Private motor insurance market investigation

Final report

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The Competition and Markets Authority has excluded from this published version of the report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✄]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Summary

The reference

1. On 28 September 2012, the Office of Fair Trading (OFT) referred the supply or acquisition of private motor insurance (PMI) and related goods and services in the UK to the Competition Commission (CC) for investigation and report. The reference was made under sections 131 and 133 of the Enterprise Act 2002 (the Act).

2. On 1 April 2014, the CC joined with the competition and certain consumer functions of the OFT to form the Competition and Markets Authority (CMA), which continued with this investigation and with other work inherited from the two organisations.

3. We were required to decide whether 'any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom'.[1] If we found that there was such a feature or combination of features, then there would be an adverse effect on competition (AEC).[2] This report sets out our findings based on the evidence we have reviewed and the analysis we have carried out.

The reference product

4. Under the Road Traffic Act 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.

5. In addition to the risks which are compulsorily insurable, risks covering fire and theft are also often covered. However, the most commonly purchased type of PMI is comprehensive insurance. This also covers damage caused to the insured's own vehicle and the insured's own medical expenses arising from an accident. Comprehensive cover may also provide extra benefits such as a courtesy car, roadside assistance, or windscreen repair or replacement. These benefits are either included in the comprehensive cover or can be purchased as an add-on on top of the comprehensive cover for an additional premium.

[1] Section 134(1) of the Act.
[2] Section 134(2) of the Act.

6. By law, the at-fault party in an accident is required to put the non-fault party 'back into the position they would have been in but for the accident', ie to compensate the non-fault party for any damage and/or injuries. PMI claims can therefore be divided between non-fault claims, which are against another driver and covered by that driver's insurance, and 'at-fault' claims, which are covered by the claimant's own insurance. In some accidents, more than one driver is at fault to some extent. Fault is either agreed between the parties or determined following litigation. Although the legal systems differ slightly between England and Wales, Northern Ireland and Scotland, the differences are not significant in relation to most areas of the claims management process, although they may result in variations in the ultimate claim costs.

Findings

7. We found that, in many post-accident non-fault claims, as a consequence of tort law, cost liability lies with the at-fault party in an accident whereas cost control lies with the non-fault party. This therefore leads to a separation of cost liability and cost control ('separation') in relation to most PMI claims (see paragraphs 26 to 42).[3] We found that this separation, in combination with various practices and conduct, gave rise to inefficiencies in the supply chain for the provision of post-accident services to non-fault claimants. In our view, these features gave rise to an AEC as they distorted competition and caused higher transactional and frictional costs in the management of non-fault claims than would otherwise be the case. Ultimately this increased PMI premiums, especially for higher-risk drivers. We found that to address the separation directly would require a significant intervention in the law, which we did not believe was warranted by the scale of the problem we had found. We considered other measures to address the detriment flowing from the AEC we had found but were unable to find a remedy within our powers which was both effective and proportionate. We observed that market participants had already developed some measures to address the transactional and frictional costs which arise due to separation, and were exploring further measures, and we encouraged them in these actions. We also questioned whether the benchmarks used in non-fault temporary replacement vehicle damages awards were still appropriate as it appeared to us that they were both artificial and too high.

8. In relation to the sale of add-ons (see paragraphs 46 to 52), we found that there were information asymmetries between PMI providers and consumers,

[3] There is no separation when the at-fault insurer 'captures' a claim, ie when it approaches the non-fault driver directly and deals with their claim (eg by repairing their vehicle and providing a temporary replacement vehicle), or when both the at-fault and non-fault parties are insured with the same insurer.

and that consumers faced difficulties in comparing the price and terms of their chosen add-ons across different providers. We found that these two features together gave rise to an AEC, as they distorted competition by making it more difficult for consumers to identify the best-value offers in the market and to make informed purchasing decisions. We decided to introduce remedies to improve information on NCB protection, where we found that consumers' lack of information was most acute. We will require insurers and brokers to provide information to consumers on the implied price of NCB protection, the average NCB discount according to the number of NCB years, and 'step-back' procedures (ie what happens to the number of NCB years with and without NCB protection in the event of one or more claims). We will also require better information about NCB protection to be provided. We also decided to make two recommendations to the FCA concerning PMI-related add-ons, that:

(a) in relation to price information provided to consumers about PMI-related add-ons, it considers: (i) whether insurers and brokers should be required to provide their prices for all or certain add-ons they offer to PCWs and, if so, whether this should be for all PMI-related add-ons or only for the most commonly-purchased add-ons; and (ii) how consumers' information needs in relation to PMI-related add-ons can best be met on PCWs, in particular in relation to enabling consumers to compare prices across providers for their desired package of PMI and PMI-related add-ons; and

(b) in relation to add-on information more generally, it works with insurers, brokers and PCWs to consider if and how these providers might improve their descriptions of all or certain PMI-related add-ons, either as part of the FCA's general supervisory work or as part of its remedy proposals resulting from its market study into general insurance add-ons.

9. We found that some of the contracts between PMI providers and price comparison websites (PCWs) contained conditions which limited price competition and innovation, and could restrict entry (see paragraphs 53 to 63). We found that these 'wide' most-favoured nation (MFN) clauses, which restricted PMI providers' ability to set different prices on different sales channels, were a feature of the PCW market which limited competition, giving rise to an AEC. Ultimately, this led to higher PMI premiums. We decided to remedy this AEC by *(a)* prohibiting wide MFNs, and *(b)* prohibiting behaviours by large PCWs which seek to replicate the anticompetitive effects of wide MFNs.

10. In some areas of our investigation we found no features giving rise to an AEC.

Non-fault claims

11. A non-fault party in an accident is entitled to have their car restored to its condition prior to the accident and, while it is being repaired, is entitled to the use of a like-for-like temporary replacement vehicle (‘replacement car’), subject to their duty to mitigate their loss with consideration to their need. The at-fault party has no right to choose the provider of these services or to specify the terms of any services provided but by law is required to pay for their reasonable costs. The non-fault claimant can arrange these services themselves but, in practice, arrangements for repair and the provision of a replacement car are typically made by the organisation with which the non-fault party makes initial contact after the accident. Alternatively, the at-fault insurer may ‘capture’ the non-fault claimant and deal with their claim directly.

12. Several companies can be involved in a non-fault claim process, including the non-fault claimant’s broker (non-fault broker), their insurer (non-fault insurer), the at-fault party’s insurer (at-fault insurer), a claims management company (CMC) and a credit hire company (CHC).

13. The company (usually their insurer or broker) with which a non-fault claimant makes first contact, known as first notification of loss (FNOL), might do one or both of the following:

    (a) it might handle all or some of the claim itself, ie providing the service (usually by contracting with other companies such as repair shops and CHCs) and passing a request for payment to the at-fault insurer; or

    (b) it might refer some or all aspects of the claim to another company (eg a CMC or CHC), often in return for a referral fee, with that other company providing the service and seeking payment from the at-fault insurer.

    Typically, non-fault insurers handle repairs themselves but refer provision of a replacement car to a CHC, though some handle both (eg with their contracted repairer providing a courtesy car or through a direct contract with a car hire company, known as direct hire), and others handle neither (eg referring both repair and replacement car provision to a CMC/CHC).

14. The company taking FNOL will seek to make an immediate assessment of who is at fault. We estimated that, at FNOL, insurers established who was at fault in 75% of cases; 20% of cases were categorised as split liability; and 5% of cases were not decided. Evidence from the ten largest motor insurers suggested that the categorisation of a driver as non-fault very rarely changed.

Industry background (see Section 2)

15. Our terms of reference were confined to the insurance of private motor cars. At the end of 2012, there were around 26 million privately registered cars in the UK, representing about 75% of the vehicles registered in the UK.

16. Insurance policies are underwritten by insurers. We estimated that the value of the gross written premium (GWP) for PMI was just over £10 billion in 2012, of which about 70% was accounted for by the ten largest motor insurers. The largest PMI provider is Direct Line Insurance Group. Insurance policies are sold through a number of different distribution channels. In 2012, the ten largest insurers sold over a third of their GWP direct by telephone or online, just under a third via brokers, and around a quarter via PCWs.

17. Of the four largest PCWs, two are owned or part-owned by the larger insurers and one by a large broker. Of the ten largest PMI providers, three also own brokers.

The relevant markets (see Section 4)

18. PMI is sold by insurers and brokers but we did not separate the market by seller or cover type. Although some suppliers operate on a local or regional basis, most insurance sales are transacted by telephone or online and we concluded that the appropriate geographic market for PMI was national rather than regional or local.

19. Our terms of reference referred to PMI and related goods or services and we identified two kinds of related services which were relevant to our investigation: PCWs and post-accident services. We did not investigate personal injury because of the significant work being conducted by the Ministry of Justice in this area.

20. PCWs facilitate the buying and selling of PMI. The PCWs constitute a ‘two-sided market’ with two groups of users: consumers searching for PMI and PMI providers. We decided that PCWs were a distinct market whose geographic scope was the UK.

21. Post-accident services are an important part of the supply chain for PMI and, consequently, the efficiency with which these services are supplied affects the price of PMI. We identified that the main post-accident activities which were relevant to our investigation were claims management, repairs, salvage and car hire. We did not find it necessary for our investigation to define the specific markets associated with each of these activities, as their relevance to our investigation arose from them being part of the supply chain for PMI.

Theories of harm (see Section 5)

22. We investigated different ways in which competition could be harmed in the relevant markets (also known as 'theories of harm' (ToHs)) and used these to structure our investigation.

23. We initially identified five possible theories, which were not necessarily mutually exclusive:

- ToH 1: separation of cost liability and cost control;
- ToH 2: the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services;
- ToH 3: market concentration;
- ToH 4: competition-softening strategies by sellers; and
- ToH 5: vertical relationships.

24. On initial investigation of the relevant markets, we were able to discount some of our theories. We observed low levels of concentration in most relevant markets, which allowed us to discount ToH 3, except in relation to PCWs which we considered under ToH 5. We observed high levels of switching in relation to PMI so our investigation under ToH 4 focused on the sale of add-on products. Under ToH 5 we did not find signs of competition problems other than in relation to MFN clauses in contracts between PMI providers and PCWs.

25. We therefore focused on the following areas:

- ToH 1: Separation of cost liability and cost control
- ToH 2: Possible underprovision of services to those involved in accidents
- ToH 4: The sale of add-on products
- ToH 5: PCWs and MFNs

Separation of cost liability and cost control (see Sections 6 and 10)

26. Separation occurs because, under tort law, a non-fault driver is entitled to compensation for their loss from the at-fault driver through the at-fault driver's insurer. The cost liability lies with the at-fault insurer whereas the cost control lies with the party managing the claim. This party is usually the non-fault insurer or an intermediary such as a CMC or a CHC rather than the at-fault

insurer. The value of the claim that can be submitted by the party managing the claim is determined not by the actual cost incurred but by the level of claim which a court would consider ‘reasonable’.

27. At-fault insurers have an incentive to ‘capture’ a claim so that they can control costs effectively. A captured claim is one where the at-fault insurer agrees with the non-fault driver that it will manage the claim. We estimated that claims were captured in about 25% of cases. For these captured claims, and for the small proportion of claims where both drivers are insured with the same insurer, the at-fault insurer has both cost liability and cost control such that there is no separation. There is separation of cost liability and control in the remainder of claims.

28. Associated with this separation, the party handling the non-fault claim often has the opportunity to earn a rent by recovering from the at-fault insurer the ‘reasonable costs’ of the post-accident services provided as determined under tort law despite this amount typically being significantly above the actual costs incurred. When the claim is managed by a CMC/CHC, this rent is often ‘captured’ by the party which referred the non-fault claim to the service provider (eg the non-fault insurer or broker) through a referral fee. For example:

(a) Claims handling and car hire intermediaries can charge at-fault insurers more than the costs incurred and compete to obtain work via referral fees, providing non-fault insurers, brokers (and others) with an opportunity to earn a revenue stream

(b) Some, but not all, non-fault insurers directly charge at-fault insurers more than the cost of repairs incurred.

(c) When cars are written off, at-fault insurers may not receive the full salvage value of the car.

29. We found that, as a result of these practices and conduct, there was a higher potential for dispute over claims and an excessive level of frictional and transactional costs, representing inefficiencies in the supply chain.

30. In assessing the competitive effects of this market structure and the conduct of parties within it, we considered a benchmark ‘well-functioning market’ to be a market which delivered consumers’ legal entitlements in an efficient way. Relative to this benchmark, we found three effects on consumers:

(a) Higher costs for at-fault insurers could lead to higher PMI premiums.

(b) The revenue stream to non-fault insurers and brokers (from referral fees and profits on directly-managed claims) could lead to lower PMI premiums.

(c) Separation could have some direct benefits to customers.

31. We found that the higher costs incurred by at-fault insurers were likely to be broadly reflected pro rata in higher premiums. We therefore expected that the effect on individual premiums would vary according to a driver's risk of having an at-fault accident, being greatest for drivers with the greatest risk.

32. We also found that the revenue stream to non-fault insurers and brokers from referral fees was likely to reduce the premiums charged by insurers (though there was more uncertainty about the extent of the pass-through than in relation to the higher costs leading to increased premiums). We found that the size of this offsetting revenue stream was smaller than the increased costs both because of the transactional and frictional costs incurred in the management of non-fault claims, and because of some referral fees being paid to parties which did not provide PMI. Therefore, we found that the net effect on PMI was to increase premiums.

33. We found that the effects were greatest in the provision of replacement cars which were often provided by CHCs. We found that the effects were smaller in repairs and write-offs, where different non-fault insurers often had different practices, and frictional and transactional costs were lower.

34. We found that the practices and conduct we identified had some direct benefits to customers but these were small relative to the net effect of higher costs. We also recognised that the existence of credit hire was likely to act as a constraint on at-fault insurers providing non-fault claimants with less than their legal entitlement.

35. Overall, we concluded that the following two features had, in combination, an AEC:

(a) separation, ie the insurer liable for the non-fault driver's claim (the insurer to the at-fault driver) is often not the party controlling the costs; and

(b) various practices and conduct of the parties managing non-fault claims, which (i) are focused on earning a rent from the control of claims rather than simply competing on the merits; and (ii) give rise to inefficiencies in the supply chain involving excessive frictional and transactional costs.

36. We concluded that these features distorted competition in the PMI market. Our central estimate of the net adverse effect on customers was about

£110 million per year (with a range from £101 million to £214 million). Of this, about £84 million (with a range from £67 million to £178 million) related to replacement cars.

37. We considered a number of potential remedies including: recommending a change in tort law, which would have the effect of removing separation for replacement cars; measures to make it easier for at-fault insurers to capture claims; price caps on replacement cars, repairs and write-offs; measures to increase mitigation by non-fault claimants in regard to replacement cars; a ban on referral fees; and improved information to consumers on their rights following an accident.

38. We gave serious consideration to a package of remedies which we thought could reduce transactional and frictional costs for replacement cars while protecting non-fault claimants' ability to obtain their tort law entitlements. This package included a cap on the amount charged for replacement cars (with two rates, the lower rate applying if the at-fault insurer accepted liability quickly), a revised mitigation statement relating to need and improved information to consumers on their rights following an accident. We consulted on this package in our provisional decision on remedies; however, we found that, in relation to the price cap, we did not have powers to implement the remedy as we had envisaged. We then consulted again on an alternative way by which a price cap remedy could be implemented, but found that it could be easily circumvented and there was considerable risk it would give rise to some distortions. We also considered recommending to government to implement the original price cap remedy through a change in the law. Overall, in light of the responses we received, we decided that a price-cap remedy was not likely to be an effective and proportionate remedy to the AEC and/or detriment and, without this key measure, the supporting measures we considered were also not proportionate.

39. We did not find that any of the other remedies we had initially considered would be both effective and proportionate in addressing the AEC and/or detriment. Some of these remedies would have required a change in the law but we found that such measures represented too fundamental a change in rights given the size and nature of the detriment we had found.

40. We recognised that market participants had already developed some measures to address the transactional and frictional costs which arise due to separation, eg a general industry agreement to which both insurers and CHCs can subscribe, and bilateral agreements either between two insurers or between an insurer and a CMC/CHC. In our view, further development of these voluntary measures would be likely to reduce the detrimental effects of the AEC and be beneficial to customers.

41. We also noted that there appeared to be market-wide support for additional information to be given to consumers concerning their rights following an accident, which we wished to encourage.

42. Lastly, we wanted to highlight that although it was apparent why a basic hire rate, based on the retail hire rates for the type of vehicle hired in the location of the claimant, had become the established benchmark in case law for non-fault replacement cars, we questioned whether this was still the most appropriate benchmark given that, following the establishment and expansion of the credit hire industry, very few non-fault claimants now sourced their temporary replacement vehicles in the retail hire market. In our view, the basic hire rate was, accordingly, artificial and, based on the level of referral fees paid to insurers, brokers and others, it also appeared to us too high.

Possible underprovision of service to those involved in accidents (see Section 5)

43. We did not find evidence of any systematic underprovision in relation to replacement cars or write-offs. We considered repairs in more detail.

44. We considered a large amount of evidence on the quality of repair, including evidence from interested parties (insurers, CMCs and repairers), consumer surveys and an independent study of a sample of repairs. On balance, we considered that there was insufficient evidence of a detrimental effect on consumers for us to find an AEC.

45. Nevertheless, it appeared to us that the measures taken by insurers and CMCs to ensure repair quality (eg PAS 125 accreditation, audits, monitoring and the provision of warranties) were unlikely always to be sufficient to ensure that repairs were carried out to the applicable legal standard. Though we did not find an AEC, we hoped that by shining a light on industry practices and by making these observations we could encourage insurers and others involved in managing repairs to improve the ways in which they ensure that consumers receive the repairs to which they are entitled.

The sale of add-on products (see Sections 7 and 11)

46. PMI providers offer consumers a range of additional products known as add-ons. These products provide cover for various risks over and above the core risks covered by a basic PMI policy and are usually sold for an additional premium. The cover provided by any particular add-on may vary from insurer to insurer. Examples of PMI add-ons are motor legal expenses insurance, windscreen cover, breakdown cover, personal injury cover, courtesy car cover, key loss cover, extended foreign use cover and no claims bonus (NCB) protection.

