCs/CHCs to cover the handling of credit hire bills outside of the GTA. Indeed, the very existence of these 'protocols' proves that the GTA is ineffective. CISGIL doubts that these protocols promote efficiency (so do not provide "benefits" to insurers⁵⁵), but merely improve slightly an otherwise clearly unacceptable, inefficient and detrimental situation in which CHCs and CMCs seek to generate excessive profits from insurers, causing considerable and unnecessary frictional costs of tens of millions per annum.⁵⁶ The GTA is certainly not "a framework for the efficient negotiation and settlement of credit hire claims".⁵⁷ [X] would eliminate the unnecessary and inefficient costs of both 'friction' and the countermeasures put in place in attempts to counteract it; and
- (f) the costs described as "bad debt provision" incurred by CHCs and CMCs are not bad debts, but unrecovered hire costs.⁵⁸ In the case of insurers, no contract exists and the sum is in fact a disputed claim and no debt arises.⁵⁹ Where a non-fault claim subsequently turns out not to have been one, the CHC/CMC can enforce the credit agreement against the claimant, but for obvious business reasons chooses not to do so. Finally, in the case of a fraudulent claim, there is not a bad debt, but a claim against the motorist for fraud. None of these "costs" can be relied upon to justify the excessive hire rates charged for TRVs.

⁵³ *Id.*, para. 93.

⁵⁴ *Id.*, paras. 95 to 99.

⁵⁵ *Id.*, para. 99

⁵⁶ The Commission itself estimates frictional costs at between £46 million and £186 million: *id.*, para. 101. On top of this must be added the costs of the "considerable effort and expense incurred by both CMCs/CHCs and insurers in seeking to mitigate these costs": *id.*

⁵⁷ *Id.* para. 106.

⁵⁸ *Id.*, paras. 102 *et seq.*

⁵⁹ As is clear from the "partial write-off" of hire costs as result of a settlement with the fault insurer, such that no debt arose, but simply the hirer has received less than he had sought to recover: *id.*, para.110.

Vehicle write-offs

- 3.27 CISGIL agrees with the Commission that a number of aspects of the process by which vehicles are written-off enable certain market participants to generate excessive profits at the expense of fault insurers. This leads to over-costing, as identified in Working Paper ToH 1/2: Vehicle write-offs.
- 3.28 Whilst these do not directly cause detriment to claimants (since they receive the pre-accident value ("**PAV**") of their vehicle), it does lead to higher costs for insurers and reduces competition in the provision of PMI (since not all insurers engage in such practices) and thereby to higher premiums. CISGIL does not engage in the practices identified by the Commission and does not receive rebates or referral fees at any stage of the write-off process.
- 3.29 The biggest market failures arising from vehicle write-offs are subrogation based on estimated rather than actual salvage values and the lack of transparency of the various models being used. In CISGIL's experience some market participants (including CMCs and some insurers) seek to inflate or deflate the amounts they receive for salvage on subrogation, in either case to generate additional income. Artificially low salvage values are estimated and arrangements are entered into with the salvage dealers where they receive 10 to 20% of the actual salvage value in every case. This excess profit is then paid to the insurer or CMC annually or on a six-monthly basis. In addition, non-fault insurers may benefit from setting a PAV that is above the actual market value, as this would result in increased customer satisfaction and increase the prospect of retaining the customer at renewal; this also raises the costs of the fault insurer
- 3.30 CISGIL considers that insurers and CMCs may have an incentive to write-off vehicles of non-fault claimants which are 'borderline', as this will increase the duration of the credit hire period. Therefore, credit can also have an adverse impact on the vehicle write-off process.

4 THEORY OF HARM 2 – SEPARATION OF PROCURER AND BENEFICIARY OF POST-ACCIDENT SERVICES (INFORMATION ASYMMETRIES)**Overview**

- 4.1 CISGIL agrees with the Commission's findings that there is not an under-provision of repairs, whether a claim is managed by an insurer (whether non-fault or fault, including for captured claims) or a CMC. CISGIL rejects suggestions that insurers engage in "corner cutting" of repairs:⁶⁰ it does not do so (and indeed guarantees all repairs carried out by its approved repairers) and it would appear that all insurers and their repairers

⁶⁰ See WP ToH 2: Under-provision of repairs, para. 3.

handle all claims in the same manner, irrespective of fault, with repairs being of the same quality in all cases.

