

## **Aviva response to Working Papers**

**Comments are track changed and highlighted**

**PRIVATE MOTOR INSURANCE MARKET INVESTIGATION****Theory of harm 1: Overcosting and overprovision of repairs****Summary**

1. Under theory of harm (ToH) 1, we are investigating whether the separation of cost liability and cost control in the supply of services (excluding personal injury) to non-fault parties involved in motor accidents increases the costs of the services supplied. This working paper addresses the questions: (a) whether there is overcosting for post-accident vehicle repair services; and/or (b) whether there is overprovision of services in relation to post-accident vehicle repairs as a result of the separation of cost liability and cost control.

**Overcosting**

2. By 'overcosting' in this paper we refer to the overall difference in the cost to the fault insurer of a vehicle repair provided to a non-fault claimant between when the party paying for the repair procures it and when another party procures it.<sup>1</sup> We recognise that the overall difference in cost may in part reflect underlying differences in the business models of different providers, and we discuss some of these differences in this paper. In our analysis of 'overprovision' we consider whether there are differences between the repair service which a non-fault claimant receives and that to which he/she is entitled, which would give rise to an increase in costs for the fault insurer. This paper represents part of our current thinking on the overall effect of the separation of cost liability and cost control.<sup>2</sup>

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<sup>1</sup> We do not use the term 'overcosting' pejoratively as any differences in costs may arise for legitimate reasons. The term refers to the costs of a vehicle repair service provided by a non-fault insurer or CMC being 'over and above' the costs of a repair service provided by a fault insurer (ie where there is no separation of cost liability and cost control). The term should be distinguished from 'overcharging'.

<sup>2</sup> Please also see the working papers 'ToH 1: Overcosting and overprovision of TRVs', 'ToH 1: Analysis of the results of the non-fault survey in relation to overprovision', 'ToH 1: Statistical analysis of claims costs' and 'ToH 1/2: Vehicle write-offs'.

3. Most non-fault post-accident repairs are either managed by non-fault insurers or by claims management companies (CMCs) providing credit repairs, or they are managed directly by the fault insurer (as a result either of the fault insurer capturing the non-fault claimant or the fault insurer being the same as the non-fault insurer). ToH 1 addresses overcosting as a result of the party liable for the cost (ie the fault insurer) being different from the party controlling the cost (eg the non-fault insurer or the CMC). We compared the costs of captured non-fault repairs (ie a situation with no separation of cost liability and control) with the costs paid by the fault insurer to a CMC providing credit repair services or to a non-fault insurer managing the repairs.

### *Credit repairs*

4. We found that fault insurers on average pay around 35 per cent (or around £400) more for credit repairs than they pay for captured non-fault repairs (ie non-fault repairs which the fault insurer manages itself, usually through its approved repair network). It appears to us that this difference reflects that:
  - (a) Credit repairs are likely to be more expensive because credit repairers are more likely to authorize the replacement rather than the repairing of parts; and because they usually use original equipment manufacturer (OEM) parts (whereas captured non-fault repairs could use some non-OEM parts). We were not able to quantify these effects.  
**Aviva Comment - Whilst we agree there may be differences in repair vs. replace ratios the bigger influence on repair cost differential is without doubt the charging rates. We agree it is also very difficult to quantify point a.**
  - (b) Some credit repairers charge between £200 and £300 more per average repair to fault insurers than the net repair costs they incur, (eg they negotiate substantial discounts with repairers or receive rebates back from repairers which they do not pass on to the fault insurer).
  - (c) The cost averages for captured non-fault repairs do not include the cost incurred by the fault insurer in managing the repair (eg the need to record the claim, instruct the repairer, approve the repair cost estimate and deal with customer

complaints), whereas the average cost of a credit repair covers these costs. We estimate that these costs are around £58 to £77 per repair.

(d) The average costs of captured non-fault repairs and credit repairs may not necessarily be on a like-for-like basis, because credit repairs are usually done in conjunction with the provision of temporary replacement vehicles (TRVs) and captured non-fault repairs may therefore include more low-value repairs (where no TRV is needed). We were not able to quantify this effect.

5. Taking into account the costs the fault insurer incurs in managing the repair (as set out in paragraph 4(c)), and if we were to assume that the effects set out in paragraph 4(d) are zero, we estimate that a fault insurer pays on average £325 to £344 more for a non-fault repair that is managed by a credit repairer than a repair which it manages (ie £402 less £58 to £77).
6. Given that we were not able to estimate the effects set out in paragraph 4(a) and 4(d), we focused our analysis on the £200 to £300 difference between the repair costs incurred by the credit repairer and the repair costs invoiced to the fault insurer by the credit repairer (see paragraph 4(b)).
7. We found that a credit repairer spends around £100 on managing the repair claim, £15 on unrecoverable repair bills (eg due to liability disputes) and around £65 on referral fees. Table 1 summarizes our finding.

TABLE 1 **Comparison of average repair costs between credit repairs and captured non-fault repairs**

a	Cost of repair itself (for a captured non-fault claim performed by an approved repairer)	£1,174
b	Estimated cost of managing the repair (incurred by the fault insurer)	£58–£77
c=a+b	Total costs incurred by fault insurer for a captured non-fault repair performed by an approved repairer	£1,232–£1,251
d	Cost billed by credit repairer to fault insurer	£1,576
e=d–c	= Estimated excess costs of credit repair	£325–£344
f	which reflects:	
	(i) differences in mix of repair cases	Not quantified
	(ii) differences in the use of OEM parts and repair vs replace	Not quantified
	(iii) credit repair revenues less repair costs incurred	£200–£300
f(iii)	which the credit repairer spends on:	
	(a) managing the claim	£100
	(b) unrecoverable bills	£15
	(c) referral fees	£65

Source: CC.

### Aviva Comment - [🔗]

8. Estimates we have received from insurers and CMCs indicate that the market size for credit repair is around £200 million a year. Based on an average credit repair bill of £1,600, this amounts to around 125,000 credit repairs per year. Assuming overcosting of up to £300 per repair, this would suggest that overcosting by credit repairers could cost fault insurers around £37.5 million a year. However, we treat this estimate with some caution as it is based on some very broad estimates. We also note that some of this amount will flow back to non-fault insurers and brokers through referral fees.

### *Non-fault insurer repairs*

9. We also examined whether there was overcosting when non-fault insurers passed the bills from repairs they managed to the fault insurer. We found that insurers managed their non-fault repairs in many different ways, some of which had the effect of inflating their non-fault repair charges passed to fault insurers above the net costs they incurred (eg by allowing approved or insurer-owned repairers to

charge bills which were higher than they otherwise would be in return for the receipt of referral fees, rebates or dividends which were not passed on to the fault insurer, by making amendments to the repair bill received from the repairer, or by not passing on rebates received from input suppliers to repairers). However, other insurers did not appear to engage in any of these practices and passed across to the fault insurer the repair bill as it is incurred.

10. On average, we estimate that repair bills passed from non-fault insurers to fault insurers are around 15 per cent (or £180) higher than the average cost of own insurer-managed non-fault repairs. Moreover, we estimate that rebates to the insurer from suppliers to its repairers (eg for paint, parts and repair cost estimation systems) could be between £10 and £20 per repair.
11. Overall, it appears to us that, on average, non-fault insurers charge fault insurers around £200 more per repair than the repair cost actually incurred. However, many insurers do not appear to inflate their non-fault bills charged to fault insurers at all and it appears to us that insurers which engage in such practices have the potential to charge up to around £270 to £390 more than the net cost they incur. We note that the cost of managing a repair for a non-fault insurer is around £100 and these costs are not passed to the fault insurer.

### *Summary of overcosting*

12. It appears that the separation of cost liability and cost control enables non-fault insurers and CMCs to increase the average cost to the fault insurer of a non-fault repair by up to around £300 if it is a credit repair and by up to around £270 to £390 if the non-fault insurer manages the repair compared with a scenario in which the fault insurer manages the repair. It appears that the average increase for the fault insurer if the non-fault insurer manages the repair is around £200. Table 2 summarizes these findings.

**Aviva Comment** - [🔗].

TABLE 2 Summary of our findings

Repair provider	Average repair cost paid by fault insurer	Bill paid by fault insurer less actual repair costs incurred by repair provider	Cost of managing the repair (including unrecoverable bills)	Referral fees	£
Fault insurer (captured non-fault repairs)	1,174 (see Table 1, row (a))	0	58–77 (see paragraph 4(c))	0	
CMCs (credit repair)	1,576 (see Table 1)	200–300 (see paragraph 4(b))	115 (see paragraph 7)	65 (see paragraph 7)	
Non-fault insurer	1,347 (see Table 1)	200 (see paragraph 11)	100 (see paragraph 11)	0	

Source: CC.

**Aviva Comment** - The competition commission has correctly identified an element of 'waste' in the process. This is a combination of administration costs and profits of a third party who are not necessary in the claims process

### Overprovision

13. Insurers told us consistently that when they manage a repair, the repair process is identical whether it is a fault repair or a non-fault repair.
  
14. We have also seen no evidence suggesting that credit repairers overprovide repair services to non-fault claimants. It appears to us that the main differences between credit repairs and repairs managed by insurers are (a) the more frequent use of OEM parts by credit repairers, and (b) a higher ratio of parts being replaced to parts being repaired. However, we found no basis for believing these choices to be unreasonable or excessive. We also note that the fault insurer can challenge inappropriate repair methods (eg the excessive use of replacement parts) through scrutiny from its engineers.
  
15. Our survey evidence also does not suggest that CMCs or non-fault insurers systematically overprovide in terms of the quality of the repair service.
  
16. For these reasons, it appears to us unlikely that there is any overprovision of repair services provided to non-fault claimants as a result of the separation of cost liability and cost control.



## Introduction

17. In our update to the issues statement, we said: 'We intend to investigate whether the separation of cost liability and cost control in the supply of services to non-fault parties involved in motor accidents increases the costs of the services supplied (due to a lack of price competition or an unwarranted increase in quality)'.<sup>3</sup>
18. Under ToH 1, we are analysing whether non-fault drivers receive better services than those to which they are entitled (overprovision), and/or whether fault insurers which pay for these services pay higher prices when these services are managed by a third party than when they manage them (overcosting). We are therefore interested in what services are provided to fault and non-fault drivers and the costs of these services.
19. In this paper we focus on differences in the cost of non-fault vehicle repairs depending on which party manages the repair, and differences in the repair service provided. We consider differences between credit repairs (managed by CMCs) and captured non-fault repairs (managed by the fault insurer) and differences between non-fault insurer-managed repairs and captured non-fault repairs.
20. We begin by providing an overview of different approaches to managing vehicle repairs. We then set out:
  - (a) the differences in non-fault repair bills for various types of non-fault repairs (ie captured non-fault repairs, credit repairs and own-insurer-managed non-fault repairs), using a number of different estimation methodologies;
  - (b) the cost of providing repair services; and
  - (c) some differences in the services provided to non-fault drivers.

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<sup>3</sup> [Updated issues statement](#), paragraph 5.

21. Our analysis under subparagraphs (a) and (b) above addresses the issue of overcosting; while (c) focuses on overprovision.

### **Different approaches to managing repairs**

22. Post-accident vehicle repairs are managed by a number of different accident management service providers. The most common providers are:
- (a) insurers (either as the non-fault or fault insurer); and
  - (b) CMCs, which provide claims management services mostly to customers who have been referred to them by insurers and brokers. CMCs can operate either as credit repairers or on behalf of an insurer (where the insurer has outsourced some or all of its claims management function). Some CMCs also provide credit repair services directly to non-fault drivers.
23. There are two main categories of repairs: fault repairs and non-fault repairs.<sup>4</sup>
24. In most cases, fault and non-fault drivers have the option either to use a repairer which is in the approved network of their repair services provider (ie an insurer or CMC) or to use a repairer of their own choice.<sup>5</sup>

### ***Fault and non-fault repairs***

25. Fault repairs are either managed by the insurer or on an outsourced basis by a CMC.
26. Non-fault repairs are usually managed by the non-fault driver's insurer (the non-fault insurer), by a CMC or by the fault insurer (if the non-fault driver is 'captured'). Where a CMC manages the repairs, this could be on a credit repair basis or on an outsourced basis where the CMC acts as the insurer would.

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<sup>4</sup> In most accidents, fault is determined very quickly, but in some cases it requires further investigation. In some cases, there is split liability.

<sup>5</sup> Insurers and CMCs might encourage customers to use repairers within their networks, eg by not guaranteeing the repair if it is conducted by a non-approved repairer.

27. In some cases, repair services are also provided by a dealership or repairer directly to the customer without being managed by a CMC or insurer.
28. Nine of the ten largest PMI insurers ([REDACTED], AXA GB (AXA), Aviva, Direct Line Group (DLG), esure, RSA, LV, [REDACTED] and Zurich) told us that they made no referrals to credit repairers and managed the repairs of their non-fault customers themselves. Admiral told us that it referred its non-fault customers to a CMC which then offered credit repair services (as part of a broader uninsured loss recovery (ULR) service); and we noted that, until December 2012, esure also offered its non-fault customers the option of being referred to a CMC which then provided credit repair services.
29. We found that PMI brokers usually referred non-fault drivers either to the non-fault insurer or to a CMC which then provided credit repair services. For example, BGL told us that it referred its non-fault customers to a CMC which might then offer credit repair. Swinton said that its customers could have the repair managed by the non-fault insurer or through a credit repairer; while Endsleigh told us that non-fault drivers were offered the option of a credit repair managed by a CMC or claiming on their own policy for the repairs, which would be managed by Endsleigh. Ageas Retail (ie the broking part of Ageas) said that its non-fault customers [REDACTED].

### ***Subrogation of non-fault repairs***

30. Under tort law, a non-fault party is entitled to be put back into as good a position as he/she was in before the accident occurred and the fault party is liable to cover the reasonable cost of repair.
31. Under the doctrine of subrogation, an insurer has a right to be subrogated to the rights of its insured (ie its policyholder) when the insurer indemnifies its policyholder pursuant to the policy of insurance. Essentially, this means that, once the non-fault

insurer has put the non-fault party back into the position he/she was in before the accident, the non-fault insurer is able to exercise its policyholder's rights in relation to the underlying tort law claim. The non-fault insurer usually does this by pursuing the fault party's insurer in order to recover the costs that have been incurred. We understand that insurance policies (as well as contracts between CMCs and claimants) typically include a clause entitling the insurer on indemnifying the non-fault driver (or the CMC, on provision of the repair services) to take control of proceedings.

32. The recent case of *Coles v Hetherington* (currently on appeal) considered subrogated claims brought by the non-fault insurer in the name of its policyholders. It was determined that where a vehicle is negligently damaged and reasonably repaired, the measure of the non-fault driver's loss can be taken as the "reasonable cost of repair"; and that "reasonable cost of repair" is merely a way of ascertaining the diminution in the value of the car and therefore is not necessarily the repair cost actually incurred by either the non-fault driver or his insurer. It was noted that recovery is possible regardless of repair or payment for repair; and that the "reasonableness of the repair" charge is to be assessed from the position of the individual non-fault driver (without reference to his insurers or to any benefits he obtains under his insurance policy). This means that it is not relevant whether the cost of the repair could have been lower by virtue of the non-fault insurer's bargaining power.
33. The effect of this judgment, in practice, would appear to be that, where a non-fault insurer repairs the vehicle, that party has the opportunity to charge to the fault insurer more than the repair costs it actually incurred provided the sum claimed does not exceed the reasonable cost of repair to the individual claimant (ie the cost that the non-fault driver would have reasonably incurred had he/she managed the repair).

34. The fault insurer can challenge the value of subrogated claims (eg if the costs are not related to the accident or are unreasonable).

***Strategies for gaining value from non-fault repairs with the effect of inflating non-fault repair bills***

35. We have identified that insurers and CMCs manage their non-fault repairs in many different ways, some of which have the effect of inflating their non-fault repair charges passed to fault insurers above the net costs they incur. Such practices include:
- (a) performing non-fault repairs in repair subsidiaries at retail rates (eg by allowing high labour rates) and extracting the profits as dividends or referral fees ([§]);<sup>6</sup>
  - (b) making an upward adjustment to the repair bill to inflate it above the costs incurred ([§]);
  - (c) requiring approved repairers to discount the repair bill they charge (or to pay a parallel rebate), but not passing on this discount to the fault insurer ([§]);
  - (d) charging an administration fee and an engineering fee, and various other extras, to the fault insurer in addition to the repair bill;<sup>7</sup> and
  - (e) taking rebates (which are not passed on to the fault insurer) from suppliers to repair subsidiaries or approved repairers (eg of paint, parts and repair cost estimation systems) in return for requiring the use of these inputs, often resulting in higher input costs for repairers (with the likelihood of higher repair bills) ([§]).
36. Where non-fault brokers or insurers do not manage the repair but act as an intermediary, they can extract referral fees from the party managing the repair (usually a CMC performing a credit repair). Such payments are part of the costs incurred by a

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<sup>6</sup> Three of the ten largest insurers have their own repair subsidiaries (DLG, Aviva and RSA). Total PMI-related repairs performed by these subsidiaries generated around £[§] million in revenues in 2012 (£[§] million for QRC (RSA), £60 million for Solus (Aviva) and £112 million for UKAARC (DLG)). On the assumption that around [§] per cent of repairs are non-fault repairs, these three repairers conducted non-fault repairs worth about £[§] million in 2012.

<sup>7</sup> For example, the General Terms of Agreement (GTA) allows CMCs providing credit repair services to make these additional charges.

CMC in managing the repair and in this paper we consider these costs in our analysis of the costs of providing credit repairs.

### **Differences in repair costs**

37. We have used four different ways to identify overcosting in non-fault repairs managed by third parties (eg CMCs or non-fault insurers). We have examined:
- (a) average repair bills paid by insurers;
  - (b) discounts received by insurers in bilateral agreements;
  - (c) differences in the repair bill sent to the fault insurer and the actual repair costs incurred by CMCs providing credit repair; and
  - (d) repair bills from repairers.

We discuss each in turn.

### ***Average repair bills paid by insurers***

38. In order to identify and evaluate the extent of any effect on repair costs arising from the separation of cost liability and cost control, we considered various comparators against which to assess non-fault repair costs when managed by non-fault insurers or CMCs. We noted that fault repairs were on average more expensive than non-fault repairs, which insurers told us was because fault damage was more often at the front of the vehicle and non-fault damage was more often at the rear of the vehicle, which was typically cheaper to repair. Also, we were told that there are more low-value claims for non-fault repairs than for fault repairs as non-fault drivers do not typically have to pay their excess, or can claim it back from the fault insurer. For these reasons, we decided that comparing average repair costs between fault and non-fault repairs would not be particularly informative.

39. Nevertheless, we were interested in using costs controlled by the fault insurer (where there was no separation of cost liability and cost control), as the base against which

to compare the cost of other non-fault claims. Therefore, we used captured non-fault claims as our base figure and we estimated the cost of different categories of non-fault repairs against this base. Table 3 sets out our results.

TABLE 3 Average repair bills for non-fault repairs paid by the fault insurer

Average repair bills, including VAT (2012)	Average	Low	High	Number of insurers in sample	Versus base %	Difference £
(a) Average captured non-fault repair cost, network repairer	1,174	[REDACTED]	[REDACTED]	7	Base	Base
(b) Average captured non-fault repair cost, non-network repairer	1,325	[REDACTED]	[REDACTED]	8	+13%	151
The repair costs in (a) and (b) are the average repair bills that the fault insurer receives from repairers that have carried out its captured non-fault repairs, with subcategory (a) being those repairs that are done in the fault insurer's network of approved repairers and subcategory (b) being those that are done in a repairer of the customer's choice.						
(c) Average credit repair bill received by fault insurer	1,576	[REDACTED]	[REDACTED]	8	+34%	402
The average repair bill in (c) covers those bills that the fault insurer has received from CMCs providing credit repair services to the non-fault driver.						
(d) Average own non-fault repair costs incurred by non-fault insurer	1,169	[REDACTED]	[REDACTED]	7	0%	-5
The average repair costs in (d) are the costs to the non-fault insurer in managing the repair. We note that if the non-fault insurer inflates the repair bill to market rates or adds a management or administration fee before passing it across to the fault insurer, the cost shown in this row may or may not be prior to this inflation or fee. Similarly, if the non-fault insurer receives a discount off the repair bill, this discount may or may not be reflected in the costs shown in this row						
(e) Average repair bill received by the fault insurer from other insurers (excl bilateral agreements)	1,347	[REDACTED]	[REDACTED]	7	+15%	173
The average repair bill in (e) covers those bills received by the fault insurer from non-fault insurers that have managed the non-fault repair. These average bills exclude repair bills that have been settled under bilateral agreements. However, it appears that the overall prevalence of bilateral agreements is low (see paragraphs 52 to 53) so we do not think that including repairs performed under bilateral agreements would significantly change this number.						

Source: CC.

40. As a cross-check to the figures in Table 3, Table 4 shows the average credit repair revenues per repair as provided to us by CMCs that provide credit repair services.

TABLE 4 Average credit repair revenues

Average repair revenues per repair, including VAT	Average	Low	High	Number of replies
Average credit repair revenue per repair (2012)	1,594	[REDACTED]	[REDACTED]	7
Average credit repair revenue per repair (2011)	1,515	[REDACTED]	[REDACTED]	7
Check: average credit repair bill received by fault insurers (2012) (see Table 3, row (c))	1,576	[REDACTED]	[REDACTED]	8

Source: CC.

41. Table 4 shows that the average credit repair bill reported to us by paying insurers (see row (c) in Table 3) is similar to the average credit repair revenue reported to us by CMCs.
42. Table 3 shows that the lowest non-fault repair costs paid by fault insurers are for captured non-fault repairs, ie repairs managed by the fault insurer. This is consistent with the fault insurer having the greatest incentive to keep repair costs low.

#### *Captured non-fault repair costs by repairer*

43. Comparing lines (a) and (b) in Table 3 shows that costs are around 13 per cent higher where the captured non-fault repair is performed outside the fault insurer's network of approved repairers (ie in a repairer of the non-fault driver's choice). This is because repairers in an insurer's network have a contract with the insurer that is usually agreed through a tendering process, and the insurer is in a strong bargaining position in such negotiations due to the large volume of repairs that it can bring to an approved repairer. In contrast, the fault insurer has less bargaining power in repairs undertaken by repairers that are not part of its network of approved repairers. However, even in these cases, it usually retains some control over the repair costs, as the customer needs to provide a repair cost estimate to the insurer before the insurer will agree to meet the costs of the repair. It is also likely that the difference shown in Table 3 between captured non-fault repairs which are performed within the network of approved repairers and those repairs that are performed outside the network is not entirely on a like-for-like basis, as one insurer told us that that drivers with more expensive vehicles are more likely to choose their own repairer (eg in order to use an authorized dealer).



### *Captured non-fault repair costs and non-fault insurer managed repair bills*

44. Comparing lines (a) and (e) in Table 3 shows that the average repair bill the fault insurer receives from other insurers is 15 per cent (or around £173) higher than captured non-fault repair costs. We considered possible explanations for this difference. Two insurers ([redacted] and [redacted]) told us that more expensive repairs were less likely to be captured by the fault insurer.<sup>8</sup> However, we have not seen evidence to verify this on average across all PMI providers. We also noted that line (e) included repairs performed in a repairer of the non-fault driver's choice (which are not included in line (a)). However, insurers told us that 80 to 95 per cent of non-fault claimants opted for an approved repairer rather than choosing their own repairer so any effect of this difference was likely to be limited. Lastly, we considered whether the difference could be explained by the practices of some insurers which had the effect of inflating the repair bill in some way before passing it across to the fault insurer (as set out in paragraph 35). It appears to us that this is the principal cause of the difference. We note that different insurers apply different policies in billing the fault insurer for non-fault claims, as follows:

(a) Most of the ten largest insurers (ie [redacted]) told us that they pass on to the fault insurer the repair costs they incur. However, we note that the repair costs incurred by these insurers might already be inflated, eg by performing non-fault repairs in repair subsidiaries at retail costs (see paragraph 35(a)), or by repair subsidiaries or approved repairers inflating repair bills to retail rates (see paragraph 35(b)).<sup>9</sup> We discuss some of these mechanisms further below. As such, even if most insurers do not add a fee to the bill they receive from their repairer, some of them could still contribute to a difference between the cost of

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<sup>8</sup> These insurers told us that captured non-fault repairs related predominantly to lower speed impacts, which required less substantial repairs, as where the damage was more severe the claimant was more inclined to ask his/her own insurer to manage it.

<sup>9</sup> For example, RSA told us that it bills the fault insurer the cost of the repair as it receives it from its wholly-owned subsidiary, RSAAR. This cost is no more than the 'reasonable repair cost', which is approximately [redacted]. We note that claims made pursuant to RSA's business model have been challenged in the courts and the relevant decision is currently on appeal (see paragraph 32). We also note that RSA has entered into bilateral agreements with several other insurers under which, when it is the non-fault insurer, it charges the fault insurer the repair cost [redacted].

captured non-fault repairs and the cost of repair bills passed to fault insurers from non-fault insurers by inflating the repair bills charged by their repairers. For example, one insurer ([redacted]) told us that the average bill it received for both fault and non-fault repairs was £[redacted] more than the net cost actually incurred.<sup>10</sup>

(b) Two out of the ten largest insurers told us that they did not pass on discounts they received from repairers so the repair bill passed on was higher than the repair bill received. Esure told us that it retained a discount of around £[redacted] per repair; and LV told us that, until October 2012, it retained 10 per cent of the repair bill.<sup>11</sup>

We note that, currently, we do not know to what extent cost data for captured non-fault repairs might also include some of these effects, meaning that these costs might also be inflated above the net costs actually incurred.<sup>12</sup>

#### *Captured non-fault repair costs and non-fault insurer managed repair costs*

45. Comparing lines (a) and (d) in Table 1 shows that the cost of managing a non-fault repair for a non-fault insurer is the same as the cost of managing a captured non-fault repair for a fault insurer. The ten largest insurers all told us that they managed fault, non-fault and captured non-fault repairs in the same way and this data confirms these submissions.

#### *Non-fault insurer managed repair costs and non-fault insurer managed repair bills*

46. Comparing lines (d) and (e) in Table 3 shows that the costs incurred by non-fault insurers for non-fault repairs (£1,169) are £178 (13 per cent) lower than the costs they pass on to fault insurers for these repairs (£1,347). In our view, this difference captures some of the various billing practices set out in paragraph 35(a) to (d).

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<sup>10</sup> This amount does not reflect any further rebates received by [redacted] from input suppliers to repairers, which are worth around £10 to £20 per repair (see paragraph 47). Adding this amount suggests that [redacted] could earn up to £[redacted] from non-fault repairs.

<sup>11</sup> [redacted].

<sup>12</sup> This is because it is possible that the strategies insurers apply which have the effect of increasing non-fault repair costs also have the effect of increasing the captured non-fault repair costs, for example where captured non-fault repair costs are not shown net of discounts or rebates received by the insurer.

However, it appears to us that this is likely to be a lower bound of the difference between captured fault costs and the costs actually incurred by non-fault insurers as there might be some billing practices giving rise to an uplift to both captured non-fault costs and non-fault bills sent to the fault insurer, for example if the strategy applied by the non-fault insurer increases the bill for all repairs (ie captured non-fault and own-insurer-managed non-fault repairs (see paragraph 44)).

47. We also note that several large insurers receive rebates and commissions from suppliers of inputs to their owned and approved repairers (eg for paint and parts) (see paragraph 35(e)). These payments are made in return for the insurer mandating or recommending the use of the input by its repairers, which will in many cases increase those repairers' repair costs. This uplift in costs is likely not to be reflected in the difference of £178 reflected above, as the effect is to increase all repair costs; but, whereas in the case of a captured non-fault claim the fault insurer will receive the rebates, which they can effectively net off from the repair cost, in the case of non-fault insurer-managed claims, the rebates will be retained by the non-fault insurer, meaning that the effective non-fault repair cost is inflated. From the information provided by insurers, such rebates are usually in the range of £[redacted] to £[redacted] for paint, around £[redacted] for the repair cost estimation system and very low for parts. We estimate that, in total, such rebates, on average, amount to around £10 to £20 per repair (recognizing that not all insurers achieve the maximum paint rebate and not all insurers receive rebates from all possible sources).

#### *Captured non-fault repair costs and credit repair bills*

48. Comparing lines (a) and (c) in Table 3 shows that credit repairs are the most expensive type of repairs, costing fault insurers on average around 34 per cent more (around £400) than captured non-fault repairs performed by an approved repairer. Again, we recognize that these average costs may not be on a like-for-like basis, for

example because credit repair is almost always provided as an additional service to credit hire so minor repairs, where a TRV is not required, might not be handled in this way. However, we note that this effect may be offset to some extent by a reluctance of some credit repairers to undertake very expensive repairs due to the credit risks that they involve. For example, [redacted] told us that, for certain repairs which were more expensive than average, it would contact the fault insurer directly to see if it wanted to manage the repair. Although we saw merit in both these arguments, we were not able to estimate their net effect.

49. We found that some CMCs received rebates from suppliers of inputs to their approved repairers (eg for paint and parts) in the same way as some large insurers (see paragraph 47), with the likely effect of increasing the cost of repairs billed, with the CMC retaining the rebate. We consider these rebates further in paragraph 60 below.
50. We were also told that the labour costs charged in many captured non-fault repairs included the costs to the repairer of providing a courtesy car (irrespective of whether a courtesy car was actually provided), which increased the effective cost of captured non-fault repairs. This is not the case for credit repair, where a TRV is usually provided under a separate agreement. Aviva told us that it estimated the cost of this service within the captured non-fault repair bill to be on average around £40 to £60.

*Summary: effect of separation of cost liability and cost control*

51. Overall, on the basis of the average repair bills paid by insurers, we estimate that the average difference in a non-fault repair cost for the fault insurer if the non-fault insurer manages the repair rather than if it manages the repair is around £200 (£178 (see paragraph 46), which is a lower bound, and a further £10 to £20 (see paragraph 47)); and the average cost difference for the fault insurer between if a CMC manages

the repair and if it manages the repair is around £420 (£400 (see paragraph 48) and a further £10 to £20 (see paragraphs 49 and 47)). These cost differences do not take account of the costs saved by the fault insurer in having another party manage the repair. It appears to us that these costs difference arise because of the separation of cost liability and cost control.

**Discounts received by insurers in bilateral agreements**

52. We found that six of the ten largest insurers had bilateral agreements with at least one other insurer in relation to vehicle repairs. We found that these bilateral agreements usually operated by the parties continuing to pass on repair bills in the same way as prior to their agreement but, in addition, applying a discount. This discount would reflect the actual cost of the repair to the non-fault insurer, taking into account any referral fees, rebates and discounts. One insurer described this as effectively billing the wholesale cost of the repair.

53. Table 5 sets out the discounts off the repair bills insurers with bilateral agreements give to and receive from each other. [redacted] and [redacted] are not included as they were unable to provide this data. (DLG, Aviva, Admiral and AXA do not have bilateral agreements with other insurers in relation to vehicle repairs.)

TABLE 5 Discounts to repair bills passed on to fault insurers under bilateral agreements

Discount from	Discount to				per cent
	[redacted]	[redacted]	[redacted]	[redacted]	
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: CC.

[redacted].  
Note: N/A = not applicable.

54. Table 5 shows that [redacted].

**Differences in the repair bill passed to the insurer and the actual credit repair costs incurred**

55. We sought to identify the factors which contributed to the £400 difference between the average credit repair bill charged to fault insurers and the cost of a non-fault captured repair. We looked at the additional charges CMCs added to the repair bill they received from their approved repairers before passing it on to the fault insurer, and we reviewed the discounts CMCs received from their approved repairers. We also considered the rebates some CMCs received from suppliers of inputs to their approved repairers (eg paint or parts suppliers).

56. Table 6 shows the additional charges CMCs add to their repair bills, the discounts CMCs receive off repair bills and the rebates they receive from repairers and suppliers to their repairers.

TABLE 6 Discounts and additional charges for CMCs<sup>13</sup>

CMC	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Average discount given to CMCs per repair	[redacted]			[redacted]	[redacted]	[redacted]	[redacted]	[redacted] <sup>10</sup>
Discount given to CMCs as a % of repair bill	[redacted] <sup>2</sup>	[redacted]	[redacted] <sup>1</sup>	[redacted]	[redacted]	[redacted]	[redacted] <sup>3</sup>	[redacted] <sup>11</sup>
Rebates and commissions (paint etc)	[redacted] <sup>6</sup>	[redacted] <sup>7</sup>		[redacted] <sup>5</sup>		[redacted] <sup>4</sup>	[redacted] <sup>9</sup>	[redacted]
Admin and engineering fees		[redacted] <sup>7</sup>	[redacted] <sup>8</sup>				[redacted] <sup>9</sup>	[redacted]

Source: CC.

1. [redacted].
2. [redacted].
3. [redacted].
4. [redacted].
5. [redacted].
6. [redacted].
7. [redacted].
8. [redacted].
9. [redacted].
10. [redacted].
11. [redacted].
12. [redacted].

57. All the CMCs which responded to our information request told us that they earned discounts from repairers, ranging from [redacted] per cent of the repair bill to around [redacted]

<sup>13</sup> [redacted].

per cent. These discounts allowed the credit repairer to pass on a higher bill to the fault insurer than the net bill incurred (see paragraph 35(c)).

58. Three of the eight CMCs in our sample ([redacted],[redacted] and [redacted]) told us that they charged the fault insurer an administration fee in addition to the repair bill, as permitted under the terms of the GTA. However, this fee varied from £ [redacted] ([redacted]) to £ [redacted] ([redacted]). One CMC ([redacted]) said that it also added an engineering charge, which insurers told us was common practice among CMCs. Two CMCs ([redacted] and [redacted]) told us that they received a referral fee from [redacted] (worth up to [redacted] per repair).
59. Five CMCs ([redacted]) provided us with an analysis of how an average credit repair bill is made up. This showed that the invoice from the repairer accounted for around 90 to 95 per cent of the total repair bill (net of write-offs and discounts), engineering charges accounted for around 3 to 5 per cent and the remainder was made up mainly of administration charges, storage charges and penalty income.
60. Four CMCs in our sample ([redacted]) told us that they received rebates from paint suppliers of between £ [redacted] per repair; one CMC ([redacted]) told us that it received rebates from parts suppliers ([redacted]); and one CMC ([redacted]) told us that it received a rebate from Audatex ([redacted]). In all these cases, the rebate payment was likely to increase the cost of the repair to the credit repairer, and ultimately to the fault insurer.
61. Overall, taking all sources of income together, we found that the CMC with the highest income from the repair management process (ie through discounts and other rebates and charges) received around £300 per repair in 2012 ([redacted]). We found that [redacted] earned about £265 per repair, and both [redacted] and [redacted] earned about £ [redacted] per repair. We note that these discounts, rebates and charges explain a large part of the

£400 difference between the average credit repair bill received by fault insurers and the cost of a captured non-fault claim.

62. We found that, if we excluded the £200 to £300 per repair earned by some CMCs from their average credit repair bills, the remaining cost of repair was still around £100 to £200 higher for credit repairs than the average cost of captured non-fault repairs. We considered what might give rise to these higher costs. We noted that, in part, they might be explained by insurers benefitting from larger economies of scale in their negotiations with repairers; however, as most of the CMCs in our sample also managed a large number of repairs, we did not think this effect was likely to be significant. We also considered whether there were differences in how repairs were performed depending on the party managing the repair. We noted that the parts used in some credit repairs could be different from the parts used in equivalent captured non-fault repairs, due to both (a) less use of cheaper non-OEM parts and (b) a greater proportionate use of replacement parts instead of repair (see paragraph 72). However, we were not able to quantify the impact on average repair costs of these differences.

### *Referral fees*

63. We found that CMCs typically paid referral fees to work providers (ie non-fault insurers or brokers) to gain referrals of non-fault claimants to whom they could then provide credit repair (and in most cases also TRV) services. Table 7 summarizes the evidence we received from CMCs on the amounts paid in relation to credit repair.

TABLE 7 Referral fees paid by CMCs for credit repair

CMC	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Referral fee paid per repair	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: CC.

\* [REDACTED].

Note: [REDACTED] told us either that they did not pay referral fees to work providers in relation to credit repair services or that they did not pay referral fees directly related to credit repair.



64. From this data, it appears to us that the typical referral fee paid by a CMC in order to provide credit repair services is around £33 to £80. This represents a marketing cost for CMCs in order to win business but, as they compete by paying higher referral fees, it is also the means by which non-fault insurers and brokers, which 'control' the claimant at the first notification of loss (FNOL), can extract profits earned by CMCs through the credit repair process.

### ***Repair bills from repairers***

65. We looked at how repairers invoiced insurers and CMCs for repair work they performed. In particular, we looked at the agreements that repairers had with different work providers in order to consider how repair bills varied depending on the work provider.
66. Five repairers (three insurer-owned and two independent) provided us with data which enabled us to analyse repair bills by work provider.
67. Overall, we found that, on average, repair bills consisted of approximately 40 per cent labour costs, 40 per cent parts costs and 20 per cent paint costs. We first describe how these elements are negotiated and reflected in contracts before comparing repair bills between work providers.

### ***Labour costs***

68. Labour costs are calculated as the time taken for a repair multiplied by the labour rate per hour. Repairers told us that repair times were usually based on industry standards, set by reference to a cost estimation system (eg Audatex or Glassmatix), and were therefore generally the same irrespective of which party managed the repair or whether it was a fault or non-fault repair. Any differences in labour costs in vehicle repairs were principally a function of differences in the labour rate per hour.

**Aviva Comment** - A key point here is the fact labour costs can vary based on the rate charged and the percentage of repair vs. replace, as the competition commission has previously identified in this document. However, whilst 'replace' labour times are largely dictated by manufacturer timings and these are in the estimation system, 'repair' labour times are classified as 'opinion times' and are agreed between the estimator and engineer leading to potentially a greater amount of labour hours on a repair vs. a replace to ensure the vehicle is returned to pre-accident condition safely. Despite this, repair will normally always result in a cheaper overall cost as it negates the cost of a part.

### *Part and paint costs*

69. We understand that, for most repairs, the repair cost estimation system will specify which parts are needed and will calculate a repair cost based on a recommended retail price for each part. However, work providers and repairers, in reaching their agreements, will agree a discount off the recommended retail price for parts which is then reflected in the repair bill.
70. Similarly for paint, the repair cost estimation system will usually specify the quantity of paint and materials which are needed in a repair and will calculate an invoice value based on the price of paint in a paint basket. We understand that the paint basket in Audatex (the most commonly used repair cost estimation system) is based on the weighted average retail paint price for a range of brands of paint and, therefore, a work provider specifying the use of a certain paint will not be able to change the base price used in negotiations. Rather, work providers, in their contracts with repairers, will agree discounts off the paint basket (known as the paint index), which will be reflected in their repair bills.

### *Variables in a repair bill*

71. The following elements of a repair bill therefore represent the key variables which create differences in repair bill prices between repair service providers: the labour rate per hour, the discount for parts and the paint index. We have seen no evidence to suggest that the time taken for a repair (ie the number of hours billed) and/or the amount of paint used varies according to which party manages the repair.
72. We have seen some evidence of differences in parts used. We found that some insurers stipulate the use of some non-OEM parts or sometimes require the repairing of a part rather than replacing it; while, in contrast, some CMCs use only OEM parts and, according to some repairers, are more inclined to replace parts. However, these

differences appear small. We found that, across all post-accident repairs, the amount of non-OEM parts used is a small fraction of all parts, representing between 2 and 15 per cent of total parts costs (ie no more than 6 per cent of total repair costs); and we did not receive evidence indicating a significant difference in the choice of replacement or repair between work providers. Therefore, in our analysis in Tables 8, 9 and 10, we have made the simplifying assumption that the parts and paint used for different work providers are the same.

### Repairer data

73. [X] provided us with an explanation of how it charges labour, parts and paint costs, which enabled us to calculate indicative differences in repair bills for fault and non-fault claims for different work providers, as set out in Table 8.

TABLE 8 Repair costs by category: [X]

	Labour rate (£/h) A	Parts discount (%) B	Paint index* (%) C	Indicative bill value (£)† D	Difference to captured costs (%) E
<i>Fault claims</i>					
For repairs as an insurer's approved repairer	28	10	85	94	0
For repairs as a non-approved repairer (ie customer choice)	30	5	90	100	6
Repairs referred by a dealership	28	10	100	97	4
<i>Non-fault claims</i>					
Captured non-fault (as approved repairer)	28	10	85	94	Base
Non-fault insurer managed (as approved repairer)	28	10	85	94	0
CMC managed (as approved repairer)	34	0	100	110	17
Dealership managed	28	10	100	97	4
Non-approved repairer (ie customer choice)	30	5	90	100	6

Source: Columns A to C: based on data from [X]; columns D and E: CC analysis.

\*The paint index can alternatively be expressed as a discount off the paint basket, ie a paint index of 85 per cent is the same as a 15 per cent discount off the paint basket.

†The indicative bill values are notional but represent relative differences, assuming 40 per cent of captured non-fault repair costs are for labour, 40 per cent are for parts and 20 per cent are for paint.

74. [X] provided similar information, as set out in Table 9.

TABLE 9 Repair costs by category: [REDACTED]

	<i>Labour rate £/h A</i>	<i>Parts Discount % B</i>	<i>Paint index % C</i>	<i>Indicative bill value D</i>	<i>Difference to captured fault costs % E</i>
Fault repairs as an insurer's approved repairer	23.5	10	65	100	
Non-fault insurer managed (as approved repairer)	23.5	10	65	100	
Credit repairs	33	0	0	131	31

Source: Columns A to C: based on data from [REDACTED]; columns D and E: CC analysis.

Note: See notes to Table 8, which apply also to Table 9.

75. [REDACTED] told us that, [REDACTED].

76. We noted that, [REDACTED], as shown in Table 10.

TABLE 10 Repair costs by category: [REDACTED]

	<i>Labour rate £/h A</i>	<i>Parts discount % B</i>	<i>Paint index* % C</i>	<i>Indicative bill value† D</i>	<i>Difference to captured fault costs % E</i>
<i>Fault claims</i>					
Fault repairs	27	18	75	100	0
<i>Non-fault claims</i>					
Captured non-fault repairs	27	18	75	100	Base
Non-fault repairs	36	0	100	129	29

Source: Columns A to C: based on data from [REDACTED]; columns D and E: CC analysis.

Note: See notes to Table 8, which apply also to Table 10.

77. The data provided by [REDACTED], [REDACTED] and [REDACTED] shows that average repair bills can vary by up to around 30 per cent between a captured non-fault repair and a non-fault insurer or CMC-managed non-fault repair. The data submitted by [REDACTED] suggests that, [REDACTED], this equates to around £390 per repair. However, repairers do not retain all the benefits of a higher repair bill as it appears that repairers pass most of the extra income back to the work provider in the form of a discount or referral fee (see paragraph 57). For example, [REDACTED] told us that it discounted its repair bills [REDACTED],[REDACTED] told us that it discounted its repair bills by around [REDACTED], and [REDACTED] told us that it applied a discount [REDACTED].[REDACTED] said that [REDACTED].

### **Summary: differences in repair costs**

78. Non-fault repair costs are, on average, lowest when the repair is managed either by the fault insurer (ie captured) or by the non-fault insurer. However, when a repair is managed by the non-fault insurer the net cost incurred and the cost passed on to the fault insurer can vary considerably. The average non-fault repair bill passed by a non-fault insurer to the fault insurer is around £200 higher per repair than the net repair cost actually incurred (see paragraph 51), and this difference can be up to around £270 (see paragraph [X]) to £390 (see paragraph 77) per repair, depending on the strategy adopted by the non-fault insurer in managing its repairs. This finding is supported by the discounts off the repair bill (up to [X] per cent), which certain insurers are willing to grant other insurers in bilateral agreements (see paragraph 54).
79. We found that some providers of credit repair charge between £200 and £300 more per repair than the costs they incur for the repair itself (see paragraph 61), some of which is then passed back to work providers in referral fees. This finding is based on the level of discounts (up to [X] per cent) which CMCs are able to earn from repairers, which are retained by them and not passed on to the fault insurer, and by the other income which CMCs can earn in relation to credit repair (eg administration fees, engineering fees, and parts and paint rebates).

### **The costs of managing a repair**

80. The average cost of a captured non-fault repair in Table 3 does not include the cost incurred by the fault insurer in managing the repair (eg the need to record the claim, instruct the repairer, approve the repair cost estimate and deal with customer complaints). In most cases, other than where an administration or engineering fee has been added, these costs are also not recognized for non-fault insurers or credit repairers. In this section, we examine the costs of managing repairs. We consider in

turn the costs for fault insurers in managing captured non-fault repairs, the costs for CMCs in managing credit repairs, and the costs for non-fault insurers in managing own-insurance non-fault repairs.

### ***Captured non-fault repairs***

81. CISGIL and esure provided us with their estimates of the costs of managing a captured non-fault repair. Esure estimated these costs at £[~~30~~] per repair and CISGIL estimated them at £[~~30~~] per repair.
82. On the basis of this evidence, we estimated the total cost of a captured non-fault repair to be on average between £1,232 and £1,251 (ie the cost of the repair itself (£1,174) plus the cost of managing the repair (£58 to £77)).
83. Comparing these costs with the average cost of a credit repair as set out in line (c) in Table 3 (£1,576), it appears that a fault insurer pays on average between £325 and £344 more for a credit repair than the total cost it would incur if the repair were captured (though we note that the mix of captured non-fault repairs and credit repairs may not be the same (see paragraph 48)). We also note that the fault insurer will incur some costs when receiving a bill from a credit repairer which are not reflected in this comparison.

### ***Credit repairs***

84. Operating a credit repair business involves incurring various costs in addition to the cost of the repair, including:
- (a) the cost of managing the repair;
  - (b) the cost of invoicing the repair bill to the fault insurer and recovering the repair costs from the fault insurer;
  - (c) the cost of unrecoverable repair bills;

(d) referral fees to gain work; and

(e) some other costs.<sup>14</sup>

### *Managing the repair and invoicing and recovering repair bills*

85. Table 11 summarizes the evidence we received from CMCs and insurers on the costs of managing a credit repair and the costs of invoicing and recovering non-fault repair bills.

TABLE 11 **Cost of managing a repair and invoicing and recovering repair bills**

	Insurer/CMC							£
	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
Cost of managing a repair		[redacted]	[redacted]	[redacted]				
Cost of invoicing and recovering repair bills		[redacted]	[redacted]	[redacted]				
Total repair management costs	[redacted]*	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	

Source: CC.

\*[redacted].

86. The costs of managing a credit repair include:

(a) the cost of setting up a claim, paying independent engineers who provide repair cost estimates, monitoring the repair and liaising with the customer;

(b) the cost of administering and setting up a network of repairers, including monitoring quality; and

(c) the business overheads required in operate a credit repair business (rents, rates, utilities, management, etc).

87. On the basis of the evidence we received, we estimate the average cost of managing a credit repair to be in the range of £53 to £71 per repair (see Table 11).

<sup>14</sup> This includes, for example, the cost of capital and overheads not captured in the other cost categories. We have not sought to estimate these other costs as it appears to us that they are unlikely to be significant. However, we invite parties to tell us if they disagree with this view and, if so, to identify and provide information in relation to (i) the additional costs they consider are relevant (ii) the various elements of the service they provide to consumers and how these service elements relate to the costs incurred; and (iii) if and how such costs are reflected in the costs passed on to the fault insurer.



88. The costs of invoicing and recovering credit repair bills from the fault insurer include:
- (a) the cost of liaising with the fault insurer about the repair;
  - (b) the cost of putting together the payment pack (ie the invoice and all supporting documentation); and
  - (c) the cost of chasing unpaid bills and litigation, and the costs to minimize collection costs (eg the cost of establishing and operating bilateral agreements and the cost of GTA membership).
89. On the basis of the evidence we received (see Table 11), we estimated the cost of invoicing and recovering repair bills. We excluded the estimate of these costs from [redacted], because [redacted]. Without [redacted]'s estimate, the range provided to us by insurers was between £42 and £90. None of the CMCs provided a direct estimate of these costs; however, [redacted], and we estimated that [redacted] incurred invoicing and recovery costs for credit repair in 2012 of about £[redacted] per repair.
90. These invoicing and recovery costs include the frictional costs<sup>15</sup> associated with credit repair. Overall, we found that frictional costs (ie the costs of challenging and defending the repair claim, including related staff costs, legal costs and engineering costs), and the mitigation of these costs,<sup>16</sup> were low in relation to credit repair, for the following reasons:
- (a) Six out of the seven CMCs in our sample said that credit repair bills were rarely disputed, except for liability issues. [redacted] estimated that frictional costs for credit repair averaged about £[redacted] per repair.
  - (b) Fault insurers provided a wide range for their estimates of the frictional costs they incurred per credit repair; however, it appears that some included the cost of

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<sup>15</sup> By frictional costs, we mean the costs that arise from both the monitoring and challenging by the fault insurer of non-fault claims which have been managed by non-fault insurers and CMCs, and the costs of defending and supporting claims by non-fault insurers and CMCs.

<sup>16</sup> Mitigation costs are costs incurred to mitigate frictional costs (eg through third party capture, bilateral agreements and litigation).

establishing liability disputes which was not related to the repair. Five insurers provided estimates of the total frictional costs they incurred in 2012 in relation to credit repair, which ranged from approximately £0.1 million to £1.2 million per insurer.

- (c) One insurer ([redacted]) provided an analysis of the costs of negotiating and maintaining a bilateral agreement with another insurer (see paragraph 54), which suggested that these costs are very low.

### *Non-recoverable bills*

91. Non-recoverable bills arise most often in cases where the credit repair provider incorrectly assumes that the customer was not at fault (ie the driver turns out to be at fault or the claim is shown to be fraudulent). Fault insurers also sometimes challenge credit repair bills with regard to particular costs incurred (eg if the insurer believes that there are excessive costs for valeting or vehicle collection and delivery), but both insurers and CMCs told us that successful challenges to credit repair bills for such reasons were rare. On the basis of estimates provided to us by CMCs, we estimate that the cost of unrecoverable bills is, on average, around £15 per repair, ie about 1 per cent of the average credit repair bill.

### *Referral fees*

92. We found that referral fees paid by CMCs providing credit repair services were between £[redacted] and £[redacted] per repair (see Table 7). Endsleigh told us that it received referral fees from CMCs in relation to credit repair services of around £65 per repair, and [redacted] told us that, [redacted], it received [redacted]. Admiral (the only insurer in our sample which told us that it made referrals to credit repairers) said that it received a referral fee of between £30 and £65 per credit repair.

### **Aviva Comment** - [redacted]

## Summary of credit repair costs

93. Table 12 summarizes our assessment of the costs of providing credit repair services.

TABLE 12 **Costs of providing credit repair services**

<i>Cost category</i>	<i>Estimated cost per credit repair £</i>
Managing the repair	53–71
Invoicing and recovering repair costs	42–90
Non-recoverable bills	15
Referral fees	33–80
Total	143–256

Source: CC.

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94. In total, we estimate that the cost of managing a credit repair service is likely to be around £180 per repair. This figure is based, in particular, on evidence from [REDACTED], [REDACTED] and [REDACTED], each of which indicated that the total cost of managing a repair and invoicing and recovering repair bills was around £100 per repair, together with the average cost of unrecoverable bills of £15 (see paragraph 91) and a typical referral fee of £65 (see paragraph 92).

95. However, we note that there are some uncertainties around these estimates, due principally to the wide range of figures provided by insurers and CMCs for some elements of the total cost. We note also that credit repair is usually not offered on a stand-alone basis but rather in conjunction with credit hire, which means that the costs of a stand-alone credit repair business may be higher.

### **Own-insurer non-fault repairs**

96. We considered the costs incurred by a non-fault insurer in managing a non-fault repair. In this scenario, the claimant will have claimed under his own insurance, (possibly with payment of an excess), and the non-fault insurer will seek to recover the costs of the claim from the fault insurer (possibly repaying the excess to the claimant if successful). Table 13 shows our estimate of the costs incurred by a non-fault insurer in providing non-fault repair services.

TABLE 13 **Costs of providing non-fault repair services**

<i>Cost category</i>	<i>Estimated cost per repair £</i>
Managing the repair (as per Table 11)	53–71
Invoicing and recovering repair costs (as per Table 11)	42–90
Non-recoverable bills	-
Referral fees	-
Total	95–161

Source: CC.

97. The data in Table 13 suggests that, for a non-fault insurer, the total cost of providing a non-fault repair service is around £100. This cost is lower than the cost incurred by a CMC in providing a credit repair as non-fault insurers (a) have no risk of unrecoverable bills because, if the fault insurer does not pay, the customer will be deemed to have made a fault claim; and (b) do not pay referral fees. Therefore, the non-fault insurer only incurs costs in managing the repair and in invoicing and recovering repair costs, which we estimated to be around £100 (see paragraph 94).

### **Differences in service provided**

98. In this section, we examine whether there are differences in the repair services provided by different providers. We consider whether any such differences or our survey evidence indicate that customers of any particular repair service provider are overprovided in the quality of repair services they receive. (We discuss whether customers of any particular repair service provider are underprovided in the quality of repair services they receive in the working paper ‘ToH 2: Underprovision of repairs’.)

99. We found that, overall, insurers did not differentiate significantly in how they managed repairs between fault and non-fault repairs (see paragraph 45).

100. We found that, to a limited extent, credit repairs were less likely to use non-OEM parts than insurer-managed repairs; and credit repairs had a higher proportion of replacement to repair than insurer-managed repairs (see paragraph 62). However,

we were not able to quantify the impact on average repair costs of these differences. Also, we found no evidence to indicate that this additional level of service from credit repair was unreasonable. We noted that the fault insurer can challenge inappropriate repair methods (eg the excessive use of replacement parts) through the scrutiny of its engineers.

101. We observed a few differences between own-insurer managed repair services, captured repair services and credit repair services, as follows:
- (a) As repairs handled by non-fault insurers arise from customers claiming on their own insurance, customers are sometimes required to pay their insurance excess, in particular if liability is unclear or if claimants wish to use their own repairer. The claimant must then claim the excess back from the fault insurer, often with little assistance from the non-fault insurer. In contrast, for both credit repairs and captured non-fault repairs, no excesses are payable.
  - (b) Another consequence of customers claiming on their own insurance is that they might lose their no-claims bonus. As for the excess (see point (a)), this should only be a temporary loss until liability is fully established or until the claim is settled but, again, this does not happen in credit repairs or captured non-fault repairs.
  - (c) A benefit for non-fault-insurer customers claiming on their own insurance is that their insurer takes the risk of not being able to recover the costs of the claim from the fault insurer (other than the customer's excess). In contrast, credit repair customers may be exposed to the risk of being liable for the repair bill should the cost not be fully recovered from the fault insurer. However, in practice, this risk appears small as some credit repairers offer insurance cover for this eventuality and others told us that, although a customer might be legally liable, they would never expect a customer to pay.

(d) Captured non-fault claimants and CMC customers do not have access to the Financial Ombudsman Service (FOS) in case of a dispute with the fault insurer (though CMCs are regulated by the Claims Management Regulator and customers can seek advice from the Claims Management Regulation Unit (part of the Ministry of Justice)).

102. We also noted that, alongside a credit repair service, a CMC often provided non-fault claimants with other services, which might not be provided to a captured non-fault claimant by a fault insurer, as follows:

(a) In addition to claiming for a repair, some CMCs will also claim, if appropriate, for a diminution in value of the vehicle as a result of the accident (ie due to a repaired car being worth less than the same car without an accident history). None of the insurers which responded to our questionnaire offered their non-fault customers help with diminution claims. We found that, when such payments are made, they are typically for between 5 and 15 per cent of the pre-accident value of the vehicle, but that diminution payments are rare (ie they occur in less than 2 per cent of claims).

**Aviva Comment** -[~~§~~]

(b) Some CMCs also assist their non-fault customers in recovering uninsured losses, such as travel expenses, loss of earnings, recovery of insurance excesses and vehicle recovery costs. CMCs provided us with a wide range for the cost of providing these services, from £[~~§~~] to £187 ([~~§~~]) per repair. We found that some insurers only provided these services to their non-fault claimants if they had a motor legal expenses insurance (MLEI) policy.

103. When comparing the services (other than the repair itself) provided to credit repair customers and the services provided to own-insurer non-fault customers, it appears to us that credit repair services (and captured non-fault repair services) are slightly better. In particular, this is because credit repair providers do not require the payment

of an excess and the claim does not affect the no-claims bonus of the claimant, albeit that these comparative benefits might be temporary as non-fault insurer claimants might be restored to their pre-accident condition in respect of these things subsequently. Importantly, though, we do not think that these differences are relevant to the difference in the costs of providing repair services. This is because these differences do not occur in all repairs and because the costs of these differences are borne by the non-fault driver (and therefore do not affect the costs of the repair to the fault insurer).<sup>17</sup>

**Aviva Comment** - we fundamentally disagree that there is any evidence of a better service from a CMC/Credit repairer. We have a strong safety/integrity of repair ethos, using OEM parts in the vast majority of repairs as well as a workmanship guarantee. When a non-fault customer claims with Aviva we also waive the excess to ensure a smooth claims service.

A CMC/Credit repairer may pass the customer into a credit agreement, not waive the excess and adds costs into the process. The customer survey findings seem to indicate no quantifiable difference in the provision of a TRV or repair as part of a motor claims between the Insurer or a CMC. We would therefore not agree with this point.

104. With regard to the additional services provided by some CMCs (see paragraph 102), these would appear to be services provided to assist some claimants in pursuing their entitlements under tort law.

**Aviva Comment** - Whilst it is not argued tort law entitles the customer to enhanced services on a non-fault claim. In many instances the customer already has comprehensive cover which would entitle them to claims service, a service they chose to buy at point of sale. In addition the CMC does not, due to the separation of costs liability and control, inform the customer they have comprehensive cover or could contact the at fault insurer who could provide exactly the same service and TRV at a lower cost. There is no incentive for the CMC to do so and this is leading to the cost differential the CC has identified.

105. We also looked at survey evidence to see if it indicated that non-fault claimants were overprovided in relation to repair services. Our survey of non-fault claimants found the following results (see the working papers 'Survey report' and 'ToH 1: Analysis of the results of the non-fault survey in relation to overprovision'):

(a) 1 per cent of respondents thought that their vehicle was worth more after the accident than before the accident (80 per cent said about the same and 14 per cent said it was worth less). The percentage was higher (at 3 per cent) where a party other than an insurer handled the claim (eg CMC, repairer, dealership).

(b) 5 per cent of respondents said that their vehicle was in a lot better condition after the repair than before the repair and 8 per cent said that it was in a somewhat better condition (75 per cent said the same, 10 per cent said worse and 1 per cent said much worse). The numbers were similar for repairs managed by the fault insurer and repairs managed by the non-fault insurer, which supports our finding that there is no significant difference in how fault and non-fault repairs are handled by insurers (see paragraph 99). Where a party other than an insurer

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<sup>17</sup> Unless the non-fault driver subsequently fails to recover the excess from the fault insurer.



managed the claim, 9 per cent of respondents said that the vehicle was in much better condition, and 5 per cent said that it was somewhat better. Adding together the percentage of respondents who said the vehicle was in a much better condition and a somewhat better condition, there was no significant difference in the percentage of customers who thought that their vehicle was in a better condition than before the accident between insurer-managed and other-party-managed repairs.

(c) For those respondents who said that their car was in a better condition post-repair than before the accident, the main reasons given for this were that the damage was repaired, the vehicle was resprayed and that new/better parts were used.

106. In our view, the results of our survey of non-fault claimants do not suggest that CMCs or non-fault insurers systematically overprovide in terms of the quality of their repair service. It appears that the majority of customers believe themselves to receive a repair service which restores their car to its pre-accident condition, with no more and no less.

107. Overall, on the basis of the evidence set out in this section, it appears to us unlikely that there is any overprovision of repair services provided to non-fault claimants as a result of the separation of cost liability and cost control.

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 1: Overcosting and overprovision of TRVs

#### Introduction

1. Under theory of harm (ToH) 1, we are investigating whether the separation of cost liability and cost control in the supply of services (excluding personal injury) to non-fault parties involved in motor accidents increases the costs of the services supplied.
  
2. In this paper, we assess whether there is overcosting and overprovision of temporary replacement vehicle (TRV) services provided to non-fault claimants due to the provider of these services (the non-fault insurer, Claims Management Company (CMC) or credit hire company (CHC)) being different from the party which pays for them (the fault insurer).
  
3. By ‘overcosting’, we refer to the overall difference in the cost to the fault insurer of TRV services provided to a non-fault claimant between when the party paying for the services procures them and when another party procures them.<sup>1</sup> We recognize that the overall difference in cost may be in part the result of underlying differences in the business models of different providers, and we discuss these differences in this paper. In our analysis of ‘overprovision’ we consider whether there are differences between the TRV services which a non-fault customer receives and those to which he/she is entitled and desires.<sup>2</sup>

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<sup>1</sup> We do not use the term ‘overcosting’ pejoratively as any differences in costs may arise for legitimate reasons. The term refers to the costs of a TRV service provided by a non-fault insurer or CMC/CHC being ‘over and above’ the costs of a TRV service provided by a fault insurer (ie where there is no separation of cost liability and cost control). The term should be distinguished from ‘overcharging’.

<sup>2</sup> Some non-fault customers might choose to receive a service which is less than their legal entitlement.

4. This paper represents part of our current thinking on the overall effect of the separation of cost liability and cost control (ie ToH 1).<sup>3</sup>

## Summary

### ***Credit hire/direct hire***

5. TRV services can be provided to non-fault customers under a credit hire or direct hire agreement. We have compared the costs of credit hire (where a TRV is supplied on credit to the non-fault claimant by a CMC/CHC and the cost is subsequently recovered from the fault insurer) with the costs of direct hire (where a TRV is supplied either by the fault insurer or by the non-fault insurer, in the latter case often pursuant to a bilateral agreement between the non-fault insurer and the fault insurer, with the costs recovered from the fault insurer).
6. We have found that credit hire appears to be more expensive than direct hire. On average, insurers pay around twice as much for a credit hire vehicle than for a direct hire vehicle. This is driven principally by a higher daily rate but also by a longer hire duration. Our analysis has found that the average credit hire daily rate is between about 50 and 120 per cent higher than the average direct hire daily rate. The average credit hire duration is about 3.7 days longer than the average direct hire duration.
7. The higher daily rate of credit hire compared with direct hire appears to be, at least in part, a result of the different incentives of and constraints on the different providers. For a direct hire provider, the daily rate is the result of competition against other direct hire providers and negotiation with an insurer in respect of a large volume of prospective direct hires. For a credit hire provider, the daily rate is usually set by the General Terms of Agreement (GTA) (the majority of credit hire claims are settled

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<sup>3</sup> See also the working papers 'ToH 1: Overcosting and overprovision of repairs', 'ToH 1: Analysis of the results of the non-fault survey in relation to overprovision', 'ToH 1: Statistical analysis of claims costs' and 'ToH 1/2: Vehicle write-offs'.

under the GTA) and, in practice, the only limitation is that the rate represents the reasonable costs that can be recovered from the fault insurer under tort law.

8. However, the business model of a CMC/CHC which provides credit hire involves some additional costs and some additional services compared with direct hire.

### ***Additional costs***

9. In seeking to analyse the higher daily hire rate of credit hire compared with direct hire, we have looked at the underlying costs borne by providers under the two models. The two principal additional costs which arise in the provision of credit hire compared with direct hire are referral fees and frictional costs. Both these costs provide some evidence of overcosting.
10. Referral fees constitute a cost of acquiring business for a CMC/CHC. CMCs/CHCs appear to compete to be selected by insurers and brokers (and others) to provide services to their non-fault customers by, among other things, paying higher referral fees. In doing so, referral fees have the effect of enabling non-fault insurers and brokers to extract some of the profits generated by CMCs/CHCs in the provision of credit hire (and other services). Therefore, it appears to us that the level of referral fees may be an indication of the extent of the underlying profitability (ie prior to referral fees being paid) in credit hire (and other services).
11. Frictional costs arise from the administration, management and settlement of non-fault claims and are generated by the fault insurer attempting to minimize the cost of claims passed on to it by a non-fault insurer or CMC/CHC, and by the non-fault insurer or CMC/CHC defending its claim. It appears to us that the frictional costs incurred by fault insurers and CMCs/CHCs taken together amount to around between £46 million and £186 million. The establishment of various mitigation strategies by

both insurers and CMCs/CHCs, including the GTA and bilateral agreements, seek to reduce both the level of the claim (eg the daily hire rate and/or the hire duration) and the frictional costs associated with such claims.

12. Some of the other additional costs incurred in the provision of credit hire (eg bad debt provision and the cost of credit) reflect the inherent risk and the associated costs of the credit hire business model.

### ***Additional services***

13. We have found that credit hire durations are on average 3.7 days longer than direct hire durations (see paragraph 6), which might indicate the provision of TRV services under credit hire for an unnecessarily long period. However, hire duration is largely determined by repair duration and it is not clear from the evidence that we have seen so far that non-fault repair durations are longer when a non-fault claimant is provided with TRV services under credit hire than under direct hire.

**Aviva Comment** - Repair durations do not explain the differential as credit repair vs. insurer repair are broadly similar. We believe the difference may be driven through different total loss settlements

14. The non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need for an alternative vehicle can be established. In practice, this usually involves the provision of a TRV which is broadly equivalent to the customer's own vehicle (often referred to as a 'like-for-like' TRV) for as long as is reasonably necessary. This is subject to the non-fault driver's duty to mitigate their loss with consideration to their need. We have seen some evidence that non-fault customers are not always invited to consider whether their needs would be met with a lower class of TRV, whether handled by a CMC/CHC or the fault insurer (ie captured). However, given the small sample of cases which we have reviewed so far, we treat this evidence with some caution.

15. Some additional services are often provided by CMCs/CHCs to non-fault claimants under a credit hire agreement, which are beyond the level of services provided by a fault insurer to a captured non-fault claimant (eg the delivery and collection of the TRV, a collision damage waiver for the TRV, after-the-event (ATE) insurance, and uninsured loss recovery services). However, we have seen no evidence to suggest that this difference in provision results in consumer harm.

### **Outline of the paper**

16. In this paper, we analyse the cost of credit hire and direct hire and we estimate the overall cost differential between these two forms of TRV provision. We consider the extent to which this differential represents overcosting and we consider some of the cost elements which give rise to it. We also consider differences in the services provided between credit hire and direct hire and we assess whether there is evidence of overprovision in any aspect of these services.
17. The paper is structured as follows:
  - (a) Background to the provision of post-accident TRV services.
  - (b) Differences between credit hire and direct hire costs.
  - (c) Overcosting of credit hire, including an analysis of (i) the payment of referral fees by CMCs/CHCs to non-fault insurers and brokers (and others) in order to provide credit hire services; and (ii) the frictional costs incurred by both insurers (fault and non-fault) and CMCs/CHCs in relation to the provision of credit hire services.
  - (d) Overprovision of credit hire, including an analysis of the service differentials between credit hire and direct hire.

### **Background**

18. A fault insurer is legally responsible (on behalf of the fault party) for the reasonable costs of restoring the non-fault driver to their pre-accident position. If the non-fault

driver's vehicle is temporarily unavailable (generally due to repairs), this involves compensating the non-fault driver for the temporary loss of use of their vehicle. The non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need<sup>4</sup> for an alternative vehicle can be established. In practice, this usually involves the provision of a TRV which is broadly equivalent to the customer's own vehicle (often referred to as a 'like-for-like' TRV) for as long as is reasonably necessary.<sup>5</sup> This is subject to the non-fault driver's duty to mitigate their loss with consideration to their need.<sup>6</sup>

19. Non-fault claimants might have their non-fault claim managed by their non-fault insurer through a claim under their own PMI policy, by a CMC/CHC (eg upon referral by the non-fault insurer, broker or another party), or by the fault insurer if 'captured'. Elements of a non-fault claim (eg repairs and TRV provision) may be handled by different parties.
20. When non-fault claimants make a claim under their own PMI policy, they typically receive a TRV in accordance with the terms of their policy. This may be a courtesy car from the insurer's repairer (if the non-fault insurer is also managing the customer's repair) or, where the customer has purchased additional cover, a like-for-like TRV from the non-fault insurer's direct hire TRV provider. On occasion, if the non-fault insurer is satisfied that the customer is not at-fault, it might provide a vehicle of a higher class compared with the customer's contractual entitlement because it believes the customer is entitled to it under tort law and, therefore, the cost of this vehicle can be legitimately recovered from the fault insurer.

#### **Aviva Comment - [✂]**

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<sup>4</sup> In the case of a private individual who has lost access to their vehicle following a road accident, the scenarios in which they would clearly not have need for an alternative vehicle are likely to be relatively limited (eg because they have access to another vehicle or because they are on holiday abroad for the period in which their own car is unavailable).

<sup>5</sup> The hire duration is usually determined by the repair duration.

<sup>6</sup> A non-fault driver can only claim the costs of credit associated with a credit hire if they can demonstrate that it was reasonable in the circumstances to hire the TRV on credit (ie the customer is impecunious). However, the assessment of what the tort law entitlement requires in a given case will be informed by the specific facts of that case, which, in view of the nature of the 'impecuniosity test', may lead to some practical difficulties for CMCs/CHCS in assessing whether a non-fault customer requires

a TRV on credit terms.



21. When a non-fault customer's claim is handled by a CMC/CHC, often following a referral by a non-fault insurer or broker, the TRV is usually provided under credit hire.
22. Direct hire applies principally when a fault insurer captures a non-fault claim, or when a non-fault insurer is party to a bilateral agreement with the relevant fault insurer, or when the fault insurer and the non-fault insurer are the same. Some non-fault customers whose claims are handled by the fault insurer receive a courtesy car from the fault insurer's repairer handling the repair.
23. Table 1 summarizes the different ways in which TRV services are typically provided to non-fault claimants.

TABLE 1 **Typical provision of TRV services to non-fault claimants**

<i>Insurer controlling claim</i>	<i>Credit hire</i>	<i>Direct hire</i>
Fault insurer	N/A	Referral of captured non-fault customer to a direct hire provider. On average, 35 per cent (a range of 10 to 81 per cent across nine of the ten largest insurers) of captured non-fault customers receive a direct hire TRV. (The remaining captured non-fault customers receive a courtesy car through an approved repairer or do not require a TRV.)
Non-fault insurer	Referral to a CMC/CHC for credit hire. On average, 38 per cent (a range of 10 to 81 per cent across nine of the top ten insurers) of non-fault customers managed by a non-fault insurer receive a credit hire TRV. (The remaining customers receive a courtesy car, a direct hire TRV under their own PMI policy, a direct hire TRV for the reasons set out in the next box, or do not require a TRV).	Referral to a direct hire provider if fault insurer and non-fault insurer are party to a bilateral agreement or if fault insurer and non-fault insurer are the same.

Source: See Appendix A.

## **Aviva Comment - [✂]**

### ***Credit hire***

24. If a non-fault insurer or broker controls a customer's non-fault claim, the customer will often receive a TRV from a CMC/CHC under a credit hire agreement, following a referral to the CMC/CHC from the insurer or broker (for which the insurer or broker earns a fee). Assuming the CMC/CHC also assesses the claimant to be non-fault, the CMC/CHC will typically then provide a like-for-like TRV to the non-fault claimant,

subject to some checks regarding the claimant's duty to mitigate their loss with consideration to their need, and will recover the cost from the fault insurer.

25. With the exception of CISGIL (Co-op),<sup>7</sup> all of the ten largest PMI insurers told us that they referred some of their non-fault customers, with the customer's consent, to a CMC or CHC for the provision of TRV services under a credit hire agreement.