47. We found that consumers had a limited understanding of many add-ons. Although there were significant differences between insurers, the quality and quantity of information provided to consumers about add-ons was in many cases insufficient for consumers to be able to make informed purchasing decisions. This led to consumers demonstrating a willingness to pay prices for add-ons which were higher (or lower) than their value to the consumer. We found that the problem was particularly acute for NCB protection, because of the nature of the product.

48. We found that this informational asymmetry between insurers and consumers resulted in a weakening of competition as it meant that it was more difficult for consumers to identify the best-value offers in the market. It was difficult and time-consuming for consumers to compare the aggregate price of a basic PMI policy and their desired add-ons across different providers at the point at which the purchasing decision was made. Because of this, consumers were less likely to compare the price of add-ons from different providers once they had selected add-ons from their preferred provider of the basic PMI policy, which could lead them to pay higher prices for add-ons than would otherwise be the case or to buy products which they would not otherwise have bought. Further, searching through a PCW did not significantly diminish this effect as the quotes returned by a PCW were ranked based on the price of basic PMI only, not including the desired add-ons, so that the ability of consumers to make comparisons across insurers for their desired total policy remained limited.

49. We noted that our conclusions were consistent with the results of the FCA's market study.

50. Overall, we concluded that two features of the supply of PMI together gave rise to an AEC:

(a) information asymmetries between motor insurers and consumers in relation to the sale of add-ons; and

(b) difficulties faced by consumers in trying to compare the aggregate price of a PMI policy and the price and terms of their chosen add-ons across different motor insurers.

We concluded that these two features distorted competition in the market for PMI as they meant it was more difficult for consumers to identify the best-value offers in the market and to make informed purchasing decisions.

51. We decided to introduce remedies to improve information on NCB protection, where we found that consumers' lack of information was most acute. We will require insurers and brokers to provide, at the point at which NCB protection

is purchased, information to consumers on the implied price of NCB protection, the average NCB discount according to the number of NCB years, and 'step-back' procedures (ie what would happen to the consumer's number of NCB years with and without NCB protection in the event of one or more claims). We will also require two statements about NCB protection to be presented on PCWs when consumers seek more information about NCB protection, and to be provided by insurers and brokers at the point consumers purchase NCB protection.

52. We recognised the FCA's role in regulating the sale of add-on insurance products (including the descriptions provided by insurers, brokers and PCWs for those products). We recognised also that the FCA had conducted a thematic review of insurance PCWs and was developing remedy proposals following its market study into general insurance add-on products. We therefore decided that it was most appropriate to address the other aspects of the AEC by making two recommendations to the FCA concerning PMI-related add-ons. These were:

    (a) that the FCA considers:

        (i) whether insurers and brokers should be required to provide their prices for all or certain add-ons they offer to PCWs and, if so, whether this should be for all PMI-related add-ons or only for the most commonly purchased add-ons; and

        (ii) how consumers' information needs in relation to PMI-related add-ons can best be met on PCWs, in particular in relation to enabling consumers to compare prices across providers for their desired package of PMI and PMI-related add-ons; and

    (b) that the FCA works with insurers, brokers and PCWs to consider if and how these providers might improve their descriptions of all or certain PMI-related add-ons, either as part of its general supervisory work or as part of its remedy proposals resulting from its market study into general insurance add-ons.

PCWs and MFNs (see Sections 8 and 12)

53. PCWs are a two-sided market which match consumers searching for car insurance with PMI providers looking for customers. About 23% of all PMI business is conducted through PCWs and between 55 and 65% of new business comes through PCWs. We found evidence that price competition between insurers on PCWs was strong and that PCWs had increased competition between PMI providers.

54. PCWs earn a commission fee on insurance policies which are sold through their service but PMI providers set the premiums at which their policies are made available.

55. We examined concentration and market power in the PCW market and considered the contracts between PCWs and insurers. We found that certain contracts contained clauses which restricted the ability of the insurer to charge on other sales channels a price less than the price offered through the PCW. These clauses are known as Most Favoured Nation (MFN) clauses.

56. We found that there were four large PCWs, which appeared to enjoy a significant degree of market power against PMI providers because a proportion of the customers of each PCW did not shop on other PCWs. Therefore, these consumers were accessible online to PMI providers only through each specific PCW. We found that unilateral market power allowed the PCWs to negotiate effective MFN clauses. We found that entry and expansion appeared to offer a limited threat to the four large incumbent PCWs, and was made harder by MFNs.

57. We categorised MFN clauses into two broad types: 'wide' and 'narrow'. Wide MFN clauses specify that the premium for a policy may not be lower on any other PCW, on the PMI provider's own website and, in some cases, on any sales channel at all; narrow MFN clauses specify that the PMI provider's own website will not offer the policy at a lower premium than it is available on the PCW. 'Wide' MFNs therefore prohibit lower prices being offered through other sales channels, while 'narrow' MFNs prohibit lower prices being offered only on the insurer's own website.

58. We found that wide MFN clauses soften price competition between PCWs in relation to PMI. With a wide MFN clause in place, a PCW does not face the possibility that a retail customer will find the same PMI policy more cheaply on a competing PCW. There is little incentive for a PCW facing a competitor with a wide MFN clause to seek better PMI prices for their retail consumers from insurers because that better price would be passed on to the competitor also. There is, therefore, little reward for commission fee reductions and less disincentive against raising fees.

59. We found that the softening of price competition between PCWs regarding their services to PMI providers due to wide MFN clauses was likely to lead to less entry, less innovation and higher commission fees, all leading to higher PMI premiums. We found that:

(a) The common strategy for an entrant seeking to gain a foothold in a market by offering a cheaper product was precluded by wide MFNs. We found

evidence that entry had been deterred because of the difficulty of offering a differentiated product.

(b) Innovation by PCWs, to the extent that it reduces the expected cost of supplying PMI (eg through better fraud prevention), would not be incentivised as much in the presence of wide MFNs because the lower cost of PMI provision would not be reflected in lower PMI premiums.

(c) PMI premiums are higher with wide MFNs because it is not possible for competing PCWs to offer lower prices to gain market share. We found evidence of price reductions and commission reductions being offered by PCWs but being turned down by PMI providers because of the presence of wide MFNs in contracts with other PCWs.

60. We found that narrow MFN clauses between PCWs and PMI providers are unlikely to have the same impact on competition because they maintain the possibility of premiums varying on different PCWs. We recognised that narrow MFNs reduced the constraint on PCWs imposed by the PMI provider's own website, but found that the constraint PMI providers' own websites imposed on PCWs was small compared with the constraint from other PCWs. Overall, we found that if there were any anticompetitive effects from narrow MFNs, they were unlikely to be significant in the context of PMI.

61. We found that PCWs had had a significant positive effect in enhancing competition between PMI providers, and we found that narrow MFN clauses might be necessary for the viability of the current PCW business model. A narrow MFN enables a PCW to assert that the PMI policies found on the PCW cannot be found more cheaply by going directly to the PMI provider and, without that reassurance, consumers' trust in PCWs might be undermined, leading them to use PCWs less, resulting in a reduction in competition between PMI providers. We also believed that narrow MFNs might play a role in helping consumers reduce their search costs. We did not believe that wide MFNs between PCWs and PMI providers had any significant beneficial impacts over and above those provided by narrow MFNs.

62. Overall, we concluded that wide MFN clauses were a feature of the PCW market which gave rise to an AEC because they led to reduced entry and innovation in the PCW market, higher commission fees and higher PMI premiums.

63. We decided to remedy this AEC by: *(a)* prohibiting all MFNs between PCWs and PMI providers except narrow MFNs; and *(b)* prohibiting behaviours by PCWs which seek to replicate the anticompetitive effects of wide MFNs (applying to PCWs generating more than 300,000 PMI sales per year).

1. The reference

1.1 On 28 September 2012, the OFT, in exercise of its powers under sections 131 and 133 of the Act, referred to the CC for investigation the supply or acquisition of PMI and related goods and services in the UK. On 1 April 2014, the CMA took over this investigation from the CC.[1]

1.2 The CMA is required to determine whether any feature, or combination of features, of the relevant markets prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.[2] If the CMA decides that there is such a prevention, restriction or distortion of competition, there will be an AEC.[3]

1.3 The terms of reference and a more detailed description of how we conducted our investigation is set out in Appendix 1.1.

1.4 Our investigation relates to motor insurance supplied to or acquired by drivers of privately-owned motor cars. It excludes motorcycles. It concerns around 26 million cars or around 75% of the vehicles registered in the UK.

1.5 The OFT identified two features of the PMI market which it had reasonable grounds to suspect prevented, restricted or distorted competition. They were:

(a) Insurers of at-fault drivers, which are responsible for paying the claims for the provision of repairs or replacement vehicles to non-fault drivers, appear unable to exercise choice over how these services are provided. These insurers appear to find it difficult to assess the extent to which the costs claimed are reasonable, and appear to exercise only limited control over these costs.

(b) Insurers of non-fault drivers, brokers, credit hire providers, credit repairers and others that supply services to motor insurers have the opportunity, and the incentive, to take advantage of the lack of control over costs. They do this by practices which allow them to generate revenues through referral fees or rebates, while simultaneously increasing the costs that the insurer of the at-fault driver pays.

1.6 The OFT was also concerned that features of the market encouraged insurers to compete in a way that could cause further consumer detriment over the long term. Insurers appeared to have had a focus on gaining a competitive

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[1] On 1 April 2014, the OFT and CC ceased to exist and the CMA began its operations as the UK's central competition authority, pursuant to measures in the Enterprise and Regulatory Reform Act 2013. The CMA took over the functions of the CC and the competition and certain consumer functions of the OFT.
[2] See section 134(1) of the Act.
[3] As defined in section 134(2) of the Act.

advantage by becoming more successful at increasing revenues through referral fees and rebates, with the effect of raising their rivals' costs, while the OFT noted that it would like to see insurers focus on the quality and value of the services they provide.

1.7 In its reference, the OFT decided to keep the scope for the market investigation broad, referring to 'the market or markets for the supply or acquisition of PMI and related goods or services in the UK' (see Appendix 1.1). Therefore, although we were mindful of the concerns identified by the OFT, we were not constrained by them. The theories of harm we identified are set out in Section 5.

1.8 The OFT investigation took place whilst a number of government and regulatory bodies were looking at different aspects of motor insurance, including the Ministry of Justice (MoJ), the Department for Transport and the Financial Conduct Authority (FCA). One area of focus was personal injury claims, where the Jackson Review of civil litigation costs[4] led the MoJ to implement reforms through LASPO.[5] These reforms came into force in April 2013 and led to changes which affected the incentives and competitive strategies of all firms involved in personal injury claims, including claims arising from road traffic accidents. Through the course of our investigation, the MoJ continued to consider further reforms. Due to the MoJ's ongoing activity in this area, we decided that personal injury arising from road traffic accidents should not be part of the focus for our investigation. Moreover, we were mindful that any data we might have used in any analysis of this area would have pre-dated the measures coming into force, making it impossible to assess the effect of the statutory and regulatory changes. For both these reasons, we decided not to focus on personal injury claims in our investigation.

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[4] Review of Civil Litigation Costs: Reports.

[5] Legal Aid, Sentencing and Punishment of Offenders Act 2012, see sections 56–60.

2. Background

Introduction

2.1 This section provides background information on motor insurance and describes the different types of PMI. It also provides some background on the firms involved in the provision of PMI (insurers, brokers and PCWs), and on CHCs/CMCs and repairers. We also provide some background data on the volume and value of motor insurance claims.

Scope of motor insurance relevant to our investigation

2.2 Table 2.1 shows the breakdown of the 34.5 million vehicles registered in the UK as at 31 December 2012. It shows that the vast majority (28.7 million or 83%) of vehicles were cars.

TABLE 2.1 **Vehicles registered in the UK at 31 December 2012 by body type**

	'000	*%*
Cars	28,722	83
Motor cycles	1,225	4
Light goods vehicles	3,281	10
Heavy goods vehicles	461	1
Buses & coaches	166	0
Other vehicles	667	2
Total	34,522	100

Source: DfT: www.dft.gov.uk/statistics/series/vehicle-licensing/.

2.3 Of the 28.7 million registered cars, 89% were privately registered, as shown in Table 2.2.

TABLE 2.2 **Vehicles registered in the UK at 31 December 2012 by ownership**

	'000	*%*
Privately registered	25,701	89
Company registered	2,377	8
Between keepers	645	2
Total	28,722	100

Source: DfT: www.dft.gov.uk/statistics/series/vehicle-licensing/.

2.4 Our investigation related to motor insurance supplied to or acquired by drivers of privately-owned motor cars used for non-business (private) use (and excludes motorcycles). It therefore concerned around 25.7 million cars, or around 75% of the vehicles registered in the UK.

Types of PMI

2.5 PMI is usually purchased for a one-year term. There are two types of PMI, non-comprehensive and comprehensive, which can be described as follows:

(a) Non-comprehensive PMI is third party or third party, fire and theft insurance. Third party cover insures against liability for death or injury to third parties,[1] as well as damage to the property of third parties, and is required under the Road Traffic Act 1988 before a vehicle can be driven. Third party, fire and theft cover extends this to insure also for fire and theft of the vehicle.

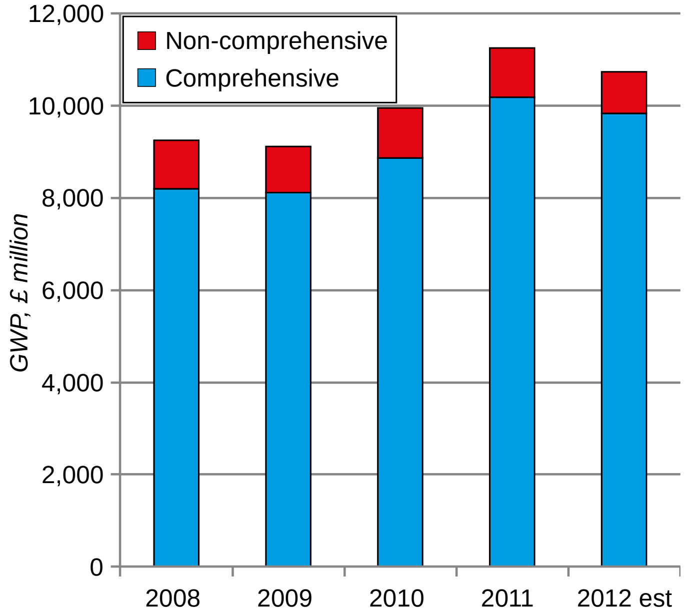
(b) Comprehensive PMI, in addition to third party, fire and theft cover, also insures for damage caused to the insured's own vehicle and the insured's own medical expenses arising from an accident. Comprehensive cover may also provide extra benefits such as a temporary replacement vehicle, roadside assistance, and windscreen repair or replacement, but these may not be standard. If these benefits are not included in the basic policy offered by an insurer, they can often be bought as add-ons.

2.6 The most commonly sold type of PMI is comprehensive. Over 90% of PMI gross written premiums (GWP) in 2012 related to comprehensive policies.[2] Figure 2.1 shows total PMI GWP split between comprehensive and non-comprehensive policies for 2008 to 2012. The figure shows that the proportion of non-comprehensive policies (by value) has declined year on year since 2008.

[1] 'Third parties' includes passengers in the insured party's vehicle.
[2] Datamonitor, *UK Private Motor Insurance: Market Dynamics and Opportunities*, Table 2, p12. Estimated GWP in 2012 (excluding motorcycles) was £10,739 million, of which comprehensive policies accounted for £9,836 million and non-comprehensive policies accounted for £902 million.

FIGURE 2.1

Split of GWP between type of motor insurance policy, 2008 to 2012 (estimate)



Source: Datamonitor, *UK Private Motor Insurance: Market Dynamics and Opportunities*.

2.7 Insurers told us that intense competition in the comprehensive insurance market and the knock-on effect on pricing had rendered non-comprehensive products obsolete for many customers. Insurers also said that they had sought to limit their risk exposure as, historically, non-comprehensive policies, being most popular with young and/or newly-qualified drivers, had accounted for greater underwriting losses. Under these policies, insurers were still exposed to third party personal injury claim costs, which had represented an increasing cost for insurers.[3]

2.8 Data on motor insurance premiums suggested that over the longer term the price of motor insurance had increased faster than general inflation. There was a particularly rapid increase during 2009-2010 but since 2011 there has been a fall in motor insurance premiums (see Appendix 2.1). Similar data for house insurance shows that premiums have not increased faster than general inflation, suggesting the longer term increase in motor insurance prices has been driven by motor-specific factors (eg motor insurance claims costs) rather than factors general to insurance.

[3] Datatmonitor: UK Private Motor Insurance 2012, p31.

Providers of PMI

Insurers

2.9 Insurance policies are underwritten by insurers. The ten largest motor 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).

2.10 Table 2.3 shows, for each of the ten largest motor insurers, their GWP from PMI in 2012, their average number of policies in 2012, and, by computation, their average GWP per policy in 2012. This data includes non-comprehensive policies.

TABLE 2.3 **GWP, average number of motor insurance policies, and GWP per policy, 2012, for the ten largest insurers**

	2012 GWP £m	*Average number of policies in year '000*	*Average GWP/policy £*
DLG	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]
LV	[✂]	[✂]	[✂]
Admiral	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]
Ageas Insurance	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]
RSA	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]
Zurich	[✂]	[✂]	[✂]
Total	[✂]	[✂]	393

Source: The ten largest insurers.

2.11 From the figures provided by the ten largest motor insurers, GWP totalled £[✂] billion in 2012. With an estimated total market size in 2012 of £10.7 billion,[4] we estimated that the ten largest motor insurance providers represented about [✂]% of the total market. The largest PMI provider is DLG, which is responsible for almost one-quarter of the sales made by the ten largest insurers. The GWP of the four largest motor insurers accounted for [✂]% of the GWP of the ten largest insurers (and [✂]% of the estimated total market size in 2012), with a large drop in GWP between the fourth largest PMI insurer ([✂], with [✂]% of the total market) and the fifth largest insurer ([✂], with [✂]% of the total market).

[4] 2012 GWP estimated in Datamonitor: *UK Private Motor Insurance: Market Dynamics and Opportunities*, p12.