- 4.2 CISGIL also considers that there is no under-provision of TRVs to captured non-fault claimants. Insurers have a very strong incentive to ensure that a captured claimant does not decide to go to another provider (such as a CMC) and therefore will ensure that a captured claimant receives a TRV that is appropriate to his or her needs and satisfies his or her legal entitlement.
- 4.3 For these reasons, CISGIL considers that there is no risk of under-provision of either repairs or TRVs.

Under-provision of repairs

- 4.4 CISGIL agrees with the Commission's findings that there is not an under-provision of repairs. The use of authorised repair networks ensures timely, consistent, high-quality, cost-effective and safe repairs, whether for fault or non-fault motorists and suggestions by some market participants (such as CMCs and repairers) to the contrary⁶¹ appear misplaced and self-serving.
- 4.5 Indeed, a very high proportion, nearly nine in 10, of customers (both fault and non-fault) have told the Commission that they are satisfied with repairs, irrespective of who handled the repair,⁶² including for captured claims. This is also consistent with the clear evidence that insurers use the same processes for fault and non-fault claims managed by them⁶³ (including for captured claims)⁶⁴ and that insurer and CMC-managed repairs are handled in a similar way.⁶⁵ In addition, CISGIL also subscribes to GIMRA's market benchmarking assessment (which covers about 15 of the major PMI providers) and is routinely ranked highly for customer satisfaction.
- 4.6 When considering specifically captured non-fault claims, any concerns about under-provision are unfounded: these do not result in lower quality repairs. Such repairs are usually undertaken by the fault insurer's authorised repairer network, but can also be undertaken by a repairer of the claimant's choice. CISGIL uses an approved repairer network and all repairs undertaken by the network are handled in the same manner. CISGIL and its service providers comply with the ABI Code of Practice for

⁶¹ *Id.*

⁶² See WP ToH 2: Analysis of the results of the non-fault survey in relation to under-provision, paras. 4 to 6.

⁶³ Although it should be noted that insurers (and also CMCs) may pay the same repair cost to their repairers, some receive rebates and discounts, which - in the case of non-fault claims - are not subsequently passed on to the fault insurer in subrogation: this has been addressed in respect of ToH 1 as a feature of the moral hazard arising from the separation of cost liability and cost control.

⁶⁴ See WP ToH 2: Under-provision of repairs, paras. 10 to 14.

⁶⁵ *Id.*, paras 15 to 19.

Unrepresented Claimants⁶⁶ and remind captured third parties of their legal rights throughout. Captured third parties also remain free to choose their repairer and [X]% did in 2012: this ensures that they can obtain high quality repairs, whilst also ensuring that the fault insurer can keep repair costs under control.

4.7 CISGIL has the following specific further comments on the Commission's Working Paper ToH 2: Under-provision of repairs:

- (a) whilst there is no obvious difference in the number of hours billed to carry out repairs managed by CHOs,⁶⁷ there is routinely a significant difference in the number of days it takes to complete the repair: for example, a repair billed at 20 hours labour could take 7 days when managed by an insurer, but 10 days when managed by a CHO which is also providing a TRV to the claimant. This practice of prolonging the repair period generates additional revenue for the CHO in credit hire costs, and so leads to over-costing: this is considered above in relation to ToH 1; and
- (b) it is common practice for insurers to waive the excess and allow the NCB for their non-fault customers meeting certain criteria.⁶⁸ Therefore, there is no obvious reason why a non-fault customer should not claim under his or her own PMI policy and doing so should not lead to consumer harm. In any event, both the excess and the loss of NCB can be recovered separately from the fault party as uninsured losses (including through instructing a CMC); therefore there is no under-provision and no consumer detriment. This would also be the case if the claim is captured by the fault insurer, which would then manage the claim.

Under-provision of TRVs

4.8 CISGIL considers that there is no likelihood of captured non-fault claimants not receiving a TRV that meets their mobility needs and their legal entitlement. Insurers have a strong incentive not to do so: consumers are generally well aware of their rights and will be contacted by multiple parties seeking to manage their claim against the fault insurer. This will include parties, such as CHCs and CMCs, offering TRVs on a credit basis. If a fault insurer were to attempt to under-provide a TRV, the non-fault party would simply exercise his or her right to move to an alternative provider, who would then (irrespective of proven need and the duty to mitigate) provide a 'like for like' TRV on a credit basis and at a significantly higher daily rate and almost certainly for a longer

⁶⁶ The ABI Code of Practice on the handling of captured claims is being revised and will improve further the 'claim experience', which is already characterised by high levels of satisfaction.

⁶⁷ See WP ToH 2: Under-provision of repairs, paras. 17 and 70.