### *GTA*

26. With the exception of AXA, all ten of the insurers in our sample subscribe to the GTA.<sup>8</sup>
27. The GTA is a voluntary non-binding protocol which sets out the arrangements between insurer and CMC/CHC subscribers for the provision of credit hire TRVs to non-fault customers. It was established with the intention of removing confrontation, avoiding costly litigation in disputing the cost of credit hire and stimulating collaboration in the management and settlement of credit hire claims.
28. Although subscription to the GTA is voluntary, the Credit Hire Organisation (CHO) (a trade body) told us that it estimated that the GTA was supported by CHCs/CMCs and insurers which accounted for about 90 per cent of the credit hire market in the UK. According to the CHO, about 77 per cent of credit hire and credit repair claims are settled under the GTA (see Table 2). The remaining cases, which are handled initially within the GTA but then 'fall out', are settled through negotiation and, often, litigation.<sup>9</sup>

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<sup>7</sup> CISGIL told us that it did not refer its non-fault customers directly to CHCs. However, it said that it referred its non-fault customers with motor legal expenses insurance (MLEI) cover to Co-operative Legal Services (CLS) in respect of their uninsured losses. CLS managed these customers' claims against the fault party, including the provision of a TRV. CISGIL said that around [X] per cent of these customers were referred, on the basis of need, by CLS to [X] for the provision of a TRV on credit hire terms.

<sup>8</sup> [X] told us that all of its brands subscribed to the GTA with the exception of [X].

<sup>9</sup> Under the GTA, a CMC/CHC can pursue payment outside the terms of the GTA for claims not settled within 90 days, ie through litigation.

TABLE 2 Credit hire and credit repair claims settled under the GTA, 2009 to 2011

	2009	2010	2011
Proportion of credit hire and credit repair claims settled under the GTA (%)	76	77	77
Credit hire and credit repair claims issued under the GTA	23,500	28,400	19,200
GTA claims resulting in a court case	2,290	2,270	1,590

Source: CHO.

29. The GTA covers the terms, conditions and rates of credit hire for TRVs provided to non-fault customers in the UK. The GTA hire rates are agreed between the insurance industry and the CMCs/CHCs by a Technical Committee, which is constituted with equal representation by insurers and CMCs/CHCs and an independent Chairman.
30. The GTA Technical Committee is currently conducting a feasibility study into the establishment of a GTA portal, which would be an online tool to improve the management of credit hire claims and reduce administrative costs for both insurers and CMCs/CHCs. The concept has received backing from both insurers and CMCs/CHCs.

**Aviva Comment** - We do not see this as a future solution/remedy to the theory of harm, merely another way to navigate the current environment. We should not be looking for ways to ease the administrative burden, we should seek solutions which remove the opportunity for inflating costs.

This does need to be qualified as a statement. We have only reached this point in the absence of a wider industry solution and does not tackle the referral fee embedded into the cost.

31. We consider the role of the GTA as a way in which insurers and CMCs/CHCs mitigate frictional costs in paragraphs 91 to 94.

**Aviva Comment** - These frictional costs would not be incurred and could be removed entirely if consumers had to go to the fault insurer first or use their own cover.

### **Direct hire**

32. Direct hire vehicles are often supplied to non-fault claimants when the fault insurer captures and controls the non-fault claim or where there is a bilateral agreement in

place between the fault insurer and the non-fault insurer or where the fault insurer is also the non-fault insurer.

33. Under a direct hire agreement, the fault insurer arranges and pays for a TRV through its contracted provider at pre-agreed rates. Six of the ten CMCs/CHCs in our sample

(Accident Exchange, Ai Claims Solutions, Enterprise, Helphire, Kindertons and WNS Assistance) told us that, as well as providing credit hire services, they also provide direct hire services to fault customers and captured non-fault customers (following a referral from the fault insurer).

**Aviva Comment** - This endorses our view that if there was a move to direct hire across the whole market they would then be able to compete on service and reduce their overheads as there could, as a remedy, be no need for credit hire.

*Non-fault party capture*

34. Insurers told us that, when they were the fault insurer, they often attempted to capture the non-fault claimant, in order to control the costs of the claim, including the cost of a TRV. Table 3 shows the varied success of insurers in non-fault party capture.

TABLE 3 Insurer non-fault party capture rates, 2012

	<i>Third party capture rate</i> %*
Admiral	[X]
Ageas Insurance	[X]
Aviva	[X]
AXA UK	[X]
AXA Northern Ireland	[X]
CISGIL	[X]
DLG	[X]
Esure	[X]
LV=	[X]
RSA	[X]
Zurich	[X]
Unweighted average	25

Source: Insurers.

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\*The capture rate is the proportion of successful captures (where the insurer has captured at least one element of the non-fault party's claim) from all capture attempts. Therefore, in part, the different capture rates represent the different degrees to which insurers attempt to capture.

35. Fault insurers capture non-fault claimants by contacting them directly as early as possible following an accident where their customer appears to be at fault. They usually obtain the contact details of the non-fault party from their fault customer during the first notification of loss (FNOL) process. Where the fault customer cannot provide full contact information, the insurer will use a range of easily available data sources to obtain or verify the details. For example, AXA told us that [X].

36. With the exception of [redacted],<sup>10</sup> all the insurers in our sample told us that [redacted].
37. The results of our survey of non-fault customers (see the working paper ‘Survey report’) suggest that the first contact following an accident is a key factor in determining which party ultimately handles the claim. The results show that, where the first contact following the accident was the non-fault insurer, 68 per cent of claims were ultimately handled by the non-fault insurer; and where the first contact following the accident was the fault insurer, 82 per cent of claims were ultimately handled by the fault insurer. We discuss the evidence from our survey further in the working paper ‘ToH 1: Analysis of the results of the non-fault survey in relation to overprovision’.
38. The primary cost incurred by insurers in capturing non-fault parties is the cost of employing claims handlers to try to identify and contact these parties (usually by following up an inbound call from a fault customer with an outbound call to the non-fault party). Esure told us that this claims handling cost was around £[redacted] per claim. LV= told us that it estimated it cost around £[redacted] to capture a non-fault party.

### *Bilateral agreements*

39. Five of the ten insurers in our sample told us that they had bilateral agreements relating to TRV services with other insurers ([redacted],[redacted],[redacted],[redacted] and [redacted]) (see Table 4).

TABLE 4 **Insurer mobility bilateral agreements**

[redacted]

Source: Insurers.

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\* [redacted] bilateral agreement with [redacted] only applies to [redacted] brand.

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<sup>10</sup> [redacted].

40. Where such bilateral agreements exist, fault insurers can avoid the referral of a non-fault claimant to a CMC/CHC by the non-fault insurer and can reduce frictional costs by, typically, mutually agreeing to provide a TRV to their non-fault customers at direct hire rates.

#### *Alternative model*

41. Enterprise told us that it had recently entered the credit hire market with a subscriber model for the provision of TRVs to non-fault claimants. It said that, where both the fault and non-fault insurer were subscribers to its model, it would pay the non-fault insurer a referral fee for referring its non-fault customer to Enterprise and it would invoice the fault insurer for (a) the cost of the hire and (b) the referral fee it had paid. However, the cost of the hire would be at contracted direct hire rates rather than at credit hire rates. The fault insurer would be required to pay the invoice within [✂] days.

#### **Aviva Comment** - [✂]

#### **Northern Ireland**

42. There are several commercial and legal differences between Northern Ireland and the rest of the UK in relation to the provision of TRV services. The main differences appear to us to be:
- (a) CMCs/CHCs are less prevalent in Northern Ireland than in the rest of the UK. It has been put to us that this might be due to:
- (i) The effective ban of the payment of referral fees by solicitors in Northern Ireland. Although referral fees are not explicitly prohibited in Northern Ireland, they are effectively banned by the operation of Article 28 of the Solicitors (NI) Order 1976, which prohibits the sharing of profits or fees with an unqualified person. In England and Wales, the growth of the claims management industry coincided with the lifting of the ban on referral fees to solicitors in 2004.

(ii) Means-tested legal aid for personal injury cases.<sup>11</sup> The Belfast Solicitor's Association (BSA) told us that 45 per cent of people were financially entitled to legal aid in Northern Ireland (although we understand that this entitlement is currently under review). Consequently, non-fault claimants pursuing compensation were less likely to require the services of a CMC/CHC, in order to negate the risk of having to bear the costs should they be unsuccessful in their claim.

(b) The GTA is not used as much in Northern Ireland. For example, Crash Services, a leading CMC/CHC in Northern Ireland, does not subscribe to the GTA.

(c) The Ministry of Justice (MoJ), which includes the MoJ's Claims Management Regulator, does not have jurisdiction in Northern Ireland, meaning that CMCs/CHCs in Northern Ireland are not regulated.

### **Cost of credit hire and direct hire**

43. Table 5 sets out the average credit hire bill and the average direct hire bill paid by the ten large insurers in our sample, and the average credit hire bill and the average direct hire bill issued by the nine CMCs/CHCs in our sample. The amounts paid by insurers will include amounts paid to providers of TRVs other than CMCs/CHCs.

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<sup>11</sup> We note that personal injury cases were within the scope of the England and Wales legal aid scheme prior to the introduction of Conditional Fee Agreements (CFAs) in 1998.



TABLE 5 Average cost of credit hire and direct hire

Insurer/CMC/CHC	Average credit hire bill paid/issued by insurer/CMC/CHC	Average direct hire bill paid/issued by insurer/CMC/CHC	Difference	Multiple of average credit hire bill over average direct hire bill
	£	£*		
<i>Insurer</i>				
Admiral	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ageas Insurance	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
AXA UK	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
AXA Northern Ireland	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Esure	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
LV=	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	1,301	647	654	2.0x
<i>CMC/CHC</i>				
Accident Exchange†	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
ACM‡	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ai Claims Solutions	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
ClaimFast§	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Crash Services¶	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Enterprise	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Helphire	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Kindertons	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
WNS Assistance	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	1,181	590	591	2.0x
Overall unweighted average	1,241	618	622	2.0x

Source: Insurers and CMCs/CHCs.

\*The direct hire data may include fault claims.

†[REDACTED].

‡ACM is a CMC and does not provide credit hire or direct hire services.

§ClaimFast does not provide direct hire services, except as an outsourced function for [REDACTED].

¶Crash Services does not provide direct hire services.

44. Table 5 shows (on an unweighted average basis) that insurers pay around twice as much for a credit hire vehicle than for a direct hire vehicle, and this data is confirmed by CMCs/CHCs charging around twice as much for a credit hire vehicle than for a direct hire vehicle. The value of this difference is about £600.

45. Credit hire bills and direct hire bills are usually calculated simply by multiplying the daily hire rate by the hire duration (ie the number of days), so we now discuss each of these elements in turn.

## Daily rate

46. The daily rate is determined by the type of vehicle. For credit hire claims, the GTA sets the maximum daily rate for each vehicle class, which will be the rate typically charged by a subscribing CMC/CHC. Table 6 presents a comparison of the credit hire daily rates of the GTA with the average direct hire daily rates of both insurers and CMCs/CHCs for different vehicles. Table 7 presents a comparison of average credit hire daily rates and average direct hire daily rates paid by insurers and charged by CMCs/CHCs.

TABLE 6 Comparison of GTA credit hire daily rates and insurer and CHC/CMC direct hire daily rates

GTA vehicle Category	Example vehicle	GTA credit hire daily rate £	Average insurer direct hire daily rate £*	Multiple of GTA rate over average insurer direct hire rate	Average CHC/CMC direct hire daily rate £*	Multiple of GTA rate over average CHC/CMC direct hire rate
<i>Standard</i>						
S1	Peugeot 107	[£]	[£]	[£]	[£]	[£]
S4	Ford Focus 1.6	[£]	[£]	[£]	[£]	[£]
S5	Ford Mondeo 1.8	[£]	[£]	[£]	[£]	[£]
S7	Peugeot 607	[£]	[£]	[£]	[£]	[£]
Weighted average				2.1x		1.6x
<i>MPV</i>						
M1	Ford Focus C-Max 1.4/1.6	[£]	[£]	[£]	[£]	[£]
M3	Ford Galaxy	[£]	[£]	[£]	[£]	[£]
M4	Mercedes Benz Viano 2.0	[£]	[£]	[£]	[£]	[£]
Weighted average				2.2x		1.5x
<i>4x4</i>						
F1	Toyota RAV4 2.0	[£]	[£]	[£]	[£]	[£]
F3	BMW X3 2.0	[£]	[£]	[£]	[£]	[£]
F5	BMW X5 3.0	[£]	[£]	[£]	[£]	[£]
F9	Porsche Cayenne Turbo 4.5	[£]	[£]	[£]	[£]	[£]
Weighted average				2.2x		1.4x
<i>Prestige</i>						
P1	BMW 116 1.6	[£]	[£]	[£]	[£]	[£]
P4	BMW 320 2.0	[£]	[£]	[£]	[£]	[£]
P5	BMW 520 2.0	[£]	[£]	[£]	[£]	[£]
P8	BMW 730 3.0	[£]	[£]	[£]	[£]	[£]
P11	Bentley Continental	[£]	[£]	[£]	[£]	[£]
Weighted average				2.2x		1.6x
<i>Sports</i>						
SP1	Mini Cooper 1.6	[£]	[£]	[£]	[£]	[£]
SP4	Audi TT Coupe 1.8T	[£]	[£]	[£]	[£]	[£]
SP8	BMW 325 Cabriolet	[£]	[£]	[£]	[£]	[£]
SP9	BMW 630	[£]	[£]	[£]	[£]	[£]
SP10	BMW M5	[£]	[£]	[£]	[£]	[£]
SP11	Aston Martin Vantage 6.0	[£]	[£]	[£]	[£]	[£]
Weighted average				2.2x		1.6x
Overall weighted average				2.2x		1.5x

Source: Insurers and CMCs/CHCS.

\*The direct hire data may include fault claims.

Note: The weighted averages are based on the prevalence of each vehicle within each vehicle category.

TABLE 7 Average credit hire daily rate and direct hire daily rate paid/charged by insurers/CHCs/CMCs

<i>Insurer/CMC/CHC</i>	<i>Average credit hire daily rate £</i>	<i>Average direct hire daily rate £*</i>	<i>Difference £</i>	<i>Multiple of average credit hire rate over average direct hire rate</i>
<i>Insurer</i>				
Admiral	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ageas Insurance	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
AXA UK	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
AXA Northern Ireland	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
LV=	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	67.56	32.40	35.16	2.1x
<i>CMC/CHC</i>				
Accident Exchange	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
ACM†	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ai Claims Solutions	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
ClaimFast‡	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Crash Services§	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Enterprise	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Helphire	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Kindertons	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
WNS Assistance	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	54.19	26.41	27.78	2.1x
Overall unweighted average	60.88	29.41	31.47	2.1x

Source: Insurers and CMCs/CHCs.

\*The direct hire data may include fault claims.

†ACM is a CMC and does not provide credit hire or direct hire services.

‡ClaimFast does not provide direct hire services, except as an outsourced function for [REDACTED].

§Crash Services does not provide direct hire services.

47. Table 6 shows that the average GTA credit hire daily rate is between about 50 and 120 per cent higher than the average direct hire daily rate. Table 7 shows (on an unweighted average basis) that average credit hire daily rates are around twice as much as average direct hire daily rates. GTA credit hire daily rates are higher than average direct hire daily rates for all vehicle categories and for all insurers from which we gathered data.

48. The higher daily rate of credit hire compared with direct hire appears to be, at least in part, a result of the different incentives of and constraints on the different providers. For a direct hire provider, the daily rate is the result of competition against other direct hire providers and negotiation with an insurer in respect of a large volume of prospective direct hires. For a credit hire provider, the daily rate is usually set by the

GTA and, in practice, the only limitation is that the rate represents the reasonable costs that can be recovered from the fault insurer under tort law.

### **Hire duration**

49. Table 8 compares the average credit hire and direct hire duration. The evidence provided by insurers suggests that the average credit hire duration is about 3.7 days longer than the average direct hire duration. Although the evidence provided by CMCs/CHCs was limited, where figures were provided, the average credit hire duration was longer than the average direct hire duration. Our survey results also found that a greater proportion of claims handled by CMCs/CHCs resulted in long hire periods (eg of three weeks or more) than claims handled by insurers.

TABLE 8 **Average credit hire and direct hire durations**

<i>Insurer/CMC/CHC</i>	<i>Average credit hire duration (days)</i>	<i>Average direct hire duration (days)*</i>	<i>Difference (days)</i>
<i>Insurer</i>			
Admiral	[REDACTED]	[REDACTED]	[REDACTED]
Ageas Insurance	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]
AXA	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]	[REDACTED]
LV=	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	15.5	11.8	3.7
<i>CMC/CHC</i>			
Accident Exchange	[REDACTED]	[REDACTED]	[REDACTED]
ACM†	[REDACTED]	[REDACTED]	[REDACTED]
Ai Claims Solutions	[REDACTED]	[REDACTED]	[REDACTED]
ClaimFast‡	[REDACTED]	[REDACTED]	[REDACTED]
Crash Services§	[REDACTED]	[REDACTED]	[REDACTED]
Enterprise	[REDACTED]	[REDACTED]	[REDACTED]
Helphire	[REDACTED]	[REDACTED]	[REDACTED]
Kindertons¶	[REDACTED]	[REDACTED]	[REDACTED]
WNS Assistance	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	18.5	13.5	5.0
Overall unweighted average	17.0	12.7	4.3

Source: Insurers and CMCs/CHCs.

\*The direct hire data may include fault claims.

†ACM is a CMC and does not provide credit hire or direct hire services.

‡ClaimFast does not provide direct hire services, except as an outsourced function for [REDACTED].

§Crash Services does not provide direct hire services.

¶Kindertons' average credit hire duration is based on the average time taken to complete a credit repair (performed by Kindertons) on a repairable and roadworthy vehicle.

50. We note that the difference between the average credit hire and direct hire duration could be due to:
- (a) the mix of claims, ie with TRVs for more complex claims, which require longer repair periods, being provided under credit hire;
  - (b) the underprovision of TRV services under a direct hire agreement in relation to duration (though we have not found any evidence to support this view (see the working paper 'ToH2: Underprovision of TRVs'));
  - (c) the manipulation of credit hire durations (eg by disproportionately booking in vehicles for repair on Fridays or returning them on Mondays, or by extending repair durations) (see paragraphs 122 to 134); and/or
  - (d) the overprovision of TRV services under a credit hire agreement (see paragraphs 121 to 166).

### ***Relative impact of daily rates and hire duration***

51. We considered how much the difference in the cost of credit hire and direct hire (see paragraph 44) is attributable to a higher daily hire rate and how much it is attributable to a longer credit hire duration.
52. Given our finding that the average cost of credit hire appears to be around twice the average cost of direct hire and our finding that the average credit hire daily rate appears to be around twice the average direct hire daily rate, the difference in the daily rate would appear to explain entirely the difference between credit hire and direct hire bills.
53. However, on the basis of the average credit hire duration being 3.7 days longer than the average direct hire duration, we also calculated that around 38 per cent of the difference between the average credit hire bill and the average direct hire bills could be explained by the difference in hire duration, as shown in Table 9.

**Aviva Comment** – please see comments attached to 13.

TABLE 9 **Difference in the cost of credit hire and direct hire bill attributable to a longer credit hire duration**

	<i>Average credit hire daily rate</i> £ (A)	<i>Difference in average credit hire and direct hire duration</i> (days) (B)	<i>Difference between credit hire bill and direct hire bill attributable to a longer credit hire duration</i> £ (AxB) =C)	<i>Overall difference between credit hire bill and direct hire bill</i> £ (D)	<i>Proportion of overall difference between credit hire bill and direct hire bill attributable to a longer average credit hire duration</i> % (E=C/D)
Insurer data	67.56	3.7	250	622	38

Source: CC analysis.

54. Clearly these numbers are not precisely consistent and the differences we have found in the two elements of hire charges (the daily rate and the hire duration) suggest that the difference in the total cost of credit hire and direct hire should be more than the 100 per cent difference we have found. However, they are directionally consistent and they indicate that the difference in the daily rate is the more significant element in causing credit hire to be more expensive than direct hire.

### **Overcosting of credit hire**

55. In seeking to analyse the higher daily hire rate of credit hire compared with direct hire, we considered the underlying costs borne by providers under the two models. In this section, we discuss the following costs, which would appear to contribute to and/or reflect the overcosting:

- (a) referral fees;
- (b) administration costs (both duplicated costs and frictional costs);
- (c) bad debt provision; and
- (d) credit risk.

### **Referral fees**

56. A CMC/CHC usually pays a fee to the referring non-fault insurer or broker (or other party), in order to secure the provision of credit hire services to the non-fault customer (a 'referral fee').

57. According to the evidence we have seen, most agreements between insurers and direct hire providers do not involve referral fees and, where fees are paid for direct hire, they are typically of much lower value than credit hire referral fees.
58. With the exception of CISGIL (see paragraph 25), all of the ten largest insurers told us that they received fees for credit hire referrals. [REDACTED].
59. Table 10 shows the average referral fee for a credit hire TRV paid by each of the CMCs/CHCs in our sample and received by each of the insurers and brokers in our sample. These averages are between £[REDACTED] and £[REDACTED].



TABLE 10 Credit hire referral fees received/paid by insurers/brokers/CMCs/CHCs

<i>Insurer/broker/CMC/CHC</i>	<i>Average referral fee paid/received per referral</i> £
<i>Insurers</i>	
Admiral	[REDACTED]
Ageas Insurance	[REDACTED]
Aviva	[REDACTED]
AXA UK	[REDACTED]
AXA Northern Ireland*	[REDACTED]
CISGIL	[REDACTED]
DLG	[REDACTED]
Esure	[REDACTED]
LV=	[REDACTED]
RSA	[REDACTED]
Zurich	[REDACTED]
Unweighted average	249–358
<i>CMCs/CHCs</i>	
Accident Exchange	[REDACTED]
ACM	[REDACTED]
Ai Claims Solutions	[REDACTED]
ClaimFast	[REDACTED]
Crash Services	[REDACTED]
Enterprise	[REDACTED]
Helphire	[REDACTED]
Kindertons	[REDACTED]
WNS Assistance	[REDACTED]
Unweighted average	247–310
<i>Brokers</i>	
AA	[REDACTED]
Ageas Insurance 50†	[REDACTED]
BISL‡	[REDACTED]
Castle Covert†	[REDACTED]
Endsleigh	[REDACTED]
Express Insurance†	[REDACTED]
Kwik Fit Insurance†	[REDACTED]
Swinton	[REDACTED]
The Green Insurance Company†	[REDACTED]
UKAIS†	[REDACTED]
Unweighted average	248–277
Overall unweighted average	248–315

Source: Insurers, CMCs/CHCs and brokers.

\*AXA Northern Ireland [REDACTED].

†Ageas Insurance had six broking companies at the date of responding to us: Ageas Insurance 50 (trading as RIAS), UKAIS, Castle Cover, Express Insurance Services, Kwik Fit Insurance Services and The Green Insurance Company.

‡BISL did not provide an indication of the average referral fee it receives from a referring party, but it told us that its credit hire referral fee income was £[REDACTED] and £[REDACTED].

60. The significant variation in the estimates of the referral fees paid by CMCs/CHCs and received by insurers and brokers provided in Table 10 reflects:

(a) the different forms in which referral fees can be structured (see paragraph 57);

(b) the importance of the referring party to the CMC/CHC in securing credit hire revenue (insurers typically handle more non-fault claims than brokers and therefore have more bargaining power against CMCs/CHCs); and

(c) the competitive pressure between CMCs/CHCs in securing referrals from all referring parties.

61. Despite the considerable referral fees earned by almost all of the ten largest insurers, these insurers all told us that the size of the referral fee was only one of the factors they considered when establishing or renegotiating an agreement with a CMC/CHC for the provision of credit hire services. These insurers told us that they also considered the quality of the services provided. For example:

(a) DLG told us that it required its credit hire provider, [REDACTED], to meet its customer vehicle safety and security requirements and to provide sufficient capacity and coverage of vehicle classes to meet its customer service requirements. DLG said that, in addition, it had key performance indicators (KPIs) within its agreements (eg defining acceptable and unacceptable performance levels for contacting customers in a timely manner) and targets for customer satisfaction and complaints ratios. DLG said that, although the level of referral fee it received was an important consideration, these other criteria had to be met before DLG awarded its business to [REDACTED].

(b) Aviva told us that when selecting credit hire providers it took into account the following:

- (i) the process for relaying instructions from Aviva to the CMC/CHC;
  - (ii) the CMC's/CHC's customer service performance, including how sizes of vehicles were determined, time frames for provision, available options for collection and delivery, deposits, fuel policy, excesses, and the process should the hire vehicle be damaged;
  - (iii) expected service levels; and
  - (iv) fleet size, branch footprint, internal processes and IT capabilities.
- [REDACTED]

**Aviva Comment** – [REDACTED]

*Our assessment*

62. Referral fees constitute a cost of acquiring business for a CMC/CHC. As non-fault insurers and brokers often 'control' the non-fault customer following FNOL, CMCs/CHCs appear to compete to be selected by insurers and brokers (and others) to provide services to their non-fault customers by, among other things, paying higher referral fees. It appears to us that the result of this market structure is that referral fees represent a method by which non-fault insurers and brokers can extract the profits generated by CMCs/CHCs in the provision of credit hire (and other) services. If CMCs/CHCs were able to generate more profits (eg from daily rates rising or hire durations getting longer), we would expect referral fees to go up; and vice versa. We note that CMCs/CHCs are able to secure direct hire referrals from insurers and brokers without the payment of referral fees, competing instead on the price of the services they offer.
63. Overall, it appears to us that the level of referral fees may be an indication of the extent of the underlying profitability (ie prior to referral fees being paid) in credit hire (and other services).

### ***Administrative costs***

64. Insurers and CMCs/CHCs incur administrative costs in the management of a credit hire claim, eg in the setting up of the claim, the assessment of liability and the

processing and submission of documentation to the fault insurer (in line with GTA guidelines, such as the mitigation statement).<sup>12</sup>

65. We have considered two categories of administrative costs relevant to assessing the effects of the separation of cost liability and cost control: (a) duplicated administrative costs, which arise from having two parties (rather than one) involved in the management of a non-fault claim; and (b) frictional costs, which arise from having two parties with different interests involved in a non-fault claim.

#### *Duplicated administrative costs*

66. Duplicated administrative costs are those costs which arise from both the CMC/CHC managing the claim and the fault insurer, which will ultimately pay for it, conducting similar activities. These costs primarily include the employment of claims handlers to:
- (a) assess all circumstances relating to the provision of TRV services, including the accident circumstances and the non-fault customer's need for a TRV;
  - (b) assess (prior to the commencement of the hire period) whether the non-fault customer's vehicle is roadworthy;
  - (c) assess whether the customer's vehicle is economical to repair<sup>13</sup> and the repair methodology and cost is reasonable;
  - (d) ensure that the non-fault customer has entered into a binding and enforceable contract for the supply of TRV services;
  - (e) monitor actively the repair of the non-fault customer's vehicle during the hire period or the total loss settlement process (for vehicle write-offs), in order to keep the hire costs to a minimum; and
  - (f) manage the recovery/payment of claims.

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<sup>12</sup> Under the terms of the GTA, a mitigation statement signed by the customer must be provided by the CMC/CHC to the fault insurer. This statement should set out the reasons why the non-fault customer requires a TRV.

<sup>13</sup> The assessment of whether a vehicle is economical to repair is determined by comparing the likely cost of repair with the pre-accident value of the vehicle.

The GTA's guidelines specify that payment in settlement of a credit hire or credit repair claim should be made within 30 days of the dispatch of the claim to the fault insurer. If payment is late, the outstanding amount incurs a late payment penalty at both 30 and 60 days. Under the terms of the GTA, a CMC/CHC is entitled to progress settlement outside of the GTA (eg through litigation) if a claim has not been settled after 90 days from the dispatch of the claim to the fault insurer. Helphire told us that [X] per cent of its credit hire claims were not settled within 90 days.

### *Frictional costs*

67. Frictional costs arise from the party controlling the credit hire TRV service (the CMC/CHC) having a different interest from the party paying for it (the fault insurer). They are incurred by both the CMC/CHC and the fault insurer.
68. We recognized that, when a fault insurer captures a non-fault claim, frictional costs can arise between the fault insurer and the non-fault customer, as the fault insurer might have an incentive to underprovide services in order to keep costs down. However, we consider the issue of underprovision separately in the working paper 'ToH 2: Underprovision of TRVs'.
69. We have also not assessed in this paper the frictional costs incurred by non-fault insurers, as non-fault insurers often refer their customers to CMCs/CHCs for the provision of TRV services under a credit hire agreement and therefore incur minimal frictional costs (though they do incur some small duplicated administrative costs).<sup>14</sup>

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<sup>14</sup> Non-fault insurers incur frictional costs in relation to the settlement of non-fault repair costs, as non-fault repairs are more commonly handled by non-fault insurers than the provision of non-fault TRV services. However, insurers told us that repair claims were disputed much less than TRV claims and therefore the frictional costs incurred in relation to repairs were significantly lower than those incurred in relation to credit hire (see the working paper 'ToH 1: Overcosting and overprovision of repairs').

*Frictional costs incurred by CMCs/CHCs*

70. The frictional costs incurred by a CMC/CHC in the provision of credit hire TRV services to non-fault customers include:

- (a) administrative costs to increase the likelihood of the claim being settled by the fault insurer—these include the costs of complying with the obligations of the GTA; and
- (b) costs of pursuing and recovering credit hire claims, including litigation. Under the terms of the GTA, a CMC/CHC is entitled to progress settlement outside the GTA (eg through litigation) if a claim has not been settled 90 days after the dispatch of the claim to the fault insurer (see paragraph 66).

71. Table 11 sets out the frictional costs incurred by the CMCs/CHCs in our sample. It suggests that a CMC/CHC incurs, on average, £[redacted] to £[redacted] of frictional costs per credit hire TRV claim.<sup>15</sup>

TABLE 11 Frictional costs incurred by CMCs/CHCs, 2012

CMC/CHC	GTA claims		Non-GTA claims		All claims		
	Annual costs £	Average costs per claim £	Annual costs £	Average costs per claim £	Annual costs £	Average costs per claim £	Frictional costs as a proportion of average credit hire bill %
Accident Exchange	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ACM*	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Ai Claims Solutions	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ClaimFast	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Crash Services†	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Enterprise	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Helphire	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Kindertons	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
WNS Assistance	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Unweighted average							10

Source: CMCs/CHCs.

\*ACM told us that [redacted].

†Crash Services told us that [redacted].

72. Five of the nine CMCs/CHCs in our sample were able to provide us with an estimate of their overall frictional costs. However, there was significant variation in these esti-

<sup>15</sup> Many CMCs/CHCs found it difficult to distinguish between duplicated administrative costs (which relate to having two parties involved in managing a claim) and frictional costs (which relate to those two parties having different interests in the claim).

mates, with these costs representing between [X] and [X] per cent of the average credit hire bill. It appeared to us that this reflected the difficulty for CMCs/CHCs to distinguish frictional costs from their general claims management costs.

73. In Appendix B, we present an analysis of the different cost elements which are included within the frictional costs incurred by CMCs/CHCs. Administration costs, in particular the cost of employing claims handlers to manage credit hire claims and to process documentation in line with the GTA, and litigation costs incurred in pursuing the fault insurer for settlement of credit hire claims are the largest elements of the frictional costs incurred by CMCs/CHCs.
74. The level of frictional costs incurred by CMCs/CHCs suggests that considerable resources are expended in order to gain settlement of credit hire claims. We also found that claims often lasted a long period. Accident Exchange told us that its debtor days were [X] days and that it spent on average around [X] resolving each claim.<sup>16</sup> Similarly, Ai Claims Solutions told us that its debtor days were over [X] days and each claim required, on average, [X] actions from the point of referral to the ultimate recovery of the claim.

**Aviva Comment - Please see comments made under section (93)**

75. Only two of the nine CMCs/CHCs in our sample ([X] and [X]) were able to provide a breakdown of their frictional costs between GTA and non-GTA credit hire claims. Based on [X] evidence, frictional costs incurred in relation to non-GTA claims (£[X] on average per claim) were significantly higher than those incurred in relation to GTA claims (£[X] on average per claim). We noted that, although the GTA is not binding and is open to interpretation, it does provide a framework for the efficient negotiation and settlement of credit hire claims. However, we also noted that the large

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<sup>16</sup> Accident Exchange told us that this was a rough estimate based on the number of claims settled 'in-house' and the number of people employed exclusively in the settlement of claims. It excluded, for example, the time spent by external solicitors in

settling claims.



discrepancy between GTA and non-GTA claims was explained in part by many claims which were initially submitted under the GTA falling out of this system when they were not settled within 90 days (see paragraph 66). As these tended to be the claims which were most likely to be subject to dispute, they often required substantial cost in reaching settlement.

**Aviva Comment** - An example of a 'least worst option' as we have sought to avoid intervention as part of the GTA. It might be seen as efficient but it is because the overall landscape that sits behind it is dysfunctional that we have reached the position that we have.

76. Ai Claims Solutions told us that the GTA facilitated a collaborative negotiation process and the GTA settlement guidelines were beneficial in providing higher industry standards, better relationships between CMCs and insurers, and fewer frictional exchanges. Ai Claims Solutions told us that a claim process not under the GTA tended to be more combative. Accident Exchange told us that claims settled outside of the GTA generally involved additional costs (such as legal costs which were not usually fully recoverable) and took longer to settle, with cash flow consequences.
77. We note that the frictional costs incurred by CMCs/CHCs are to some extent offset by (a) late payment penalties paid by the fault insurer to the CMC/CHC in respect of GTA claims not settled within 30 days of the claim being submitted by the CMC/CHC to the fault insurer (as set out in the GTA); and (b) the reimbursement of legal fees by the fault insurer in relation to litigated credit hire claims which the CMC/CHC wins.<sup>17</sup> Both these forms of offsetting income represent frictional costs for fault insurers so, in our calculations, we have sought to ensure that they are not double counted.
78. Table 12 sets out the extent of this offsetting income for CMCs/CHCs. In 2012, late payment penalties amounted to between [X] and [X] per cent of the frictional costs incurred by CMCs/CHCs.

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<sup>17</sup> The GTA requires that insurers settle credit hire claims within 30 days of a claim being submitted to it for payment. Failure to settle the claim within this period results in a late payment penalty of 12.5 per cent of the amount invoiced for claims settled between 30 and 60 days, and 20 per cent of the amount invoiced for claims settled between 60 and 90 days. The CMC/CHC can pursue payment outside the terms of the GTA for claims not settled within 90 days, ie through litigation.

TABLE 12 Offsetting income received by CMCs/CHCs, 2012

CMC/CHC	Annual income		Income per claim		Income as proportion of frictional costs	
	Late payment penalties	Reimbursement of legal fees	Late payment penalties	Reimbursement of legal fees	Late payment penalties	Reimbursement of legal fees
	£	£	£	£	%	%
Accident Exchange*	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ACM†	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Ai Claims Solutions	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ClaimFast	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Crash Services‡	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Enterprise	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Helphire	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Kindertons	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
WNS Assistance	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: CMCs/CHCs.

\*Accident Exchange's offsetting income relates to both credit hire and credit repair claims.

†ACM [redacted].

‡Crash Services does not subscribe to the GTA and therefore is not entitled to late payment penalties under the GTA.

79. Table 13 sets out the frictional costs incurred by CMCs/CHCs net of offsetting income. It shows net frictional costs of £[redacted] to £[redacted] per credit hire claim, representing, on average, between [redacted] and [redacted] per cent of the average credit hire bill issued by a CMC/CHC to the fault insurer.

TABLE 13 Net frictional costs incurred by CMCs/CHCs (net of offsetting income), 2012

CMC/CHC	Annual frictional costs	Annual offsetting income	Net frictional costs	Net frictional costs per claim	Net frictional costs as a proportion of average credit hire bill
	£	£	£	£	%
Accident Exchange*	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ACM†	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Ai Claims Solutions	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ClaimFast	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Crash Services‡	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Enterprise	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Helphire	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Kindertons	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
WNS Assistance	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Unweighted average					5
Unweighted average excl [redacted]§					4

Source: CC analysis.

\*Accident Exchange's offsetting income relates to both credit hire and credit repair claims.

†ACM [redacted].

‡Crash Services does not subscribe to the GTA and therefore is not entitled to late payment penalties under the GTA.

§[redacted] offsetting income appears to be higher than its frictional costs. Therefore, we have excluded this when calculating the average frictional costs as a proportion of the average credit hire bill.

*Frictional costs incurred by fault insurers*

80. A fault insurer incurs frictional costs in relation to the verification, negotiation and settlement of credit hire claims. These costs include:
- (a) administrative costs to verify and negotiate credit hire claims;
  - (b) costs relating to the establishment and maintenance of mitigation strategies to reduce the cost of credit hire claims (eg non-fault party capture and bilateral agreements); and
  - (c) costs of challenging credit hire claims, including litigation.
81. Table 14 shows the frictional costs incurred by the ten large insurers in our sample. The table suggests that a fault insurer incurs on average £[redacted] to £[redacted] of frictional costs per claim in verifying, negotiating, challenging (where necessary) and settling credit hire claims.

TABLE 14 **Frictional costs incurred by insurers, 2012**

Insurer	GTA claims		Non-GTA claims		All claims		
	Annual costs £	Average costs per claim £	Annual costs £	Average costs per claim £	Annual costs £	Average costs per claim £	Frictional costs as a proportion of average credit hire bill %
Admiral*	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Ageas Insurance	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Aviva	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
AXA	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
CISGIL	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
DLG†	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
esure	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
LV=	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
RSA	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Zurich	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Unweighted average							10

Source: Insurers.

\*Admiral's frictional costs include those incurred in relation to credit repair as well as credit hire. However, Admiral told us that it believed the frictional costs associated with credit repair would be significantly lower than those associated with credit hire due to fewer areas of contention relating to credit repair.

†DLG was unable to provide the relevant data, as it does not separately identify its frictional costs from its overall operational costs.

82. Nine of the ten insurers in our sample were able to provide us with an estimate of their overall frictional costs. However, there was significant variation in these estimates, with these costs representing between [redacted] and [redacted] per cent of the average

credit hire bill. It appeared to us that, as for CMCs/CHCs (see paragraph 72), this reflected the difficulty for insurers to distinguish frictional costs from their general claims management costs. For example, CISGIL told us that it could not quantify the costs it incurred in setting up and maintaining bilateral and third party capture agreements, as these activities involved numerous CISGIL staff, who spent only a small amount of their time doing these things and the associated costs were therefore absorbed as part of their roles.

83. In Appendix C we present an analysis of the different cost elements which are included within frictional costs for insurers. Administrative costs, in particular the cost of employing claims handlers to manage non-fault claims, and the payment of late payment penalties in relation to GTA credit hire claims are the largest elements of the frictional costs incurred by insurers.
84. Six of the ten insurers in our sample ([redacted]) were able to provide a breakdown of their frictional costs between GTA and non-GTA credit hire claims, but only two were able to estimate a cost per claim. According to the evidence from these two insurers, frictional costs incurred in relation to non-GTA claims were higher than those incurred in relation to GTA claims for one insurer and they were almost identical between the two categories of claims for the other insurer.
85. Six of the ten insurers in our sample (Admiral, Ageas Insurance, Aviva, CISGIL, DLG and esure) told us that the level of disputes tended to be higher for non-GTA claims than for GTA claims.<sup>18</sup> For example, Aviva told us that it took about [redacted] to handle a non-GTA claim than a GTA claim. CISGIL told us that CMCs/CHCs which did not subscribe to the GTA were more difficult to negotiate with and usually presented

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<sup>18</sup> Of the remaining four insurers, AXA does not subscribe to the GTA, RSA told us that it was unable to compare the level of disputes in GTA and non-GTA cases, and both LV= and Zurich told us that subscription to the GTA did not affect the level of disputes they experienced with CMCs/CHCs.

higher credit hire claims (CISGIL's experience was that the daily rates charged by non-GTA subscribing CMCs/CHCs were typically [redacted] per cent higher than the maximum GTA daily hire rates). Insurers told us that the lack of any agreed protocols in non-GTA credit hire claims gave rise to more frequent disputes, which were harder to resolve and often resulted in litigation. CISGIL told us that, in 2012, [redacted] per cent of its credit hire claims were outside of the GTA, but these claims accounted for [redacted] per cent of its litigation costs.

86. Despite the significant frictional costs incurred by fault insurers, it appears to us that, overall, they achieve significant costs savings from challenging credit hire bills. On this issue:

- (a) Admiral told us that it saved costs in [redacted] per cent of credit hire claims settled in 2012 and the average saving was £[redacted] per claim.
- (b) Ageas Insurance told us that it saved around [redacted] per cent on all credit hire bills in 2012, which equated to approximately £[redacted] million.
- (c) CISGIL told us that it saved about £[redacted] million in 2012 as a result of challenging credit hire bills.
- (d) Zurich told us that it achieved savings of £[redacted] million against credit hire claims in 2012 through challenging bills (£[redacted] million against GTA claims and £[redacted] million against non-GTA claims).

87. Table 15 compares the total credit hire bills received by six of the ten insurers in our sample ([redacted]) and the costs paid out in relation to these bills.

TABLE 15 Credit hire bills received and costs paid out by insurers, 2012

Vehicle type	Example car	GTA claims			Non-GTA claims		
		Total value of credit hire bills received £	Total credit hire costs paid out £	Difference %	Total value of credit hire bills received £	Total credit hire costs paid out £	Difference %
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

[REDACTED]		[REDACTED]	[REDACTED]	[REDACTED]		[REDACTED]	[REDACTED]	[REDACTED]
Total		104,873,135	92,464,351	12		22,688,663	13,762,735	39

Source: Insurers.

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88. Table 15 shows that the six insurers saved, on average, 12 per cent against credit hire claims within the GTA through challenging the bills they received, and 39 per cent against non-GTA claims. It appears to us that the significantly lower savings made against GTA claims compared with non-GTA claims suggests that:

(a) the GTA is effective to some extent in providing a framework for the efficient negotiation and settlement of credit hire claims, such that fewer disputes arise; and/or

(b) there is significant friction in non-GTA claims, in part because this category includes claims which began under the GTA but fell out of that system.

89. We note that the cost savings to insurers through challenging bills are partially offset by the payments made by insurers to CMCs/CHCs of late payment penalties under the GTA. For example, RSA told us that it achieved an average saving of [REDACTED] per cent of the total credit hire bill through challenging the bill, but incurred an average late payment penalty of [REDACTED] per cent under the terms of the GTA.

90. We identified that insurers and CMCs had adopted some mitigation strategies aimed at reducing frictional costs, which are:

(a) the GTA (as already discussed to some extent); and

(b) bilateral agreements between insurers and CMCs/CHCs.

We discuss each in turn. We note that insurers also use other strategies to avoid frictional costs, eg seeking to capture the non-fault claim when they are the fault insurer and establishing bilateral agreements with other insurers, as previously discussed (see paragraphs 32 to 40).

- *The GTA*

91. The CHO told us that the GTA helped control the rules of engagement between subscribing insurers and CMCs/CHCs, and that customers benefited from a less acrimonious environment as a consequence (eg in avoiding having to attend court). The overriding principle of the GTA was that whoever was first to a customer and obtained their agreement should provide the service and no other subscriber should seek to intervene. 'First to a customer' was defined as the receipt and acceptance by the customer of a suitable offer which they could understand. The GTA also applied pre-agreed administrative processes and pre-agreed daily hire rates.<sup>19</sup>
92. It appears to us that the GTA plays an important role in reducing the level of disputes (and therefore frictional costs) between insurers and CMCs/CHCs (see paragraphs 70 to 89). Frictional costs incurred by insurers and CMCs/CHCs in relation to claims settled under the GTA are lower<sup>20</sup> than those in relation to claims settled outside of the GTA (see Tables 11 and 14).
93. However, the GTA has not eliminated friction. For example, Accident Exchange told us that, in 2012, it incurred administrative costs of around £[redacted] million and litigation costs of around £[redacted] million relating to the management and settlement of non-fault claims. It estimated that it could save around [redacted] per cent of these administrative costs and around [redacted] per cent of these litigation costs if fault insurers settled claims more efficiently. [redacted] also told us that simplification of the legal standing of credit hire could facilitate the removal of frictional costs arising from the current adversarial relationship between insurers and CMCs/CHCs. It estimated that this could save it up

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<sup>19</sup> The GTA is intended to apply to situations where a CMC/CHC feels the non-fault customer has the prospect of full recovery against the fault insurer and, in such cases, all subscribers are required to follow the GTA. In all other cases (ie where full recovery is not anticipated), subscribers may elect to follow the same principles, provided that they comply with the spirit and terms of the GTA, including by applying the relevant settlement rates.

<sup>20</sup> Though we acknowledge the limited sample for which we have data split on that basis.



to £[redacted] million a year on administrative and litigation costs, depending on the extent of such reforms.

**Aviva Comment** - Whilst it is fair to assume better working relationships may remove frictional costs, the type of vehicle and duration would still need to be controlled. However, previous WP' and the customer survey indicate that the service provision of the vehicle is broadly similar whomever provides it and thus there is little value for a CMC/CHO in the process. The bigger opportunity through legal reforms would be the removal of the need for a customer to sign a credit agreement.

**Aviva Comment** – [redacted]

94. We note that it is the continuing presence of frictional costs which explains the presence of other mitigation strategies.

**Aviva Comment** - Caused by the underlying tort system and a customer not having to make a claim on their policy even where they have comp cover or a TRV under their policy. We need a simple solution that avoids all frictional costs

- *Insurer and CMC/CHC bilateral agreements*

95. In an attempt to mitigate the frictional costs incurred in the provision of credit hire TRV services, some CMCs/CHCs and insurers have established bilateral agreements. These agreements are typically in the spirit of the GTA but outside the GTA, specifying the terms of credit hire, including the daily hire rate, and the claims management and settlement process. Six of the nine CMCs/CHCs in our sample ([redacted]) have such agreements or protocols in place. For example:

(a) Accident Exchange told us that it currently had a non-GTA protocol arrangement with [redacted], whereby it accepted a fixed amount per claim, regardless of the recoverable value of each claim. This arrangement currently covered around [redacted] per cent of Accident Exchange's credit hire revenue.

(b) Kindertons told us that it had 'specialised relationship' agreements with [redacted],[redacted] and [redacted]. These agreements were inside the GTA but were in place to expedite payments, minimize frictional cost and reduce litigation. Kindertons said that it

also had 'working benefit relationship' agreements with [redacted],[redacted] and [redacted]. These agreements were outside the GTA and were created to remedy a past adverse relationship. Kindertons told us that, where it did not have a formal agreement in place with an insurer but the insurer's market share exceeded 1 per cent, it reviewed the insurer's outstanding aged debt on a monthly basis.

96. It appears to us that the benefits of these agreements to CMCs/CHCs are:

- (a) fewer disputes and fewer claims requiring litigation, reducing frictional costs (eg Kindertons told us that, in 2012, only around [X] per cent of its claims involving relationship insurers resulted in litigation, compared with around [X] per cent of claims involving non-relationship insurers);
- (b) faster settlement of claims (eg Kindertons told us that, in 2012, relationship insurers settled their invoices on average in [X] days, whereas non-relationship insurers settled their invoices on average in [X] days); and
- (c) fewer resources required to comply with the obligations of the GTA and to pursue and recover claims.

97. Despite these benefits, Accident Exchange told us that [X].

98. Six of the ten insurers in our sample ([X]) have bilateral agreements with CMCs/CHCs. On this issue:

- (a) AXA told us that, although the agreements took a number of months to set up, the work involved once the agreements were in force was minimal (ie the production of monthly management information to verify performance).
- (b) Esure told us that it had [X] agreements with CHCs: [X]

99. It appears to us that the benefits of these agreements to insurers are:

- (a) fewer disputes and fewer claims requiring litigation, resulting in reduced frictional costs;
- (b) fewer resources required to manage non-fault TRV claims;
- (c) discounted settlement rates (eg [X]); and
- (d) greater control and certainty over the cost of a non-fault TRV claim (eg Admiral told us that, in 2012, [X] per cent of the credit hire claims it received under fixed fee arrangements [X] were settled at the negotiated flat rate, compared with only [X] per cent of claims under the GTA).

*Our assessment*

100. Our estimates suggest that net frictional costs incurred by a CMC/CHC represent, on average, between [X] and [X] per cent of the average credit hire bill issued; and frictional costs incurred by the fault insurer represent, on average, between [X] and [X] per cent of the average credit hire bill paid. However, these net frictional costs are difficult to quantify and not all insurers and CMCs were able to provide us with the required data. Moreover, we note that there is significant variance in the estimates. Therefore, we treat these calculations of averages with some caution.
101. Overall, it appears to us that the separation of cost liability and cost control gives rise to significant frictional costs for both the party which provides a TRV to a non-fault customer and the party which pays for it. The frictional costs incurred by CMCs/CHCs and fault insurers taken together amounts to between around £46 million and £186 million (based on a credit hire market of around £663 million and assuming that frictional costs are between 1 and 7 per cent of the average credit hire bill invoiced by CMCs/CHCs and between 6 and 21 per cent of the average credit hire bill received by fault insurers).<sup>21</sup> This view is supported by the considerable effort and expense incurred by both CMCs/CHCs and insurers in seeking to mitigate these costs (ie in the establishment of the GTA and in various other strategies).

**Aviva Comment** – we agree with this summary point and feel that a remedy / solution should focus on removing them

***Bad debt provision***

102. Bad debts arise in relation to non-fault TRV service provision when:
- (a) there is a dispute over a credit hire bill;
  - (b) subsequent evidence suggests that the non-fault customer was at fault; and/or
  - (c) the customer submits a fraudulent claim.

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<sup>21</sup> The CHO website states that the UK credit hire industry was estimated to be worth approximately £663 million in 2011.

103. Under the terms of a credit hire TRV agreement, the customer is ultimately liable for the costs of the provision of TRV services should the CMC/CHC be unable to recover the costs from the fault insurer. However, CMCs/CHCs told us that they rarely sought to recover costs from non-fault customers.

**Aviva Comment** - Whether they seldom do or not, the point is this is exposing the customer to a risk they needn't be exposed to. This point also applies to WP1 where it is shown similar findings for Credit Repair. We would also like to understand if the customer understands at point of signing the credit hire agreement what the final hire cost is likely to be and that if liability is disputed, by signing the agreement they are legally liable for some or all of this cost? It is also creating an inefficient process that highlights the TOH1 separation of cost control and liability that leads to extra cost which is not necessary. The need to create the liability is an artificial one and creates the uninsured loss claim that could otherwise have been serviced by the fault or the non-fault insurer.

#### *Extent of bad debt write-off*

104. The risk of non-recovery or only partial recovery of the costs incurred by CMCs/CHCs in the provision of TRV services under credit hire agreements is reflected in the high level of debt write-offs recognized by CMCs/CHCs. Table 16 shows the credit hire debt write-offs for the nine CMCs/CHCs in our sample. The table shows that, in 2012, CMCs/CHCs wrote off between [x] and [x] per cent of their gross revenue, with an unweighted average write-off of 20 per cent.

TABLE 16 Credit hire debt write-offs, 2012

CMC/CHC	Write-offs £			Write-offs as proportion of gross revenue %		
	GTA*	Non-GTA	Total	GTA*	Non-GTA	Total
Accident Exchange	[x]	[x]	[x]	[x]	[x]	[x]
ACM†	[x]	[x]	[x]	[x]	[x]	[x]
Ai Claims Solutions	[x]	[x]	[x]	[x]	[x]	[x]
ClaimFast	[x]	[x]	[x]	[x]	[x]	[x]
Crash Services‡	[x]	[x]	[x]	[x]	[x]	[x]
Enterprise§	[x]	[x]	[x]	[x]	[x]	[x]
Helphire	[x]	[x]	[x]	[x]	[x]	[x]
Kindertons	[x]	[x]	[x]	[x]	[x]	[x]
WNS Assistance	[x]	[x]	[x]	[x]	[x]	[x]
Unweighted average	9,356,973	3,393,580	12,750,553	18	30	20

Source: CMCs/CHCs.

\*We note that, in relation to claims settled under the GTA, the difference between the gross commercial value of a hire and the amount settled under the GTA's discounted rates is often the result of a settlement discount rather than a write-off.

†ACM does not provide credit hire services.

‡Crash Services does not subscribe to the GTA.

§Enterprise's credit hire activity is all under the GTA.

105. [X] told us that write-offs were driven by the severe cash flow pressures on CMCs/CHCs, caused by lengthy settlement periods, which often required them to accept lower settlement payments than were justifiable.
  
106. Table 16 also shows that, in 2012, the level of write-offs was significantly higher for credit hire claims outside the GTA than for claims within the GTA, which suggests

that the GTA plays a significant role in providing a framework for the efficient negotiation and settlement of credit hire claims.

107. [redacted] told us that the likelihood of full recovery from the fault insurer fell as the size of claim increased, as shown in Table 17.

TABLE 17 [redacted] claims recovery (last three years)

	Value of claim (£)			
	[redacted]	[redacted]	[redacted]	[redacted]
Cases where full recovery was made (%)	[redacted]	[redacted]	[redacted]	[redacted]

Source: [redacted].

108. Direct hire write-offs are less frequent than credit hire write-offs, as direct hire is usually arranged at pre-agreed rates with the party paying for it. For example, [redacted] told us that, historically, it wrote off around [redacted] to [redacted] per cent of its non-credit hire revenue, and this was only if it failed to provide adequate services to the insurer or customer (eg relating to the delivery of the vehicle, the billing process or the hire duration).

109. Table 18 shows the proportion of full and partial write-offs recorded by the CMCs/CHCs in our sample in relation to credit hire bills in 2012.



TABLE 18 Full and partial credit hire write-offs, 2012

<i>CMC/CHC</i>	<i>Full write-offs</i> £	<i>Partial write-offs</i> £	<i>Total write-offs</i> £	<i>Full write-offs as a proportion of total write-offs</i> %	<i>Partial write-offs as a proportion of total write-offs</i> %
Accident Exchange	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
ACM†	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ai Claims Solutions	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
ClaimFast	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Crash Services‡	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Enterprise	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Helphire	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Kindertons	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
WNS Assistance	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	1,790,748	9,810,173	11,600,922	15	85

Source: CMCs/CHCs.

\*We note that in relation to claims settled under the GTA, the difference between the gross commercial value of a hire and the amount settled under the GTA's discounted rates is often the result of a settlement discount rather than a write-off.

†ACM does not provide credit hire services.

‡Crash Services does not subscribe to the GTA.

110. The vast majority of debt written off by CMCs/CHCs in relation to credit hire TRV services is due to a partial write-off, ie a settlement discount being agreed with the fault insurer, rather than a full write-off, which only tends to occur where subsequent evidence suggests that the non-fault customer was actually at fault. Disputes in relation to the provision of the TRV (eg the customer's need for it, the class of vehicle, the hire duration, and the daily rate) are much more common than disputes in relation to liability for the accident. We note that [REDACTED].

### *Change in the initial assessment of liability and fraud*

111. Table 19 shows that the termination of a credit hire claim due to a change in the initial assessment of liability (from non-fault to fault) only occurs, on average, in between [REDACTED] and [REDACTED] per cent of cases. This appears to be due to the significant time and resources spent by CMCs/CHCs in establishing liability.

TABLE 19 Termination of credit hire claims due to a reassessment of liability, 2012

CMC/CHC	Proportion of credit hires claims terminated due to a reassessment of liability %	Proportion of credit hires claims terminated due to fraud %
Accident Exchange	[redacted]	[redacted]
ACM	[redacted]	[redacted]
Ai Claims Solutions	[redacted]	[redacted]
ClaimFast	[redacted]	[redacted]
Crash Services	[redacted]	[redacted]
Enterprise	[redacted]	[redacted]
Helphire	[redacted]	[redacted]
Kindertons	[redacted]	[redacted]
WNS Assistance	[redacted]	[redacted]
Unweighted average	1.73	0.37

Source: CMCs/CHCs.

112. Accident Exchange told us that, in cases where the customer’s vehicle was not drivable as a result of an accident (so the customer required a TRV immediately), it might make an initial assessment of liability and agree to provide hire on that basis until further investigations had been undertaken. In cases where Accident Exchange subsequently changed its initial assessment, the hire might have to be terminated. Accident Exchange said that this was rare but, if it did happen, then it would bear the costs incurred to that point.

113. Kindertons told us that, in some circumstances, it provided a TRV on credit hire to a perceived non-fault customer for up to seven days at no charge while it tried to establish liability. It said that this was only offered if the customer’s vehicle was not road-worthy and was provided as an enhanced service to its work providers. Kindertons said that the hire was accepted in [redacted] per cent of cases.

114. [redacted] told us that, if a CMC/CHC changed its initial assessment of liability, it could only recover its costs from the customer if the customer had deliberately misled it or made a fraudulent claim. It said that the costs of pursuing such customers and the likelihood of making any meaningful recovery meant that it would usually suffer the loss.

### ***Cost of credit***

115. A CMC/CHC incurs a working capital cost in providing credit hire services, as it does not receive payment for the services it provides until subsequently.
116. The cost of credit incurred by CMCs/CHCs is a factor of both the cost of the service provided and the time taken to recover that cost from the fault insurer. CMCs/CHCs told us that this time was often significant. For example, Helphire told us that its debtor days were around [X] days, whereas its typical credit period under a direct hire agreement was [X] days. Ai Claims Solutions told us that, although it recovered over [X] per cent of its invoices in full, it took on average [X] days to receive payment.

### ***Our assessment of the overcosting of credit hire***

117. In seeking to analyse the higher daily hire rate of credit hire compared with direct hire, we have looked at the underlying costs borne by providers under the two models. The two principal additional costs which arise in the provision of credit hire compared with direct hire are referral fees and frictional costs. Both these costs provide some evidence of overcosting.
118. Referral fees constitute a cost of acquiring business for a CMC/CHC. CMCs/CHCs appear to compete to be selected by insurers and brokers (and others) to provide services to their non-fault customers by, among other things, paying higher referral fees. In doing so, referral fees have the effect of enabling non-fault insurers and brokers to extract some of the profits generated by CMCs/CHCs in the provision of credit hire (and other services). Therefore, it appears to us that the level of referral fees may be an indication of the extent of the underlying profitability (ie prior to referral fees being paid) in credit hire (and other services). It appears to us that this profitability is likely to be a result of credit hire daily rates being, on average,

significantly higher than direct hire daily rates and credit hire durations being, on average, longer than direct hire durations (see paragraphs 46 to 54), although we also recognise that the provision of credit hire services involves some additional costs to be incurred compared with direct hire.

**Aviva Comment** - It is the referral fee element that in part drives this and any remedy that banned referral fees has to result in a net reduction of the rates and the duration.

119. Frictional costs arise from the administration, management and settlement of non-fault claims and are generated by the fault insurer attempting to minimize the cost of claims passed on to it by a non-fault insurer or CMC/CHC, and by the non-fault insurer or CMC/CHC defending its claim. It appears to us that the frictional costs incurred by fault insurers and CMCs/CHCs taken together amount to around between £46 million and £186 million. The establishment of various mitigation strategies by both insurers and CMCs/CHCs, including the GTA and bilateral agreements, seek to reduce both the level of the claim (eg the daily hire rate and/or the hire duration) and the frictional costs associated with such claims.

**Aviva Comment** - Whilst we feel 'bilateral agreements' are another 'least worst option' they do prevent the customer from entering credit hire agreements and do form the basis of a potential remedy/solution

120. Some of the other additional costs incurred in the provision of credit hire (eg bad debt provision and the cost of credit) reflect the inherent risk and the associated costs of the credit hire business model.

### **Overprovision of credit hire**

121. In this section, we consider whether there are differences between the TRV services which non-fault claimants receive and those to which they are entitled and desire. We consider the length of the credit hire duration and other services received alongside credit hire. We make comparison against direct hire, though we recognize that this is an imperfect comparator as there could be underprovision to customers who receive

a TRV under direct hire (see the working paper 'ToH 2: Underprovision of TRVs').

### ***Credit hire duration***

122. The credit hire duration, when multiplied with the daily rate, determines the cost of credit hire. It appears that, on average, the length of an average credit hire is 3.7 days longer than the length of an average direct hire (see paragraph 49). To the extent this represents overprovision, it would result in overcosting, ie the cost of a TRV to a non-fault claimant being higher than it would be if there were not the separation of cost liability and cost control. In this section, we consider the extent to which the longer average credit hire duration compared with the average direct hire duration reflects overprovision.

### ***Repair duration***

123. Hire duration is largely determined by repair duration.<sup>22</sup> Table 20 sets out the average credit hire durations for the nine CMCs/CHCs in our sample for three scenarios: (a) where a vehicle is repairable and drivable; (b) where a vehicle is repairable but not drivable; and (c) where a vehicle is not repairable (ie a write-off). The repair duration, and therefore the credit hire duration, is longer if a vehicle is not drivable, as (a) the customer is likely to require a TRV immediately (often before their vehicle is recovered and repairs have commenced); and (b) non-drivable vehicles typically have more significant damage than drivable vehicles and therefore require more extensive repair. Credit hire durations are longest where the vehicle is a write-off, as a pre-accident valuation needs to be agreed and, under the GTA, the non-fault customer is entitled to a TRV for up to seven days following receipt of the settlement payment.

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<sup>22</sup> Repair duration is the length of time taken to repair a vehicle. The repair duration commences on the booking-in date and concludes when the vehicle is returned to the customer. This is sometimes referred to as the 'key-to-key' period.

TABLE 20 Average credit hire durations for repairable vehicles and write-offs, 2012

CMC/CHC	Average credit hire duration (days)		
	Drivable vehicle	Non-drivable vehicle	Write-off
Accident Exchange	[redacted]	[redacted]	[redacted]
ACM*	[redacted]	[redacted]	[redacted]
Ai Claims Solutions	[redacted]	[redacted]	[redacted]
ClaimFast	[redacted]	[redacted]	[redacted]
Crash Services	[redacted]	[redacted]	[redacted]
Enterprise	[redacted]	[redacted]	[redacted]
Helphire	[redacted]	[redacted]	[redacted]
Kindertons	[redacted]	[redacted]	[redacted]
WNS Assistance	[redacted]	[redacted]	[redacted]
Unweighted average	10.3	19.8	29.8

Source: CMCs/CHCs.

\*ACM does not provide credit hire or direct hire services.

†Enterprise told us that its average credit hire duration for non-drivable vehicles was likely to be lower than shown, as Enterprise’s system recorded the drivability of the vehicle at the time of the notification of the claim, and some repairable non-drivable claims became write-offs during the claim process.

124. Our survey of non-fault claimants found that 73 per cent of respondents who received a TRV had the use of it for seven days or more, and 22 per cent had it for three weeks or more (see the working paper ‘Survey report’). This survey found that 41 per cent of respondents with a high level of damage to their vehicle received a TRV for three weeks or more compared with only 8 per cent of respondents with a low level of damage. This supports the view that credit hire durations are typically longer where the vehicle being repaired has sustained more damage.

125. We asked repairers whether their processes for conducting repairs varied according to the work provider or the fault status of the customer. With the exception of [redacted], all the repairers in our sample told us that they did not differentiate between fault, non-fault and captured claims in how they conducted repairs, including in the time taken to complete the repair. They told us that usually they did not know the fault status of the customer. [redacted] told us that it managed fault repairs to completion as quickly as possible but non-fault repairs were not as fast, as it was in the interest of the non-fault insurer or CMC/CHC to delay repair authorization and vehicle inspection, in order to extend the hire period.

126. In response to our survey of non-fault claimants:

(a) A higher proportion of claimants who received a TRV said that the repair of their vehicle took longer than initially advised by the repairer than claimants who did not receive a TRV (24 and 17 per cent respectively).

(b) The average repair duration was longer for non-fault claims than for captured non-fault claims (21 days and 15 days respectively for vehicles which suffered a high level of damage, and 9 days and 7 days respectively for vehicles which suffered a low level of damage).

This evidence is consistent with the view of [redacted] that non-fault repairs are not completed as quickly as fault repairs (or captured non-fault repairs) in order to extend the hire period (see paragraph 125).

127. All of the ten large insurers in our sample told us that a CMC/CHC could employ a number of methods in order to extend the credit hire period, including:

(a) Arranging for the collection and delivery of a roadworthy vehicle to the repairer prior to either the authorization of the repair or the repairer being ready to perform the repair (eg on a Friday afternoon). However, [redacted] told us that the practice of booking in non-fault repairs on a Friday was not now as common as it used to be. Table 21 presents the proportion of hire commencements by day of the week for the nine CMCs/CHCs in our sample and shows that, on average, 15 per cent of credit hires and direct hires commence on a Friday. This evidence supports the view that disproportionately booking in vehicles for repair on a Friday to extend a credit hire is not common.



TABLE 21 Hire commencement, 2012

*Proportion of hires that commenced on each day (%)*

	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
<i>Credit hire</i>							
Accident Exchange							
ACM*							
Ai Claims Solutions							
ClaimFast							
Crash Services							
Enterprise							
Helphire							
Kindertons							
WNS Assistance							
Unweighted average	23	20	19	17	15	6	0
<i>Direct hire†</i>							
Accident Exchange							
ACM*							
Ai Claims Solutions							
ClaimFast‡							
Crash Services§							
Enterprise							
Helphire							
Kindertons							
WNS Assistance							
Unweighted average	22	20	19	17	15	7	0

Source: CMCs/CHCs.

\*ACM does not provide credit hire or direct hire services.

†The direct hire data may include fault claims.

‡ClaimFast does not provide direct hire services, except as an outsourced function for [redacted].

§Crash Services does not provide direct hire services.

(b) Delaying the process for the authorization and completion of the repair, eg by delaying the appointment of an engineer to inspect the vehicle, delaying the submission of evidence to the fault party or sending it to the wrong address, and not monitoring the repair closely or resolving delays. [redacted]<sup>23</sup> told us that CHCs/CMCs could delay the start of the repair by instructing the engineer to wait up to five days before inspecting the vehicle, and could delay the authorization of the repair once the engineer had provided a repair cost estimate.

(c) Delaying the return of a repaired vehicle to the customer.

(d) Denying the fault insurer access to the vehicle.

(e) Failing to monitor expeditiously and progress total loss claims.

128. The insurers in our sample told us that they monitored closely the hire and repair period (for repairable vehicles) or total loss settlement process (for write-offs) by:

<sup>23</sup> [redacted]

- (a) verifying with the repairer and/or non-fault insurer the date on which the non-fault customer lost use of the vehicle;
  - (b) monitoring the progress of the repair against the estimated repair period;
  - (c) regularly communicating with the CMC/CHC in relation to the repair; and
  - (d) validating parts delays with the repairer and parts suppliers.
129. Five of the nine CMCs/CHCs in our sample ([redacted]) told us that they could not influence the credit hire period, as the key determinant of the hire duration was the repair duration (if the vehicle was repairable) or the time taken to remit the settlement payment to the non-fault customer (if the vehicle was a total loss). They added that the commencement and termination of hire periods is governed by the GTA (eg the GTA states that the vehicle requiring repair should be inspected and authorized for repair on day 1 of the hire period, repairs should commence on day 2 and the hire period must end not later than 24 hours after repairs to the vehicle have been completed).
130. Two CMCs/CHCs told us how they tried actively to minimize credit hire periods:
- (a) [redacted] told us that where a customer's vehicle was not roadworthy, it would provide a TRV immediately (subject to the customer meeting the relevant criteria); and, where a customer's vehicle was roadworthy, it would look to provide a TRV from the date the vehicle was booked in for repairs. All scheduling of repairs was undertaken by the repairers. Where [redacted] provided credit repair through its own repairer network, the selection of the repairer was based on geographical location and performance but, if the selected repairer was too busy, an alternative repairer was selected. [redacted] said that it liaised with the repairer and/or engineer to ensure the repair process was completed as quickly as possible, and it informed both the customer and the fault insurer of progress.
  - (b) [redacted].

131. The nine CMCs/CHCs in our sample also mentioned the following as influencing the length of the repair period:
- (a) the extent of the damage to the vehicle;
  - (b) parts delays;
  - (c) the acceptance of liability by the fault insurer (as a failure to accept liability could lengthen the hire period by delaying the commencement of repairs); and
  - (d) the speed with which repairs were authorized or the claim settled (where the vehicle was a write-off) by the fault insurer.

### *Role of the GTA*

132. The length of the credit hire duration is affected by whether the claim is handled under the GTA. Table 22 sets out the average credit hire durations for GTA and non-GTA claims for four of the ten large insurers in our sample ([X]) and seven of the nine CMCs/CHCs in our sample ([X]). The average duration of a non-GTA credit hire claim is almost three times the average duration of a GTA credit hire claim when the claim has been referred to the CMC/CHC by an insurer. However, looking at credit hire services provided by CMCs/CHCs to all work providers, we note that the average hire duration is actually slightly lower for non-GTA claims than for GTA claims.

TABLE 22 Average credit hire durations for GTA and non-GTA claims, 2012

Vehicle type	Example car	GTA claims			Non-GTA claims		
		Hires	Hire days	Average hire duration (days)	Hires	Hire days	Average hire duration (days)
<i>Credit hire services provided by CMC/CHC upon referral from insurers</i>							
Standard	Peugeot 107	[X]	[X]	[X]	[X]	[X]	[X]
MPV	Vauxhall Meriva	[X]	[X]	[X]	[X]	[X]	[X]
4x4	Toyota RAV4 2.0	[X]	[X]	[X]	[X]	[X]	[X]
Prestige	BMW 116 1.6	[X]	[X]	[X]	[X]	[X]	[X]
Sports	Mini Cooper 1.6	[X]	[X]	[X]	[X]	[X]	[X]
Total		71,442	1,173,343	16.4	4,911	215,068	43.8
<i>Credit hire services provided by CMC/CHC to all work providers</i>							
Standard	Peugeot 107	[X]	[X]	[X]	[X]	[X]	[X]
MPV	Vauxhall Meriva	[X]	[X]	[X]	[X]	[X]	[X]
4x4	Toyota RAV4 2.0	[X]	[X]	[X]	[X]	[X]	[X]
Prestige	BMW 116 1.6	[X]	[X]	[X]	[X]	[X]	[X]
Sports	Mini Cooper 1.6	[X]	[X]	[X]	[X]	[X]	[X]
Total		258,985	4,243,547	16.4	44,918	705,186	15.7

Source: Insurers and CMCs/CHCS.

133. CISGIL told us that, where a CMC/CHC was operating under the GTA, it was able to challenge excessive credit hire lengths wherever the CMC/CHC had failed to comply with its obligations under the GTA but, where a CMC/CHC was operating outside the GTA, challenging excessive credit hire lengths could be more difficult.

*Our assessment*

134. Credit hire durations are on average 3.7 days longer than direct hire durations, which might indicate the provision of TRV services under credit hire for an unnecessarily long period. However, hire duration is largely determined by repair duration and it is not clear from the evidence we have seen so far that non-fault repair durations are longer when a non-fault claimant is provided with TRV services under credit hire than under direct hire. Although there is a general consensus among repairers that there is no difference in their treatment of fault, captured non-fault and non-fault repairs, CMCs/CHCs have an incentive to extend hire durations (so long as they remain recoverable) and have some ability to do so, in particular through their influence over the repair process. On the other hand, insurers are able to monitor hire durations and

challenge credit hire claims (in particular claims within the GTA, where hire durations are governed by clear guidelines).

**Aviva Comment** - [✂]

### ***Additional services***

135. In this section we consider various aspects of 'quality' relating to the provision of TRVs, under three headings:

(a) type of TRV;

(b) services and add-ons provided with a TRV; and

(c) other aspects of quality relating to TRV services.