2.12 Insurance policies are sold through a number of different distribution channels: direct online or direct by telephone; through brokers (see paragraphs 2.15 to 2.23) or PCWs (see paragraphs 2.24 to 2.35); or through partnerships with retailers or banks/building societies. Overall, across the ten largest motor insurers and measuring by GWP, over one-third of PMI in 2012 was sold direct (telephone and online), 31% was sold via brokers and nearly one-quarter was sold via PCWs.[5] Table 2.4 shows the overall split of GWP and the number of PMI policies sold by the top ten insurers by sales channel.

TABLE 2.4 **Split of GWP and number of policies by sales channel, 2011/12**

	Sales channel split, %	
	By value (GWP)	*By volume (number of policies)*
Direct – Internet	20	23
Direct – telephone	17	15
Brokers	31	32
PCWs	24	21
Retail partnerships	2	2
Banks/building societies	1	1
Other	6	7
Total	100	100

Source: CMA calculations based on data provided by the parties.

2.13 Appendix 2.2 provides further details on the ten largest PMI insurers.

Vertical relationships

2.14 There are vertical relationships between insurers and both brokers and PCWs:

(a) Of the four large PCWs, one is owned by one of the ten largest motor insurers, another is part-owned by one of the ten largest motor insurers and another is owned by a large broker.

(b) Three of the ten largest motor insurers also own brokers. These operate on a non-exclusive basis and appear to enable the insurer to capitalise on its brand, by attracting customers who do not necessarily fit its underwriting risk profile but who wish to engage with the brand.

[5] We asked the ten largest insurers to provide a split of their GWP and policies sold by sales channel for 2012. 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). 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 (for example, 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.

Brokers

2.15 Insurance brokers act as an intermediary between their customers and insurance companies, and use 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 distribute motor insurance policies only through brokers and partners (eg Ageas Insurance).

2.16 '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 representatives of one or more insurance companies. The term now has no legal definition following the repeal of the 1977 Act. However, the sale of general insurance (which includes motor insurance) has been regulated by the FSA (now the FCA) since 14 January 2005. Any person or firm authorised by the FCA can call themselves an insurance broker.

2.17 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.

2.18 Brokers carry out varying amounts of activity on behalf of the insurer. Some brokers simply sell insurance on behalf of insurers and transfer all post-sale servicing, including claims handling, to the insurer; while others carry out more work, including claims handling.

2.19 Brokers use a range of distribution channels, including traditional high street branches, telephone and online, including PCWs. Brokers can be categorised into three main types: traditional, specialist and online direct, although some brokers can fall into more than one category:

- Traditional brokers use branches, telephone and online channels, including PCWs. They may also use affinity partnerships ('white label' agreements), which combine an insurer (or panel of insurers) and a well-known brand which is used to market and sell the insurance, 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.

- Specialist brokers (offering insurance for specialist needs) sell direct (by telephone and online) and use PCWs.

- Online direct brokers use Internet and social media distribution channels only.

2.20 Disintermediation (ie direct sales by insurers, using both telephone and online channels, replacing the traditional broker model) has been a general trend in the insurance market over the last 20 years. 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 and will be largely unaware of whether the policy is being arranged through a broker or directly with the insurer.

Market shares – brokers

2.21 Datamonitor reported that around one-third of motor insurance business in 2011 was sold through brokers,[6] ranging from small, high street operations to large national companies. Although direct sales by insurers accounted for the largest share of motor insurance policies (42% in 2011), this share had fallen from previous years. Datamonitor attributed this decline to brokers adapting to a PCW-defined market, as well as the success of affinity partnerships. Datamonitor suggested that smaller brokers had benefited from the level playing field created by a price-driven, commoditised market. Datamonitor also found that, while price was the dominant purchasing consideration for consumers, branding still remained critical for a majority of policies sold (see paragraph 2.35).[7]

2.22 Brokers told us that there was significant demand for non-standard motor insurance, which they were well placed to provide.[8] We noted, for example, that Groupama Insurance Company Limited (owned by Ageas (UK) Limited) had shifted its focus away from standard motor insurance towards specialist lines, with [✂]% of its motor insurance book classified as non-standard.

2.23 Appendix 2.2 provides further details on five large brokers: Acromas, Ageas Retail (owned by Ageas), BISL, Endsleigh (owned by Zurich) and Swinton (owned by Covea).

Price comparison websites

2.24 There are four large PCWs which allow consumers to compare and purchase motor insurance policies. These are:

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[6] Datamonitor report, *Personal General Insurance: UK Private Motor Insurance*, published September 2012, stated that 36% of PMI business in 2011 was through brokers. The figures we collated from the top ten insurers showed that 30% of motor insurance by GWP and 28% by number of policies were sold through brokers in 2012.
[7] Datamonitor's General Insurance Consumer Survey 2012.
[8] Non-standard motor insurance does not have a precise definition. It may include insurance for learner and young drivers, and to cover high-performance cars, modified cars, kit cars, imported cars and classic cars.

- Comparethemarket.com, owned by BISL, which is part of the BGL Group (broker)
- Confused.com, owned by Admiral (insurer)
- GoCompare.com, owned 50% by esure (insurer)
- Moneysupermarket.com

The market shares of the four large PCWs are similar. Other PCWs include Google and Tesco Compare.

2.25 The original focus of three of the four large PCWs was motor insurance, 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). [✄]

2.26 A motor insurance provider pays a PCW a fee (ie a cost per acquisition (CPA) fee, which we refer to elsewhere as a commission fee) for each motor insurance policy sold which was introduced by the PCW.

2.27 Since the policies offered by PCWs are provided by the motor insurance providers, which sell through multiple channels, these policies are unlikely to be tailored to any particular PCW. Each PCW differentiates itself and seeks to attract consumers to its website by building its own distinct brand identity, and by offering the best intermediary service. PCWs spend heavily on advertising. Datamonitor reported that all four of the large PCWs were among the top ten motor insurance advertisers in 2011. Data from the four large PCWs showed that television advertising represented around 50% of their advertising spend. All the four large PCWs told us that they did not promote motor insurance to any particular consumer demographic.

2.28 PCWs told us that their principal costs were 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% of its costs. Both of these PCWs told us that, given the high proportion of income they generated from motor insurance, most media costs were attributed to motor insurance. Comparethemarket told us that [✄]. Comparethemarket said that [✄].

2.29 Appendix 2.2 provides further details on the PCWs.

Use of PCWs

2.30 Customers who purchase motor insurance through a PCW use, on average, between one and two PCWs.

2.31 Our survey of motor insurance policyholders found that, when respondents last compared insurance providers or policies, they looked at, on average, 2.2 PCWs, with 42% looking at Comparethemarket, 46% looking at GoCompare, 23% looking at Moneysupermarket, and 15% looking at Confused.[9] Our survey found that 12% of respondents looked at other PCWs and 14% of respondents did not know which PCWs they had looked at.[10]

2.32 A Datamonitor survey found that, in 2012, Comparethemarket was the most popular PCW for customers purchasing motor insurance, with 67% of those customers who purchased through a PCW having searched using this site. The other three large PCWs had lower but roughly similar levels of usage (Confused: 49%; GoCompare: 43%; and Moneysupermarket: 48%). Datamonitor found that usage of PCWs outside the four large PCWs was limited, with only 5% of consumers who went on to purchase through a PCW using another PCW.

2.33 Datamonitor found that, as of September 2012,[11] 54 to 56% of new motor insurance business was being written by insurers through PCWs.[12,13,14] However, responses to Datamonitor's General Insurance Consumer Survey 2012 found that 23% of consumers made their final purchase through 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 motor insurers regarding their GWP by sales channel, which suggested that, in 2012, 26% by GWP and 28% by number of policies were sold through PCWs. We noted that there was a large gap between the proportion of consumers using PCWs for research (around 77%) and the proportion making a final purchase through this channel (around 20 to 30%).

2.34 Datamonitor's 2012 report also stated that the growth of PCWs had had a significant effect on motor insurers' 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 motor insurance

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9 See survey report.
10 PCWs included in 'Other' included Compare NI, Google, Quote Zone, Tesco Compare, uSwitch and several others.
11 Datamonitor references this finding to 'aggregator experts' but does not specify who these aggregator experts are.
12 New motor insurance business excludes renewals with the same insurer.
13 Datamonitor report, *UK Private Motor Insurance 2012*, p62.
14 Data from ebenchmarkers suggests that [55–65]% of new motor insurance was written through PCWs.

product in order to produce a cheaper, headline price (known as ‘hollowing out’).

2.35 Datamonitor also found that a majority of consumers did not select the cheapest quote on a PCW. Of consumers surveyed who purchased motor insurance from a PCW, 37% selected the cheapest quote and 56% selected a policy from within the top five but not the cheapest. Although showing the importance of a high ranking, this data 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.

CMCs and CHCs

2.36 CMCs typically offer to manage all aspects of a claim, including personal injury, from start to finish. They often act on behalf of insurers and brokers but they also have claims referred to them by other parties, such as motor dealerships or solicitors. They may also be approached directly by non-fault claimants.

2.37 The range of services provided by CMCs can include:

(a) handling the FNOL;

(b) managing repairs, which may be through a network of approved repairers;

(c) providing replacement vehicles;

(d) providing credit repair and credit hire for non-fault claimants (in credit repair and credit hire the service provider receives no payment until the claim is settled by the at-fault insurer);

(e) handling claims and recovering claims costs from the at-fault insurer; and

(f) recovering uninsured losses.

2.38 CHCs provide rental vehicles on a credit hire basis to non-fault claimants (see Section 3). The companies which offer credit hire typically also provide rental vehicles on a direct hire basis. In addition, CHCs may provide other services such as repair management, credit repair and claims management, such that the distinction between CHCs and CMCs is often blurred.

2.39 A more detailed description of the activities of CHCs is set out in Appendix 2.2.

Repairers

2.40 Three of the large motor insurers own vehicle repair companies: Aviva owns Solus Accident Repair Centres Limited; DLG owns UK Assistance Accident Repair Centres Limited; and RSA owns RSA Accident Repairs Limited. Other repair businesses may be part of other companies, such as motor dealerships, or be independent. The independent companies typically have a regional, rather than national, presence. The large insurers and CMCs/CHCs generally have established networks of approved repairers in order to control repair costs and to manage the level of service provided to their customers.

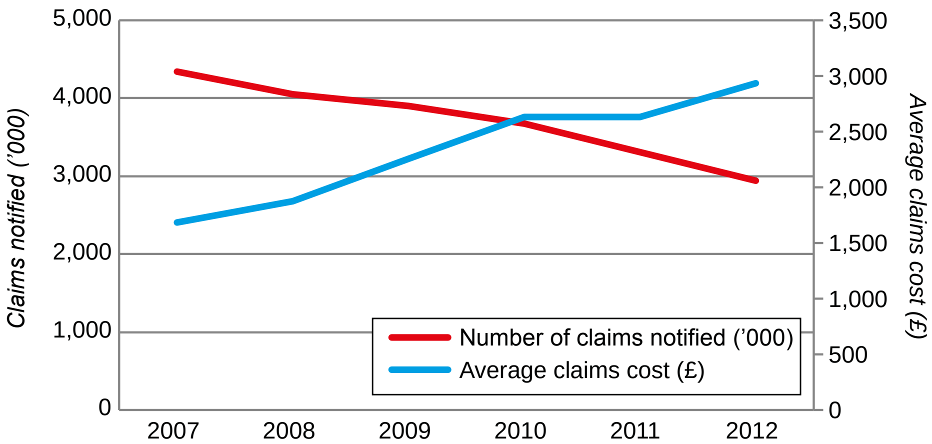
Volume and value of motor insurance claims

2.41 In this subsection we provide a summary of the volume and value of motor insurance claims.

2.42 Datamonitor reported that in 2012 there were 2.9 million claims notified and that the gross claims incurred amounted to £8.6 billion, giving an average claim cost of £2,933. Figure 2.2 shows that average claim costs have risen every year since 2007. The average cost of a claim was £1,684 in 2007 and £2,942 in 2012, though there was a fall in the number of claims over the period. Datamonitor stated that the increase in average costs was the result of rising personal injury claims, though road traffic casualties had declined due to cars and roads getting safer.[15]

FIGURE 2.2

Number and average cost of claims, 2007 to 2012



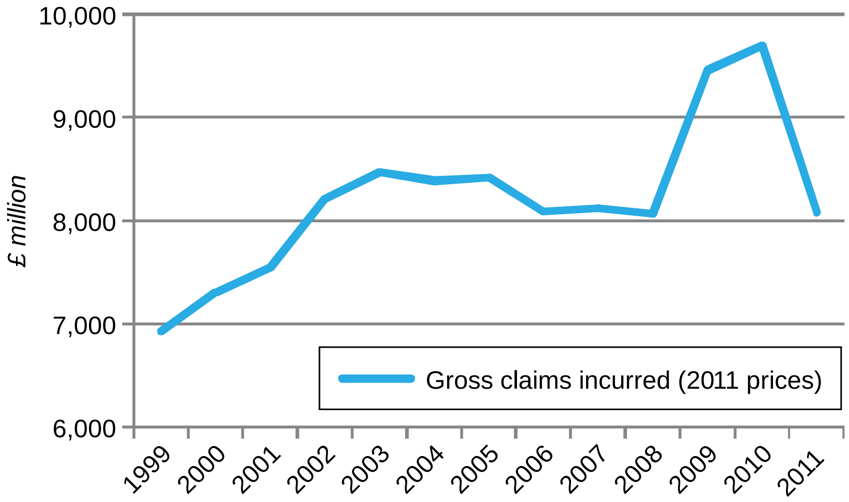
Source: Datamonitor: *UK Private Motor Insurance: Market Dynamics and Opportunities*.

[15] Datamonitor, *UK Private Motor Insurance, 2012*.

2.43 The Association of British Insurers (ABI) reported that, in 2011, motor insurance claim costs fell to £8.1 billion,[16] which was broadly in line with the annual level of claims through most of the last decade (as shown in Figure 2.3, which shows gross motor insurance claims in the period 1999 to 2011 based on ABI data).

FIGURE 2.3

Gross motor insurance claims incurred in the UK



Source: ABI.

2.44 We noted that Figure 2.3 was consistent with Figure 2.2 as fewer more expensive claims had resulted in total claims costs staying at broadly similar levels.

2.45 Table 2.5 shows data on the number of claims and claims frequency from a report by Mintel. The data for 2003 to 2011 was sourced from the ABI. The figures for 2012 were estimated by Mintel based on data covering the first three quarters of the year. Mintel estimated that there would be 2.8 million motor insurance claims in 2012, down from 4.4 million in 2006; and that the frequency of motor insurance claims (ie the number of claims in a year as a percentage of the number of insured cars) had declined from 18.9% in 2003 to 12.5% in 2012.

[16] ABI, *UK Insurance Key Facts*, 2012.

TABLE 2.5 **Total number of private car insurance claims notified and claims frequency, 2003 to 2012***

	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	23.4	–2.5	3.6	–5.6	15.5
2011	23.5	0.3	3.3	–10.0	13.9
2012 (est)‡	22.7	–3.4	2.8	–13.1	12.5

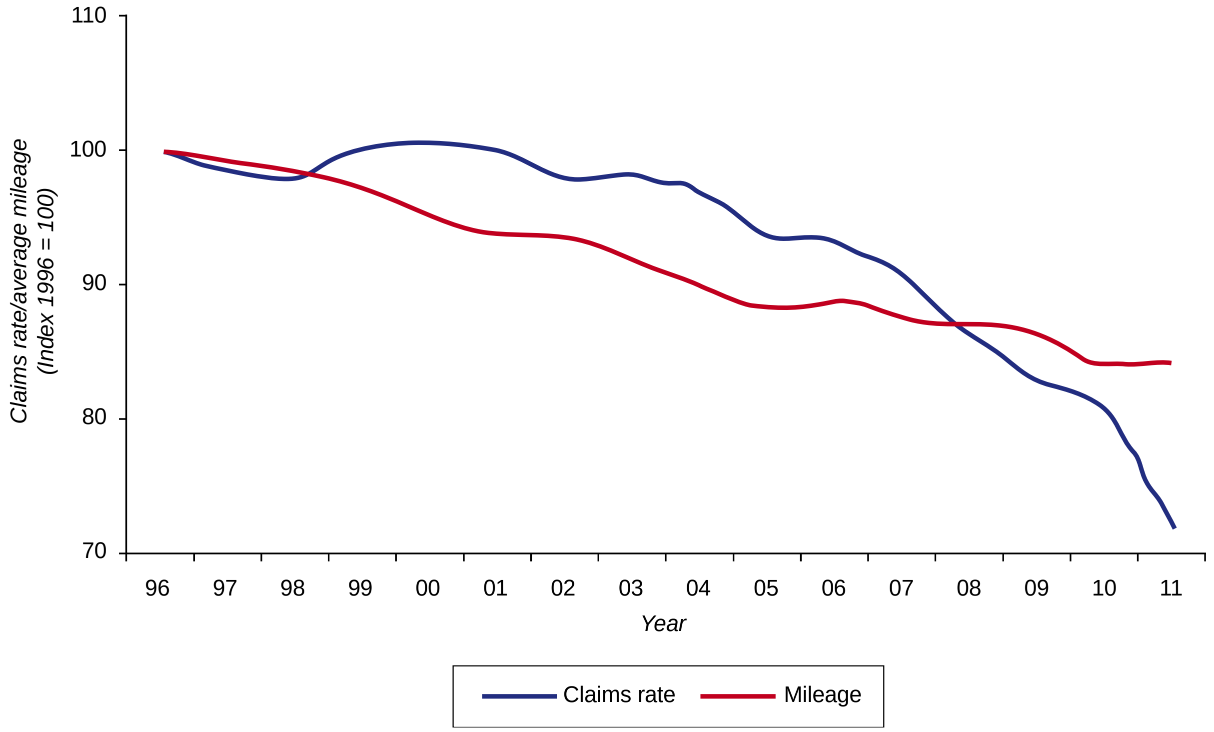
Source: Mintel: Motor Insurance – UK, March 2013.

*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.

2.46 Figure 2.4 shows that, as the average annual mileage of cars in the UK has fallen, there has been a decline in claims frequency.