⁶⁸ *Id.*, para. 90.

duration. This would increase significantly the costs for the fault insurer, who may well then also lose control over the repair.

- 4.9 It is correct that a fault insurer would assess more closely the claimant's need for a particular 'quality' of TRV than would a CHC or CMC, such that a 'like for like' replacement would not necessarily be provided.⁶⁹ However, this does not constitute under-provision (but rather, the 'like for like' TRV provided by a CHC or CMC would represent over-provision). This likely accounts for any perceived claimant 'dissatisfaction' with the TRV provided to them.⁷⁰

5 THEORY OF HARM 3 – MARKET CONCENTRATION

Overview

- 5.1 CISGIL writes very little PMI business in Northern Ireland, it is not in a position to comment in any detail on whether the level of market concentration in Northern Ireland may give rise to an AEC.
- 5.2 In regard to PCWs, CISGIL notes the very high level of market concentration and the high levels of PCW profitability identified by the Commission. It considers that PCWs have a considerable degree of market power, as exemplified by the imposition of MFN clauses (in respect of which CISGIL makes observations below when considering ToH 5) and the inability of PMI providers to negotiate, to any significant extent, cost per acquisition ("CPA") fees. This market power is not effectively constrained by either insurers or consumers and therefore may be expected to lead to an AEC.
- 5.3 CISGIL has no specific views on the level of concentration in cost estimation systems and does not disagree with the Commission's view that Autadex' market position does not lead to an AEC.

Northern Ireland

- 5.4 CISGIL writes very little PMI business in Northern Ireland: it does not actively market PMI products in Northern Ireland and has only a very small number of active legacy policies, representing [~~3~~] % of CISGIL's PMI business in 2012. Therefore, CISGIL is unable to comment in any detail on whether there is a distinct geographic market for the supply of PMI in Northern Ireland, or - if so - the level of market concentration in Northern Ireland may give rise to an AEC.

⁶⁹ This would appear to be the case, as the small minority of respondents to the Commission's survey who considered that the TRV provided did not meet their needs complained that the vehicle was less spacious, smaller, of a 'worse' make or model, or less powerful than their own vehicle: see WP ToH 2: Under-provision of TRVs, paras. 22 and 23. None of these necessarily indicate that a claimant's reasonable needs for mobility have not been met and most likely represents a degree of 'over-entitlement' by some claimants.

⁷⁰ See *id.*, para. 6.

- 5.5 As reflected in the relevant Working Paper (WP ToH 3: Horizontal concentration in PMI providers in Northern Ireland), there are a number of other insurers who are active in Northern Ireland and do actively compete for business.
- 5.6 CISGIL would, however, observe that comparative data on claims ratios and profitability need to be treated with care. Historically Northern Ireland had a higher claims ratio than Great Britain, mainly due to jury awards and thus was less profitable for PMI providers. However, claims costs (and thus claims ratios) in Great Britain have rocketed in the last five years (leading to reduced underwriting profitability, to unsustainably low levels), whilst those in Northern Ireland have remained broadly the same. This may also be due to the limited presence of both CMCs and CHCs in Northern Ireland and the ban on solicitors paying referral fees:⁷¹ the activities of CMCs and CHCs, and referral fees, have been a major contributor to the significant increase in claims costs in Great Britain in recent years. Therefore, whilst Northern Ireland may, by these parameters, appear to be more profitable, this may well be due to PMI business in Great Britain having become less profitable in recent years, due to increasing personal injury awards and the market features and practices identified in ToH 1.

PCWs

- 5.7 CISGIL considers that PCWs do provide benefits for consumers, provided that their limitations are understood. PCWs have increased transparency and ease of comparison, so leading to some downward pressure on the pricing of PMI premiums and driving customer churn (as customers using PCWs tend to be purchasing solely on price and not overall value, so switch frequently). However, it should be understood that PCWs do not cover the whole market and policies sold via PCWs are usually standardised and 'stripped down' to allow comparisons, which may result in consumers not understanding fully the policies they are purchasing (and differences between them) and, potentially, not having all insurance features that they may require (or having to purchase 'add ons').⁷²
- 5.8 There is a very high level of market concentration amongst PCWs, with only the four largest PCWs (Compare the Market, Go Compare, Money Supermarket and Confused) having a significant market position, apparent barriers to entry and consistently high levels of PCW profitability. The four largest PCWs have, individually and collectively, market power and this leads to consumer detriment, including through the imposition of

⁷¹ WP ToH 3: Horizontal concentration in PMI providers in Northern Ireland, para. 22 and Appendix 1.