### *Type of TRV*

136. In practice, a non-fault claimant is usually provided with a like-for-like TRV for as long as is reasonably necessary, subject to their duty to mitigate their loss with consideration to their need (see paragraph 18).

137. Sometimes non-fault claimants receive a TRV of a higher class than their own vehicle (ie an upgrade) at no extra cost due to the unavailability of a like-for-like TRV. In these cases, the CMC/CHC only recovers from the fault insurer the hire charges applicable to the class of the customer's own vehicle. Table 23 shows the proportion of TRV upgrades provided by the nine CMCs/CHCs in our sample to their credit hire and direct hire customers in 2012.

TABLE 23 Provision of TRV upgrades, 2012

CMC/CHC	Proportion of credit hire customers provided with free upgrades	Proportion of direct hire customers provided with free upgrades
	%	%*
Accident Exchange	[redacted]	[redacted]
ACM†	[redacted]	[redacted]
Ai Claims Solutions	[redacted]	[redacted]
ClaimFast‡	[redacted]	[redacted]
Crash Services§	[redacted]	[redacted]
Enterprise	[redacted]	[redacted]
Helphire	[redacted]	[redacted]
Kindertons	[redacted]	[redacted]
WNS Assistance	[redacted]	[redacted]
Unweighted average	17	10

Source: CMCs/CHCs.

\*The direct hire data may include fault claims.

†ACM does not provide credit hire or direct hire services.

‡ClaimFast does not provide direct hire services, except as an outsourced function for [redacted].

§[redacted] does not record the provision of upgrades to credit hire customers (as they are infrequent) and does not provide direct hire services.

138. Table 23 shows that between [redacted] and [redacted] per cent of credit hire customers were provided with upgrades (at an average of 17 per cent), compared with between [redacted] and [redacted] per cent of direct hire customers (at an average of 10 per cent). However, for two of the three CMCs/CHCs where figures were provided for both credit hire and direct hire ([redacted] and [redacted]), there was a greater proportion of upgrades for direct hire customers than credit hire customers, suggesting that there are no clear conclusions from this evidence. Given that upgrades are the result of operational issues and do not increase the bill to the fault insurer, we have not analysed this practice further.

139. Our survey of non-fault claimants found that 17 per cent of respondents who received a TRV claimed that the vehicle provided exceeded their needs. The main reasons given were that, compared with their own vehicle, the TRV was a better make or model, it was newer, it was bigger, and/or it had a more powerful engine (see the working paper 'Survey report'). However, it is difficult to assess to what extent this is a result of some customers receiving upgrades (17 per cent on average (see Table 23)) and/or to what extent it might represent the overprovision of credit hire TRV services.

*Review of insurer and CMC/CHC electronic call records*

140. We reviewed a sample of electronic call records provided by the ten large insurers in our sample and the nine CMCs/CHCs in our sample where a TRV was provided in order to assess whether there was any evidence of differences in the level of TRV services between direct hire services and credit hire services. We were aware that these call records reflected only one interaction between the customer and the provider and there may have been other interactions.<sup>24</sup>

- *Review of insurer electronic call records*

141. Table 24 summarizes 11 insurer call records (one non-fault claim and ten captured non-fault claims) in each of which the non-fault customer was provided with a TRV.

TABLE 24 **Insurer electronic call records involving the provision of TRV services to a non-fault customer**

<i>Insurer</i>	<i>Type of hire</i>	<i>Level of TRV provided</i>
<i>Non-fault claims</i> [X]	Credit hire	Like-for-like
<i>Captured non-fault claims</i> [X]	Direct hire	Like-for-like
[X]	Direct hire	Not disclosed
[X]	Direct hire	Like-for-like
[X]	Direct hire	Lower class
[X]	Direct hire	Lower class
[X]	Direct hire	Lower class
[X]	Direct hire	Like-for-like
[X]	Direct hire	Not disclosed
[X]	Direct hire	Like-for-like
[X]	Direct hire	Like-for-like

Source: Insurers.

142. The table shows that, of the 11 insurer calls resulting in the provision of a TRV to a non-fault customer that we have reviewed so far, only one related to the insurer's non-fault customer (rather than a captured non-fault customer). In this case, the customer was provided with a like-for-like TRV under credit hire. Although we do not draw any conclusions from one call, we found that, in this call, the claims handler did

<sup>24</sup> We note that an assessment of the customer's need for a TRV might have been carried out at a later stage in the process. Also, by focussing only on cases where a TRV was provided, we have not captured those cases where there was an assessment of the customer's need, which resulted in no TRV being provided.

not appear to assess whether the customer required a like-for-like TRV or whether a replacement vehicle of a lower class would have met their needs.

143. We have so far reviewed ten insurer calls where a captured non-fault customer was provided with a TRV under direct hire:

(a) In two cases, the type of TRV provided was not discussed between the insurer and the customer.

(b) In five cases, the captured non-fault customer was provided with a like-for-like TRV. In one of these cases, the customer demonstrated a genuine need for a like-for-like TRV but, in the remaining four cases, the claims handler did not appear to assess whether the customer required a like-for-like TRV or whether a TRV of a lower class would have met their needs. We note that, although a fault insurer has the incentive to minimize the cost of TRV services to a captured non-fault customer, if it offers a poor quality of service the customer may go to a CMC, which is likely to be more expensive for the fault insurer (due to higher daily rates and, possibly, a longer hire duration).

(c) In three cases, the captured non-fault customer was provided with a TRV of a lower class than their own vehicle. In these cases, the customer was encouraged to accept a lower class of TRV, as this appeared sufficient for their needs.

- *Review of CMC/CHC electronic call records*

144. Table 25 summarizes 11 CMC/CHC call records, in each of which the non-fault customer was provided with a TRV.

TABLE 25 **CMC/CHC electronic call records involving the provision of TRV services to a non-fault customer**

<i>CMC/CHC</i>	<i>Type of hire</i>	<i>Level of TRV provided</i>
[X]	Credit hire	Like-for-like
[X]	Credit hire	Not disclosed
[X]	Credit hire	Lower class
[X]	Credit hire	Like-for-like
[X]	Credit hire	Like-for-like
[X]	Credit hire	Like-for-like*
[X]	Credit hire	Like-for-like
[X]	Credit hire	Like-for-like*
[X]	Credit hire	Not disclosed





Credit hire      Like-for-like  
Credit hire      Not disclosed

Source: CMCs/CHCs.

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145. We have so far reviewed 11 CMC/CHC calls where a non-fault customer was provided with a TRV under credit hire:

(a) In three cases, the type of TRV provided was not discussed between the CMC/CHC and the customer.

(b) In seven cases, the non-fault customer was provided with a like-for-like TRV. In two of these cases, the customer demonstrated a genuine need for a like-for-like TRV. In the remaining five cases, the claims handler did not appear to assess whether the customer required a like-for-like TRV or whether a TRV of a lower class would have met their needs. This may indicate some overprovision of TRV services as, for some of these customers, a lower class of vehicle might have been sufficient to meet their needs.

(c) In one case, the non-fault customer was provided with a TRV of a lower class than their own vehicle. In this case, the customer was encouraged to accept a lower class of TRV, as this appeared sufficient for their needs.

- *Our assessment*

146. Given that determining the level of TRV service which will meet a claimant's tort law entitlement involves an assessment of the specific facts of a case,<sup>25</sup> our particular interest in listening to a sample calls was the approach taken by the claim handler (captured non-fault, non-fault or CMC/CHC) to assess the claimant's needs (ie the kinds of enquiries made). We recognise that claims handlers process a large volume of claims, and seek to do so efficiently, in order to ensure non-fault claimants are not underprovided in their need for a TRV.

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<sup>25</sup> The non-fault driver is entitled to recover the reasonable costs of car hire provided the reasonable need for an alternative vehicle can be established.

147. Overall, we have so far reviewed 12 call records where a non-fault customer was provided with TRV services under a credit hire agreement and ten call records where a captured non-fault customer was provided with TRV services under a direct hire agreement.
148. Where the type of TRV to be provided to the customer was discussed between the call handler and the customer, the majority of customers received a like-for-like TRV, irrespective of whether the TRV was provided under a credit hire or direct hire agreement. However, in the small number of calls which we have reviewed so far, there was a greater likelihood of receiving a lower quality TRV if captured by the fault insurer (3 in 10 compared with 1 in 12). Also, around half of the non-fault claimants who received a TRV received a like-for-like TRV without having to explain why it was needed (6 in 12 of those handled by a CMC/CHC/non-fault insurer and 4 in 10 of those captured by the fault insurer).
149. Given the small number of calls which we have listened to so far, we treat this evidence with caution. We intend to listen to more such calls.

**Aviva Comment** - We feel if the insurer controlled the process a better and more informed conversation would take place with the customer about their specific needs, which coupled with the commercial agreements in place with direct hire companies would potentially reduce the cost of claims without compromising the customer service/need.

#### *Services and add-ons provided with a TRV*

150. Credit hire agreements sometimes include additional services for non-fault customers (over and above the provision of TRV on credit), which are not typically provided with a direct hire TRV. In this section we consider the following:
- (a) collision damage waiver;
  - (b) ATE insurance; and
  - (c) other additional services.

151. Credit hire customers are not usually charged for these additional services, though they represent costs for the CMC/CHC, which are funded by the higher daily hire rate of credit hire compared with direct hire (and, possibly, the longer hire duration).
152. We note that the provision of add-ons, such as satellite navigation systems and child car seats, and the provision of TRVs to non-standard drivers are treated similarly under credit hire and direct hire. These items/services are charged on top of the daily rate. We have seen no evidence to suggest that there is any overcosting or over-provision in relation to these items and therefore we do not consider them further.

*Collision damage waiver*

153. Both credit hire and direct hire non-fault customers are provided with a comprehensively-insured TRV. Under credit hire, there is typically an accidental damage excess of £50 as required by the GTA.<sup>26</sup>
154. Table 26 shows the average cost of this comprehensive insurance for the nine CMCs/CHCs in our sample.

TABLE 26 Cost of insurance for credit hire TRVs

CMC/CHC	Annual cost £	Cost per TRV £
Accident Exchange*	[£]	[£]
ACM†	[£]	[£]
Ai Claims Solutions	[£]	[£]
ClaimFast	[£]	[£]
Crash Services‡	[£]	[£]
Enterprise	[£]	[£]
Helphire	[£]	[£]
Kindertons	[£]	[£]
WNS Assistance	[£]	[£]
Unweighted average	2,242,165	49

Source: CMCs/CHCs.

\*Accident Exchange's insurance costs include the costs of repairing any damage caused to their hire vehicles.

†ACM does not provide credit hire or direct hire services.

‡Crash Services operates in Northern Ireland, where a CMC/CHC cannot obtain insurance for hire vehicles. Therefore, Crash Services provides insurance cover under the customer's own policy and recovers the cost from the fault insurer.

<sup>26</sup> A CMC/CHC may charge an additional premium or require a customer to insure the TRV on his/her own PMI policy in rare circumstances (eg if the customer's occupation is excluded from standard cover or the vehicle is of a particularly high value).

155. In addition to comprehensive insurance, a CMC/CHC which subscribes to the GTA is required to include a collision damage waiver for all credit hire TRVs.<sup>27</sup> In contrast, direct hire customers have to pay an additional fee if they choose to take out this cover. ClaimFast told us that the cost of a collision damage waiver for retail car rental could be as much as £10 per day.

**Aviva Comment** - Whilst a retail customer may need to take this cover, any insurance claim customer where the insurer has arranged a hire will have cover from the insurer whilst their vehicle is being repaired.

#### *ATE insurance*

156. Four of the nine CMCs/CHCs in our sample ([REDACTED]) told us that they provided their credit hire customers with insurance in the event that they were unable to recover from the fault insurer the cost of the services provided by their CMC/CHC and other suppliers (eg engineers, investigators, lawyers and doctors) and were required to pursue the customer for settlement of the claim. The cost of this insurance was borne by the CMC/CHC:

(a) Accident Exchange told us that the cost of this insurance was small in the context of its overall costs (£[REDACTED] per credit hire TRV).

(b) ClaimFast told us that the underlying cost of this service was around £[REDACTED] per hire.

(c) [REDACTED].

157. We understand that irrespective of whether a customer takes out ATE insurance, it is very rare for a CMC/CHC to pursue a customer for settlement of the costs of credit hire where the CMC/CHC cannot recover the costs from the fault insurer.

158. ATE insurance is not required under a direct hire agreement, as the customer does not enter into a credit agreement with the direct hire provider.

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<sup>27</sup> A collision damage waiver requires the TRV services provider to waive its right to charge the customer for valid damages to the vehicle. Consequently, the services provider is ultimately responsible for any damage incurred to the TRV whilst in use by the customer.

*Other additional services*

- *Delivery and collection of the TRV*

159. CMCs/CHCs which subscribe to the GTA must provide delivery and collection of the TRV to and from the customer at no charge to the customer. CISGIL told us that CMCs/CHCs which did not subscribe to the GTA often made an additional charge to the customer for the delivery and collection of the TRV, which was passed to the fault insurer. AXA told us that a non-GTA subscribing CMC/CHC typically charged around £[redacted] for the delivery and collection of the TRV. Zurich told us that the charge was in the region of £[redacted] to £[redacted] per day.

- *Indirect services*

160. Five of the nine CMCs/CHCs in our sample ([redacted]) told us that they also provided uninsured loss recovery services to their credit hire customers at no additional cost. Helphire told us that it provided these services in around [redacted] per cent of its credit hire cases. ClaimFast told us that it incurred a cost of £[redacted] per claim to provide this service.

161. Under this service, the CMC/CHC pursues on behalf of its customer any uninsured losses which they might have suffered, such as:

- (a) payment of the PMI policy excess;
- (b) loss of earnings (if the customer could not work as a result of the accident);
- (c) loss of personal effects (if any items were damaged in the accident);
- (d) vehicle recovery charges (if incurred);
- (e) vehicle storage charges (if incurred); and/or
- (f) loss of value to their vehicle (ie post-repair compared with pre-accident (a diminution claim)).

*Other aspects of quality relating to TRV services*

162. The ten large insurers in our sample told us that they monitored the quality of the TRV services provided to their customers by their credit hire and direct hire providers by:
- (a) monitoring customer complaints;
  - (b) reviewing performance against contracts or service level agreements;
  - (c) performing audits of the customer experience; and/or
  - (d) meeting regularly with providers to review performance.
163. For example, DLG told us that its direct hire and credit hire provider, [REDACTED], must meet clear service standards, including in relation to quality and safety requirements and detailed performance measures and targets. DLG said that it monitored [REDACTED] performance against these service levels and against customer metrics (eg satisfaction and complaint rates). They also had regular service reviews.
164. Table 27 presents customer complaint data for the ten insurers and nine CMCs/CHCs in our samples, relating to direct hire and credit hire. The table shows that there is no significant variation in the level of customer complaints received by insurers and CMCs/CHCs in relation to credit hire and direct hire services, which suggests that there is no significant difference in customers' perceptions of these services. However, we note that this evidence is limited, as the majority of the parties do not record complaints relating to credit hire and direct hire separately and instead capture complaints data for all TRVs provided, including courtesy cars.

TABLE 27 Credit hire and direct hire customer complaints, 2012<sup>^</sup>

Insurer/CMC/CHC	Credit hire		Direct hire*	
	Number of complaints	Proportion of complaints in relation to total claims %	Number of complaints	Proportion of complaints in relation to total claims %
<i>Insurer</i>				
Admiral	[X]	[X]	[X]	[X]
Ageas Insurance	[X]	[X]	[X]	[X]
Aviva	[X]	[X]	[X]	[X]
AXA	[X]	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]
LV=	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]
Zurich	[X]	[X]	[X]	[X]
Unweighted average	43	0.4	24	0.6
<i>CMC/CHC</i>				
Accident Exchange	[X]	[X]	[X]	[X]
ACM†	[X]	[X]	[X]	[X]
Ai Claims Solutions	[X]	[X]	[X]	[X]
ClaimFast‡	[X]	[X]	[X]	[X]
Crash Services§	[X]	[X]	[X]	[X]
Enterprise	[X]	[X]	[X]	[X]
Helphire	[X]	[X]	[X]	[X]
Kindertons	[X]	[X]	[X]	[X]
WNS Assistance	[X]	[X]	[X]	[X]
Unweighted average	33	0.1		0.5
Overall unweighted average	38	0.3	24	0.5

Source: Insurers and CMCs/CHCs.

\*The direct hire data may include fault claims.

†ACM does not provide credit hire or direct hire services.

‡ClaimFast does not provide direct hire services, except as an outsourced function for [X].

§Crash Services does not provide direct hire services.

Note: A number of the parties questioned do not separately record customer complaints in relation to the provision of credit hire and direct hire services.

### **Our assessment of the overprovision of credit hire**

165. We have found that credit hire durations are on average 3.7 days longer than direct hire durations, which might indicate the provision of TRV services under credit hire for an unnecessarily long period. However, hire duration is largely determined by repair duration and it is not clear from the evidence that we have seen so far that non-fault repair durations are longer when a non-fault claimant is provided with TRV services under credit hire than under direct hire.

166. The non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need for an alternative vehicle can be established. In practice, this usually involves the provision of a like-for-like TRV for as long as is reasonably



necessary, subject to the non-fault driver's duty to mitigate their loss with consideration to their need. We have seen some evidence that non-fault customers are not always invited to consider whether their needs would be met with a lower class of TRV, whether handled by a CMC/CHC or the fault insurer (ie captured). However, given the small sample of cases which we have reviewed so far, we treat this evidence with some caution.

**Aviva Comment – please see comments 149**

167. Some additional services are often provided by CMCs/CHCs to non-fault claimants under a credit hire agreement, which are beyond the level of services provided by a fault insurer to a captured non-fault claimant (eg the delivery and collection of the TRV, a collision damage waiver for the TRV, ATE insurance, and uninsured loss recovery services). However, we have seen no evidence to suggest that this difference in provision results in consumer harm.

## Routes to the provision of TRV services

TABLE 1 Proportion of non-fault claimants who receive a credit hire TRV

<i>Insurer</i>	<i>Proportion of non-fault claimants who receive a credit hire TRV</i> %
Admiral	[X]
Ageas Insurance	[X]
Aviva	[X]
AXA UK	[X]
AXA Northern Ireland	[X]
CISGIL	[X]
DLG	[X]
esure	[X]
LV=	[X]
RSA	[X]
Zurich	[X]
Unweighted average	38

Source: Insurers.

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\*Insurers are only able to provide this data based on non-fault claims notified to them where they know that a credit hire vehicle has been received by the non-fault customer.

TABLE 2 Proportion of captured non-fault claimants who receive a direct hire TRV

<i>Insurer</i>	<i>Proportion of captured non-fault claimants who receive a direct hire TRV</i> %
Admiral	[X]
Ageas Insurance	[X]
Aviva	[X]
AXA UK	[X]
AXA Northern Ireland	[X]
CISGIL	[X]
DLG	[X]
esure	[X]
LV=	[X]
RSA	[X]
Zurich	[X]
Unweighted average	35

Source: Insurers.

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\*CISGIL's figure relates to the proportion of all cases referred to its suppliers as suitable for capture and which resulted in a TRV being provided to the customer. The figure includes both the provision of direct hire TRVs and courtesy cars to non-fault customers.

APPENDIX B

**Frictional costs incurred by CMCs/CHCs, 2012 (split by GTA and non-GTA claims)**

CMC/CHC	GTA claims				Non-GTA claims				£
	Admin costs	Litigation costs	Annual costs	Average costs per claim	Admin costs	Litigation costs	Annual costs	Average costs per claim	
Accident Exchange	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
ACM*	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
Ai Claims Solutions	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
ClaimFast	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
Crash Services†	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
Enterprise	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
Helphire	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
Kindertons	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
WNS Assistance	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	

Source: CMCs/CHCs.

\*ACM [X].

†Crash Services [X]

## Frictional costs incurred by CMCs/CHCs, 2012 (all claims)

<i>CMC/CHC</i>	<i>Admin costs</i> £	<i>Litigation costs</i> £	<i>Annual costs</i> £	<i>Average costs per claim</i> £	<i>Average credit hire bill issued</i> £	<i>Frictional costs as a proportion of average credit hire bill</i> %
Accident Exchange	[X]	[X]	[X]	[X]	[X]	[X]
ACM*	[X]	[X]	[X]	[X]	[X]	[X]
Ai Claims Solutions	[X]	[X]	[X]	[X]	[X]	[X]
ClaimFast	[X]	[X]	[X]	[X]	[X]	[X]
Crash Services†	[X]	[X]	[X]	[X]	[X]	[X]
Enterprise	[X]	[X]	[X]	[X]	[X]	[X]
Helphire	[X]	[X]	[X]	[X]	[X]	[X]
Kindertons	[X]	[X]	[X]	[X]	[X]	[X]
WNS Assistance	[X]	[X]	[X]	[X]	[X]	[X]
Unweighted average						10

Source: CMCs/CHCs.

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\*ACM [X]

†Crash Services [X]

### Frictional costs incurred by insurers, 2012 (split by GTA and non-GTA claims)

Insurer	GTA claims					Non-GTA claims				
	Admin costs (£)	Mitigation costs (£)	Litigation costs (£)	Annual costs (£)	Average costs per claim (£)	Admin costs (£)	Mitigation costs (£)	Litigation costs (£)	Annual costs (£)	Average costs per claim (£)
Admiral*	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Ageas Insurance	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Aviva	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
AXA	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
DLG†	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
LV=	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Zurich	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]

Source: Insurers.

\*Admiral's frictional costs include frictional costs incurred in relation to credit repair as well as credit hire. However, Admiral estimated that the frictional costs associated with credit repair would be significantly lower than those associated with credit hire due to fewer areas of contention relating to credit repair.

†DLG was unable to provide the relevant data, as it does not separately identify its frictional costs from its overall operational costs.

## Frictional costs incurred by insurers, 2012 (all claims)

<i>Insurer</i>	<i>Admin costs</i> £	<i>Mitigation costs</i> £	<i>Litigation costs</i> £	<i>Annual costs</i> £	<i>Average costs per claim</i> £	<i>Average credit hire bill paid</i> £	<i>Frictional costs as a proportion of average credit hire bill</i> %
Admiral*	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Ageas Insurance	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Aviva	[X]	[X]	[X]	[X]	[X]	[X]	[X]
AXA	[X]	[X]	[X]	[X]	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]	[X]	[X]	[X]	[X]
DLG†	[X]	[X]	[X]	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]	[X]	[X]	[X]
LV=	[X]	[X]	[X]	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Zurich	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Unweighted average							10

Source: Insurers.

\*Admiral's frictional costs include frictional costs incurred in relation to credit repair as well as credit hire. However, Admiral estimated that the frictional costs associated with credit repair would be significantly lower than those associated with credit hire due to fewer areas of contention relating to credit repair.

†DLG was unable to provide the relevant data, as it does not separately identify its frictional costs from its overall operational costs.

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 1: Analysis of the results of the non-fault survey in relation to overprovision

1. This working paper discusses evidence from the non-fault survey (see working paper ‘Survey report’) on whether there may be overprovision of repair services and temporary replacement vehicles (TRVs) to non-fault claimants.<sup>1</sup>
  
2. As we explained in the issues statement, the separation of cost liability and cost control might increase the costs of the services supplied by non-fault insurers, or claims management companies (CMCs)/credit hire companies (CHCs), to non-fault claimants (due to a weakened constraint on prices or an unwarranted increase in quality). In this paper we consider evidence from our non-fault survey on whether there is an unwarranted increase in quality (ie overprovision). As an example, the non-fault insurer may provide a better TRV to a claimant than that to which the claimant is entitled.

### Approach

3. Our non-fault survey asked respondents for their perceptions about four key post-accident service variables, as follows:
  - (a) the condition of the car after repairs were completed;
  - (b) the length of time taken to repair the car;
  - (c) the extent to which TRV needs were met; and
  - (d) the length of time for which the TRV was provided.
  
4. Under the hypothesis of theory of harm (ToH) 1, the incentive to keep the costs of a claim down will differ depending on whether the party handling the claim is liable for

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<sup>1</sup> Figures in this paper have been weighted to correct for oversampling in Wales, Scotland and Northern Ireland (NI). Details about our survey and the results can be found in the working paper ‘Survey report’.

the cost. Therefore, for each variable, we assessed whether there was any significant difference in respondents' perceptions of the service provided depending on the party mainly responsible for managing the claim. We considered the following two scenarios:<sup>2</sup>

- (a) The non-fault insurer manages the claim (and has no agreements in place with the fault insurer and is not itself the fault insurer ('NF' in the tables below)).
- (b) The fault insurer manages the claim as a result of capturing it ('captured' in the tables below).

5. Under the hypothesis of ToH 1, the incentive to keep costs low is greatest for claims handled by the fault insurer (where there is no separation of cost liability and cost control) and lowest for the non-fault insurer. Therefore, in this paper, we compare the perceptions of 'non-fault' and 'captured' respondents.<sup>3</sup>

## Summary of results

6. Overall, the majority (75 per cent) of respondents said that their vehicle was in the same condition after the repair as it was prior to the accident, with 13 per cent saying that it was in a better condition and 10 per cent saying that it was worse. Of those respondents who received a TRV, the majority (68 per cent) said that it met their needs, with 17 per cent saying that it exceeded their needs and 14 per cent saying it was below their needs.<sup>4</sup> Similarly, the majority (87 per cent) said that they had it for about the right amount of time, with only 4 per cent saying that they had it for longer

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<sup>2</sup> We also considered categories of claims where the non-fault insurer manages the claim but has a bilateral agreement with the fault insurer which requires it to mitigate costs as well as claims where the fault insurer and non-fault insurer were the same. However, we found that the number of responses for claims in these two categories did not allow for a meaningful comparison.

<sup>3</sup> In the tables below, we also refer to 'All'. This refers to all types of claim, namely captured claims, claims handled by the non-fault insurer, claims where non-fault and fault insurer are the same, and claims where a bilateral agreement is in place between the non-fault insurer and the fault insurer.

<sup>4</sup> We noted that some consumers' vehicles might have been repaired to a better condition than prior to the accident if the repair to the accident-damaged part required replacing or repairing a part which was old or previously damaged. If this improvement was unavoidable as part of the repair, it would not be an instance of overprovision. With regard to the provision of TRV services, we are aware that some customers receive a higher grade TRV than their own vehicle due to the availability of car types within the provider's fleet. Again, this would be seen as a better service than necessary by the claimant but would not constitute overprovision and the bill charged by the provider to the fault insurer would be for the lower-grade vehicle to which the provider believed the claimant to be entitled.



than needed and 9 per cent saying that they had it for shorter than needed. For those responses which could indicate overprovision, there were no statistically significant differences between those whose claim was handled by the non-fault insurer and those whose claim was handled by the fault insurer liable for the cost.<sup>5,6</sup> However, since some repair work to accident-damaged vehicles might be hard for consumers to assess, we interpret the results on customers' perceptions of repair quality with some caution.

7. In most cases, non-fault claimants are not aware of the cost of their TRV; however, of those who were aware of this cost (25 per cent of those that received a TRV), 41 per cent said that they would have been content with a less good-quality TRV and 21 per cent would have been content with having it for less time. Since these proportions are significantly higher than across the sample base overall (for which the proportions are 17 and 4 per cent respectively), this would appear to us to suggest that some consumers might have been more willing to accept a lower-class TRV had they known the cost, thereby reducing the cost of their claim.

**Aviva Comment** - We believe the Competition Commission has successfully identified that If the customer was asked what car size met their needs & had transparency of the costs between credit hire versus direct hire this may influence the decision on the level of class of the vehicle and provision.

We fundamentally agree and would support the conclusion that the involvement of a CMC does not materially improve the TRV service or repair quality, the insurer can and does provide the same or better service and we therefore question the value they add in the process.

8. In interpreting these results, we recognize that survey responses are subject to error, that the sources for this analysis are respondents' perceptions, which are inherently subjective and not based on an objective assessment of post-accident services, and that there may be other factors influencing these responses.

## Provision of repairs

9. In this section, we discuss respondents' perceptions regarding the condition of the

repaired car and the length of time required to complete the repair work.

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<sup>5</sup> The separation of cost liability and cost control might also drive differences in the degree of underprovision of post-accident services to claimants. Evidence on underprovision is discussed in the working paper 'ToH 2: Analysis of the results of the non-fault survey in relation to underprovision'.

<sup>6</sup> We also performed further analysis to consider whether other variables (such as the involvement of a CMC, the extent of personal injuries, the country and the severity of the damage) might influence the provision of post-accident services.

## **Condition after repairs**

10. Different perceptions of the condition of repaired cars might reveal a different quality of repair service. Table 1 shows respondents' perceptions of the condition of their repaired car.

TABLE 1 **Condition after repairs**

	<i>All</i>	<i>Captured</i>	<i>NF</i>
<i>Compared with before the accident (%)</i>			
A lot better	5	4	5
Somewhat better	8	10	8
Same condition	75	73	78
Worse	10	13	8
Don't know	1	0	0
Other	0	0	0
Base (weighted)	1,163	364	629

Source: CC survey.

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11. Most respondents said that the condition of their vehicle was the same or better after repairs (88 per cent). About 13 per cent of respondents considered that their vehicle was in a better condition, but there was no significant difference in these rates between captured and NF claims.
12. The main reasons for respondents perceiving their vehicle to be at least in the same condition as before the accident were because newer/better parts were used in the repair (5 per cent) and because in general the vehicle looked better than before the accident (3 per cent of respondents said the vehicle looked better and 2 per cent said the vehicle was cleaned/polished). These reasons appear to be the same both for captured and NF claimants. However, these results should be interpreted with caution since the number of responses was low.
13. Table 2 shows respondents' perceptions of their ability to assess the repairs to their vehicle. Overall, respondents perceived themselves to be fairly or very confident of their ability to assess the condition of their vehicle following the repairs (85 per cent), but a higher proportion of those who said that their vehicle was in a better condition

post-repair considered themselves able to assess this than those who said their vehicle was in a worse condition (92 per cent and 60 per cent respectively).

TABLE 2 Confidence of respondents to be able to assess repair work, by condition after repairs

	<i>Better condition</i>	<i>Same condition</i>	<i>Worse condition</i>	<i>Total</i>
Confident (%)	92*	87	60*	85
Indifferent (%)	5*	7	13*	8
Not confident (%)	4*	5	25*	7
Don't know (%)	0	1	2	1
Base (weighted)	154	872	128	1,154

Source: CC survey.

\*Difference is statistically significant; comparing 'better' and 'worse'.

14. We also considered whether the involvement of other organizations such as CMCs<sup>7</sup> might influence the repair work/process and cause a higher level of service provision.

Table 3 shows respondents' perceptions of the condition of their vehicle after the repair, split by whether a CMC was involved or not.

TABLE 3 Condition after repairs, by involvement of CMC

	<i>No CMC</i>	<i>CMC</i>
<i>Compared with before the accident</i>		
<i>Captured (%)</i>		
Better	15	7
Same	73	75
Worse	12	18
<i>NF (%)</i>		
Better	13	11
Same	79	79
Worse	8	9
<i>All (%)</i>		
Better	14	11
Same	75	77
Worse	11	12
Base (weighted)	927	230

Source: CC survey.

15. Table 3 suggests that the involvement of a CMC does not affect materially perceptions of repair quality compared with if there is not a CMC involved.

<sup>7</sup> Involvement of CMCs refers to the respondents' belief that a CMC managed the claim or was involved at some stage of the repair process. However, we found that the proportion of consumers stating that a CMC was involved was much lower than suggested by the data supplied to us by insurers. This indicates that some consumers are unaware when a CMC is involved.

### ***Length of time required to complete the repair work***

16. As another possible indicator of the extent of repair service provided, we considered the length of time taken to complete the repair work. To avoid spurious results driven by the mix of different types of damage across categories, rather than differences in the handling of the claim, we considered the average length of time taken to repair damage to the back of the vehicle as this was the damage most commonly reported by non-fault claimants in our survey. We conducted this analysis for high, medium and low levels of damage. Table 4 shows our results.

TABLE 4 **Average length of time (days) taken to repair a vehicle suffering rear damage, by severity of damage**

	<i>Days</i>	
	<i>Captured</i>	<i>NF</i>
Low damage	7	9
Medium damage	22	12
High damage	15	21

Source: CC survey.

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17. In our view, this comparison of the average length of time to complete the repair work between captured and NF claims does not suggest a distinct pattern. The average length of time to repair vehicles appears to be higher for NF claims than for captured claims for both vehicles which suffered a high level of damage or a low level of damage.

18. Similarly, we found no distinct results relating to the length of time to complete repair work when considering the effect of a CMC being involved.

### ***Further analysis***

19. We also conducted further analysis to consider other key variables, such as the extent of personal injury, the country of origin and the severity of accident damage. However, none of these other variables appeared informative with regard to the overprovision of post-accident repair services.

## TRVs

20. This section discusses whether there are differences in the quality of TRV services according to the party which principally manages the claim. In particular, we considered respondents' satisfaction with the quality of the TRV provided and whether the length of time respondents had access to their TRV was adequate for their needs.

### ***Satisfaction with the TRV provided***

21. In our survey of non-fault claimants, 90 per cent of respondents said that they were offered a TRV. Where no TRV was offered, 24 per cent of these respondents then asked for a TRV, resulting in 56 per cent of these respondents then being provided with a TRV. Where a TRV was requested but not provided, we asked respondents why this was the case, with the most common reasons being that they had been told they were not entitled to a vehicle or that there was a dispute over liability.
22. Table 5 shows the proportions of respondents who received a TRV split by who managed the claim.

TABLE 5 Respondents who received a TRV

	<i>All</i>	<i>Captured</i>	<i>NF</i>
<i>Have you received a replacement car? (%)</i>			
Yes	80	78	81
No	20	22	19
Base (weighted)	1,488	443	789

Source: CC survey.

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23. Overall, 80 per cent of respondents received a TRV as part of their accident claim. A higher proportion of NF claimants received a TRV than captured claimants (81 and 78 per cent respectively). We asked respondents who received a TRV whether they needed it and a higher proportion of NF claimants said that it was not needed than

captured claimants (10 and 7 per cent respectively). However, these results were not statistically significant.

### ***Quality of the TRV provided***

24. As a further indicator of the possible overprovision of TRV services, we considered differences in whether the TRV met or exceeded the needs of respondents according to the party which managed their claim. Table 6 shows our results.

TABLE 6 **How well the TRV met needs**

	<i>All</i>	<i>Captured</i>	<i>NF</i>
Exceeded needs (%)	17	15	17
Met needs (%)	68	66	70
Below needs (%)	14	19*	13*
Base (weighted)	1,184	344	641

Source: CC survey.

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\*Difference is statistically significant.

25. Overall, the vast majority (85 per cent) of those who received a TRV said that it met or exceeded their needs (68 per cent said that it met their needs and 17 per cent said that it somewhat or far exceeded their needs). The proportion of respondents who were satisfied with the vehicle was higher among NF claims than captured claims, but the difference was not statistically significant.

26. The reasons why respondents considered their TRV to exceed their needs were most commonly that it was a better make/model than the vehicle they owned and it was newer or more spacious/bigger. We then considered whether these reasons varied according to the party which handled the claim. Table 7 presents the results.

TABLE 7 Reason(s)\* why the TRV exceeded the needs†

	<i>per cent</i>		
	<i>All</i>	<i>Captured</i>	<i>NF</i>
It was newer	39	53‡	34‡
It was more powerful/had a bigger engine	12	6	13
It was more spacious/bigger	30	23	31
It was less bulky/smaller	1	0	3
More economical	3	10‡	2‡
Higher specification	5	6	6
Low expectations/requirements	5	0	5
Was a good car (various)	2	4	2
Similar to my car/suitable to my needs	4	6	5
More expensive to run	2	0	3
Had vehicle for longer than was needed	1	0	2
Other	2	0	2
Base (weighted)	204	51	107

Source: CC survey.

\*Each respondent may give more than one reason.

†Data should be interpreted with caution since bases are low .

‡Difference is statistically significant.

27. As shown in Table 7, there were no discernible patterns in the data. In the absence of a summary measure that combines the different car characteristics, we could not draw any conclusion over which organization was most likely to provide a vehicle that was better overall. Moreover, this data should be interpreted with caution since some of the underlying bases are low.

28. We then considered whether some types of vehicle were less likely to be replaced on a like-for-like basis than others. We found, for example, that 14 per cent of hatchback drivers received a saloon, estate, people carrier or four-by-four TRV; 8 per cent of saloon drivers received an estate, people carrier or four-by-four TRV; 10 per cent of estate drivers received a people carrier or four-by-four TRV; and 6 per cent of people



carrier drivers received a four-by-four TRV.<sup>8</sup> Overall, 10 per cent of respondents who received a TRV were given a vehicle larger than the one they owned.<sup>9</sup>

### ***Length of time respondents had access to their TRV***

29. As a further variable which could be informative about overprovision, we considered the length of time respondents had access to their TRV. Table 8 presents our results.

TABLE 8 Length of time respondent had access to TRV

	<i>per cent</i>		
	<i>All</i>	<i>Captured</i>	<i>NF</i>
longer than needed	4	3	3
the right amount of time	87	87	88
shorter than needed	9	9	8
Don't know	1	1	1
Base (weighted)	1,194	346	644

Source: CC survey.

30. In the vast majority of cases (87 per cent), the length of time respondents had access to their TRV was commensurate with their needs, with only 4 per cent of respondents having their TRV for longer than required. There was no significant difference between NF and captured claims.

31. The main reason given by the small proportion of respondents who had their TRV for longer than required for this perceived overprovision was that they retained the car for some time after the repair to their own vehicle was completed (41 per cent). However, this data should be interpreted with caution since the base size was low.

### ***Involvement of a CMC***

32. We considered whether the involvement of a CMC might affect the provision of a TRV, as shown in Tables 9 and 10.

<sup>8</sup> We have not considered the results for van, convertible and sports/coupe cars as base sizes were low.

<sup>9</sup> This result is based on the assumption that vehicles can be classified according to their size (eg a saloon can be considered bigger than a hatchback, an estate car is bigger than a saloon etc).

TABLE 9 How well TRV met needs, by involvement of a CMC

	<i>per cent</i>		
	<i>No CMC</i>	<i>CMC</i>	<i>Total</i>
Exceeded	17	18	17
Met	68	70	68
Below	15	12	14
Base (weighted)	909	276	1,185

Source: CC survey.

TABLE 10 Length of time respondent had access to TRV, by involvement of a CMC

	<i>per cent</i>		
	<i>No CMC</i>	<i>CMC</i>	<i>Total</i>
Longer than needed	3	5	3
Right amount of time	88*	83*	87
Shorter than needed	8*	12*	9
Don't know	1	0	1
Base (weighted)	914	276	1,190

Source: CC survey.

\*Difference is statistically significant.

33. These tables suggest that the involvement of a CMC has little effect on the perception of overprovision, both regarding the extent to which the TRV meets the respondents' needs and the length of time respondents have access to their TRV. Any such differences shown in the table are not statistically significant.

### ***Further analysis on TRVs***

34. In our survey, we asked respondents whether they were made aware of the total hire cost of their TRV and whether, given such cost, they would have been content with a lower-quality car or having the car for less time. Overall, of those aware of the total cost (25 per cent of those that received a TRV), 41 per cent said that they would have been content with a less good-quality TRV and 21 per cent said that they would have been content with having the TRV for less time. These proportions are considerably higher than for the population overall, as only 17 per cent overall said that the TRV provided exceeded their needs (see Table 6) and only 4 per cent overall said that they had it for longer than needed (see Table 8). In our view, this suggests that many non-fault TRV users are likely to expect the TRV with which they are

provided to cost the fault insurer less than it actually does; and knowledge of the actual cost might increase their willingness to accept a reduced service.

35. We also conducted further analysis to consider other key variables, such as the extent of personal injury, the country of origin and the severity of accident damage. However, none of these other variables we considered appeared informative with regard to the overprovision of TRV services.

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theories of harm 1 and 2: Vehicle write-offs

#### Introduction

1. This paper examines theories of harm (ToHs) 1 and 2 in situations where a vehicle is deemed uneconomical to repair following a road traffic accident, ie where the vehicle is a write-off (total loss). First, with relevance to ToH 1, it discusses whether there is overcosting and/or overprovision in the services provided to non-fault claimants when their vehicle is a write-off.<sup>1</sup> Second, with relevance to ToH 2, it discusses whether there is underprovision of services to fault and/or non-fault claimants when their vehicle is a write-off due to a lack of alignment between their interests and those of the parties which procure services on their behalf.

#### Summary

##### *The write-off process*

2. In general terms, a vehicle is deemed to be beyond economic repair (and hence a write-off) when:
  - (a) the estimated cost to repair the vehicle exceeds the estimated pre-accident value (PAV) of the vehicle less any costs that could be recovered for its salvage (the estimated salvage value); or
  - (b) where the vehicle is so significantly damaged to render the vehicle unable to be repaired (eg flood damage or in some cases where a vehicle has rolled over).
3. If a vehicle is being written off, a customer can elect to retain the vehicle or to give it up to the insurer or claims management company (CMC) managing the claim (which

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<sup>1</sup> By 'overcosting' we refer to the overall difference to the fault insurer in the cost of a non-fault write-off between when the party paying for the service procures it and when another party procures it. We recognize that the overall difference in cost may be in part the result of underlying differences in the business models of different providers. We do not use the term 'overcosting' pejoratively as any differences in costs may arise for legitimate reasons. The term refers to the costs of a write-off procured by a non-fault insurer or CMC/credit hire company (CHC) being 'over and above' the costs of a write-off procured by a fault insurer (ie where there is no separation of cost liability and cost control). The term should be distinguished from 'overcharging'.

will then arrange for it to be taken away by a salvage company). The payment made to the customer by the insurer differs according to whether or not the customer retains the written-off vehicle, as follows:

- (a) If the customer gives up the vehicle, they will receive a payment of the agreed PAV of the vehicle (ie the PAV agreed between the claimant and the party managing the claim).
- (b) If the customer chooses to retain the vehicle, they will receive a payment of the agreed PAV of the vehicle less the estimated salvage value.
- (c) In a fault claim (and in some own insurer non-fault claims), they will receive either of the payments above, as appropriate, less the amount of the excess in their private motor insurance (PMI) policy.

- 4. Non-fault insurers and CMCs will seek to recover from the fault insurer the agreed PAV and any other charges they incur (eg vehicle storage and collection costs), less the estimated salvage value. Practices vary as to what the insurer or CMC receives from the salvage company responsible for disposing of the vehicle, but typically it will be the estimated salvage value plus any commission or referral fee.
- 5. A salvage company will receive the actual salvage proceeds, less the estimated salvage value paid to the insurer or CMC, less any costs of disposal and less any referral fees or rebates paid to the insurer or CMC which provided the work.

### ***ToH 1: overcosting and overprovision***

#### *Overcosting*

- 6. It appears to us that the separation of cost liability and cost control results in the overcosting of non-fault vehicle write-offs. This is achieved by estimated salvage values for non-fault vehicles being set artificially low by some non-fault insurers and CMCs, increasing payouts by fault insurers. We found that most CMCs receive a

referral fee payment of between £[~~xxx~~] to £[~~xxx~~] per salvage vehicle from salvage companies and that some non-fault insurers earn between £[~~xxx~~] and £[~~xxx~~] per salvage vehicle. The level of the commission payments and referral fees received by some non-fault insurers and CMCs from salvage companies indicates that the extent of the overcosting is likely to be up to around £200 per non-fault written-off vehicle.

7. We note that the claimant neither gains nor loses out from a low estimated salvage value as they still receive the PAV. However, it does result in a transfer of value from the fault insurer to the non-fault insurer/CMC. We also note that, in the event that the customer chooses to retain the vehicle, a lower estimated salvage value would benefit the claimant rather than the non-fault insurer or CMC because the claimant would receive a higher payout (PAV less the estimated salvage value).
8. We did not find similar concerns in relation to the PAV. The insurer or CMC managing a write-off passes the PAV of the written-off vehicle to the claimant. Therefore the insurer or CMC does not gain directly from setting a higher or lower PAV. Given that the PAV of a vehicle is determined by reference to publicly available data, such as used-car price guides and adverts for used cars (such as Autotrader), it appears to us highly likely that the fault insurer would be able successfully to challenge any inflated valuations of the PAV of a vehicle.

### *Overprovision*

9. We did not find any evidence of overprovision of services to non-fault customers who had a vehicle write-off. (We discuss the overprovision of temporary replacement vehicles (TRVs) associated with vehicle write-offs in our paper 'ToH 1: Overcosting and overprovision of TRVs'.)

## **ToH 2: underprovision**

10. We considered five ways in which underprovision might occur but in all cases it appeared to us that it was unlikely to arise, as follows:

(a) Due to the ready accessibility of used-vehicle valuations, it appeared to us that underprovision in relation to a low PAV is unlikely.

(b) We identified what appears to be a gap between the duration of TRV services which claimants in the event of a vehicle write-off might want (both fault and non-fault claimants) and those services which some claimants receive when they claim under their own insurance. We found that fault claimants or non-fault claimants who claimed under their own PMI policy usually received the TRV to which they were entitled under their policy, while other non-fault claimants who were provided with a TRV on, for example, the basis of credit hire, received the TRV for the entire period of the claim, and often for up to 7 days after they had received the settlement payment. However, it appears to us that any customer harm which arises from this gap would be due to (i) consumers not understanding and/or appropriately valuing the terms of their PMI policy or guaranteed courtesy car add-on policy at the point of purchase, or (ii) in the case of the non-fault claimant, not appreciating the implications of claiming under their own insurance or their alternative options at the time of their claim. With regard to (i) and the main PMI policy, we said in our statement of issues that we would not consider more generally the issue of the complexity of PMI and the transparency of information supplied at the point of sale; and, with regard to (i) and the guaranteed courtesy car add-on, we consider the transparency and complexity of this product, and its profitability, in the working paper 'ToH 4: Analysis of add-ons'. With regard to (ii) and claimants' awareness of their options at the point of claim, we consider this issue in both the working papers 'ToH 2: Underprovision of repairs' and 'ToH 2: Underprovision of TRVs'.

- (c) We have not seen evidence that there is any preference by insurers or CMCs to write off rather than repair a vehicle. Rather, the evidence we have seen on the underestimation of salvage values would suggest that repairs are more likely (ie low salvage values would increase the likelihood of the repair cost being less than the PAV minus the salvage value).
- (d) We have not seen any evidence of estimated salvage values being set too high when a customer chooses to retain the vehicle.
- (e) Although some insurers cancel insurance policies following a write-off (even sometimes for non-fault customers claiming under their own insurance), this does not seem to be common practice. Moreover, where such cancellation does occur it is pursuant to a term in the PMI policy so any customer harm would again be due to either (i) consumers not understanding and/or appropriately valuing the terms of their PMI policy at the point of purchase or (ii) not appreciating the implications of claiming under their own insurance or their alternative options at the time of their claim (see point (b) above).

## **Background**

11. Under ToH 1, we are investigating ‘whether the separation of cost liability and cost control in the supply of services to non-fault parties involved in motor accidents increases the costs of the services supplied (due to a lack of price competition or an unwarranted increase in quality)’.<sup>2</sup>
12. Under this ToH, we are analysing whether fault insurers, which pay for the post-accident services received by non-fault claimants, pay higher prices when these services are managed by another party than when they manage them (overcosting), which might be in part because non-fault claimants receive better services than those to which they are entitled (overprovision). In this paper we discuss the services

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<sup>2</sup> [Update to statement of issues](#), paragraph 5.



provided to non-fault claimants in relation to vehicle write-offs and the costs of these services.

13. Under ToH 2, we are investigating ‘the various ways in which consumers may be put at a disadvantage due to information asymmetries leading to a lack of alignment between their interests and those of the parties which procure post-accident services on their behalf.’<sup>3</sup>
14. Under this ToH we are analysing whether fault and/or non-fault drivers receive a service from insurers or CMCs which is less than that to which they are entitled, either under contract or under tort law (respectively). In this paper we consider this issue in respect of services received in relation to vehicle write-offs.
15. A vehicle write-off occurs in a PMI claim where it is (or appears to be) uneconomical to repair the vehicle. In this paper we first set out the process for a vehicle write-off before considering whether customers receive:
  - (a) compensation payments for vehicle write-offs which are lower (ToH 2) or higher (ToH 1) than the PAV of the vehicle; and
  - (b) services which are more (ToH 1) or less (ToH 2) than appropriate in relation to vehicle write-offs.

### ***Vehicle write-offs***

16. According to Trend Tracker,<sup>4</sup> around 600,000 cars were written off in 2012 (out of a total of around 4 million repair claims for private and fleet cars).
17. We gathered data in relation to vehicle write-offs from seven of the ten largest insurers, which together were responsible for around half of the total gross written

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<sup>3</sup> [Update to statement of issues](#), paragraph 5.

<sup>4</sup> The Future of the Car Body Repair Market in the UK 2012–2017.

premium (GWP) for PMI in 2012.<sup>5</sup> These insurers, in aggregate, managed in 2012 around 183,000 PMI-related write-offs, made up of 106,000 write-offs for fault claimants, 56,000 for non-fault claimants managed by the non-fault insurer and 21,000 for captured non-fault claimants. This data would suggest that there were around 365,000 PMI-related write-offs in 2012 managed by insurers.<sup>6</sup>

### *The write-off process*

18. In general terms, a vehicle is deemed to be beyond economic repair (and hence a write-off) when:
  - (a) the estimated cost to repair the vehicle exceeds the PAV of the vehicle less any costs that could be recovered for its salvage (the estimated salvage value); or
  - (b) where the vehicle is so significantly damaged to render the vehicle unable to be repaired (eg flood damage or in some cases where a vehicle has rolled over).
  
19. However, some insurers use slightly different criteria. For example:
  - (a) Aviva told us that a vehicle was usually deemed a total loss if repair costs would generally exceed 80 per cent of the PAV of the vehicle; and other factors will be taken into account
  - (b) [✂].

**Aviva Comment – please amend as per above**

20. Eight out of the ten largest insurers (Zurich, RSA, LV, esure, Direct Line Group (DLG), Co-op (CISGIL), AXA and Aviva) told us that they did not differentiate between fault and non-fault claims in how they determined whether a vehicle was a write-off.
  
21. Vehicle write-offs are classified into various categories. Categories A and B cannot be repaired or resold at all (and must be scrapped), whereas categories, C, D, F and

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<sup>5</sup> See working paper 'Background to PMI: insurers, brokers and PCWs', Appendix 1.

<sup>6</sup> We understand from data provided to us by CMCs that the number of write-offs managed by CMCs is small relative to the number managed by insurers.

X are usually resold in car auctions and may subsequently be repaired or used for spare parts.

22. If a vehicle is being written off, a customer can elect to retain the vehicle or to give it up to the insurer or CMC managing the claim (which will then arrange for it to be taken away by a salvage company). The payment made to the customer by the insurer or CMC differs according to whether or not the customer retains the written-off vehicle, as follows:
- (a) If the customer gives up the vehicle, they will receive a payment of the agreed PAV of the vehicle.
  - (b) If the customer chooses to retain the vehicle, they will receive a payment of the agreed PAV of the vehicle less the estimated salvage value.
  - (c) In a fault claim (and in some own insurer non-fault claims), they will receive either of the payments above, as appropriate, less the amount of the excess in their PMI policy.<sup>7</sup>
23. Non-fault insurers and CMCs will seek to recover from the fault insurer the PAV and any other charges they incur (eg vehicle storage and collection costs), less the estimated salvage value. Practices vary as to what the insurer or CMC receives from the salvage company responsible for disposing of the vehicle, but typically it will be the estimated salvage value plus any commission or referral fee.
24. A salvage company will receive the actual salvage proceeds, less the estimated salvage value paid to the insurer or CMC, less any costs of disposal and less any referral fees or rebates paid to the insurer or CMC which provided the work.

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<sup>7</sup> Where a non-fault claimant claims under their own PMI policy, the non-fault insurer may handle the claim in various ways: (i) it may indemnify the non-fault claimant for the insured losses only and seek to recover the costs of these losses from the fault insurer; (ii) it may also indemnify the non-fault customer for some uninsured losses (eg by waiving the excess) and seek to recover these losses from the fault insurer as well; or (iii) the non-fault insurer may choose to indemnify only the insured losses (not uninsured losses) but nevertheless seek to recover uninsured losses as well (eg any excess that had been previously charged), either by virtue of the claimant having motor legal expenses insurance or as a service to its customer.

## ***Possible concerns of overcosting, overprovision or underprovision***

25. Table 1 shows the possible ways in which overcosting, overprovision or underprovision may arise when a vehicle is written off.

TABLE 1 **Overcosting, overprovision or underprovision in vehicle write-offs**

*Ways in which concern might arise*

Overcosting	<ul style="list-style-type: none"><li>• PAV is set too high</li><li>• Estimated salvage value is set too low when the vehicle is scrapped</li></ul>
Overprovision (also giving rise to overcosting)	<ul style="list-style-type: none"><li>• PAV is set too high</li><li>• Estimated salvage value is set too low when the customer retains the vehicle</li><li>• TRV is provided for too long during the write-off process</li></ul>
Underprovision	<ul style="list-style-type: none"><li>• PAV is set too low</li><li>• TRV is provided for insufficient time</li><li>• Bias in the write-off decision towards write-off rather than repair</li><li>• Estimated salvage value is set too high</li><li>• Policy cancellations</li></ul>

Source: CC.

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26. The remainder of the paper is structured as follows. We first consider overcosting, then overprovision and, lastly, underprovision. We note that the PAV and salvage value concerns for overcosting and overprovision are very similar.

### **ToH 1: Overcosting**

27. In considering overcosting, we first compare the average payments for vehicle write-offs for fault customers and non-fault customers. We then discuss the incentives for insurers or CMCs to overstate the PAV or to understate the estimated salvage value and we consider the evidence on whether or not this occurs in practice. We also consider the payment and receipt of referral fees in relation to the salvage process.

### ***Payments for vehicle write-offs***

28. We received cost data from seven of the ten largest insurers in relation to vehicle write-offs, as summarised in Table 2.

TABLE 2 Average payments for vehicle write-offs by insurers

	£				
	<i>Unweighted average*</i>	<i>Weighted average†</i>	<i>Low‡</i>	<i>High‡</i>	<i>Insurers providing estimates</i>
Fault write-offs	3,211	2,853	[REDACTED]	[REDACTED]	[REDACTED]
Captured non-fault write-offs	1,859	1,988	[REDACTED]	[REDACTED]	[REDACTED]
Non-fault insurer managed write-offs	2,240	2,292	[REDACTED]	[REDACTED]	[REDACTED]
Write-offs received from other parties	2,104	2,122	[REDACTED]	[REDACTED]	[REDACTED]

Source: CC.

\*This is the average of the average write-off payouts provided to us by insurers (ie insurers which payout for few write-offs will be over-represented as each insurer's data is given equal weight).

†This is the average payout for all write-offs in the data, calculated as the total value of all write-offs (ie from all insurers in our sample) divided by the total number of write-offs in each category. These figures are more reliable than the unweighted figures as they give equal weight to each payout cost in the total sample.

‡This is the highest and lowest average write-off payment provided to us by insurers.

29. Only one insurer ([REDACTED]) provided us with average write-off values where a claim was managed by a CMC. The average cost was £[REDACTED], which was slightly higher than that insurer's average write-off value for captured non-fault claimants.
  
30. Comparing non-fault write-offs in Table 2, we find that, using weighted averages, non-fault insurer-managed write-offs are 15 per cent (or around £300) more expensive than captured non-fault write-offs (ie where there is no separation of cost control and liability). However, eight out of ten of the large insurers told us that, in their write-off decision-making, they did not distinguish between fault, non-fault or captured non-fault customers (see paragraph 20).
  
31. Esure told us that captured third party write-off payments were typically lower in value than other non-fault write-offs because a claimant was more likely to deal with a third party insurer (rather than their own insurer) where the claim involved a less valuable car (ie an older or smaller car).
  
32. Table 2 also shows that average write-off costs are significantly higher for fault write-offs. It is not clear to us why this is the case.

## **PAVs**

33. Insurers told us that they usually used valuation guides (eg Glass's Guide) to establish a damaged vehicle's PAV, though they also said that they might make adjustments to guide prices, eg to reflect local market variations<sup>8</sup> or the condition of the damaged vehicle before the accident (eg its mileage, service history, pre-existing damage, etc). LV said that it would take into account where the customer would normally buy the vehicle (eg a main dealer or auction) when making a write-off decision.
34. Nine of the ten largest insurers told us that they gave their customers the opportunity to provide additional evidence in relation to the appropriate vehicle value (pre-accident) if they were not happy with the initial vehicle valuation and, from the evidence we have seen, it appears that customers frequently make use of this opportunity. For example:
- (a) Admiral said that its initial estimate of the write-off value was disputed in [redacted] per cent of cases where it managed the write-off for its own customer, and in [redacted] per cent of cases where it was a captured non-fault claim.
- (b) [redacted] said that [redacted].
- (c) [redacted] said that [redacted] per cent of its initial write-off estimates were rejected by the customer.
- (d) DLG said that [redacted] per cent of its write-off decisions were disputed and [redacted] per cent of its valuation disputes were unresolved.
35. Customers who are not happy with their insurer's final decision on the write-off value can complain to the Financial Ombudsman Service (FOS), except for captured non-

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<sup>8</sup> Insurers told us, for example, that they sometimes checked vehicle values in Autotrader.

fault drivers and non-fault drivers who claim through a CMC.<sup>9</sup> Esure said it had had [redacted] valuation disputes with the FOS in 2012. [redacted] said that [redacted].

36. [redacted] told us that, where it was acting as the fault insurer, the PAV estimate of a written-off vehicle from the non-fault insurer was rarely contested. Esure said that, where it was the fault insurer and it received a claim for a vehicle write-off from a non-fault insurer or CMC, its internal engineers would review the estimate to ascertain that the costs reflected a fair market value. However, LV told us that CMCs would often make it very difficult for LV to inspect the vehicle which they proposed to write off as the longer the CMCs could make the process last, the longer the credit hire would last. LV said that it therefore had to balance how much time it spent validating the cost of a claim.

#### *Our assessment*

37. Given that the insurer or CMC managing a write-off pays the PAV of the written-off vehicle to the claimant, it does not gain directly from setting a higher or lower PAV. Even if the PAV were to be mis-stated, it is determined by reference to publicly available data such as used-car price guides and adverts for used cars. For this reason, it appears to us highly likely that the fault insurer would be able to challenge successfully any inflated valuation of the PAV presented by a non-fault insurer or CMC managing a non-fault write-off claim.

#### ***Estimated salvage value***

38. We examined the amount of revenue earned by CMCs and insurers from salvage. We found that most CMCs received a referral fee payment from salvage companies. [redacted] and [redacted] both received £[redacted] a year from salvage companies and [redacted] received

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<sup>9</sup> Captured non-fault claimants are not claiming under an insurance policy; CMCs are regulated by the Claims Management Regulator (within the Ministry of Justice) rather than by the Financial Conduct Authority (FCA). For these reasons, captured non-fault claimants and customers of CMCs do not have access to the FOS.



£[redacted]. This equates to on average between £[redacted] and £[redacted] per written-off vehicle.

[redacted]. However, the overall numbers of written-off vehicles managed by most CMCs is small (eg [redacted] told us that it managed around 3,000 salvage cases in 2012). In aggregate, the seven CMCs in our sample received [redacted] £[redacted] from salvage companies in 2012.

39. Three out of eight of the largest insurers ([redacted]<sup>10</sup>[redacted]) told us that they earned income from salvage and, on the basis of the data they provided, we estimated this to be on average between £[redacted] and £[redacted] per written-off vehicle. The aggregate of this income for these three insurers was around £[redacted] million in 2012 (though this may include some income related to fault claims). [redacted].[redacted] told us that the amount obtained for salvage and the fees paid were frequently a cause of dispute. [redacted] noted that some insurers received a fixed amount or a fixed percentage of PAV for the sale of salvage. In non-fault claims, this value then became the estimated salvage value, which was deducted from the PAV to give the settlement value to be paid by the fault insurer. However, when the salvaged vehicle was later sold at auction and if the amount realized was in excess of the fixed sum, a rebate was paid to the non-fault insurer.
40. The other five insurers in our sample ([redacted])<sup>11</sup> told us that they did not receive any commission or referral fee payments in relation to salvage.
41. We also considered whether there were any payments made by salvage companies to non-fault insurers or CMCs with regard to vehicle recovery and storage. [redacted] in relation to vehicle storage. [redacted] in 2012.

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<sup>10</sup> [redacted] told us that, [redacted].

<sup>11</sup> [redacted] told us that, prior to May 2013 it obtained an average income per salvage of £[redacted] in non-fault cases. However, as from May 2013, [redacted] has changed its model so that it now does not receive any income from non-fault write-off claims. The proceeds of sale from salvage which [redacted] receives are now the same as those credited in its non-fault recovery claims.

### *Our assessment*

42. Overall, it appears to us that salvage companies often pay large commissions or referral fees in order to gain work from insurers and CMCs, which indicates that they are able to sell a salvage vehicle for considerably more than its estimated salvage value. The following arbitrary and unrepresentative numbers illustrate the flow of funds in an example:

**Assume:**

- PAV = £30.
- Estimated salvage value = £10.
- Salvage proceeds = £17.

**Flow of funds:**

- The claimant receives £30 from the non-fault insurer or CMC.
- The fault insurer pays the non-fault insurer or CMC £20.
- The salvage company pays the non-fault insurer or CMC £10 for the vehicle.
- The salvage company makes a profit of £7 on its salvage, of which say £3 covers its costs and £4 is paid to the non-fault insurer or CMC (as a rebate, referral fee or commission payment).
- Overall, the non-fault insurer or CMC makes a profit of £4.

43. We note that the claimant neither gains nor loses out from a low estimated salvage value as they still receive the PAV. However, it does result in a transfer of value from the fault insurer to the non-fault insurer/CMC.

44. We also note that, in the event that the customer chooses to retain the vehicle, a lower estimated salvage value would benefit the claimant rather than the non-fault insurer or CMC because the claimant would receive a higher payout (PAV less the estimated salvage value).

45. Overall, it appears to us that the estimated salvage value of the vehicle may be systematically understated by some insurers and CMCs, as a result of which the fault insurer will pay more for the claim than if it were to manage it.

### ***Our assessment of overcosting***

46. It appears to us that the separation of cost liability and cost control results in the overcosting of non-fault vehicle write-offs. This is achieved by estimated salvage values being set artificially low by some insurers and CMCs, increasing payouts by fault insurers. The level of the commission payments and referral fees received by some non-fault insurers and CMCs from salvage companies indicates that the extent of this overcosting is likely to be up to around £200 per non-fault written-off vehicle.

### **ToH 1: Overprovision**

47. On the basis of the evidence presented above in relation to overcosting, it appears to us highly unlikely that PAVs would be systematically overstated (see paragraph 37).
48. We did not find any other evidence of overprovision of services to non-fault customers that had a vehicle write-off. (We discuss the overprovision of TRVs associated with vehicle write-offs in our working paper 'ToH 1: Overcosting and overprovision of TRVs').

### **ToH 2: Underprovision**

49. We have considered the following ways in which underprovision might occur in relation to vehicle write-offs:
- (a) the PAV being set too low;
  - (b) a TRV being provided for an insufficient time;
  - (c) a bias towards write-off rather than repair;

- (d) the estimated salvage value being set too high when a customer chooses to retain the vehicle; and
- (e) policy cancellation.

50. Some repairers told us that many of the vehicles which were written off and sold as salvage were then cheaply and badly repaired before re-entering the used car market. Although we have received some anecdotal evidence indicating that consumers of used cars are often unable to detect when a vehicle has been in an accident, or to assess the quality of the repairs which have been conducted, we judged that this was an issue relating to the supply of used cars and was not related to the provision of PMI and related goods and services. Therefore we did not consider it further.

### **PAV**

51. We found that information on the value of used vehicles is readily accessible to consumers, meaning that claimants were easily able to challenge a low offer for the PAV of a vehicle. We noted also that, in the event of any disagreement on the PAV, some claimants had recourse to the FOS (see paragraph 37).

52. We recognized that:

- (a) there was a limited period in which claimants could dispute the PAV estimate;
- (b) some claimants might not want to delay the receipt of funds while a PAV estimate is being disputed;
- (c) some customers may not be aware of the FOS; and
- (d) captured non-fault customers and customers of CMCs do not have access to the FOS.

53. However, it appeared to us that these limitations for some consumers were unlikely to affect significantly the extent of underprovision in relation to a low PAV offer. Overall, due to the ready accessibility of used vehicle valuations, it appeared to us that underprovision in relation to a low PAV was unlikely.

### ***TRVs for insufficient time***

54. The provision of a TRV to fault customers when they have a vehicle write-off (as opposed to requiring a repair) is often very limited. Zurich told us that it provided a TRV for up to five days; RSA said for up to three days; and esure, Admiral and Ageas Insurance said that no TRV was provided unless the customer had bought cover for a guaranteed courtesy car. RSA said that there was no contractual entitlement to a TRV on claims where the vehicle was a write-off, although, in practice, a courtesy vehicle was provided until the decision on write-off was finalized.
55. We found that that this was also generally the case for non-fault customers who claimed on their own insurance. However, some insurers told us that they were less restrictive: AXA GB told us that its customers were allowed to retain the TRV until such time as an offer was made for the PAV of the written-off vehicle; while Aviva and LV told us that its customers could keep the TRV for up to 14 days.
56. In contrast, we found that captured non-fault claimants and non-fault claimants managed by a CMC/credit hire company (CHC) typically received a TRV for the entire period of the claim and for up to 7 days after the funds were received from the insurer or CMC managing the claim.<sup>12</sup>

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<sup>12</sup> The duration of the TRV hire to which a claimant is entitled under tort law is assessed on the facts in the light of the circumstances of each case. However, the practice by some CMCs/CHCs of extending the period of TRV hire for up to 7 days beyond the claim being settled appears to be intended to meet a customer's entitlement under tort law.

57. We asked insurers how long it typically took when they were managing the claim between agreeing the PAV with the claimant and the claimant receiving the payment. RSA told us that, once settlement had been agreed with a claimant, the funds should be released within five days (in accordance with ABI requirements). LV said that on average it took ten days, AXA GB said eight days, and DLG said ten to 14 days. DLG said that the time frame could be influenced by factors such as delays by the customer in sending the required vehicle documentation or by outstanding settlement figures that needed to be provided by finance companies.
58. We also asked insurers how long it typically took between the first notification of loss (FNOL) and a write-off claimant receiving payment. Zurich told us that, in 2012, it took on average 37 days from FNOL to send out the payment for a total loss; esure said that in 70 per cent of cases its customer (whether fault or non-fault) would receive compensation within 21 days from FNOL when their vehicle was a write-off; and Admiral told us that the average length of time between the report of the accident and payment in a vehicle write-off case was 20 days for fault claims and 19 days for non-fault claims.

### *Our assessment*

59. We found that, for both fault claimants and non-fault claimants who claimed under their own insurance, many insurers would not provide a courtesy car in the case of a vehicle write-off (though most of these insurers would provide a TRV if the vehicle was being repaired). We also found that, for those customers who bought guaranteed courtesy car cover, this add-on usually guaranteed the provision of a TRV in the event of a vehicle write-off but for a limited period, usually around 21 days. Given that, from the evidence we have seen, the average time from FNOL to receiving payment in vehicle write-offs cases is at least 20 days, this would suggest

that many write-off claimants with guaranteed courtesy car cover would not have a TRV for all of the time until the claim is settled.

60. Where a non-fault claimant is provided with a write-off service by a fault insurer, or a CMC, without claiming on their own insurance, the limits of the service are as determined by tort law. We found no evidence that services provided to claimants in this scenario are less than those to which claimants are entitled and no party told us that these limits were insufficient to meet claimants' needs.
61. We noted that there could be some difference between the TRV service a non-fault claimant receives under their own policy and that to which they are entitled under tort law and, therefore, we considered whether non-fault claimants might be suffering an underprovision in relation to the provision of a TRV as a result of non-fault claimants claiming for a write-off under their own insurance.
62. We noted that non-fault insurers might prefer claimants to claim under their own insurance as there is a potential profit opportunity in managing a vehicle write-off. However, we found that the decision for a non-fault claimant of whether to claim under his/her own insurance or not was usually made at the point of first notification of loss (FNOL), at which time neither the insurer nor the claimant would usually know whether the vehicle was likely to be a write off.
63. We identified what appears to be a gap between the duration of TRV services which claimants in the event of a vehicle write-off might want (both fault and non-fault claimants) and those services which some claimants receive when they claim under their own insurance. We found that fault claimants or non-fault claimants who claimed under their own PMI policy usually received the TRV to which they were

entitled under their policy,<sup>13</sup> while other non-fault claimants who were provided with a TRV on, for example, the basis of credit hire, received the TRV for the entire period of the claim, and often for up to 7 days after they had received the settlement payment. However, it appears to us that any customer harm which arises from this gap would be due to (i) consumers not understanding and/or appropriately valuing the terms of their PMI policy or guaranteed courtesy car add-on policy at the point of purchase, or (ii) in the case of the non-fault claimant, not appreciating the implications of claiming under their own insurance or their alternative options at the time of their claim.

64. With regard to (i) and the main PMI policy, we said in our statement of issues that we would not consider more generally the issue of the complexity of PMI and the transparency of information supplied at the point of sale. With regard to (i) and the guaranteed courtesy car add-on, we consider the transparency and complexity of this product, and its profitability, in the working paper 'ToH 4: Analysis of add-ons'.
65. With regard to (ii) and claimants' awareness of their options at the point of claim, we consider this issue in both the working papers 'ToH 2: Underprovision of repairs' and 'ToH 2: Underprovision of TRVs'.

### ***Bias towards write-offs rather than repairs***

66. If insurers and CMCs have a general preference to do a write-off rather than a repair, in particular in relation to non-fault claims because of the value which they are able to generate from such claims (see paragraph 46), there could be an underprovision of

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<sup>13</sup> Where a non-fault claimant claims under their own PMI policy, the non-fault insurer may handle the claim in various ways: (i) it may indemnify the non-fault claimant for the insured losses only and seek to recover the costs of these losses from the fault insurer; (ii) it may also indemnify the non-fault customer for some uninsured losses (eg by waiving the excess) and seek to recover these losses from the fault insurer as well; or (iii) the non-fault insurer may choose to indemnify only the insured losses (not uninsured losses) but nevertheless seek to recover uninsured losses as well (eg any excess that had been previously charged), either by virtue of the claimant having motor legal expenses insurance or as a service to its customer.



repair services. Therefore, we considered if insurers (or CMCs) had incentives to favour write-offs over repairs (or vice versa).

67. We noted that non-fault insurers or CMCs might also prefer a write-off to a repair in order to generate a longer hire duration and a higher CHC referral fee.
68. However, we found no evidence to suggest that there is any actual preference by insurers or CMCs to write-off rather than to repair a vehicle.
69. Rather, the evidence we found on the underestimation of salvage values (see paragraphs 42 to 45) suggested that repairs were more likely than write-offs (ie a low salvage value would increase the likelihood of the repair cost being less than the PAV minus the salvage value).
70. We also found that customers (on average) appear to prefer repairs over write-offs. LV told us that customer satisfaction scores for repair claims were much higher than for write-offs and we noted that many repairers (in conjunction with insurers) offered their customers cheaper repair alternatives (eg by using recycled parts) in order to avoid a write-off. This would suggest that insurers with excessive write-offs would be more likely to lose customers following a claim.
71. Moreover, although we have found that there is a revenue opportunity for non-fault insurers and CMCs from a write-off, the amounts which these parties might be able to achieve from it do not appear any better than they would appear able to achieve through a repair (see working paper 'ToH 1: Overcosting and overprovision of repairs'). Esure told us that the process of managing a non-fault write-off takes only slightly longer than the process of managing a non-fault repair, which we thought was

likely to be due to write-offs attracting more scrutiny from insurers due to their higher average value.