FIGURE 2.4

Insurance claims rate versus average annual mileage*

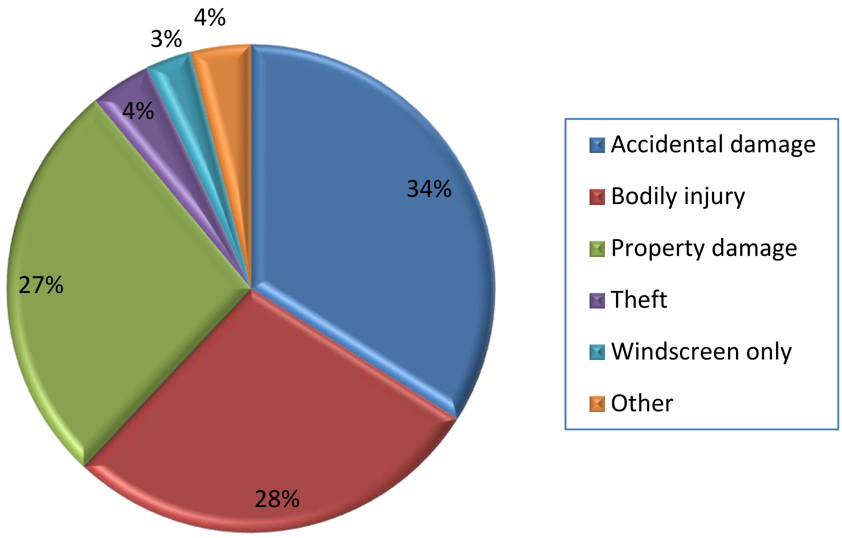


Source: www.trendtracker.co.uk/blog/2012/10/the-uk-car-body-repair-market.

2.47 Figure 2.5 shows a breakdown by the ABI of motor insurance claims costs in 2012 by type of claim, based on data submitted by its members.

FIGURE 2.5

Claims costs, 2012



Source: ABI.

2.48 The ABI told us that 'accidental damage' related to claims payable by an insurer to its policyholder, whether for damage to their vehicle or for their personal injury; while 'property damage' and 'bodily injury' related to payments made by an insurer to third parties for damage caused by its insured driver. However, the ABI noted that claims were often comprised of different elements, and the categorisation of costs in the submissions from its members depended on each insurer's systems.

2.49 The ABI told us that insurers were likely to report the costs of replacement cars in the accidental or property damage categories or in the 'other' category. We noted that the accidental damage, property damage and other categories together accounted for around 65% of total claims costs in 2012.

2.50 We also noted that many claims related only to windscreen damage, which had a low average claim cost. Datamonitor reported that, in 2012, 1.2 million of the 3.3 million motor insurance claims notified and settled in the year related only to windscreens, with an average cost of £121.[17]

2.51 The General Insurance Market Research Association reported that, in 2011 and 2012, accidents were the reason for approximately [✄] of claims made

[17] Datamonitor: *UK Private Motor Insurance: Market Dynamics and Opportunities*.

under comprehensive insurance policies. Vandalism or damage accounted for approximately one-quarter of claims.

2.52 Based on data provided to us by six of the ten largest motor insurers, we estimated that claims costs relating to road traffic accidents (ie excluding windscreen and fire and theft claims) in 2012 could be split as follows:

- 62% related to claims by non-fault claimants (ie claims by a third party when the insurer's own policyholder was at fault)
- 12% related to non-fault claims by policyholders on their own policy
- 14% related to at-fault claims by policyholders for their own damage
- 11% related to claims when there was split liability[18]

We understood that the disparity between the cost of non-fault claims and at-fault claims was largely because of the high cost of *(a)* non-fault personal injury claims and *(b)* replacement car provision to non-fault claimants.

2.53 Based on the information from insurers, we estimated that write-offs accounted for between 365,000 and 600,000 motor insurance claims in 2012 (see Appendix 6.3, paragraphs 3 and 4).

Claims experience by channel

2.54 We asked the motor insurers about the level of their claims in each of the channels they used to distribute motor insurance. The lower the level of claims experience (ie the lower the percentage claims/loss ratio), the more favourable the position for the insurer. Of the eight insurers which provided us with data, four told us that claims rates were generally higher for sales made via PCWs compared with sales made via other channels, as follows:

- Admiral told us that the first-year claim cost was highest for policies purchased through PCWs, followed by policies purchased over the telephone. First-year claim costs were lowest for policies purchased online.
- AXA told us that [✂]. Its total loss ratio[19] [✂].

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[18] Figures do not add up to 100% due to rounding.
[19] 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.

- DLG told us that, over the lifetime of the customer, business transacted through [✄].[20]

- esure provided data on its claims showing that [✄].

2.55 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:

- 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.

- DLG told us that it experienced a slightly higher 'burn cost'[21] in 2012 on business generated through [✄], but this was likely to be a function of the slightly different demographic profile of [✄].

- Additionally, we noted that the loss ratio would be affected by the level of premium: a high loss ratio could be attributable to one or both of a high burn cost and a low premium.

2.56 The other four insurers had inconclusive data regarding the difference in their claims experience between their direct and PCW channels, as follows:

- Aviva only started selling policies via PCWs in 2011 and told us that the data was not representative.

- RSA provided data on burn cost as follows: direct website £[✄]–£[✄]; direct telephone £[✄]; broker £[✄]; PCWs £[✄]–£[✄]; and partnerships £[✄]–£[✄].

- Zurich provided data on burn cost as follows: direct website £[✄]; direct telephone £[✄]; broker £[✄]; and PCW £[✄]. It did not provide us with an average for direct sales.

- Ageas Insurance provided data for brokers and partnership channels but, as it does not sell directly to customers, it did not provide any information on the PCW channel.

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[20] 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.
[21] Burn cost is effectively average claims cost per policy.

3. Legal and regulatory framework and the claims management process

Introduction

3.1 This section is in two parts: the first part describes the legal and regulatory framework relating to motor insurance; the second part provides an overview of claims and the claims management process.

Legal and regulatory framework

Principle of compensation under tort law

3.2 Tort law concerns civil wrongs (torts) which give rise to a civil action for compensation for the damage caused. A person who causes damage (ie the at-fault party) to another person (ie the non-fault party) is liable to compensate the non-fault person for the losses sustained so that the non-fault party is restored to ‘as good a position as he would have been in if no wrong had occurred’.[1] Compensation is usually a monetary sum. In the case of damage to property, the amount of compensation is usually equal to the cost of repairing or replacing the damaged property. Other losses caused by the damage of the at-fault party are also compensable. Although the compensation may be paid by an insurer, the principles determining how much compensation is paid and what losses can be compensated are determined by the principles of tort law developed by case law.

Principle of insurance

3.3 The principle underlying insurance is that, in return for payment of a premium, the insurer undertakes to indemnify the policyholder for the losses caused by the risks specified in the insurance policy.

Claiming under contract: general principles

3.4 The terms of an insurance policy will set out what risks are covered as well as how and in what circumstances the policyholder can claim for losses. The policy may have exclusions for certain types of loss or conditions for being able to claim.

3.5 The policy might include restrictions for where and how a repair is conducted. For example, some policies require the use of the insurer’s network of repairers and some policies state that non-original equipment manufacturer

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[1] *Livingstone v Raywards Coal Co (1880) 5 App. Cas. 25.*

(OEM) parts will be used in the repair. The policyholder will typically have to pay any costs up to the excess set out in their policy.

3.6 We discuss claims by an at-fault driver under their own policy in paragraphs 3.31 and we discuss claims by a non-fault driver managed by their own insurer in paragraphs 3.37 to 3.41.

Principle of subrogation

3.7 The principle of subrogation enables a non-fault insurer which has indemnified its policyholder to recover compensation for the losses caused by the at-fault party from that party (in reality the at-fault party's insurer). Although the claim is conducted in the names of the individual parties involved, it is in practice conducted by the parties' insurers and payment of the compensation is between these businesses.

3.8 In the context of a motor vehicle accident, where the insurer of the non-fault driver (the non-fault insurer) has indemnified its policyholder by arranging and paying for the repair of the damage and any other losses incurred by the non-fault driver, the non-fault insurer exercises the right to be subrogated to the non-fault driver's rights against the at-fault driver's insurer and claims compensation for the losses associated with damage to the vehicle and other consequential losses against the at-fault driver/insurer. This is called a subrogated claim.[2] Once the non-fault insurer has indemnified its policyholder, it will, pursuant to the principle of subrogation, claim for compensation for the direct and consequential losses caused by the at-fault driver against the at-fault driver (in practice the at-fault insurer). In a subrogated claim the claim is for compensation for losses, determined in accordance with tort law principles, and not reimbursement for costs incurred because it is the non-fault claimant's losses that are compensated not the costs of the non-fault insurer.

Types of motor insurance[3]

Compulsory third party

3.9 The tort law principle whereby the at-fault party is liable to the non-fault party is reflected in the Road Traffic Act 1988 requirement for drivers to hold third

[2] Although not the technical legal meaning, the industry uses the terms subrogated bills, invoices or claims to refer to the documentation sent by subrogated parties (eg non-fault insurers who have indemnified a non-fault driver on the basis of their comprehensive policy) to fault insurers. We have used this shorthand terminology throughout this report.
[3] Further details on types of motor insurance are in Section 2.

party insurance as a legal minimum. Third party insurance ensures that the at-fault driver's liabilities to a non-fault driver who suffers property damage or personal injury as a result of an accident are covered regardless of the financial status of the at-fault driver.[4]

Comprehensive insurance

3.10 Comprehensive insurance indemnifies the policyholder for liabilities to third parties and losses arising from damage by fire or theft or accidental damage to the policyholder's own vehicle. Additional benefits may be included in the basic price or may be purchased as add-ons (see Section 7).

Losses arising from a motor vehicle accident

3.11 In the context of a motor vehicle accident, it is established law that the at-fault driver is liable to compensate the non-fault claimant for any direct losses flowing from the accident such as the losses as a result of damage to the non-fault vehicle or if it cannot be repaired, for it to be replaced and any consequential losses, such as the loss of use of the vehicle.[5]

3.12 Decisions by the courts have established that the at-fault driver is liable for the 'reasonable costs' of restoring the non-fault claimant to their pre-accident condition.

Direct losses

- *Repairs*

3.13 Case law has established that the loss suffered by the non-fault driver when their vehicle is damaged is the diminution of the vehicle's value; the amount of compensation awarded for that loss is the reasonable cost of repair to the damaged vehicle. The reasonable cost is taken as the cost the non-fault driver could obtain on the open market. The recent case of *Coles v Hetherton*[6] confirmed that principle when it considered whether the 'reasonable cost' of repair should be the price the non-fault insurer actually paid when it arranged and paid for the repair, or the price the non-fault claimant could obtain on the market (ie a retail rate).

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[4] Failure to insure 'third party' risks is a criminal offence, the punishment for which is a fine of between £200 and £5,000 and six to eight points on the driver's licence. In the event that an at-fault driver does not hold third party motor insurance, non-fault drivers can obtain compensation from the Motor Insurance Bureau.
[5] Losses related to personal injury are also compensated, but we did not investigate personal injury due to the significant work being conducted by the MoJ in this area.
[6] *Coles and Others v Hetherton and Others, [2012] EWHC 1599 (Comm)*.

3.14 The case concerned 13 subrogated claims brought by the non-fault insurer against the two at-fault insurers. Each claim arose from a motor vehicle accident where liability was admitted. The non-fault insurer arranged repair pursuant to the insurance policy which provided that the non-fault claimant could have their vehicle repaired by and at the expense of the non-fault insurer in accordance with the scheme set up by the insurer. Repairs through this scheme cost the non-fault insurer less than the retail rate. The non-fault insurer submitted a subrogated claim for the cost of repair to the at-fault insurer which was higher than the actual cost of repair. The at-fault insurers argued that the claim for the higher amount showed a failure to mitigate loss.

3.15 The Court held that the loss sustained by the non-fault driver was diminution in value of the motor vehicle which was a direct loss which did not require mitigation. The Court held that 'reasonable cost of repair' was the practical way that the courts have calculated this diminution in value. The Court further held that the cost of repair was a question of fact and was to be assessed from the position of the individual non-fault driver and not from the position of the insurer. In relation to the amount claimed and the costs incurred by the non-fault insurer, the Court held that the arrangements of the non-fault insurer were irrelevant. It said it would be unjust and unreasonable for the at-fault driver to enjoy any benefit that accrued to the insured under the policy (in this case having the repairs done and paid for by the insurer).

3.16 Provided that the costs are reasonable, there are no restrictions on the non-fault driver's right *(a)* to choose a repairer and/or *(b)* to require the use of reasonable parts.[7] In practice, the non-fault insurer or other party managing the non-fault claim will often determine which garage is used and what parts are used (see paragraph 3.48).

- *Written-off vehicles*

3.17 A vehicle is deemed to be beyond economic repair (and hence a write-off) when:

- the estimated cost to repair the vehicle exceeds the pre-accident value of the vehicle less any costs which could be recovered from its salvage (the estimated salvage value); or

- the vehicle is so significantly damaged to render the vehicle unable to be repaired.

[7] In new cars, this could be to require OEM parts; in older cars, it might be deemed reasonable to use non-OEM parts.

3.18 The loss the non-fault driver sustains is the loss of the value of the vehicle at the time of the accident. The amount of compensation the non-fault driver is entitled to differs according to whether or not the customer retains the written-off vehicle:

(a) If the non-fault claimant does not retain the vehicle, they will receive the agreed pre-accident value of the vehicle as compensation.

(b) If the non-fault claimant retains the vehicle, they will receive the agreed pre-accident value of the vehicle less the actual or estimated salvage value as compensation. The non-fault claimant can then retain any salvage value they realise.

Consequential losses

- *Temporary replacement vehicle*

3.19 Case law has established the principles concerning the basis on which a non-fault claimant can recover the cost of hiring a temporary replacement vehicle and the amount of costs that can be recovered.[8] If a non-fault driver's vehicle is not driveable as a result of the accident or is temporarily unavailable (due to repairs), the loss the non-fault driver sustains is the loss of use of the vehicle. This is a loss which the claimant is required to mitigate. The courts have held that hiring a temporary replacement vehicle by the non-fault claimant is mitigation of the loss of use and the cost of hire of the vehicle will be the amount of damages recoverable for the loss of use of the vehicle.[9]

3.20 The entitlement to a temporary replacement vehicle is not automatic and the claimant is required to demonstrate the need for a replacement vehicle of the type hired.[10] In practice, 'reasonable need' is a relatively low threshold so it is unusual for a non-fault driver not to receive damages for the cost of a temporary replacement vehicle of the type hired.[11]

3.21 A temporary replacement vehicle may be hired on credit terms that defers payment, or on a direct hire basis where the non-fault insurer has paid for it (see paragraph 3.51). In either case, the non-fault claimant has incurred a loss and may claim the reasonable costs of hiring a temporary replacement vehicle as compensation for that loss.

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[8] See Bent v Highways and Utilities Construction and Or [2011] EWCA Civ 1384 at 29-41.
[9] Dimond v Lovell [2002] 1 AC 384 per Lord Hobhouse.
[10] Singh v Yaqubi [2013] EWCA Civ 23.
[11] Singh v Yaqubi discusses 'reasonable need' and the level of proof required. In that case reasonable need was not established by the claimant.

3.22 In the case of credit hire the amount the non-fault driver is able to recover depends on the claimant's financial circumstances. If the non-fault claimant is able to hire a car without credit terms, ie by paying in advance for the hire term, the claimant is said to be not impecunious and only the basic hire rate is recoverable.[12]

3.23 The basic hire rate is determined by the court in establishing the amount of damages to award. It is calculated either by reference to the published non-credit hire rates of the credit hire company or by evidence of the rates charged for the type of vehicle hired by other hire companies in the local area. The basic hire rate is not an average rate but the actual rate the court determines that the non-fault claimant is more likely than not to have paid.[13]

3.24 If the non-fault claimant is impecunious, ie unable to pay in advance for the hire term and has no choice but to hire on credit terms, the non-fault claimant is entitled to recover as damages for loss of use of the vehicle at the amount payable under the credit hire agreement.[14]

3.25 In all cases, however, the non-fault claimant is only able to recover 'reasonable costs'. The onus is on the at-fault insurer to prove that the sum claimed is not reasonable because the claimant had no need for the temporary replacement vehicle or the type hired was better than the claimant's own, the length of hire was too long or the claimant was not impecunious.[15] If the at-fault party is unable to discharge the onus of proof the non-fault claimant is entitled to recover the amount claimed.

3.26 Where a non-fault driver receives an offer of a replacement vehicle from the at-fault insurer, they do not have to accept it but, under tort law principles, it might be unreasonable to claim the cost of a replacement vehicle at credit hire rates if the at-fault insurer offered an equivalent replacement vehicle at a lower cost.[16] We note that under the ABI General Terms of Agreement between subscribing insurers and CHCs (the GTA (see paragraph 3.42)), insurers and CHCs agree not to intervene once a non-fault driver has been captured by another entity (referred to as the 'first to the customer' principle).

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[12] Lagden v O'Connor [2004] 1 AC 384
[13] Bent v Highways and Utilities Construction Ltd and Anor [2011] EWCA Civ 1384 at 41.
[14] Lagden v O'Connor ibid
[15] See Bent v Highways ibid.
[16] Copley v Lawn [2009] EWCA Civ 580. The at-fault insurer will have to demonstrate that sufficient information had been provided to the non-fault driver in order to allow the non-fault driver to make an informed decision whether to hire from a credit provider or to accept the offer from the at-fault insurer. In such cases, the non-fault driver will only be able to recover the costs which the at-fault insurer would have incurred had it provided the vehicle.

3.27 In the case where a non-fault insurer has provided and paid for a temporary replacement vehicle pursuant to the insurance contract, the non-fault claimant is still entitled to recover damages for loss of use of their own vehicle and the amount recoverable is the basic hire rate.[17,18] The non-fault claimant's policy will set out the circumstances where a temporary replacement vehicle is provided. In general, under such entitlements, the vehicle may not meet the like-for-like standard unless specific enhanced cover has been purchased as an add-on.