⁷² This appears to be borne out by the conclusion of a recent *Which?* Survey, which found that comparison sites need to be clear that they do not cover the whole market and work harder to be transparent about what is and is not included in the policies they are selling. *Which? Is the Price Right?* Survey dated August 2013 page 34

MFNs and high CPA fees,⁷³ which dampen competition and increase insurers' distribution costs and thus have an adverse effect on premiums.

- 5.9 The market power enjoyed by PCWs is not effectively constrained by either smaller PCWs,⁷⁴ insurers or consumers. [§]. This clearly represents the exercise of market power, as insurers need to be listed on most (and ideally all four) of the major PCWs, so limiting the extent to which an individual PCW needs to compete with other PCWs to list a particular PMI provider. [§]. There is certainly no evidence that PCWs are passing on any economies of scale in the form of reduced CPA fees, as one might expect in a competitive market.⁷⁵
- 5.10 PMI providers need to be listed on most (and ideally each) of the largest PCWs in order to achieve broad market coverage. As the Commission itself observes, consumers do not typically use all four PCWs⁷⁶ and 37% of those customers using PCWs searched on only one PCW: thus almost two in five of customers that use PCWs 'single home', giving each PCW operator a significant 'gatekeeper' position that a PMI provider cannot easily circumvent.⁷⁷ PCWs are not an alternative to other sales channels, but essentially complementary, as PMI providers will generally use a combination of channels. Therefore, as found by the Commission, the threat of delisting is not credible at all.⁷⁸
- 5.11 The increasing importance of PCWs as a sales channel (particularly for new business⁷⁹) and customers' decreasing propensity to shop around,⁸⁰ would suggest that the significance (and thus market power) of each individual PCW is increasing.
- 5.12 CISGIL therefore respectfully disagrees with the Commission's emerging thinking that horizontal concentration alone is unlikely to give rise to significant market power and thus a major source of consumer detriment. The fact that there is apparently strong (advertising-based) competition between PCWs to attract consumers to their respective websites⁸¹ does not alter this conclusion. Therefore, horizontal concentration between PCWs may be expected to lead to an AEC.

⁷³ Blocking insurers from offering 'cashbacks' would also appear to be another commercial strategy in which PCWs can engage as a result of their market power: TOH 3: Horizontal concentration in PCWs, para. 57

⁷⁴ WP ToH 3: Horizontal concentration in PCWs, para. 35.

⁷⁵ *Id.* para. 24.

⁷⁶ *Id.*, para. 42.

⁷⁷ *Id.*, para. 13. See also paras. 84 *et seq.*

⁷⁸ *Id.*, para. 72. See also para. 80.

⁷⁹ *Id.* paras. 51 – 53.

⁸⁰ *Id.*, para. 14.

⁸¹ *Id.*, paras. 38 *et seq.*

Repair cost estimation systems

- 5.13 CISGIL agrees with Competition Commission that there are no competition concerns in relation to cost estimation systems, notwithstanding the fact that Autadex presently has a high market share, albeit one achieved as a result of pro-competitively developing a superior estimation platform (which CISGIL itself uses and requires its authorised repair network to use, [X]).
- 5.14 CISGIL has no comments on Working Paper ToH 3: Horizontal concentration in repair cost estimation systems.

6 THEORY OF HARM 4 – STRATEGIES TO SOFTEN COMPETITION**Overview**

- 6.1 In the AIS and related Working Papers, two possible market features are considered: the transparency and complexity of 'add-on' products and services and whether insurers are increasing the obstacles to customers switching PMI provider.
- 6.2 CISGIL considers that there is no consumer detriment as a result of either the sale of 'add-ons' or from any of the three possible 'obstacles' to switching considered by the Commission (i.e. automatic renewals, cancellation fees and NCB protection). Therefore, there is no basis for the Commission to investigate these further as ToH 4 has not identified any possible AEC leading to consumer detriment.

'Add-on' products and services

- 6.3 CISGIL sells a range of add-on products, some which it underwrites (i.e. MLEI and extended foreign use cover) and some of which it distributes (i.e. breakdown cover, extended courtesy car, key cover and 'gadget' cover). CISGIL now sells all 'add-ons' on an opt-in basis. Full explanations are provided at the point of sale to enable the customer to make an informed choice.
- 6.4 CISGIL fully supports any initiatives to ensure customers are fully aware of products and the results of the Commission's consumer survey would appear to indicate that there is room for further improvement in this regard.⁸² However, this is not the result of any market features that prevent, restrict or distort competition: there is plainly effective competition in the supply of 'add-ons', both as part of the wider product offering (comprising the basic PMI product and any selected 'add-ons') and on a standalone basis. Improving the information provided to consumers is an issue that can be addressed most appropriately by the FCA.