72. In the case of a captured claim, we noted that the fault insurer was much less likely to prefer a write-off over a repair as the TRV hire length is usually longer for write-offs than repairs.
73. Overall, it appears to us highly unlikely that there is any underprovision of services in relation to vehicle write-offs by service providers preferring to write off rather than to repair a vehicle.

### ***Estimated salvage value***

74. We have not found any evidence that estimated salvage values are set too high. Indeed, the evidence we have seen raises the opposite concern (see paragraphs 42 to 45).

### ***Policy cancellations***

75. Some fault insurers cancel their fault driver's PMI policy in cases of a write-off. In certain circumstances, some also, when the non-fault insurer, cancel their non-fault driver's policy (if the claim was made under the customer's own policy). They do not do this when a vehicle is repaired.
76. However, most insurers told us either that they did not cancel policies or said that the policy could continue if the customer replaced the vehicle within a reasonable period.
77. Overall, it appears to us that, although some insurers cancel insurance policies following a write-off (even sometimes for non-fault customers claiming under their own insurance), this does not seem to be common practice. Moreover, where such

cancellation does occur it is pursuant to a term in the PMI policy so any customer harm would again be due to either (i) consumers not understanding and/or appropriately valuing the terms of their PMI policy at the point of purchase or (ii) not appreciating the implications of claiming under their own insurance or their alternative options at the time of their claim (see paragraph 63).

***Assessment on underprovision***

78. Overall, it did not appear to us that underprovision was likely to arise in relation to the supply of services to claimants in a vehicle write-off situation.

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 2: Underprovision of repairs

#### Summary

1. In this paper we assess whether there is underprovision of post-accident vehicle repair services provided to fault and non-fault claimants due to the beneficiary of these services (ie the fault or non-fault claimant) being different from and possibly less well informed than the procurer of the services (ie the fault insurer, non-fault insurer or claims management company (CMC)).
  
2. From the evidence we have seen so far, it appears to us unlikely that customers are systematically put at a disadvantage by insurers or CMCs procuring repair services on their behalf. This is because:
  - (a) Survey evidence shows that customers are generally satisfied with the quality of vehicle repairs:
    - (i) Our survey of non-fault claimants showed that 94 per cent of respondents felt that all of their accident damage was repaired; 88 per cent felt that the vehicle was in the same or a better condition after the accident repair compared with the condition prior to the accident; and 89 per cent were satisfied with the repair service overall (only 7 per cent said that they were dissatisfied with the repair service overall).
    - (ii) A December 2012 survey by GIMRA showed that [X] per cent of customers felt that the repair to their vehicle put it back at least to its condition before the accident and [X] per cent of respondents said they were extremely or very satisfied with the repair service they received overall (only [X] per cent of respondents were dissatisfied with the repair service overall).<sup>1</sup>

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<sup>1</sup> On a quarterly basis, GIMRA contacts around 2,500 PMI claimants whose claims have settled in the last three months. Claimants must have comprehensive cover and have claimed off their own insurance. Also, the claim must have been settled

- (b) Customer complaints about the quality of repairs are low:
- (i) Four independent repairers<sup>2</sup> provided data which showed that repair-related complaints arose in only [redacted] to [redacted] per cent of repair cases (and not all of these complaints were about the quality of repair).
  - (ii) Two insurer-owned repairers said that they received complaints about the quality of repair in about [redacted] to [redacted] per cent of repair cases.
  - (iii) Three CMCs said that they received complaints in [redacted] to [redacted] per cent of the repair cases they managed.
  - (iv) [redacted],[redacted] and [redacted] provided data which showed that they received customer complaints<sup>3</sup> in 1 to 4 per cent of all the PMI claims they managed. Of these complaints, between 9 and 27 per cent related to repair quality, with the result that repair complaints arose in 0.25 to 0.7 per cent of all PMI claims (although we note that not all PMI claims involve repairs).
  - (v) The GIMRA survey showed that fewer than [redacted] per cent of repairs resulted in a complaint about the quality of the repair.
- (c) [redacted] out of the ten largest insurers require their approved repairers to have PAS 125 accreditation or manufacturer approval.
- (d) Insurers and CMCs usually provide a guarantee for the repairs they manage, typically of three to five years.
- (e) All of the ten largest insurers and five<sup>4</sup> out of the seven CMCs from which we gathered evidence said that they monitored the performance of their approved repairers. [redacted] of the ten largest insurers told us that they performed repair quality audits, including physical checks of vehicle repairs performed by their approved repairers, without being prompted by customer complaints.

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within six months of it being lodged, and no serious personal injury must have been involved. We reviewed GIMRA's survey from December 2012, covering claims settled in the period April to September 2012.

<sup>2</sup> We refer to repairers which are not subsidiaries of PMI providers as 'independent repairers'. In many cases these repairers have repair contracts with PMI providers.

<sup>3</sup> 'Customer complaints' refers to reportable complaints, which are complaints that have not been resolved by close of business on the business day following receipt of the complaint.

<sup>4</sup> [redacted],[redacted],[redacted],[redacted]and [redacted], but not [redacted]and [redacted] which rely solely on independent engineers.

3. Notwithstanding this evidence, we also received a number of submissions (mainly from repairers, CMCs and other industry participants) suggesting that the repair quality of insurer-managed repairs is often poor. These submissions suggested that insurers' incentives are to keep their costs as low as possible which can lead to 'corner cutting' in the repairs they approve. As examples, one repairer told us how there was constant pressure to repair rather than to replace parts, even where replacement would provide a better repair; and another repairer said that insurers sometimes asked for savings which could worsen the cosmetic appearance of a vehicle, eg by stipulating the use of non-OEM parts which might not fit very well. We also found that the main purpose of repair audits was to control costs rather than to ensure high-quality repair standards and noted that a number of repairers suggested that there was limited monitoring of actual repair quality.
4. We also noted that many consumers might not be able to assess whether a repair to their vehicle is adequately performed. Whilst our survey of non-fault claimants found that 84 per cent of respondents were at least 'fairly confident' that they could spot if their vehicle was returned to its pre-accident condition (see working paper 'Survey report'), we interpreted this evidence with caution as it seemed to us likely that this confidence would relate mainly to assessing cosmetic aspects of the repair and not aspects relating to parts of the vehicle which are technical or not easily visible.
5. Overall, notwithstanding the allegations of some repairers and the potential for some customers to be unaware of poor repairs, we have to date found no evidence of systematic underprovision of repairs. Nevertheless, in order to investigate this issue further we have commissioned MSXI to perform audits of vehicles that have been repaired after an accident and this study is ongoing. We will publish the results of this study once it has been completed.

## Introduction

6. Under ToH 2, we are investigating the various ways in which consumers may be put at a disadvantage due to information asymmetries leading to a lack of alignment between their interests and those of the parties which procure post-accident services on their behalf.<sup>5</sup> This involves analysing whether fault and/or non-fault drivers receive a service from insurers or CMCs which is less than that to which they are entitled, either under contract or under tort law (respectively).
7. The key services which fault and non-fault claimants receive from insurers and CMCs in relation to PMI are vehicle repair and the provision of a temporary replacement vehicle (TRV). In this paper we consider whether claimants are receiving sub-standard vehicle repair services. We discuss the possible underprovision of TRVs in a separate working paper, 'ToH 2: Underprovision of TRVs'.
8. In this paper we have conducted our assessment on underprovision by considering the quality of repairs generally rather than against a specific contractual or tort law entitlement. In relation to core elements of the quality of a repair we would not, in any event, expect any difference between the contractual and tort law entitlement, eg relating to the safety of the repaired vehicle. We recognize that there may be scope for difference between a non-fault driver's entitlement under tort law and a fault driver's entitlement under contract because of certain restrictions in the insurance contract (eg provisions relating to the type of parts which can be used); however, we have not differentiated according to a tort and contract standard and have rather considered more generally the implications for consumers (eg relating to the use of non-OEM parts). This is because (a) the contractual entitlement of an individual claimant will be determined by the specific provisions of their contract and (b) the

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<sup>5</sup> [Updated issues statement](#), paragraph 5.

assessment of what the tort law entitlement requires in a given case will be informed by the specific facts of that case.

9. In this paper we first consider some of the differences in how repairs are handled and performed depending on whether they are fault or non-fault and depending on the party managing the repair. We then consider:
  - (a) the incentives of insurers, CMCs and repairers in relation to the quality of vehicle repairs;
  - (b) quality standards and the monitoring to those standards; and
  - (c) levels of customer satisfaction with regard to PMI-related vehicle repairs.

## **Differences in how repairs are handled and performed**

### ***Differences between fault and non-fault repairs***

10. All of the ten largest insurers told us that their fault and non-fault repairs (including captured non-fault repairs) were managed in the same way and, if handled by the insurers' approved repair network, were performed in the same way. The only difference we found was that some insurers stipulated the use of non-OEM parts for some fault repairs and some own-insurer non-fault repairs (eg for certain parts in fault repairs of vehicles more than three years old), whilst on equivalent captured non-fault repairs, OEM parts were used. [redacted],[redacted] and [redacted] each told us that they differentiated their handling of repair claims in this way. However, we found that the use of non-OEM parts in insurer-managed repairs is small (between 2 and 15 per cent of all parts used, by value) so the effect from this difference is unlikely to be significant.
11. All three of the large insurer-owned repairers confirmed that they repaired fault and non-fault vehicles in the same way.



12. Most of the largest insurers told us that they did not pay repairers differently for fault and non-fault repairs (eg in terms of the labour rate) and evidence from both insurer-owned and independent repairers confirmed this. The only exceptions we found were that one insurer uses two different CMCs to handle separately some of its fault and non-fault claims and one insurer pays its repairers a higher labour rate for non-fault repairs.
13. Repairers told us that the time allowed for a repair was the same regardless of whether it was a fault or non-fault repair, as this was determined by the repair cost estimation system (usually Audatex); and that, although work providers might stipulate the use of a certain paint, the same paint would be used in that work providers' fault and non-fault repairs.
14. Overall, it appears to us that, for insurer-managed repairs, whether a repair is fault or non-fault makes little difference in how it is performed.

### ***Differences between insurer-managed repairs and credit repairs***

15. We considered whether there were any systematic differences between insurer-managed repairs and credit repairs. We asked both CMCs and insurers about the parts they used and the time they allowed for repairs.
16. We found that credit repairs were more likely than insurer-managed repairs to receive OEM parts and more parts were likely to be replaced rather than repaired.<sup>6</sup> However, the use of non-OEM parts in insurer-managed repairs is small (see paragraph 10) so the effect from this difference is unlikely to be significant, and we did not receive evidence of a significant difference of replacement or repair depending on the work provider. We were also unable to assess whether the greater

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<sup>6</sup> This difference is also discussed in the working paper 'ToH 1: Overcosting and overprovision of repairs'.

use by CMCs of OEM parts and replacement instead of repair was due to the repair being managed by a CMC rather than an insurer (as suggested to us by some repairers) or due to differences in the mix of repairs they handled (eg CMCs might handle on average more complex repairs).

**Aviva Comments** - It is worth pointing out that in most cases where a repair is possible, it is better to repair rather than replace, as replacement often means cutting into the shell of the vehicle then welding new parts in place, to repair retains the original structural integrity of the vehicle, therefore it is more likely to respond in the manner intended in any future accidents.

17. We did not find evidence of any difference in the time allowed for repairs as both insurers and CMCs told us that the time was determined by the repair cost estimation system (usually Audatex).
18. Kindertons, a CMC, told us that there was little difference between how it performed its credit repairs and how insurers performed their repairs, as both its repair network and those of insurers adhered to either PAS 125 (see paragraph 32) or manufacturer-approved guidelines.
19. Overall, it appears to us that there are no significant differences between credit repairs and insurer-managed repairs.

### **Incentives of insurers, CMCs and repairers in relation to repair quality**

20. Fault insurers are liable for the cost of both fault and non-fault repairs so, where they manage the repair, they are incentivized to keep costs as low as possible.
21. Non-fault insurers and CMCs are not liable for repair costs so the incentive to keep costs as low as possible is weaker. However, in practice this does not appear to affect the repair service non-fault customers receive (see paragraphs 10 to 19). We have found that non-fault insurers and CMCs often charge fault insurers higher costs than the costs they incur, after taking account of all rebates, commissions and

referral fees (see the working paper 'ToH 1: Overcosting and overprovision of

repairs') but it appears that their incentive is still to manage the repair as efficiently as possible.

22. Therefore, we considered how fault and non-fault insurers and CMCs (together referred to as 'work providers') might lower repair quality. We identified the following two possibilities:

(a) Work providers could require their approved repairers to conduct low-quality repairs. For example, one independent repairer told us that there was constant pressure from insurers to repair rather than to replace parts, even where replacement would provide a better repair; and another independent repairer told us that fault insurers often asked for cosmetic corners to be cut.

(b) Work providers could lower the prices they pay to repairers to a level which incentivizes these repairers to perform substandard repairs. One party told us that the cost pressures on repairers could potentially lead to repairers taking risks on repairs and to poor repairs.

**Aviva Comment** - We feel the combination of PAS125 standards in the industry (repairers have two audits a year) and each Insurers own audit functions mitigate this risk.

23. In considering these possibilities we examined the relative bargaining positions of work providers and repairers. We found that repairers compete aggressively to become part of an insurers' network of approved repairers, which results in insurers and CMCs having a strong bargaining position relative to them. The National Association of Bodyshops (NAB) told us that repairers received most (about 80 per cent) of their work from insurers, with the remainder made up of consumer retail work (which was increasing due to higher excesses in PMI policies), self-insured fleet work and credit repair work (for CMCs). NAB said that insurers typically tendered for repairers to become their preferred repairer in a defined geographic area (by post-code), thus establishing their approved network. It told us that contracts were typically for five years but could be cancelled by the insurer at any time for many reasons. NAB said that tenders were usually awarded by reverse auction, focusing

particularly on the labour rate. The result was that insurers, through their immense buying power, had squeezed labour rates to just £23 to £25 per hour, compared with £18 per hour in 1991 and compared with £45 to £50 per hour which garages could earn for mechanical repair work. NAB said that the labour rate on credit hire repair work was generally higher (at £32 to £35 per hour), which meant that, even after paying a referral fee to a CMC to gain the work, credit repairs were usually more profitable than insurer work. NAB noted, though, that any repairer which took on more than a small amount of credit repair work was likely to be ostracized by insurers. NAB also told us that the body repair sector had been in decline for 20 years due to fewer accidents, safer cars and, more recently, reduced car usage.

24. One CMC (WNS) told us that there was some overcapacity in accident repairers, which had driven labour costs down; and another CMC (Helphire) said that it believed that the labour rates which insurers agreed with their network repairers were often so low as to be almost uneconomic for repairers.
25. In our view, the effect of such strong price competition between repairers is likely to be a strong incentive for repairers to reduce their costs, with the implication of a financial pressure to cut corners in repair work (see paragraph 22(b)). However, this incentive is clearly limited by repairers having to satisfy the repair requirements stipulated by work providers and being monitored by both work providers and customers. Therefore, it appears to us that any cost cutting is most likely to occur in areas which are least likely to be identified in audits by insurers, CMCs and standard monitors (eg in respect of PAS 125 accreditation) or by consumers (eg to unseen parts of the vehicle).
26. We found also that some insurers had moved to agree repair bills with repairers on a fixed price average repair basis, whereby the repairer receives the same income

regardless of its costs in performing the repair. In our view, the incentives for repairers under these contracts were likely to be even more to cut corners where possible, particularly in relation to more expensive repairs. One repairer ([redacted]) told us that fixed average price contracts (and also average repair cost penalty contracts) between insurers and repairers encouraged repairers to perform minimal repairs, which could compromise safety, quality and post-repair vehicle values. We also noted that *Post* (an insurance industry magazine), quoting an industry source, said that insurers were unlikely to mandate an unsafe repair but unsafe repairs could happen if an approved repairer had to work to an average repair cost contract.<sup>7</sup>

27. On the other hand, both work providers and repairers told us that their incentives were to conduct good-quality repairs. Work providers told us that they were keen to keep customer complaints low in order to retain customers and to build a good industry reputation for claims management; and repairers told us that they were keen to remain an approved repairer for work providers, not to have to carry out expensive post-repair remedial work, to sustain their reputations and not to lose any accreditations they may have (eg PAS 125 or manufacturer accreditations).

### **Quality standards in vehicle repair**

28. In this section, we consider the quality of vehicle repairs, the standards applied by work providers and the monitoring of repairs to those standards. We summarize in turn the evidence relating to insurers, brokers, CMCs and repairers. We then consider evidence on the quality of materials used and the time taken for repairs.

#### ***Insurers***

29. Insurers usually require repairers to perform vehicle repairs to certain quality standards, using one or more of the following measures:

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<sup>7</sup> *Post Magazine*, 28 February 2013.

- (a) requiring repairers to have PAS 125 accreditation, or at least requiring them to aspire to this accreditation (in order to receive this accreditation, repairers need to demonstrate that they carry out vehicle repairs using certain processes and procedures);
- (b) specifying the repair methods to be followed (eg manufacturer methods or Thatcham methods);
- (c) monitoring repairers through audits (eg by the insurer's engineers), and setting performance targets (eg low levels of customer complaints, adherence to time-lines for repairs, etc);
- (d) monitoring customer complaints and gathering evidence through customer surveys; and
- (e) requiring repairers to provide a warranty for their repairs, putting the financial burden on repairers for any post-repair remedial work.

30. We consider each of these measures in turn.

#### *PAS 125 and manufacturer approvals*

31. [REDACTED] out of the ten insurers in our sample said that they required repairers to have PAS 125 accreditation (or at least to be working towards this accreditation). [REDACTED] insurers ([REDACTED],[REDACTED] and [REDACTED]) said that they did not require its approved repairers to have PAS 125 accreditation.
32. The PAS 125 standard is owned and maintained by the British Standards Institution (BSI) as the National Standards Body of the UK.<sup>8</sup> BSI told us that PAS 125 was a technical specification, which provided repairers with the requirements for processes

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<sup>8</sup> [www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/](http://www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/).

and procedures related to the safe repair of accident-damaged vehicles. PAS 125 details minimum requirements for:

- (a) competent personnel;
- (b) appropriate and well-maintained equipment;
- (c) suitable repair methods; and
- (d) the quality of repair materials.

33. In order to gain and retain PAS 125 accreditation, repairers must adhere to the PAS 125 repair standards and have this adherence certified by a provider of accreditation services. BSI is the largest provider of PAS 125 accreditation, in the form of a Kitemark (a mark owned by BSI), but other providers also offer accreditation. Where BSI certifies a provider, it will undertake two unannounced audits per year (or one for repairers with fewer than seven employees). Appendix 1 provides more details on the PAS 125 standard and PAS 125 accreditation.
34. Some repairers have manufacturer approvals (either in addition to or instead of being PAS 125 accredited). Where repairers have such approvals, they are required to adhere to the repair methods and standards set out in their agreements with the manufacturers (eg to use OEM parts and the manufacturer's recommended paint brand, and to comply with the manufacturer's warranty requirements). Aviva said that it required some repairers to have manufacturer approval in order to handle prestige vehicle repairs (eg Mercedes, BMW and Porsche). AXA GB said that its approved repairers must have either PAS 125 accreditation (or be working towards it) or equivalent manufacturer approvals. It said that manufacturer approvals would override PAS 125. However, the Institute of Automotive Engineer Assessors (IAEA) told us that, in practice, the requirements of PAS 125 and manufacturer approvals were quite similar.



### *Specifying repair methods*

35. Both PAS 125 and manufacturer approvals require repairers to adhere to certain vehicle repair methods. These methods are usually either Thatcham methods or manufacturer methods.
36. Thatcham is a not-for-profit organization, established in 1969. It is independently operated with a board of directors drawn from around 30 insurer members which fund its work. We were told that its main purpose was to carry out research targeted at containing or reducing the cost of motor insurance claims, whilst maintaining safety and quality standards. Thatcham methods are specific to each make and model of vehicle and set out the process by which each part of those vehicles should be repaired.
37. Manufacturer methods are similar to Thatcham methods in that they also prescribe the way in which each damaged part of a vehicle should be repaired.
38. Although some insurers do not stipulate that repairers need to have PAS 125 accreditation (see paragraph 31) or manufacturer approvals, they may specify in their repair contracts that repairers must adhere to Thatcham or manufacturer methods (eg Admiral requires adherence to manufacturer methods by its approved repairers).

### *Monitoring the quality of repairs*

39. All of the ten large insurers in our sample told us that they monitored the performance of their approved repairers. For example, [X] told us that it audited the compliance of its approved repairers with PAS 125. It said that in 2012 it performed more than [X] audits and found that [X] per cent of repairs were PAS 125 compliant. We found that most of the insurers carried out checks on a sample of vehicles at their repairers' premises (in addition to investigating specific customer complaints).

40. We asked the insurers and some independent repairers what the repair quality checks of insurers involved and we found that these checks were typically part of repair audits, the main purpose of which was to control costs rather than to ensure a high quality of vehicle repairs. Appendix 2 sets out the extent of monitoring by each of the ten insurers in our sample.
41. We found that where insurers refer non-fault repairs to CMCs, these insurers monitor the performance of their preferred CMC, and in some cases also monitor the quality of some of the repairs their CMC handles ([X]).

#### *Monitoring customer complaints and customer surveys*

42. Eight out of the ten large insurers in our sample told us that they monitored the level of customer complaints in order to identify any systematic problems in repair quality. Six of the ten insurers told us that they conducted customer surveys.

#### *Requiring repairers to provide warranties*

43. Insurers usually provide claimants with a warranty for vehicle repairs undertaken by their approved repairers. However, insurers usually require their approved repairers to carry out any rectification work in relation to repairs they performed at their own expense. Warranties are typically for five years, though some insurers provide a warranty for three years and some provide a lifetime warranty (as long as the vehicle is not sold).

#### **Brokers**

44. All of the brokers in our sample told us that they either passed claimants to the underwriting insurer or to a CMC for their repair to be managed. None of the brokers which provided us with information had its own approved repairer network.

45. The brokers told us that they monitored the performance of the CMCs to which they referred claimants (eg in terms of call answer times, complaints, customer survey data, etc) but they did not monitor the quality of repair services.

**Aviva Comment** - This should suggest that the involvement of brokers in managing repairs for customers does not in fact add value to the customer experience, it merely generates revenue for the broker.

## **CMCs**

46. Four of the seven CMCs in our sample told us that the majority or all of the repairers in their networks were PAS 125 accredited and/or had manufacturer approvals.
47. All seven of the CMCs told us that they monitored the quality of vehicle repairs. Four CMCs told us that they carried out audits of repairers, one saying that it did this solely through the appointment of independent engineers. Five CMCs told us that they reviewed or investigated complaints received; and two CMCs told us that they solicited customer feedback on repairs.
48. Three CMCs told us that they provided a five-year warranty on the repairs they managed and another CMC said that it provided a three-year warranty.

## **Repairers**

### *Insurer-owned repairers*

49. Two of the three insurer-owned repairers in our sample either had PAS 125 accreditation or were working towards it, and one of them told us that it also had manufacturer approvals. Two of these repairers told us that they had service level agreements with their related insurers, against which each insurer monitored the repairer's performance, including through audits and inspections. Two of the three repairers told us that their related insurer also conducted customer surveys. All three of the repairers said that they were required to use Thatcham or manufacturers' methods. One of the repairers said that it was required to comply with manufacturers'

warranty requirements.

50. UKAARC told us that its related insurer (DLG) was keen to ensure that costs were kept to a minimum, but not at the expense of repair quality or the safety of the customer. Solus (owned by Aviva) told us that it had never been asked by a work provider to carry out a repair in a way which would compromise vehicle safety and it would not allow this to occur.

### *Independent repairers*

51. Nine independent repairers told us about the standards to which they conducted repairs and how they were monitored ([REDACTED],[REDACTED],[REDACTED],[REDACTED],[REDACTED],[REDACTED],[REDACTED],[REDACTED]and [REDACTED]). Six of these repairers ([REDACTED],[REDACTED],[REDACTED],[REDACTED],[REDACTED] and [REDACTED]) told us that they performed repairs to PAS 125 or manufacturer standards, while two of the remaining three repairers ([REDACTED]and [REDACTED]) told us that all repairs were carried out in accordance with Thatcham methods.
52. Evidence from these nine repairers indicates that the quality of their repairs is monitored mostly through PAS 125 audits (for PAS 125 accredited repairers), internal checks and/or checks by work providers. They told us the following:
- (a) [REDACTED] said that the quality of its work was checked through PAS 125 biannual unannounced audits, manufacturer annual audits at approved sites, an internal audit performed quarterly, and work provider audits on an ad-hoc basis.
- (b) [REDACTED] said that its repairs were all subject to internal quality control checks before the vehicle was released to the customer, and all its sites were subject to periodic audits by BSI to maintain their PAS 125 accreditation.
- (c) [REDACTED] said that it was audited by some insurers, but mainly for cost control purposes. [REDACTED] said that insurers did very little monitoring of repairers' repair quality, giving, as an example, [REDACTED].<sup>9</sup> However, [REDACTED] added that the BSI PAS 125 Kitemark was a rigorous standard, with twice-yearly unannounced audits which

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<sup>9</sup> [REDACTED] told us that it did not agree with this view.

drilled down into the repair process. [redacted] said that credit repair work providers (CMCs) did not do any quality control checks.

(d) [redacted] said that the quality of all the repairs it performed was checked internally, regardless of the source of work, through stage checks and final checks by a quality control manager. In addition, insurance repairs were subject to external audits by the insurers. [redacted] said that BSI also audited its repair sites.

(e) [redacted] said that the primary methods used by work providers to ensure repair quality were insisting on PAS 125 accreditation and analysing customer feedback.

(f) [redacted] said that the quality of repair was self-monitored by repairers and CMCs/insurers only became involved if there was a customer complaint.

(g) [redacted] said that an insurer only found out about a repairer cutting corners if a customer complained. It said that the audits conducted by insurers were primarily desktop exercises which went through a repairer's files rather than involving any physical inspections looking at quality. [redacted] said that [redacted] did some inspections, but these were announced in advance and focused on analysis of paperwork.<sup>10</sup> [redacted] said that inspections by work providers did not focus on the quality of the vehicle repair and sometimes the inspectors were not even engineers.

(h) [redacted] said that the majority of insurers rarely came out to check on repair quality. It said that insurer audits were more about whether the assessment and invoice reflected the work carried out rather than the quality of the repair.

**Aviva Comment** - Whilst our post repair audit focuses on the invoice/assessment accuracy and the parts used, we do feel repair quality is also at the forefront of our controls for two reasons; the repairer holding PAS125 has two unannounced BSI audits per year and we endorse these standards and we also deploy work in progress audits at intervals through the year. However, the comment and the link to (56) is in the context of 'majority of insurers', therefore we are merely making the point we do not agree from an Aviva stand-point.

(i) National Accident Repair Group, a marketing association for repairers, said that \_\_\_\_\_ larger insurers (eg [redacted] and [redacted]) had teams of engineers which audited repairs, \_\_\_\_\_

<sup>10</sup> [redacted] told us that it did not agree with this view.

though these audits were mainly either in relation to customer complaints or to check that a repair was done in line with the repair estimate.

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<sup>11</sup> [X] told us that it did not agree with this view.

53. [X], [X] and [X] said that there was no difference in the monitoring of repairs between fault and non-fault repairs.
54. Five repairers ([X],[X],[X],[X] and [X]) told us categorically that they would not compromise vehicle safety in any of their repairs. [X] explained that it would not perform repairs which compromised vehicle safety, even if the alternative involved additional costs, as this would impact on its brand and reputation. Nevertheless, some repairers told us about poor-quality repairs, as follows:
- (a) [X] said that there was corner cutting by repairers and that this was increasing, as insurers wanted cars repaired as cheaply as possible. [X] said that corner cutting included using lots of filler in a damaged part rather than replacing it, painting without taking off detachable parts (eg a door handle), not blending the paint on newly-fitted parts with the rest of the car (in particular on metallic cars and older cars where the colour had faded), and patching up (gluing) rather than replacing parts (eg a broken headlamp). [X] said that some insurance repairs could compromise vehicle safety, but that the evidence on this was inconclusive.
- (b) [X] said that fault insurers sometimes asked for cosmetic corners to be cut.
- (c) [X] said that repairers could cut corners by using non-OEM parts and that this was particularly possible with credit repair companies, due to these work providers not checking repair quality.
- (d) [X] said that insurers accepted repair proposals by repairers despite them failing to address properly all accident-related damage.

### ***Summary of standards (insurers, brokers, CMCs and repairers)***

55. The information provided by insurers, CMCs and repairers indicates that insurers often require repairers to adhere to an independently-audited PAS 125 quality standard and/or to manufacturer standards. [X] of the ten largest insurers told us that they performed repair quality audits, including physical checks of vehicle repairs



performed by their approved repairers, without being prompted by customer complaints.

56. Nevertheless, it appears that there is the possibility for repairers sometimes to cut corners in repairs. Submissions from some parties suggest that insurers' incentives are to keep their costs as low as possible which can lead to 'corner cutting' in the repairs they approve. We also found that the main purpose of repair audits was to control costs rather than to ensure high-quality repair standards and noted that a number of repairers suggested that there was limited monitoring of actual repair quality.

### ***Quality of materials used and time taken for repair***

57. The principal inputs in vehicle repairs are labour, parts and paint. We considered whether the choice of parts and paint used in vehicle repairs and the time allowed for a repair gave rise to quality concerns.

### ***Quality of parts***

58. There are four types of parts used in vehicle repairs: OEM parts, original equipment supplier (OES) parts, non-OEM parts and recycled parts. OEM parts are manufactured and branded by the original vehicle manufacturer; OES parts are the same as OEM parts (ie produced by the same parts manufacturer), but are not branded by the original vehicle manufacturer; non-OEM parts are copies of the OEM part; and recycled parts are parts taken from other vehicles (eg written-off vehicles).
59. We have received no evidence of quality concerns in relation to OEM and OES parts. We were also told that recycled parts were rarely used in insurer-funded post-accident vehicle repairs.

### *Non-OEM parts*

60. Several repairers raised concerns about non-OEM parts, which mainly related to difficulties in fitting the part. For example:
- (a) [X] said that the labour time required to fit non-OEM parts in order to achieve an acceptable fit and finish was typically longer than for OEM parts and hence resulted in a higher labour cost.
  - (b) [X] said that non-OEM parts were cheaper than OEM parts but were often of poorer quality. [X] said that this meant that additional time was required to make them fit, though insurers did not pay for this additional time.
  - (c) Solus (owned by Aviva) said that using non-OEM parts could reduce the cost of the repair, but could cause fitting difficulties.

**Aviva Comment** - This is indeed the case, however it is fair to say that there are quality variations in non OEM parts, some brands/sources being better than others.

61. Some repairers also told us that the use of non-OEM parts could impact on the look and value of the repaired vehicle. For example:
- (a) [X] said that using non-OEM parts often made achieving a good fit very difficult, which could affect repair quality. This was because repairers were not given extra time by insurers to correct misshapen or badly moulded parts, which incentivized them to undertake 'rushed' work and potentially resulted in poor-quality repairs. For example, shut lines and fit lines could be affected, which impacted on the vehicle's appearance and could affect its value.
  - (b) [X] said that panels which fitted poorly could reduce a car's value by 5 per cent.
  - (c) [X] also said that the use of non-OEM parts could impact the resale price of a repaired vehicle.

**Aviva Comment** – We feel are strong statements that if the person making them is not prepared to be named should potentially be removed.

62. We were also told that the use of non-OEM parts invalidated manufacturer warranties for repaired vehicles, though no party provided any evidence to indicate that this was

a material issue in practice.

63. Both insurers and repairers told us that non-OEM parts were mainly used for the standardized, non-safety critical parts of a vehicle. For example:
- (a) Aviva said that safety-related parts were often not available from non-OEM suppliers, due to the high development cost of these parts.
  - (b) QRC (owned by RSA) said that non-OEM parts accounted for [redacted] per cent of the total number of parts it purchased, and were generally used only for non-structural elements of repair work.
  - (c) [redacted].
64. It appears to us that if the use of non-OEM parts results in any detriment to consumers it is likely to be due to a poorer cosmetic appearance of the vehicle with possible implications for the value of the vehicle. However, evidence from repairers indicates that in most cases they would look to overcome this detriment by working to make the part fit, even though it might take longer than to fit the equivalent OEM part.
65. Moreover, whilst we have some concerns that many consumers might not be able to assess whether a repair to a hidden or technical part of their vehicle was adequately performed, we are less concerned in relation to cosmetic aspects of the repair. Our survey of non-fault claimants found that 84 per cent of respondents were at least 'fairly confident' that they could spot if their vehicle was returned to its pre-accident condition. This would suggest that the potential for work providers and repairers to cut corners through using ill-fitting non-OEM parts is limited.
66. We also note that insurers usually provide warranties of at least three years on vehicle repairs, enabling customers to challenge any issues which emerge over time from poor-quality parts; and we note that insurers do not typically use non-OEM parts in repairs of vehicles less than three years old.

### *Repair or replace*

67. Several repairers told us that there was often a tension between them and insurers in how a repair should be conducted and, in particular, whether a damaged part should be repaired or replaced. Repairers said that, due to low labour rates, insurers sometimes sought repair work to be performed when, in the repairer's opinion, the part needed to be replaced.

### *Summary on quality of parts*

68. Overall, it did not appear to us that consumers were likely to suffer a systematic underprovision in general repair quality from the mix of parts currently used in post-accident repairs. However, we recognized that, in specific cases, the use of non-OEM parts or the choice to repair rather than to replace a part could be relevant to whether an individual has received his/her tort law entitlement, if as a result of the repair the non-fault claimant is not put into as good a position as he/she would have been in if no accident had occurred.

### *Quality of paint*

69. We received no evidence to indicate that there is systematic use of poor-quality paint in vehicle repairs. We found that several insurers and some CMCs require repairers to use specific premium paint brands but we found no evidence to suggest that the use of non-premium paint brands has any detrimental effect on the quality of vehicle repairs. For example, [REDACTED] told us that the quality of repair was more influenced by the preparation and application of the paint than by the paint itself.

### *Time taken for repairs*

70. We found no evidence to suggest any difference in the time taken for repairs between fault and non-fault repairs or between insurer-managed and CMC-managed

repairs. In all such repairs, we found that the allocated time was usually determined by the repair cost estimation system (ie usually Audatex).

### *Summary*

71. Overall, it does not appear to us that the paint and parts used in insurer-funded vehicle repairs are typically of a substandard quality. We have also found no evidence that there is a difference in the labour hours used in fault and non-fault vehicle repairs or that insurers systematically make inappropriate decisions to repair rather than to replace parts.

### **Customer complaints and satisfaction with vehicle repairs**

72. We reviewed survey evidence relating to customers' satisfaction with the quality of vehicle repairs. We looked at the results of our survey of non-fault claimants and the GIMRA motor claims satisfaction survey, which was informative particularly with regard to fault claims. We also considered customer complaint evidence provided by some insurers, CMCs and repairers.

### ***Our non-fault survey***

73. The results of our survey of non-fault claimants are in the working paper 'Survey report'. Some analysis of these results in relation to the possible underprovision of post-accident services to consumers is in the working paper 'ToH 2: Analysis of the results of the non-fault survey in relation to underprovision'.
74. The vast majority of respondents to our survey (around 94 per cent) felt that all of their accident damage was repaired. Of the remaining 6 per cent, 29 per cent said that repairs were not carried out properly, and 14 per cent said that minor or cosmetic issues were not fixed.

75. Around 88 per cent of respondents felt that their vehicle was in the same or a better condition after the accident repair compared with its pre-accident condition. 10 per cent said that it was in a slightly worse condition, and 1 per cent said that it was in a much worse condition.
76. Overall, 89 per cent of respondents said that they were satisfied with the repair service, and only 7 per cent said that they were dissatisfied.

### ***GIMRA survey***

77. On behalf of a significant number of GIMRA members (about 14 insurers), research firm Harris Interactive contacts on a quarterly basis around 2,500 PMI claimants whose claims have settled in the last three months. Claimants must have comprehensive cover and have claimed off their own insurance. Also, the claim must have been settled within six months of it being lodged, and no serious personal injury must have been involved.
78. We reviewed GIMRA's survey from December 2012, covering claims settled in the period of April to September 2012.
79. The results of the GIMRA survey indicated that the quality of repair is the second most important aspect of the claims-handling experience for claimants (with communication throughout the claim being the most important). The third most important aspect is the time taken from FNOL to the car being returned post-repair (or a cheque being received if a write-off).
80. [X] per cent of respondents to the GIMRA survey said that the quality of the repair they received was at least of 'good' quality, ie it restored the vehicle to at least its

pre-accident condition. [X] per cent of respondents said that the repair left their vehicle in a better condition than prior to the accident.<sup>11</sup>

81. The GIMRA survey also found that only [X] per cent of respondents were dissatisfied with the overall repair experience, compared with [X] per cent who were either very satisfied or extremely satisfied.

82. [X] per cent of respondents to the GIMRA survey made a complaint about their claim and, of these complaints, [X] per cent were because of poor-quality repairs. This means that complaints in relation to the quality of repairs were made in less than [X] per cent of claims.<sup>12</sup>

### ***Customer complaint evidence from insurers, CMCs and repairers***

83. The CMCs in our sample all told us that they received low levels of complaints in relation to vehicle repairs. For example, Quindell told us that it only received complaints in 1 per cent of its repair claims; and WNS said that it received justified complaints in relation to the quality of repairs performed by its approved repairer network in less than 1 per cent of cases. Claimfast said that it received complaints in less than 1 per cent of the claims it managed. Helphire, Enterprise and Accident Exchange all told us that they received complaints in less than 1 per cent of the claims they managed. [X] said that it received complaints in 4 per cent of the claims it managed; and [X] indicated that it received complaints in 6 per cent of the repairs it managed in 2012.

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<sup>11</sup> It appears to us that the number of respondents stating that the repair left their vehicle in a better condition is high in comparison with both our survey results (see paragraphs 73 to 76) and the results of surveys carried out by insurers and repairers (see paragraphs 83 to 87). We note that the GIMRA survey appears to be mainly focused on the quality of customer communication and the customer service experience and it might be that responses to this question have to some extent reflected the overall customer service experience in relation to the repair.

<sup>12</sup> Not all claims had an associated vehicle repair (the base for the total percentage of complaints was 2,512 claims, of which 1,708 claims involved a vehicle repair).



84. Repairers also told us that complaint rates were low and generally in a range of between 1 and 5 per cent of repairs. For example:
- (a) QRC (owned by RSA) said that it received complaints in 0.6 per cent of its repairs; and RSA told us that it received FSA-reportable complaints in 0.2 per cent of repairs carried out by QRC.
  - (b) Solus (owned by Aviva) said that it received complaints via Aviva in less than 1 per cent of its repairs (though we note that such complaints might only arise if earlier attempts to resolve issues have failed).
  - (c) UKAARC (owned by DLG) said that DLG received complaints in [redacted] per cent of its repairs in 2012 and, of these complaints, around half were in relation to [redacted]. UKAARC said that, in addition, some customers complained directly to UKAARC.
  - (d) Independent repairers (eg [redacted]) also told us that complaint rates were low. [redacted] said that it received complaints in 3 per cent of its repairs; [redacted] said 5 per cent of repairs, [redacted] said 1 to 2 per cent of repairs and [redacted] said in less than 1 per cent of repairs.
85. [redacted],[redacted] and [redacted] provided data which showed that they received reportable customer complaints (ie complaints which have not been resolved by close of business on the business day following receipt of the complaint) with respect to between 1 and 4 per cent of total motor claims managed. Of these complaints, between 9 and 27 per cent related to repair quality, with the result that repair complaints arose in 0.25 to 0.7 per cent of all PMI claims (although we note that not all motor claims involve repairs, eg vehicle write-offs).
86. We note that a 2 per cent complaint rate relating to repairs would equate to approximately 40,000 complaints a year (assuming a basis of around 2 million accident repairs paid for by insurers a year).

87. Repairers told us that customer complaints related mostly to:
- (a) [✂];
  - (b) the scope of the service received (eg the exclusion of damage caused by wear and tear, additional work not being authorized, the courtesy car being insufficient, or the excess being higher than expected);
  - (c) delays in booking the repairs; and
  - (d) a lack of communication with the customer.

### **Other considerations**

88. In this paper we have focussed on whether claimants receive substandard vehicle repair services and we consider separately the possible underprovision of TRVs in a separate working paper (see 'ToH 2: Underprovision of TRVs'). However, we note that there are other ways in which there could be underprovision to claimants due to the claimant being different from and possibly less well informed than the party procuring post-accident services (ie the fault insurer, non-fault insurer or CMC) on their behalf.
89. We note that non-fault drivers may be entitled to recover other losses (other than personal injury), for example the diminution in value of their car or a loss of earnings. There would appear to be scope for consumer harm if consumers were not aware of their wider entitlements or faced obstacles in pursuing those entitlements. In the working paper 'ToH 1: Overcosting and overprovision of repairs', we note, for example, that certain CMCs provide assistance with such claims while most insurers do not.
90. We have identified some potential disadvantages for non-fault claimants in claiming under their own insurance. For example, in some cases they may need to pay an excess (at least in the short term), their no-claims bonus may be (temporarily)

affected, or their access to a TRV might be shorter than needed in the case of a write-off (see the working paper 'ToH 1/2: Vehicle write-offs'). Consumer harm could result from the non-fault claimant not appreciating the implications of claiming under their own insurance or their alternative options at the time of making a non-fault claim (ie not to claim under their insurance).

91. At this stage, we have not reached a view on these issues and we would invite submissions from parties on them.

## PAS 125 and the BSI Kitemark

1. In order to become part of an insurer's approved repair network, repairers are often required either to be PAS 125 accredited (eg through achieving the Kitemark) or to be working towards achieving this accreditation.
2. BSI owns both PAS 125 and the Kitemark. However, these are two different products, which we discuss in turn.<sup>13</sup>

### PAS 125

3. BSI told us that, about six years ago, it was commissioned by Thatcham, insurers and insurance-related parties to set up PAS 125 as a publicly available standard. This was undertaken by BSI's standard-setting division, being the National Standards Body of the UK, which also maintains and updates this standard. QRC told us that the PAS 125 scheme was UKAS-accredited.<sup>14</sup>
4. BSI told us that the PAS 125 standard prescribed the process by which a vehicle was repaired, including requiring competent personnel, quality repair materials, appropriate and well-maintained equipment, and appropriate repair methods.
5. Aviva told us that the materials requirements in the original PAS 125 2009 standard were that parts, components and fasteners should be either:
  - (a) OEM branded, with the vehicle manufacturer's trademark;
  - (b) OEM branded, with the component manufacturer's trademark and independently certified under a recognized conformity certification scheme;

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<sup>13</sup> [www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/](http://www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/).

<sup>14</sup> The United Kingdom Accreditation Service (UKAS) is the sole national accreditation body recognized by the Government to assess, against internationally agreed standards, organizations that provide certification, testing, inspection and calibration services: [www.ukas.com/about-accreditation/about-ukas/](http://www.ukas.com/about-accreditation/about-ukas/).

- (c) of matching quality independently certified under a recognized conformity certification scheme; or
- (d) an alternative part (including recycled parts) of a non-safety-related status, supplied under a work provider agreement.

### **The BSI (PAS 125) Kitemark**

6. BSI told us that, separate to setting the PAS 125 standard, it also provided certification of the PAS 125 standard in the form of a Kitemark pursuant to BSI's PAS 125 Kitemark scheme. The scheme was owned and operated by a separate company falling within the BSI group. BSI operated a strict observance of separation of business function between the National Standards Body and the company that promoted the Kitemark, enforced through law by agreement with HM Government. The Kitemark service was provided through BSI's certification division. BSI said that it competed for this work against other certifying organizations. It said that around 860 repairers currently had the BSI (PAS 125) Kitemark and this level had remained stable for the last three years.
  
7. BSI said that the difference between PAS 125 and the associated Kitemark was that the Kitemark was awarded to those repairers who were PAS 125 certified by BSI. BSI said that, to achieve this certification, PAS 125 had to be followed according to a scheme set down by BSI. BSI told us that other certifiers had their own schemes, but it believed that its scheme and its audit process were among the most robust.<sup>15</sup> For example, PAS 125 would set out that a repair needed to be done using appropriate methods but BSI would check what those appropriate methods were, eg to follow either manufacturer methods or Thatcham methods. BSI said that a repairer could follow PAS 125 without being certified by anyone.

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<sup>15</sup> BSI said that its certification was the strongest, in part because, unlike the other certifiers, BSI did unannounced audits of repairers.

8. BSI said that, to be certified by BSI (and awarded the Kitemark), repairers were audited twice yearly through unannounced audits. In a typical audit, BSI would work back through a sample of repair records to check that the appropriate processes had been followed, and look at some vehicles (which included vehicles in various stages in the repair and finished vehicles). BSI said that quality was not audited directly (as the auditors were not usually engineers) but if the processes were being followed properly, repair quality should be maintained. BSI also said it checked that finished vehicles had been repaired as per the work instructions to identify whether vehicles had been repaired to the pre-damaged condition. BSI added that, during an audit, it would look at the complaints register of the repairer. It said that it would also consider any complaints it received directly from customers relating to vehicle repairs conducted by a BSI-certified repairer, though the number of such complaints was very low.
9. BSI said that, in addition, it performed in-depth audits of repairers, in particular where the initial audit indicated possible weaknesses. BSI said that non-compliance with the Kitemark requirements was usually higher when a repairer was seeking to gain the Kitemark for the first time rather than when it had become accustomed to the required processes.
10. We were told that if BSI found non-compliance through its audit processes, an agreed action plan was put in place, which was managed within certain service level agreement time frames. If the repairer did not respond with an acceptable action plan or keep to it, non-conformities could result in the repairer being suspended or, in more serious cases, removed from the Kitemark.

## Insurer PAS 125 accreditation requirements and monitoring

The table below sets out, for each of the ten insurers in our sample, their requirements for PAS 125 accreditation and the extent of their monitoring of repair quality.

TABLE 1 PAS 125 accreditation requirements and monitoring of repair quality

<i>Insurer</i>	<i>PAS 125 accreditation requirements</i>	<i>Monitoring of repair quality through physical vehicle inspection</i>
Admiral	None	Yes ([X])
Ageas Insurance	[X]	[X]
Aviva	Requires BSI PAS 125 Kitemark	Repairer audits have an element of repair quality checks of vehicles
AXA GB	Requires PAS 125 accreditation (or to be working towards it) or manufacturer approval	Carries out audits on the repairers' quality assurance processes (repairer audits are limited to cost control and adherence to PAS125 standards)
AXA NI	None	Repair quality audits on vehicles since 2013. Prior to 2013, repair quality checks only done in response to customer complaints
CISGIL	Requires PAS 125 accreditation	Repairer audits have an element of repair quality checks on vehicles
DLG	Requires BSI PAS 125 Kitemark	Repairer audits include repair quality checks on vehicles
esure	Requires BSI PAS 125 Kitemark	Repairer audits include repair quality checks on vehicles
LV	None	To a limited extent: quality checks on vehicles only in response to customer complaints
RSA	Required PAS 125 accreditation (or be working towards it)	Repair quality checks on vehicles included in repairer audits, but quality is not an audit focus (but rather cost and process control)
Zurich	Requires BSI PAS 125 Kitemark	Repair quality checks on vehicles included in repairer audits, but quality is not an audit focus (cost control is focus)

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 2: Underprovision of TRVs

#### Introduction

1. Under theory of harm 2 (ToH 2), we are investigating whether harm arises from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services. In this paper, we assess whether there is underprovision of temporary replacement vehicle (TRV) services to non-fault claimants. By ‘underprovision’, we refer to a level of TRV service which is below that to which non-fault claimants are entitled and desire.<sup>1</sup>
  
2. We do not consider the provision of TRV services to fault claimants, as a fault customer’s entitlement to a TRV is based on their insurance policy (in contrast to non-fault customers where the entitlement is based on tort law). A fault customer is usually entitled to a courtesy car or, where the customer has purchased additional cover, a like-for-like TRV. We have no reason to believe that, following an accident, a fault customer experiences any underprovision against their contractual entitlements.
  
3. The procurer of TRV services for most non-fault claimants is not the party which pays for the service. Rather, a claims management company (CMC)/credit hire company (CHC) or non-fault insurer usually procures the service while the fault insurer pays for it. In these circumstances, it does not appear to us that the procurer has any incentive to underprovide TRV services to the non-fault customer. For this reason, in this paper we focus on whether non-fault claimants whose claims are captured by the fault insurer receive a less good quality service than that to which they are entitled. We consider the responses to our survey and also analyse electronic call records provided by the ten large insurers and nine CMCs/CHCs in our sample (using the

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<sup>1</sup> Some non-fault customers might choose to receive a service which is less than their legal entitlement.



provision of TRV services to non-fault claimants by CMCs/CHCs as a comparator).<sup>2</sup>

We focus primarily on the type of TRV provided to the customer and the length of the hire duration.

4. CMCs/CHCs usually provide TRV services to non-fault customers on credit hire terms, whereby a TRV and related services are supplied to the customer on credit and the cost of these services is recovered subsequently from the fault insurer. Fault insurers provide captured customers with a TRV under direct hire terms, whereby the cost of the provision of TRV services is borne by the fault insurer (or, where there is a bilateral agreement, borne by the non-fault insurer and recovered immediately from the fault insurer).

## Summary

5. The results of our survey of non-fault claimants (see the working paper 'Survey report') suggest that there is the potential for the underprovision of TRV services to non-fault claimants due to some uncertainty among claimants of their legal entitlements.
6. However, the survey also suggests that the vast majority of non-fault claimants are satisfied that the TRV services they received following an accident met their needs (or exceeded them), both in terms of the quality of the TRV provided and the hire duration, regardless of whether their claim was managed by the non-fault insurer, a CMC/CHC or the fault insurer (as a result of being captured).
7. We note that, although representing a small minority of the relevant customers surveyed, dissatisfaction in relation to the type of car was significantly higher among captured claims than claims handled by the non-fault insurer, which could suggest

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<sup>2</sup> However, we acknowledge that CMCs/CHCs might have an incentive to overprovide TRV services to non-fault customers and therefore we do not presume that providing a lesser service would necessarily represent underprovision.

some underprovision by fault insurers. The results of our initial review of a small sample of insurer and CMC/CHC electronic call records also suggest that there is a greater likelihood of receiving a lower quality TRV if captured by the fault insurer than if the claim is handled by a party other than the fault insurer (ie a non-fault insurer or CMC/CHC). However, we acknowledge that this does not necessarily indicate underprovision, as identifying and meeting a customer's needs may be conducted more effectively by fault insurers than by parties which have no incentive to keep costs down. We intend to extend our analysis of call records further.<sup>3</sup>

**Aviva Comment** - We do not agree with a difference in quality of TRV, particularly as the cars are usually provided by similar hire car companies. We try to provide a car the customer is happy to accept and mitigate their claim but ultimately will give a like for like. It is not so much an issue of quality issue; more matching the needs and requirements of the customer.

## Outline of the paper

8. In this paper, we examine:
  - (a) background to the provision of TRV services to non-fault claimants;
  - (b) non-fault claimants' awareness of their legal entitlements in relation to TRV services;
  - (c) non-fault claimants' views on the type of TRV provided and the hire duration;
  - (d) data on the provision of TRV downgrades (where the customer received a TRV of a lower class than their own vehicle); and
  - (e) evidence from electronic call records provided to us by insurers and CMCs/CHCs.

## Background

### *Legal framework*

9. A fault insurer is legally responsible (on behalf of the fault party) for the reasonable costs of restoring the non-fault driver to their pre-accident position. If the non-fault driver's vehicle is temporarily unavailable (generally due to repairs), this involves compensating the non-fault driver for the temporary loss of use of their vehicle. The

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<sup>3</sup> What is of particular interest to us in listening to these call records is the approach taken by the handler of the call in the assessment of a claimant's needs.

non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need<sup>4</sup> for an alternative vehicle can be established. In practice, this usually involves the provision of a TRV which is broadly equivalent to the customer's own vehicle (often referred to as a 'like-for-like' TRV) for as long as is reasonably necessary.<sup>5</sup> This is subject to the non-fault driver's duty to mitigate their loss with consideration to their need.<sup>6</sup>

### ***Provision of TRV services to non-fault claimants***

10. Non-fault claimants can either claim under their own private motor insurance (PMI) policy (in which case the non-fault insurer manages the claim), or their claim can be managed by a CMC/CHC (usually following a referral by the non-fault insurer, broker or another party), or the fault insurer may capture their claim. Elements of a non-fault claim (eg repairs and TRV provision) may be handled by different parties.
  
11. When non-fault claimants make a claim under their own PMI policy, they typically receive a TRV in accordance with the terms of their policy. This may be a courtesy car from the non-fault insurer's repairer (if the non-fault insurer is also managing the customer's repair) or, where the customer has purchased additional cover, a like-for-like TRV from the non-fault insurer's direct hire TRV provider.<sup>7</sup> On occasion, if the non-fault insurer is satisfied that the customer is not responsible for causing the accident, it might provide a vehicle of a higher class (compared with the customer's contractual entitlement) because it believes the customer is entitled to it under tort law and therefore the cost of this vehicle can be recovered from the fault insurer.

**Aviva Comment** – This is not correct and insurers will only be able to do this where a bilateral exists, because otherwise they are exceeding the policy cover and do not have a strict legal right of subrogation. We would however, if the circumstances were correct refer into a CHC as per paragraph 12. Aviva is not aware of insurers providing more than the cover unless a bilateral is in place.

It is not always like for like provision which customers purchase, this may be simply enhanced, which can be a class of vehicle higher than a courtesy car, but a lower standard to that which the policyholder owns.

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<sup>4</sup> In the case of a private individual who has lost access to their vehicle following a road accident, the scenarios in which they would clearly not have need for an alternative vehicle are likely to be relatively limited (eg because they have access to another vehicle or because they are on holiday abroad for the period in which their own car is unavailable).

<sup>5</sup> The hire duration is usually determined by the repair duration.

<sup>6</sup> A non-fault driver can only claim the costs of credit associated with a credit hire if they can demonstrate that it was reasonable in the circumstances to hire the TRV on credit (ie the customer is impecunious). However, the assessment of what the tort law entitlement requires in a given case will be informed by the specific facts of that case, which, in view of the nature of the 'impecuniosity test', may lead to some practical difficulties for CMCs/CHCS in assessing whether a non-fault customer requires a TRV on credit terms. We do not consider credit further in this paper.

<sup>7</sup> We discuss how the potential disadvantages for non-fault claimants from claiming under their own PMI policy could lead to consumer harm in the working paper 'ToH 2: Underprovision of repairs'.

12. If the non-fault insurer or broker controls a customer's non-fault claim, they may refer the non-fault customer to a CMC/CHC (in return for a referral fee). Assuming the CMC/CHC also assesses the customer to be non-fault, the CMC/CHC will then provide the customer with a like-for-like TRV, subject to some checks regarding the customer's duty to mitigate their loss, with consideration to their need. The CMC/CHC will recover the cost from the fault insurer.
  
13. Direct hire applies principally when a fault insurer captures a non-fault claim, or when a non-fault insurer is party to a bilateral agreement with the relevant fault insurer, or when the fault insurer and the non-fault insurer are the same.<sup>8</sup> Some non-fault claimants whose claims are handled by the fault insurer receive a courtesy car from the fault insurer's repairer handling the repair rather than from the fault insurer's direct hire provider.
  
14. Table 1 summarizes the different ways in which a non-fault claimant may receive a TRV.

TABLE 1 Typical provision of TRV services to non-fault claimants

<i>Insurer controlling claim</i>	<i>Credit hire</i>	<i>Direct hire</i>
Fault insurer	N/A	Referral of captured non-fault customer to a direct hire provider. On average, 35 per cent (a range of 10 to 81 per cent across nine of the ten largest insurers) of captured non-fault customers receive a direct hire TRV. (The remaining captured non-fault customers receive a courtesy car through an approved repairer or do not require a TRV.)
Non-fault insurer	Referral to a CMC/CHC for credit hire. On average, 38 per cent (a range of 10 to 81 per cent across nine of the top ten insurers) of non-fault customers managed by a non-fault insurer receive a credit hire TRV. (The remaining customers receive a courtesy car, a direct hire TRV under their own PMI policy, a direct hire TRV for the reasons set out in the next box, or do not require a TRV).	Referral to a direct hire provider if fault insurer and non-fault insurer are party to a bilateral agreement or if fault insurer and non-fault insurer are the same.

Source: See Appendix 1.

<sup>8</sup> Six of the ten CMCs/CHCs in our sample (Accident Exchange, Ai Claims Solutions, Enterprise, Helpfire, Kindertons and WNS Assistance) told us that they provided direct hire services to fault customers and captured non-fault customers (following a referral from the fault insurer).

## **Non-fault claimants' awareness of their legal entitlements**

15. We considered the extent of non-fault claimants' awareness of their legal entitlements in relation to the provision of TRV services. We noted that there could be greater potential for the underprovision of TRV services where a non-fault claimant is unaware of their rights.
16. Our survey of non-fault claimants sought to investigate this issue.<sup>9</sup> Further discussion of this survey evidence can be found in the working paper 'ToH 2: Analysis of the results of the non-fault survey in relation to underprovision', and the underlying results are presented in the working paper 'Survey report'.
17. 33 per cent of respondents to our survey said that they were made aware of all or some of their legal rights at some point during the claims process following an accident. Those whose claim was managed by the non-fault insurer or a CMC/CHC were more likely to say that they were made aware of their legal rights than those whose claim was managed by the fault insurer (35 per cent, 47 per cent and 28 per cent respectively).
18. 76 per cent of respondents to our survey said that, at the time of the accident, they thought that they were legally entitled to a TRV.<sup>10</sup> 92 per cent of these respondents were either offered or asked for a TRV and 79 per cent of these respondents received a TRV. Where a TRV was requested but not received (this only occurred in 22 cases out of the 1,500 in our sample), the primary reason was that the customer was told that they were not entitled to a TRV under their PMI policy.

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<sup>9</sup> In interpreting these results, we recognize that survey responses are subject to error, that the sources for this analysis are respondents' perceptions, which are inherently subjective and not based on an objective assessment of post-accident services, and that there may be other factors influencing these responses.

<sup>10</sup> We note that the responses may have been influenced by the respondents' experiences after the accident rather than reflecting their knowledge at the time of the accident.

19. 64 per cent of the respondents to our survey who thought at the time of the accident that they were legally entitled to a TRV believed that they were legally entitled to a TRV that met their needs but was not better than the vehicle damaged.

### ***Our assessment***

20. The results of our survey suggest that there is some potential for the underprovision of TRV services to non-fault claimants due to some claimants being unclear about their legal entitlements in relation to TRV services. This appears to be particularly the case for captured non-fault claimants.

### **Non-fault claimants' views on the type of TRV and the hire duration**

21. Our survey of non-fault claimants also investigated both the type of TRV provided to non-fault claimants and the length of the hire duration.

### ***Type of TRV***

22. 85 per cent of respondents to our survey who received a TRV stated that it at least met their needs. However, 14 per cent of respondents said that the TRV fell short of their needs (9 per cent of respondents said that it fell slightly short of their needs and 5 per cent of respondents said that it fell well short of their needs). The main reasons why these respondents felt that the TRV they received fell short of their needs were that it was less spacious or smaller than their own vehicle, it was a worse make/model than their own vehicle and/or it had a less powerful or smaller engine than their own vehicle.
23. Of the respondents who said that the TRV they received fell short of their needs, dissatisfaction was significantly higher among captured claimants (19 per cent) than where the non-fault insurer handled the claim (13 per cent), which could suggest some underprovision by fault insurers.



### ***Hire duration***

24. 87 per cent of respondents to our survey who received a TRV felt that they had access to the TRV for the right amount of time for their needs, and three per cent of respondents who received a TRV felt that they had access to it for longer than needed. However, 9 per cent of respondents felt they did not have the vehicle for long enough. The main reasons given by respondents for requiring the TRV for longer than it was provided were that they did not have access to any other vehicle or another suitable vehicle during the repair and they needed time to find a vehicle to purchase (ie in cases of a write-off).
25. Of the respondents who said that the TRV was not provided for long enough, dissatisfaction was slightly higher among captured claims (9 per cent) than where the non-fault insurer handled the claim (8 per cent).

**Aviva Comment** - This difference of 1% is not significant and we feel represents the fact the TRV service provided is broadly similar whoever provides it

### ***Our assessment***

26. It appears that the vast majority of non-fault claimants are satisfied with the TRV services they receive following an accident, both in terms of the quality of the TRV and the hire duration. However, where there is dissatisfaction, this appears to be greater in relation to the type of TRV provided (and marginally greater in relation to the length of the hire duration) among captured non-fault claimants (who are typically provided with TRV services under a direct hire agreement) than among non-fault claimants whose claims are handled by the non-fault insurer (who are typically provided with TRV services under a credit hire agreement).

### **TRV downgrades**

27. The non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need for an alternative vehicle can be established (see paragraph 9).

In practice, this usually involves the provision of a 'like-for-like' TRV for as long as is

reasonably necessary, subject to the non-fault driver's duty to mitigate their loss with consideration to their need.

28. However, sometimes non-fault customers receive a TRV of a lower class than their own vehicle (ie a downgrade). This can occur when:
- (a) The age of the customer's vehicle does not justify a like-for-like TRV. Where the customer's vehicle is six years old or older, the General Terms of Agreement (GTA) requires the CMC/CHC to provide a TRV of a lower class than the customer's vehicle (subject to the need for a vehicle at all). For example, [X] told us that, in certain GTA vehicle groups, where the customer's vehicle is over ten years old, the TRV provided was typically two vehicle groups lower than the customer's own vehicle, although the specific circumstances of a customer's need must also be considered.
  - (b) The customer is encouraged to accept a lower class TRV by the claims handler. [X] told us that, when direct hire customers were provided with a downgrade, it was the fault insurer which determined the category of vehicle to be supplied to the customer.
29. Table 2 sets out the proportion of TRV downgrades to non-fault customers for the nine CMCs/CHCs in our sample, in relation to both credit hire and direct hire customers in 2012. We note that the proportion of TRV downgrades to non-fault customers under a direct hire agreement may be inflated by the inclusion of some fault claims, as a fault customer may be entitled to a TRV on a direct hire basis under their policy (subject usually to them purchasing the appropriate additional cover).

TABLE 2 Proportion of TRV downgrades to non-fault customers, 2012

CMC/CHC	per cent	
	Proportion of credit hire customers provided with downgrades	Proportion of direct hire customers provided with downgrades*
Accident Exchange	[X]	[X]
ACM†	[X]	[X]
Ai Claims Solutions	[X]	[X]
ClaimFast‡	[X]	[X]
Crash Services§	[X]	[X]
Enterprise	[X]	[X]
Helphire	[X]	[X]
Kindertons	[X]	[X]
WNS Assistance	[X]	[X]
<b>Unweighted average</b>	<b>15</b>	<b>30</b>

Source: CMCs/CHCs.

\*The direct hire data may include fault claims.

†ACM does not provide credit hire or direct hire services.

‡ClaimFast does not provide direct hire services, except as an outsourced function for [X].

§Crash Services does not record the proportion of downgrades to credit hire customers (as they are infrequent) and does not provide direct hire services.

30. Table 2 shows that between [X] and [X] per cent of direct hire customers were downgraded compared with between [X] and [X] per cent of credit hire customers. This suggests that more non-fault customers are encouraged to accept a TRV of a lower class than their own vehicle when captured by the fault insurer than when handled by another party. However, we note that the data set is limited and two of the three CMCs/CHCs which provided data for both direct hire and credit hire actually downgraded a greater proportion of their credit hire customers than their direct hire customers ([X] and [X]).

### Review of insurer and CMC/CHC electronic call records

31. We reviewed a small sample of electronic call records provided by the ten largest PMI insurers and nine CMCs/CHCs in order to assess whether there was any evidence of the underprovision of TRV services to non-fault claimants.

### Review of insurer electronic call records

32. Table 3 summarizes 11 insurer call records (one non-fault claim and ten captured non-fault claims) in each of which the non-fault customer was provided with a TRV.

TABLE 3 Insurer electronic call records involving the provision of TRV services to the non-fault customer

<i>Insurer</i>	<i>Type of hire</i>	<i>Level of TRV provided</i>
<i>Non-fault claim</i> [X]	Credit hire	Like-for-like
<i>Captured non-fault claims</i> [X]	Direct hire	Like-for-like
[X]	Direct hire	Not disclosed
[X]	Direct hire	Like-for-like
[X]	Direct hire	Lower class
[X]	Direct hire	Lower class
[X]	Direct hire	Lower class
[X]	Direct hire	Like-for-like
[X]	Direct hire	Not disclosed
[X]	Direct hire	Like-for-like
[X]	Direct hire	Like-for-like

Source: Insurers.

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33. Table 3 shows that, of the 11 insurer calls resulting in the provision of a TRV to a non-fault customer that we have reviewed so far, only one related to the insurer’s non-fault customer (rather than a captured non-fault customer). This customer received a like-for-like vehicle under credit hire.
34. We have so far reviewed ten insurer calls where a captured non-fault customer was provided with a TRV under direct hire:
- (a) In two cases, the type of TRV provided was not discussed between the insurer and the customer.
  - (b) In five cases, the captured non-fault customer was provided with a like-for-like TRV. In one of these cases, the customer demonstrated a genuine need for a like-for-like TRV but, in the remaining four cases, the claims handler did not appear to assess whether the customer required a like-for-like TRV or whether a TRV of a lower class would have met their needs.<sup>11</sup> We note that, although a fault insurer has the incentive to minimize the cost of TRV services to a captured non-fault customer, if it offers a poor quality of service the customer may go to a

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<sup>11</sup> We note that such an assessment might have been carried out at a later stage in the process. Also, by focussing only on cases where a TRV was provided, we have not captured those cases where there was an assessment of the customer’s need, which resulted in no TRV being provided.

CMC, which is likely to be more expensive for the fault insurer (due to higher daily rates and, possibly, a longer hire duration).

(c) In three cases, the captured non-fault customer was provided with a TRV of a lower class than their own vehicle. In these cases, the customer was encouraged to accept a lower class of TRV, as this appeared sufficient for their needs.

**Review of CMC/CHC electronic call records**

35. Table 4 summarizes 11 CMC/CHC call records, in each of which the non-fault customer was provided with a TRV.

TABLE 4 CMC/CHC electronic call records involving the provision of TRV services to the non-fault customer

<i>CMC/CHC</i>	<i>Type of hire</i>	<i>Level of TRV provided</i>
[REDACTED]	Credit hire	Like-for-like
[REDACTED]	Credit hire	Not disclosed
[REDACTED]	Credit hire	Lower class
[REDACTED]	Credit hire	Like-for-like
[REDACTED]	Credit hire	Like-for-like
[REDACTED]	Credit hire	Like-for-like
[REDACTED]	Credit hire	Like-for-like
[REDACTED]	Credit hire	Like-for-like
[REDACTED]	Credit hire	Not disclosed
[REDACTED]	Credit hire	Like-for-like
[REDACTED]	Credit hire	Not disclosed

Source: CMCs/CHCs.

36. We have so far reviewed 11 CMC/CHC calls where a non-fault customer was provided with a TRV under credit hire:

(a) In three cases, the type of TRV provided was not discussed between the CMC/CHC and the customer.

(b) In seven cases, the non-fault customer was provided with a like-for-like TRV. In two of these cases, the customer demonstrated a genuine need for a like-for-like TRV. In the remaining five cases, the claims handler did not appear to assess whether the customer required a like-for-like TRV or whether a TRV of a lower class would have met their needs.<sup>12</sup> This may indicate some overprovision of

<sup>12</sup> See footnote to paragraph 34(b).

TRV services as, for some of these customers, a lower class of vehicle might have been sufficient to meet their needs.

(c) In one case, the non-fault customer was provided with a TRV of a lower class than their own vehicle. In this case, the customer was encouraged to accept a lower class of TRV, as this appeared sufficient for their needs.

### ***Our assessment***

37. Given that determining the level of TRV service which will meet a claimant's tort law entitlement involves an assessment of the specific facts of a case,<sup>13</sup> our particular interest in listening to a sample calls was the approach taken by the claim handler (captured non-fault, non-fault or CMC/CHC) to assess the claimant's needs (ie the kinds of enquiries made). We recognise that claims handlers process a large volume of claims, and seek to do so efficiently, in order to ensure non-fault claimants are not underprovided in their need for a TRV.
38. Overall, we have so far reviewed 12 call records where a non-fault customer was provided with TRV services under a credit hire agreement and ten call records where a captured non-fault customer was provided with TRV services under a direct hire agreement.
39. Where the type of TRV to be provided to the customer was discussed between the call handler and the customer, the majority of customers received a like-for-like TRV, irrespective of whether the TRV was provided under a credit hire or direct hire agreement. However, in the small number of calls which we have reviewed so far, there was a greater likelihood of receiving a lower quality TRV if captured by the fault insurer (3 in 10 compared with 1 in 12). Also, around half of the non-fault claimants

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<sup>13</sup> The non-fault driver is entitled to recover the reasonable costs of car hire provided the reasonable need for an alternative vehicle can be established.

who received a TRV received a like-for-like TRV without having to explain why it was needed (6 in 12 of those handled by a CMC/CHC/non-fault insurer and 4 in 10 of those captured by the fault insurer).

40. Given the small number of calls which we have listened to so far, we treat this evidence with caution. We intend to listen to more such calls.



## Routes to the provision of TRV services

TABLE 1 Proportion of non-fault claimants who receive a credit hire TRV

<i>Insurer</i>	<i>Proportion of non-fault claimants who receive a credit hire TRV (%)*</i>
Admiral	[REDACTED]
Ageas Insurance	[REDACTED]
Aviva	[REDACTED]
AXA UK	[REDACTED]
AXA Northern Ireland	[REDACTED]
CISGIL	[REDACTED]
Direct Line	[REDACTED]
Esure	[REDACTED]
LV=	[REDACTED]
RSA	[REDACTED]
Zurich	[REDACTED]
<b>Unweighted average</b>	<b>38</b>

Source: CC analysis of data from the parties.

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\*This data is limited to non-fault claims notified to non-fault insurers and cases where the non-fault insurer knows that a credit hire vehicle has been provided.

TABLE 2 Proportion of captured non-fault claimants who receive a direct hire TRV

<i>Insurer</i>	<i>Proportion of captured non-fault claimants who receive a direct hire TRV (%)</i>
Admiral	[REDACTED]
Ageas Insurance	[REDACTED]
Aviva	[REDACTED]
AXA UK	[REDACTED]
AXA Northern Ireland	[REDACTED]
CISGIL	[REDACTED]
Direct Line	[REDACTED]
Esure	[REDACTED]
LV=	[REDACTED]
RSA	[REDACTED]
Zurich	[REDACTED]
<b>Unweighted average</b>	<b>35</b>

Source: CC analysis of data from the parties.

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\*[REDACTED] figures include the provision of both direct hire TRVs and courtesy cars to non-fault customers.