Claims management process

3.28 In this subsection we provide an overview of how the claims management process works in practice, applying the legal and regulatory framework described above. We set out how fault is typically established and describe the claims management process for at-fault and non-fault claims, including the provision of repairs and replacement vehicles and what happens in vehicle write-offs.

Establishing fault

3.29 The drivers involved in an accident may or may not know or agree at the time of the accident which driver is at fault. Insurers need to identify which driver is at fault in order to establish which insurer will ultimately pay for any resulting claims.

3.30 Based on our survey of non-fault claimants[19] we found that 68% of non-fault claimants made their first notification of loss or FNOL to their own insurer, 11% had first contact with the at-fault insurer, and 20% had first contact with another organisation such as a repairer, vehicle recovery provider or the police. We found that 84% of non-fault claimants were proactive and made the first contact, rather than being contacted by one of these parties.

3.31 The first step in establishing fault (and hence liability) will be by the claims handler at an insurer or broker.[20] 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, specialist claims handlers will conduct

[17] Bee v Jenson [2007] EWCA Civ 923 at 22.
[18] *Coles v Hetherton*, at 50. The court noted because provision pursuant to the contract of insurance was an exercise of a contractual right there was no duty to mitigate the exercise of that right.
[19] See Survey of non-fault claimants.
[20] We understand that most but not all brokers conduct an FNOL process.

a further investigation, which may include gathering witness statements or other evidence from the scene of the accident.

3.32 We found that, at FNOL, insurers on average established fault in 75% of cases; 20% of cases were categorised as split liability; and 5% of cases were not decided. Evidence from the ten largest motor insurers suggested that the categorisation of a driver as non-fault changed following FNOL in between 2 and 12% of cases.

At-fault claims

3.33 Claims by the at-fault party are handled pursuant to the provisions of the insurance contract. Repairs to the at-fault driver's vehicle are usually managed by the at-fault insurer, sometimes using an outsourced CMC. Most policies allow the owner to have their vehicle repaired at a repairer of their choice but the insurer retains a right to approve the repair estimate prior to the work being undertaken. Some PMI policies contain incentives for at-fault claimants to use the insurer's approved repairers, such as the provision of a courtesy car or the repairs only being guaranteed if the repair is carried out by an approved repairer, or the payment of an additional excess if a non-approved repairer is used.

Non-fault claims

3.34 Non-fault claims are resolved through the application of tort law principles and the way in which the claims are conducted will depend on the provisions of the insurance contract. Although the legal systems differ slightly between the UK jurisdictions (England and Wales, Northern Ireland and Scotland), we did not find that there were significant differences in relation to most elements of the claims management process.

Parties which may be involved in non-fault claims

3.35 Resolving a non-fault claim may involve several parties:[21]

(a) the non-fault driver is likely to contact their insurer or broker immediately after the accident, and/or might contact a repairer or car dealership;

(b) the non-fault driver might be contacted by the at-fault insurer in an attempt by the at-fault insurer to 'capture' the non-fault driver; and/or

[21] 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/CHCs, might contact the non-fault driver as a result of a referral from another party (eg from the non-fault insurer or broker, a repairer, a dealership, a vehicle recovery provider or the emergency services).[22]

3.36 In Section 6, we consider issues which can arise where there is a separation of cost liability and cost control, ie when services are provided to a non-fault claimant by their non-fault insurer or a CMC/CHC, but the cost of the services are paid for by the at-fault insurer.

Different claims management processes according to how claims are managed

- *Claims by a non-fault claimant managed by their own insurer*

3.37 A non-fault claimant may choose to contact their own insurer to manage their claim because *(a)* they are unaware or uncertain about their other options; *(b)* because fault has not been established and they only have the option of claiming under their own policy, at least initially; *(c)* they believe that it is most efficient and appropriate to use their own insurer, or *(d)* they do not wish to deal with the at-fault insurer or a CMC.

3.38 A non-fault claim managed by the non-fault insurer is likely to fall into one of three categories:

(a) *Liability is agreed rapidly.* If the customer has comprehensive insurance, the non-fault insurer will usually manage the claimant's repair and recover the damages from the at-fault insurer pursuant to the principle of sub-rogation (see paragraphs 3.7 to 3.8). Provision of a replacement vehicle by the non-fault insurer will depend on whether (i) the customer is entitled to one under their insurance policy; and/or (ii) the insurer has a bilateral agreement with the at-fault insurer to cover this provision. If there is no entitlement and no bilateral agreement, many insurers refer the non-fault claimant to a CHC. We found that, on average, 38% (a range of 10 to 81% across nine of the ten largest motor insurers) of non-fault drivers managed by a non-fault insurer received a temporary replacement vehicle under a credit hire agreement.[23] In these cases, the CHC will enter into a

[22] 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).
[23] The remaining drivers receive a courtesy car, a direct hire temporary replacement vehicle or do not require a replacement vehicle.

credit hire agreement with the claimant and the claimant will authorise the CHC to pursue the claim on the claimant's behalf with the at-fault insurer.

(b) *Liability is not agreed rapidly.* The fault insurer will usually manage the claim pursuant to the insurance contract whilst resolving the issue of liability with the insurer of the other driver. When liability is accepted or agreed, the non-fault insurer will recover the costs (in part if liability is split) from the at-fault insurer pursuant to the principle of subrogation (see paragraphs 3.7 to 3.8). During the period of uncertainty, the insurer may refer the claimant to a CHC for a replacement vehicle, but whether the CHC supplies one will depend on its own assessment of liability and whether it is willing to take the risk on recovery. Some CHCs only provide a replacement vehicle when liability has been agreed.

(c) *Referral to a CMC.* A non-fault insurer may refer a claim to a CMC, in which case the CMC will manage the claim and will seek to recover both repair and car-hire costs from the at-fault insurer. We found that only one of the ten largest insurers referred non-fault claims to a CMC and, even in this case, it was only some of these claims. A CMC is only likely to take on a claim if liability has been agreed or if there are strong reasons to believe the claimant was not at fault.

3.39 We found that some insurers treated a claim as a possible at-fault claim until liability had been agreed or, if liability was not agreed rapidly, until the claim had been settled with the at-fault insurer. We observed that this had two possible effects on the non-fault claimant: *(a)* a non-fault claimant might be asked to pay their policy excess, although in principle this could be recovered subsequently from the at-fault insurer; and *(b)* a non-fault claimant might temporarily lose their no claims bonus (NCB)[24] or be required to pay a higher PMI premium if their policy is renewed during this period. In both cases this caused additional losses to the non-fault claimant. However, if liability is subsequently agreed, the requirement to pay the excess may be waived (because the claims costs will be recovered from the at-fault insurer) and the NCB should be unaffected. Eight of the ten largest insurers told us that they usually waived the excess for non-fault claims. Where a non-fault claimant has MLEI, this insurer usually recovers any excess which has been paid on the claimant's behalf.

3.40 We noted that, even when liability was agreed, a non-fault claimant could still see an increase in their PMI premium following an accident. Insurers told us

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[24] A non-fault claimant's NCB may be temporarily lost when claiming under their PMI policy and subsequently reinstated following an admission of liability from the at-fault insurer or the recovery of the non-fault insurer's costs incurred in relation to the claim.

that many factors went into assessing risk and pricing policies and sometimes the fact of having had an accident might indicate that a driver is a higher risk than they otherwise would be. There is no compensation to a non-fault driver for this loss.

3.41 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 temporary replacement vehicle services to claimants was poor and often below a claimant’s legal entitlement. CHCs said that the emergence of credit hire had improved temporary replacement vehicle services significantly for consumers. We did not hear views to the contrary, though we were told by insurers that this higher level of service to non-fault claimants was now the norm, regardless of whether the service was provided by a CHC or by the at-fault insurer (ie on a captured basis).

3.42 The GTA is a voluntary non-binding protocol between a number of insurers and CHCs which sets out the terms, conditions and rates of credit hire for replacement vehicles provided to non-fault claimants. Nine of the ten largest insurers subscribe to the GTA and the Credit Hire Organisation told us that it estimated that approximately 80% of credit hire and credit repair claims were settled under the GTA.

- *Claims by a non-fault claimant managed by the at-fault insurer*

3.43 Because the at-fault insurer bears the cost of a non-fault claim, it has an interest in controlling these costs. Therefore, most insurers, when receiving an accident report from their customer, where they believe their customer is likely to have been at fault, will contact the non-fault driver directly in order to try to ‘capture’ the claim.[25] Our survey of non-fault claimants found that in 51% of cases when the non-fault driver did not contact their own insurer following a road traffic accident, the reason given was that the at-fault insurer had already contacted them.

3.44 When the non-fault claimant is captured by the at-fault insurer, the at-fault insurer will arrange repair services and for a temporary replacement vehicle to be provided, utilising their direct hire agreement with a car provider where they have one.[26]

[25] This is also sometimes called ‘third party intervention’.
[26] In Section 6 we discuss, among other things, whether the incentives faced by the at-fault insurer might lead to non-fault claimants receiving a lower quality of post-accident services than those to which they are entitled.

- *Claims by a non-fault claimant managed by a broker*

3.45 If a non-fault claimant purchased their PMI policy through a broker, they will often make 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 claims management services.

3.46 When the broker refers the non-fault claimant to a CMC/CHC, the CMC/CHC will typically arrange for repairs to be undertaken on a credit repair basis and for a temporary replacement vehicle to be provided on a credit hire basis. The CMC/CHC will pursue settlement of the claim with the at-fault insurer on the non-fault claimant's behalf.[27]

- *Other service providers*

3.47 A non-fault claimant may contact another service provider, such as the dealership from which they purchased the car, or a repairer or breakdown service. In such circumstances, the dealership or repairer would be likely to undertake the repairs itself but would typically refer the non-fault claimant to a CMC/CHC to manage the claim. The non-fault claimant may be provided with a courtesy car by the dealership or repairer or with a temporary replacement vehicle arranged by the CHC on a credit hire basis. The CMC/CHC will pursue settlement of the claim with the at-fault insurer on the non-fault claimant's behalf.

Non-fault vehicle repairs

3.48 Non-fault repairs are usually managed by the non-fault insurer, by a CMC or by the at-fault insurer (if the non-fault claim is 'captured'). Accordingly, the non-fault claimant might receive repair services from:

(a) a repairer of the non-fault claimant's choice (whether captured or not); or

(b) a repairer to which the non-fault claimant is referred by the non-fault insurer, the CMC or the at-fault insurer.

Insurers and CMCs often have an approved repair network, and some own a repair network. In most cases these repairers are non-exclusive but in some cases these repairers undertake work exclusively for the insurer or CMC concerned.

[27] Industry participants often refer to this process as 'making a subrogated claim' but in fact the CHC/CMC has no legal right of subrogation as they do not indemnify the claimant.

3.49 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 at-fault insurer and not be recovered in full. Repair cost estimates are usually prepared by estimating systems which calculate the hours required to complete a repair job, using manufacturers' or Thatcham[28] repair times, and specify the parts and paint needed in a repair and their cost. 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.[29]

- *Credit repair*

3.50 When a non-fault claimant has been referred to a CMC, the claimant may be offered repair on credit, ie the CMC will arrange for the repair to be carried out and the non-fault claimant's liability to pay is deferred. The claimant would, as part of the agreement, authorise the CMC to claim the costs of repair on their behalf from the at-fault insurer.[30] In this scenario, no policy excess is payable by the non-fault claimant and their NCB is not affected.

Non-fault temporary replacement vehicles

3.51 A temporary replacement vehicle is provided to a non-fault claimant either under a credit hire agreement or directly by an insurer:

(a) Under a credit hire agreement a hirer is liable for the cost of hire, deferred until the end of the rental period. The hirer authorises the CHC to pursue the hirer's claim against the at-fault party and to retain any settlement money paid to the hirer in order to settle the car-hire liability. The CHC typically provides the non-fault claimant with a like-for-like temporary replacement vehicle, subject to consideration of their need. The non-fault claimant is required to give a mitigation statement setting out the reasons why they require a like-for-like replacement vehicle.

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[28] Thatcham is a not-for-profit organisation whose main purpose is 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. (See Appendix 5.3, paragraph 27.)

[29] 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. The Auto Body Professionals 2012 yearbook reported that in October 2012 slightly more than 50% of repairers used the Audatex system

[30] 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 at-fault insurer. However, we understand that CMCs rarely seek to recover costs from non-fault customers.

(b) Alternatively, a temporary replacement vehicle may be provided to the non-fault claimant, either by the at-fault insurer (when captured) or by the non-fault insurer (where it has a bilateral agreement with the at-fault insurer or it is the same insurer on both sides). The insurer would usually contract with a car hire company, such as Enterprise, to supply the car. We refer to this as direct hire. Under direct hire, the car hire company requires the claimant to sign a contract covering matters such as charge for keeping the car beyond the period for which the insurer has agreed to pay, damage to the vehicle during the period of hire and fuelling (eg if the car is returned with less fuel than when hired). The car hire company may take a credit card authorisation or payment as security.[31] Instead of arranging a direct hire vehicle, an insurer may in some circumstances arrange for a non-fault claimant to receive a courtesy car from its authorised repairer.

Non-fault write-offs

3.52 When a vehicle is written off, a non-fault claimant can elect to either 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 loss the non-fault claimant has sustained when the vehicle is written off is its pre-accident value. The amount of compensation received, however, differs according to whether or not the customer retains the written-off vehicle:

(a) If the non-fault claimant does not retain the vehicle, they will receive the agreed pre-accident value of the vehicle as compensation.

(b) If the non-fault claimant retains the vehicle, they will receive the agreed pre-accident value of the vehicle less the actual or estimated salvage value as compensation. The non-fault claimant can then retain any salvage value they realise.

3.53 Non-fault insurers and CMCs will seek to recover from the at-fault insurer the agreed pre-accident value and any other charges they incur (eg vehicle storage and collection costs), less the actual or estimated salvage value.

3.54 In an at-fault claim (and in some own-insurer non-fault claims), the at-fault claimant will receive a payment in accordance with *(a)* or *(b)* above, as applicable, less the amount of the excess in their PMI policy.

3.55 We discuss vehicle write-offs in more detail in Appendices 5.2 and 6.3.

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[31] Enterprise told us that it ran the customer's consent as a £1 charge. It did this when a customer was not required to pay the rental charges in advance, as applied in both a credit hire and a direct hire scenario.

4. Market definition

Introduction

4.1 In this section we set out our approach to market definition.[1] Our guidelines state that defining the market helps to focus on the sources of any market power and provides a framework for the assessment of the effects on competition of features of a market. However, market definition and the assessment of competition are not distinct chronological stages of an investigation but rather are overlapping and continuous pieces of work, which often feed into each other.[2]

4.2 A market is a collection of products provided in particular geographic areas connected by a process of competition. The process is one in which firms seek to win customers' business over time by improving their portfolios of products and the terms on which these are offered, so as to increase demand for them. The willingness of customers to switch to other products is a driving force of competition. In forming our views on market definition, we therefore consider the degree of demand substitutability. In some markets, supply-side constraints will also be important.[3] Market definition in a market investigation flows from the statutory questions the investigation is required to address. Markets defined in the context of answering other statutory questions, or under other regimes, may not therefore be comparable.[4]

4.3 Our guidelines also state that market definition is a useful tool, but not an end in itself, and that identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of our competitive assessment of a market in any mechanistic way. The competitive assessment takes into account any relevant constraints from outside the market, segmentation within it, or other ways in which some constraints are more important than others.[5]

4.4 Our terms of reference refer to the supply or acquisition of PMI and related goods or services. In the remainder of this section, we consider first the appropriate market definition for PMI. We then turn to the related goods and services. We consider there to be two main categories of related goods and services relevant to our investigation: PCWs and post-accident services.

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[1] The 'relevant market' is defined in the Act to mean the market for the goods or services described in the terms of reference given to the CMA for investigation. However, the market definition(s) used by the CMA need not correspond with the 'relevant market(s)' (see *Guidelines for market investigations: their role, procedures, assessment and remedies, CC3*, April 2013 (*CC3*), paragraph 26).
[2] *CC3*, paragraphs 94 & 132.
[3] *CC3*, paragraph 130.
[4] *CC3*, fn 74 (paragraph 132).
[5] *CC3*, paragraph 133.

Private motor insurance

4.5 There are normally two dimensions to the definition of a market: a product dimension and a geographic dimension. We consider each of these aspects below.

Product definition

4.6 We discuss first whether the market is wider than PMI and then consider whether it is narrower.

Whether the market is wider than motor insurance

4.7 As noted in Section 3, third party PMI is a legal requirement, and consequently there are no demand-side substitutes. We also noted that a change in average PMI premiums could only affect market demand if it induced changes in the number of vehicles insured (eg an increase in price might discourage some drivers from owning their own vehicle and encourage them to share or hire a vehicle as needed). However, as the cost of PMI is, on average, a relatively small part of the total annual cost of driving, we considered that this effect was likely to be weak. Insurers supported this view. Overall we found that the market demand for PMI was likely to be price inelastic. This suggested that the market is no wider than PMI.

4.8 Our guidelines state[6] that the composition of a relevant market is usually determined by the degree of demand substitutability, but that the CMA will, where relevant, include supply-side factors in defining the market (see paragraph 4.2). The guidelines note that there might, for example, be a possibility that firms supplying non-substitute products have the capabilities and assets to redirect production to goods and services which would be substitutes for those in the market. Our terms of reference refer specifically to PMI and thus exclude insurance of commercial and public service vehicles, and motorcycles. We considered whether the market included insurance of commercial and public service vehicles and/or motorcycles but found that the conditions of competition for these types of insurance appeared to be different from PMI. We observed that there are many specialist providers for these types of insurance and, in our view, it was unlikely that they would have the capabilities and/or assets to switch to the provision of PMI in a way which would impact significantly on the sale of PMI.

4.9 For these reasons, we concluded that the market was not wider than PMI.

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[6] *CC3*, paragraph 134.

Narrower markets

4.10 We also considered whether the market should be defined more narrowly according to the type of cover, the type of seller (direct or via a broker) and certain risk factors.

- *Cover type*

4.11 There are three types of basic PMI cover: third party only; third party, fire and theft; and comprehensive. We observed that the first two types of cover had decreased in importance over recent years and were now mainly relevant to the highest-risk drivers. However, we found that PMI providers generally competed across all three cover types and we concluded that all three cover types were in the same market.