⁸² See WP ToH 4: Analysis of add-ons, paras. 32, 37, 39, 41 and 44.

- 6.5 'Add-on' products can provide considerable additional value to customers, over and above the premium cost (which is generally low): they provide 'peace of mind' (as the Commission itself acknowledges⁸³) and for an individual customer the perceived 'value' would appear to be the ratio of the premium (low) to the costs that would otherwise be incurred if an insured event occurs (often high): consumers themselves recognise this, as is clear from the Commission's own survey evidence.⁸⁴ The incremental premium for an 'add on' is often lower than when it is sold as a standalone product, as the insurer (or distributor) can share sales and customer acquisition costs across several products.
- 6.6 The sale of 'add-ons' reflects the extensive use of PCWs: in order to facilitate easy comparison, PMI products sold through PCWs are 'stripped down' basic products, without many of the additional protections that motorists may and often do require. To ensure that customers are adequately protected against additional risks, the sale of 'add-ons' is thus necessary, as such products are no longer bundled into the main PMI product: indeed, customers prefer this⁸⁵ and can easily compare prices (including for standalone products),⁸⁶ as they have told the Commission itself. This should ensure effective competition, particularly as 'add ons' are also sold via PCWs.
- 6.7 As low-premium products, the profitability of 'add-ons' is not easy to assess and is heavily dependent on the chosen allocation of costs and revenues and the method of distribution: the FCA recognised this in its own thematic study into MLEI.⁸⁷ It is not obvious that there is excessive pricing or consumer harm and the Commission has not identified any harm.
- 6.8 The FCA has recently undertaken a thematic study into MLEI (with a further review in 2014 to revisit progress)⁸⁸ and is also undertaking a review into the sale of add-ons generally.⁸⁹ CISGIL supports fully the FCA's work in this area. In view of the FCA's work into 'add-ons' and its general statutory objective (under the Financial Services Act 2012) to promote effective competition in the interests of consumers, including by addressing sales practices that may restrict, prevent or distort competition. The FCA's study has led to changes in the way MLEI is sold and the information that is provided to customers. This work has also led to similar changes in the way many other 'add-on' products are sold. Although MLEI was not one of the six 'add ons' reviewed by the

⁸³ *Id.*, para. 11.

⁸⁴ *Id.*, paras. 26 to 29.

⁸⁵ *Id.*, para. 22.

⁸⁶ *Id.* paras. 23 to 25 and 29.

⁸⁷ *Motor Legal Expenses Insurance (MLEI): Report on the thematic project*, supra, note 88, para. 34.

⁸⁸ Financial Conduct Authority, *Motor Legal Expenses Insurance (MLEI): Report on the thematic project (TR 13/1)*, June 2013. See <http://www.fca.org.uk/news/tr13-1-motor-legal-expenses-insurance>.

⁸⁹ Financial Conduct Authority, *FCA confirms market study into general insurance "add-ons"* (press release), 9 July 2013. See <http://www.fca.org.uk/news/fca-confirms-market-study-into-general-insurance-add-ons>.

Commission in Working Paper ToH 4: Analysis of add-ons, the FCA's work in this area will undoubtedly have a positive influence on the way in which 'add-ons' more generally are sold.

- 6.9 In view of the FCA's on-going work and extensive powers, including in respect of ensuring effective competition, it would clearly be inappropriate and unnecessary for the Commission to investigate further the sale 'add-ons' within the context of the current market investigation, as this would lead to two parallel and over-lapping investigations into the same issue and (even with coordination between the Commission and the FCA) gives rise to the risk of potentially different or inconsistent outcomes. Furthermore, the FCA has the necessary regulatory powers to address any issues that either it or the Commission might identify.

Barriers to switching

- 6.10 CISGIL agrees with the findings in the AIS that, given the very high levels of customer switching (which are considerably higher than for other consumer services),⁹⁰ there are no barriers to switching that might prevent consumers from switching PMI provider or make switching more difficult. This is the case for each of automatic renewals, cancellation fees and NCB protection. Whilst PMI providers wish to establish long relationships with their customers, this can be achieved only through offering high-quality, value for money services: customers simply cannot be 'locked in' at renewal.
- 6.11 Accordingly, given the intense competition for PMI products (which are purchased on an annual basis) and a high propensity for consumers to both switch and consider switching, there is no basis for finding an AEC.
- 6.12 CISGIL agrees with the Commission's findings that automatic renewals and cancellation fees are not obstacles to switching.
- 6.13 In relation to NCB protection, the Commission suggests that it is "less clear cut" that NCB protection is not a barrier to switching.⁹¹ CISGIL considers that it is clear that NCB protection is not a barrier to switching. Customers with NCB protection, both those which have not claimed (so have not used their NCB protection) and those which have claimed (so have used their NCB protection), can clearly switch insurer, provided that another insurer can offer them a more compelling value proposition than their existing insurer (taking account of premium, NCB discount and protected NCB). NCB and NCB protection can only cause a customer to remain with their existing insurer if the overall value proposition is more compelling than that offered elsewhere.