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 3: Horizontal concentration in PCWs

#### Introduction

1. Price comparison websites (PCWs) have grown in popularity in recent years, reflecting increasing Internet usage and following high-profile advertising campaigns. Consumers are attracted to these sites in order to search quickly and to be able to compare across a range of private motor insurance (PMI) policies online (as well as other goods and services). PMI providers are incentivized to participate on the sites in order to reach potential customers.
2. The services of PCWs are 'free' to consumers in the sense that they do not pay to search. However, each time a consumer purchases a PMI policy, the PMI provider (ie insurer or broker) pays a cost-per-acquisition (CPA) fee.
3. PCWs are a significant sales channel for new business, both for those purchasing PMI for the first time and for those switching from their previous provider.
4. There are four large PCWs, which together constitute the vast majority of sales via this channel: Comparethemarket, Gocompare, MoneySupermarket and Confused.
5. In our statement of issues, we said that we would consider whether the level of concentration in PCWs gave rise to competition concerns. Such concerns may arise if the level of concentration results in one or more PCW having market power, which could allow that PCW to charge higher CPA fees to PMI providers. High CPA fees might, in turn, be passed on to consumers in the form of higher insurance premiums.

## Summary

6. PCWs compete to win customers through advertising and marketing, by providing access to a wide range of competitive PMI policies and by offering a good customer experience. Of these, advertising and promotions appear to have had the biggest impact on the relative success of PCWs, giving rise to rapid changes in the share of supply between PCWs.
7. The direct impact of advertising campaigns and promotions appears to have been driven by consumer behaviour as many consumers have shown little loyalty to a particular PCW and have tended to compare policies on multiple websites and alternative channels, eg on PMI providers' own websites and by telephone. However, it appears that customers are, on average, shopping around less as the proportion of new customers (ie those using a PCW for the first time) declines, which suggests that the focus of competition between PCWs might change, from attracting new customers to encouraging further purchases from previous customers. Overall, though, it appears that the costs for consumers switching between PCWs are low and customers are probably still willing to switch PCWs if the offering of the PCW they currently tend to use declined.
8. PCWs compete with other sales channels to attract some customers but it appears that a large proportion (around half) of consumers who use PCWs use no other sales channel.
9. PCWs also compete to attract insurers and brokers to offer quotes on their websites, and to get exclusive pricing and promotional offers (both of which make the PCW more attractive to consumers). PCWs compete to attract PMI providers by offering access to potential customers, charging low CPA fees, and providing additional information and data services.

10. The ability of PMI providers to constrain the CPA fees charged by PCWs depends on their relative bargaining position with respect to PCWs. It appears to us that this depends on three factors:
- the relative importance of the PCW for the PMI provider: PCWs are an important source of new business for PMI providers and most PMI providers would lose sales by delisting from any of the four large PCWs;
  - the relative importance of the PMI provider for the PCW: there is some evidence that large or specialist PMI providers are in a better bargaining position than other PMI providers; and
  - customer behaviour: PMI providers are less reliant on a PCW if its customers shop around other PCWs or sales channels (or if they would if premiums rose).
11. Overall, it appears to us that the four large PCWs have some bargaining power against PMI providers as PMI providers believe that they would lose a significant volume of sales by delisting from any of the large PCWs. However, there is also evidence that PCWs face constraints in their ability to raise CPA fees to PMI providers. For example, large PMI providers typically pay lower CPA fees than small PMI providers (although the negotiating power of PCWs may still lead to an increase in CPA fees to PMI providers on average). Moreover, CPA fees are constrained by the possibility that many consumers shop around and PMI providers may be able to reach potential customers via other PCWs or sales channels. It appears to us that the constraint from other retail channels will depend on the proportion of customers who shop around and the relative cost to the PMI provider of using these other channels (eg selling direct). It will also depend on the scope and coverage of any Most Favoured Nation (MFN) clauses (see the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers').

12. The results of our survey of PMI policyholders (see the working paper 'Survey report') show that a relatively low proportion (10 per cent) of consumers searched on only one PCW and did not shop around further (ie 'single-homing'). This would suggest that, for a PMI provider, each of the four large PCWs has approximately 2.5 per cent of potential PMI consumers who may not be reachable except through that site. In our view, since 97.5 per cent of potential customers are available through other PCWs or other sales channels, this suggests that a PCW may be constrained in raising CPAs.
13. However, we note that, of PMI consumers who last shopped around on a PCW (rather than all PMI consumers), 37 per cent only checked prices on a single PCW. This suggests that, for a PMI provider which only sold via PCWs, each of the four large PCWs would have approximately 9 per cent of potential consumers who may not be reachable except through that site. While higher than the proportion of all consumers, we consider that this is still a relatively low proportion. We also note that the proportion of 'single-homing' customers is likely to be higher in the presence of MFNs as more searching is less likely to result in finding a better deal.
14. We also found that CPA fees have risen only slightly during recent years, at near or below the rate of general inflation, while at the same time, PCWs have become a more important sales channel and the propensity for consumers to shop around has declined. Overall, it appears to us that this is consistent with PCWs having faced some constraint when setting their CPA fees.
15. We found that there is some evidence of the existence of barriers to entry or expansion for PCWs, including the use of MFN clauses and the substantial sums the four large PCWs spend on advertising. Also, we found little to suggest that the four large PCWs are constrained by the prospect of new entry.

**Aviva Comment** - Aviva considers that all forms of MFN are inherently problematic as they inhibit insurance providers from differentiating (particularly by price) between distribution channels and providing a wide range of offerings to customers.

MFNs mean that insurance providers are not able to provide cheaper prices to customers in channels which have lower costs of acquisition; and even MFNs which only require parity between a PCW and the insurance provider's own website (so called "narrow" MFNs) are problematic. AVIVA believes these could suppress the growth in market sales for lower cost distribution channels such as digital and social media and could restrict competition.

16. We examined the profitability of [redacted] PCWs and found that, in aggregate, they had achieved an operating profit margin of around 25 per cent over the last three years. We did not conduct a more detailed analysis of their profitability but, in our view, this finding could be consistent with [redacted] PCWs having some bargaining power against PMI providers.
17. Overall, it appears to us that the four large PCWs have some bargaining power against PMI providers, derived from the fact that some consumers 'single home' and only search for a PMI policy on one PCW. However, a high proportion of consumers shop around and most PMI providers can utilize other sales channels to reach these consumers. In our view, it does not appear that horizontal concentration alone is likely to give rise to significant market power and is unlikely to be a major source of consumer detriment.
18. Nevertheless, it does appear to us that there are other factors arising from the nature of competition between PCWs which might cause consumer detriment, notably the existence of some wide-scoped MFNs in contracts between PCWs and PMI providers. The effect of these clauses may be to increase PCW market power by, for example, limiting price competition (reducing the incentives for consumers to shop around) and raising barriers to entry (see the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers').

## Background

19. PCWs have grown in popularity in recent years, reflecting increasing Internet usage

and following high-profile advertising campaigns. Consumers are attracted to use these sites in order to search quickly and to be able to compare across a range of PMI policies online (as well as other goods and services). PMI providers participate on the sites in order to reach potential customers.

20. PCWs have emerged as a significant sales channel for PMI, and account for an estimated 23 per cent of all PMI policies sold and between 54 and 56 per cent of new PMI business.<sup>1</sup> Furthermore, Aviva told us that a high proportion of customers used PCWs to search and compare PMI policies, even if they then purchased their preferred policy elsewhere, eg directly from the PMI provider.
21. As recognized by the OFT,<sup>2</sup> when operating effectively, PCWs enable consumers to compare products, reduce the amount of time spent searching and comparing PMI policies, increase price transparency and can potentially increase price competition. They may also be a cost-effective way for PMI providers to reach large numbers of potential customers.
22. The services of PCWs are 'free' to consumers in the sense that they do not pay to search. However, each time a consumer purchases a PMI policy, the PMI provider (ie insurer or broker) pays a CPA fee which ranges from £[£] to £[£].<sup>3</sup>
23. There are currently four large PCWs: Comparethemarket, Gocompare, MoneySupermarket and Confused.
24. We considered whether the level of concentration in PCWs gave rise to competition concerns. Such concerns may arise if the level of concentration results in one or more PCWs having market power, which could allow that PCW to charge higher CPA fees to PMI providers, which might, in turn, be passed on to consumers in the form of higher insurance premiums. On the other hand, if large PCWs benefited from

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<sup>1</sup> Source: Datamonitor.

<sup>2</sup> 'Price comparison websites: trust, choice and consumer empowerment in online markets' (OFT 1467).

<sup>3</sup> Range based on CPA fees charged by the four largest PCWs. PCWs may also provide additional services such as online display advertising and supply of data and information services. We noted, for example, that MoneySupermarket provides PMI providers with information and analysis on their brand's performance on the website.



economies of scale, they might face lower costs, which could be passed on to consumers in the form of lower CPA fees and lower insurance premiums.

25. In this paper, we consider the extent of concentration in PCWs and the effects of this concentration. We consider how PCWs' bargaining power against PMI providers might harm consumers and whether there is any evidence that consumer harm exists.<sup>4</sup>

### **How could concentration in PCWs harm competition?**

26. We considered two ways in which a lack of competitive constraints on the behaviour of PCWs could harm competition.
27. First, we considered if PCWs could raise CPA fees to PMI providers. In the presence of market power, PCWs may use their bargaining position with PMI providers to charge higher CPA fees than they would in the presence of greater competition, ie if there were a larger number of alternative PCWs through which PMI providers could sell. This issue is the focus of this paper.
28. Second, we considered if PCWs could reduce the quality of services to consumers. A PCW with market power could reduce the quality of its services to consumers by, for example, investing less in maintaining and developing its website. This could impact several aspects of its service, including the speed and/or reliability of its website, the sophistication of its search functionality and how up to date and/or thorough is the information provided to consumers. However, it appears to us that PCWs face a strong incentive to attract high numbers of consumers in order to remain attractive to PMI providers, and internal documents supplied to us by PCWs supported this view,

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<sup>4</sup> We discuss other possible competition issues related to PCW in other working papers. We consider the effect of the MFNs in the contracts between PCWs and PMI providers in the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers'; and we consider the effects of the integration of some PCWs with some PMI providers in the working paper 'ToH 5: Vertical relationships involving PCWs'.

highlighting the importance of competition to win consumers via marketing strategies and by maintaining the quality of customers' experiences using their websites. Therefore, we do not consider this issue further.

29. In this paper, we focus on the constraints PCWs face in charging PMI providers higher fees (or imposing other price restrictions).
30. We noted that there were two ways in which higher CPA fees might harm consumers:
- (a) they might be passed on to consumers in the form of higher insurance premiums; and
  - (b) a PMI provider might choose to delist from the PCW or might limit the types of customers for which it is willing to quote through the PCW. In this case, a consumer may face higher search costs or miss out on the most suitable policy.

### Extent of concentration between PCWs

31. As shown in Table 1, PMI search activity and PMI purchases on PCWs are concentrated in four providers: Comparethemarket, Gocompare, MoneySupermarket and Confused.

TABLE 1 Share of PMI search activity and PMI policies sold

PCW	Per cent who searched		Policies sold 2012‡
	Datamonitor (2012)*	CC consumer survey†	
Comparethemarket	67	42	[X]
MoneySupermarket	48	23	[X]
Gocompare	43	45	[X]
Confused	49	17	[X]
Other	5	13	N/A

\*Percentage of consumers who used each PCW, based on those consumers who purchased via a PCW. Source: Datamonitor's General Insurance Consumer Survey 2012.

†Respondents were asked which PCW(s) they looked at when they last compared insurance providers or policies. PCWs included within 'Other' were: Call & Compare, Compare NI, Google, Money Saving Expert, Quote Zone, Tesco Compare, uSwitch and several others.

‡Source: data provided by PCWs.

32. The discrepancy between the Datamonitor results and the results of our survey (see the working paper 'Survey report') in relation to search behaviour is likely to reflect the different sample groups surveyed. While the Datamonitor results show the behaviour of consumers who purchased their PMI policy using a PCW, the results of our survey show the behaviour of consumers who searched on at least one PCW the last time they compared PMI providers, but who may have made their purchase of PMI through another sales channel.
33. We asked the PCWs about which firms they perceived to be their competitors. The four large PCWs [X].
34. We reviewed some of the internal documents of the four large PCWs and found that [X].
35. The low proportion of searches made on PCWs other than the four large PCWs and [X] suggests to us that the small PCWs may represent a weak constraint on the behaviour of the four large PCWs.
36. We considered the intensity of the competitive interaction between the four large PCWs, with respect to both competition for consumers searching for PMI policies and competition to attract PMI providers.

### **Competition for consumers**

37. We considered both competition for consumers between PCWs and competition between PCWs and other sales channels.

## **Competition between PCWs**

38. We reviewed some of the internal documents of the four large PCWs, and some publicly available information, and noted that PCWs appear to compete against each other to attract consumers by, among other things:

- marketing and advertising: each of the four large PCWs tries to create an awareness of its service and a strong brand through:
  - television advertising;
  - online search engine optimization and paid advertising; and
  - non-price promotions, such as free toys and Nectar points;
- providing access to a wide range of PMI providers and price-competitive PMI policies: in particular, policies which are of lower, or at least equal, cost to those available through rivals; and
- offering a good customer experience: the websites are designed to make a customer journey easy and to minimize the number of steps through which customers have to go before getting a quotation.

39. We considered how the market shares of the four large PCWs had changed in recent years as an indicator of the extent of rivalry between them. Figure 1 shows the results, indicating that there have been significant movements in market shares over the last five years.

FIGURE 1

### **Share of policies sold via PCWs, 2006 to 2012**

[✂]

Source: [✂].

40. We found that Confused's internal documents indicated that changes in shares of supply had been driven by the success (or failure) of marketing campaigns and promotions. These documents noted, for example, that:

- Gocompare became the most-used PCW in 2009 after launching the Gio character in its advertisements; and
- Comparethemarket increased its market share after launching its meerkat commercials, later becoming the most-used PCW after launching its meerkat toys promotion in 2011.

41. It appears to us that the significant impact of advertising campaigns and promotions in driving consumer behaviour is indicative of a lack of consumer loyalty to any specific PCW. We noted that MoneySupermarket's board observed in February 2010 that 'price comparison sites appear to fall out of consumers' consciousness quickly when they stop advertising their services on TV'. Similarly, Confused's board observed that 'there is no innate loyalty to price comparison sites – customers often can't remember which site they used, or even if they used a price comparison site'.

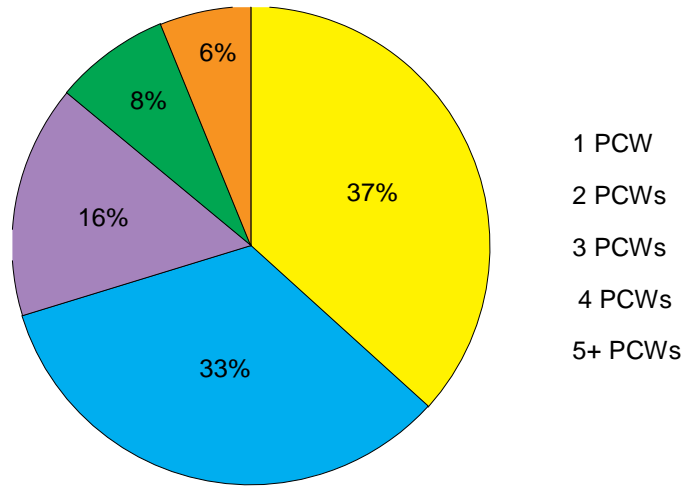
42. Successful marketing campaigns may attract consumers to search on a PCW but our survey of PMI policyholders found that 63 per cent of the customers of PCWs search on multiple PCWs, as shown in Figure 2 (see working paper 'Survey report'). On average, consumers searched on 2.2 PCWs the last time they shopped around for PMI.<sup>5</sup> As noted in a business plan presentation from Confused, the propensity for consumers to shop around appears to have been driven by the fact that they 'see little, if any, difference between the price comparison sites in terms of performance or customer experience.'

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<sup>5</sup> Similarly, MoneySupermarket told us that consumers searched on an average of 2.8 PCWs before making a purchase decision and its internal strategic plan noted that [X] per cent of enquirers compared two aggregators or more.

FIGURE 2

**How many PCWs did consumers use the last time they used a PCW to research PMI?**





Source: CC Consumer Survey.

Note: Respondents were asked 'Which Price Comparison Websites did you look at'. (Base: all those who used price comparison websites last time they made a comparison, excluding 'don't know' answers, unweighted sample size = 724)

### *Features of competition between PCWs for consumers*

43. Since many consumers shop around, PCWs compete to provide consumers with a better PMI policy than their rivals, whether in price or other features.
44. Many consumers use PCWs to find the cheapest PMI policy. MoneySupermarket told us that it estimated the proportion of customers on its website who bought the cheapest policy was 57 per cent. Datamonitor estimated that 37 per cent of customers who purchased from a PCW selected the cheapest quote.
45. MoneySupermarket told us that range was another important feature of competition for consumers, saying that a PCW needed to compare 'as many motor insurers as possible including the market leading and/or well known motor insurers in order to compete with other PCWs'. An internal board document from Confused confirmed that it monitored the number of PMI providers available through its competitors and said that it was 'critical' to offer more choice.
46. We found that competition between PCWs has been focused on attracting customers who actively shop around and are not loyal to a particular PCW. For example, [redacted]. We also found that the target of instilling loyalty among customers [redacted]. For example, we saw in [redacted]. We noted that PCWs usually send renewal emails to re-attract previous customers and to make use of the information provided by a customer during past searches.
47. As evidence of a lack of consumers' loyalty, [redacted].<sup>6</sup> However, we noted that many of

the customers who did not buy again from the same PCW did not buy a new policy on a different PCW or through a different channel, but renewed the policy directly with the same insurer (renewals account for an estimated 59 per cent of all policies sold<sup>7</sup>). We also found that the proportion of customers returning to the same PCW may be increasing. An internal document from [redacted].

48. We recognized that, even if consumers' propensity to shop around were to decline, this would not in itself indicate that switching costs were particularly high or that customers would not be willing to switch if their 'preferred' PCW's proposition declined. A sufficient number of active customers may remain to constrain the behaviour of PCWs effectively.

**Aviva Comment** - Notwithstanding, Aviva believes there would clearly be an incentive for PCWs to increase CPAs if customers did not shop around

### ***Competition between PCWs and other sales channels***

49. Customers can purchase PMI policies through several alternative sales channels: directly from an insurer (online, by telephone, by post or in a branch), from a broker (through the same mediums), via a PCW, etc. The extent to which PCWs compete with other sales channels to win customers will depend on the ability and willingness of customers to switch to these other sales channels.

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<sup>6</sup> [redacted].

<sup>7</sup> Source: Mintel.



50. To assess the importance of the different channels for the sale of PMI we looked at market research reports and responses to our survey. Respondents to our survey of PMI policyholders were asked what sales channel they used when they first purchased their PMI policy from their current provider (see the working paper 'Survey report'). Responses included 'over the phone', which accounted for 42 per cent of sales; 33 per cent said that they purchased online via a PCW; 9 per cent said they purchased through an insurer's or brokers' website;<sup>8</sup> and 7 per cent purchased the policy in person.
51. An estimated 23 per cent of PMI policy sales are through PCWs (see paragraph 20). However, the total base from which this 23 per cent is derived includes sales to customers who opted to renew their policy with their current provider, and renewals account for about 59 per cent of all policies sold (see paragraph 47). Therefore, PCWs account for a greater proportion of new business (ie customers purchasing PMI for the first time or switching from their previous provider). Our survey found that 33 per cent of new PMI business was through a PCW (see working paper 'Survey report'); and Datamonitor estimates that, as of September 2012, between 54 and 56 per cent of new PMI business was bought through PCWs.<sup>9,10</sup>
52. The reason for the large discrepancy between the results of our survey and those of Datamonitor is not clear. One explanation is that the share of new sales attributed to PCWs in our survey might be understated if any respondents answered with respect to their last policy purchase rather than with respect to the last time they switched PMI provider (as a number of respondents will have renewed their policy).

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<sup>8</sup> In total, 46 per cent of respondents said that they first purchased their PMI policy from their current provider 'online'.

<sup>9</sup> Source: Datamonitor.

<sup>10</sup> [X]

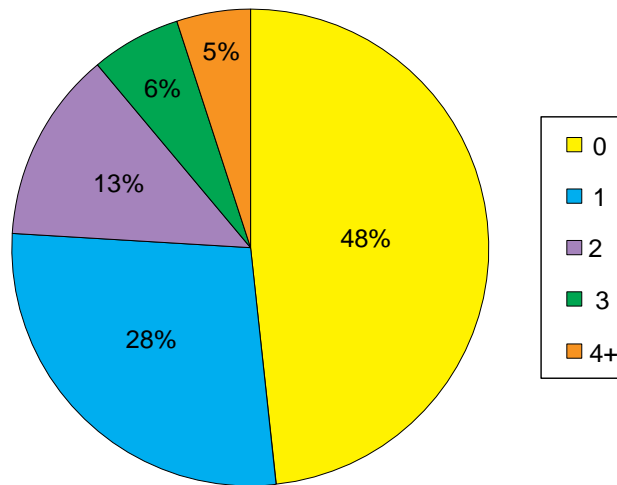
53. Recognizing that changes in the shares of supply between different sales channels could be informative of the degree of rivalry between sales channels, we asked the ten largest UK PMI insurers to provide data on their new PMI business won by different sales channels in the last three to five years. Five insurers provided us with data which we could meaningfully compare. This data indicated that PCWs had become relatively more important as a source of new business for insurers, especially compared with call centres, suggesting that the constraint on PCWs from sales made by phone is likely to have declined over recent years.
54. However, we also recognized that shares of supply were less likely to be informative on the closeness of competition between sales channels if the different channels were differentiated, for example by catering for different customer needs. We noted that survey results presented in MoneySupermarket's Strategic Plan for 2012–14 showed that among the most common reasons for people not buying through a PCW (after using it to compare prices) was a preference for talking through options with someone and the possibility of discounts or cashbacks when contacting an insurer directly. This suggested that at least some consumers used a PCW for searching for PMI but were unlikely to use it for purchasing PMI, possibly limiting the extent to which the PCW would compete against other sales channels.

**Aviva Comment** - A significant revenue stream of PCWs are insurance provider sales that originate from PCWs but where the customer completes the purchase over the phone with the insurance provider. In such instances the insurance provider pays commission to the PCW. This is a significant portion of PCW sales and a customer base that Aviva targets through the General Accident brand.

55. We considered the extent to which consumers used multiple search tools as another piece of evidence in assessing consumers' willingness to switch. The results of our survey of PMI policyholders indicated that 52 per cent of those who last checked PMI prices on a PCW also searched on other sales channels, as shown in Figure 3. Table 2 shows the relative importance of the alternative channels for searching.

FIGURE 3

**How many sales channels other than PCWs did consumers check on the last occasion they compared PMI policies (of those who checked on a PCW)?**



*Source:* CC Survey, based on responses to question 'When you compared insurance providers or policies did you ...' and 'and when you compared insurance companies or policies online was this ...'.  
(Base: respondents who searched on a PCW on the last occasion they checked PMI policies, unweighted sample = 841.)

*Note:* Alternative channels include other online channels (brokers' websites, insurer's websites, cashback websites, websites of banks or building societies, websites of retailers and other websites) and offline channels (in person, over the phone, through the post, some other way).

TABLE 2 **The proportion of consumers who searched on another channel as well as a PCW on the last occasion they checked PMI policies by other channel**

	%
By phone	33
PMI provider's website	30
Retailer's website	10
In person	8
Bank/building society's website	5
Cashback website	4
Post Office website	3
Other website	1

*Source:* CC survey. (See notes to Figure 3 for details.)

*Note:* Unweighted sample = 841.

**Aviva Comment** - It should be noted that PCWs appear on cashback sites and other portals such as MoneySavingExpert and therefore act as a conduit to PCWs just in the same way as other media spend eg Google sponsored searches

56. This survey evidence suggests that for those consumers who use a PCW to search for a PMI policy, call centres also remain a popular additional search method.

**Aviva Comment** - As per our answer in section 54 above, Aviva finds through its General Accident brand that many consumers like to search online but like the reassurance of completing the sale on the phone. In such instances where the quote was PCW originated the insurance provider pays commission to the PCW

57. We noted that at least some PCWs had implemented or considered various strategies to compete more effectively with other sales channels. These included:

- developing their own telephony interaction;

- requiring contractual restrictions, like MFN clauses which limit the extent of pricing competition from providers' own websites and possibly from other sales channels (see the working paper 'ToH 5: Impact of MFN clauses in contracts between PCWs and PMI providers'); and
- offering cashback or blocking insurers from offering cashbacks.<sup>11</sup>

**Aviva Comment** - As per our previous comments, Aviva believes that PCWs see cashback websites as a threat as an alternative distribution channel that can offer consumers cheaper prices. We also believe MFN clauses reduce a provider's ability to offer cheaper prices in these alternative distribution channels.

### Competition for PMI providers

58. PCWs also compete to attract insurers and brokers to the list of providers quoting for PMI through their websites. Almost all of the 10 largest UK PMI insurers currently quote on all four large PCWs. Internal documents from the PCWs confirmed that they considered it important to attract the large insurers. For example, in Confused's internal documents we noted the necessity of 'identifying and attracting up and coming brands'.
59. PCWs also compete to establish and maintain good relationships with PMI providers which may, for instance, allow them the opportunity to offer exclusive pricing deals and other promotions (within the restrictions set by MFN clauses).

**Aviva Comment** - Aviva's experience is that this depends on a PCW's strategy with some more willing than others to enter into such agreements.

60. We found that competition to attract PMI providers and to develop a close relationship with them included:
- offering PMI providers access to a large numbers of customers;
  - charging a low CPA fee; and
  - providing additional information and data services.<sup>12</sup>

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<sup>11</sup> [REDACTED].

<sup>12</sup> We understand that PMI providers are typically charged for these additional services. [REDACTED].

## **Is the behaviour of the four large PCWs constrained by the bargaining power of PMI providers?**

61. A PMI provider's bargaining position against a PCW will derive from the possibility that it could delist its products from the PCW and use alternative PCWs or sales channels (including direct selling).
62. In their submissions to us, PMI providers and PCWs were consistent on the factors which affected their relative bargaining positions, though they sometimes had different views on how these factors should be measured and on the scale of their impact. The four large PCWs also varied in their overall assessment of their bargaining positions. Two of the large PCWs noted that the dynamic of negotiations was specific to individual cases.
63. On the basis of the submissions we received, we identified three factors as likely to impact the relative bargaining positions of a PMI provider and a PCW:
- (a) the relative importance of the PCW and the PCW channel for the PMI provider;
  - (b) the relative importance of the PMI provider for the PCW; and
  - (c) consumer behaviour.
- We discuss each of these factors in turn.

### ***Relative importance of the PCW and the PCW channel for the PMI provider***

64. A PMI provider's bargaining position will be weaker if an individual PCW (or the PCW channel) represents a significant sales channel, such that it may lose a large volume of sales if it delisted. It will also be weaker if alternative sales channels, eg direct selling, are less attractive, eg because they entail higher costs per sale. The bargaining position of a PMI provider would be particularly weakened if losing sales via a PCW would reduce the efficiency of the PMI provider, harming its competitiveness.
65. Most of the large PCWs told us that the proportion of PMI policies sold via PCWs is

relatively small. An estimated 23 per cent of all PMI policies are sold via PCWs (see paragraph 20). However, as pointed out by several PMI providers, the proportion of new business acquired via PCWs is much higher (see paragraph 51).

66. We noted that the large share of new business won via a PCW might not reduce significantly a PMI provider's bargaining position if it is able to access the customers of a particular PCW through other PCWs or sales channels at similar cost. We found that many customers shop for PMI policies using several PCWs and other sales channels (see paragraph 42). However, two PMI providers provided us with estimates of the proportion of customers of an individual PCW which could be recaptured on other PCWs or sales channels, suggesting that this was within a range of 30 to 42 per cent.<sup>13</sup>
67. The cost of selling through alternative sales channels is another determinant of a PCW's bargaining power. The AA told us that PCWs set the CPA at a level which made listing on a PCW marginally more attractive than using conventional direct marketing. The AA said that PCWs had been able to demand a higher CPA as the effectiveness of marketing channels such as online 'paid search' advertisements had declined.
68. We noted that delisting from a PCW could also lead a PMI provider to lose sales which would have been made on other sales channels as many consumers search on a PCW and then purchase elsewhere. Aviva told us that some customers used PCWs to get an indicative price and then visited the insurer's own website or contacted its call centre to see if they could obtain a better price or to obtain cash back.

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<sup>13</sup> One large PMI provider estimated that it would recover 30 per cent of the sales lost if it delisted from a large PCW; another large PMI provider estimated it would recover between 35 and 42 per cent of its lost sales.



69. As shown in Table 3, the reliance on the PCW channel (at least relative to own websites or call centres) appears to vary considerably across PMI providers. However, although some PMI providers use the PCW channel to a relatively small extent, we did not take this to mean that it would be easy for other PMI providers to reduce their reliance on PCWs, especially for those which do not have such a strong retail brand.

TABLE 3 Proportion of new business won through direct sales channels (ie excluding sales through brokers), 2012

	<i>per cent</i>							
	<i>Aviva*</i> †	<i>AXA UK‡</i>	<i>CISGIL‡</i>	<i>DLG</i>	<i>esure</i>	<i>LV§</i>	<i>RSA¶</i>	<i>Zurich‡</i>
PCW	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
PMI provider website	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
PMI provider call centre	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	100	100	100	100	100	100	100	100

Source: PMI providers.

\*[redacted].  
 †[redacted].  
 ‡[redacted].  
 §[redacted].  
 ¶[redacted].

Note: We have sought to exclude sales made through brokers as not all parties submitted this information. However, some parties may have included sales made by a broker listed on a PCW within their numbers shown in the table above. Therefore, the figures above may, in some cases, understate the proportion of sales made through a PCW.

70. Evidence from both PMI providers and PCWs confirmed that the bargaining position of PMI providers was weaker when a PCW represented a significant proportion of their sales. For example, in 2012 Comparethemarket was the largest PCW [redacted] and [redacted]. MoneySupermarket also described this rival as being ‘willing to lose major partners that don’t pay or won’t agree to their terms’. [redacted].

71. MoneySupermarket also told us that [redacted].

72. Despite their differing relative bargaining strengths, almost all of the 10 largest insurers quote on all four of the large PCWs (see paragraph 58), which could suggest that the threat of completely delisting from one of them is not very credible. AXA told us that ‘providing quotes through the four large PCWs at least is a ‘must have’ in order to achieve sufficient market coverage’; and Aviva said that, to remain

competitive, it was necessary to quote on a minimum of three of the four main PCWs but it was desirable to quote on all four.

73. The large insurers told us that they had more bargaining power against those PCWs which were less significant sales channels for them. [✂]; though this was contradicted by esure, which claimed that Google and Tesco Compare had equal bargaining strength to the four large PCWs. esure pointed to other sources of bargaining power for a PCW besides the share of supply, such as the extent of customer information to which the PCW had access and its potential for future growth.
74. We have very limited data on the CPA fees charged by Tesco Compare and Google, but [✂]. In our view, this was consistent with these PCWs having less bargaining power than the four large PCWs, commensurable with their lower share of supply.
75. We noted that the bargaining dynamic between PMI providers and PCWs could change rapidly, in line with the trading positions of both the PMI provider and the PCW. [✂]

### ***Relative importance of the PMI provider for the PCW***

76. A PMI provider's bargaining position with a PCW also depends on the additional value of the PMI provider to the PCW, given the other PMI providers the PCW already offers on its site. This value is likely to be greater if the PMI provider has a large customer base or 'must have' brands which consumers would expect to see offered. Aviva told us that the four large PCWs would always have the balance of negotiating power given that no provider on a PCW had a large share. However, Admiral told us that being large did improve the bargaining position.

**Aviva Comment** - In Aviva's experience the PCWs are looking for incremental sales from insurance providers and will negotiate on this basis. Clearly, a large consumer brand name could be important to it. However, the impacting of list / delisting of the incremental sales a PCW will receive is likely to be less than the impact on an individual insurance provider's

brands sales volumes given each PCWs share of new business in the PMI market.

77. Gocompare told us that, in recent years, consumer surveys and anecdotal feedback suggested that it had become the 'trusted' brand for consumers rather than the individual PMI providers. Insurers also told us that the impact of delisting would be larger for them than for PCWs. DLG told us that:

when a consumer is obtaining a quote on a PCW, he/she will not generally go looking for a particular brand, and in general will not know whether a brand's absence from the leading quotes is due to a higher premium, a decline to quote, or the absence of the brand from the PCW altogether.

78. RSA told us that:

on more than one occasion, PCWs have presented RSA [REDACTED]. By way of example, [REDACTED] has effectively forced RSA to accept a [REDACTED] conversion floor for eChoice and a [REDACTED] floor for MoreTh>n as a condition of relisting RSA's insurance products.<sup>14,15</sup>

79. We noted that bargaining power could be concentrated among a relatively small proportion of the PMI providers offered by a PCW. An internal document from [REDACTED] indicated that [REDACTED]. However, we also noted that specialist or niche PMI providers with high conversion rates (ie high numbers of consumers purchasing a policy after searching) could also have bargaining power, as they could make the PCW more attractive to specific types of drivers.

80. Some of the PCWs told us that consumer confidence in their services was based on their perceived ability to cover as much of the market as possible. Consequently, the removal of even one PMI provider could undermine confidence that the consumer

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<sup>14</sup> With these conversion floors, RSA agreed to convert a proportionate minimum number of click-throughs from PCWs into actual sales on its website. This guaranteed a minimum cost per click to PCWs, regardless of how many actual sales were concluded through the PCW.

<sup>15</sup> We also note that [REDACTED] has a conversion floor agreement with [REDACTED].

was able to achieve the lowest price possible. However, we noted that the number of PMI providers on PCWs is both large and variable between PCWs. It did not appear likely to us that the loss of an individual PMI provider would lead to a loss of consumer confidence unless the provider had significant brands or was particularly price competitive in a market segment.

81. Supporting this view, we found that, as the number of PMI providers offered by PCWs had grown, so the large PCWs had appeared to focus on factors other than encouraging PMI providers to sell through them. In its strategic plan for the years 2012 to 2014, MoneySupermarket stated: 'We will re-focus around preferred partners – this leads to best products, budget allocation and test partners'. Moreover, we found that the large PCWs had been willing to remove PMI providers from their websites (albeit this was probably driven by considerations of poor performance (eg poor conversion rates)).
82. We found some evidence that the bargaining position of smaller PMI providers with [redacted] PCWs is weaker than for larger (or otherwise more important) PMI providers. In particular, we found that the level of average CPA fees varied depending on the size of the PMI provider. We plotted the level of the average fee against the providers' PMI sales on the PCW and observed that [redacted] Figure 4 shows the CPA fees charged by [redacted] in 2012, with similar analysis for [redacted] and [redacted] shown in Appendix 1.

FIGURE 4

**CPA fees and sales volume by provider [redacted], 2012**

[redacted]

Source: [redacted].

83. We noted that the CPA fee may also relate to the value that a PMI provider derives from a policy sold. Therefore, the higher CPA fees paid by specialist or niche insurers

may reflect the higher value of such policies, as well as possibly reflecting a poorer bargaining position due to the size of these providers.

### ***Consumer behaviour***

84. To the extent that consumers would switch away from a PCW in response to an increase in the CPA fee (because of increased premiums or less choice (see paragraph 30)), their behaviour adds an additional constraint on a PCW's behaviour.
  
85. Our survey found that, when consumers searched for PMI, around 10 per cent of them searched on just one PCW and through no other sales channels (so-called 'single homing'). Therefore, for a PMI provider, each one of the four large PCWs has approximately 2.5 per cent of potential PMI customers who can only be reached through that site. None of these customers would be accessible other than through that PCW. By being the gatekeeper to these customers and the value they represent to the PMI provider, the PCW derives bargaining power. However, with 97.5 per cent of potential customers remaining available through other PCWs or other sales channels, we might expect PMI providers to be willing to at least consider delisting from a specific PCW.
  
86. However, we note that, of consumers who last shopped around for PMI and used a PCW, 37 per cent of these consumers only checked prices on a single PCW. This suggests that, if a PMI provider only sells via PCWs, each of the four large PCWs has approximately 9 per cent of potential consumers who are not accessible via another PCW. While higher, we consider that this is still a relatively low proportion.
  
87. The extent to which customers utilize one PCW or shop around multiple PCWs and/or sales channels will likely depend on two factors: (a) their expectations of

getting a better deal from searching more widely; and (b) the level of search and switching costs. We discuss both these factors in turn.

### *Customer expectations of getting a better deal*

88. Customer expectations of getting a better deal through shopping around will rely on the perceived level of differentiation between the PMI policies available on rival PCWs and through other sales channels. If consumers believe that most of the policies relevant to them (or a sufficiently high number) are available on a PCW, then they will be unlikely to look further. Confused told us that 'customers ... believe that you need to use more than one price comparison site, as well as go direct, to get the best deal'. We noted that the presence of MFN clauses was likely to reduce the incentive for a consumer to shop around.

### *Search and switching costs*

89. The extent to which customers shop around (or would in the event of a price rise or lessening of choice) is also likely to depend on the costs involved in searching between PCWs (and other sales channels). The cost of searching for a PMI policy is reduced by PCWs but consumers still invest time (typically around 5 to 10 minutes) in finding a PCW and entering their details. This is likely to explain partially why customers, on average, only search on 2.2 PCWs.

**Aviva Comment** - Consumer behavior may also be driven by what consumers read in the media in terms of how to get the best deal for their car insurance. Websites such as MoneySavingExpert describe the process

90. We found some indications of a decline in shopping around between PCWs in recent years (see paragraph 47), which appeared to us to indicate that, while new customers had tried a few PCWs, many had then become less willing to shop around due to their familiarity with a site or because they saw little distinction in the results. We noted that repeat search costs might be particularly low with the same PCW if the PCW saved the consumer's details such that they did not have to be re-entered. We

found evidence in the internal documents of the large PCWs which showed that they



spend considerable effort in making use of information gathered through previous purchases and in making a returning customer's repeat purchase as easy as possible.

### **Evidence of negotiation outcomes**

91. As evidence of bargaining power possessed by the PMI providers, we observed that:

- Large PMI providers are able to negotiate CPA fees which are lower than those paid by some smaller providers (see Figure 4 and Appendix 1, and paragraphs 82 and 83).
- CPA fee increases have been close to or below the rate of inflation. [REDACTED]
- Some PCWs told us that PMI providers had negotiated CPA fee increases down from their initial proposals. MoneySupermarket told us that this was due in part to the well-resourced negotiating teams that PMI providers used. However, while some PMI providers recognized that they had been successful in negotiating lower fee increases, they told us that the initial fee increase proposals of the PCWs had been unrealistically high. By contrast, [REDACTED] told us that the PCWs' fee increases [REDACTED] imposed on a 'take it or leave it' basis, leaving little room for negotiation.<sup>16</sup>

92. As evidence of bargaining power possessed by the PCWs, we observed that:

- Almost all of the 10 largest insurers are listed on all four of the large PCWs.
- There appear to have been very few instances of PMI providers choosing to delist from one of the large PCWs as a result of negotiation.<sup>17</sup>

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<sup>16</sup> [REDACTED]  
<sup>17</sup> [REDACTED]

### **Does the threat of entry (or expansion) constrain the behaviour of PCWs?**

93. Entry or expansion, or the prospect of it, may stimulate competition within a market and limit the market power of incumbents. However, this source of competitive discipline is reduced by barriers to entry or expansion, which may give incumbent PCWs an advantage over efficient potential rivals and therefore reduce competition.
94. We considered the scope for new entry, evidence of recent attempted entry and the features of the market which may represent a barrier to entry or expansion.

### ***Customer switching***

95. The scope for new entry will depend on the ease with which a PCW can win new customers. This will rely on the propensity for customers to switch from rivals and the scope for customers to use PCWs at the expense of other sales channels.
96. We noted that, in recent years, the number of customers switching to the PCW channel had been significant (see paragraph 19), and that most customers used multiple PCWs or sales channels, showing little loyalty to any specific PCW (see paragraph 42). However, we also noted that the rate of customer switching from other sales channels appeared to be declining, in particular as existing users of PCWs became more attached to a specific PCW. Nevertheless, given many customers' current apparent willingness to shop around multiple PCWs, it does not appear to us that a lack of customer switching is a significant barrier to entry at present.

### ***MFN clauses***

97. In our working paper under Theory of Harm 5 on the impact of MFN clauses in contracts between PCWs and PMI providers, we discuss the possibility that wide MFN clauses might restrict entry by making a price-cutting entry strategy impossible.

We find some evidence that entry with this strategy may have been restricted by such clauses, though we state that we intend to consider this issue further.

### ***Indirect network effects***

98. In a two-sided market, if a customer on one side derives more utility when participation on the other side is greater, the market is said to be subject to indirect network effects. With regard to PCWs, a customer may prefer to use an established PCW over a new entrant if it offers the products of more PMI providers. Similarly, a PMI provider may prefer to participate on a PCW which has a large customer base. If indirect network effects are strong, then established PCWs may have an advantage over new entrants.
99. We recognized that these indirect network effects were likely to apply but noted that they would be dampened by the fact that PMI providers typically pay PCWs a fee per transaction. Under this pricing structure, a PMI provider would face little disincentive to participate on a new PCW, albeit with fewer customers. We found that some of the small PCWs offered the products of as many PMI providers as the four large PCWs.

### ***Economies of scale and scope***

100. Firms whose costs are, to a large extent, fixed rather than variable may benefit from economies of scale. To the extent that this is the case, incumbent PCWs would be able to spread fixed costs over a wider customer base, providing services at a lower cost than new entrants.
101. We found that the large PCWs adopted very different approaches to assigning costs as being either variable or fixed. [✂].

102. We noted that all four large PCWs spent substantial sums on advertising and marketing, of which a significant proportion was offline. It did not appear to us likely that a new entrant would be able to enter successfully without also incurring the cost of a high-profile advertising campaign, unless it already possessed a very strong brand. On this basis, it appears to us that there are significant economies of scale.
103. The four large PCWs also offer a range of services on their websites, including life assurance, and insurance for home and contents, travel, bike, pet, etc. They also offer other financial products. We found in the internal documents of MoneySupermarket that cross-selling to customers is raised as a main objective; and [REDACTED]. Therefore, it appears to us that economies of scope also exist, although it is not clear whether successful entry would require being able to offer multiple product lines.

***Sunk costs (eg advertising and marketing)***

104. Sunk costs are investments which cannot be recovered upon exit and hence would commit a PCW to stay in the market. For example, the cost of establishing a trusted and recognized brand would represent a significant sunk cost for a new entrant.
105. PCWs invest heavily in advertising and marketing. Comparethemarket told us that [REDACTED]; and MoneySupermarket's 2011 annual report shows that its marketing investment amounted to £78 million, corresponding to around 43 per cent of its revenue in the same year.
106. We found that the three main forms of marketing costs for the large PCWs have been:
- (a) television advertising;
  - (b) online paid search or pay per click (PPC); and

(c) promotions (including toys).

107. We noted [REDACTED]. We found that:

- Some PCWs considered that [REDACTED] or had an ‘overreliance’ on television advertising, [REDACTED].
- PPC advertising was noted to have become more expensive due to aggressive bidding by both PCWs and insurers on key search terms. Gocompare also noted that PPC prices had risen as a result of Google reducing the availability of premium search positions after launching its own price comparison service.
- [REDACTED]

108. It appears to us that the large marketing expenditure of the four large PCWs has been driven by the intense competition between them to win customers, rather than representing any strategic effort to raise barriers. [REDACTED] We noted that expenditure on television advertising may decline as the number of new customers declines and, [REDACTED].

109. We also recognized that a significant proportion of the advertising expenditure incurred by the PCWs might not have been incurred had there not been wide MFN clauses. It appears to us that these clauses tend to reduce price-based competition, thus encouraging advertising-based competition between PCWs instead. We discuss this possibility in our working paper ‘TOH 5: Impact of MFN clauses in contracts between PCWs and PMI providers’.

### ***Regulatory barriers***

110. PCWs need to obtain relevant permissions from the FCA and need to comply with the FCA’s guidance on the sale of PMI through PCWs. However, no PCW raised this as a significant barrier to entry.

### ***Evidence of the threat of entry as a constraint***

111. We reviewed [REDACTED] the threat of entry (or expansion by a small provider). In particular, we found that [REDACTED].<sup>18</sup> However, we found little evidence that the behaviour [REDACTED] had been impacted [REDACTED].
112. Tesco Compare entered the market in 2008 but less than 1 per cent of respondents to our survey of PMI policyholders recalled searching on it the last time they checked PMI policy prices (see working paper ‘Survey report’).<sup>19</sup> Also, the potential entry of [REDACTED] has not materialized.
113. Google entered the market in September 2012, which we found, [REDACTED]. However, we found little evidence that Google had impacted the PCW market significantly so far. From the results of our survey of PMI policyholders, it appears that less than 1 per cent of people searching on PCWs for PMI were able to recall looking at Google the last time they checked prices.

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<sup>18</sup> [REDACTED]  
<sup>19</sup> [REDACTED]

**Analysis of CPA fees and sales**

FIGURE 1

**CPA fees and sales volumes [✂], 2012**

[✂]

Source: [✂].

FIGURE 2

**CPA fees and sales volumes [✂], 2012**

[✂]

Source: [✂].

## Profitability of [X] PCWs

1. This appendix examines the profitability of [X] PCWs.

### Why we look at profitability in market investigations

2. The CC's updated *Market Investigation Guidelines*<sup>20</sup> (the guidelines) state that outcomes of the competitive process in their different forms in a market, eg prices and profitability, can provide evidence about its functioning.<sup>21</sup>
3. The guidelines<sup>22</sup> state that, in practice, a competitive market would be expected to generate significant variations in profit levels both between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. The profitability of some firms may exceed what might be termed the 'normal' level, for example as a result of past innovation or superior efficiency, but a situation where the profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process. Examples of these limitations could be the presence of entry barriers, or the existence of significant market power.
4. The guidelines<sup>23</sup> mention four possible types of analysis of prices and profitability: pricing patterns; price cost margins; price comparisons; and profitability. Annex A of the guidelines (Market characteristics and outcomes) states<sup>24</sup> that where capital employed cannot be reliably valued, the CC may consider alternative measures, such as the return on sales or other relevant financial ratios.

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<sup>20</sup> *Guidelines for Market Investigations: Their role, procedures, assessment and remedies*, April 2013; CC3 (Revised): [www.competition-commission.org.uk/assets/competitioncommission/docs/2013/publications/cc3\\_revised.pdf](http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/publications/cc3_revised.pdf).

<sup>21</sup> Paragraph 103.

<sup>22</sup> Paragraphs 117–118.

<sup>23</sup> Paragraph 107.

<sup>24</sup> Paragraph 15.



## Analysis

5. The [X] PCWs were not able to provide figures from their management accounts for PMI-only profit because they did not allocate costs to PMI sales. Therefore, we asked the [X] PCWs to provide us with an analysis which would identify the operating profit for the PMI part of their business for the last five years. We did not look at other measures of profitability such as return on assets or return on capital as we considered that it would be very difficult for the PCWs to calculate an appropriate asset base and cost of capital for the PMI part of their business only. We asked the PCWs to set out clearly their approach for allocating both their direct and indirect costs to the PMI part of their business, if necessary differentiating between divisional, group and holding company overheads. We said that we expected to see at least the following headings in their analysis: turnover/income, cost of sales, gross profit, expenses, contribution, allocation of shared costs, operating profit, interest, and profit before tax.
6. [X] PCWs [X] provided us with a profitability analysis.
7. Table 1 shows the combined turnover, operating profit and operating margin for [X] PCWs for the three years 2010 to 2012 for the PMI part of their business.

TABLE 1 Summary of total PMI profitability, 2010 to 2012

	<i>£ million</i>		
	<i>2010</i>	<i>2011</i>	<i>2012</i>
Turnover	[X]	[X]	[X]
Operating profit	[X]	[X]	[X]
	<i>per cent</i>		
Operating profit margin	[X]	[X]	[X]

Source: CC calculations based on data provided by the parties.

8. Turnover [X] by [X] over the three-year period; operating profit [X] by [X]; and the operating profit margin [X].

9. Overall, we noted that, in aggregate, [REDACTED] PCWs had achieved an operating profit margin of around [REDACTED] per cent over the last three years. We did not conduct a more detailed analysis of their profitability but, in our view, this finding could be consistent with [REDACTED] PCWs having some bargaining power against PMI providers.
  
10. In the rest of this appendix [REDACTED].

[REDACTED]

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 3: Horizontal concentration in repair cost estimation systems

#### Introduction

1. As we have gathered evidence from repairers in relation to other theories of harm (ToH), many have raised concerns about the practice of many work providers (such as insurers) to require them to use the Audatex cost estimation system. These repairers have told us that Audatex is more expensive than alternative repair cost estimation systems and that, as a result of its relationships with work providers, Audatex has now become the industry standard for those repairers which conduct work under 'preferred status' relationships. The repairers told us that, as a result, Audatex' market share was very high.
2. Under ToH 5 (harm arising from vertical relationships) we have considered whether harm arises from the vertical relationships in the industry in relation to repair cost estimation systems—ie the contractual relationships between work providers, Audatex and repairers (see the working paper 'ToH 5: Analysis of potential foreclosure as a result of vertical relationships').
3. In this working paper we discuss whether we should investigate in more depth an additional horizontal theory of harm in relation to repair cost estimation systems given the indications we have received that Audatex has a large market share. This issue was not identified in our issues statement.
4. For the reasons set out in this paper, we believe that there are insufficient grounds for undertaking further detailed analysis in this area.

## Evidence

5. There are two main repair cost estimation systems in the market: Audatex and Glassmatix. A third system, offered by Inter-est, is also available.
6. Insurers and other work providers generally recommend or require their preferred repairers to use a specific repair cost estimation system. This makes their processes easier, with one consistent feed of data into their systems and a consistent process for their engineer assessors. We found that, of the ten largest insurers, only Ageas does not recommend or require a specific system to be used and the other nine insurers all recommend or require the use of Audatex.
7. Audatex charges a fee for several elements of the estimation process, including a per-estimate fee and a per-photograph fee. Audatex estimates that its average cost per estimate, charged to the repairer, is £[redacted].
8. Glassmatix charges an annual subscription fee of £1,800 for a licence for up to five users. It does not charge a per-estimate fee but does charge a transmission fee if the estimate is sent to an insurer, which is between £[redacted] and £[redacted]. Glassmatix told us that its recent deals with repairers had been at the lower end of this range due to its weakened market position. Repairers told us that the Glassmatix price structure made Glassmatix the preferred option for repairers which undertook a substantial amount of work for retail customers (ie not through work providers), for whom estimates were required but where there was no transmission, as such estimates could be generated in the Glassmatix system at **zero** marginal cost.

### **Aviva Comment – this cannot be zero and marginal**

9. Glassmatix told us that it could not determine how many estimates were produced by its system as many were created without transmission. However, it has estimated the number of estimates produced on the basis of the number of online registration

checks which are run through its system on the DVLA database (as almost all estimates will require such a check). On this basis, Glassmatix estimates that its system costs repairers about £[redacted] per estimate (including subscription revenue).

10. In the last five years, Glassmatix has lost several contracts with work providers, including with Zurich, AXA, CISGIL and RSA. It told us that Zurich switched away from Glassmatix because it ~~was already having~~already had to use Audatex for its work with fleet managers (similar to claims management companies (CMCs) for commercial vehicles) which meant that it ~~was having~~had to input Audatex outputs manually into its system. RSA told us that [redacted].

**Aviva Comment – Please make amendments as shown above**

11. Glassmatix told us that there were two principal reasons why it had lost contracts with work providers to Audatex. First, Glassmatix had [redacted]. Glassmatix said that [redacted]. Second, Glassmatix said that Audatex had offered work providers rebates for estimates submitted by their repair networks as a way of incentivizing work providers to mandate or to recommend strongly the adoption of Audatex by their repairers. Glassmatix said that the effect of these deals for work providers was to make the system approximately costless for them, with all the cost paid by repairers.

**Aviva Comment – This is not the experience of Aviva.**

12. Glassmatix told us that it had lost market share to Audatex very quickly over a short period. In 2007, its revenue was £[redacted], whilst in 2014 its projected revenue will be £[redacted]. It said that Audatex had built its market share very quickly, almost entirely at the expense of Glassmatix.
13. Glassmatix told us that its market analysis suggested that there were 3,500 primary bodyshop outlets,<sup>1</sup> with around a further 2,500 businesses in the UK offering “car body repairs.”<sup>2</sup> These sites provide repairs to insurance, CMC, fleet and retail

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<sup>1</sup> Source: Trendtracker.

<sup>2</sup> Source: Auto Industry Insider website and Bodyshop Magazine circulation numbers.

customers. Glassmatix is used in approximately 650 sites and Audatex is used in approximately 2,200 sites. Glassmatix said that some small repairers which focus on retail customers do not use a repair cost estimation system at all.

14. Glassmatix said that it was now focusing its business on large repairers which targeted the retail market and on small repairers for which purchasing the Audatex system was inefficient. Glassmatix said that it believed Inter-est was targeting this same customer base, also recognizing that, in the short term at least, Audatex had an insurmountable position with work providers.
15. Glassmatix told us that the costs for an insurer in switching its repair cost estimation system would depend on the degree to which the system was integrated into the insurer's back office systems, and these costs could be high. However, we noted that there was now effectively an industry standard for the form of the input into back office systems, which meant that the cost of switching had reduced, at least for some insurers. Glassmatix said that the other principal cost of switching was training engineer staff on to the new system, which would require approximately two days for each engineer. However, as Glassmatix (or another repair cost estimating system provider) would usually provide this training at no cost to the insurer, it did not believe that the insurer would consider this alone as a major impediment to switching.
16. Glassmatix told us that the products its group offers are broadly the same across Europe, though sometimes under different brands. Glassmatix said that Audatex offers systems across Europe under the same brand and is now the undisputed European market leader. Glassmatix said that there are other 'local' vendors in some countries (such as Inter-est which in the UK).

17. In our conversations with repairers, they told us consistently that Audatex was the best repair cost estimation system available, but that it was also the most expensive. Many told us that, if they were free to choose their repair cost estimation system (without the interference of work providers) they were likely still to choose Audatex.

## Analysis

18. We noted that:
- Audatex has built its large market share recently and over a short period, through offering a product which is widely perceived to be better and through a differentiated marketing model.
  - Although the Audatex system is more expensive for repairers than its rivals' products, this reflects in part (a) its superior quality; and (b) the rebates Audatex pays to work providers.
  - Barriers to switching between repair cost estimation systems may be high, though common data standards are likely to have reduced these costs for some work providers.
  - The work providers which contract with Audatex are large firms with some degree of buying power.
19. We also noted that any harm arising from Audatex having market power may be offset by the network benefits from having a single consistent system in place for both insurers and repairers.
20. Nevertheless, it appeared to us that the business model of Audatex could cause:
- (a) a distortion between retail and insurance customers, with retail customers being disadvantaged through repairers paying more for their estimates on Audatex than they would pay on rival systems, due to their work providers gaining a benefit through a rebate; and



(b) a distortion between fault and non-fault customers, with the non-fault insurer gaining the rebate but passing on the higher cost to the fault insurer (ie the moral hazard problem which we are considering under ToH 1 – see the working paper ‘ToH 1: Overcosting and overprovision of repairs’).

However, both of these issues are not a result solely of a horizontal concern about Audatex but are due to its vertical arrangements which we consider under ToH 5. We note that the focus of Glassmatix and Inter-est on repairers which serve retail customers could mitigate the first distortion.

## **Conclusion**

21. On the basis of the evidence and analysis set out above, we do not intend to investigate further the horizontal concentration in repair cost estimation systems.

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 4: Analysis of add-ons

#### Introduction

1. Insurers offer their customers a range of additional products known as add-ons. Add-ons provide cover for various risks over and above the core risks covered by a basic private motor insurance (PMI) policy, eg motor legal expenses insurance (MLEI), windscreen cover, breakdown cover, medical expenses/personal injury cover, personal belongings cover, courtesy car cover, key loss cover, foreign use cover and no-claims bonus (NCB) protection. Add-ons are often sold separately from the basic PMI policy for an additional premium; however, some basic PMI policies include some of these protections, with no additional premium being paid.
2. Harm may arise where add-on products are complex and where it is difficult for consumers to know what is included or excluded in the cover, in particular if the information available to consumers at the point of sale does not enable consumers to understand the product, estimate its value or make comparisons between different potential providers.
3. The purpose of this paper is to consider the transparency and complexity of add-on products. The evidence we discuss includes the results of our survey<sup>1</sup> and a high-level assessment of the profitability of different add-on products.
4. In our analysis we have focused on those add-ons which appear complex and difficult for consumers to understand and evaluate. We reviewed the report of a qualitative survey in relation to MLEI commissioned by the Financial Services Authority

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<sup>1</sup> The CC commissioned the market research agency IFF to conduct a survey of PMI policyholders (see the working paper 'Survey report').

(FSA)<sup>2</sup> and we conducted some online research of our own. On the basis of these reviews, we chose four add-ons on which to focus our analysis: personal accident cover/medical cover, NCB protection, foreign travel cover and key cover (we refer to these together as our 'assessment group'). We did not focus on MLEI because the Financial Conduct Authority (FCA)<sup>3</sup> had undertaken its own investigation into the supply of this product.

## Summary

5. Most PMI policyholders are covered by one or more add-on. Of the nine add-ons considered in our survey (which did not include MLEI), windscreen cover was the most popular, which appears to be at least in part because many basic PMI policies include it. Our survey found that the majority of PMI policyholders preferred to have the choice of selecting add-ons separately, rather than having covers included in their basic PMI policy.
6. Add-on premiums account for a small proportion of total premiums. For the insurers in our sample, the basic PMI policy premium accounted for 92 per cent of total premiums in 2012, while add-on premiums accounted for the remaining 8 per cent.
7. Our survey of PMI policyholders found that most policyholders who said they had compared add-ons offered by different insurers believed that add-ons were easy to compare across insurers, although it also showed that the majority of consumers who purchased personal belongings cover, foreign use cover and key loss cover did not make any comparisons.

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<sup>2</sup> See [www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research](http://www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research). This study assessed customers' views on their understanding of MLEI, personal accident cover/medical cover, windscreen cover, break-down cover, courtesy car cover and NCB protection. We sought to complement the FCA's study with our own research to avoid excluding other less well-understood add-ons.

<sup>3</sup> The FSA was abolished and the FCA was formed in April 2013.

8. Table 1 shows a summary of the results of our survey and our analysis of the profitability of certain add-ons. Although we focused our assessment on four add-ons (see paragraph 4), we gathered evidence on other add-ons for comparative purposes.

TABLE 1 Selected results from our analysis of add-ons

		<i>per cent</i>		
	<i>Take-up<sup>1</sup></i>	<i>Percentage who compared insurers<sup>2</sup></i>	<i>Good value for money<sup>3</sup></i>	<i>Unweighted average claims ratio 2012<sup>4</sup></i>
Basic cover				82
MLEI	76	52	53	7
Windscreen	85	52	69	84
Breakdown	39	52	64	38
Personal accident/injury/medical expenses*	56	47	51	5
Courtesy car/temporary replacement vehicle	70	53	54	51
Key loss*	24	32	35	25
Foreign use*	30	26	38	29
NCB protection*	80 <sup>4</sup>	62	69	Not available <sup>5</sup>

*Sources:*

1,2, 3: CC analysis of data from our survey of PMI policyholders. We note that some respondents might have purchased certain add-ons as part of their basic cover and not on a separate basis for an additional premium (see paragraph 1).

4: CC calculations based on responses from insurers in our sample.

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\* Product in the assessment group.

9. We found that the majority of policyholders perceived most add-ons to be good value for money. However, with the exception of windscreen cover, the unweighted average claims ratios<sup>6</sup> were below that for basic cover, some considerably below.<sup>7,8</sup> This would appear to suggest that, on average, customers are not able to assess the value of these add-ons. Respondents to our survey perceived key loss cover and foreign use cover to be less good value than other add-ons and these products had the lowest take-up rates.

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<sup>4</sup> 80 per cent of survey respondents said that they had NCB protection; however, evidence from insurers shows that the actual take-up of NCB protection is much lower. This suggests some misunderstanding of the difference between NCB and NCB protection. Moreover, our survey found that only around 30 per cent of those who claimed to have NCB protection correctly answered the question designed to test consumers' understanding of this product.

<sup>5</sup> It has not been possible to assess the profitability of NCB protection because there is no clear cost of a 'claim' against this add-on.

<sup>6</sup> In our analysis of the claims ratios of add-ons, we have only taken into consideration data provided by insurers relating to add-ons sold separately from the basic PMI policy, ie for an additional premium (see paragraph 1).

<sup>7</sup> The claims ratio reflects the proportion of premiums paid out in claims. Therefore, all other things equal, a low claims ratio indicates higher profitability than a high claims ratio (see paragraph 46).

<sup>8</sup> None of the insurers who provided data to us could provide claims ratios for all the add-ons (see paragraphs 50 and 51).

10. One explanation for policyholders' perceiving most add-ons to be good value for money while claims ratios are so low is that policyholders do not understand fully the cover which is provided by an add-on and overestimate its value to them. Our survey asked questions to test consumers' understanding of some add-ons. We found that in relation to some add-ons the proportion of correct answers was low, and in relation to other add-ons there was a relatively high or medium proportion of correct answers in relation to some aspects of the cover but a low proportion in relation to other aspects. A significant proportion of customers who claimed that they understood an add-on did not, or did not fully understand it.
  
11. However, we recognize that there are other possible explanations. In particular:
  - (a) Because the cost of an add-on is low (relative to the cost of a basic PMI policy), some consumers might be willing to pay the price of the add-on to have 'peace of mind', in particular where the potential loss being covered could be very large.
  - (b) Because the cost of an add-on is low (relative to the cost of a basic PMI policy), some consumers might not consider it worthwhile searching in order to achieve, at most, a small saving and so they might be willing to pay a slightly higher price for the add-on.
  - (c) Because the cost of an add-on is much lower than the cost of a basic PMI policy, the expense ratio of an add-on (eg the costs of selling the policy and administering claims, expressed as a proportion of the premium) is likely to be higher than for a basic PMI policy, meaning that the profitability of an add-on overall (taking into account both the cost of claims and the cost of expenses) might not be dissimilar to the profitability of a basic PMI policy.
  
12. In this paper, we first consider the FCA's report on MLEI before setting out our analysis of:
  - (a) our survey results in relation to add-ons; and

(b) the profitability of some add-ons.

## **The FCA's review of MLEI**

13. The FCA published its report into MLEI in June 2013.<sup>9</sup> The main conclusions of this report were:
- (a) MLEI is a product which can be useful in enabling policyholders to pursue legal rights to recover uninsured losses;
  - (b) consumers have little understanding of what the product does and the benefits it provides;
  - (c) the opt-out<sup>10</sup> selling of MLEI is not consistent with good consumer protection (despite MLEI being the add-on most commonly sold with PMI on an opt-out basis).
14. The report recommended that firms should:
- (a) provide consumers with better explanations of MLEI; and
  - (b) review the basis on which MLEI is provided, especially where this is on an opt-out basis.
15. The report said that the FCA would look again at the supply of MLEI after one year and firms which had not amended their business practices in line with best practice by that time were likely to face regulatory action.

## **Analysis of our survey results in relation to add-ons**

16. Our survey of PMI policyholders sought first to ascertain the take-up of different add-ons and then to assess policyholders' understanding of each of the four add-ons in our assessment group. The approach for this assessment was first to ask consumers

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<sup>9</sup> [www.fca.org.uk/static/documents/thematic-reviews/tr13-01.pdf](http://www.fca.org.uk/static/documents/thematic-reviews/tr13-01.pdf).

<sup>10</sup> Opt-out selling means the product is pre-selected rather than actively selected by the customer.

about their perceived level of understanding and then to ask one or more factual questions about the add-on to test their understanding.<sup>11</sup>

17. The response rate to our survey was 5 per cent, giving rise to some concern about the potential for response bias in the results.<sup>12</sup> We have no particular evidence of response bias, but we note that there was a slightly higher response rate among older policyholders.

### **Take up of add-ons**

18. Table 2 shows respondents' stated take-up of add-ons.<sup>13</sup> Take-up is particularly high for windscreen cover at 85 per cent, though we note that this add-on is included in the basic PMI policy for seven of the ten largest PMI insurers (see Table 12). The majority of respondents said that they had NCB protection, legal cover, courtesy car cover and personal accident/personal injury/medical cover included in their policies. The high stated take-up of NCB protection suggests that some respondents may not be clear on the distinction between NCB and NCB protection, so we treat this result with some caution.

TABLE 2 **Products included in policy**

	<i>per cent</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
Windscreen cover	85	10	5
NCB protection	80	17	4
Legal expenses/legal protection	76	18	6
Courtesy car/TRV	70	24	6
Personal accident/personal injury/medical expenses	56	30	14
Personal belongings cover	44	40	16
Breakdown cover	39	58	3
Foreign use cover	30	56	14
Key loss cover	24	54	22

Base (unweighted) = 1,501

Source: CC PMI Customer Survey, question B2.

<sup>11</sup> The figures in this section have all been weighted to correct for oversampling in Wales, Scotland and Northern Ireland.

<sup>12</sup> As only 5 per cent of the policyholders contacted were both available and willing to respond to the telephone interview, they are therefore unusual in this respect, which causes us to question the extent to which their survey answers can be considered to be representative of all PMI policyholders.

<sup>13</sup> Take-up means the number of policyholders covered by a specific add-on, regardless of whether the add-on was bought separately (with an additional premium) or included within the basic PMI policy.

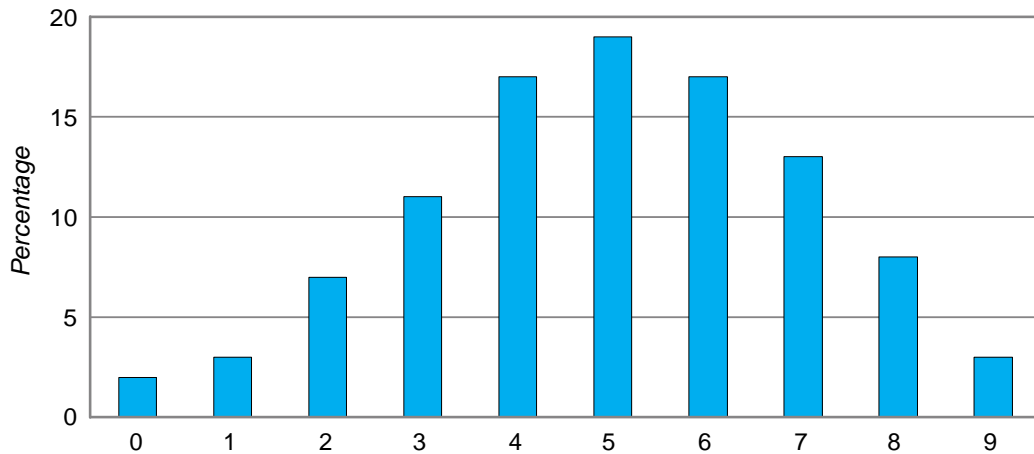
19. The final column of Table 2 shows that some policyholders were unsure about the content of their policy. The percentages of respondents who did not know whether they were protected by particular add-ons were 22 per cent for key loss cover, 16 per cent for personal belongings cover, 14 per cent for foreign use cover and 14 per cent for personal injury/personal expenses/medical expenses cover.
  
20. Differences in the take-up rates between add-ons suggest (a) differences in the number and type of add-ons offered to consumers; (b) differences in how they are typically offered to consumers; and/or (c) the exercise of choice among consumers about which add-ons to purchase. We note that some insurers include certain add-ons (often windscreen cover and glass cover) in their basic PMI policy, such that a policyholder could not opt-out from this protection (unless switching PMI provider). We also note that some add-ons are not offered by all PMI providers, such that if their policyholders wish to buy a specific protection they must do so from a different provider (or switch PMI provider).
  
21. Figure 1 shows the number of add-ons taken up by respondents. Only a very small proportion of respondents took up either all or none of the nine add-ons in our list, with the modal number being five.

**Aviva Comment** - This seems a skewed representation of the number of add-ons per policy as some of the covers are offered as standard by the majority of insurers eg Windscreen cover (7/10 insurers include as standard) and Key Cover (8/10 insurers include theft of keys as standard)



FIGURE 1

**Number of add-ons included in policy**



Source: CC PMI Customer Survey, question B2.

22. Our survey asked respondents whether they preferred to have add-ons offered to them separately, so that they could be added, or whether they preferred to have them already included in the basic PMI policy. Most respondents, 53 per cent, said that they had either a slight or strong preference for add-ons to be offered separately, while 32 per cent said that they preferred them to be included in the basic policy.
23. Table 3 shows that most people who considered an add-on at the time of purchase of their PMI policy went on to buy it (either within their basic PMI policy or separately). This is particularly true of windscreen cover, the most frequently taken-up add-on. In contrast, 23 per cent of those who considered breakdown cover did not take it up, which might be due to there being many stand-alone options for breakdown cover (eg from the AA or RAC).<sup>14</sup>

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<sup>14</sup> We note that only 3 per cent of respondents said that they did not know whether breakdown cover was included in their motor insurance policy, suggesting a high level of customer awareness about this add-on (see Table 2).

TABLE 3 Products considered by the policyholder

			<i>per cent</i>
	<i>Considered</i>	<i>Included</i>	<i>% who considered but did not include</i>
Windscreen cover	89	85	4
No claims bonus protection	86	80	8
Legal expenses/legal protection	83	76	9
Courtesy car/temporary replacement vehicle	77	70	10
Personal accident/personal injury/medical expenses	64	56	12
Personal belongings cover	49	44	10
Breakdown cover	51	39	23
Foreign use cover	33	30	11
Key loss cover	29	24	18

Base (unweighted) = 1,501

Source: CC PMI Customer Survey questions B2, B3.

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\*Percentage of those who included this add-on in their policy.

24. Most respondents who had an add-on in their policy (either purchased separately or included in the basic cover) said that they compared that add-on across insurers the last time they compared PMI policies (see Table 4). Summing across the nine add-ons in our list, 52 per cent of add-ons included in policies were compared in this way. However, we note that different consumers might have meant different things in terms of the comparisons they made.
25. Most respondents who compared features of add-ons across insurers said that they found it easy to do so, in particular for windscreen cover and NCB protection (see Table 4). It appears that consumer purchasing behaviour is similar for personal belongings cover, personal accident/personal injury/medical expenses, foreign use cover and key loss cover, with relatively little comparison of these add-ons across insurers.

TABLE 4 Percentage of policyholders covered by the product who compared the product across insurers

	<i>Included</i> %	<i>of which:</i>		<i>Unweighted base</i>
		<i>Compared Insurers</i> %	<i>Comparison of feature was</i> <i>Easy</i> % <i>Difficult</i> %	
Windscreen cover	85	52	73 9	653
No claims bonus protection	80	62	65 12	735
Legal expenses/legal protection	76	52	55 17	569
Courtesy car/temporary replacement vehicle	69	53	59 14	539
Personal accident/personal injury/medical expenses	56	47	53 17	399
Personal belongings cover	44	32	52 18	210
Breakdown cover	39	52	59 13	355
Foreign use cover	30	26	59 18	114
Key loss cover	24	32	52 15	127

Source: CC PMI Customer Survey questions B2, B7, B8.

\*'Easy' combines responses to B9 of 'quite easy' and 'very easy'; 'difficult' combines 'quite difficult' and 'very difficult'.