4.12 In addition to basic cover, PMI policies may include optional additional covers, eg motor legal expenses insurance (MLEI), windscreen cover, breakdown cover and NCB protection. We discuss such add-ons in Section 7. We noted that the cover provided by add-ons could be included in the basic PMI cover and that the practice of insurers varied, with the basic PMI of some insurers including covers which other insurers only sold as an add-on. We also noted that the most commonly purchased add-ons could be compared on PCWs, though there were limitations to such comparisons (see Section 7). Generally, we did not find grounds for defining a separate market for add-on products and therefore we included them in the PMI market. This view did not affect our competitive assessment of add-ons in Section 7.[7]

- *Type of seller (direct insurers and brokers)*

4.13 PMI can be purchased directly from an insurer or via a broker (see Section 2). Therefore, we considered whether the market should be defined according to the type of seller.

4.14 Brokers sell PMI to consumers on behalf of a panel of insurers. The broker chooses the most suitable policy for the consumer and provides a quote to the customer on that basis.

[7] PMI add-ons have some similarity with secondary, or aftermarket, products (products purchased only as a result of the customer having purchased a primary product). Our guidelines state that the CMA may sometimes consider primary and secondary products to be in separate markets; but we may also consider the products to be in the same market where customers take into account the cost of the secondary product when purchasing the primary product; and that whichever of the two definitions is chosen will not determine the outcome of the CMA's competitive assessment, since the competitive constraint from other suppliers will be taken into account in either case. See *CC3*, paragraph 144.

4.15 We observed that many brokers operated similarly to direct-selling insurers, ie selling to consumers through their own websites, PCWs and over the phone. Some brokers also used local retail outlets from which they made sales in person, but this sales channel was in decline as more sales were made remotely. (We discuss geographic market definition, including the relevance of local outlets, below (see paragraph 4.20).)

4.16 Given the similarities in how brokers and direct-selling insurers reach consumers, we concluded that they competed with each other in the sale of PMI. We did not define separate markets for PMI sold directly and sold through brokers.

- *Risk factors*

4.17 PMI suppliers' prices are tailored to each prospective customer, with the price depending on the driver's risk factors, such as their age, number of previous accidents, number of years of driving, occupation, address, where the car is kept overnight, etc. However, drivers are typically able to obtain quotes from a number of different suppliers and suppliers compete across a broad range of risk factors. We noted that it was difficult to divide drivers into any distinct risk groups as insurers assessed risks differently.

4.18 We found that it was not necessary for the purposes of our competition analysis to define separate markets according to the different risk factors and, for this reason, we did not do so.

Geographic definition

4.19 Our Guidelines state that geographic markets may be based on the location of suppliers and defined as an area covering a set of firms or outlets which compete closely because enough customers consider them to be substitutes.[8]

4.20 Some brokers use retail outlets to sell PMI (see paragraph 4.15), and we observed that at least one direct-selling insurer had some retail outlets too.[9] We noted that the prices obtained through suppliers with local outlets could differ from those obtained through other PMI suppliers (ie those selling online or by telephone),[10] but we also noted that the customers of local outlets could check prices via PCWs even if they purchased from their local outlet. For this reason, while we recognised that suppliers with outlets in a particular local

[9] AXA in Northern Ireland.
[10] Direct-selling insurers and larger national brokers set their own prices and the prices charged by insurers selling through smaller regional brokers could depend on the commission rates agreed.

area were likely to compete with each other, we believed they were also likely to face competition from other PMI suppliers selling remotely. We did not see evidence that the competition from other PMI suppliers was so weak against suppliers with local retail outlets in a particular area or region to indicate that any local region or area should be regarded as a separate market.

4.21 Although the location where a car is kept is one of the risk factors which affects PMI prices, we found that competition between PMI suppliers is across drivers with a broad range of risk characteristics. Therefore, just as we found that it was not necessary for our competition analysis to define separate markets according to individual risk factors (see paragraph 4.17), we also found that there was no basis for defining local markets on the basis of one of those risk factors.

4.22 For these reasons, we concluded that the appropriate geographic market for our assessment of PMI was national rather than regional or local.

4.23 We saw some reasons for considering that competition in Northern Ireland operated differently from the rest of the UK and we carried out a separate analysis of competition in Northern Ireland pursuant to one of our theories of harm (see Appendix 5.4). We did not reach a final view on whether there was a separate PMI market in Northern Ireland but we did not believe that such a view was necessary for the remainder of our analysis which was relevant to both Great Britain and Northern Ireland.

PCWs

4.24 A PCW is an Internet platform which facilitates the buying and selling of, among other things, PMI.[11] A PCW provides consumers with a means of comparing PMI policies and provides suppliers with sales opportunities (both directly via click-through from a PCW, and indirectly through consumers contacting a supplier after researching policies on a PCW). A PCW therefore has two groups of users: consumers searching for PMI and PMI suppliers (insurers and brokers).

4.25 A characteristic of a platform is that it has more than one group of users, and demand from each group depends on demand from the other. In the case of a PCW, demand from consumers of PMI depends on the number of PMI suppliers whose prices are quoted on the PCW; and demand from PMI suppliers depends on the number of PMI consumers using the PCW. When a

[11] We use the term 'PCW' to describe a price comparison website which compares the prices of PMI. Generally, websites which only compare prices of other products are not included when we use the term 'PCW'.

number of platforms compete with each other, the resulting market is often described as two-sided. PCWs are therefore potentially a two-sided market.

4.26 PCWs are paid by suppliers of PMI according to the number of policies bought which can be traced back to having been sourced by the PCW. Principally this is via click-through from the PCW, but some sales made directly with the insurer by telephone or online might also be captured if it can be shown that the customer found the policy on a particular PCW. PCWs make no charge to consumers for use of their websites, though we observed that some PCWs offer inducements to consumers (eg a free product, such as a cuddly toy), which is in effect a negative price.

4.27 In defining the relevant product market, we considered whether PCWs were a market separate from PMI. We considered both demand- and supply-side substitutes.

4.28 With regard to the demand side, we considered two possible substitutes: individual searching on the Internet without a PCW, and using a broker.

4.29 A possible substitute for searching via a PCW would be for consumers to search across the individual websites of PMI suppliers. However, we found that this was likely to be more difficult and much more time-consuming than using a PCW because consumers would need to be aware of the offers of each individual supplier. We noted that, whilst a PMI supplier's own website could compete with PCWs to attract customers of PMI, a PMI supplier would need to engage in a high level of advertising and promotional activity to ensure that consumers included its website in their search.

4.30 We also found that, although some PMI suppliers had brands which were not quoted on PCWs and which competed to attract consumers directly to the supplier, the owners of these brands also had other brands which were quoted on PCWs. This confirmed the importance of PCWs to the sale of PMI. We concluded that, although the unlisted brands competed with PCWs to some extent, the constraint the supply of PMI through these brands had on PCWs was not sufficiently strong to prevent PCWs from being a separate market.

4.31 For these reasons, we concluded that individual searching for PMI not using a PCW was a poor substitute for using a PCW, and searching without a PCW was a not sufficiently strong constraint on PCWs to prevent PCWs from being a separate market.

4.32 We considered whether using a broker to search for PMI was a possible substitute for a PCW. A broker provides a service which is similar to that of a PCW in that a broker compares the policies and prices of a number of different motor insurers; however, the services are also very different as a broker's comparison usually involves far fewer insurers than a PCW comparison, and, whereas a PCW simply presents the results to a consumer, a broker seeks to make a recommendation. We also found that many brokers quoted on PCWs as a way of reaching customers. For these reasons, we concluded that the supply of PMI by brokers was not a sufficiently strong constraint on PCWs to prevent PCWs from being a separate market.

4.33 On the supply side, we considered whether there were websites which did not currently compare PMI but which would be able to redirect their capability and assets to such a comparison, and could therefore be regarded as supply-side substitutes. We found that several websites which were known for offering related services (eg Google for general search, uswitch for energy prices and Moneyfacts for savings and loans) all offered PMI comparisons already and thus were in the PCW market, though they represented only a small share of this market. We concluded that, even if there were other significant websites in similar areas which did not currently compare PMI (and we saw no evidence that there were), the small market share of the websites we identified suggested that others would be unlikely to have the capabilities and assets to compete significantly in PMI in the near future (we discuss the possibility of significant new entry into the PCW market in Section 8). We therefore concluded that supply-side substitution was unlikely to be a significant constraint on PCWs and PCWs were a separate product market.

4.34 One party (BGL) disagreed with our defining PCWs as a market, stating that our approach was inadequately developed, unsupported by economic analysis and unreflective of the various alternative mediums through which PMI is actually advertised and distributed. We have set out above the economic analysis underlying our defining PCWs as a market. We have noted that direct sale to consumers by insurers and brokers is a constraint on PCWs but not a sufficiently strong one to prevent PCWs from being a separate market.

Geographic definition

4.35 PCWs operate across the UK. We found that there were some PCWs concentrating on Northern Ireland but that use of PCWs was lower in Northern Ireland than elsewhere in the UK. We did not find it necessary to reach a final view on whether the PCW market in Northern Ireland differed from the rest of the UK because, as with PMI, we did not find that this issue affected our analysis which was relevant to both Great Britain and Northern Ireland. We therefore concluded that the relevant geographic market for our assessment of PCWs was national across the UK.

Post-accident services

4.36 After an accident has occurred, the affected parties may make claims against one or more insurers. These claims must be assessed and appropriate restitution or compensation arranged. All insured drivers have third party cover, such that the non-fault driver who makes a claim against the at-fault driver will have their costs paid by the at-fault driver's insurer. The vast majority of UK drivers (about 92%) have comprehensive PMI which covers the risk of damage to the policyholders' own vehicle in an accident even if the driver is at-fault. One of the most important costs incurred by insurers is that of meeting the claims against them after accidents occur. The cost of post-accident services is therefore part of the supply chain for PMI and the efficiency with which these services are supplied affects the expected cost of providing PMI and hence the price of PMI. Motor insurers may compete by offering an attractive claims service to their customers and by seeking to control the costs of the claims for which they are liable.

4.37 The main post-accident activities are claims management, repairs, temporary replacement vehicle provision and salvage. These activities are relevant to our investigation principally in relation to the separation of cost liability and cost control and the possible underprovision of services to those involved in accidents (see Sections 5 and 6).[12] For this reason, although we considered the market definition for each area, we did not believe it necessary for our investigation to define specific markets associated with each activity. For the purposes of our investigation, the relevance of each activity was as part of the supply chain of PMI.

Claims management

4.38 We found that most insurers manage their claims themselves, particularly in relation to at-fault claims and the repair element of non-fault claims. However, some insurers outsource the management of their claims, or one or more elements of their claims,[13] to a CMC. Brokers, repairers, dealerships, break-down companies and others also refer suspected non-fault claimants to CMCs,[14] and non-fault claimants may engage a CMC directly (see Section 3). We observed that CMCs competed for outsourced business from insurers and for customer referrals. This suggested to us that there was a broad claims management market, including both insurer-outsourced claims management

[12] We are not considering compensation for personal injury (see Section 1).
[13] An insurer's claims would include claims from its policyholders who were at fault in accidents; from those otherwise claiming on their own insurance; and from those non-fault in accidents, who have asked it to manage their claims.
[14] Non-fault insurers may also refer non-fault claims to a CMC, rather than manage them in-house. One of the ten large insurers told us that it refers some of its non-fault claims to a CMC, and smaller insurers may also do so.

and claims management directly for claimants. We did not see evidence that insurers were competing for other insurers' outsourced claims management.

Repairs and salvage

4.39 Claimants are entitled, either under tort law (when non-fault) or the terms of their policy (if a comprehensive policy), to be compensated for their property damage, either by their car being repaired or, when this is not possible or economic (ie when the car is written off), by a financial payment. The repair is usually arranged by the insurer or the CMC managing the claim.

4.40 Some insurers operate their own repair network, but most repairs are carried out by independent repairers. We observed that all insurers use independent repairers to some extent even if they have their own repair business. All large insurers and CMCs have a network of independent repairers to which they refer repair jobs on pre-agreed terms.

4.41 Post-accident vehicle repair requires several input products including parts, paint and cost estimation systems, and where insurers use independent repairers, they may impose requirements on the specific input products used. Often this is because the insurer or CMC has negotiated discounts or rebates with the input supplier for the use of their product. If claimants request it, an insurer or CMC may agree to the repair being carried out by a repairer of the claimant's choice (eg a manufacturer's franchised dealership or a local, trusted repairer). In such cases, the insurer or CMC will approve a quote for the proposed repairs before work begins.[15] The National Association of Bodyshops (NAB) told us that insurance work accounted for about 80% of all repair work carried out by repairers.[16]

4.42 It appeared to us that competition between independent repairers was across both insurance and non-insurance work and that independent repairers competed with insurers' owned repair networks for insurance work. We therefore concluded that the repair market was likely to include both independent and in-house repairers, and non-insurance as well as insurance work.

4.43 When a car is written off, it is sold for salvage (unless the claimant wishes to retain the damaged vehicle). The insurer or CMC usually sells the car to a salvage firm, and the salvage firm arranges either the break-up of the car for parts and/or scrap metal or its sale to a dealer or private individual.[17] This

[15] Under tort law, non-fault claimants are able to arrange repair themselves and send the bill to the at-fault insurer.
[16] This excludes credit repair work (see Appendix 5.3, paragraph 14).
[17] Under a voluntary code of practice supported by the ABI and a number of other organisations, insurers categorise write-offs into one of four categories: A – scrap only; B – break for spare parts if economically viable;

process can involve several parties (see Appendix 6.3). We did not find it necessary for the purposes of our investigation to reach a view on the appropriate market definition in relation to salvage.

Temporary replacement vehicle provision

4.44 Tort law has established that a non-fault claimant is entitled to a temporary replacement vehicle that is broadly equivalent to their own car while their car is unavailable (eg being repaired), subject to the non-fault claimant's duty to mitigate their loss with consideration to their need. Sometimes a courtesy car from the repairer is sufficient but, in order to provide a 'like-for-like' car, or in the case of a write-off, a hire car is often provided. Some at-fault claimants are entitled under their PMI policies to an enhanced courtesy car while their own car is repaired and may also be provided with a hire car.

4.45 A distinction may be drawn between direct hire, which is when a car is provided to a claimant under a pre-agreed contract between the provider and an insurer with agreed rates and settlement dates, and credit hire, which is when the hire company provides the car on credit to a suspected non-fault claimant, with payment only being made if and when the non-fault claimant's claim against the at-fault insurer is settled. We noted that this distinction was at the centre of the issues referred to us, relating to the separation of cost liability and cost control (see Section 6). However, since it was the distinction between credit hire and direct hire which was relevant to our investigation, rather than the extent of competition within each of type of hire, we did not see a need to define separate markets for each type of hire. We also found that many suppliers provided both credit hire and direct hire. In addition, we noted that consumers hired cars for reasons unrelated to accidents and it appeared relatively easy for any car hire firm not currently supplying post-accident replacement vehicles to start doing so, ie there was significant supply-side substitutability.

Conclusion on market definition

4.46 The markets which we found to be relevant to our assessment of competition were:

C – repairable total loss vehicles where repair costs exceed the vehicle's pre-accident value; D – repairable total loss vehicles where repair costs do not exceed the vehicle's pre-accident value (eg constructive total losses, vehicles replaced under 'new for old' schemes (say 60% damage) which would not otherwise have been treated as total losses). Under the code of practice, categories A and B vehicles should not be sold on, but categories C and D vehicles may be sold on.

(a) a PMI market (including both basic insurance and add-ons), where insurers and brokers compete to supply PMI to consumers; and

(b) a PCW market, which is a two-sided market where PCWs provide comparisons between PMI policies to consumers and sales opportunities to insurers and brokers.

4.47 In relation to post-accident services, we noted that the main activities relevant to our investigation were claims management, repairs, car hire and salvage. We did not find it necessary for our investigation to define the specific markets associated with each of these activities, as their relevance to our investigation arose from them being part of the supply chain for the PMI market.

4.48 We found that in all product markets the relevant geographic market was national.

5. Theories of harm

Introduction

5.1 This section describes our theories of harm, which provided us with a framework for our analysis. We identified five broad theories:

(a) harm to the efficient provision of post-accident services to non-fault claimants arising from the separation of cost liability and cost control in such claims;

(b) harm to the quality of post-accident service provision arising from the beneficiary of services being different from, and possibly less well informed than the insurer or CMC which is the procurer of those services;

(c) harm due to horizontal effects (market concentration);

(d) harm arising from PMI providers' strategies to soften competition; and

(e) harm arising from vertical relationships (including vertical integration).

5.2 None of the areas of harm we identified were mutually exclusive. There were clearly some interrelations between the different theories, and we have sought to indicate these interrelations where they arise.

5.3 In the remainder of this section, we describe our analysis of each of the theories of harm, where appropriate referring forward to sections of the report setting out in more detail our analysis of adverse effects on competition (see Sections 6 to 8).

Theory of harm 1: separation of cost liability and cost control

5.4 A PMI customer may make a claim if they have had or have been involved in an accident.[1] In relation to non-fault claims, tort law gives the non-fault party the right to be put back into their position prior to the accident, with the cost borne by the at-fault party (usually covered by their insurance). One effect of this market structure in relation to non-fault claims is that a basic incentive mechanism of competition in many markets is not present as the party paying for the service is not the party receiving its benefits.

5.5 Non-fault claimants, or the procurers of services for non-fault claimants,[2] do not face any ordinary budget constraint which would lead them to weigh up

[1] PMI policies also cover fire and theft, although these are not the focus of our investigation.
[2] For example, insurers of non-fault claimants (if different from the insurer of the at-fault claimant) or CMCs or credit hire/repair companies.

the pros of additional service against the cons of additional cost. As discussed in Section 3, the courts effectively cap claims to 'reasonable costs', which is a level to be assessed from the position of the individual non-fault claimant. This means that it is not relevant, for example, whether the cost of repair was or could have been lower by virtue of the service provider's bargaining power. 'Reasonable costs' may be higher than those actually incurred by non-fault insurers and CMCs in the provision of services to non-fault claimants, which provides an opportunity for non-fault insurers and CMCs to profit from non-fault claims.