⁹⁰ See WP ToH 4: Obstacles to switching, paras. 2 and 13.

⁹¹ *Id.*, para. 6.

- 6.14 The Commission's survey evidence confirms that both NCB and NCB protection are matters that customers take into account when renewing their policy, but that these do not prevent and are not obstacles to switching.⁹² This is clearly the case, as levels of both propensity to switch and actual switching are high, with price and service the key determinants of whether customers will or will not switch.⁹³ NCB and NCB protection are clearly part of this dynamic: insurers' NCB scales vary (a driver with a three year claims free history might obtain a 30% discount with one insurer, but 60% with another insurer), as do the criteria applied for offering NCB protection.

7 THEORY OF HARM 5 – VERTICAL RELATIONSHIPS AND VERTICAL INTEGRATION

Overview

- 7.1 In assessing ToH 5, the Commission considers whether a number of types of vertical relationships may give rise to consumer detriment and thus to an AEC.
- 7.2 The Commission does not, however, consider the effect of vertical relationships between insurers and repairers, whether through ownership or by contract. CISGIL considers that these relationships are the most likely to prevent, restrict or distort competition and thereby causes consumer detriment, leading to an AEC. This is because, in the current market structure for handling non-fault claims, integration facilitates integrated insurer/repairer groups to engage in behaviour that harms both other (fault) insurers and consumers. Such behaviour has been considered above in relation to ToH 1: the 'moral hazard' arising from the separation of liability and cost control identified in ToH 1 gives some insurers (including, but not only, integrated insurer/repairer groups) the ability and incentive to allocate costs inappropriately and thereby increase rival insurers' costs. As a result, any efficiencies of vertical integration and relationships with suppliers of inputs (such as paint, parts, glass and repair cost estimation systems), including rebates and discounts, are not being passed on to fault insurers, enabling the integrated groups to generate and retain excessive revenues.
- 7.3 CISGIL does not have any concerns in relation to the full or partial equity ownership by insurers or brokers of PCWs.
- 7.4 CISGIL considers that the practice of PCWs imposing MFN clauses on both insurers and brokers as a condition of their listing on the relevant PCW restricts, prevents and distorts competition, leads to consumer detriment and thus causes an AEC. This is the case for both 'broad' and 'narrow' MFN clauses. The use of MFNs is both a manifestation of PCWs' market power and a means for its perpetuation. CISGIL notes

⁹² *Id.*, paras. 38 to 42.

⁹³ *Id.*, paras. 12 to 14.

that the Commission intends to consider further the effects of MFNs:⁹⁴ CISGIL encourages it to do so, in respect of all types of MFN clause and to find that the imposition of MFNs leads to an AEC.

- 7.5 The Commission correctly considers that vertical relationships between insurers' paint suppliers can facilitate anti-competitive behaviour by increasing the cost of paint (and thus of overall repairs) charged to the fault insurer. Whilst these contractual relationships can reduce the net cost of paint to an insurer (taking account of rebates and discounts paid directly to it), a higher price is charged to the fault insurer, as the 'top line' paint costs incurred by the repairer are higher. This prevents any efficiencies from these arrangements being passed on to the fault insurer. This leads to an AEC. The fact that not all insurers enter into such contracts (including five of the top 10, including CISGIL) indicates that this practice is not justified.
- 7.6 Similar adverse effects can arise from similar vertical agreements between suppliers of other inputs, such as parts and glass, which provide for a retrospective rebate to be paid directly to the insurer without reducing the input price paid by the repairer and charged to the fault insurer in subrogation. CISGIL considers that these should also be investigated further.
- 7.7 Vertical agreements in relation to paint, parts (including glass) or repair cost estimation systems: are unlikely to have foreclosure effects.