26. Table 5 shows respondents' perceptions of the value for money of add-ons which they have taken up.

TABLE 5 Perceived value for money among those that have the feature

	<i>Included</i>	<i>Value for money*</i>		
		<i>Good</i>	<i>Poor</i>	<i>Don't know</i>
Windscreen cover	85	65	8	7
No claims bonus protection	80	69	6	7
Legal expenses/legal protection	76	53	6	14
Courtesy car/temporary replacement vehicle	69	54	7	14
Personal accident/personal injury/medical expenses	56	51	7	12
Personal belongings cover	44	37	18	10
Breakdown cover	39	64	7	9
Foreign use cover	30	38	16	23
Key loss cover	24	35	8	10

Source: CC PMI Customer Survey questions B2, B9.

\*Question B9 of the survey asks 'On a five point scale where 5 is very good value and 1 is very poor value, how would you rate the value for money of the feature available to you'. Responses of 4 or 5 are categorized as 'good' for the purpose of this table, and responses of 1 or 2 are categorized as 'poor'.

27. Most respondents thought that the add-ons they had taken up were good value for money.<sup>15</sup> This was particularly true of NCB protection (69 per cent). For most add-ons, only a small percentage of respondents who had taken up an add-on regarded it as poor value for money (6 to 8 per cent for most add-ons). The proportions were

<sup>15</sup> We note that, where an add-on was purchased as part of a basic PMI policy and without the payment of an additional premium, the 'cost' of the add-on might still have been assessed by comparison with the cost of the add-ons from another provider.

higher for foreign use cover and personal belongings cover, which are discussed below.

28. A relatively high proportion (23 per cent) of those respondents who said that they had foreign use cover said that they did not know whether it was good value. This suggests to us that many consumers of this add-on are unclear of the cover provided and whether or not it is needed in order to drive abroad.
29. 18 per cent of those respondents who said that they had personal belongings cover said that they thought it was poor value for money. We considered whether people who took up this add-on were likely to be particularly risk averse, but the evidence from the survey suggested this was not the case (13 per cent of those who said that it was very important to cover all eventualities in the risk-aversion question<sup>16</sup> said that this add-on was poor value for money compared with 14 per cent among the rest of those who had the add-on).

### ***Personal accident/personal injury/medical expenses***

30. The name of this add-on varies between insurers. Over half of the respondents to our survey of PMI policyholders (56 per cent) said that they had this add-on. Stated take-up was particularly high among those who also had personal belongings cover (71 per cent). We noted that there was also evidence of a seasonal effect with the add-on being taken up more often when policies were renewed in the first three months of the calendar year (60 per cent), possibly reflecting greater awareness of the risk of injury at that time of year.

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<sup>16</sup> Question B12 asks 'How important is it to you that you have a very comprehensive private motor insurance policy that covers all possible eventualities?' The choice of responses is 'Very important', 'Fairly important', 'Neither important nor unimportant', 'Not very important', or 'Not at all important'.

31. Table 6 shows the extent to which respondents believed they understood the personal accident/personal injury/medical expenses add-on,<sup>17</sup> analysed by their rating of its value for money. Half of respondents rated the add-on as good or very good value for money and these respondents tended to be those who claimed to understand it. This pattern applies to all nine add-ons, ie the more respondents believed they understood the add-ons, the better value for money they perceived the add-on to be.

TABLE 6 Perceived understanding compared to perceived value for money

Personal accident/personal injury/medical expenses

	<i>How well the respondent believed they understood the feature</i>					<i>All</i>
	<i>Not at all</i>		<i>Very well</i>			
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	
	<i>%</i>	<i>%</i>	<i>%</i>	<i>%</i>	<i>%</i>	<i>%</i>
Poor or very poor value	21	28	10	6	3	9
Neither poor nor good value	28	30	41	29	19	30
Good or very good value	26	27	35	57	71	50
Don't know	26	16	14	8	8	11
Total	5	10	30	26	29	100
Base	43	90	279	244	266	922

Source: CC PMI Customer Survey questions B9, B10.

32. Table 7 shows the results of a suite of three questions designed to test actual understanding of personal injury benefits. The questions were asked of all those who had considered (most of whom also took up) personal injury/personal accident/medical expenses cover. While most respondents said that they were covered by the add-on, only 17 per cent answered correctly that passengers, other than themselves and their spouse, were not covered by it. Only 5 per cent of respondents answered all three questions correctly.

<sup>17</sup> Question B10 of the Customer Survey asked the following:

'And still thinking about the last time you were considering which features to include in your Private Motor Insurance Policy, how well do you believe you understood what exactly the feature covered? Please answer on a scale of 1 to 5 where 5 is very well understood and 1 is not at all understood.'

The results shown in this paper categorise respondents' perceived understanding into 'High' (a response of 4 or 5 to the question), 'Medium' (a response of 3) and 'Low' (a response of 1 or 2). The very small number of respondents who said they didn't know have been excluded from the analyses.

TABLE 7 **Actual understanding of personal injury benefits**

	<i>per cent</i>		
	<i>Do you think the following are covered?</i>		
	<i>You</i>	<i>Your spouse</i>	<i>Any passengers</i>
Yes	84*	58*	56
No	6	22	17*
Don't know	9	20	27
<i>% 'yes' by claimed understanding</i>			
High	89*†	61*	59
Medium	83*	56*	53
Low	79*†	56*	50

Source: CC PMI Customer Survey questions B10, B10a.

\*Indicates the correct answer (although a few insurers might provide cover with a slightly different scope, we believe the market shares of such providers is insufficient to materially affect our results).

†Statistically significant difference.

33. The second part of Table 7 shows the percentage of respondents who said 'yes' to each of the questions asked broken down by their perceived level of understanding of the add-on. The table shows that the percentage of respondents who said 'yes' increases with their perceived level of understanding, though in the last case 'yes' is the incorrect answer (59 per cent of those who thought that they understood the add-on well answered incorrectly).
34. Table 6 shows that the perception of understanding of an add-on tends to make a customer value it more. Table 7 suggests that this is because such customers think that the add-on offers wider cover than other customers, though sometimes they do so incorrectly. Subsequent tables in this paper support this finding (see Tables 8 to 11).
35. Table 8 shows the results of a similar set of questions for medical expenses. In this case the correct answer to all three questions was 'yes', and 40 per cent of those with the add-on answered all three questions correctly. Again, the perceived coverage of the add-on tended to increase with the perceived understanding (though in this case it was correct that coverage was wider).

TABLE 8 Actual understanding of medical expenses

	<i>per cent</i>		
	<i>Do you think the following are covered?</i>		
	<i>You</i>	<i>Your spouse</i>	<i>Any passengers</i>
Yes	84*	58*	50*
No	7	23	20
Don't know	10	19	30
<i>% 'yes' by claimed understanding</i>			
High	87*	62*	55*†
Medium	83*	54*	45*†
Low	80*	60*	45*

Source: CC PMI Customer Survey questions B10, B10b.

\*Indicates the correct answer.

†Statistically significant difference.

### **NCB protection**

36. Our survey found a high stated take-up of NCB protection (80 per cent). However, as noted in paragraph 18, it appears to us that this is likely to be an overstatement due to some customers confusing NCB and NCB protection. Data from five of the ten largest PMI insurers suggests that actual take-up rates of NCB protection are between [ ] and [ ] per cent, with an unweighted average of 49 per cent. This suggests that a significant proportion of consumers who think that they have the protection do not have it.

37. Nevertheless, a high proportion of respondents (77 per cent) thought that they had a good understanding of this add-on. Table 9 shows that 59 per cent of those who claimed to understand it well wrongly thought that NCB protection would prevent their PMI premium going up as a result of a claim, and only 29 per cent of respondents who said that they had the add-on answered this question correctly.<sup>18</sup> Respondents claiming a high level of understanding of NCB protection tended to be the most optimistic about the extent of its cover (see paragraph 34).

<sup>18</sup> A PMI premium may rise following an accident, notwithstanding NCB protection, as a motorist involved in an accident (whether fault or non-fault) may be deemed by an insurer to be statistically more likely to have an accident in the future. NCB protection is also usually limited to a certain number of claims in a defined time period, such that if there are more accidents, the NCB will decrease.

TABLE 9 **Actual understanding of NCB protection**

	<i>per cent</i>		
	<i>Does the protection prevent your premium going up as a result of a claim?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
All with feature	56	29*	14
<i>By claimed understanding</i>			
High (base 991)	59†	29*	12†‡
Medium (base 182)	46†	31*	23†
Low (base 108)	50	27*	23‡

Source: CC PMI Customer Survey questions B10, B10c.

\*Indicates the correct answer.

† and ‡ indicate statistically significant differences.

38. 37 per cent of those who said that they had made a 'claim' against their NCB protection answered the question correctly. 47 per cent of those who had made a 'claim' said that they understood the add-on very well; with 48 per cent of respondents who had not made a 'claim' saying the same. This is different from all other add-ons (except foreign use travel where the number of claims is very low), where the experience of claiming against the add-on tends to increase both the stated and actual understanding.

### **Foreign use cover**

39. Only 30 per cent of respondents said that they had foreign use cover. Among these, 60 per cent said that they had a good understanding of this add-on, but only 30 per cent of these correctly answered the question testing their understanding of it (see Table 10).<sup>19</sup> A higher proportion (42 per cent) of those who said they had a low understanding of the add-on gave the correct answer.

<sup>19</sup> Foreign use cover is not necessary in order for the policyholder to drive their car in Europe (as a basic PMI policy provides at least third party cover abroad).



TABLE 10 **Actual understanding of foreign use cover**

	<i>per cent</i>		
	<i>Do you need the feature to be able to drive your vehicle at all in continental Europe?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
All with feature	55	30*	16
<i>By claimed understanding</i>			
High (base 272)	61†	30*	9
Medium (base 108)	56	27*	17
Low (base 71)	42†	42*	15

Source: CC PMI Customer Survey questions B10, B10d.

\*Indicates the correct answer.

†Indicates statistically significant difference.

### **Key loss cover**

40. Only 24 per cent of respondents said that they had key loss cover. Take-up was higher among the C2DE socioeconomic group (29 per cent) and much higher in Northern Ireland (38 per cent). It was also higher among those who had personal belongings cover (35 per cent), and those who had foreign travel cover (32 per cent).
41. Of respondents with key loss cover, 67 per cent said that they had a good understanding of it. However, only 9 per cent correctly answered both the survey questions which tested their understanding (see Table 11).<sup>20</sup> Those who thought that they understood the add-on tended to be more optimistic about its coverage, though not always correctly (see paragraph 34).

<sup>20</sup> Key loss cover insures for the replacement cost of locks and keys for the car if the policyholder loses the keys, but the insurance company will not send someone to sort out the problem. From the evidence we have seen, a very small proportion of key loss covers will include the insurer sending someone out.

TABLE 11 Actual understanding of key loss cover

	<i>per cent</i>		
	<i>Will this pay for replacement keys and locks to your car if you lose your keys?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
all with feature	75*	6	18
<i>By claimed understanding</i>			
High (base 267)	86*†‡	3†‡	11†‡
Medium (base 86)	63*†	10†	27†
Low (base 47)	57*‡	15‡	28‡
	<i>Will someone appointed by the insurance company come out to you and fix the problem if you lose your keys?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
All with feature	50	14*	37
<i>By claimed understanding</i>			
High (base 267)	55	12*	32
Medium (base 87)	43	17*	40
Low (base 48)	46	17*	38

Source: CC PMI Customer Survey questions B10, B10e, B10f.

\*Indicates the correct answer.

† and ‡ indicate statistically significant differences, eg in column 1, 86 per cent is statistically higher than 63 and 57 per cent but 63 per cent is not statistically higher than 57 per cent.

### **Summary of analysis of our survey results in relation to add-ons**

42. Most PMI policyholders are covered by one or more add-ons. Of the nine add-ons considered in our survey (which did not include MLEI), windscreen cover was the most popular, which appears to be at least in part because many basic PMI policies include it. Our survey found that the majority of PMI policyholders preferred to have the choice of selecting add-ons separately, rather than having covers included in their basic PMI policy. A minority of respondents were unsure about which add-ons they had.
  
43. Most respondents to our survey who said that they had compared the add-ons offered by different insurers believed that add-ons were easy to compare across insurers but, for some add-ons, particularly personal belongings cover, foreign use cover and key loss cover, most of those who said they were covered by the add-on did not make any comparisons.

44. Respondents' understanding of the cover provided by add-ons was generally poor. Even among those who claimed they understood an add-on, many answered questions about it incorrectly. In particular, we note that 80 per cent of survey respondents said that they had NCB protection, though we know from evidence from insurers that actual take-up is much lower, suggesting some confusion between NCB and NCB protection. Of those who claim to have NCB protection, only three in ten correctly answered the question about it.

### **Analysis of the profitability of some add-ons**

45. We looked at the claims ratio of some add-ons as a basic measure of their profitability. We could not review expense ratios as insurers do not allocate expenses between their add-on products.<sup>21</sup>
46. The claims ratio, which is presented as a percentage, measures the proportion of premiums paid out in claims. It is calculated as claims costs divided by net earned premiums (NEP). Claims costs are the total of claims paid, net of any recoveries from reinsurers, and any changes in provisions for claims, net of reinsurance; NEP is gross written premiums (GWP), net of Insurance Premium Tax (IPT) and premiums ceded to reinsurers and any changes in provisions for unearned premiums. All things being equal, a low claims ratio indicates higher profitability for an insurer than a high claims ratio.

### ***Data requested from the parties***

47. We asked insurers to complete a template spreadsheet containing a split of NEP and claims costs by type of risk covered. The template spreadsheet covered the five years 2008 to 2012. The types of risks covered were:
- (a) basic cover;

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<sup>21</sup> The expense ratio is expenses expressed as a percentage of premiums.

- (b) MLEI;
- (c) NCB protection;
- (d) windscreen;
- (e) breakdown;
- (f) personal injury;
- (g) courtesy car; and
- (h) other (including key loss and foreign use cover).

### ***How insurers provide add-on products***

48. We note that insurers provide add-on products in two different ways depending on which party bears the risk:

- (a) Some add-ons are designed, underwritten, supplied and managed by the insurer, eg NCB protection and foreign use cover. In these cases, the risk is borne by the insurer.
- (b) Some add-ons are designed, underwritten and managed by a third party provider but supplied by the insurer, either under its name or under the name of the supplier. In these cases, the risk is borne by the third party supplier and the insurer acts as a distributor. The retail price consists of the unit cost (controlled by the third party), the margin (controlled by the insurer) and IPT (payable on the retail cost). As this is risk-free income for the insurer, it is usually recognized as fee income. The third party supplier is responsible for all claims handling in relation to these products.

Some add-ons (eg breakdown cover, windscreen cover and MLEI) are offered by some insurers under the in-house model and offered by other insurers under the outsourced model. For example, esure offers breakdown cover which is supplied by Green Flag, whereas LV offers breakdown cover underwritten in-house (Britannia

Rescue). Where add-on products were supplied by an outsourced provider, most insurers were unable to provide us with claims data.<sup>22</sup>

49. Three insurers told us that the pricing and profitability of add-ons could not be assessed by looking at add-ons individually:

(a) One insurer ([REDACTED]) told us that, due to the complexity of rating and cross-cover rating dynamics in the price calculation, it was not simple to split out the add-on premium. For example, if the overall premium had been overridden by the sales representative to achieve the sale, this could impact the premium of any one of the covers included.

(b) [REDACTED] provided an analysis of claims costs by the take-up of certain add-ons (NCB protection, courtesy car cover and foreign use cover). It showed, for example, that customers buying guaranteed NCB protection were more likely to make more frequent and smaller claims than other customers. [REDACTED] told us that its pricing approach was to compare the overall profitability of a customer who selected the add-on, against eligible customers who did not select it.

(c) [REDACTED] told us that any additional margin from add-on products, such as breakdown cover, fed into the overall underwriting result and ultimately into customers' basic PMI premium prices.

### **Data received**

50. Of the ten large insurers, only seven were able to provide data splitting NEP and claims costs for some add-on products. No insurer was able to provide data on all the add-on products in our list (see paragraph 47). Insurers provided data on the following add-ons:

(a) Aviva: [REDACTED];

(b) AXA: [REDACTED];

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<sup>22</sup> With the exception of data on breakdown, courtesy car and key loss covers provided by CISGIL (see paragraph 72 onwards).

(c) CISGIL: [REDACTED];

(d) DLG: [REDACTED];

(e) esure: [REDACTED];

(f) LV: [REDACTED]; and

(g) RSA: [REDACTED].

51. Three insurers ([REDACTED]) did not provide a split of NEP and claims costs by add-on product, for the following reasons:

(a) [REDACTED] add-ons were all launched in the second half of 2012, so it had limited data.

(b) [REDACTED] has a limited range of add-on products, which are mainly provided by third parties.

(c) [REDACTED] add-on products are either included in its basic cover, or provided by third parties.

52. Table 12 summarizes which of the ten large insurers offers which add-ons and whether they are provided by a third party supplier, underwritten by the insurer or included by the insurer in the basic cover.

TABLE 12 Summary of add-on products offered by each insurer

Insurer	MLEI	NCB protection	Windscreen	Breakdown	Personal injury	Courtesy car	Other
Admiral	Included in basic	Yes	Included in basic	Yes via 3P	Yes	Included in basic	
Ageas Insurance	Yes via 3P	Yes	No	Yes via 3P	No	No	Key loss cover (only 2010-2011 via an MGA relationship)
Aviva	Yes	Yes	Included in basic	No	No	Yes	Foreign use, PhysioFast
AXA	Yes	Yes	Yes	Yes via 3P	Yes	Yes	Key loss
CISGIL	Yes	Yes for purchase by qualifying customers only	Included in basic	Yes via 3P	Some elements of personal accident cover are included in basic	Yes via 3P	Extended foreign use; key loss ( via 3P)
DLG	Yes	Yes*	Included in basic	Yes	Included in basic	Yes†	
esure	Yes	Yes‡	Included in basic	Yes via 3P	Yes	Included in basic	Foreign use ; Key loss (from Oct 2012); Misfuelling
LV	Yes	Yes	Included in basic	Yes	Yes§	Yes	Foreign use
RSA	Yes	Yes	Yes¶	Yes	Yes	Yes#	Foreign use
Zurich	Yes via 3P	Yes	Included in basic	Yes via 3P	Yes	Included in basic	Key loss (via 3P)

**Aviva Comment** - Aviva data is incorrect. We do offer Breakdown as an add on and there is a PA (personal injury) upgrade add on to the inclusive cover provided by Aviva Direct. Aviva IB have PA cover included with no upgrade option

Source: CC based on responses from the parties.

\*DLG does not treat NCB protection as an add-on, but as a variation to its pricing of the basic PMI policy.

†DLG offers guaranteed hire car (GHC) and guaranteed car hire+ (GHC+) as add-ons which enable customers to purchase hire car provision. DLG does not consider this to be the provision of a courtesy car. There are a very small number of DLG legacy policies which do provide a courtesy car.

‡esure offers NCB protection as an extension to the basic policy (for an increase in the premium).

§LV noted that personal injury/accident cover is included in basic comprehensive cover.

¶,#RSA noted that windscreen and courtesy car cover are optional extras only for policies sold through eChoice. For MoreTh>n customers, windscreen and courtesy car cover are included in the basic PMI policy.

Notes:

Yes = sold as a separate add-on.

Yes via 3P = sold as a separate add-on provided by a third party.





## Analysis of the data

53. Table 13 shows which insurers provided data on which add-ons in order for us to be able to calculate claims ratios.

TABLE 13 Data available for add-on products

Add-on product	Insurers providing suitable data	Number of parties with data compared to number offering add-on
Breakdown	[X]	3 out of 3
MLEI	[X]	6 out of 8
NCB protection	[X]	0 out of 10
Windscreen	[X]	2 out of 3
Personal injury	[X]	1 out of 6
Courtesy car	[X]	3 out of 5
Other: key loss	[X]	1 out of 4
Other: foreign use	[X]	2 out of 6

Source: CC based on responses from the parties.

## NEP

54. Table 14 shows the aggregate NEP for basic cover and each add-on product for the five-year period for the seven insurers listed in paragraph 50.

TABLE 14 Analysis of NEP by type of risk

	2008	2009	2010	2011	2012	2012 share to total NEP %
Basic cover	5,302.7	5,285.6	5,558.9	5,699.5	5,176.7	91.9
Breakdown	172.3	188.0	186.0	175.4	161.1	2.9
NCB protection	129.0	117.7	122.6	154.2	152.0	2.7
MLEI	70.6	84.6	87.5	104.2	109.4	1.9
Windscreen	20.7	20.3	25.0	28.3	21.9	0.4
Personal injury	-	0.0	0.2	0.3	0.2	0.0
Courtesy car	15.4	13.7	11.4	13.5	12.5	0.2
Other	2.5	2.6	2.7	2.6	2.0	0.0
Total	5,713.0	5,712.5	5,994.3	6,178.1	5,635.8	100.0

Source: CC analysis.

55. Table 14 shows that basic cover accounted for 92 per cent of total NEP in 2012. Breakdown cover and NCB protection accounted for 2.9 and 2.7 per cent respectively, and no other add-on accounted for more than 2 per cent.

## Claims ratios

56. Table 15 shows the claims ratios for basic cover and each add-on product for the five year period. The averages are weighted according to the size of the insurer (based on NEP).

TABLE 15 Claims ratios by type of risk covered, 2008 to 2012

	2008	2009	2010	2011	2012	per cent	
						Average	Parties providing data
Basic cover	84	96	108	85	82	91	All 7
Breakdown	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	3: [REDACTED]
MLEI	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	6: [REDACTED]
Windscreen	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	2: [REDACTED]
Personal injury	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	1: [REDACTED]
Courtesy car	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	3: [REDACTED]
Key loss	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	1: [REDACTED]
Foreign use	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	2: [REDACTED]
<b>Overall</b>	<b>80</b>	<b>90</b>	<b>102</b>	<b>80</b>	<b>77</b>	<b>86</b>	

Source: CC calculations based on responses from the parties.

### Basic cover

57. The weighted average claims ratio for basic cover was 91 per cent over the five-year period, with consistency across the years except for 2010. [REDACTED].

### MLEI

58. The weighted average claims ratio for MLEI was extremely low at 5 to 10 per cent over the five-year period:

(a) [REDACTED] showed [REDACTED]. It told us that [REDACTED].

(b) [REDACTED] told us that the claims cost for MLEI was very low as it usually sought to recover the costs incurred from the fault insurer. [REDACTED] told us that this cover provided customers with valuable benefits, enabling them to recover uninsured losses or to pursue a personal injury claim following a non-fault accident.

(c) [REDACTED] had [REDACTED] claims ratio for MLEI, at an average of [REDACTED] per cent over the five-year period.

### *Windscreen*

59. Two insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 70 to 100 per cent over the five-year period, typically being only a little lower than the basic cover claims ratio.

### *Breakdown*

60. Three insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 30 to 45 per cent over the five-year period. None of the insurers provided an explanation as to why its claims ratios were so low. We note that:

- (a) [redacted] claims ratio for each year was [redacted] (between [redacted] and [redacted] per cent);
- (b) [redacted] ratio fluctuated (being [redacted] per cent in 2008 and [redacted] per cent in 2009, probably due to a build-up and subsequent release of reserves), but averaged [redacted] per cent.

### *Personal injury*

61. Only [redacted] was able to provide data on this add-on.

### *Courtesy car*

62. Three insurers provided data on this add-on. The weighted average claims ratio ranged from 25 to 75 per cent over the five-year period. [redacted] and [redacted] showed [redacted] claims ratios, of between [redacted] and [redacted] per cent, whereas RSA showed [redacted] ratios in 2009 and 2010 of [redacted] and [redacted] per cent respectively.

### *Other: key loss*

63. Only [redacted] provided data on this add-on. Its average claims ratio for the five-year period was [redacted] per cent.

*Other: foreign use*

64. Two insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 20 to 40 per cent over the five-year period. [X] average claims ratio for the five-year period was [X] per cent, and [X] was [X] per cent.<sup>23</sup>

***NCB protection***

65. Although NCB protection insures a customer against a specific risk (ie losing NCB as a result of a claim) and a premium is charged for it, there is no claims cost clearly associated with it as it relates to the amount of premium payable by a customer on renewal. Consequently none of the insurers provided us with a claims ratio. However, eight insurers told us how they priced the product (including whether it has a standard price or whether the price is dependent on the risk of the policyholder), the costs associated with the product, and how those costs were accounted for. We set out this evidence below.

*Pricing of NCB protection*

66. It appeared to us that all eight insurers took a risk-based approach to setting the price at which they offered NCB protection to policyholders:
- (a) [X],[X] and [X] noted that their pricing took account of customer profitability, which reflected claims performance. [X] told us that, where protected NCB was available, the price was calculated as a percentage addition to the premium for basic cover and therefore reflected the overall risk of the individual policyholder. [X] told us that the price was 14 per cent of the basic premium. [X] told us that the price was up to 15 per cent of the basic premium.
- (b) [X] and [X] told us that the selection of NCB protection was treated as a variable in the overall premium calculation, ie the total premium was adjusted if

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<sup>23</sup> [X] noted that its 'other' category of claims was mainly against foreign use cover but could include a small number of claims made against other covers.

the customer selected NCB protection rather than there being a separate figure calculated to represent the cost of NCB protection. [X] explained that this was because the benefit of NCB protection related to the cost of the basic cover whereas claiming under other add-ons did not affect the basic cover and its pricing. [X] told us that the price was dependent on the number of claim-free years and was 2.5 per cent if the number of NCB years protected was five or more, and 10 per cent if four years NCB was protected (and NCB protection was not offered for less than four years' NCB).

(c) [X] and [X] told us that NCB protection was priced in the same way as the basic PMI cover and was therefore based on the risk of the individual policyholder.

(d) [X] told us that NCB protection was priced as an additional percentage of the basic PMI cover premium and was therefore based on the risk of the individual policyholder. [X] said that the price was currently 10 or 15 per cent of the basic premium for [X].

#### *The cost to insurers of NCB protection*

67. Seven of the eight insurers told us that the cost to them of NCB protection was the income forgone from not reducing the discount applied to the premium at renewal (which would otherwise happen if the customer had made a claim).
68. [X] estimated that the opportunity cost of not increasing the renewal premium was between 0.5 and 1 per cent of the NEP for basic cover plus the NCB protection add-on. [X] noted that, for [X] renewals in Q1 2013, for a customer who had nine years' NCB but had made at least one fault claim during the previous year, there was an average premium increase of over 60 per cent for customers without NCB protection and a significantly lower increase of below 15 per cent for customers with NCB protection.

69. [REDACTED], AXA, DLG and LV told us that an additional cost to the insurer was that customers with NCB protection were more likely to make small claims than customers without NCB protection (since the latter might decide not to make a claim in order to avoid an increase in premium due to losing their NCB). However, [REDACTED] noted that, whilst in theory customers with NCB protection could be expected to make more small claims than customers without it, its experience was that overall the claims cost of customers with NCB protection was lower than for customers without it. Similarly, [REDACTED] noted that its loss ratio was better (ie lower) on policies with protected NCBs. [REDACTED] noted that customers with NCB protection who had made a claim were more likely to switch insurers at renewal than customers without NCB protection who had made a claim because they would be able to obtain more competitive renewal quotes.

#### *Accounting treatment*

70. It appears to us that the extent to which renewal premiums are lower as a result of NCB protection than would have been the case otherwise is reflected in insurers' overall premium income. Similarly, the extent to which claims are higher than would have been the case is reflected in the overall claims cost. Two insurers, LV and Zurich, noted that the costs associated with NCB protection could not be separated from the overall claims cost as it was not possible to know which claims the customers with NCB protection had made which they would not have made had they not purchased it.

#### ***Add-on products supplied by third parties***

71. The insurers in our sample were generally unable to supply us with data on the profitability of add-on products supplied by third parties. However, we received some data on selected add-ons from two insurers: CISGIL and esure.

72. CISGIL's breakdown and courtesy car cover add-ons are provided by a third party (so not included in the calculations above). Table 16 shows the maximum retail price and margin to CISGIL for each of these products (ie the retail price less the IPT (currently 6 per cent), the direct cost to CISGIL, allocated costs (such as marketing, sales staff, system expenses, etc), and a contribution towards indirect costs).

TABLE 16 CISGIL breakdown and courtesy car cover add-on products

	<i>Breakdown</i>	<i>Courtesy car</i>
Maximum retail price (£)	60	17.50
Margin (£)	[REDACTED]	[REDACTED]
Margin (%)	[REDACTED]	[REDACTED]

Source: CISGIL; CC calculations.

73. Since October 2010 CISGIL has also offered key loss cover from a third party supplier (Keycare). CISGIL sets the retail price (currently £15) to cover the net rate payable to the claims administrators (currently £[REDACTED] for each new business policy and £[REDACTED] for each policy renewal (ie effectively the claims costs per policy)), direct and indirect CISGIL costs, IPT and its profit. The retail price net of IPT less the amounts payable to the claims administrators produces a margin of between £[REDACTED] and £[REDACTED] which cover CISGIL's costs of selling, allocated costs, indirect costs and profit.

74. esure's breakdown cover is provided by Green Flag. esure told us that [REDACTED].

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 5: Impact of MFN clauses in contracts between PCWs and PMI providers

#### Introduction

1. Contracts between price comparison websites (PCWs) and private motor insurance (PMI) providers often contain clauses that restrict the price at which the PMI provider can sell a particular policy through other sales channels. These clauses are referred to as Most Favoured Nation (MFN) clauses.<sup>1</sup>
  
2. In order to assess whether these clauses cause an adverse effect on competition and give rise to consumer detriment, we consider in this paper<sup>2</sup> the trade-off between the beneficial and harmful effects that they may have on competition.
  
3. We consider four main sources of harm:
  - MFN clauses may lift constraints on cost-per-acquisition (CPA) fees and therefore result in higher CPA fees and, if these higher fees are passed through by PMI providers, higher PMI premiums;
  - MFN clauses may lead to higher PMI prices irrespective of CPA fees because price reductions become more costly to PMI providers;
  - MFN clauses may restrict entry and innovation, and therefore choice and price competition, in the provision of PCWs; and
  - MFN clauses may shift competition from being based on prices to being based on advertising, thus causing excessive advertising, which in turn might raise barriers to entry.

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<sup>1</sup> The term 'Most Favoured Nation' comes from multilateral trade negotiations, where one of the principles has been that a trading deal offered to one country (the most favoured nation) must also be offered to all other nations. Its use has been expanded to cover commercial arrangements in which the terms negotiated with one party (the most favoured) automatically become a part of the deal with other parties.

<sup>2</sup> This paper draws significantly on analysis in the OFT-commissioned research paper 'Can "Fair" Prices be Unfair? A review of Price Relationship Agreements' (2012), a report prepared by Lear, OFT1438.



4. MFNs may be pro-competitive on two grounds:
  - MFN clauses may enhance the search experience by reducing the need for consumers to shop around to find a cheaper price; and
  - MFN clauses may protect the sunk and fixed cost investments required for a good PCW offering.
5. In this paper we discuss all of these possible effects.

## Summary

**Aviva Comment** - Aviva considers that all forms of MFN are inherently problematic as they inhibit insurance providers from differentiating (particularly by price) between distribution channels and providing a wide range of offerings to customers.

MFNs mean that insurance providers are not able to provide cheaper prices to customers in channels which have lower costs of acquisition; and even MFNs which only require parity between a PCW and the insurance provider's own website (so called "narrow" MFNs) are problematic. Aviva believes these could suppress the growth in market sales for lower cost distribution channels such as digital and social media and could restrict competition.

As an analogy, Aviva would like the Competition Commission to consider whether the PCW market would have emerged 10 years ago if brokers had at the time had MFN clauses in their contracts with insurers. Aviva would urge the Competition Commission to consider remedies which would allow providers to provide their best price to customers through different distribution channels, and to prohibit the use of all MFN clauses.

6. PMI providers sell policies via a large number of sales channels, including PCWs; and many contracts between PCWs and PMI providers include MFN clauses. These clauses apply to approximately [X] per cent of PMI policies sold through PCWs.<sup>3</sup>
7. MFN clauses stipulate that the PMI provider cannot sell a policy on a particular sales channel at a cheaper price than it is available on the PCW.
8. MFN clauses vary in scope but for the purpose of our assessment we define three common scopes for an MFN:
  - (a) a PMI provider may not offer a particular policy on its own website for less than it

is advertised on the PCW ('own website-MFN');

(b) a PMI provider may not offer a particular policy on any online sales channel for less than it is advertised on the PCW ('online-sales MFN'); and

(c) a PMI provider may not offer a particular policy on any sales channel for less than it is advertised on the PCW ('all sales-MFN').

9. The extent to which an MFN clause might give rise to harm (see paragraph 3) will depend on the scope of the clause.

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<sup>3</sup> See [Appendix 1](#), Table 2.

10. In the case of an own-website MFN, we do not expect substantial harm from at least three out of the four possible sources of harm:

(a) Competition over CPA fees is unlikely to be weakened by own-website MFNs.

Other channels, and especially other PCWs, continue to be a source of competition when an own-website MFN is in place. Moreover, our survey of PMI policyholders suggests that most consumers are likely to visit multiple channels, with 63 per cent of those who searched on one PCW visiting more than one PCW (see working paper 'Survey report'). We have no evidence that CPA fees are higher for policies with own-website MFNs than for those with no MFN.

(b) The degree to which an own-website MFN will make it costlier for a PMI provider to reduce its prices depends on the proportion of sales that go through PCWs covered by the MFN compared with the proportion going through the direct channel only. If sales exclusive to the direct channel are a small proportion of total sales, we would expect the own-website MFN to increase significantly the cost of a price reduction on the PMI provider's own website.

(c) Entry to the PCW market could be based on the ability to compete on CPA fees, with the expectation that PMI providers would pass through their lower costs to lower policy prices. An own-website MFN does not hamper this process.

**Aviva Comment** - Aviva notes that channels of distribution are not restricted to those that provide a direct connection to a partner's website eg cashback sites. For large, more familiar brands, other forms of marketing activity generate substantial business direct to an insurance provider's website. Some of this media will be more cost effective than a PCW but an insurance provider will certainly be constrained in its proposition messaging by such MFN clauses.

(d) The mechanism by which MFNs might lead to high levels of advertising expenditure is directly related to the degree to which they allow for higher CPA fees.

Since we expect CPA-fee competition to be maintained by own-website MFNs, we would not expect them to lead to higher advertising expenditure.

11. An online-sales MFN has a wider scope, specifying that a PMI provider may not offer a particular policy on any online sales channel (as well as the PMI provider's own

website) for less than it is advertised on the PCW. This type of MFN is more likely to lead to harm under our four theories:

- (a) Under an online-sales MFN, there is little scope for CPA fee competition being used to gain market share. Therefore, CPA fee competition between PCWs is effectively undermined. A PCW wishing to gain sales by lowering its CPA fee to a PMI provider in the hope of the PMI provider offering lower consumer prices will not be able to follow this strategy if another PCW has an online-sales MFN which applies to the policies concerned. The incentive for competing PCWs to lower their CPA fees is thus reduced. Moreover, a PCW with an online-sales MFN which is considering a rise in the CPA fee will not have to worry that such a rise will make its offering uncompetitive, since any pass-through of the CPA fee rise will need to be applied to all PCWs. Overall, there is thus less incentive to reduce CPA fees and less incentive not to raise them. Our empirical evidence suggests that CPA fees are higher on policies with online-sales MFNs than they are on policies with weaker or no MFNs, although we have not excluded alternative explanations of the data. We discuss more generally the negotiations between PMI providers and PCWs and the extent of the PCWs' bargaining power in the working paper 'ToH 3: Horizontal concentration in PCWs'.
- (b) We would expect that an online-sales MFN would make price cuts more costly for a PMI provider, and therefore that prices for PMI would be higher. We have observed that policies with wider MFNs tend to sell in smaller volumes than those with narrower MFNs, and this is consistent with them being more expensive. However, we have not excluded other causal accounts of this difference, for example that these policies are offered by niche PMI providers with lower bargaining power.
- (c) To the extent that entry is encouraged by the ability to pursue a strategy of lowering CPAs in an effort to offer lower overall premium prices, we would expect an online-sales MFN to reduce entry. We note that no PCW has entered the market with this strategy, despite the fact that PMI purchasers are known to be price sensitive. An online-sales MFN might also stifle innovation which was aimed at

reducing PMI premiums. For example, as a result of the MFN, a PCW would not see any direct benefit to its market share from improving its fraud detection or from enabling the more accurate pricing of risks. These innovations could plausibly reduce premiums by reducing the cost of provision but a PMI provider constrained by an online MFN could not reward the PCW which invested in such innovation by reducing PMI premiums through its website without also reducing PMI premiums to all PCWs with the MFN. Incentives to innovate are therefore reduced.

(d) To the extent that online-sales MFNs increase CPA fees, they will tend to encourage competition for market share through advertising expenditure rather than through price competition. PCWs will spend on advertising as long as the cost of acquiring a customer is smaller than the CPA they can expect from a customer, so higher CPA fees imply higher advertising expenditure. This may constitute excessive advertising expenditure measured against a benchmark of price-based competition between PCWs, and may also raise barriers to entry. There are other possible benchmarks but this might be an appropriate benchmark, especially if any MFN-induced advertising is simply reallocating customers between similar PCWs.

**Aviva Comment** - Aviva agrees that MFN clauses have the effect of encouraging competition through advertising expenditure rather than through price competition. The increase in PCW advertising spend over the last 5 years would tend to support this. However, we also believe that this serves to sustain the PCW competitive position against challenge from either insurers seeking to sell their products direct to consumers, or from new business models that offer potentially lower-cost channels for insurers and consumers to benefit from, such as social media or cashback sites.

12. We found that [redacted]. Prior to 2012, [redacted] had some similar MFNs.<sup>4</sup> We would expect such MFNs to have similar, but stronger, potential for harm than online-sales MFNs.
13. Any increase in prices on one policy due to MFN clauses may change the pricing decisions of competing providers, both other PCWs pricing CPAs and other PMI

providers pricing insurance products. Therefore, there is the potential for knock-on effects and price increases. We considered two types of knock-on effect:

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<sup>4</sup> [REDACTED].

- (a) If a policy is covered by just one online-sales (or stronger) MFN with just one PCW, then other PCWs have a reduced incentive to try to reduce retail prices through lower CPAs.
- (b) If an MFN leads to higher PMI prices on one policy, then the best response from providers of competing policies is likely to be to raise prices as many policies are close substitutes and if the price of one policy increases, other 'close' policies will find that they are faced with higher demand and a price increase is likely to be their best response.

14. Some parties told us that it was possible to circumvent MFNs. However, many of these strategies are likely to be costly (eg a multi-brand strategy) or in fact restricted by MFN clauses (eg time-limited price-based offers).

15. While MFNs may give rise to some harms, they also give rise to some pro-competitive benefits. PCWs create a brand and a platform which allow consumers to search and compare a range of PMI policies online. MFNs may be pro-competitive on two grounds:

- (a) They may enhance the consumer experience of searching for PMI products by reducing the need for consumers to shop around to find a cheaper price. With an MFN in place, consumers can reasonably infer that they are getting a good deal on the PCW, which reduces their search time and effort. This effect would be particularly strong if the MFNs are commonly known to be in place, but could also be the result of learning.

**Aviva Comment** - Because most of the PCWs ask consumers slightly different questions (and insurance providers rate on these questions) consumers will always find (without uniform question sets) slightly different prices on different PCWs. We believe this will always cause customers to shop around. It should also be noted that insurance providers' own websites are likely to ask slightly different questions as well and therefore there are other significant factors that will drive consumers to look for different prices.

- (b) They may protect the sunk and fixed cost investments required for a good PCW offering. If a PCW invested in offering good-quality search (including the invest-



ment required to advertise this product) but consumers discovered that the policy offered on the PCW was available cheaper elsewhere, they might use the search but not purchase the product through the PCW. The PCW might then reduce the

quality of its offering or go out of business. As a result, good search solutions might not be offered to consumers. An MFN acts to protect a sunk cost in the PCW and might allow a PCW to earn a return on its investment. In order to assess whether an MFN is a proportionate reaction to the problem of fixed and sunk cost recovery, we need to understand the scale of the cost recovery problem and alternative mechanisms which might address it. The fixed and sunk costs which need to be recovered may be lower than would appear from PCWs' actual costs to the extent that advertising expenditure is a substitute for price competition which would not occur in the absence of an MFN (see paragraph 11(d)). We note also that an MFN is not the only way by which PCWs might seek to protect their investment. Other possible solutions to this problem are:

- (i) fixed costs are covered by the CPA fees earned from consumers who do not switch to competing sales channels; or
- (ii) listing fees, minimum guaranteed CPAs or cookie-based affiliate marketing fees are used to reward PCWs irrespective of their sales-conversion rates.

16. We expect that both of the two types of pro-competitive effects of MFNs become stronger the wider the scope of the MFN: ie the comfort a consumer has from knowing that no alternative channel will offer the same product for cheaper will be enhanced the wider the scope of the MFN; and the probability that a PCW is used for search but is not the recipient of the conversion fee is lower if the chance of finding a cheaper similar product elsewhere is lower, as would be the case with a wide MFN in place.
17. We considered the evolution of MFN clauses in the industry and noted that their scope has tended to widen as competition has increased (ie as the number of PCWs has risen). This suggests that they may have been introduced with the intention of shielding PCWs from the full impact of competition.

**Aviva Comment** - AVIVA would also reference the rise of cashback sites as a potential threat to PCWs ; it is not just a rise in the number of PCWs which has increased competition for PCWs.

18. Overall, it appears to us that own-website MFNs have weak anti-competitive effects and may have some pro-competitive effects. However, MFNs with wider scope appear likely to have more substantial impacts, both anti- and pro-competitive. We intend to consider this issue further in order to form a view on whether, on balance, the wide MFNs in contracts between PCWs and PMI providers are pro- or anti-competitive. Specifically, we intend to consider further:
- (a) the impact of MFN clauses on PMI premiums;
  - (b) the likely extent to which advertising expenditures might be reduced if price competition were to replace advertising-based competition; and
  - (c) the likely magnitude of the efficiency gains from wider MFNs.

### **The role of MFNs in the PMI market**

19. Insurers and brokers ('PMI providers') are able to sell PMI policies via a large number of sales channels including: direct (online or telesales), on a PCW, via a broker (if an insurer), etc. Some of these sales options include both an online and offline channel.

20. PCWs are platforms which allow customers to search and compare across a range of PMI policies online (as well as other goods and services). If a customer finds a PMI policy which they wish to purchase, they click through to a PMI provider's website and make the purchase. The PMI provider typically pays the PCW a CPA fee for every PMI policy purchased.

**Aviva Comment** - Consumers can also purchase without ever clicking through to an insurance provider but by calling the insurance provider having noted their telephony details on the PCWs; or by an insurance provider calling the consumer. Many consumers follow this route and insurance providers typically pay the PCW a fee for every PMI policy purchased this way.

21. Approximately [30] per cent of PMI policies sold through PCWs are under contracts which include some form of MFN clause stipulating that the policy may not be advertised for less through another sales channel.<sup>5</sup> MFNs do not apply to quotes provided by an insurer to a customer on renewal. However, these clauses vary considerably, both in terms of the sales channels which are covered by the clause and

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<sup>5</sup> See [Appendix 1](#), Table 2.

the exceptions which may apply. For the purpose of our assessment, we define three MFN clauses with different scopes which broadly describe the main features of the majority of MFN clauses currently in force:

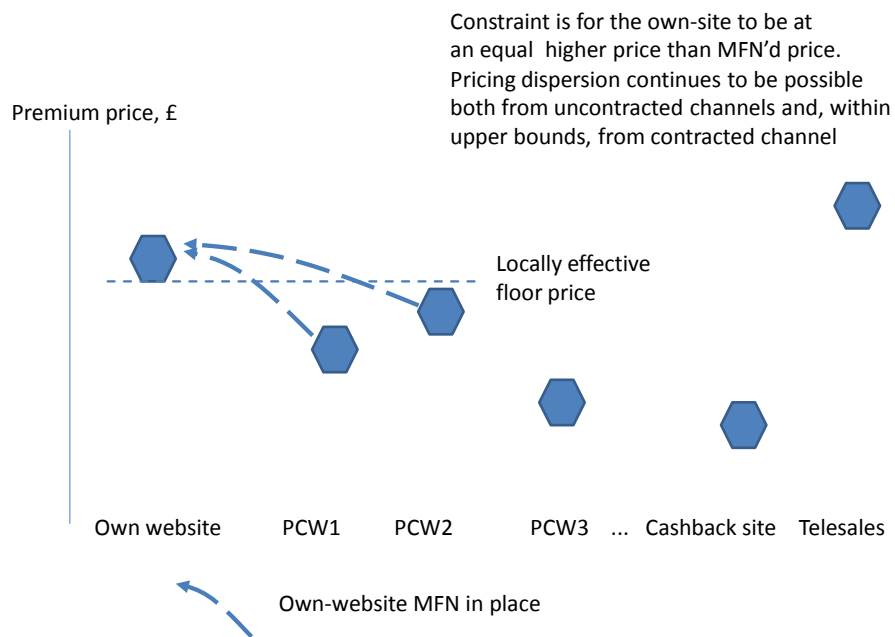
- (a) A PMI provider may not offer a particular policy on its own website for less than it is advertised on the PCW ('own-website MFN').
- (b) A PMI provider may not offer a particular policy on any online sales channel for less than it is advertised on the PCW ('online-sales MFN').
- (c) A PMI provider may not offer a particular policy on any sales channel for less than it is advertised on the PCW ('all-sales MFN').

22. In this paper, we discuss 'narrow' MFNs, referring to own-website MFNs and 'wide' MFNs, referring to online-sales and all-sales MFNs. We illustrate the different constraints imposed on PMI premium pricing by narrow and wide MFNs in Figures 1 and 2.

FIGURE 1

**The constraint imposed by narrow MFNs**

**Network effects of own-website MFNs**



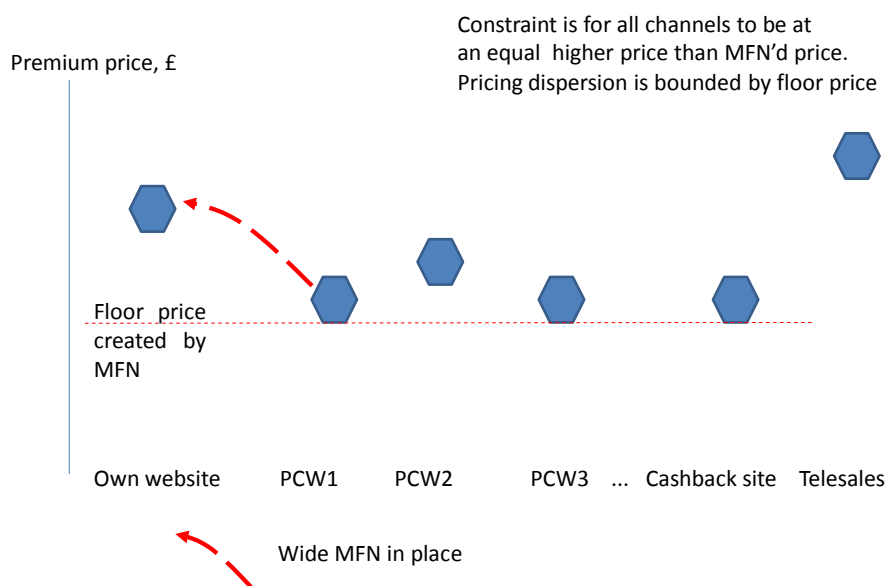
Source: CC.

23. In Figure 1, channels are represented on the horizontal axis, and premium prices on the vertical axis. PCW1 and PCW2 are assumed to have an own-website MFN with the PMI policy in question. They therefore know that their own prices will be no higher than those on the PMI provider's own website. However, there is no guarantee that PCW3, or the cashback website, will not be able to post lower prices on this policy. There is potential pricing competition from all channels except the own website. There is no 'network' or spillover effect from the own-website MFN for other channels.

FIGURE 2

**The constraint imposed by wide MFNs**

**Network effects of wide MFNs**



Source: CC.

24. In Figure 2, channels are represented on the horizontal axis, and premium prices on the vertical axis. PCW1 is assumed to have a wide MFN with the PMI policy in question. PCW1 knows that its prices will set a floor to the price that anyone can charge. There is no pricing competition from any channel covered by the wide MFN. This is a 'network', or spillover, effect.

25. The pro- and anti-competitive effects of an MFN will depend on its scope, so we consider each harm and each scope separately. Table 1 lists these possible effects and summarizes our view of the strength of them, which we discuss in more detail in the rest of this paper.

TABLE 1 Summary of mechanisms and impacts of MFNs

Effect	Type of MFN		
	Own site	Online	All-channel
<b>Anti-competitive</b>			
<i>CPA upward price pressure</i>			
Upward price pressure at PCW	X	√	√√
Absence of downward price pressure at other PCWs	X	√	√√
Absence of negotiating pressure from PMI providers threatening lower prices elsewhere	X	√	√√
Coordination between PCWs	X	√	√
<i>PMI upward price pressure</i>			
Direct	√	√	√
Dynamic	X	√	√√
Absence of PCW sales channel negotiating pressure for lower prices	X	√	√√
Entry restriction	X	√	√√
Excess advertising expenditure	X	√	√√
<b>Pro-competitive</b>			
Improvement of one-stop search	√	√√	√√
Protection of sunk costs investment	√	√√	√√

Source: CC.

Note: A cross indicates that we do not consider there to be a substantial effect. A single tick indicates a possibly substantial effect. Multiple ticks indicate that the effect is possibly stronger as the scope of the MFN increases.

## Potential anti-competitive effects of MFN clauses

26. We consider the harm that MFN clauses might cause under four broad headings:

- increased pressure for high CPA fees;
- increased pressure for high PMI premium prices;
- restrictions on entry and innovation on the PCW market; and
- excessive advertising expenditure.

27. The first two of these issues each comprise a number of distinctive mechanisms which we discuss in turn. In each case, the scope of the MFNs will affect the degree to which the harm is likely.



## ***Pressure for higher CPA fees***

### *Upward price pressure at the PCW possessing an MFN clause*

28. Without an MFN, a PCW should be constrained in the CPA fee it charges by the fear that a higher fee would lead to higher PMI premium prices on that PCW and therefore a loss of market share. With a sufficiently wide MFN, that fear is reduced, since the PCW knows that it will always be at least as competitive as any channel included in the scope of the MFN. The lessening of the competitive constraint can be expected to lead to higher CPA prices.
29. The degree to which an alternative channel constrains CPA fees ought to be related to the probability that a consumer visits that alternative channel. If it is very unlikely that an alternative channel is visited, then the pricing on that channel is unlikely to exert a strong constraint on the CPA fees. Our survey of PMI policyholders found that only 4 per cent of respondents checked just one PCW and at least one PMI provider website (see working paper 'Survey report'). This suggests that, without any MFN in place, the PMI provider website price is unlikely to be much of a constraint on the PCW price.<sup>6</sup> On the other hand, 63 per cent of respondents visited at least two PCW sites. This suggests that competition from other PCWs is likely to be a considerable constraint to the pricing of PCW fees.
30. The constraint on CPA fees from a PMI provider's website is unlikely to be significant. Therefore, an MFN with an own-website scope is unlikely to alter any existing upward pricing pressure on CPA fees. However, the constraint on CPA fees from other PCWs is likely to be significant. Therefore, a wide MFN is likely to lead to substantial upward pricing pressure on CPA fees.

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<sup>6</sup> Our survey results report behaviour in the presence of MFNs. It may be that without the MFNs, different behaviour would arise. Therefore, we should not put too much weight on survey evidence when coming to conclusions about what behaviour would be like without MFNs.

31. If an MFN is of great value to a PCW, then it may accept a lower CPA fee in exchange for an MFN. This effect might mean that wide MFNs are associated, at least at first, with low CPA fees rather than the high CPA fees suggested by the pricing constraints argument. If we assume (as seems to be the case) that negotiations over the scope of the MFN are less frequent than negotiations over the level of CPA fees, then we might expect that wider MFNs may be associated with lower CPA fees at first but with a higher growth rate in CPA fees than if the MFNs were not in place as PCWs take advantage of the reduction in pricing constraint that they create.
32. Figure 3 shows the evolution of CPA fees for [X] between 2010 and 2012 for policies covered by narrow (and no) MFNs and those covered by wide MFNs. Wide MFNs have higher average CPA fees, which is consistent with the view that the pricing constraints are weaker on wider MFNs. However, we note that this evidence does not separate out the effects of the MFN from simple bargaining-strength effects. It might be that higher CPAs and wider MFNs are jointly caused by the stronger bargaining position of PCWs relative to some insurers.<sup>7</sup>

FIGURE 3

**Changes in CPA fees over time for [X] for wide and narrow-MFN policies**

[X]

Source: CC analysis.

33. We examined the hypothesis that a widening of the MFN might lead to an acceleration in the growth rate of CPA fees. During 2010, [X] introduced wider MFNs into its contracts with [X] insurers. In Figure 4 we plot the evolution of the CPA fees for these [X] insurers compared with the evolution of the fees of narrow and wide MFNs in general.

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<sup>7</sup> The relative bargaining strengths of the participants is discussed in greater detail in our working paper 'ToH 3: Horizontal concentration in PCWs'.

FIGURE 4

**Changes in CPA fees over time for [redacted], showing prices for those insurers for which MFNs have widened during 2010**

[redacted]

Source: CC analysis.

34. The top line in the chart shows the CPA fees for those insurers which had wide MFNs introduced into their contracts during 2010. The growth rate of their CPA fees accelerated after the introduction of the wider MFN. While this is consistent with the argument that wider MFNs lessen a pricing constraint, it does not provide support for the argument that PCWs might accept lower CPA fees in exchange for a widening of the MFN. We note that there are a very small number of changes in the data set and, for this reason, we put little weight on this evidence.
35. We examined further the possible joint determination of MFN clauses and CPA fees by looking at the impact of insurer size on these variables. In Figure 5, we compare CPA fees for the largest 50 per cent of insurers measured by total sales against the CPA fees for the smallest 50 per cent.<sup>8</sup> The average CPA fees are between 6 and 8 per cent lower for the large insurers than for the small insurers, which is consistent with the view that lower CPA fees are the result of weaker PCW bargaining positions.

FIGURE 5

**CPA fees for large and small insurers\***

[redacted]

Source: CC analysis.

\*[redacted].

36. Figure 6 compares the proportion of sales conducted under wide MFNs for the largest 50 per cent of insurers against the proportion for the smallest 50 per cent.

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<sup>8</sup> This only includes insurers who use all [redacted].

Large insurers have fewer sales under wide MFNs than small insurers. This is consistent with the view that the scope of MFNs is affected by the relative bargaining strength of the parties.

FIGURE 6

**Prevalence of wide-MFN clauses for large and small insurers\***



Source: CC analysis.

\*[redacted].

37. In Figure 7, we compare CPA fees charged to large and small insurers depending on whether they are under wide or narrow MFNs. For all the PCWs for which we had data, there was an impact on CPA fees from widening MFNs for both large and small insurers.

FIGURE 7

**CPA fees for large and small insurers under wide and narrow MFNs\***



Source: CC analysis.

\*[redacted].

38. Overall, the evidence suggests a correlation between wide MFNs and higher CPA fees. However, the evidence does not exclude the possibility that higher CPA fees and MFNs are jointly a matter of bargaining strength, rather than MFNs being a partial cause of the higher CPA fees. It could be that wide MFNs are one of the mechanisms through which a stronger bargaining position is used to increase CPA fees. We discuss the way negotiations work between PMI providers and PCWs in the working paper 'ToH 3: Horizontal concentration in PCWs'. In that paper, bargaining strength is analysed in terms of the dependency of an insurer on any one specific PCW and vice versa. The fact that small insurers tend to face higher CPA fees and tend to have wider MFNs than large insurers is consistent with bargaining strength

jointly determining both variables; but it is also consistent with wider MFNs being the direct cause of higher CPA fees. We note that even large insurers on average face higher CPA fees on policies that have wider MFNs.

#### *Absence of downward price pressure at other PCWs*

39. Without MFNs, a PCW might seek to gain market share from other PCWs by lowering its CPA fees and negotiating with PMI providers for them to offer consumers lower PMI prices on its PCW. This would create downward pricing pressure on CPA fees. However, in the presence of a wide MFN, a PCW (even one not covered by an MFN) would see no competitive reason to reduce its CPA fees. The PMI provider bound by a wide MFN would be unable contractually to offer premiums lower than its competitors' in exchange for lower CPA fees. Therefore, a wide MFN reduces downward pricing pressure from other PCWs and may lead to higher CPA fees.
40. Evidence that the PCWs perceive MFNs as fulfilling the role of limiting competition from lower-cost providers is suggested by the experience of cashback websites. These websites offer to share referral fees between consumers and the website by offering post-purchase payments to consumers who have earned the website a fee. When these websites started to offer PMI policies, [REDACTED] expanded the scope of [REDACTED] wide MFNs to include cashback websites.<sup>9</sup> The cashback websites were effectively offering discounted premiums by taking a lower CPA fee. The widened MFNs were intended to stop insurers offering premiums that would lead to post-cashback prices being lower than the prices on the PCWs. Cashback websites have not been successful entrants in PMI sales but we do not have evidence on whether this lack of success can be attributed to the operation of MFNs.

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<sup>9</sup> [REDACTED]

41. A number of PCWs have sought to engage PMI providers in exclusive offers by reducing CPAs in return for a lower premium being published. [REDACTED].

*Absence of negotiating pressure from PMI providers threatening lower prices elsewhere*

42. A PMI provider facing a request for a higher CPA fee can be expected to try to resist the increase. With no or narrow MFNs in place, the PMI provider can threaten to offer the policy at a lower premium through alternative channels. This would mean that, as consumers learned that the policy was available cheaper elsewhere, the PCW asking for the CPA fee rise would see lower sales of that policy through its own site, and therefore lower CPA fee revenues. DLG said that the freedom to price more competitively on alternative channels (other PCWs and direct channels) would [REDACTED]. However, that negotiation tactic is eliminated by the presence of a wide MFN.
43. Where there is a wide MFN, the negotiating option left to a PMI provider is to threaten to delist the policy entirely from the PCW.<sup>10</sup> However, there appears to be little evidence of PMI providers voluntarily delisting from PCWs. DLG told us that, given that PCWs now account for around 60 per cent of new business sales in the UK PMI market, and given that their use is a feature of consumer search behaviour, it would be very difficult for a large insurer to maintain its sales volume whilst not making its products available through PCWs. Aviva also told us that, to remain competitive, it was necessary to quote on a minimum of three of the four large PCWs (although it was desirable to quote on all four). AXA also said that it was essential to be listed on all four large PCWs. We noted that both DLG and Aviva had one or more brands which did not sell through PCWs but other brands which did.

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<sup>10</sup> Another option would be to renegotiate the scope of the MFN. We assume in this part of the discussion that the PCWs have sufficient bargaining power to maintain the wide MFNs which are currently in place.

## *Coordination between PCWs*

44. Coordination requires the simultaneous fulfilment of three conditions:<sup>11</sup>
- the ability to reach and monitor terms of coordination;
  - internal sustainability, with it being in each firm's interest to maintain the coordinated outcome; and
  - external sustainability, with the coordinating firms being able to exclude competition that could undermine the coordinated outcomes.
45. We considered the hypothesis that coordination could be with regard to setting a floor price for the price of PMI policies.<sup>12</sup> We discuss each condition for this coordination in turn in relation to the operation of an MFN:
- If a policy is covered by a wide MFN, then the floor price of the policy is determined by its price on the PCW which has the wide MFN clause. Monitoring is effectively carried out through the monitoring of MFNs by the PCWs which have them.
  - Internal sustainability requires that deviations from the coordinated outcome be punished. To the extent that deviation breaks the MFN clause, it is punishable in law and thus the MFN provides a very strong mechanism for internal sustainability.
  - External sustainability requires that entry be constrained or that fringe competitors who are not covered by the MFN be unable to disrupt coordination. The MFN helps to do this by softening the competitive constraint from other sales channels/PCWs and excluding a common entry strategy based on offering lower prices. Indeed, in the absence of price competition, entry requires substantial investment in advertising, which is likely to create a barrier to entry.

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<sup>11</sup> See the CC *Guidelines for market investigations*, CC3, April 2013, [paragraph 250](#).

<sup>12</sup> It is possible that PCWs could try to coordinate over CPA fees rather than final PMI prices. It is also possible that MFNs would help this task. We focus on coordination on PMI prices because this is the most direct way that MFNs might affect coordination. Our hypotheses on the effects of MFNs (CPA upward price pressure, PMI upward premium price pressure, and restrictions on entry) all suggest that they could lead to an increase in PMI premiums.

46. Overall, it appears to us that MFN clauses can be thought of as potentially reproducing conditions akin to coordination, but doing this in a fragmented market using bilateral contracts. We would usually think of coordination as involving the adjustment of the behaviour of each party in response to the history of the behaviour of all other parties to the coordinated outcome. However, MFNs do not require that sort of adjustment; they simply require that bilateral contracts be honoured. It appears to us that wide MFNs potentially replicate the outcomes of coordination, ie increased upward pressure on PMI premiums for all PCWs.

### *Conclusions on CPA upward pricing pressure*

47. It appears to us that there are three mechanisms by which MFNs could lead to upward pricing pressure on CPA fees. A wide MFN:

- removes a means for PMI providers or other PCWs to punish a PCW for increasing its CPA fees;
- removes the rewards to competing PCWs from lowering CPA fees; and
- lessens the bargaining power of PMI providers facing increased CPA fees.

48. It appears to us that the evidence we have seen is consistent with wide MFNs being associated with higher CPA fees. However, the evidence is not conclusive as alternative explanations are available. We have also considered evidence based on the contracting behaviour of PCWs in the face of increased competition.

49. Overall, it appears to us likely that wide MFNs create upward pricing pressure for CPA fees.

### ***Pressure for higher PMI premium prices***

#### *Direct effect*

50. If an MFN is introduced on a policy which previously had none, then the policy provider may need to make some pricing adjustments. For example, if the policy was available on the provider's own website at a lower price than elsewhere, after the



introduction of an MFN (even a narrow, own-website MFN) the PMI provider will either have to increase the price on its own website or reduce the price on the PCW with which it has the MFN.<sup>13</sup> If most sales come from PCWs rather than the own website, then increasing the price on the own website will tend to be preferred, since reduced prices on a channel responsible for most sales will cause a large reduction in profits, while lost sales from a price increase through a channel that has fewer sales is likely to reduce profits less. Given that sales through PCWs account for [REDACTED] per cent of online sales,<sup>14</sup> we would expect that the direct effect of the introduction of MFNs would be to increase PMI prices rather to reduce them.

51. [REDACTED] told us that it had introduced a specific product aimed at the PCW market. [REDACTED] said that, if it had not introduced this product ([REDACTED]), specifically designed for sale on PCWs, and had instead sold its existing [REDACTED] product via PCWs, it is likely that the presence of MFN clauses preventing [REDACTED] from offering a lower price on its own direct sales website would have caused that price to increase. (Although this is an example of a circumvented direct effect, it illustrates the danger.)
  
52. LV told us that MFN clauses restricted insurers' ability to apply different prices to PCWs and other sales channels to reflect their relative risk performance. For example, although the direct online channel may yield more profitable business, the insurer would not have the freedom to reflect this in a lower price.

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<sup>13</sup> This argument applies also to wider MFNs.

<sup>14</sup> Ebenchmarkers Online Car Insurance Benchmark, Autumn 2012 Report.

### *Dynamic effect*

53. MFNs can also increase the cost to a PMI provider of reducing premium prices. For example, faced with the choice of reducing a policy price in order to win a specific customer (or customer type), a PMI provider without an MFN could opportunistically reduce the price for that one customer without a concern about the knock-on effects on other customers; but, with a wide MFN in place, the decision to reduce prices for just one transaction then applies to all transactions. A wide MFN effectively establishes a floor price for a policy across all the channels within its scope. A lowering of price which might make sense without an MFN in place could become unprofitable with an MFN such that the MFN has the effect of lowering the probability of premium price reductions.
54. [X].<sup>15</sup> This appears to us to be an attempt to introduce the kind of opportunistic price reductions described above. However, it has not occurred and it is possible that the reason why is because it would contravene the MFN clauses in PMI providers' contracts with other PCWs.

### *Coordination between PMI providers*

55. An MFN clause reduces the variation in the prices of PMI providers' policies (ie across different online sales channels). In theory, this could increase the ability of PMI providers to monitor each other's prices, and in turn their ability to coordinate.
56. However, it is not clear that a reduction in pricing variation across channels would significantly improve the ability of PMI providers to monitor each other's prices. This is because premiums charged (online at least) are publicly available. Collecting and evaluating price information across online sales channels may therefore not be diffi-

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<sup>15</sup> [X] indicated to us that it believed [X] had developed this technology. [X] told us that it had considered the option in 2012 but had decided not to implement it.

cult, especially if only a subset of prices needs to be monitored. Moreover, it is also not obvious how PMI providers would be able to coordinate PMI policy prices given that they are specific to individual customers. The large number of PMI providers and the differentiation of policies also suggest that it is unlikely that PMI providers would be able either implicitly or tacitly to coordinate on premiums.

57. For these reasons, we do not intend to consider this issue further.

#### *Absence of PCW sales channel negotiating pressure for lower prices*

58. If PCWs were competing to offer PMI policies at the best prices for the final consumer, we could expect them to use any negotiating strength they might have to put pressure on PMI providers to offer policies at lower premiums. A successful negotiation of a lower premium for a specific PCW would mean higher market share and higher revenues from CPA fees.

59. However, in the presence of a wide MFN this strategy cannot work. As long as a policy is covered by even just one wide MFN, PCWs will not be able to negotiate a price advantage. Therefore, there is reduced pressure from the sales channel for lower PMI premium prices.

#### *Conclusion on MFNs' contribution to upward pricing pressure on PMI premiums*

60. We have identified three mechanisms by which MFNs might lead to upward pricing pressure on PMI premiums, and we have some evidence of direct effects limiting price competition in PMI premiums (see paragraphs 50 to 52). However, we do not currently have econometric evidence that wider MFN clauses are associated with higher PMI premiums.

## ***Restriction on entry and innovation***

### *Entry*

61. A frequent strategy for entry in many markets is for the entrant to offer a cheaper price. Datamonitor reported that 74 per cent of PMI policyholders listed price as a main factor for choosing their current provider,<sup>16</sup> and PCWs told us that around 60 per cent of their customers purchased the cheapest PMI policy. Therefore, as the majority of consumers of PMI appear to be price sensitive, this strategy might be the obvious route to successful entry.
62. Entry and the threat of entry would have a number of pro-competitive consequences:
- potentially lower premiums (to the extent that lower prices are used to gain market share);
  - increased consumer choice of platforms; and
  - innovation (to the extent that competition is on features as well as on price).
63. However, a wide MFN undermines an entry strategy based on lower premiums. An entrant cannot offer consumers lower PMI policy prices as long as those policies are covered by a wide MFN.
64. An example of attempted entry of this sort is that of some cashback websites. An internal document from [redacted] identified the threat posed from cashback sites such as Quidco, which, it noted, if they continued to grow, could erode [redacted] profits. The document mentioned using a 'best price guarantee' (among other things) to achieve a competitive advantage over cashback websites, and we noted that the contracts that [redacted] with a number of PMI providers specifically mentioned cashback websites being within the scope of the MFN clause. The inclusion of cashback websites [redacted].

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<sup>16</sup> UK Private Motor Insurance 2011 (Datamonitor), p72.

65. There has been entry into the PCW market, specifically by Google and Tesco. However, neither has been particularly successful in gaining market share. Nevertheless, [redacted] told us that it did not consider MFNs to be problematic, saying that they added credibility to attempts to offer a PCW service, since its consumers could be confident that prices on [redacted] were at least as good as they were elsewhere.
66. Overall, we would expect effective entry to be pro-competitive and we would expect entry based on price competition to be particularly pro-competitive in the price-sensitive PCW market. However, the evidence we have seen suggests that entry on the basis of price competition has been limited by wide MFN clauses. Therefore, it appears to us that wide MFNs are likely to constitute a barrier to entry.

**Aviva Comment** - Aviva agrees with this point, and notes that the Competition Commission investigation has focused on ownership of PCWs by insurance providers, but there are an increasing number of other forms of distribution channels (for example, cash back sites, online forums & editorials) which could, in the future if not now, raise the same types of concerns as the existing provider-owned PCWs. Such channels already have significant consumer reach. For example, QuidCo.com claims that it has over 3 million customers.

### *Innovation*

67. A PCW might be in a position to offer cost-saving innovations to PMI providers by, for example:
- putting in place questions and filters which reduce the rate of fraud in policy sales (eg through misrepresentation); or
  - using the non-questionnaire information it gathers about users through its website to contribute to better overall assessments of risk by the PMI provider.
68. This sort of innovation has the potential to offer customer benefits through lower PMI premiums, with the prospect of generating more sales for the PCW. However, lower premiums are excluded by wide MFNs, with the effect that there is no incentive for a PCW to engage in the development of such innovative solutions.<sup>17</sup>

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<sup>17</sup> We recognize that PCWs continue to have an incentive to innovate to make their platforms more attractive to consumers of PMI, for example through a better user experience or through branding strategies.

### ***Excess advertising expenditure***

69. It appears to us that wide MFNs soften price competition between PCWs (see paragraph 49). Without MFNs, we would expect to see more price competition and lower CPA fees, and as a result we would expect lower CPA fees to justify lower advertising expenditure. Hence, if we compare outcomes with and without wide MFNs, we would expect a market with lower CPA fees and lower advertising in the no or narrow MFN case, and higher fees and higher advertising in the wide MFN case.
70. If the MFN is having the effect of channelling competitive pressures from price-based competition to non-price, advertising-based competition, the MFN may be creating a wasteful level of advertising. We do not suggest that the industry does not need advertising as there are clearly pro-competitive aspects to consumers being well informed about the availability of PCWs; however, MFNs may increase the level of advertising beyond this amount. Moreover, it is possible for advertising expenditure to be used by the PCWs to make entry unprofitable. In such a case, a combination of MFNs and increased advertising expenditure could be restricting competition through limiting entry.
71. Several PMI providers told us that PCWs had reached (or were near to reaching) saturation and that additional investment in advertising was only taking share from other PCWs rather than increasing the number of customers using PCWs as a whole. Indeed, PMI providers told us that additional expenditure on advertising and marketing had been the reason given by some PCWs for increases in CPA fees. Swinton told us that additional volume from a PCW as a result of advertising did not necessarily guarantee additional revenues for Swinton overall as, in many cases, it simply took business from another PCW. DLG said that the harmonizing effect of MFN clauses on prices across PCWs mitigated the risk of PCWs losing business to

their competitors, with the result that PCWs competed more on the basis of non-price benefits to customers (eg cuddly toys or nectar points).

72. We have not analysed advertising expenditure to establish how much might be due to MFN clauses. However, we intend to consider this issue further.

### ***Summary on anti-competitive effects of MFN clauses***

73. It appears to us that wide MFN clauses might lessen pricing constraints on CPA fees and on PMI premiums. They might also restrict entry and switch competition from price-based competition to advertising-based competition, possibly incentivizing excessive advertising expenditure. In summary, it appears to us that wide MFN clauses might have considerable anti-competitive effects.
74. It does not appear to us that narrow MFN clauses are likely to be problematic in the same ways, although we have identified one way in which even narrow MFNs might have a direct impact on PMI premiums.

### **Potential pro-competitive effects of MFN clauses**

75. We consider two ways in which MFNs might enhance competition: first, wide MFNs might improve the quality of the search experience by assuring consumers that the price they obtain is the best price for that policy available; second, MFNs, by reducing cross-channel competition, might allow fixed and sunk investments in channels to be recouped. We consider each of these effects in turn.