5.6 We examine this theory of harm in Section 6, considering the provision of temporary replacement cars, repairs and compensation for written-off vehicles.

Theory of harm 2: possible underprovision of services to claimants

5.7 We identified as a theory of harm the possibility that claimants might not get post-accident services of the quality to which they are entitled because:

(a) Claimants may not be sufficiently well informed to judge whether they receive the quality of service to which they are entitled either because they are not aware of their legal or contractual rights, or because they do not have the technical skills to assess the quality of the service they have received.

(b) Insurers and CMCs procuring repairs, replacement cars and write-offs do not necessarily have the incentive to ensure that claimants get the quality of service to which they are entitled.

5.8 We discuss these two elements in turn and then present our assessment.

Claimants' awareness of their rights and ability to assess service quality

Awareness of rights

5.9 Our survey of non-fault claimants suggested that claimants tended not to be fully aware of their legal rights under tort law. For example, when told that 'legally, as the non-fault party to an accident your legal right was to be restored to your pre accident position and while your vehicle was being repaired or replaced to have a like-for-like replacement vehicle subject to you having a need for such a vehicle', 62% of respondents who could remember said that they were not made aware of any of these rights, and a further 10%

said that they were made aware of only some of them.[3] Respondents were aware that they were entitled to have their car repaired and 76% were aware that they were entitled to a replacement car while their car was unavailable[4] but, beyond this, understanding was limited. For example:

(a) Non-fault claimants are legally entitled to have the car repaired at a repairer of their choice,[5] but only 33% of all respondents said that they thought this was the case (though it was higher (61%) when an organisation other than an insurer handled the claim).[6] 45% said that they thought they were entitled to have their car repaired at a repairer of the insurer's choice and 20% said they did not know their entitlement.

(b) 76% of respondents said that they were entitled to have a replacement vehicle while their car was unavailable, but only 49% of respondents knew that they were entitled to a replacement car that met their needs but was not better than their own car. 14% of respondents[7] thought they were entitled to a replacement which was the same make and model as their own vehicle damaged in the accident (which could exceed the legal entitlement and depended on the non-fault claimant's need). 13% thought the replacement vehicle could be any vehicle depending on what was available at the time or was a particular vehicle specified in their insurance policy. 24% of respondents thought they were not entitled to a replacement vehicle at all.

5.10 The rights of an at-fault claimant depend on their insurance contract. As an at-fault claimant can therefore refer to their insurance policy to be informed of their rights at any time, we did not investigate the awareness of such claimants of their contractual entitlements.

Ability to assess service quality

5.11 We considered whether, during or after receiving a post-accident service, claimants were able to assess the quality of service they received. If claimants were able to assess the quality of service, they could ask for any performance issues to be addressed, but if they were unable to assess quality, eg for technical reasons, they would be unable to get problems rectified. It appeared

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[3] Figures in this paragraph are expressed as a percentage of respondents, excluding 13% who responded 'Don't know' or 'Can't remember'. See survey report (question D30).
[4] The figures in this paragraph are expressed as a percentage of all respondents. See survey report (questions D28 and D29).
[5] In practice, claimants often delegate the management of the repairs to a third party (non-fault insurer, at-fault insurer or intermediary) who then selects the repairer on behalf of the claimant.
[6] 36% of respondents whose claim was handled by the at-fault insurer and 29% of respondents whose claim was handled by the non-fault insurer said that they were entitled to have the car repaired at a garage of their choice.
[7] Excludes some respondents who also answered that they were entitled to a replacement vehicle that met their needs but was not better than their car.

to us that the area in which this was most likely to be an issue was with regard to repairs as the quality of non-cosmetic repairs might be hard for many consumers to assess. However, we noted that, if consumers were unable to assess repair quality, this would be an issue for all car repairs and would not be specific to post-accident PMI repairs.

Incentives and reputation effects

5.12 Generally, insurers and other organisations managing claims have a short-term incentive to minimise their costs. For non-fault claims, this is not the case if the actual cost is recovered from the at-fault insurer, but if the amount recovered is based on what is reasonable for the service provided and not on the amount actually incurred (see paragraph 5.5), the incentive to minimise costs will still apply.

5.13 We distinguished three main categories of claim, according to the party managing it:

(a) *Claims managed by the insurer with cost liability.* In these cases, the insurer has both the ability and incentive to minimise its costs. Claims in this category include at-fault claims, claims where liability cannot be established and non-fault claims managed by the at-fault insurer (ie captured claims or claims where the insurer insures both the non-fault and at-fault party).

(b) *Non-fault claims managed by the non-fault insurer.* In these cases, the non-fault insurer does not have liability for the costs which are claimed from the at-fault insurer but might still have an incentive to minimise its own costs in order to maximise the difference between the reasonable cost claimed and the actual cost incurred (see paragraph 5.12). Sometimes non-fault insurers claim from the at-fault insurer the actual costs incurred (net of all discounts, rebates and referral fees), eg if there is a bilateral agreement between them, and in such circumstances the insurer might have less incentive to minimise its costs.[8] Insurers told us that they managed repairs similarly irrespective of whether they were non-fault, captured or at-fault repairs, suggesting that cost control was important for all insurer-managed repairs.

(c) *Non-fault claims managed by CMCs.* Claims in this category are similar to non-fault claims managed by non-fault insurers (except that CMCs are not

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[8] There are two types of bilateral agreement: full bilateral agreements, which cover relatively few claims, and RIPE agreements, which are quite common.

party to bilateral agreements). Thus, similarly to non-fault insurers, CMCs generally have the incentive to control their own costs.

5.14 If claimants are unaware of their rights and are unable to assess repair quality, it is easier for insurers and CMCs to reduce quality below the standard to which the claimant is entitled. If insurers and CMCs have the incentive to minimise their own costs, they have an incentive to provide a service which is cheaper, and this might lead them to provide lower quality repairs. However, we recognised that the short-term incentive to minimise costs, with the effect of reducing quality, might be mitigated by reputational effects. Any deficiency in quality might eventually be revealed, leading an insurer or CMC to acquire a reputation for poor service and making it less attractive to customers in the future. If the quality of a PMI provider's claims service was taken into account by consumers when purchasing insurance, this would provide insurers with an incentive to maintain service quality.

Assessment

5.15 We did not find evidence of any systematic underprovision in relation to replacement cars or write-offs (see Appendices 5.1 and 5.2). We considered repairs in more detail, as summarised below. Our detailed analysis of this issue is presented in Appendix 5.3.

5.16 Several insurers told us that reputational effects meant that insurers had a strong incentive to provide a high quality of service. However, although we recognised that some consumers might take into account an insurer's reputation for claims service when purchasing PMI, we did not see evidence that this was the case generally. Therefore, we did not agree that reputational effects were sufficiently important to exclude concern about post-accident repair quality.

5.17 Several insurers pointed to evidence that they were concerned with the quality of repair, in particular by emphasising the importance they attached to compliance with PAS 125.[9] However, it appeared to us that PAS 125, while valuable, focused on procedures and processes, and compliance with PAS 125 did not, on its own, ensure that a repair was adequately performed. In our view, while ensuring that repairers complied with PAS 125 was valuable, it appeared to us that some insurers placed undue reliance on compliance with PAS 125 to ensure adequate repair quality standards. We did not believe that compliance with PAS 125 removed the need for insurers and CMCs to

[9] See Appendix 5.3 paragraphs 21–29, and Annex A.

monitor and audit repair quality in order to ensure that repairs were adequately performed.

5.18 We found that most insurers did audit their repairers and in most, but not all, cases, these audits covered quality. However, we observed that the main purpose of these audits was to control costs rather than to ensure a high quality of repair. We also found a mixed picture with regard to the ongoing monitoring of repair quality: some insurers did monitor repair quality (though some of these only started doing so recently), some did not, and in other cases the position was unclear. Overall, we concluded that some insurers were not monitoring and auditing repair quality sufficiently to ensure that cars were repaired to their pre-accident condition and that some insurers left it largely and unduly to claimants to identify repair deficiencies.

5.19 We recognised that most insurers and CMCs provided warranties on the repair work performed. However, it appeared to us that, for repairs where the claimant was unable to assess the quality of repair, the provision of a warranty was not on its own sufficient to ensure that all aspects of a repair had been performed adequately.

5.20 Overall, we concluded that the measures taken by insurers and CMCs to ensure repair quality (eg PAS 125 accreditation, audits, monitoring and the provision of warranties) were unlikely always to be sufficient to ensure that cars were repaired to their pre-accident condition.

5.21 Some repairers told us that excessive pressure on costs could be leading to 'cutting corners' on repairs, and some provided us with examples of where this might be the case. Several repairers told us that the industry needed to be 'rebalanced' away from the large insurers and CMCs, which dictated the terms under which repairers had to operate. However, many repairers told us that they would never compromise on quality, in particular if it related to safety. Overall, given the limited examples provided and the interest of the repairers represented in their views, we found it hard to assess this evidence and attached limited weight to it.

5.22 Evidence from consumers, for example in our survey of non-fault claimants, suggested that consumers generally believed, in the vast majority of cases, that their vehicles were repaired to their pre-accident condition. However, given the technical nature of many repairs, we believed that many consumers might not be able to make this assessment accurately.

5.23 In order to assess post-accident repair quality, we commissioned an independent study of a sample of repairs by MSXI. The results suggested that the proportion of cars not repaired to their pre-accident condition was considerably higher than suggested by consumers themselves. Nevertheless, the interpretation of the MSXI results was subject to a number of uncertainties, including around the size and representativeness of the sample and the impact any defects would have on vehicle values (which was relevant to the size of any detrimental effect on consumers). In light of these uncertainties, we found on balance that we could not place much weight on the findings of the MSXI study in reaching our conclusions on this theory of harm.

5.24 Overall, considering all the evidence on this issue together, we concluded that there was insufficient evidence of a detrimental effect on consumers for us to find that poor quality of repair had an adverse effect on competition.[10]

5.25 Nevertheless, as noted in paragraph 5.18, we continued to believe that some insurers were not monitoring repair quality sufficiently to ensure that vehicles were repaired to their pre-accident condition and some insurers and CMCs left it largely and unduly to claimants to identify repair deficiencies. Although not finding an AEC under this theory of harm, we hoped that by having shone a light on industry practices and by having made these observations we might have encouraged insurers and others involved in managing repairs to improve the ways in which they ensure that consumers receive the repairs to which they are entitled.

Theories of harm 3 and 4: harm due to horizontal effects and providers' strategies to soften competition

5.26 We considered the effectiveness of competition in both the PMI market and the PCW market. We discuss each in turn.

Competition between PMI providers

Concentration and profitability

5.27 There are many active suppliers of PMI products in the UK. A typical search on a PCW can yield as many as 100 quotes (by brand) from over

[10] In our provisional findings, we attached more weight to evidence from repairers and the MSXI study suggesting that cars were being repaired to below pre-accident standard. In the light of responses received, we revised our view, as set out in our working paper 'Revised evaluation of the possible underprovision of post-accident repair services (theory of harm 2)'.

50 providers.[11] No single insurer has a particularly large share of the market. Concentration levels are therefore low.[12]

5.28 The ten largest private motor insurers provided us with their financial data for the five years ended 31 December 2012, which we used to estimate their profitability. On average over the period, PMI activities alone were loss-making. Across the five-year period, the unweighted average claims ratio was 84% and the unweighted average expense ratio was 28%, resulting in an unweighted average combined operating ratio of 112%.[13] However, when other income and investment activities were taken into account, PMI activities were profitable, with income (including investment income) less total claims less total expenses (ie the underwriting result plus investment income) across all ten insurers over the five years totalling £1.8 billion. Appendix 2.3 shows the claims and expense ratios and the combined operating ratio, as well as the underwriting result plus investment income, for each of the ten largest motor insurers over the last five years.

5.29 Initially, we saw some evidence that profitability, premiums and concentration were somewhat higher in relation to PMI in Northern Ireland than in Great Britain. We also found that concentration appeared to be particularly high in Northern Ireland for the sale of PMI to high-risk drivers. However, we did not find that these effects were likely to be as a consequence of a failure of competition. We found that, while profits from the sale of PMI in Northern Ireland were somewhat higher than in Great Britain, the overall level of underwriting profits was not high. Furthermore, it did not appear to us that entry barriers were high. We observed that concentration in the supply of PMI in Northern Ireland was currently high largely because of the success of AXA in expanding its market position, which it had achieved since 2006. We saw that there were some indications that others were now expanding and challenging AXA’s position. We also found that there were a number of recent reforms in Northern Ireland which were likely to have an effect on premiums (eg a new arbitration procedure for smaller claims and a new driving licence aimed at reducing the riskiness of young drivers), which could narrow the gap in average prices between Northern Ireland and Great Britain, especially for higher-risk drivers. Our analysis of competition in relation to PMI in Northern Ireland is set out in more detail in Appendix 5.4.

[11] Some insurers have several brands, so not every quote represents a single provider. However, there are more than 50 unique providers.
[12] Our central estimate of the Herfindahl-Hirschman Index of concentration is below 1,000, which CMA guidelines take as a cut-off point for considering a market to be ‘concentrated’.
[13] Appendix 2.3, Annex A, provides definitions of the terminology relating to insurer profitability.

Strength of competition, including switching and add-ons

5.30 Even when there are many suppliers, effective competition requires consumers to be both willing and able to: *(a)* access information about the various offers available in the market; *(b)* assess these offers to identify the good or service which will provide the best value for them; and *(c)* act on this assessment by switching to purchasing the good or service from their preferred supplier, taking account of the full costs of provision as well as the benefits. To assess the extent to which this was the case, we considered the responsiveness of sales to price changes and the extent of switching and we also considered separately certain products which were frequently sold as 'add-ons' to basic PMI. We set out our findings on these two issues in turn.

- *Responsiveness of sales to price changes and the extent of switching*

5.31 The sale of PMI occurs through different channels, including online and via PCWs, by telephone and in branches. We looked at the sensitivity of sales to the price level as an indicator of the extent of competition faced by PMI providers in each channel.

5.32 PCWs are the largest source of new PMI business, responsible for [55–65]% of new PMI sales in 2012, and continuing to grow at about 8% a year. We found that PCWs had increased competition between insurers as they created high levels of price sensitivity, see paragraph 8.6 and Table 8.1. Many consumers use PCWs to find the cheapest PMI policy. [✂] told us that it estimated that the proportion of customers on its website who bought the cheapest policy was [✂]%. Datamonitor estimated that 37% of customers who purchased from a PCW selected the cheapest quote.

5.33 We found that, although price sensitivity was lower for phone and own-website sales, customer switching was still substantial. We commissioned a survey of PMI policyholders, which found that 72% of PMI policyholders previously insured their vehicle with another provider, and an earlier OFT study found that 61% of car insurance customers had switched in the previous five years, which was the highest rate of switching in all the markets considered by the OFT.[14] Overall, we found that switching levels for PMI appeared high relative to comparable products.

5.34 We considered whether there were significant obstacles to switching, for example due to automatic renewal, cancellation fees and NCB protection, which might give rise to competition concerns.[15] In our assessment, we

[14] See Review of the personal current account market, July 2008, Chart 3.8.
[15] See our working paper, 'Theory of harm 4: Obstacles to switching'.

considered information from PMI providers and evidence from our consumer survey. Overall, it did not appear to us that automatic renewals or cancellation fees were obstacles to switching which were likely to give rise to harm. With regard to NCB protection, the findings were less clear, in particular with mixed evidence coming from our consumer survey. However, with regard to NCB protection, it appeared to us that the principal issue arose in relation to the nature of the product and consumers' limited understanding of it. We therefore considered this product alongside the other add-ons where we suspected similar issues might also arise (see next paragraph).

- *Add-ons*

5.35 When buying a basic PMI policy, a consumer is usually presented with the opportunity to buy several other related products, commonly referred to as 'add-ons'. Some of these products are available separately as free-standing products (eg breakdown cover), while others are more closely associated with the policy (eg NCB protection, extended cover for windscreen damage, and the provision of a courtesy car). We investigated two potential concerns with the sale of add-ons, each of which could have the effect of softening competition in their supply and acquisition: *(a)* that consumers might face difficulties in trying to compare the aggregate price of a PMI policy and the price and terms of their chosen add-ons across different motor insurers, which might reduce the ability of a consumer to compare, assess and/or switch providers for it; and *(b)* that consumers might be ill-informed about the product they are buying, making them poorly equipped to assess its value to them and/or its cost. We examine these issues in Section 7.

Competition between PCWs

5.36 There are four large PCWs which together account for over 95% of all PMI sales through PCWs. All other PCWs have a very small market share. We found that the profitability of the four large PCWs was high, with average operating margins around 25% (see Appendix 8.1, Annex H) and low capital intensity.

5.37 We found that the four large PCWs competed intensely for consumer attention, with high advertising expenditure, in particular on television.

5.38 In Section 8, we examine the market power that the large PCWs might hold as a result of a substantial proportion of their retail customers 'single homing', ie using only one PCW and so being accessible by a PMI provider only through that PCW.

Theory of harm 5: harm arising from vertical relationships

5.39 In Section 8, we also examine the impact on competition of 'most favoured nation' clauses in the contracts between some of the PCWs and some of the PMI providers which sell through them. These clauses constrain the prices which the PMI provider can quote on alternative sales channels, including other PCWs, and consequently may affect competition both between PCWs and between PMI providers.

5.40 There is some vertical integration between insurers/brokers and PCWs, with three of the four PCWs being wholly or partially owned by insurers or brokers. We investigated the possibility that these PCWs were using their market power to foreclose other insurers (see Appendix 8.1, Annex J), but we found no evidence currently of this sort of behaviour.