Ownership of PCWs by insurers or brokers

- 7.8 A number of PCWs are wholly or partly owned by insurers or brokers. In principle, this could provide the insurer or broker with the ability to exploit that ownership position, for example by gaining access to other insurers' confidential information (in order to engage in price under-cutting) or by discriminating against other insurers listed on the particular PCW. The Commission correctly identifies this concern, but it would appear that safeguards are in place within integrated groups to prevent such behaviour, in particular PCWs and their owners' PMI businesses being operated at arm's length. CISGIL has not experienced any such anti-competitive behaviour itself, although its ability to both identify and respond to any such behaviour may be limited. Therefore, in the absence of any evidence of such anti-competitive behaviour, further investigation by the Commission would appear not to be necessary.

MFN clauses

- 7.9 CISGIL considers that the practice of PCWs imposing MFN clauses on both insurers and brokers as a condition of their listing on the relevant PCW restricts, prevents and

⁹⁴ WP ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers, para. 18.

distorts competition, leads to consumer detriment and thus causes an AEC. This is the case for both 'broad' and 'narrow' MFN clauses. CISGIL therefore agrees with the Commission's view that 'broad' MFNs have anti-competitive effects but disagrees with its view that 'narrow' MFNs do not do so: the use of all forms of MFN clause by PCWs should be prohibited. The use of MFNs also leads to higher CPA fees: the imposition of MFNs is therefore an example of the market power enjoyed by PCWs, whether individually or collectively (which is being considered under ToH 3).

- 7.10 The use of MFNs has increased as competition increases:⁹⁵ MFNs are clearly being used to limit competition to the disadvantage of insurers and consumers, allowing PCWs to earn significant profits (itself a further manifestation of the market power enjoyed by PCWs, as the Commission also appears to identify in respect of ToH 3⁹⁶).
- 7.11 Whilst PCWs have undoubted benefits for customers, the use of MFNs is not necessary to achieve these. It is doubtful that MFNs in fact have the claimed benefits of reducing the need for consumers to 'shop around' for the best prices and protecting PCWs' fixed costs and sunk investment costs.⁹⁷ Rather, whilst consumers may be aware that a better price cannot be obtained elsewhere (although evidence suggests that they still 'shop around'⁹⁸, such that any benefit would be limited), that is because of a lack of price competition, with MFNs leading to a price higher than the competitive price. Price competition, through lower CPA fees and competition between distribution channels would not prevent PCWs recovering their costs and making a return on investment: it is not obvious why a reduction in competition can be justified to protect against the normal entrepreneurial risk of business failure.
- 7.12 MFN clauses prevent, restrict and distort competition in a number of ways, to the detriment of consumers. Self-evidently, they limit price competition. They also discourage innovation by PCWs, for example to improve fraud controls or risk analysis: if a PCW were to strengthen its fraud controls, this could lead to lower risk profiles for insurers and thus to lower premiums for customers of that PCW. However, the existence of an MFN clause prevents the insurer from offering the lower premium, as it would then also need to offer the lower premium on other PCWs on which it is listed, even if those sites would not have the same levels of fraud controls. For the same reason, MFNs remove insurers' incentives to invest in their direct sales channels as any benefits of such improvements would need to be shared with PCWs. MFNs also restrict product differentiation, as policies sold on PCWs are inherently 'stripped-down' and standardised. MFN clauses also lead to reduced competition in the CPA fees charged

⁹⁵ *Id.*, para. 17.

⁹⁶ *Id.* para. 38.

⁹⁷ *Id.*, paras. 15 and 75 *et seq.*

⁹⁸ *Id.*, para. 78.

by PCWs, by preventing price competition in the underlying PMI product, which would be necessary to achieve an increase in sales through a PCW offering a lower CPA fee.