### ***MFN clauses and improvement of the search experience***

76. MFNs may enhance the consumer experience of searching for PMI products by reducing the need for consumers to shop around to find a cheaper price. With an MFN in place, consumers can reasonably infer that they are getting a good deal



when the PCW returns its quotes. This reduces the consumer's search time and effort. This effect would be particularly strong if the MFNs are commonly known to be in place, but could also be the result of learning.

77. We would expect this efficiency benefit of MFNs to increase with the scope of the MFN. If there were only own-website MFNs in place, then a consumer would still need to check all the other channels apart from the PMI provider's own website to ensure that they had the best deal. In Italy, the *Autorità Garante della Concorrenza* (Italian Competition Authority) investigated PMI and found that PCWs had not been able to grow in Italy because, among other reasons, there were no mechanisms to ensure that the premiums quoted by PCWs were the same as the premiums quoted directly by each insurer.<sup>18</sup> As a consequence, PCWs had a lower-quality customer experience. This provides an example of what might happen in a market with no MFNs but other interpretations of the Italian market are also possible, eg that insurers in strong bargaining positions do not want to be subject to the competition that PCWs bring.
78. We note that, even in the presence of a large number of wide MFNs, 63 per cent of respondents to our survey who visited one PCW went on to visit at least one more, and only 20 per cent who used a PCW used just one PCW and no other sales channel. This suggests to us that PCWs are not currently effective at making consumers believe that they offer the best prices available.
79. Overall, it appears to us that MFNs are likely to improve the consumer search experience. However, we have not tried to quantify this consumer benefit, and we intend to consider this issue further.

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<sup>18</sup> Final Report of the *Autorità Garante della Concorrenza* (Italian Competition Authority), 22 February 2013.

### ***MFN clauses and the ability to recover fixed and sunk costs***

80. MFNs may protect the sunk and fixed cost investments of a PCW. If a PCW invested in offering good-quality search but consumers discovered that the policies offered were cheaper elsewhere, they might use the search but not purchase products through the PCW. The PCW might reduce the quality of its offering and indeed go out of business. As a result, good search solutions might not be offered to consumers.
81. Esure and Admiral (both with ownership stakes in a PCW) told us that own-website MFNs were a core part of a PCW's proposition.
82. One PCW told us that if it became widely known that PMI providers' own websites offered better prices than PCWs then consumers may search for policies on a PCW but purchase the policy direct. Another PCW told us that [✂].
83. Although the diversion of consumers from the PCW to the PMI provider's own website might be the most obvious danger to a PCW, diversion to other PCWs would have the same effect. For example, if one PCW were known for its good search experience while another were known for low prices, then a sufficient number of consumers might search on the first but buy through the second for the investment in search functionality by the first to become unprofitable.
84. In order to assess whether an MFN is a proportionate reaction to the problem of fixed and sunk cost recovery, we need to understand the scale of the cost recovery problem and alternative mechanisms that might address it. We note that the fixed and sunk costs that need to be covered may be lower than would appear from PCWs' actual costs to the extent that advertising expenditure is a substitute for price competition which would not occur in the absence of an MFN. We have not tried to

assess what advertising expenditure might be in the absence of MFNs but we intend to consider this issue further (see paragraph 72).

85. Alternative mechanisms by which PCWs might seek to protect their investment include:

- Doing nothing, as some proportion of consumers will not switch to another channel, and some proportion who do switch may switch back, having failed to find a better deal. These proportions may be sufficient to cover the fixed and sunk costs of a PCW.
- Listing fees, minimum guaranteed CPAs or cookie-based affiliate marketing fees could be used to reward PCWs irrespective of their sales-conversion rates. As PCWs provide a service to PMI providers irrespective of the sales they generate (ie by informing consumers that a given policy is reasonably good value), PMI providers could pay for this service directly. We note that there appear to be some moves in the industry in this direction, with minimum guaranteed CPA rates becoming more common.<sup>19</sup>

### ***Summary on pro-competitive effects of MFN clauses***

86. It appears to us that MFN clauses may help to solve two issues in the market for PCWs: search trustworthiness and fixed/sunk cost recovery. However, we have not estimated the magnitude of these effects or evaluated whether they might be sufficient to counteract the anti-competitive effects of MFNs. Also, it appears to us that other mechanisms might exist which could solve these problems, although we have not examined those alternative mechanisms in detail.

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<sup>19</sup> [X]

## Prevalence and characteristics of MFN clauses in contracts between PCWs and PMI providers

### Introduction

1. This appendix discusses the prevalence of the different types of MFN clauses in contracts between PMI providers and PCWs.

### Summary

2. The least restrictive type of MFN, the own-website MFN, is currently the most frequently used MFN (in [X] per cent of PMI sales through PCWs), while more restrictive online MFNs are less prevalent ([X] per cent of PMI sales through PCWs) and the most restrictive, the all-channel MFNs, are least frequent ([X] per cent of PMI sales through PCWs).
3. Although these are the current proportions, we note that the use of MFNs seems to be a point of current discussion between some PCWs and PMI providers. We found that a recent request by some PCWs to extend the scope of their MFNs was strongly resisted by PMI providers. We also found that some PCWs had relaxed their MFN clauses, possibly due to increased interest by competition authorities in these clauses.

### Background

4. The vast majority of contracts signed by PMI providers and PCWs have an MFN clause which prevents the PMI provider offering the same policy at a cheaper price via some other channel(s).
5. PCWs present consumers with quotes provided by PMI providers. PCWs ask consumers questions and the answers are passed on to PMI providers, which they map





covered by an online MFN; and [X] per cent were covered by an all-sales MFN.<sup>21</sup>

However, we note that the proportions for some PMI providers were different from these averages. For example, [X].

11. We note that PCWs do offer policies from some PMI providers without an MFN in place. [X]. However, PMI providers told us that they did not believe they had sufficient bargaining power against the PCWs to resist an MFN clause where a PCW insisted on it. PMI providers said that they felt obliged to accept MFNs if they wanted to sell their products on PCWs.
12. It appears to us that differences in the scope of MFNs are due largely to differences in the bargaining power between PMI providers and PCWs. For PMI providers, strong bargaining power might stem from their reputation and their position in the market, as well as the need for PCWs to compare as many PMI providers as possible; while PCWs' bargaining power might stem from their ability to refuse to list a provider's PMI policies.<sup>22</sup>

### **Extensions/change of scope of MFN clauses**

13. Some PMI providers told us that in 2012 they had received requests from PCWs for the scope of the MFNs in their contracts to be extended. They each told us that they had resisted this change. Moreover, some PMI providers told us that they were trying to change the MFNs in their contracts to make them less restrictive.
14. Some PCWs told us that they had recently lessened the scope of the MFNs in some of their contracts. A PMI broker told us that, in October 2012, MoneySupermarket

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<sup>21</sup> These percentages have been calculated on the basis of PMI policies sold through the four largest PCWs under an MFN clause compared with the total number of PMI policies sold through these PCWs. However, the sales under MFNs through PCWs other than the four largest were a small share of the total. On average, the share was about 1 per cent of total sales.

<sup>22</sup> The negotiations between PCWs and PMI providers are discussed in greater detail in the working paper 'ToH 3: Horizontal concentration in PCWs'.

wrote to all the PMI providers listed on its site to say that it was relaxing its MFNs and to encourage PMI providers to challenge the MFN clauses they had in their contracts with other PCWs. Commenting on this statement, MoneySupermarket explained that this was an attempt to encourage PMI providers to review the MFN clauses they had in their contracts with other PCWs to ensure that they were compliant with competition law. [✂].



## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Theory of harm 5: Analysis of vertical agreements for the supply of paint (excluding foreclosure)

#### Introduction

1. This paper considers the contracts between private motor insurance (PMI) providers and paint manufacturers or distributors, and their possible effects on competition. There is a range of such agreements. In general, the agreements provide for referral fees or rebates to be paid to insurers in return for them recommending (or mandating) the use of a particular paint brand to their network of approved repairers.
  
2. The main question we assess in this paper is whether these contracts lead to an increase in the billed cost of paint, which may increase the cost of non-fault claims if the billed cost is passed to the fault insurer without taking into account the referral fee or rebate income received. This may harm final consumers through higher PMI premiums. This issue is part of our analysis of theory of harm (ToH) 1, as it is a potential mechanism by which the separation of cost liability and cost control in the management of non-fault claims can lead to higher costs for fault insurers (see also the working paper 'ToH 1: Overcosting and overprovision of repairs'). We also consider in this paper some of the other concerns relating to the supply of paint which have been raised by various parties.
  
3. Another potential issue with paint supply contracts is whether they lead to vertical foreclosure, ie whether they provide a means for paint manufacturers or insurers to raise rivals' costs in a way that leads to a reduction in effective competition. We discuss this issue separately in the working paper 'ToH 5: Analysis of potential foreclosure as a result of vertical relationships'.

## Summary

4. The contracts between insurers and paint manufacturers can be divided into two groups:

(a) *Non-exclusive contracts*: Under these agreements, the insurer recommends a paint brand, and possibly a distributor, to its network of repairers and, in return, the paint manufacturer (and distributor) pays a fixed fee and/or per-repair fee to the insurer. The repairers retain some control over which paint to use. Such contracts exist between [§], as well as between some claims management companies (CMCs) and paint marketing associations (PMAs).

(b) *Exclusive contracts*: Under these agreements, the insurer mandates a paint brand, and possibly a distributor, to its network of repairers. [§].

### **Non-exclusive contracts**

5. It appears to us that repairers face slightly higher costs for paint as a result of the contracts between insurers and paint manufacturers. However, the evidence from repairers suggests that such cost increases are generally low, being not larger (and usually much smaller) than £18 per repair, which is a small percentage of the total cost of paint for insurers and around 1.5 per cent of the total cost of a repair. Moreover, we note that such cost increases are likely to be close to the level of rebates earned by insurers.

6. Since the rebates from paint manufacturers (and distributors) received by the non-fault insurer (in relation to non-fault claims) are not passed on to the fault insurer, the contracts lead to a difference between the effective cost of paint faced by the non-fault insurer (ie net of the rebate) and the cost incurred by the fault insurer (which pays the price which is higher than it otherwise would be). This difference is around [§] to [§] per repair. In our working paper 'ToH 1: Overcosting and overprovision of repairs' we estimate the total overcosting in repairs arising from the separation of

cost liability and cost control and this amount relating to paint supply contracts is one element of that overcosting.

**Exclusive contracts: [X]**

7. [X] This arrangement gives [X] an incentive to set a high paint price for its repairers to pay to [X], notwithstanding that this will result in a higher cost of paint in the repair bills it receives than would otherwise be the case.
  
8. When [X] is the non-fault insurer, this structure of payments inflates the cost of repairs passed on to the fault insurer as the costs passed on are those reflected in the billed cost of paint and do not take account of the rebates received. However, our assessment finds that the cost of paint charged to [X] by its approved repairers is in line with the prices agreed between other insurers and their approved repairers, which suggests that [X] does not lead to a greater degree of overcosting than non-exclusive paint contracts (see paragraph 6). Separately, we note that, [X] but it appears to us that this is another mechanism by which non-fault repair costs can be inflated before they are passed to the fault insurer (see the working paper 'ToH 1: Overcosting and overprovision of repairs') and is not dependent on [X].

**Other concerns**

9. Currently, it appears to us that none of the other concerns which parties have raised in relation to paint supply contracts are likely to give rise to competition problems in relation to the supply of PMI and related services.<sup>1</sup>

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<sup>1</sup> In our analysis we have considered whether such paint supply contracts might affect the provision of post-accident repair services covered by PMI. We have not considered whether such contracts might affect the conditions of competition in the paint market.

## Structure of the paper

10. In the first part of the paper, we explain how the cost of paint is determined in the absence of vertical agreements between insurers and paint suppliers. We then describe such vertical agreements, distinguishing between non-exclusive contracts (with or without minimum volume requirements) and exclusive contracts (ie [✂]). We also discuss briefly agreements involving car manufacturers. We consider the implications of these agreements for repairs which are handled by other parties and non-insurance repairs. Finally, we consider to what extent the discounts and rebates stipulated in the contracts are passed on to fault insurers.
  
11. The second part of the paper considers the rationale for such agreements, including possible efficiencies. We also discuss possible sources of harm for consumers arising from them. Here we discuss whether such contracts contribute to overcosting (ie our hypothesis under ToH 1). We consider whether payments to insurers have a significant effect on the cost of paint and the extent to which they generate differences between the costs faced by different insurers. Finally, we discuss briefly other concerns parties have raised.

## Background

12. Refinish paint accounts for around 20 per cent of the average billed cost of a post-accident repair.<sup>2</sup> Its price is determined by complex interactions between paint manufacturers, distributors, repairers, insurers or CMCs, and car manufacturers. We can distinguish between:
  - (a) the trade price of paint (ie the published list price);
  - (b) the wholesale price paid by paint distributors to paint manufacturers;
  - (c) the retail price paid by repairers to paint distributors; and
  - (d) the billed price, charged by repairers to insurers or final customers.

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<sup>2</sup> See the working paper 'ToH 5: Analysis of potential foreclosure as a result of vertical relationships'.

13. In addition, rebates are sometimes paid by paint manufacturers or distributors to insurers, CMCs or car manufacturers (referred to by some parties as ‘influencers’) or to repairers.

### ***Paint sourcing in absence of vertical supply contracts***

14. Although there is a published trade price for each paint product, repairers do not typically pay this price. Paint distributors commonly offer large discounts to repairers, either reducing the price or establishing a parallel rebate.<sup>3</sup>
15. The cost of paint charged by a repairer to an insurer, is typically neither the trade price nor the price paid by the repairer but rather is based on the Audatex ‘weighted average paint price’. This price is calculated by Audatex using a basket of trade prices and weighting them according to their respective market shares.<sup>4</sup> The repairer’s price to the insurer is usually a percentage of this weighted average Audatex price, in particular where the repairer is part of the insurer’s approved repair network (having had to compete to become part of this network).
16. We can illustrate the different prices for paint in an example.<sup>5</sup> Suppose that the paint needed for a repair has a trade price of £230 but the paint distributor charges a retail price to the repairer of £100. Suppose that Audatex calculates that the cost of paint for the repair, based on the weighted average paint price, is £250. When billing the insurer, the repairer will use the Audatex paint price as a reference but will apply a discount of, say, 20 per cent, resulting in a price billed of £200 (with the repairer making a profit of £100).

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<sup>3</sup> [X] told us that its approved repairers [X] negotiated rebates with paint suppliers independently. The rebates earned by [X] totalled just under £[X] in 2012.

<sup>4</sup> The paint brands included in the Audatex paint basket are PPG, Nexa Autocolor, Sikkens, Standox, Spies Hecker, DuPont, Glasurit and R-M.

<sup>5</sup> Please note that the prices are illustrative only and are not meant to reflect real prices.

17. It appears that the difference between retail prices and the prices billed to insurers is substantial. Repairers told us that the cost of paint was between 20 and 40 per cent of the Audatex weighted average paint price, while insurers were usually charged between 70 and 80 per cent of this price.<sup>6</sup> In absolute terms, it appears that repairers spend, on average, around £80 to £90 on paint per repair (less when they are free to choose their supplier) but bill insurers, on average, around £200 to £350.<sup>7</sup> According to TrendTracker, repairers, constrained by low labour rates and narrow margins on replacement parts, rely on the high margin they achieve on paint.<sup>8</sup>

### ***Vertical supply contracts to source paint***

18. Currently, five of the ten largest insurers have contracts with paint manufacturers:  
[redacted]
19. Some of these agreements also involve PMAs (see Appendix 1). In addition, some CMCs (eg [redacted] and [redacted]) have similar paint supply agreements.
20. Such contracts are not standard practice as five of the ten largest insurers do not have them and we have seen no evidence that other insurers (outside of the ten largest) have them. However, the five insurers with such agreements had, in 2012, a combined share of [redacted] per cent of the PMI market in the UK.<sup>9</sup>

### **Structure of the contracts**

21. Although each paint supply contract is different, they can be divided into three groups:

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<sup>6</sup> [redacted] told us that it paid 25 per cent of the Audatex price and received from insurers 70 per cent of this price. [redacted] told us that it paid between 20 and 32 per cent of the Audatex price and usually charged 80 per cent of this price (although the amount could be as low as 50 per cent with some insurers). [redacted] said that [redacted]

<sup>7</sup> A repairer told us that it paid between £80 and £90, while charging around £180. It said that it would be able to save around £15 if it were free to choose its supplier. In [redacted] if the repairer were free to decide on the paint used. [redacted] seemed to suggest that average costs were even lower. For their average paint costs invoiced to insurers, repairers gave us the following values: [redacted] (£243–£328), [redacted] (£360), [redacted] (£228), [redacted] (£235–£250), [redacted] (£275).

<sup>8</sup> 'The Future of the Car Body Repair Market in the UK', 2012–2017, p27.

<sup>9</sup> Based on data from the insurers. The estimated total market size is from Datamonitor report, p30, based on ABI data.

(a) *Non-exclusive contracts*: an insurer (or CMC) recommends a paint brand to its approved repairers for use on its repairs in return for a rebate ([REDACTED]).

(b) *Non-exclusive contracts with minimum volume requirements*: an insurer (or CMC) recommends a paint brand for use on its repairs but the rebate is conditional on a minimum volume being purchased ([REDACTED]); and

(c) *Exclusive contracts*: an insurer mandates a paint brand to its approved repairers for use on its repairs in return for a rebate ([REDACTED]).

We discuss each in turn.

### ***Non-exclusive contracts without volume restrictions***

22. Table 1 summarizes the main characteristics of the [REDACTED] non-exclusive contracts without volume requirements.

TABLE 1 **Paint supply contracts involving [REDACTED]**

[REDACTED]

Source: [REDACTED]

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23. The main characteristics of these contracts are:

- Insurers recommend a paint manufacturer (and possibly a distributor) to their repairers but the repairers are free to choose from which supplier to buy their paint. A typical clause specifies that the insurer shall ‘use its best endeavours to persuade its approved repair network to utilise the supplier’s refinish materials’.<sup>10</sup> In practice, it could be that this recommendation is interpreted by repairers as an effective mandate.<sup>11</sup>
- There is typically a flat fee and/or a rebate paid [REDACTED].
- The fee is [REDACTED].

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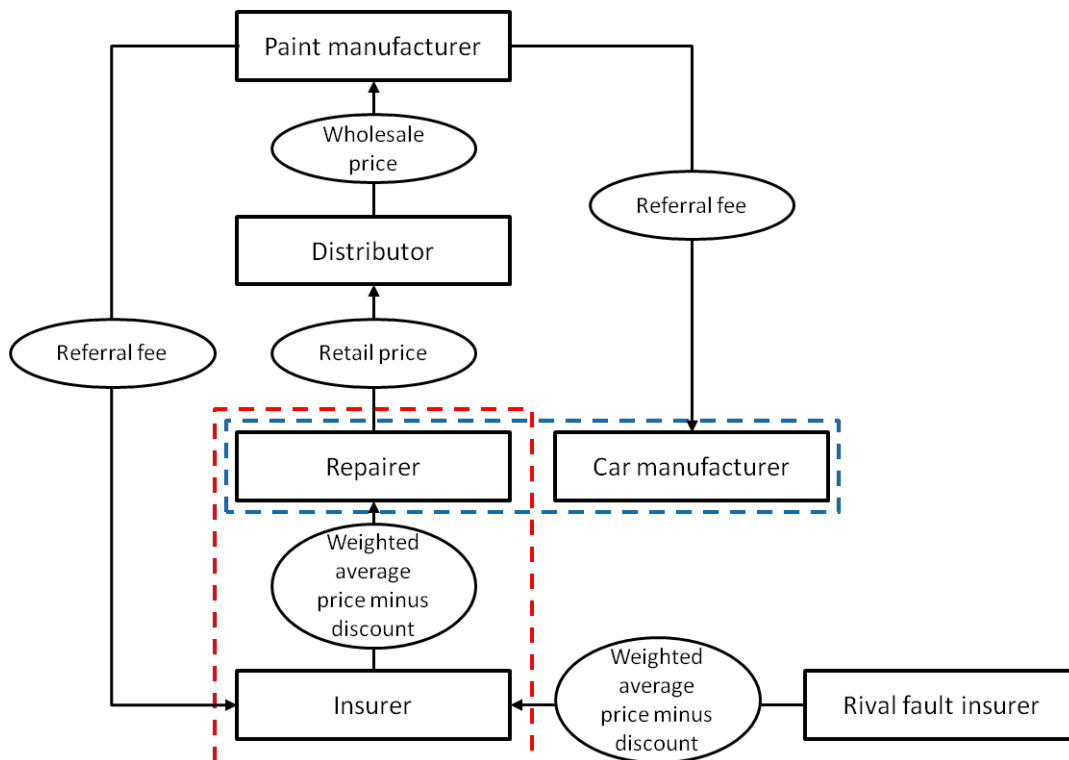
<sup>10</sup> [REDACTED]

<sup>11</sup> For example, [REDACTED] told us that [REDACTED] mandated [REDACTED] paint. [REDACTED] said that ‘often the recommendation is such that the business considers it to be mandated’.

24. Figure 1 shows a stylized example of such a contract between a paint manufacturer and an insurer, and the resulting payments. It also shows a concurrent contract (and referral fee payment) between the paint manufacturer and a car manufacturer. Figure 2 represents the case in which an insurer has agreements with both a paint manufacturer and a PMA.

FIGURE 1

**Contract between an insurer and a paint manufacturer**



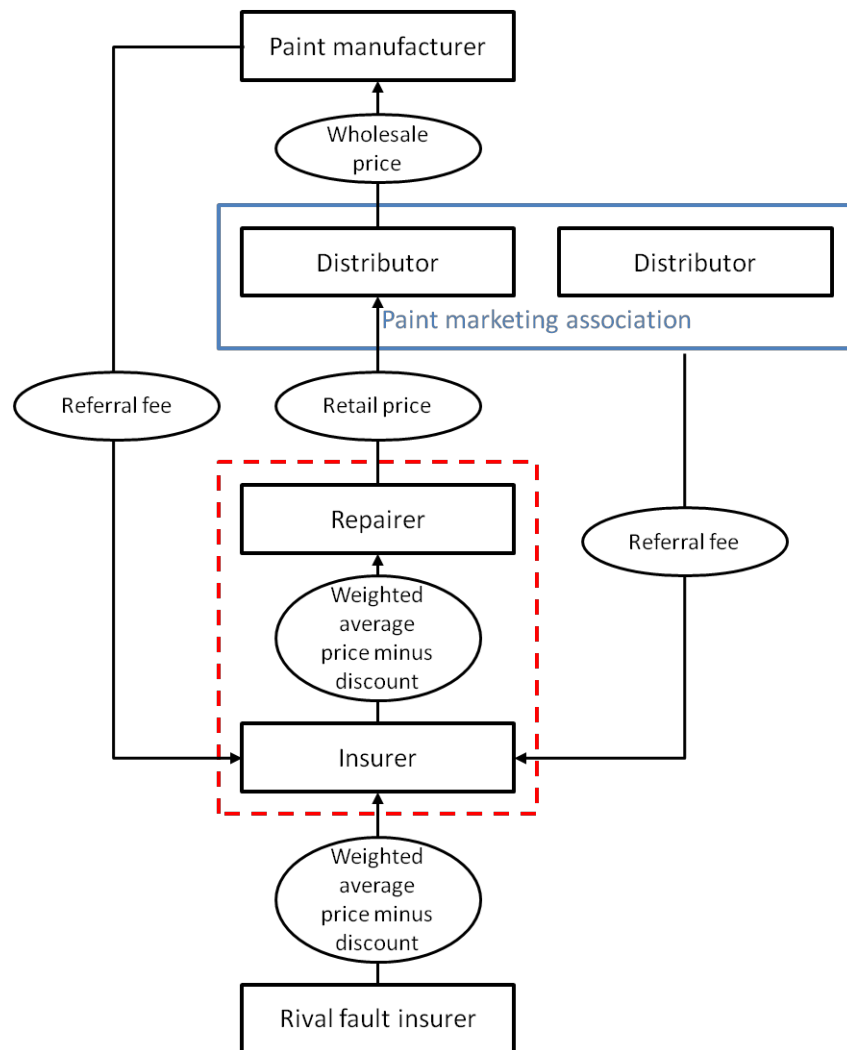
Source: CC analysis

Note: The repairer in the figure is approved by both the insurer and the car manufacturer.



FIGURE 2

**Contracts between an insurer and both a paint manufacturer and a PMA**



Source: CC analysis.

25. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).<sup>12</sup> Suppose that, for each repair in which the recommended paint is used, the paint manufacturer pays a rebate of £5 to the insurer. When the insurer is in the fault position, the net cost of a repair is £195 (ie it pays £200 to the repairer but receives a rebate of £5 from the paint manufacturer); but when the insurer is in the

<sup>12</sup> Please note that the prices are illustrative only and are not meant to reflect real prices.

non-fault position, it still receives the £5 rebate but bills the fault insurer the full £200,<sup>13</sup> making a profit of £5.

### **Non-exclusive contracts with minimum volume requirements**

26. [X] similar to the non-exclusive contracts described above. However, [X] the rebate is conditional on a minimum spend per repair on paint and related consumables.

Table 2 summarizes [X] characteristics. The table also shows for comparison details [X].

TABLE 2 Paint supply contracts involving [X]

[X]

Source: [X]

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27. In the [X]<sup>14</sup> This is equivalent to [X]. One repairer told us that this minimum amount was in general substantially in excess of what it needed per repair.<sup>15</sup>

### **Exclusive contracts**

28. The [X] introduces a different system of rebates from the non-exclusive contracts discussed above.

29. [X]. Table 3 shows the [X].

TABLE 3 [X]

[X]

Source: [X]

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<sup>13</sup> We note that there are some exceptions, for example when the fault and non-fault insurer have signed a bilateral agreement.

<sup>14</sup> [X].

<sup>15</sup> [X] told us that 'you need to commit to the volume of spend of 3 jobs to [X] for every [X] job repaired'. However, another repairer provided an estimate of the average cost of paint in the absence of vertical agreements, on the basis of which it seems that the minimum volume requirement set by [X] would be sufficient for at most 1.5 repairs.

30. [✂].

31. [✂] Figure 3 illustrates [✂].

### FIGURE 3

[✂]

*Source:* CC analysis

32. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).<sup>16</sup> Suppose that the amount of paint required for a repair costs [✂]. In this case, [✂].

33. Figure 4 illustrates [✂]

### FIGURE 4

[✂]

*Source:* CC analysis

*Note:* [✂]

34. We can again illustrate the flow of funds in an example (using the numbers from paragraph 15).<sup>17</sup> Suppose that the amount of paint required for a [✂]. Figure 5 illustrates this numerical example.

### FIGURE 5

[✂]

*Source:* CC analysis

35. [✂].

36. [✂].

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<sup>16</sup> Please note that the prices are illustrative only and are not meant to reflect real prices.

<sup>17</sup> Please note that the prices are illustrative only and are not meant to reflect real prices.

### ***Contracts involving car manufacturers***

37. Contracts similar to those between paint suppliers and insurers (and CMCs) also exist between paint suppliers and car manufacturers. Car manufacturers have their own networks of approved repairers to which they may recommend the use of specific paint brands, in return for a fee.
38. Some car manufacturers have agreements with paint manufacturers (eg [X]), some have agreements with paint distributors or PMAs (eg [X]) and some have agreements [X]. The fees earned may be either fixed or proportional to the value of the refinish paint sold to the manufacturer's approved repairers. In 2012, the fees received by [X] from two paint manufacturers totalled £[X], while [X] received a total of £[X] from [X].
39. As these fees accrue to car manufacturers, the potential cost increases affect all insurers, irrespective of whether they are in the fault or non-fault position (ie the separation of cost liability and cost control applies to both fault and non-fault claims).
40. The same repairer can belong to the network of more than one insurer and car manufacturer, and different insurers/manufacturers might have agreements with the same paint supplier. In this case, a fee would be paid by the paint supplier to all the insurers and manufacturers entitled to it; however, some adjustments are usually applied to take into account the presence of multiple work providers. (For example, [X] records sales against each repairer and allocates them to different work providers in order to calculate a theoretical maximum number of paint jobs, which may be lower than the amount claimed by each insurer/manufacturer ([X]). Similarly, [X] crosschecks the number of repairs reported to it by work providers with the sales volumes to repairers communicated to it by its distributors.) It appears to us that, due

to these controls, rebates are not usually paid to multiple insurers and manufacturers for a single repair.

### **Implications for repairs handled by other insurers or non-insurance repairs**

41. Although repairers are free to choose the paint they use for all repairs they conduct for parties which do not have paint supply contracts, an effect of the paint supply contracts which exist might be to restrict this choice in practice, especially if the repairer is small, for the following reasons:
- (a) each paint requires the use of specific equipment so using multiple paint brands is costly (in terms of physical infrastructure and training);
  - (b) repairers can obtain better retail prices if they purchase larger volumes of paint so they would prefer to use a single brand;<sup>18</sup> and
  - (c) where there are volume requirements in a paint supply contract [X], the paint purchased under the contract might be more than is needed, with the excess used in other repairs.
42. Different repairers adopt different strategies: some use only the brands which they are required (or encouraged) to use by some of their work providers; others use a different brand of paint when they are free to choose.

### **Costs passed on to fault insurers**

43. In general, insurers told us that they passed on to the fault insurer the repair bill as they received it from the repairer. Moreover, repairers told us that when they were an approved repairer and they calculated a repair bill for their work provider, they did not take into account whether the customer was a fault or non-fault claimant. On the basis of this evidence, it appears to us that non-fault insurers generally pass on the

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<sup>18</sup> In 2012, [X] used paint only from those suppliers which were mandated by insurers, in order to achieve volume discounts. However, it told us that it was moving away from this model.

discounts (on invoice) they obtain from repairers but do not pass on the rebates they receive from paint manufacturers or distributors (or others, including the repairers themselves).<sup>19</sup>

### **Business rationale for paint supply contracts**

44. We asked insurers about their incentives for entering into vertical paint supply contracts. All the insurers mentioned similar reasons:

(a) to ensure that the paint used is of an appropriate quality;<sup>20</sup> and

(b) to achieve cost savings.<sup>21</sup>

45. [X] told us that, using its bargaining power, it believed it was able to negotiate better terms with suppliers than each repairer could gain individually. [X] said that, moreover, it was confident that it was achieving the most competitive price that it could for the paint used [X] added that there were also administrative efficiencies from using a single supplier, though it could not quantify these savings.

46. [X] told us that it entered into an agreement with [X] because [X] could negotiate better discounts, due to its collective purchasing volume, and then pass on these discounts to [X]. However, we noted that [X] negotiates directly with individual distributors (not with [X]). [X] said that it estimated it saved [X] per cent in its purchasing of certain non-paint goods due to using [X] as its distributor, but it did not provide an estimate of its savings on paint costs from this agreement.

47. Paint manufacturers told us that their rationale for vertical supply contracts was to facilitate their access to large repair networks. Similarly, [X].

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<sup>19</sup> We note that there are some exceptions, for example when the fault and non-fault insurer have signed a bilateral agreement (eg where [X] is the non-fault insurer and [X] is the fault insurer, [X] passes on to [X] (with which it has a bilateral agreement) the rebates it receives from [X]).

<sup>20</sup> This rationale was mentioned by [X].

<sup>21</sup> This rationale was mentioned by [X].

48. We noted that [REDACTED].

49. We did not see any efficiencies arising from minimum purchase volumes per repair (such as [REDACTED]).

### **Allegation of raising costs for rival insurers**

50. In this section we discuss whether the vertical paint supply contracts might have the effect of raising costs billed to rival insurers. We consider non-exclusive and exclusive contracts separately.

#### ***Non-exclusive contracts***

##### *Reduced competition leads to higher costs for repairers*

51. It appears to us that, as a result of the contracts between paint suppliers and insurers (and CMCs), repairers face higher retail prices for refinish paint than would otherwise be the case (see paragraph 59). One repairer told us that it could procure paint for around £15 less per repair if it were free to choose its supplier. [REDACTED] made a similar remark.

52. It appears to us that the fact repairers buy the brands of paint recommended to them by insurers (and CMCs), despite them being more expensive than the paint they would otherwise choose, is indicative of the pressure put on them by insurers. [REDACTED] told us that 'often the recommendation is such that the business considers it to be mandated'.

53. We note that the contracts between insurers and paint suppliers reduce competition at the retail level, changing the relative bargaining power of repairers and paint suppliers in favour of the suppliers. In the contracts involving [REDACTED], competition between distributors appears almost completely eliminated as repairers are

recommended to buy a specific brand through a specific distributor; however, the contracts involving [X] appear to preserve competition between distributors, with only the paint brand being specified. The rebates paid to insurers could be seen as the way in which insurers extract from paint suppliers the additional profits they enable them to make.

*Higher costs for repairers may be reflected in the bills invoiced to insurers*

54. Higher paint costs for repairers may (or may not) be reflected in the bills they charge to insurers. At one extreme, if the higher cost is not passed on, paint suppliers and insurers (through the rebates they receive) may be benefitting from reducing repairers' profits. In this case, the contracts could be beneficial to PMI consumers, as insurers might be expected to pass on their additional income in lower PMI premiums. At the other extreme, if the higher cost is passed on, insurers' claims costs might be expected to increase by as much as they make from the paint supply contract, or possibly even more.<sup>22,23</sup> The reason why an insurer may prefer rebates from the manufacturer, notwithstanding a higher billed cost of paint from the repairer is due to the separation of cost liability and cost control, as it achieves the benefit in all cases and only incurs the higher cost when it is liable for the cost of the claim.
55. The extent to which the increase in paint cost is extracted from the paint supplier by the insurer as a rebate depends on the relative bargaining power of insurers and paint suppliers. If paint suppliers are in a strong bargaining position, they will increase the retail price as much as possible and pay a small rebate; however, if

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<sup>22</sup> The increase in the cost of paint billed to an insurer might be higher than the rebate it receives from the paint supplier. For example: suppose that a paint supply contract results in a £7 increase in the retail price of paint to a repairer and this higher cost is fully passed on, and suppose that the paint supplier pays the insurer £5 for each repair conducted by one of the insurer's approved repairers. If the insurer is at fault, it then loses £2 per repair compared with the prior situation; however, in all other cases it gains £5. (Please note that these prices are illustrative only and are not meant to reflect real prices.)

<sup>23</sup> The extent to which costs are passed through the supply chain will depend on the relative bargaining power of paint suppliers, repairers, and insurers, and the competitive pressure in the paint and repair markets. It will also depend on whether payments to insurers are fixed or on a per-repair basis ([X]). Per-repair payments have a direct impact on the suppliers' marginal cost and a profit-maximizing supplier would respond by increasing its prices; fixed fees do not change the marginal cost of producing and distributing paint, so they are unlikely to determine price increases in the short term.



insurers are in a stronger position, they will extract a high rebate. We note that if all of the higher cost to repairers is passed on to insurers and paint suppliers retain some of the additional revenue (ie it is not all extracted by insurers in rebates), then paint supply contracts are unlikely to be beneficial to PMI consumers overall as there is likely to be some 'leakage' of value to paint suppliers and claims costs overall are likely to have risen.

56. Overall, we note that the amount by which some insurers benefit when in the non-fault position due to their paint supply contracts (typically around £[redacted] to £[redacted] per repair) is small relative to the average billed cost of paint and even smaller relative to the average total cost of a non-fault repair.

#### *Minimum volume requirements*

57. The minimum volume clause in [redacted] introduces an additional potential source of cost increase. This clause appears to set the sales volume higher than is needed, causing some of the paint bought under the agreement to be used on repairs for work providers other than [redacted], including non-insurance repairs.<sup>24</sup> We note that the costs billed to insurers are related to the actual volume of paint used for the repair, and not the, potentially higher, minimum purchase level, but it appears to us that the surplus paint may lead to a higher paint cost for other repairs if the repairer would otherwise have sourced the required paint more cheaply (and the customer does not have the bargaining power to avoid the cost increase).

#### *Direct effect of contracts on PMI consumers<sup>25</sup>*

58. In order to estimate the direct effect of the paint supply contracts on consumers, we considered:

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<sup>24</sup> A similar effect arises if repairers prefer to use only recommended brands because of the additional cost associated with the use of multiple brands (see paragraph 41).

<sup>25</sup> In our analysis we have considered whether such contracts might affect the provision of post-accident repair services covered by PMI. We have not considered whether such contracts might affect the conditions of competition in the paint market.

- (a) the magnitude of the increase in the billed cost of paint;
- (b) whether the increase in the billed cost of paint is higher than the rebates earned by insurers (to assess the extent of 'leakage' to paint manufacturers);
- (c) whether any saving to a repairer from not having the paint supply contract would be passed on to insurers.

59. Using the data from Tables 1 and 2, we estimate that rebates are, on average, between [X] and [X] per repair.<sup>26</sup> We asked repairers to estimate the effective cost increase due to the contracts and they told us that, using a paint brand different from that recommended by insurers but of comparable quality could generate savings of up to between £[X] and £[X] per repair, or between [X] and [X] per cent of the cost of paint in a repair.<sup>27</sup> Repairers told us that the saving would be mostly due to higher volume discounts from using only one paint brand. Most repairers told us that using recommended distributors would not give rise to significant cost increases (and any cost increase would be difficult to quantify). However, one repairer told us that using different distributors could save it up to [X] per cent of its total cost of paint.<sup>28</sup>
60. Overall, it appears to us that the cost increases due to the paint supply contracts are likely to be close to the level of rebates earned by the insurers which are party to those contracts. There might be cases in which the cost increase is higher than the rebate earned, but the difference is likely to be very small. In other words, it appears that insurers extract the vast majority of the additional profit generated by paint suppliers from the paint supply contracts.

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<sup>26</sup> [X].

<sup>27</sup> For example, [X] told us that it could save up to £18, corresponding to 30 per cent of its paint costs. [X] estimated savings of £6.40, out of an average spend on paint of £80 per repair. [X] and [X] told us that no significant savings could be achieved.

<sup>28</sup> According to [X], savings would not be significant. Similarly, [X] was not able to quantify them. However, [X] estimated that it could save up to [X] per cent of costs were it not to use the distributors recommended to it [X].

61. We considered whether, were a repairer free to choose its paint supplier, and so generate a saving, it would pass on this cost saving to insurers. This would require insurers to renegotiate their repairer agreements, which we understand currently happens infrequently (see paragraph 72). Moreover, the fact that repairers usually make reasonable margins on paint (compared with labour and parts (see paragraph 17)) suggests that insurers may not go to great lengths to appropriate the savings. One repairer told us that savings on paint would amount to an additional [redacted] per cent profit, which seems to imply that gains would not be passed through.<sup>29</sup>
62. We also note that the contracts between paint suppliers and insurers may generate efficiencies along the supply chain (see paragraph 44), some of which might result in reduced costs to consumers.
63. Overall, since cost increases arising from paint supply contracts are small relative to the average repair bill, and similar to the level of the rebates paid to insurers,<sup>30</sup> and given that it seems unlikely that repairers would pass on fully to insurers any savings from not having these contracts, it appears to us that harm to PMI consumers is unlikely to arise directly from these contracts. We note that harm to consumers might still arise indirectly due to these contracts inflating non-fault repair costs (see paragraph 54).

### ***Exclusive contracts (with a specific referral fee structure)***

64. Under the [redacted]. We have investigated whether this leads to an inflation of costs of repairs passed on to fault insurers [redacted] over and above the effects identified in paragraphs 54 to 56. There are two ways [redacted] might achieve this: (a) its repairers

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<sup>29</sup> On the other hand, [redacted] estimated that a potential £18 saving would translate into an average reduction in the invoiced bill of £[redacted]. However, this was based on the assumption of a fixed percentage profit margin. [redacted] recognized that this may not be the case.

<sup>30</sup> [redacted].

might give less of a discount off the Audatex weighted average paint price; and/or (b) it might 'inflate' the Audatex weighted average paint price. We discuss each in turn.

*Raising costs to rivals through giving less of a discount off the Audatex weighted average paint price*

65. One way to 'inflate' repair bills is to give less of a discount off the Audatex weighted average paint price. [REDACTED]<sup>31</sup>

66. Similarly, [REDACTED]<sup>32</sup>

67. However, we also note that there may be reasons for [REDACTED].

68. It appears to us that the data suggests that [REDACTED].

69. An analysis of billed paint costs [REDACTED].

70. Overall, it appears to us that [REDACTED] does not lead to [REDACTED] repair bills from repairers which are significantly inflated compared with those where there is a non-exclusive contract through [REDACTED] less of a discount off the Audatex weighted average paint price.

*Raising costs for rivals through manipulation of the Audatex weighted average paint price*

71. An alternative way to 'inflate' repair bills is to increase the Audatex weighted average paint price. However, we note that this would only have an effect if insurers could not quickly renegotiate their contracts with repairers to take into account the new base price. Therefore we considered the nature of these negotiations.

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<sup>31</sup> [REDACTED].

<sup>32</sup> [REDACTED]

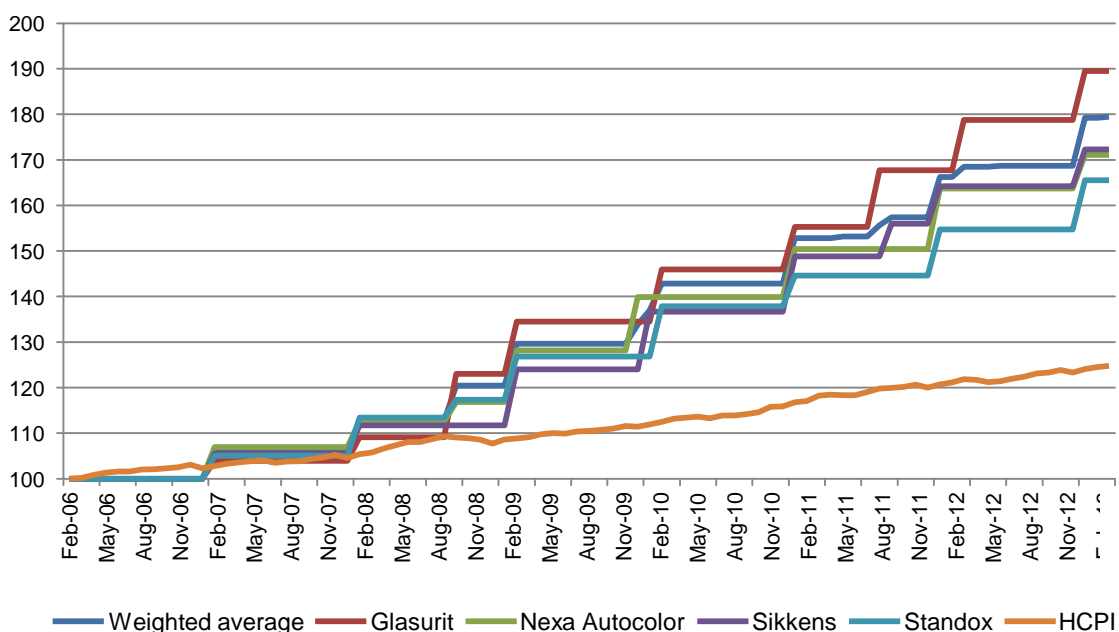
72. We found that insurer practice varied. Some insurers, like [X] and [Y], told us that they would not renegotiate the discount in their contracts with repairs were there to be an increase in the Audatex weighted average price, assuming the increase was justifiable. Other insurers told us that they would consider renegotiation if it increased by 5 per cent. [Z] told us that, if there were a 10 per cent increase, it would immediately renegotiate its discount. In general, however, we found that renegotiations are infrequent. On this basis, the strategy of inflating rival costs through increasing the weighted average paint price could be effective, so we considered it further.

73. We noted that [X].

74. However, we considered the change over time of the trade price [X]. Figure 6 compares the trade prices of the bestselling brand of each of the four main paint manufacturers for the last seven years.

FIGURE 6

**Increase in trade prices since 2006**



Source: Audatex, Eurostat.

75. We recognized that the impact of the price increase of a given paint brand on the weighted average paint price did not depend on the percentage increase but on the absolute increase, as a similar percentage increase of a more expensive brand would have a greater effect. We noted that [REDACTED]<sup>33</sup>
76. Overall, it appears to us that the change in trade price of [REDACTED] and the impact of [REDACTED] on the Audatex weighted average paint price has been similar to that of other leading paint brands.

**Aviva Comment** - This section (Paragraph 65 to 76) - we feel does not fully address the problem or leading Paint brands increasing prices at similar times leading to increased 'weighted average' price on the Paint Index held in audatex and other estimating systems pricing algorithms. This graph clearly shows this. There are no Insurer specific paint index tables (to our knowledge) which means you cannot alter rivals prices via this mechanism as there is only one industry table. The only manner to change the repair bill (paint element) is through higher or lower discounts with the repairer. Whilst Insurers would re-negotiate with repairers if Paint prices increase, the overall repairer net margin is suppressed to less than 4% on average and whilst the repairer does have a greater margin on paint, it is commonly known in the industry this helps subsidise significantly lower margins on parts and labour. Therefore any renegotiation is at the 'net expense' of the repairer and this would lead to the repairer not making suitable margin and potentially going out of business if it was to continue - the foreclosure element.

### Further concerns

77. Through the course of our inquiry so far, we have heard a number of other concerns in relation to paint supply contracts. In this section, we consider some of these concerns.
78. RML and the VBRA have argued that the DLG/Akzo paint supply agreement reduces competition between paint distributors, resulting in higher prices for repairers and to consumers. We have considered their concern from the perspective of any effect on the provision of post-accident repair services covered by PMI (we are not, in our investigation, examining the conditions of competition in the paint market). Within this context, it does not appear to us that a retail price negotiated directly between an insurer and a paint manufacturer will necessarily lead to higher prices compared with a situation where each repairer is free to choose a distributor from which to source a mandated paint brand (in particular given the bargaining power of insurers).

79. Hex told us that paint manufacturers forbid distributors from purchasing paint from outside the UK, which, it said, amounted to a restriction on parallel trade. However, it appears to us that, if the case, this would be an issue relating to the supply of refinish

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<sup>33</sup> [✂]

paint overall, rather than one linked to post-accident repair services covered by PMI. Therefore, we did not believe that it would fall within the focus of our inquiry and did not consider it further.

80. RML and the VBRA raised an additional concern related to the DLG/Akzo agreement, saying that [REDACTED] paint could cause customers to lose their car manufacturer's anti-corrosion warranty (if the warranty is linked to the use of other brands of paint). They told us that the warranty offered by [REDACTED] might not be a reasonable substitute, as it would be underwritten by the repairer and not by [REDACTED]. DLG told us that it offered all its customers a five-year guarantee on all repairs, or the manufacturer warranty period, whichever was longer. Therefore, it appears to us that if there is a problem it would relate to [REDACTED]. However, we note that [REDACTED]. In those cases, the repairer is free to choose any paint brand so it is a matter for the repairer (and work provider) to agree with the customer the most appropriate paint to use. Therefore, it appears to us that this issue is likely only potentially to affect non-fault claimants captured by DLG.<sup>34</sup>

81. RML and the VBRA also said that a higher billed cost of paint may affect a customer's decision on whether to claim on their insurance or to pay for the repair themselves. They said that some customers, who might have preferred to meet the repair costs themselves, will end up claiming, so losing their no claims bonus, resulting in a higher PMI renewal price. However, it appears to us that the small increase in the billed cost of paint because of vertical paint supply contracts is unlikely to 'tip the balance' of whether to claim or not in most cases. The increase in the cost of paint is a very small fraction of the average total repair cost (see paragraph 59).

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<sup>34</sup> In our analysis we have considered whether this agreement might affect the provision of post-accident repair services covered by PMI. We have not considered whether this agreement might affect the conditions of competition in the paint market.



82. NAB raised an additional concern, saying that the way in which Audatex established the weighted average paint price used for its cost estimates could skew paint manufacturers' pricing.<sup>35</sup> It said that every year the UK's four principal paint suppliers provided Audatex with details of their proposed price increases. This data was then embedded in the Audatex estimating system. NAB told us that these increases could often be significantly above the rate of inflation and that the insurers' use of the weighted average paint price led to large annual increases in the price of paint. However, as far as we are aware, repairers do not usually charge the Audatex weighted average paint price to insurers, but use it as a reference point when agreeing a price (see paragraph 15). Also, although renegotiations are not frequent and there may be a lag between an increase in the Audatex price and a resetting of the discount, insurers told us that they would renegotiate discounts, especially if they considered an increase in the Audatex price to be unjustified (see paragraph 72). Moreover, we see no reason why insurers and repairers could not negotiate their paint prices without reference to an index at all, should that index become less helpful.

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<sup>35</sup> In our analysis we have considered whether this concern might affect the provision of post-accident repair services covered by PMI. We have not considered how this concern might affect the conditions of competition in the paint market.

## Paint marketing associations

1. PMAs are associations of paint distributors. There are four PMAs operating in the UK: ACIS, IRIS, NIBS, and UPD. Table A1 shows the members of each PMA.

TABLE A1 **Members of PMAs**

<i>Distributors</i>	<i>ACIS</i>	<i>IRIS</i>	<i>NIBS</i>	<i>UPD</i>
Autotrade Centre		x		
BeeBee refinish supplies		x		
Body & Paintshop supplies			x	
Carlac			x	
Coachfinish		x		
Cunbar			x	
Dingbro	x	x		
F&K Griffiths			x	
Fleet Factors				x
Gils			x	
Granlyn	x			
Grove Group (also known as G Mitchell)	x			x
Invicta paints		x		
JCA	x	x	x	
JS Husseys & Co			x	
Karkraft	x	x	x	
MacGregor			x	
Mallaband			x	
MKPE	x	x		
Movac	x		x	
Premier Paints		x		
Rainbow Paints		x		
Sayers	x			x
Sinemaster		x		
Supertune Automotive	x			
TRI			x	
Waregrain			x	
Wood Auto Supplies		x		

Source: PMA's websites.

2. Each PMA has agreements with paint manufacturers to represent some or all of their brands. The PMA's members must be distributors of at least some of these brands.

Table A2 shows the brands represented by each PMA.

TABLE A2 Brands represented by PMAs

Manufacturers	Brands	ACIS	IRIS	NIBS	UPD
PPG	PPG		x		
	Nexa Autocolor	x	x		
	Max Meyer (B)		x		
DuPont	Spies Hecker			x	
	Standox		x		
Akzo	Dupont				x
	Sikkens	x	x		x
	Lesonal (B)		x		x
BASF	Glasurit	x		x	
	RM		x		
Valspar	Octoral (B)		x		
	DeBeer (B)				
Lechler (B)					
Sherwin Williams (B)			x		

Source: ACIS; and the other PMAs' websites.

Note: B denotes a 'budget' brand. None of these are recommended by insurers or car manufacturers.

3. The same brand can be represented by more than one PMA. Also, paint manufacturers sell the same brands of paint to other distributors which are not members of PMAs. There are many more distributors which are not members of PMAs than distributors which are.
4. Paint manufacturers usually determine the terms of the supply of their products through agreements with individual distributors, not with PMAs. However, PMAs may receive marketing fees from manufacturers. For example, [X]. Marketing fees are also paid by paint manufacturers directly to individual distributors.
5. The main purpose of a PMA is to negotiate a national paint supply contract with a repair network or a repair work provider. PMAs have negotiated a number of such agreements with insurers, CMCs and car manufacturers. [X] has agreements with [X]. [X] has contracts with [X] car manufacturers ([X]), [X] CMCs and a car dealership ([X]) which [X]. [X] has agreements with [X] and [X], among others.
6. In most contracts, the PMA is given the status of a preferred distribution partner and it pays a rebate to the other party (ie the insurer, CMC, car manufacturer or dealership). In 2012, [X]. However, paint prices are usually agreed between the

repairer and an individual distributor. Typically, the PMA will negotiate a maximum price to be paid by the repairer, but the repairer can negotiate a lower price with an individual distributor member of the PMA.

7. Members of a PMA are in theory free to compete against each other. However, in practice, competition might be limited, in particular by different members having a different geographic focus. For example, [redacted] told us that it assigns each member a (non-exclusive) post code area. Moreover, when [redacted] is a preferred distributor partner, unless otherwise instructed by its client, it gives a repairer the contact details of the repairer's two closest distributors (though all of its members' contact details are published on its website). We also note that, as a result of membership, there could be an implicit threat that any member which acts to the detriment of its fellow members might be expelled. [redacted] added, though, that all its members still compete for business against external competition.

## PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

### Background to private motor insurance (insurers, brokers and price comparison websites)

#### Introduction

1. This working paper is in four parts:
  - (a) The first part provides background information on the legal and regulatory framework underpinning the private motor insurance (PMI) industry.
  - (b) The second part provides background information on the provision of insurance policies, including types of PMI and claims costs, information on each of the ten largest PMI insurers, costs of selling PMI and claims experience by channel, common measures of industry profitability, a high-level analysis of profitability, and a description of the bilateral agreements between PMI providers. The ten largest PMI insurers are: Admiral Group plc (Admiral), Ageas NV/SA (Ageas), Aviva plc (Aviva), AXA Insurance UK plc (AXA), CIS General Insurance Limited (CISGIL), Direct Line Insurance Group plc (DLG), esure Insurance Limited (esure), Liverpool Victoria Insurance Company Limited (LV), Royal & Sun Alliance Insurance plc (RSA) and Zurich Insurance plc (Zurich). We estimate that the top ten PMI insurers made up 64 per cent of the total UK PMI market in 2012. The information we set out on these insurers includes the type of each company, its distribution channels and brands used to sell PMI, its gross written premiums (GWP) and the number of policies sold in a year (as rough measures of size), and whether the insurer owns PMI-related companies such as brokers or a price comparison website (PCW). This information was gathered directly from insurers and is more up to date than the data on types of PMI and claims costs which we extracted from a 2012 Datamonitor report.<sup>1</sup>

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<sup>1</sup> Datamonitor report: 'Personal General Insurance: UK Private Motor Insurance', published September 2012.

(c) The third part provides background information on PCWs, including customers' use of PCWs, business models and financial results, and information on each of the four largest PCWs as well as some of the smaller PCWs.

(d) The fourth part provides background information on brokers, including types of broker and distribution channels, market shares, and information, including financial data, on some of the major brokers.

## **Part 1—Legal and regulatory framework**

### ***Legal framework***

2. Under the Road Traffic Act 1988 (RTA 1988), motorists are obliged to hold a valid insurance policy to cover 'third party' risks, ie the risk that they will cause death or personal injury to another person or damage to another person's property while driving and consequently have to pay damages. Third party motor insurance is the only form of motor insurance that is compulsory by law.
3. The legal framework governing motor insurance is currently being revised following national and European initiatives. For instance, as from 21 December 2012, any gender differentiation has been prohibited and insurers must offer 'unisex' premiums. According to the European Commission, this should not lead to an unjustified increase in overall prices but it is monitoring the implementation and its effects.<sup>2</sup>

### ***Regulatory framework***

4. Partially in response to the financial crisis, UK and EU authorities have also taken several initiatives to amend the institutional and regulatory framework of insurance regulation.

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<sup>2</sup> Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats), *OJEU*, 13 January 2012, (2012/C 11/01).

5. Until 31 March 2013, regulation of the insurance industry in the UK was carried out by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000 (FSMA). From 1 April 2013, the FSA was abolished and, under the terms of the Financial Services Act 2012 (which amended FSMA, the Banking Act 2009 and the Bank of England Act 1998), insurance companies are now regulated by two new regulatory institutions.
  - (a) The Prudential Regulation Authority (PRA), which is part of the Bank of England, is responsible for the prudential regulation and supervision of insurers, which includes the authority to grant and, in specific circumstances, to vary or cancel permissions to carry on insurance business and to require the maintenance of adequate financial resources (prudential supervision).
  - (b) The Financial Conduct Authority (FCA) regulates insurance firms for conduct purposes. This includes the authority to ensure that regulated firms treat customers fairly as well as to investigate marketing, sales, claims and complaint handling practices (conduct of business supervision).
6. An insurer providing motor insurance cover in the UK will fall within this regulatory framework.
7. One of the principal regulatory objectives in the regulation of insurance companies is the protection of policyholders and third party claimants, rather than shareholders or general creditors.
8. In 2009 the EU revised the current supervisory framework by adopting a new legislative framework for the banking industry (Basel III) and insurance industry (Solvency II). The new Solvency II regime is likely to enter into force by 1 January 2014 (unless the date should be postponed at EU level). The provisions of Solvency II would therefore need to be transposed into UK law (and be in force) by 1 January 2014.

**Aviva Comment** – we understand that Solvency II is delayed



9. The changes brought by Solvency II will entail, among other things:
  - (a) a new, more sophisticated, approach to risk and capital requirements, requiring valuations to be done in a prudent and market-consistent manner;
  - (b) higher standards of risk management and governance;
  - (c) increased supervision powers for authorities, eg increased powers to challenge firms on risk management issues; and
  - (d) increased disclosure and reporting requirements.
  
10. According to some analysts' commentaries on the capital requirements of Solvency II, this regime could increase consolidation in the insurance industry, since costs of compliance for smaller insurers may become prohibitive, and smaller insurers with limited diversification of risk may need to hold relatively more capital than larger, more diversified insurers.
  
11. In 2010 the European Insurance and Occupational Pensions Authority (EIOPA) was created. EIOPA is responsible for monitoring the insurance industry as a whole and for facilitating collaboration between national authorities.

## **Part 2—PMI insurers**

### ***Types of PMI***

12. As outlined in paragraph 2, the RTA 1988 requires that insurance against liability for death or injury to third parties, as well as damage to property of third parties, is obtained before a vehicle can be driven. This type of insurance is commonly known as third party only, or non-comprehensive insurance. In addition to the risks which are compulsorily insurable, risks covering fire and theft are often covered ('third party, fire and theft'). However, the most commonly sold type of PMI is comprehensive insurance, which also covers damage caused to the insured's own vehicle and the insured's own medical expenses arising from an accident. Over 90 per cent of PMI

GWP in 2011 related to comprehensive policies.<sup>3</sup> Comprehensive cover may also provide extra benefits such as a temporary courtesy car, roadside assistance, or windscreen repair or replacement, but these may not be standard. If these extra benefits are not standard, they may be sold as add-ons to the basic cover.

13. The proportion of non-comprehensive policies written has declined year on year since 2007. Insurers told us that high competition in the comprehensive insurance market and the knock-on effect on pricing had rendered non-comprehensive products obsolete for many customers. Insurers told us that they had also sought to limit their risk exposure as, historically, non-comprehensive policies, being most popular with young and/or newly-qualified drivers, accounted for greater underwriting losses. In particular, these policies do not prevent insurer exposure to third party personal injury, which has represented an increasing cost for insurers recently (see paragraph 17).<sup>4</sup>
  
14. Figure 1 shows total industry GWP split between comprehensive and non-comprehensive policies, 2007 to 2011.

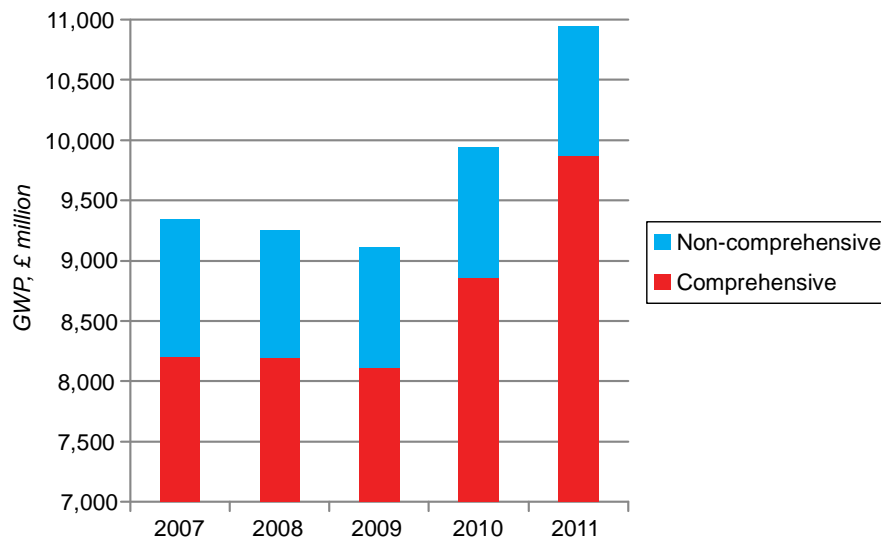
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<sup>3</sup> Source: Datamonitor 'UK Private Motor Insurance 2012, Table 1, p30.

<sup>4</sup> *ibid*, p31.

FIGURE 1

**Split of GWP between type of policy, 2007–2011**



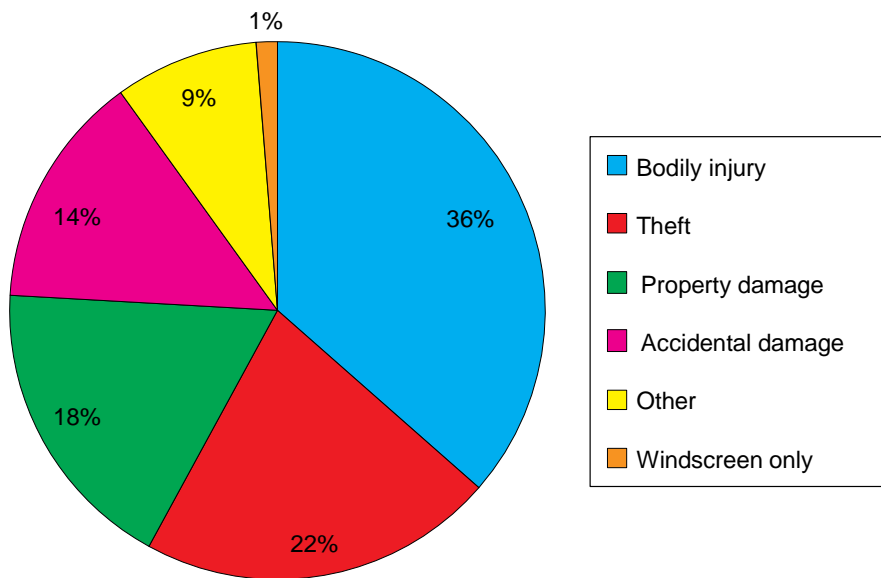
Source: Datamonitor.

**Claims**

15. Figure 2 presents an analysis of claims costs in 2010.

FIGURE 2

**Claims costs, 2010**

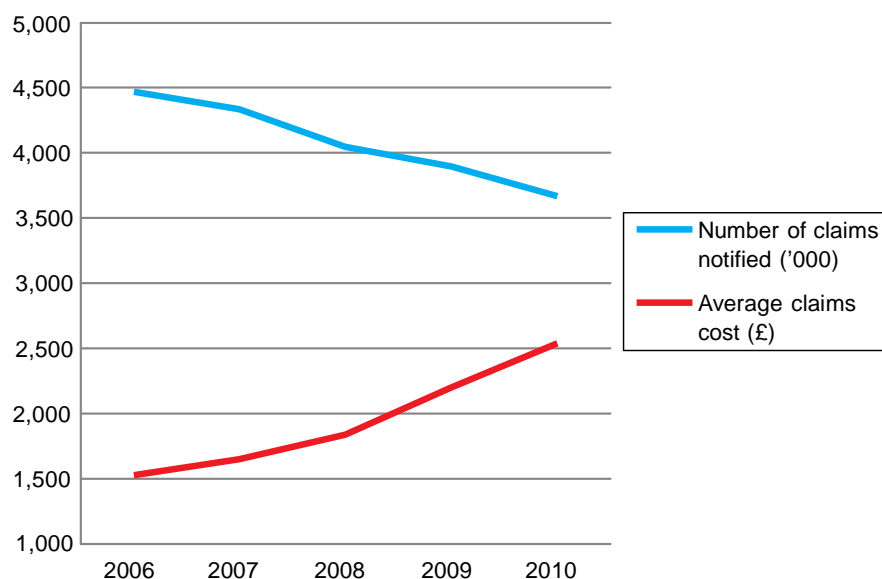


Source: Datamonitor, ABI.

16. Claims incurred amounted to £9.3 billion in 2010, which was an increase of 9 per cent on 2009. Claims costs have been rising year on year since at least 2006, which is despite a fall in the number of claims over the same period. The average costs of a claim rose from £1,527 in 2006 to £2,541 in 2010. Figure 3 shows the number and average cost of claims over the same period.

FIGURE 3

**Number and average cost of claims, 2006–2010**



Source: Datamonitor.

17. More than one-third of claims costs in 2010 related to personal injury, of which 70 per cent was estimated to be due to whiplash injury claims. While the average cost of a motor insurance claim rose by £219 between 2006 and 2010, the average cost of a personal injury claim rose by £906.

18. Accidental damage made up only 14 per cent of total claims costs in 2010, with the average payout of this type of claim being £1,379. Theft claims reduced between 2006 and 2010.

## **Background information on each of the ten largest PMI insurers**

### *Introduction*

19. In this section we present some background information on the ten largest PMI insurers: the type of company; its distribution channels and brands used to sell PMI; its GWP and average number of policies in the year (as rough measures of size); and whether the insurer owns PMI-related companies such as brokers, a PCW, etc.
20. All ten of the largest PMI insurers supplied us with information on their GWP and their average number of policies for each of the five years ended 31 December 2008 to 2012.
21. Table 1 shows the ten largest PMI insurers' GWP, average number of policies in 2012, and average GWP per policy.

TABLE 1 **GWP, average number of PMI policies, and GWP per policy, 2012, for the ten largest insurers**

	<i>2012 GWP</i> £m	<i>Average</i> <i>number of</i> <i>policies in year</i>	<i>Average</i> <i>GWP/policy</i> £
DLG	[X]	[X]	[X]
Aviva	[X]	[X]	[X]
LV	[X]	[X]	[X]
Admiral	[X]	[X]	[X]
AXA	[X]	[X]	[X]
Ageas Insurance	[X]	[X]	[X]
esure	[X]	[X]	[X]
RSA	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]
Zurich	[X]	[X]	[X]
<b>Total</b>	[X]	[X]	<b>393</b>

Source: The ten largest insurers.

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### *Share of the market estimated to be covered in this paper*

22. From the figures provided by the ten largest PMI insurers, GWP totalled £[X] in 2012. With an estimated total market size in 2012 of £10.9 billion,<sup>5</sup> we estimate that the ten largest PMI insurers represent about [X] per cent of the total market. The

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<sup>5</sup> 2011 GWP estimated in Datamonitor report, p30, based on ABI data; assuming GWP stayed flat between 2011 and 2012.

largest PMI insurer is DLG, which is responsible for almost a quarter of the sales made by the ten largest insurers. The GWP of the four largest PMI insurers accounted for [X] per cent of the GWP of the ten largest insurers (and [X] per cent of the estimated total market size in 2012), with a large drop in GWP between the fourth largest PMI insurer ([X], with [X] per cent of the total market) and the fifth largest insurer ([X], with [X] per cent of the total market).

### *Distribution channels*

23. We asked the ten largest insurers to provide a split of their GWP and policies sold by sales channel for 2012.<sup>6</sup> All the insurers provided figures for new business but excluded renewals so the figures do not tie to the total GWP. Most insurers allocated sales to the original quote channel, regardless of the channel through which the sale was completed (eg if a quote was generated online but then completed by telephone, the channel designated for the sale was online). Some insurers also applied this approach with regard to renewals in subsequent years, where the designated channel for the renewal sale was that through which the original sale was made.
24. Overall, across the ten largest PMI insurers, over one-third of GWP was sold direct (telephone and online), with 31 per cent of GWP sold via brokers and nearly one-quarter of GWP sold via PCWs.
25. Table 2 shows the overall split of GWP and the number of policies sold across the top ten insurers by sales channel.

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<sup>6</sup> Due to the timing of our request (shortly after year end), some providers were able to give us 2012 figures but other providers could only give us 2011 figures (all the providers have a December year end).

TABLE 2 **Split of GWP and number of policies by sales channel, 2011/12**

	<i>per cent</i>	
	<i>Sales channel split by value (GWP)</i>	<i>by volume (number of policies)</i>
Direct—Internet	20	23
Direct—telephone	17	15
Brokers	31	32
PCWs	24	21
Retail p'ships	2	2
Banks/building societies	1	1
Other	6	7
<b>Total</b>	<b>100</b>	<b>100</b>

Source: CC calculations based on data provided by the parties.

### *The ten largest PMI insurers*

#### *Admiral*

26. Admiral launched in 1993 and floated on the London Stock Exchange in 2004 (it is currently a FTSE 100 company). It specializes in car insurance and does not sell other types of insurance.
27. Admiral operates 13 brands in seven countries. In the UK its brands are Admiral, Bell, Diamond, and Elephant.co.uk.
28. Admiral also owns Confused, one of the four largest PCWs, which was launched in 2002.
29. In 2012, Admiral's total PMI GWP was over £1 billion, making it the fourth largest PMI insurer in the UK. Over 80 per cent of its sales are made via PCWs; its other sales channels are direct (own websites) and direct (own call centres).

#### *Ageas*

30. Ageas is an international insurance group ranked among the top 20 insurance companies in Europe. Its activities are grouped in four geographic segments: Belgium, the UK, Continental Europe and Asia. Ageas operates partnerships in Belgium, the

UK, Luxembourg, Italy, Portugal, Turkey, China, Malaysia, India and Thailand and it has subsidiaries in France, Hong Kong and the UK. Ageas is the market leader in Belgium of individual life and employee benefits, as well as the leading non-life insurer through AG Insurance. Ageas employs more than 13,000 staff and has annual revenues of more than €21 billion.

31. In the UK, Ageas (UK) Limited is a provider of life and non-life insurance products. Ageas (UK) Limited owns a 50.1 per cent shareholding in Tesco Underwriting Limited.
32. Ageas Insurance has a different business model from the other ten largest PMI insurers as it does not have any of its own brands and does not sell directly to customers, typically selling through the brands of others. 89 per cent of its PMI policies are sold through brokers. It also sells through retailer partnerships (Age UK, General Motors, John Lewis, Lloyds Banking Group, Post Office Financial Services and Toyota). Ageas (UK) Limited owns a number of brokers: Ageas 50 Limited, Kwik-Fit Insurance Services Limited, Express Insurance Services Limited, The Green Insurance Company Limited, and UKAIS Limited.
33. In September 2012, Ageas (UK) Limited acquired Groupama Insurance Company Limited, boosting its presence in personal and commercial lines, and adding a million customers in the UK.
34. In 2012, Ageas Insurance's total PMI GWP was over £500 million, making it the sixth largest PMI insurer in the UK.



## *Aviva*

35. Aviva is the UK's largest insurer and one of Europe's leading providers of life and general insurance. In the UK it provides home, motor, life and health insurance and annuities. The group was formed by the merger of CGU and Norwich Union in 2000. CGU came from the merger of Commercial Union and General Accident in 1998. It is a FTSE 100 company.
36. Aviva has three brands: Aviva, Quotemehappy (launched in August 2011) and General Accident (launched in April 2013). Aviva sells PMI via many distribution channels: direct, through brokers, corporate partners and PCWs (only using its Quotemehappy and General Accident brands). [✂].

### **Aviva Comment – PCW sales are also via broker**

37. Aviva also owns a vehicle repair company, Solus Accident Repair Centres (Solus), and a salvage company, bluecycle.com.<sup>7</sup> Solus carries out vehicle repairs, including collection and delivery, and the provision of courtesy cars. Solus also has some arrangements to carry out fleet repairs for the police and other repair networks. Bluecycle.com manages salvage, including collection, disposal and administration of vehicles.
38. Until September 2011 Aviva was also the owner of the RAC,<sup>8</sup> which it sold to Carlyle Group, a private equity group. Aviva continues to sell RAC breakdown cover to its customers and is an underwriter on RAC's panel of motor insurers.
39. In 2012, Aviva's total PMI GWP was over £1.1 billion, making Aviva the third largest PMI insurer in the UK.