- 7.13 There is also the potential for MFN clauses to increase insurers' costs (in order to circumvent their effects) and therefore cause inefficiencies. [REDACTED].
- 7.14 The Commission draws a distinction between two types of MFN, 'narrow' MFNs (referred to in the related Working Paper, ToH 5: Impact of MFN clauses between PCWs and PMI providers as 'own-website MFNs') and 'broad' MFNs (referred to in the related Working Paper as 'on-line sales MFNs' and 'all-sales MFNs').⁹⁹
- 7.15 CISGIL considers that a 'narrow' (or 'own-website') MFN prevents price competition by the insurer, which cannot offer a lower premium when it sells directly, despite a directly sold policy having lower incremental distribution costs (through the insurer not having to bear a CPA of up to approximately £[REDACTED] for a direct sale) and likely a lower risk profile (through the insurer being able to apply its own, more stringent underwriting and anti-fraud measures). As a result, the insurer cannot pass on these cost advantages to the consumer.
- 7.16 Sales through PCWs represent an important part of most insurers' total sales of PMI: the Commission itself estimates this as 23% of all policies and 54 to 56% of new PMI business.¹⁰⁰ MFNs apply to new business, so therefore have a significant effect on the sale of new policies, particularly given high switching rates and also price being the most important factor for consumers in choosing a policy.¹⁰¹ Therefore, there is a considerable disincentive to an insurer reducing (or keeping low existing) premiums on its direct sales, as this must be matched by a reduction in premiums on its sales via PCWs. Insurers are therefore discouraged from reducing the price or improving the quality of their PMI products, and also from innovating to reduce risk and fraud in the sale process. [REDACTED]. Indeed, the Commission appears to itself identify this anti-competitive effect.¹⁰²
- 7.17 CISGIL considers that a 'broad' MFN (whether an 'on-line' or 'all-sales' MFN) is also anti-competitive, for the reasons identified by the Commission:¹⁰³ 'broad' MFNs prevent PMI providers from offering different prices on different websites (even where this would be justified from underwriting, risk management and commercial perspectives), so limiting competition between PCWs (and also other distribution channels) and indirectly

⁹⁹ *Id.*, paras, 8 and 22.

¹⁰⁰ See WP ToH 3: Horizontal concentration in PCWs, para. 20.

¹⁰¹ WP ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers, para. 61.

¹⁰² *Id.*, para. 10(b).

¹⁰³ *Id.*, para. 11.

between insurers (i.e. so-called 'knock-on' effects¹⁰⁴). They also lead to higher CPA fees.

Contractual relationships with suppliers of paint, parts and repair cost estimation systems (foreclosure and non-foreclosure)

- 7.18 CISGIL considers that vertical relationships in general are unlikely to lead to foreclosure effects, whether input foreclosure or customer foreclosure: paint, parts, glass and repair cost estimation systems can all be procured by repairers on competitive terms. Therefore, CISGIL has no observations to make in respect of Working Paper ToH 5: Analysis of potential foreclosure as a result of vertical agreements.
- 7.19 However, CISGIL is concerned that vertical relationships can give rise to non-foreclosure effects, leading to effective competition being prevented, restricted or distorted, thereby causing harm to consumers and to an AEC.
- 7.20 The Commission has examined such effects in relation to contracts with paint manufacturers or distributors, but CISGIL considers that similar contracts with other suppliers could have similar anti-competitive effects and should be investigated further by the Commission.
- 7.21 CISGIL does not have any contractual relationships with paint providers and does not require its authorised repairers to purchase paint from a specific paint manufacturer or supplier. This is also the case for four of the other 10 largest PMI providers and also for smaller PMI providers.¹⁰⁵ Therefore, such contracts are not necessary in order for repairers or insurers to be able to procure paint on a competitive basis (indeed, absent these contracts, repairers would appear to be able to purchase paint more cheaply,¹⁰⁶ which is also CISGIL's experience). Rather than, such practices being used to allow insurers to exercise greater bargaining power than repairers could acting individually (as was asserted to the Commission by two parties, apparently leading insurers¹⁰⁷), it would appear that their purpose is to allow insurers with such contracts to generate higher revenues, by subrogating an inflated repair cost (i.e. the invoiced cost, taking account of a higher 'top line' paint cost) and retaining a discount or rebate paid directly by the paint manufacturer. CISGIL considers that it is likely that the higher paint costs incurred by repairers are likely to be similar to the level of rebates earned by these insurers. Therefore, rather than generating efficiencies for either manufacturers or repairers, these arrangements are an artificial device to increase certain insurers'

¹⁰⁴ *Id.* para. 13.

¹⁰⁵ See WP ToH 5: Analysis of vertical agreements for the supply of paint (excluding foreclosure), paras. 18 to 20.

¹⁰⁶ *Id.*, paras. 51 and 52.

¹⁰⁷ *Id.*, paras. 45 and 46.

revenues at the expense of fault insurers (and potentially also repairers and motorists self-funding paint work).

- 7.22 The fact that the benefit to those insurers may appear to be low, relative to paint and overall repair costs, at £18 per repair,¹⁰⁸ does not diminish the fact that there is harm to both fault insurers and, ultimately, consumers. This is exacerbated by the fact that by no means all PMI providers (including CISGIL) have such contracts, leading to a clear distortion of competition through over-costing of repairs through the exploitation of the moral hazard that arises from the separation of cost liability and cost control.

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¹⁰⁸ *Id.*, paras 5. 56 and 60.