### **Aviva Comment - Aviva shown as third largest insurer but para 60 has LV as third largest also?**

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<sup>7</sup> Aviva has announced that bluecycle.com will be closed in August 2013.

<sup>8</sup> The RAC motoring organization no longer has any connection to its previous owners, the Royal Automobile Club.

## AXA

40. AXA SA is a French global insurance group headquartered in Paris and quoted on the Euronext Stock Exchange. In the UK, AXA specializes in wealth management, insurance, and healthcare.
41. AXA sells PMI under two brands, AXA and Swiftcover, and through three channels: direct online (which is responsible for [X]), via brokers (responsible for [X]), and via PCWs (responsible for [X]). It operates call centres but these are only to assist customers as it does not sell PMI by telephone.
42. In 2012, AXA's total PMI GWP was over £[X] million, making it the fifth largest PMI insurer in the UK.

## CISGIL

43. The Co-operative Group is the UK's largest consumer co-operative. It is owned by over 7.2 million consumers and approximately 80 independent co-operative societies. The Co-operative Group includes the Co-operative Banking Group, which in turn includes CISGIL, the general insurance company within the Group.
44. CISGIL sells PMI under only one brand, The Co-operative Insurance, but it sells three different PMI products through different sales channels: 'Car Insurance' is sold direct, both online and via telephone, 'ecoinsurance' is only sold via PCWs, and 'Young Driver' is sold only direct online.
45. In 2012, CISGIL's total PMI GWP was over £[X] million, making it the ninth largest PMI insurer in the UK.

## *DLG*

46. DLG is a leading general insurer and one of the largest PMI insurers in the UK. It also has businesses in Italy and Germany. Following an EU decision to separate DLG from the Royal Bank of Scotland Group plc as a condition of the bank receiving state aid, DLG floated on the London Stock Exchange in October 2012 where it has a FTSE 250 position. DLG is still 48.5 per cent owned by RBS, although RBS has committed to selling its entire shareholding by December 2014.
47. In personal lines insurance, DLG sells home insurance, breakdown cover, pet insurance, travel insurance, PMI and income insurance. Its commercial business also offers a range of products primarily targeted at small businesses.
48. DLG offers PMI through the Direct Line, Churchill and Privilege brands, and also through the brands of a range of partners, including Sainsbury's Bank, RBS Group, Prudential and PSA (Peugeot/Citroen).
49. DLG uses different channels for its different brands of PMI: Direct Line is available only over the telephone or online, not through PCWs; while Churchill and Privilege are sold through PCWs, as well as being available directly by telephone or online. DLG also uses its partnerships with retailers, banks, building societies and motor manufacturers. Across all its brands, over three-quarters of its sales are made direct (either online or by telephone).
50. DLG owns UK Assistance Accident Repair Centres Limited (UKAARC), which provides vehicle repair services, referred exclusively to it by DLG, through a network of 16 sites exclusively to DLG.

51. In 2012, DLG's total PMI GWP was over £1.6 billion, making it one of the largest PMI insurers in the UK.

*esure*

52. esure only sells motor, home and travel insurance, and only to customers in England, Wales, Scotland and the Isle of Man. It was started in 2000 by the founder of Direct Line, and in 2010 was subject to a management buyout of the stake originally held by Halifax/HBOS and latterly Lloyds Banking Group. The company was floated on the London Stock Exchange in March 2013.

53. esure sells PMI under three brands: esure, Sheilas' Wheels (launched in 2005 to female drivers only) and First Alternative. It sells through PCWs (over [X] of its sales), and direct to customers via telephone and online. It does not distribute PMI through partnerships with retailers, banks/building societies or other distribution channels. In the past, esure provided PMI under the Sainsbury's and Halifax brands in partnership with these companies but new business under these arrangements has now ceased.

54. esure launched an insurance broker at the end of 2011 under two brands: esure broker and Sheilas' Wheels Broker. esure does not distribute PMI products through its insurance broking business but rather has a panel of other insurers which it believes complement esure's position in the market, enabling the group to offer services to all possible customers.

55. esure owns 50 per cent of GoCompare.com Holdings Limited, the parent company of GoCompare.com Limited, one of the four largest PCWs. It told us that GoCompare was independent and operationally separate from esure.

56. In 2012, esure's total PMI GWP was over £400 million, making it the seventh largest PMI insurer in the UK.

#### *LV*

57. LV is the UK's largest friendly society<sup>9</sup> and a leading financial mutual. A mutual organization is owned by its members, with membership restricted to those who have certain types of policy, such as life insurance, or a retirement policy.

58. LV distributes car insurance through the full range of distribution channels: direct to customer (online or by telephone), affinity schemes, PCWs, corporate partners and brokers. The broker channel accounts for approximately half the policies sold by LV. It only sells PMI to customers in the UK.

59. LV sells PMI through three main brands: LV for direct sales, and both ABC Insurance and Highway Insurance for broker sales (Highway Insurance Group PLC was acquired by LV in 2008).

60. In 2012, LV's total PMI GWP was over £1.1 billion, making it the third largest PMI insurer in the UK.

#### *RSA*

61. RSA is a leading global insurance group and a FTSE100 company. In the UK it is the largest commercial insurer and one of the largest personal lines insurers.

62. RSA has three PMI brands. It sells PMI directly (through its More Than and eChoice brands) and also makes PMI sales through intermediaries including brokers (where

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<sup>9</sup> A friendly society is based on the principle of mutuality. Unlike a co-operative, members usually do not contribute to the capital of the organization by direct investment but derive their right to profits and votes through their customer relationship with the organization.

some PMI will be sold under the RSA brand) and affinity partnerships. More Than is an online and telephone service provider which sells the full range of RSA's personal insurance products, including PMI, while eChoice is only sold online (through a dedicated website launched in 2010) and is only a PMI brand.

63. RSA sells PMI through a wide range of distribution channels: directly, either online or by telephone; online via PCWs (representing [X] per cent of its sales); via brokers; and indirectly through affinity partnerships (Ford and Volvo). In 2012, [X] per cent of its PMI sales were made direct and [X] of sales were made via PCWs, with [X] its sales made via brokers. However, RSA told us that, in 2013, it expected to write [X]. RSA uses 'branded' and 'non-branded' brokers:<sup>10</sup> branded brokers include AA, Brightside, Budget, Castlecover, Endsleigh, Kwik Fit and Swinton; non-branded brokers tend to be RSA-branded, with the cover based on RSA's own policy wording.
64. RSA group owns RSA Accident Repairs Limited (RSAAR) which trades under the name of Motor Repair Network Management. RSAAR operates through a network of approved garages and carries out some repairs at garages which it owns and which are staffed by its employees, known as Quality Repair Centres (QRCs), and which undertake repair work solely for RSA.
65. In 2012, RSA's total PMI GWP was over £[X] million, making it the eighth largest PMI insurer in the UK.

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<sup>10</sup> A branded broker leverages its brand name, customer loyalty and possession of customer data to obtain cheap quotations. The AA Insurance, part of the AA roadside breakdown organization, is the UK's leading branded broker of PMI. It uses a 'Motor Insurance Deal Checker' system to compare insurance policies from a selected panel of over 15 insurers (including RSA). Other branded brokers include Kwik Fit Insurance (owned by Ageas), Endsleigh (owned by Zurich), BGL and RAC.

## *Zurich*

66. Zurich is one of the world's largest insurance groups and is listed on the SIX Swiss Stock Exchange. In the UK, Zurich sells a range of general insurance products, including car, home, boat, and high net worth insurance, as well as life insurance products such as life cover, pensions and retirement products, and investments.
67. Zurich sells PMI through two main sales channels: nearly [X] per cent of sales are made through brokers, with the remainder made through PCWs. It has not written new business through partnerships since 2010. A very small amount of PMI is sold directly online.
68. Zurich owns the broker Endsleigh Insurance (over which it acquired full control in 2007).
69. In 2012, Zurich's total PMI GWP was over £[X] million, making it the tenth largest PMI insurer in the UK.

### *Vertical relationships (1): companies owned by the ten largest PMI insurers, which provide PMI-related services*

70. Table 3 shows a summary of the companies owned by, or in the same group as, the ten largest PMI insurers, which provide PMI-related services on an exclusive or non-exclusive basis:
  - (a) Three of the insurers own networks of vehicle repair centres. Each network carries out vehicle repairs exclusively for the PMI insurer which owns it.
  - (b) Two of the four large PCWs are owned or part-owned by one of the ten largest PMI insurers (and a further PCW is owned by a large broker). The PCWs sell a wide range of PMI products on a non-exclusive basis.
  - (c) Three of the ten largest PMI insurers also own brokers. These operate on a non-exclusive basis and appear to enable the PMI insurer to capitalize on its brand,

by attracting customers who do not necessarily fit its underwriting risk profile but who do wish to engage with the brand.

TABLE 3 **Summary of companies owned by, or in the same group as, the ten largest PMI insurers, which provide PMI-related services**

Admiral	PCW: Confused (100 per cent)
Ageas	Brokers: Ageas 50 Limited, Kwik-Fit Insurance Services Limited, Express Insurance Services Limited, The Green Insurance Company Limited, and UKAIS Limited
Aviva	Vehicle repairs: Solus Salvage auction: bluecycle.com*
AXA	None
CISGIL	Co-operative Legal Services
DLG	Vehicle repairs: UKAARC
Esure	PCW: GoCompare (50 per cent) Brokers: esure broker and Sheilas' Wheels Broker
LV	None
RSA	Vehicle repairs: RSAAR
Zurich	Broker: Endsleigh

Source: Responses from the insurers.

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\*Aviva has announced that bluecycle.com will be closed in August 2013.

### *Vertical relationships (2): companies providing contractual services to the ten largest PMI insurers*

71. Almost all of the ten largest insurers have non-exclusive contracts with a range of companies which provide PMI-related services. These include PCWs, breakdown, claims investigation, delegated claims handling, temporary replacement vehicles (TRVs), vehicle repair, repair assessment, paint and parts, uninsured loss recovery, salvage, repair cost estimation, and windscreen repair.
72. We noted that [redacted] agreements with vehicle parts suppliers, paint manufacturing companies or paint distribution companies.

### *Claims experience by channel*

73. We asked the PMI insurers about the level of their claims in each of the channels they used to distribute PMI. The lower the level of claims experience (ie the lower the percentage claims/loss ratio), the more favourable the position for the PMI insurer. Of



the eight insurers which were able to provide us with data,<sup>11</sup> four told us that claims were generally higher for sales made via PCWs compared with sales made via other channels, as follows:

- (a) Admiral told us that the claims experience in the first year of cover for policies purchased through PCWs was highest, followed by policies purchased over the telephone. Claims experience in the first year of cover was lowest for policies purchased online.
- (b) AXA told us [REDACTED]. Its total loss ratio<sup>12</sup> [REDACTED].
- (c) DLG told us that it experienced a slightly higher 'burn cost'<sup>13</sup> in 2012 on business generated through [REDACTED], but this was likely to be a function of the slightly different demographic profile of [REDACTED]. DLG also told us that, over the lifetime of the customer, business transacted through [REDACTED]<sup>14</sup>[REDACTED].
- (d) esure provided data on claims showing that [REDACTED].

**Aviva Comment** - This implies that the lower the claims ratio, the more favorable the position is for the insurer, but it depends upon the distribution costs. If you have a channel with high distribution costs, you will have to charge higher rates, and so this automatically lowers the claims ratio, all else being equal.

74. However, we noted that the differences in claims cost appeared to be due to the mix/demographic profile of customers buying through a particular channel, rather than the riskiness of the channel itself, as follows:

- (a) Admiral told us that the mix of business was very different between the three channels, and that it was not entirely correct to use the figures as the basis for a fair comparison between the three groups. For example, the mix of customers coming through PCWs included a much higher proportion of young drivers, which in turn led to a much higher level of claims cost.

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<sup>11</sup> Two were unable to provide data at this stage: CISGIL and LV.

<sup>12</sup> Ultimate loss ratio is total forecast claims divided by total forecast premium expected to arise from a policy or class of business. Losses include those paid and notified and an estimate of those yet to be notified.

<sup>13</sup> Burn cost is effectively average claims cost per policy.

<sup>14</sup> Scored loss ratio is a prediction of loss ratio for business written, based on a statistically modelled view of claims cost divided by written premium.

(b) DLG told us that most of the differences in burn cost corresponded to differences in customer mix in ways that could be addressed through other rating factors (eg age) so were not necessarily a function of the channel.

75. The other four insurers had inconclusive data regarding the difference in their claims experience between their direct and PCW channels, as follows:

(a) Aviva only started selling policies via PCWs in 2011 and told us that the data was not representative.

(b) RSA provided data on burn cost as follows: direct website £[redacted]–£[redacted]; direct telephone £[redacted]; broker £[redacted]; PCWs £[redacted]–£[redacted]; and partnerships £[redacted]–£[redacted].

(c) Zurich provided data on burn cost as follows: direct website £[redacted]; direct telephone £[redacted]; broker £[redacted]; and PCW £[redacted]. It did not provide us with an average for direct sales.

(d) Ageas Insurance provided data for brokers and partnership channels but as it does not sell direct to customers it did not provide any information on this channel.

### ***Common industry measures of profitability***

76. We asked the PMI insurers to identify the common measures of profitability in the industry, and to state which ones they used.

77. We found that there are two key measures of profitability which are disclosed externally: the underwriting result and the combined operating ratio (COR).

(a) The underwriting result is calculated as earned premiums (net of reinsurance),<sup>15</sup> plus other income (including referral fees), less incurred claims (usually net of any rebates), earned commission and expenses, and excludes investment

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<sup>15</sup> 'Reinsurance' is insurance purchased by an insurance company from one or more other insurance companies as a means of risk management. The function of reinsurance is to reduce an insurer's exposure to loss by passing part of the risk of loss on to a reinsurer.

income. As such it is focused only on underwriting activities and not investment activities.

(b) The COR expresses insurance outgoings as a percentage of premiums.

Insurance outgoings are claims liabilities, commission payments and expenses.

The lower the figure, the more profitable the business to the insurer, with any figure below 100 per cent meaning that the insurer is profitable on its underwriting activities (before investment income).

78. Other measures of profitability used by PMI insurers are as follows:

(a) Based on premiums received: GWP, net written premium (NWP) and net earned premium (NEP). Each of these measures is expressed as an absolute figure.

GWP is the amount of premium written in the year, gross of reinsurance, and regardless of when it was accrued; NWP is GWP net of reinsurance; NEP is the amount of premium accrued during the year, regardless of when it was written, net of reinsurance.

(b) Based on profitability: (1) Return on capital/return on equity. This is typically profit after tax divided by total capital or equity capital, expressed as a ratio. (2) Profit before tax (also called portfolio insurance result, or technical or operating result).

This is the underwriting result plus investment income, thus measuring all activities in the insurance business.

(c) Based on claims costs: (1) Claims ratio (or loss ratio). This is the claims cost as a percentage of premiums. (2) Underlying or normalized measure of claims costs.

This is claims costs excluding very large individual claims, over a certain amount, eg very large personal injury claims. This is generally then used in the calculation of a normalized claims ratio.

(d) Based on expenses: Expense ratio. This is expenses as a percentage of premiums.

79. We also asked the insurers how they accounted for referral fees and rebates from other firms, and amendment and cancellation fees from customers. We found that rebates are generally credited against the cost of claims, while referral fees and amendment and cancellation fees are generally included in 'other income'.

### ***High-level analysis of profitability***

80. The ten largest PMI insurers provided us with their financial data for the five years ended 31 December 2012, which we used to calculate their profitability. Across the five-year period, the unweighted average claims ratio was 84 per cent and the unweighted average expense ratio was 28 per cent, resulting in an unweighted average COR of 112 per cent. Therefore, on average over the period, PMI insurance activities alone were loss-making.
81. However, when investment activities are taken into account, PMI insurance activities were profitable, with income (including investment income) less total claims less total expenses (the underwriting result plus investment income) across all ten insurers over the five years totalling £1.8 billion.
82. [Appendix 1](#) shows the claims and expense ratios and the COR, as well as the underwriting result plus investment income, for each of the ten largest PMI insurers over the last five years.

## **Part 3—Price comparison websites**

### ***Introduction***

83. There are four large PCWs which allow consumers to compare and purchase PMI policies. These are:
- (a) Comparethemarket (CTM);
  - (b) Confused;

- (c) GoCompare; and
- (d) MoneySupermarket (MSM).

### **Customer use of PCWs**

84. PMI was the original focus of all four PCWs, though they all now offer many products, including other general insurance products (eg home, travel), financial products (eg personal loans, savings, credit cards) and other products (eg energy). [X].

**Aviva Comment - With the exception of MSM the price comparison sites derive the vast majority of their income through the motor insurance sales channel**

85. Customers who purchase PMI through a PCW access on average between one and two PCWs.

(a) Our survey of PMI policyholders found that respondents looked at, on average, 1.4 PCWs when they last compared insurance providers or policies, with 42 per cent looking at CTM, 45 per cent looking at GoCompare, 23 per cent looking at MSM, and 13 per cent looking at Confused (see the working paper 'Survey report'). Our survey found that 13 per cent of respondents looked at other websites.<sup>16,17</sup>

(b) A 2012 Datamonitor survey found that, in 2012, CTM was the most popular PCW for customers purchasing PMI, with 67 per cent of those customers who accessed a PCW and who then went on to purchase through a PCW using CTM (see Figure 4).<sup>18</sup> The other three large PCWs had lower but roughly similar levels of usage (Confused: 49 per cent; GoCompare: 43 per cent; and MSM: 48 per cent). Datamonitor found that usage of PCWs outside the four large PCWs was limited, with only 5 per cent of consumers who went on to purchase through a PCW using another PCW.

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<sup>16</sup> The percentage of customers using various PCWs before purchasing PMI adds up to 140 per cent, implying that on average customers use 1.4 PCWs to search before purchase.

<sup>17</sup> PCWs included in 'Other' included Compare NI, Google, MoneySavingExpert, Quote Zone, Tesco Compare, uSwitch and several others.

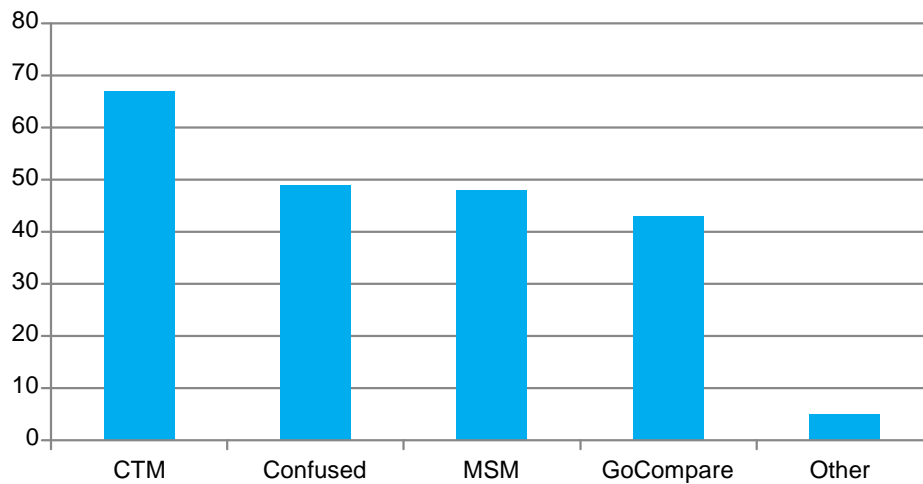
<sup>18</sup> The percentage of customers using various PCWs before purchasing PMI adds up to 212 per cent, implying that on average

customers use just over two PCWs to search before purchase.

FIGURE 4

**Relative popularity of PMI-promoting PCWs, 2012**

**Q: Which PCW did you use?**



Source: Datamonitor's General Insurance Consumer Survey 2012.

86. In Datamonitor's analysis, it records that, as of September 2012,<sup>19</sup> 55 to 56 per cent of new PMI business was being written by insurers through PCWs.<sup>20</sup> However, responses to Datamonitor's General Insurance Consumer Survey 2012 found that 23 per cent of consumers made their final purchase on a PCW, from a sample that included those renewing with the same insurer. We found that this latter figure was more in line with the figures provided to us by the ten largest PMI insurers regarding their GWP by sales channel, which suggested that, in 2012, 26 per cent by GWP and 28 per cent by number of policies were sold through PCWs (see paragraph 24). We noted that there was a large gap between the proportion of consumers using PCWs for research (around 77 per cent) and the proportion making a final purchase on them (around 20 to 30 per cent).

87. Datamonitor's 2012 report stated that annual revenue growth for the four main PCWs was in double digits in the period up to 2011, but has dipped recently to single digits.

<sup>19</sup> Datamonitor references this finding to 'aggregator experts' but does not specify who these aggregator experts are.

<sup>20</sup> Source: Datamonitor report: UK Private Motor Insurance 2012, p62.



88. Datamonitor's report stated that the growth of PCWs has had a significant effect on PMI providers' sales strategies by creating a more price-sensitive market, with consequent effects on the structure and pricing of policies, eg with less cover being included in the basic PMI product in order to produce a cheaper price. This drives the resulting headline quote, with more only being available as an add-on (known as 'hollowing out').

**Aviva Comment** - It has also meant that we are providing a less differentiated type of policy which in turn, results in less innovation for the customer.

89. Across all the PMI insurers interviewed by Datamonitor, it appears that to grow market share, insurers need to achieve a position within the top three to five headline quotes on a PCW. Of consumers surveyed who purchased PMI from a PCW, 37 per cent selected the cheapest quote and 56 per cent selected a policy from within the top five but not the cheapest. Although showing the importance of a high ranking, this data also suggests that price is not the sole consideration for consumers when selecting a policy on a PCW, with product differentiation and brand also being important.

**Aviva Comment** - For the most part this is correct. The only comment Aviva would make is rather than product differentiation, I would describe it as Product specification. Therefore (slightly) more expensive products with a stronger product specification will perform well even when presented lower down than top position as long as it is in the top 5.

### ***Business model and financial results***

90. The business model for each PCW is a simple one: PMI providers pay the PCW a fee per sale (ie a cost per acquisition (CPA) fee) for each PMI policy sold which was introduced by the PCW.

**Aviva Comment** - Some PCWs tried to make us have "conversion floors" where a conversion floor is set in place and we would pay to that level regardless if we did not achieve it [X].

91. Since the content offered by PCWs is provided by PMI providers which sell through multiple channels, it is unlikely to be unique, and thus each PCW is compelled to build a distinct brand identity to differentiate itself from other PCWs and to attract consumers to its website. As a result, PCWs spend heavily on advertising.
  
92. Datamonitor's report stated that all four of the large PCWs were among the top ten PMI advertisers in 2011, with all of them pursuing advertising campaigns focused on

television advertising. This medium represented between 90 and 99.99 per cent of their advertising spend. All of the four large PCWs told us that they did not promote PMI to any particular consumer demographic.

93. PCW's costs are mainly advertising/marketing, and creating/maintaining their websites. Confused told us that the large majority of its costs were direct in nature and related to the build, maintenance, development and promotion of the PCW. GoCompare told us that media costs (online and offline) constituted around 90 per cent of its costs. Both of these PCWs told us that, given the level of income from PMI, most media costs were attributed to PMI. CTM told us that [REDACTED]. CTM said that [REDACTED].

94. Table 4 presents a summary of the financial results for the four large PCWs. Since non-PMI-promoting activity is also carried out by all four companies, these results overstate the size of the PMI business. None of the four companies has to report publicly their PMI-only activities but the turnover for each PCW relevant to PMI is shown in the bottom half of the table. None of the four PCWs show PMI-only operating profit in their management accounts. We discuss the PCW's PMI-only profitability in our working paper 'ToH 3: Horizontal concentration in PCWs'.

TABLE 4 Summary financial results of the four largest PCWs

Company	Confused		CTM		GoCompare		MSM	
	2011	2010	2011	2010	2011	2010	2011	2010
Turnover (£m)	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Op profit (£m)	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Op profit (%)	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
<i>PMI only</i>								
Turnover (£m)	[REDACTED]		[REDACTED]		[REDACTED]		[REDACTED]	
Turnover as a % of company turnover	[REDACTED]		[REDACTED]		[REDACTED]		[REDACTED]	

Source: PCWs' published reports and accounts; and management accounts.

95. Three of the four large PCWs were able to provide us with some of their key performance indicators (KPIs) for their PMI-only PCW business on a similar basis, as

shown in Table 5. Conversion is calculated as the ratio of PMI policies sold to the number of unique customer quotes.

TABLE 5 KPIs for the three of the four largest PCWs

	<i>Confused</i>	<i>CTM</i>	<i>GoCompare</i>
Fee per policy sold (£)	[X]	[X]	[X]
Unique customer quotes (m)	[X]	[X]	[X]
Number of PMI policies sold	[X]	[X]	[X]
Conversion (%)	[X]	[X]	[X]

Source: PCWs' published reports and accounts; and management accounts.

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Note: MSM [X]

## ***The four large PCWs***

### *Comparethemarket*

96. CTM is an independent division of BISL Limited (BISL), which is part of the privately owned BGL Group.
97. PMI makes up [X] of CTM's PCW business [X].
98. CTM is [X] CTM generated turnover of £[X] from PMI in 2011. Its average income per sale was £[X].
99. CTM told us that it considered its closest competitors to be the other three large PCWs, plus Google and Tesco Compare which were of lesser but increasing significance.

### *Confused*

100. Confused is a wholly-owned subsidiary of Admiral. It promotes and compares a wide range of general insurance and finance products. It was launched in 2002, starting with PMI, and added its home insurance comparison service in 2005.

101. On PMI turnover alone, Confused is the [X] of the four large PCWs, having generated £[X] turnover from PMI in 2011. This represented [X] per cent of its total turnover. Its average income per sale was £[X].
102. Confused told us that it considered its closest competitors to be the other three large PCWs, plus Google.

### *GoCompare*

103. GoCompare is 50 per cent owned by esure.<sup>21</sup> GoCompare told us that it was operated independently of esure and no executive management was shared.
104. GoCompare provides comparison services for other insurance products including home, motorbike, van and pet. It also has a number of 'white label' agreements for the provision of other products, such as travel insurance, utilities, and business/landlord insurance.
105. On PMI turnover alone, GoCompare is the [X] of the four large PCWs, having generated £[X] turnover from PMI in 2011. This represented [X] per cent of its total turnover. Its average income per sale was £[X].
106. GoCompare told us that it considered its closest PCW competitors to be the other three large PCWs, Tesco Compare and Google.

### *MoneySupermarket*

107. MSM was founded in 1999 and provides comparison services for a range of products including insurance, financial services and non-financial services. MSM is wholly

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<sup>21</sup> Via GoCompare.com Holdings Limited.

owned by Moneysupermarket.com Group Plc, which is a FTSE-250 listed company. The group also owns Moneysavingexpert.com which is a financial journalism website.

108. MSM is structured into four 'verticals': money, insurance, home services and travel. Other than PMI, MSM provides comparison services for a wide range of insurance products: home, travel, life, mortgage protection, income protection, breakdown, motorbike, business, and van. MSM also provides comparison services for a wide range of products, both financial and non-financial: travel, energy, mobile phones, shopping, and broadband, as well as offering promotional deals and vouchers. MSM appears to offer the widest range of product comparisons of the four large PCWs.
109. On PMI turnover alone, MSM is the [redacted] of the four large PCWs, having generated £[redacted] turnover from PMI in 2011. This represented [redacted] per cent of its total PCW business.
110. MSM told us that it considered its closest competitors to be the other three large PCWs, as well as Tesco Compare, Google, Tiger, Quotezone, Moneyexpert, Uswitch, Lovemoney, Quidco, and Soswitch. This longer list of competitors appears to be because of MSM's wider product range than the other three large PCWs.

### **Other PCWs**

#### *Google and Tesco Compare*

111. We asked the four large PCWs which PCWs they considered to be their closest competitors. All four cited the other three large PCWs but three out of the four PCWs also mentioned Google and Tesco Compare. Google launched its current PMI price comparison service in the UK in September 2012 following its acquisition of Beatthatquote in March 2011, a company which was founded in 2005. Tesco

Compare launched its PMI price comparison service in September 2007, initially as a 50:50 joint venture with the Royal Bank of Scotland, though in 2008 Tesco bought the business in its entirety.

### *CompareNI*

112. CompareNI is a PCW operating only in Northern Ireland. It is part of Seopa Ltd, founded in 2003, and is still owned 100 per cent by its founder. Although originally focusing mainly on search engine optimization for the insurance industry, Seopa Ltd began to expand into the creation of price comparison technologies soon after incorporation. The company started price comparison activities in the UK with Quotezone and developed CompareNI in 2008/09.
113. CompareNI's primary revenue stream is from PMI, where it earns CPA fees and click-through fees generated from customers clicking on adverts placed on its website. The company includes links to others websites in order to give consumers a route to some of those PMI providers which do not participate on PCWs. Since 2008, CompareNI has also provided consumers with the telephone numbers of the brokers which quote on its site so that they can purchase their insurance over the phone or find out more details about the policy if they wish.
114. Table 6 summarizes CompareNI's financial performance [X].

TABLE 6 Summary financial results for CompareNI, [X]

	[X]	[X]	[X]
<i>Company</i>			
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
<i>PMI only</i>			
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]

Source: CompareNI management accounts.

Note: [X].

## Part 4—PMI brokers

### *General*

115. Insurance brokers are on the retail side of the industry, acting as an intermediary between their customers and insurance companies, and using their knowledge of risks and the insurance market to find and arrange suitable policies. They usually offer products from more than one insurer. Some insurers only distribute PMI policies through brokers and partners (eg Ageas Insurance).
  
116. 'Insurance broker' became a regulated term under the Insurance Brokers (Registration) Act 1977 which was designed to thwart the bogus practices of firms presenting themselves as brokers but in fact acting as representative of one or more favoured insurance companies. The term now has no legal definition following the repeal of the 1977 Act. However, the sale of general insurance (which includes PMI) has been regulated by the FSA (now the FCA) since 14 January 2005. Any person or firm authorized by the FCA can call themselves an insurance broker.
  
117. On the whole, insurance brokerage is largely associated with general insurance (motor, house, etc) rather than life insurance. Following more onerous FSA regulation in 2001, a more transparent regime was created based predominantly on upfront negotiation of a fee for the provision of advice and/or services. This saw the splitting of intermediaries into two groups: general insurance intermediaries/brokers and independent financial advisers (IFAs) for life insurance, investments and pensions.
  
118. In most cases, brokers receive their income from commissions and charges relating to the arrangement, sale and administration of insurance. Sometimes brokers may also be involved in the handling of their customers' claims.



### ***Types of PMI broker and distribution channels***

119. Brokers carry out varying amounts of activity on behalf of the insurer: the ‘traditional’ broker simply sells insurance on behalf of the insurer but all post-sale servicing, including claims handling, is transferred to the insurer; the ‘intermediary’ broker carries out more work by receiving delegated authority from a panel of insurers to sell PMI policies, and may also carry out post-sale servicing, including claims handling.
120. Brokers use a range of distribution channels, including traditional high street branches, telephone and online, including PCWs.
121. Brokers appear to be categorized into three main types: specialist, traditional and online direct, although we note that some brokers can fall into more than one category:
- (a) Specialist brokers use PCWs and sell direct (by telephone and online). Examples of these types of brokers are Ageas Retail and BISL.
  - (b) Traditional brokers use branches, telephone and online channels, and affinity partnerships (‘white label’ agreements). Examples of this type of broker are Swinton and Endsleigh. An affinity partnership combines an insurer (or panel of insurers) and a well-known brand which is used to market and sell the insurance policy, eg M&S, Post Office, and Auto Trader. Affinity deals can be effective for targeting specific customer segments, cross-selling, and for achieving brand power.
  - (c) Online direct brokers use Internet and social media distribution channels only and tend to be smaller. We do not examine any of the online direct brokers in this paper.
122. Disintermediation has been a general trend in the insurance market in the last 20 years, with the traditional broker model replaced by more direct sales by insurers,

using both telephone and online channels. However, competition between direct and broker businesses has been significantly blurred by the expansion of PCWs as consumers arranging insurance through such sites are presented with a range of insurance brands, largely unaware of whether or not the policy is being arranged through a broker or directly with the insurer.

### ***Market shares—general insurance brokers***

123. Insurance Age estimated in 2010 that brokers were responsible for 35 per cent of the personal lines market,<sup>22</sup> defining 'personal lines' as all general insurance in the UK, excluding private healthcare, property investor and extended warranty.
  
124. Insurance Age estimated that there were over 2,000 personal lines brokers in the UK, with the top 10 responsible for £5.6 billion of GWP, the top 50 responsible for £7.4 billion of GWP, and the remaining 2,000-plus brokers responsible for a further £1.4 billion. With a few large brokers and many small brokers, there is significant polarization between the large and small players in the market.
  
125. Insurance Age found that average revenues in 2011 for personal lines brokers were 28 per cent of premium income, down from 30 per cent in the previous year. These revenues consist of commission income from the sale of insurance policies and non-commission income (for example, referral fees). It found that there appeared to be some pressure on profits, for example with referral fees reducing and fees to PCWs increasing. We noted that the success of brokers appears often to depend on their ability to generate non-commission income, which can be more than commission income.

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<sup>22</sup> 'Top 50 Brokers in Personal Lines' published by Insurance Age, 2012.

126. Around 25 per cent of the personal lines broker market is accounted for by insurer-owned brokers, eg Ageas, Endsleigh and Swinton.<sup>23</sup>

### ***Market shares—PMI brokers***

127. Datamonitor reports that around one-third of PMI business in 2011 was sold through brokers,<sup>24</sup> with brokers ranging from small, high street operations to large national companies. Although the direct channel still accounts for the largest share of PMI policies (42 per cent in 2011), this share has fallen. Datamonitor attributes this decline to brokers adapting to a PCW-defined market, taking advantage of a cost-effective route to market and gaining exposure to a wide potential customer base, as well as the success of affinity partnerships. Datamonitor suggests that smaller brokers have benefited from the level playing field created by a price-driven, commoditized product. Datamonitor also finds that, while price is the dominant purchasing consideration for consumers, branding still remains critical for a majority of policies sold (see paragraph 89).<sup>25</sup>
128. We noted that there is significant demand for non-standard insurance, which brokers may be well-placed to provide. We noted, for example, that Groupama Insurance Company Limited (owned by Ageas (UK) Limited, since November 2012) had opted to shift its focus away from standard PMI towards specialist lines, with [X] per cent of its PMI book classified as non-standard.

### ***Information on selected PMI brokers***

129. We chose a range of large brokers to examine in more detail, including those linked to insurers, an independent and one linked to a PCW, as follows:

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<sup>23</sup> Source: Insurance Age.

<sup>24</sup> Datamonitor report: 'Personal General Insurance: UK Private Motor Insurance', published September 2012, stated that 36 per cent of PMI business in 2011 was through brokers. The figures we collated from the top ten insurers showed that 30 per cent of PMI by GWP and 28 per cent by number of policies was sold through brokers in 2012.

<sup>25</sup> Datamonitor's General Insurance Consumer Survey 2012.

- (a) Acromas (AA and Saga) (insurer-owned);
- (b) Ageas Retail (insurer-owned);
- (c) BISL (independent of any insurer; owns a PCW (CTM));
- (d) Endsleigh (insurer-owned); and
- (e) Swinton (insurer-owned).

130. Table 7 summarizes the PMI income of these five brokers.

TABLE 7 **PMI income for five brokers**

	<i>Year ended</i>	<i>£m</i>
Acromas		
AA	January 2012	[X]
Saga	January 2012	[X]
		[X]
Swinton	December 2012	[X]
Ageas Retail	December 2012	[X]
Endsleigh	December 2012	[X]
BISL (Frontline only)	[X]	[X]

Source: Parties' management accounts.

### *Acromas: AA and Saga*

131. Acromas Insurance Company Limited (AICL), part of the Acromas Group, is one of the panel insurers for the AA and the sole provider of PMI to Saga. The AA and Saga are brokers. AA and Saga are managed separately so we discuss them in turn.

#### *AA*

132. Automobile Association Insurance Services Limited (AAISL) brokers PMI through two brands: AA Car Insurance and AA Drivesafe Insurance (the latter being the AA's telematics offering).

133. The AA also sells and administers a range of general insurance products, including home and breakdown assistance.

134. The AA [X].

135. The AA told us that [REDACTED].

- *Financials*

136. Table 8 summarizes the financial performance of the AA's PMI broking business for the last three years to January 2012.

137. Sales and GWP [REDACTED]. Commission and contribution per policy [REDACTED].

TABLE 8 Summary financials, AA, for the three years ended January 2012—PMI only

PMI only	Years ended January		
	2012	2011	2010
Sales (£m)	[REDACTED]	[REDACTED]	[REDACTED]
Contribution (£m)*	[REDACTED]	[REDACTED]	[REDACTED]
Contribution (%)	[REDACTED]	[REDACTED]	[REDACTED]
Marketing costs (£m)	[REDACTED]	[REDACTED]	[REDACTED]
Total policies	[REDACTED]	[REDACTED]	[REDACTED]
GWP (£m)	[REDACTED]	[REDACTED]	[REDACTED]
Average per policy (£):			
GWP	[REDACTED]	[REDACTED]	[REDACTED]
Commission	[REDACTED]	[REDACTED]	[REDACTED]
Contribution*	[REDACTED]	[REDACTED]	[REDACTED]
Marketing costs	[REDACTED]	[REDACTED]	[REDACTED]

Source: AA management accounts.

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\*After marketing costs.

### *Saga*

138. Saga Services Limited, trading as Saga, is a general insurance intermediary business which sells and administers a range of general insurance products including PMI, home, travel and private medical insurance. It only offers PMI policies underwritten by AICL.

139. All of the broking, which includes the sale, renewal and administration of policies, is carried out by Saga; but all claims handling remains with AICL.

140. Saga offers PMI exclusively to policyholders in the over 50s market in the UK.

141. Saga features in Datamonitor’s list of the top 10 PMI advertisers (by expenditure) in 2011: it has the ninth biggest spend on advertising, with direct mail accounting for over 80 per cent of its advertising spend.<sup>26</sup>

- *Financials*

142. Table 9 summarizes the financial performance of the Saga PMI broking business for the last three years to January 2012.

143. [REDACTED], sales and contribution [REDACTED].

TABLE 9 Summary financials, Saga, for the three years ended January 2012—PMI only

PMI only	Years ended January		
	2012	2011	2010
Sales (£m)	[REDACTED]	[REDACTED]	[REDACTED]
Contribution (£m)	[REDACTED]	[REDACTED]	[REDACTED]
Contribution (%)	[REDACTED]	[REDACTED]	[REDACTED]
Marketing costs (£m)	[REDACTED]	[REDACTED]	[REDACTED]
Total policies	[REDACTED]	[REDACTED]	[REDACTED]
GWP (£m)	[REDACTED]	[REDACTED]	[REDACTED]
Average per policy (£):			
GWP	[REDACTED]	[REDACTED]	[REDACTED]
Commission	[REDACTED]	[REDACTED]	[REDACTED]
Contribution	[REDACTED]	[REDACTED]	[REDACTED]
Marketing costs	[REDACTED]	[REDACTED]	[REDACTED]

Source: Saga management accounts.

### *Ageas Retail*

144. Ageas Retail is the broking division of the Ageas group. Ageas Retail consists of the following companies which all sell PMI: Ageas 50 Limited; KwikFit Insurance Services Limited (KFIS), Express Insurance Services Limited (EIS), The Green Insurance Company (TGIC); and UK Ageas Insurance Solutions (UKAIS). KFIS was acquired in 2010. KFIS is the parent company for EIS and TGIC and these three

<sup>26</sup> [REDACTED] DLG, [REDACTED] in 2011, spent [REDACTED] per cent of its advertising expenditure on direct mail and [REDACTED] per cent on TV advertising.

businesses are managed together. Ageas 50 is the largest brand in the group, offering primarily motor and home insurance.

145. Ageas Retail's major specialisms are providing insurance to the over 50s, affinity partnerships and aggregator distribution.

### *Summary financials*

146. Table 10 presents the limited financial information available for all Ageas Retail businesses for the three years ended December 2012.

TABLE 10 **Summary financials, Ageas Retail, three years ended December 2012**

	£		
	<i>Years ended December</i>		
	<i>2012</i>	<i>2011</i>	<i>2010</i>
Whole business			
Income	[X]	[X]	[X]
Operating profit	[X]	[X]	[X]
<i>Operating profit (%)</i>	[X]	[X]	[X]
Total PMI income	[X]	[X]	[X]
Average premium	[X]	[X]	[X]

Source: Ageas Insurance.

### *BISL*

147. BISL is an insurance broker [X].
148. BISL uses multiple distribution channels: its own website and call centre, and PCWs.<sup>27</sup>
149. BISL is owned by BGL Group, which was established in 1992 as an insurer but changed strategy in 1997 to become an insurance intermediary.

<sup>27</sup> Another division of BISL is CTM, [X].





156. EIS has delegated authority from its panel of insurers to sell and service insurance and, for most of the insurers on its panel, it also handles claims on their behalf.
157. Separate to this business, EIS also offers third party administration (TPA) claims handling services to a number of insurers and insurance risk capacity providers. This is distinct from the main EIS panel business as these policyholders did not buy their policies from EIS. For these services, EIS is paid a fee by the insurer for handling the claim. This operation is referred to as The Claims Service (TCS) but sits within EIS from a legal entity perspective.
158. EIS operates a panel of 13 PMI insurers. Its [redacted].

*Financials*

159. Table 12 summarizes Endsleigh's financial performance for the past three years. The management accounts are based on an analysis of income by product type (eg motor, home, travel etc). However, expenditure is considered by category and is not linked back to the product to which it relates. As a result, although PMI [redacted], Endsleigh was not able to estimate the profitability of this business. Turnover and profits have [redacted] over the three-year period to [redacted].

TABLE 12 Summary financial performance, Endsleigh, December 2010 to 2012

		[redacted]	
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]

Source: Endsleigh management accounts.

## Swinton

160. Swinton is a part of the Covéa group.<sup>28</sup> Swinton's primary consumer brands for the broking of PMI are Swinton in mainland UK, and Open & Direct Insurance in Northern Ireland. Swinton also brokers many insurance products, including household insurance and commercial vehicle cover.
161. Swinton brokers the majority of PMI through its network of branches,<sup>29</sup> as well as through its call centres and online (new policies only). It has 512 branches in Great Britain and 16 in Northern Ireland. The inbound call centre functions as an overflow unit in support of the branches and in order to provide service outside of branch opening hours. Swinton also has an outbound call centre, used as a sales campaign unit, which sells core products, add-ons and monthly products.
162. Swinton has [redacted] main insurers on its PMI panel. The top ten insurers on its panel represent [redacted] per cent of Swinton's GWP, with the most important ([redacted]) representing [redacted] per cent of its GWP, and the second most important ([redacted]) representing [redacted] per cent of its GWP.

## Financials

163. Swinton does not allocate either divisional costs or central overheads to individual products, and therefore financial data was only available at a high level. Table 13 shows the financial performance of the whole business for the three years ended December 2012. Income, contribution and operating profits [redacted] in 2011 [redacted] in 2012. PMI has been an increasing part of Swinton's business, now constituting [redacted] of its total business.

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<sup>28</sup>Swinton Holdings Limited is a sister company of Covéa Insurance plc. Covéa Insurance was created in the UK in October 2012 through the integration of three companies: Provident Insurance, MMA Insurance and Gateway, and is part of the French Covéa mutual insurance group.

<sup>29</sup> Approximately [redacted] per cent of Swinton's overall business is generated through these branches (no figure provided for PMI specifically).

TABLE 13 Summary financials, Swinton, for the three years ended December 2012

	<i>£ million</i>		
	<i>Years ended December</i>		
	<i>2012</i>	<i>2011</i>	<i>2010</i>
Income	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
Operating profit	[X]	[X]	[X]

Source: Swinton Holdings Limited statutory accounts and Swinton management accounts.

164. Swinton provided us with a split of its income by product for the three years ended 31 December 2012, which is shown in Table 14. Total income [X] per cent over the three years, which appeared to be [X].

TABLE 14 Breakdown of PMI income, 2010–2012

	<i>£ million</i>		
	<i>2012</i>	<i>2011</i>	<i>2010</i>
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]

Source: Swinton management accounts.

## High-level analysis of profitability for the ten largest PMI insurers, 2008 to 2012

	Claims ratio (%)						Expense ratio (%)					
	2008	2009	2010	2011	2012	Average	2008	2009	2010	2011	2012	Average
Admiral	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Ageas	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Aviva	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
AXA	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Zurich	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
<b>Across all 10 providers</b>	<b>78</b>	<b>89</b>	<b>98</b>	<b>78</b>	<b>75</b>	<b>84</b>	<b>32</b>	<b>30</b>	<b>24</b>	<b>27</b>	<b>29</b>	<b>28</b>

	COR (%)						Underwriting result plus investment income (£m)					
	2008	2009	2010	2011	2012	Average	2008	2009	2010	2011	2012	Average
Admiral	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Ageas	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Aviva	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
AXA	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Zurich	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
<b>Across all 10 providers</b>	<b>110</b>	<b>119</b>	<b>123</b>	<b>105</b>	<b>104</b>	<b>112</b>	<b>596</b>	<b>-238</b>	<b>-334</b>	<b>888</b>	<b>984</b>	<b>377</b>

Source: CC calculations based on data from the ten largest insurers.

Note: [X]

## **PRIVATE MOTOR INSURANCE MARKET INVESTIGATION**

### **Background to claims management process**

#### **Introduction**

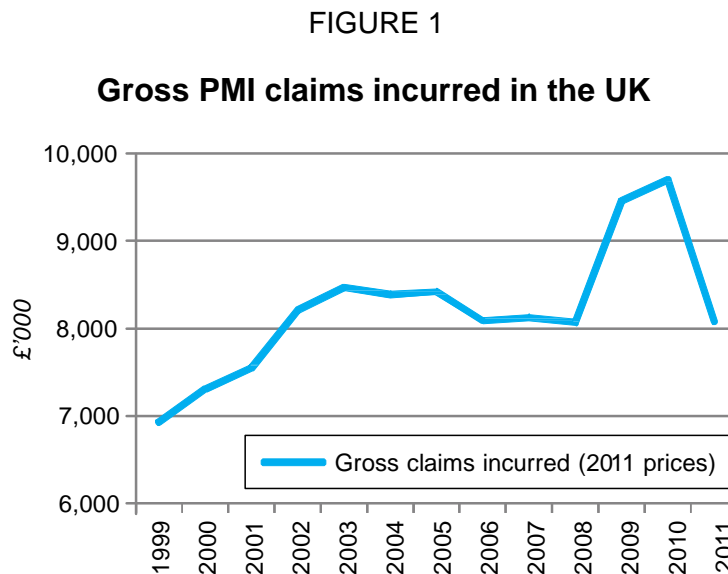
1. This working paper provides an outline of the claims management process.
2. The claims management process starts once a road traffic accident (RTA) has happened and usually involves repair to damaged property (eg vehicles or infrastructure) and/or compensation for any injuries and/or losses caused (eg personal injury (PI), vehicle write-offs, loss of vehicle use or loss of earnings). In many cases, the costs incurred in repair and compensation are covered by private motor insurance (PMI) and insurers are therefore closely involved in the claims management process.
3. This paper first provides a summary of the volume and value of PMI claims and then presents an overview of the claims management process, including the provision of vehicle repair and the provision of temporary replacement vehicles (TRVs) in relation to PMI (ie car (not motorbike) insurance for non-commercial customers).

#### **Background on volume and value of PMI claims**

4. According to Datamonitor, total PMI claims costs were £9.3 billion in 2010, having increased by 8.7 per cent from 2009 (see the working paper 'Background to PMI (insurers, brokers and PCWs)'. Datamonitor stated that this increase was the result of rising claims relating to PI, despite road traffic casualties declining due to cars and

roads getting safer.<sup>1</sup> Datamonitor also reported that the average PMI claim in 2010 was £2,541.

5. The ABI reported that, in 2011, PMI claims costs fell to £8.1 billion,<sup>2</sup> which was more in line with the annual level of claims through most of last decade (as shown in Figure 1, which shows gross PMI claims in the period 1999 to 2011 based on ABI data).



Source: ABI.

6. Table 1 shows data from Mintel on the number of claims and claims frequency. The table suggests that there were 3.3 million PMI claims in 2011, down from 4.4 million in 2006; and that the frequency of PMI claims (ie the number of claims in a year as a percentage of the number of insured cars) has declined from 18.9 per cent in 2003 to 14.2 per cent in 2011.

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<sup>1</sup> Datamonitor, *UK Private Motor Insurance 2012*.

<sup>2</sup> ABI, *UK Insurance Key facts, 2012*.

TABLE 1 Total number of private car insurance claims notified and claims frequency, 2003 to 2011\*

	Exposure in vehicle years m†	Annual change %	Number of claims notified m	Annual change %	Claims frequency %
2003	20.9	1.5	4.0	1.5	18.9
2004	21.9	4.8	4.1	3.9	18.7
2005	23.6	7.4	4.3	3.7	18.1
2006	24.6	4.5	4.4	3.9	18.0
2007	24.4	-0.7	4.3	3.1	17.5
2008	24.0	-1.9	4.0	-6.7	16.7
2009	24.0	0.1	3.9	-3.7	16.0
2010	23.6	-1.9	3.6	-5.4	15.5
2011 (est)‡	23.4	-0.5	3.3	-8.7	14.2

Source: Mintel.

\*The table covers private cars and excludes motorcycles and other personal vehicle claims.

†Exposure in vehicle years is a guide to the number of vehicles insured, measuring the period of time a policy is in force during a given year.

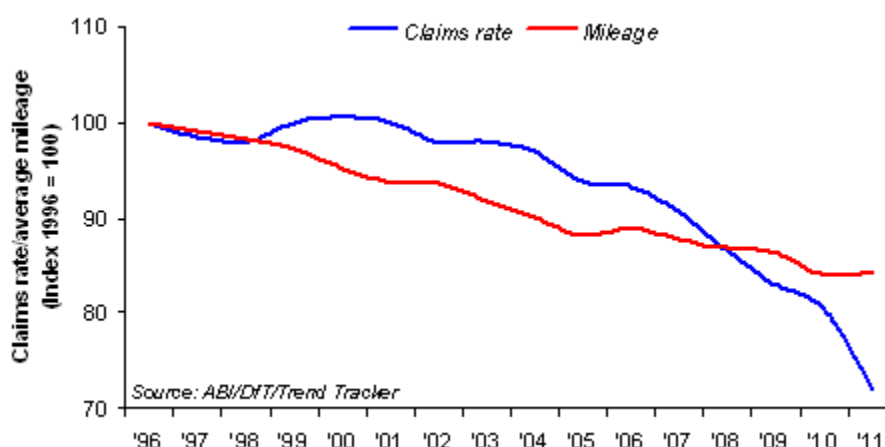
‡Mintel's estimate is based on data from the first three quarters.

7. We note that a decline in the number of PMI claims over several years (see Table 1) but a constant total claims cost (see Figure 1) is consistent with average claims costs having increased over the period (see paragraph 4).

8. One of the main reasons for the decline in claims frequency is that the average annual mileage of cars in the UK has fallen. Figure 2 shows the claims rate plotted against annual mileage (both indexed to 1996).

FIGURE 2

**Insurance claims rate versus average annual mileage\***



Source: [www.trendtracker.co.uk/blog/2012/10/the-uk-car-body-repair-market](http://www.trendtracker.co.uk/blog/2012/10/the-uk-car-body-repair-market).

9. Table 2 shows an analysis by the ABI of car insurance claims costs as a percentage of premium income in 2011. It shows that whiplash and other PI claims together accounted for 35 per cent of premium income in 2011, while repair costs and TRV costs together accounted for 29 per cent of premium income.

TABLE 2 Car insurance claims costs

Type of cost	per cent
	Estimated percentage of premium income 2011
Repair and replacement vehicles	29
Whiplash claims	20
Other personal injury claims under £500,000	15
Personal injury claims over £500,000	9
Uninsured drivers	3
Theft	2
Staffing and overheads	26

Source: ABI.

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Note: The numbers add to more than 100 per cent as claims costs exceeded premium income.

10. One insurer ([redacted]) told us that PMI claims costs could be divided as follows:
- [redacted] per cent related to claims by non-fault claimants (including PI and third party claims);
  - [redacted] per cent related to claims by fault drivers; and
  - [redacted] per cent related to other claims including fire and theft and windscreen claims.<sup>3</sup>
11. GIMRA (the General Insurance Market Research Association) reported that, in 2011 and 2012, accidents were the reason for approximately [redacted] of claims made under comprehensive insurance policies.
12. We focus in this paper on vehicle collisions rather than other collisions (eg collisions with infrastructure (such as trees and walls) or collisions with bicycles or pedestrians)

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<sup>3</sup> Based on [redacted] claims experience.



as vehicle collisions account for the majority of PMI claims costs and because our theory of harm (ToH) 1 focuses on the provision of services to non-fault parties.

### **The claims management process**

13. Following an RTA involving a vehicle collision, each driver involved is required by the Road Traffic Act 1988 (RTA 1988) to stop and, if required by any person on reasonable grounds, to give their name and address (and also the name and address of the owner of the vehicle) and the registration number of the vehicle. If any person involved in the RTA has been injured, the driver must also present his certificate of insurance at the time of the accident to (a) any person who has required the driver to produce it on reasonable grounds, or (b) a police officer. If the driver does not produce his certificate of insurance (this would be the case, for instance, where the other driver is injured and not in a position to exchange certificates of insurance), he must report the accident to the police as soon as is reasonably practicable and, in any case, within 24 hours of the occurrence of the accident.
  
14. In this section we describe how fault is typically established, the claims management process for fault and non-fault claims, including the provision of vehicle repairs and TRVs, and vehicle write-offs.

### ***Establishing fault***

15. The drivers involved in a vehicle collision may, or may not, know or agree at the time of the RTA which driver is the fault driver and which driver is the non-fault driver. The drivers' insurers need to identify which driver caused the accident in order to establish which insurer will need to pay any resulting claims (eg for repair costs and TRV costs). Drivers usually contact either their insurer or the broker which sold them their

insurance policy in order to inform them of the accident and to describe the circumstances of the accident, which is called the first notification of loss (FNOL).<sup>4</sup>

16. The claims handler at the insurer or the broker will seek to make an immediate assessment of whether its customer is the fault or non-fault driver. In order to establish fault, claims handlers ask customers relevant questions based on typical accident scenarios, types of accident damage, the accident scene and the highway code. If an immediate assessment is not possible, the claim will be passed to specialist claims handlers for further investigation, which may include gathering witness statements or other evidence from the scene of the accident.
17. We found that, at FNOL, insurers on average established fault in 75 per cent of cases; 20 per cent of cases were categorized as split liability; and 5 per cent of cases were not decided. Evidence from the ten largest PMI insurers suggested that the categorization of a driver as non-fault changed following FNOL in between 2 and 12 per cent of cases.

### ***Fault claims***

18. The legal entitlements of the fault driver involved in an RTA are as stipulated in their PMI policy.
19. Following a vehicle collision, the fault driver's vehicle may require repair and, if the repair means that the vehicle will be unavailable for a period, the driver may also require a TRV. If the fault driver has a comprehensive insurance policy then they are generally able to make a fault claim under their own insurance policy to cover the

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<sup>4</sup> In some cases, drivers will, instead of contacting their insurer or broker, contact another party such as a claims management company (CMC) or the car dealership from where they bought their car, or will be contacted by the fault insurer (see paragraph 26).

cost of repair to the vehicle, subject to a pre-agreed excess. Around 90 per cent<sup>5</sup> of insurance policies in the UK are comprehensive insurance policies. A comprehensive insurance policy will also sometimes include the provision of a TRV to the fault driver (often provided by the repairer) but, in other cases, a TRV will only be provided if TRV cover has been purchased as an add-on to the basic PMI policy (either for a basic courtesy car or on a like-for-like basis).

20. Fault repairs are usually managed by the fault insurer, sometimes using an out-sourced claims management company (CMC). The owner is entitled to have their vehicle repaired at a repairer of their choice but, under most PMI policies, the insurer retains a right to approve the repair estimate prior to the work being undertaken. Some PMI policies contain incentives for fault claimants to use the insurer's approved repairers, such as the provision of a courtesy car or the repairs being guaranteed only if the repair is carried out by an approved repairer, or the payment of an additional excess if a non-approved repairer is used.
21. If the fault driver does not have comprehensive insurance (ie only third party cover or third party, fire and theft cover), they will not be able to make a fault claim for their own loss and will need to pay for the repair of their vehicle and any TRV provision.

### ***Non-fault claims***

22. The legal rights of the non-fault driver involved in an RTA arise under tort law and entitle the non-fault driver to be put into as good a position as they would have been in had the accident not occurred, at the cost of the fault driver.
23. The non-fault driver may claim compensation from the fault driver to cover:
  - (a) repair of vehicle damage (see paragraphs 35 to 41);

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<sup>5</sup> Mintel, *Motor Insurance UK*, March 2012, p77; *UK Private Motor Insurance 2012*, Datamonitor, Table 1, p30.

- (b) the reasonable costs of car hire, provided the reasonable need<sup>6</sup> for an alternative vehicle can be established, which, in practice, usually involves the provision of a TRV on a like-for-like basis for as long as is reasonably necessary, subject to the non-fault claimant's duty to mitigate their loss (see paragraphs 42 to 44);<sup>7</sup> and
- (c) in the case of a write-off, a cash payment equivalent to the pre-accident value of the vehicle (see paragraphs 45 to 48).

24. The non-fault driver is also entitled to compensation for PI (eg damages for pain, suffering and loss of amenity, and the costs of care) and other consequential costs (such as loss of earnings, vehicle recovery and storage, public transport costs, etc).
25. Although the legal systems differ slightly between the UK jurisdictions (England and Wales, Northern Ireland and Scotland), the differences are not significant in relation to most areas of the claim management process, although they may result in variations in the ultimate claim costs.

### *Parties who may be involved in non-fault claims*

26. Several parties might be involved in a non-fault claim process, including the non-fault broker, the non-fault insurer, the fault insurer, a CMC, a repairer and a TRV provider (eg a credit hire company (CHC)).<sup>8</sup> These parties might get involved in the claim management process in various ways:
- (a) the non-fault driver is likely to contact their insurer or broker immediately after the accident, but might also contact a repairer or car dealership;
- (b) the non-fault driver might be contacted by the fault insurer, in an attempt by the fault insurer to 'capture' the non-fault driver; and

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<sup>6</sup> In the case of a private individual who has lost access to their vehicle following an RTA, the scenarios in which they would clearly not have need for an alternative vehicle are likely to be relatively limited (eg because they have access to another vehicle or because they are on holiday abroad for the period in which their own car is unavailable).

<sup>7</sup> The hire duration is usually determined by the repair duration.

<sup>8</sup> Others might also be involved, eg the emergency services, vehicle recovery providers, salvage firms, car dealerships, legal expenses insurers, etc.

(c) other service providers, such as CMCs and CHCs, might contact the non-fault driver following a referral from another party (eg the non-fault insurer or broker, a repairer, a vehicle recovery provider, the emergency services, etc).<sup>9</sup>

27. Our survey of non-fault claimants (see the working paper ‘Survey report’) found that, following an accident, 68 per cent of non-fault claimants first contacted their own insurer; 11 per cent had first contact with the fault insurer; and 20 per cent had first contact with another organization such as a garage, vehicle recovery provider or the police. We found that 84 per cent of non-fault claimants were proactive and made the first contact, rather than being contacted by another party.

### *Different claims management processes according to how claims are made*

#### *Claims by a non-fault claimant managed by their own insurer*

28. When a non-fault claimant claims under their own insurance policy, the non-fault insurer will settle the claim in accordance with the terms of the policy and will then seek to recover damages from the fault insurer under the principle of subrogation. Subrogation allows an insurer, once it has indemnified its policyholder (the insured), to benefit from the rights of the insured in relation to the loss that the insurer has indemnified. The claims that are received by fault insurers from non-fault insurers are called ‘subrogated claims’.
29. When a non-fault claimant claims under their own insurance policy, some insurers require the claimant to pay the policy excess, although this can be recovered subsequently from the fault insurer.<sup>10</sup> Some non-fault insurers will treat the claim as a fault claim until the claims cost has been recovered from the fault insurer, with the

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<sup>9</sup> Where one of these parties provides some but not all of the claims management services needed by the non-fault claimant, the party may pass the details of the claimant to other parties which provide other services (eg a repairer might perform a repair but pass the claimant’s details to a CHC).

<sup>10</sup> On occasion, if the non-fault insurer is satisfied that the customer is not responsible for causing the accident, it may decide to waive the excess and to keep the no-claims bonus unaffected because it believes the costs can be recovered from the fault insurer.

effect that the non-fault driver may temporarily lose their no-claims bonus and may pay a higher premium if their policy is renewed during this period.<sup>11</sup>

30. In order to be restored to their pre-accident position, the non-fault claimant is entitled to recover from the fault insurer all reasonable costs of repairs and the reasonable cost of a TRV, subject to need (see paragraph 22). The non-fault claimant has the right to choose the provider of each of the services required. However, in practice, where a non-fault claimant claims under their own insurance, the non-fault insurer will typically manage the provision of services to the claimant by third parties (eg repairers or TRV providers). We consider under ToH 1 the separation of cost liability (ie the fault insurer) and cost control (in this case, the non-fault insurer); and we consider under ToH 2 the separation of the beneficiary of post-accident services (ie the claimant) and the procurer of them (in this case, the non-fault insurer).
31. CMCs/CHCs told us that, in the past, when insurers paid directly for the services they provided to non-fault claimants (ie under the old ‘knock-for-knock’ regime), the provision of TRV services to claimants was poor and often below a claimant’s legal entitlement. CMCs/CHCs said that the emergence of credit hire had improved TRV services significantly for consumers. We did not hear views to the contrary, though we were told that this higher level of service to non-fault claimants was now the norm, regardless of whether the service was provided by a CMC/CHC or by the fault insurer (ie on a captured basis).<sup>12</sup>

*Claims by a non-fault claimant managed by the fault insurer*

32. Because the fault insurer bears the cost of a non-fault claim, it is usually interested in providing claim management services directly to the non-fault claimant in order to

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<sup>11</sup> We note that, even when liability is settled, a non-fault claimant may still see an increase in their PMI premium as a result of the accident, as insurers may perceive the driver to be a higher risk.

<sup>12</sup> We consider whether non-fault claimants receive a poor TRV service in the working paper ‘ToH 2: Underprovision of TRVs’.

control these costs better. Typically, the fault insurer will seek to obtain the contact details of the non-fault driver from their fault customer and will contact the non-fault driver directly in order to try to 'capture' their claim.<sup>13</sup> Our survey of non-fault claimants found that in 51 per cent of cases when the non-fault driver did not contact their own insurer following an RTA, the reason given was that the fault insurer had already contacted them. The non-fault claimant is not obliged to accept an offer of services from the fault insurer, even though the fault insurer might be the first party to make contact.

33. We discuss under ToH 2, among other things, whether the incentives faced by the fault insurer might lead to the underprovision of post-accident services to non-fault claimants.

#### *FNOL to a broker*

34. If a non-fault claimant purchased their PMI policy through a broker, they will often make their FNOL to the broker rather than the insurer as the policy documentation will be in the broker's name. In these circumstances, the broker is likely to refer the non-fault claimant either to the non-fault insurer or to a CMC/CHC to provide claim management services.

#### *Non-fault vehicle repairs*

35. When the non-fault claimant's vehicle has been damaged, they will be entitled to either (a) the repair of their vehicle (or, more precisely, to the diminution in value of the vehicle due to the accident, which is generally assessed by reference to the reasonable cost of repairs),<sup>14</sup> or (b) if the cost of the repair is higher than the pre-

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<sup>13</sup> This is also sometimes called 'third party intervention'.

<sup>14</sup> We note that there may still be a diminution in value after the repair has been completed as a result of the vehicle having an accident history. We were told that some CMCs were willing to pursue claims on behalf of non-fault drivers for this loss but that such claims were rare.

accident value of the vehicle, the pre-accident value of the vehicle in cash (ie the vehicle is a write-off (see paragraphs 45 to 48)).

36. Non-fault repairs are usually managed by the non-fault insurer, by a CMC or by the fault insurer (if the non-fault claim is 'captured'). Accordingly, the non-fault claimant might receive repair services from any one of the following:
- (a) a repairer of the non-fault claimant's choice (whether captured or not);
  - (b) a repairer to which the non-fault claimant is referred by the non-fault insurer in which case the repair would be carried out either by:
    - (i) a repairer owned by the non-fault insurer;
    - (ii) a repairer in the non-fault insurer's approved repair network, which is dedicated to the non-fault insurer (ie it does not perform work for any other work provider); or
    - (iii) a repairer in the non-fault insurer's approved repair network, which is not dedicated to the non-fault insurer (ie it also performs work for other work providers);
  - (c) a repairer to which the non-fault claimant is referred by a CMC (with the same sub-categories as (b)); or
  - (d) a repairer to which the non-fault claimant is referred by the fault insurer (with the same sub-categories as (b)).
37. Whichever party manages the claim, it will usually require the repairer to submit a repair cost estimate for approval. For a non-fault insurer or CMC, this is important to ensure that the repair costs are 'reasonable', as 'unreasonable' costs may be challenged by the fault insurer and not be recovered in full; for a fault insurer which has captured a non-fault claim, it will wish to minimize the costs incurred.



#### *Repair cost estimation software*

38. Repair cost estimates are usually prepared by estimating systems which calculate the hours required to complete a repair job, using manufacturers' or Thatcham repair times, and specify the parts and paint needed in a repair and their cost. Work providers (eg insurers or CMCs) will have agreements with repairers which specify the remaining variables, eg the labour rate and the discounts for parts and paint off the system-generated price.
39. The two most commonly-used repair cost estimating systems are Audatex and Glassmatix. Most insurers which require or recommend their approved repairers to use a certain repair cost estimation system specify the use of Audatex. In 2009, Auto Body Professionals (ABP) reported that around 50 per cent of repairers used the Audatex system.

#### *Credit repair*

40. When a CMC manages a non-fault vehicle repair (whether following a referral of the customer or having attracted the customer directly), it may instruct the repair and only subsequently seek to reclaim the cost from the fault insurer, so assuming the credit risk of the repair.<sup>15</sup> This would be a credit repair (similar to the way in which a CMC/CHC might offer credit hire (see paragraph 43)).
41. The advantage of credit repair to non-fault claimants over the repair being performed by their own non-fault insurer is that no policy excess is payable (though this could be reclaimed subsequently from the fault insurer) and the no-claims bonus is not put on hold until the fault insurer settles the claim (see paragraph 29).

**Aviva Comment** - We will waive policy excess on non fault claims provided we have details of a recovery target at time of reporting. This being the fault insurers details. This process is automatic through fault parties vehicle registration number at point of claim.

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<sup>15</sup> Under the terms of a credit repair agreement, the customer is ultimately liable for the costs of the provision of credit repair services should the CMC be unable to recover the costs from the fault insurer. However, we understand that CMCs rarely seek to recover costs from non-fault customers.

*TRVs for non-fault drivers*

42. If the non-fault claimant's vehicle is temporarily unavailable (generally due to repairs), the claimant may seek recovery for the temporary loss of use of their vehicle. The non-fault claimant may recover the reasonable costs of car hire, provided the reasonable need for an alternative vehicle can be established, which, in practice, usually involves the provision of a TRV on a like-for-like basis for as long as is reasonably necessary, subject to the non-fault claimant's duty to mitigate their loss (see paragraph 23(b)).<sup>16</sup>
43. TRV services can be provided to non-fault claimants under a credit hire or direct hire agreement. Credit hire is where a TRV is supplied on credit to the non-fault claimant by a CMC/CHC<sup>17</sup> and the cost is subsequently recovered from the fault insurer; direct hire is where a TRV is supplied either by the fault insurer<sup>18</sup> or by the non-fault insurer, in the latter case often pursuant to a bilateral agreement between the non-fault insurer and the fault insurer, with the costs recovered from the fault insurer.
44. When non-fault claimants claim under their own PMI policy, they typically receive a TRV in accordance with the terms of their policy, which may be a courtesy car from the non-fault insurer's repairer (if the non-fault insurer is also managing the customer's repair) or, where the customer has purchased additional cover, a like-for-like TRV from the non-fault insurer's direct hire TRV provider.<sup>19</sup> On occasion, if the non-fault insurer is satisfied that the customer is not responsible for causing the accident,

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<sup>16</sup> A non-fault driver can only claim the costs of credit associated with a credit hire if they can demonstrate that it was reasonable in the circumstances to hire the TRV on credit (ie the customer is impecunious). However, the assessment of what the tort law entitlement requires in a given case will be informed by the specific facts of that case, which, in view of the nature of the 'impecuniosity test', may lead to some practical difficulties for CMCs/CHCs in assessing whether a non-fault customer requires a TRV on credit terms.

<sup>17</sup> Credit hire usually requires the non-fault claimant to enter into a credit agreement with the CMC/CHC, under which (as for credit repairs (see the footnote to paragraph 40)), the customer is ultimately liable for the costs of the TRV should the CMC/CHC be unable to recover the costs from the fault insurer. However, CMCs told us that they rarely sought to recover costs from non-fault customers.

<sup>18</sup> When a fault insurer captures a non-fault claim, the TRV is usually provided under direct hire, or the non-fault claimant might receive a TRV from the repairer.

<sup>19</sup> We discuss how the potential disadvantages for non-fault claimants from claiming under their own PMI policy could lead to consumer harm in the working paper 'ToH 2: Underprovision of repairs'.

it might provide a vehicle of a higher class (compared with the customer's contractual entitlement) because it believes the customer is entitled to it under tort law and therefore the cost of this vehicle can be recovered from the fault insurer.

**Aviva Comment** - No this is not correct and insurers will only be able to do this where a bilateral exists because otherwise they are exceeding the policy cover and do not have a strict legal right of subrogation. Aviva is not aware of insurers providing more than the cover unless a bilateral is in place.

### **Write-offs**

45. A vehicle is deemed to be a write-off when:
- (a) the estimated cost to repair the vehicle exceeds the estimated pre-accident value (PAV) of the vehicle less any costs that could be recovered for its salvage (the estimated salvage value); or
  - (b) where the vehicle is so significantly damaged to render the vehicle unable to be repaired (eg flood damage or in some cases where a vehicle has rolled over).
46. If a vehicle is being written off, a customer can elect to retain the vehicle or to give it up to the insurer or CMC managing the claim (which will then arrange for it to be taken away by a salvage company). The payment made to the customer by the insurer differs according to whether or not the customer retains the written-off vehicle, as follows:
- (a) If the customer gives up the vehicle, they will receive a payment of the agreed PAV of the vehicle.
  - (b) If the customer chooses to retain the vehicle, they will receive a payment of the agreed PAV of the vehicle less the estimated salvage value.
  - (c) In a fault claim (and in some own-insurer non-fault claims), the customer will receive a payment in accordance with (a) or (b), as applicable, less the amount of the excess in the PMI policy.
47. Non-fault insurers and CMCs will seek to recover from the fault insurer the agreed PAV and any other charges they incur (eg vehicle storage and collection costs), less

the estimated salvage value.

48. We discuss vehicle write-offs in more detail in the working paper 'ToH112: Vehicle write-offs'.