Repair supply chain

5.41 We also considered a number of potential horizontal and vertical issues associated with inputs used in the provision of repairs. For example, we considered whether there was a horizontal issue in relation to cost estimation systems, and we considered whether there were vertical issues in relation to the discounts and rebates earned by insurers and CMCs which commissioned repairs from the paint and parts suppliers to repairers. We did not find these issues in themselves to lead to competition problems, though some of the vertical relationships were relevant to the issues we considered in relation to the separation of cost liability and cost control (see Section 6).[16]

Conclusion

5.42 For the reasons set out above, we did not find there to be adverse effects on competition in the following areas:

(a) low-quality post-accident service provision arising from the beneficiary of services being different from, and possibly less well informed than, the insurer or CMC which is the procurer of those services (ToH 2);

(b) horizontal effects in the PMI market (under ToH 3);

[16] Our analysis of these areas is set out in the following working papers:
- ToH3: Horizontal concentration in repair cost estimation systems
- ToH5: Analysis of vertical agreements for the supply of paint (excluding foreclosure)
- ToH5: Analysis of potential foreclosure as a result of vertical relationships

(c) horizontal effects in relation to inputs to post-accident services (under ToH 3);

(d) PMI providers' strategies to soften competition through influence over switching (under ToH 4); and

(e) vertical issues in relation to inputs to post-accident services (under ToH 5).

5.43 In the remainder of this report, we examine in greater detail the separation of cost liability and cost control (ToH 1 – see Section 6); add-ons, including NCB protection (under ToH 4 – see Section 7), and PCWs and MFNs (under ToHs 3 and 5 – see Section 8).

6. Separation of cost liability and cost control in relation to non-fault claims (theory of harm 1)

Introduction

6.1 In Section 3 we outlined the principles of tort law which provide that a person who causes damage (the at-fault party) to the property or person of another (the non-fault party) is liable for the costs of restoring the non-fault party to the position they were in before the damage occurred. In the case of damage to property, the amount of compensation is the ‘reasonable’ costs incurred by the non-fault party in restoring their position. The at-fault party is personally liable for these costs. In Section 3 we outlined how, in relation to motor accidents, insurance ensures that the liabilities of the at-fault party under tort law are met.

6.2 In Section 3 we also noted that, as a consequence of the legal principles, there is typically separation of cost liability and cost control (‘separation’): cost liability lies with the at-fault party whereas cost control lies with the non-fault party[1] whose interest is to ensure restoration to their pre-accident condition and whose incentive to control costs is not as great as for the at-fault party.

6.3 In this section, we first describe the nature and extent of separation. We then discuss how it affects insurers’ costs and revenues. We discuss whether separation is associated with differences in the quality of service received by claimants and we discuss its effect on consumers and on competition. We also discuss the practices and conduct of the parties managing non-fault claims which (i) can be focused on earning a rent from the control of claims rather than simply competing on the merits; and (ii) give rise to inefficiencies in the supply chain involving excessive frictional and transactional costs. Finally, we summarise our conclusions.

6.4 In assessing the effect of separation on competition, we considered a bench-mark ‘well-functioning market’ to be a market which delivered consumers’ legal entitlements in an efficient way. In principle, a market could depart from this benchmark either because it failed to deliver consumers’ legal entitle-ments or because, though it delivered their legal entitlements, it did so in a way which involved significant inefficiencies. The issues discussed in this section relate to the latter, ie possible inefficiencies associated with those

[1] There is no separation when the at-fault insurer ‘captures’ a claim, ie when it approaches the non-fault driver directly and deals with their claim (eg by repairing their vehicle and providing a temporary replacement vehicle), or when a non-fault insurer handles a non-fault claim but is also the at-fault insurer.

delivering consumers' legal entitlements not having the incentives to control the costs for which the at-fault party is liable.[2]

Nature and effect of separation

6.5 Depending on the wording, comprehensive insurance policies will provide, as basic contractual benefits, post-accident services such as repairs at an insurer-nominated repairer and use of a courtesy car while the repairs are carried out.[3] These benefits (which would be received under a claimant's own contract of insurance) may not meet a non-fault claimant's entitlements under tort law. The non-fault claimant might be referred by their insurer or broker (which might receive a referral fee) to other service providers to obtain these entitlements (eg allowing the claimant to receive a like-for-like temporary replacement vehicle), with the at-fault insurer liable for the costs.[4] This can result in several different parties being involved in managing a non-fault claim, including the non-fault claimant's own insurer, a CMC, a CHC, or a solicitor (see Section 3).

6.6 The party providing post-accident services to a non-fault claimant will typically seek to recover the costs of those services from the at-fault insurer on behalf of the non-fault claimant. If the claim cannot be settled between these parties, the matter will be resolved by the courts. Under tort law, if these services were required to restore the non-fault claimant to their pre-accident position and, where required, the non-fault claimant has mitigated their loss, 'reasonable costs' will generally be recoverable (see Section 3).

6.7 These reasonable costs, however, may be above the actual costs incurred by the parties providing the services (eg the non-fault insurer or a CMC/CHC), which often have negotiating power with suppliers and benefit from economies of scale.[5]

6.8 As a consequence, there is a profit or 'rent' to be gained where a party providing post-accident services to a non-fault claimant is able either by subrogation or under contract to recover payment for those services at a rate which is above the actual costs. Consequently, there is an incentive for parties to seek to provide post-accident services to non-fault claimants (eg the provision of a

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[2] We also considered, under ToH 2, whether the quality of service provided to claimants was in line with their legal entitlement – see paragraphs 5.7–5.25 and Appendices 5.1, 5.2 & 5.3.

[3] A courtesy car is often included in comprehensive PMI policies; in some cases it is not included but is offered as an add-on to the basic policy (see Section 7). Some insurers offer a like-for-like replacement vehicle as an add-on to the courtesy car cover (see Section 7).

[4] Referrals may also be made (and referral fees received) by other companies which are informed by non-fault claimants of accidents, for example breakdown companies.

[5] See *Coles v Heatherton [2013] EWCA Civ 1704,* paragraphs 36–37. The arrangements in that case were for repairs.

temporary replacement vehicle or repairs). This incentive gives rise to the following behaviour:

(a) At-fault insurers have an incentive to 'capture' non-fault claims so that they can control the costs effectively (see Section 3). Data from insurers suggested that at-fault insurers were successful in capturing about 25% of non-fault claims.[6] For these captured claims, and for the small proportion of claims where both drivers are insured with the same insurer, the at-fault insurer has both cost liability and cost control such that there is no separation.

(b) CMCs and CHCs compete to obtain referrals of non-fault claims from insurers, brokers and other parties (eg dealerships, repairers, the emergency services, etc), in particular by offering referral fees.[7] CMCs and CHCs can afford to pay referral fees because of the difference between the costs they incur in providing services to the non-fault claimant and the costs which can be recovered from the at-fault insurer (see above). Insurers and brokers are the principal referrers of non-fault claims because, after an accident, the non-fault driver is normally required under their insurance contract to notify the accident to their own insurer, with many consumers accessing their insurer through their broker.[8]

(c) Many non-fault insurers seek to retain control of at least some elements of non-fault claims for reasons such as to satisfy a customer's preference for dealing with their own insurer. This may also allow them to profit from the ability to provide services, such as repairs, to non-fault claimants at lower than retail cost.

6.9 In addition to paying out more for non-fault claims than if they had managed them, at-fault insurers also incur costs in dealing with and seeking to reduce the sums claimed by non-fault insurers, CMCs and CHCs. This process involves:

(a) keeping track of the repair process to check for undue delays and to intervene directly when appropriate (eg by sourcing a part not readily available);

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[6] See Appendix 6.1, Table 1.
[7] CHC/CMCs also obtain some business directly from non-fault claimants and from other businesses, such as repairers and breakdown companies.
[8] Where a broker refers a non-fault claimant to a CMC/CHC, it is usually for both the provision of a temporary replacement car and for repair to the non-fault claimant's car. A small proportion of non-fault claims handled by non-fault insurers are also referred to CMCs (see paragraph 6.33) but more often the referral is to a CHC just for a replacement vehicle.

(b) verifying that the replacement car is provided for no longer than is necessary and that the category of vehicle reflects the driver's needs; and

(c) challenging the sum claimed if it is considered unreasonably high (eg because of undue delays to the repair or if the replacement car was provided for longer than necessary). If the two sides do not reach agreement on the sum claimed, the dispute can result in litigation.

Each part of this process also involves the non-fault insurer, CMC or CHC incurring cost in order to provide supporting evidence for the claim and defending it.

6.10 We found it useful to distinguish different forms of additional cost to the at-fault insurer:

(a) the rent earned by the party with which the non-fault claimant makes contact: depending on which party provides the service, this may be in the form of a referral fee (paid, for instance, by a CMC/CHC) or of profits (if the party to whom the non-fault claimant makes contact itself provides the service); and

(b) additional transactional and frictional costs for all parties involved, including:

(i) verification costs and dispute-related costs, including litigation costs, arising from the high potential for dispute (see paragraph 6.9);

(ii) duplicated costs, eg arising from two parties needing to make an assessment of liability; and

(c) any costs associated with altered behaviour, for example a CMC/CHC providing a like-for-like replacement car to a non-fault claimant whose need would be met by a smaller car.[9]

6.11 We observed that the effects of separation could arise in the following three areas:

(a) temporary replacement vehicle provision, usually by a CHC (see Appendix 6.1);

[9] The evidence we saw suggested that a larger car tended to generate a higher margin for a CMC/CHC than a smaller car (for example, referral fees tending to be paid as an amount per referral, rather than as a percentage of the amount claimed). In the longer term, however, competition between CMCs/CHCs would lead to profits from hiring out larger cars being bid away in higher referral fees.

(b) repair, usually by the non-fault insurer or a CMC (see Appendix 6.2);[10] and

(c) write-off, if the damage following an accident is such that it is not economic to repair a non-fault claimant's car, usually by the non-fault insurer or a CMC (see Appendix 6.3).

Agreements and protocols involving insurers and CMCs/CHCs

6.12 We observed that insurers and those providing services to non-fault claimants had entered into agreements aimed at reducing the costs of non-fault claims. There are three main types of agreements:

(a) the GTA;

(b) bilateral agreements between an insurer and a CMC/CHC; and

(c) bilateral agreements between two insurers.

The GTA

6.13 The GTA is a voluntary non-binding protocol between a number of insurers and CHCs which sets out the terms, conditions and maximum rates which can be recovered for temporary replacement vehicles provided to non-fault claimants.[11] Most large insurers and CHCs subscribe to the GTA. The GTA includes an administration fee per hire (currently £37, or £44.40 including VAT), maximum daily hire rates for 49 groups of cars,[12] daily rates for extras such as non-standard drivers, estates and automatics and penalties for late payment. The maximum daily hire rates are revised periodically by a technical committee, which has equal representation from insurers and CHCs and an independent Chairman. We were told that the GTA's maximum daily hire rates for replacement cars were below the rates charged by CHCs outside the GTA,[13] for example one insurer said that its experience was that the daily rates charged by non-GTA-subscribing CHCs were typically 30% higher than

[10] Although some non-fault insurers charge at-fault insurers more for repair than the costs they incur, not all non-fault insurers do this (see paragraph 6.35).
[11] See http://apps.abi.org.uk/tphire/. The GTA is also discussed in paragraph 3.42 and in Appendix 6.1, paragraphs 5–9.
[12] The GTA daily rates include delivery/collection, 24-hour breakdown cover, unlimited mileage, full liability, theft and damage insurance subject to a £50 excess unless the customer has a third party/TPFT policy or their own PMI policy excess exceeds this figure, when a higher excess can apply but with no compulsory additional charge to the customer.
[13] The rate generally allowed by the courts to claimants who are not impecunious (known as the basic hire rate) is usually calculated from the highest local retail hire rate, including maximum excess waiver, available for hires 24 to 48 hours ahead. The basic hire rate does not apply to claimants who are impecunious, who may claim higher credit hire costs.

the maximum GTA daily hire rates.[14] Insurers told us that, nevertheless, GTA rates were too high; for instance, esure said that the bar was set too high in terms of the daily rates, allowing excessive claims to be made. In esure's view, the use of unjustifiably large referral fees only served to illustrate the scale of the problem.

6.14 The GTA also includes provisions covering detailed administrative arrangements; eg adherence to the 'first to the customer rule' whereby if a GTA subscriber obtains a customer's agreement to provide the service, other subscribers should not seek to intervene; and the information that CHCs must provide to at-fault insurers before, during and after a period of hire, including the information to be included in payment packs. Other aspects of the GTA are also subject to review by the technical committee.

6.15 The GTA includes a supplementary credit repair agreement. This states that claimants using credit repair may choose to have their car repaired either *(a)* by a repairer from the at-fault insurer's approved repair network, or *(b)* by an independent repairer of their choice, subject to an independent (or insurer-nominated) engineer both being satisfied that the chosen repairer has the skill and equipment to undertake the work and agreeing the repair terms. The GTA supplementary credit repair agreement does not set maximum rates for credit repair.

Bilateral agreements between an insurer and a CMC/CHC

6.16 Bilateral agreements involving an insurer and a CMC/CHC aim to reduce transactional and frictional costs. They usually involve a simpler management and settlement process than in the GTA and set hire rates which are below those in the GTA (see Appendix 6.1, paragraphs 18 and 116 to 121). They are often negotiated in parallel with negotiations over the level of referral fee to be paid when the insurer is on the non-fault side and referring to the CMC/CHC.

Bilateral agreements between two insurers

6.17 Many insurers have agreed bilaterally to practices reducing transactional and frictional costs in claims between them (known as 'reduction in paper exchange' or RIPE agreements).[15] Under these non-binding agreements, at-fault insurers request documentary evidence to substantiate claims from non-

[14] See Appendix 6.1, paragraph 113.
[15] Each participant in RIPE has bilateral agreements with other participating RIPE insurers (participants), but not necessarily with all other participants. The RIPE document states that there is no intention that participation in the RIPE process forms a contract and the terms of the process are not enforceable in a court of law.

fault insurers only in exceptional circumstances, and audit a small number of these claims.[16] We found that the RIPE process was mainly relevant to repairs and write-offs rather than replacement cars, since the provision of replacement cars to non-fault drivers was usually through CHCs. The widespread adoption of these agreements between insurers reduced some transactional and frictional costs in insurer-to-insurer claims; however, we noted that not all insurers participated in the RIPE process.[17]

6.18 Some insurers have signed stronger bilateral agreements which, in addition to reducing transactional and frictional costs, also amend the sums they claim from each other. We found two types of bilateral agreement between insurers:

(a) agreements relating to replacement cars, under which the non-fault insurer agrees not to refer the claim to a CHC but to arrange a direct hire, with the amount claimed being at agreed rates; and

(b) agreements on repairs, under which the non-fault insurer agrees to apply a discount on the amount claimed, taking into account the referral fees, rebates and discounts it has received. One insurer described this as effectively ‘billing the wholesale cost of the repair’.

6.19 It appeared to us that bilateral agreements represented an attempt by insurers to deal with the consequences of separation. However, we found that the stronger forms of bilateral agreement referred to in paragraph 6.18 were not widespread. The results of our non-fault survey suggested that only about 5% of replacement cars and 3.5% of non-fault repairs were covered by the stronger forms of bilateral agreement (see Appendix 6.4, Table 1). Insurers told us that this was because *(a)* such agreements were administratively difficult to manage; *(b)* differences between insurers made them difficult to agree;[18] and *(c)* insurers had concerns about competition law.

Our view on agreements involving insurers and CMCs/CHCs

6.20 We found that the GTA and insurer/CHC bilaterals had two main effects:

(a) They directly reduced transactional and frictional costs compared with the level that would prevail in the absence of these agreements. The GTA

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[16] We understand the RIPE document to provide for 50 claims of each participant to be audited every six months by one of the other participants. If a participant’s audit is failed, all participants with a bilateral RIPE agreement with that participant can request a further audit, or documentary evidence for all claims over a period to be agreed by the two participants. If the audit is passed, other participants with a bilateral RIPE agreement with that participant can still request an audit, to be arranged separately between the two participants. A participant can suspend or cancel a bilateral RIPE agreement with another participant at any time.

[17] [✄]

[18] Relevant differences included the importance of sales through brokers rather than directly to consumers, and the relative size of the insurers.

reduces such costs because it provides a framework for CMCs/CHCs to provide replacement vehicles and to be paid by insurers. Bilateral agreements between a CMC/CHC and an insurer further reduce transactional and frictional costs by providing for more streamlined processes. These agreements also tend to encourage early agreement on liability, further reducing transactional and frictional costs.

(b) They reduced the rates claimed by CMCs/CHCs below the level that would otherwise have been claimed based on court awards – see paragraph 6.13. It appeared to us that these developments had contributed to a significant reduction in the number of litigated replacement vehicle cases. For example, Helphire told us that CHCs and insurers had been cooperating and finding ways to compromise that recognised each party's interests in an effective manner. Helphire said that by working with insurers in this way, over [✄]% of its claims were paid in less than 90 days – in Helphire's view, this would have been an unimaginable position five years ago. In our view, litigation and consequently frictional costs were lower than they would have been in the absence of these agreements.

6.21 Bilateral agreements between insurers have similar effects: they directly reduce transactional and frictional costs by streamlining procedures, and the stronger types of bilateral agreement also control the levels at which the two insurers claim from each other and therefore reduce disputes and frictional costs. CMCs/CHCs said that bilateral agreements between insurers relating to replacement vehicles led to the non-fault claimant receiving less than their legal entitlement. However, we did not see evidence of this.[19] We noted that one of the reasons given by insurers for bilaterals not being more common was that they had concerns over competition law (see paragraph 6.19). Subject to any further assessment of individual agreements, we saw no evidence suggesting that these agreements were in breach of competition law. We found that these bilateral agreements reduced transactional and frictional costs on non-fault claims, which, as set out later in this section, would lead to lower prices for PMI; and we did not see evidence that indicated that these bilateral agreements were otherwise limiting competition between insurers, or between insurers and CHCs.

6.22 Thus, we found that all these agreements had reduced transactional and frictional costs compared with the level that would otherwise have prevailed. Nevertheless, as they were currently limited in scope and/or coverage, it was still necessary for us to assess the effects of separation by comparing the

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[19] See Appendix 6.5, paragraphs 73–80.

existing situation (in which some but not all claims are governed by such agreements) with a benchmark 'well-functioning market', ie a market which delivered consumers' legal entitlements in an efficient way (see paragraph 6.4).

Effects of separation on insurers' and brokers' costs and revenues

6.23 In this subsection we discuss the impact of separation on insurers' and brokers' costs and revenues. We discuss separately temporary replacement cars, repairs (both credit repairs managed by a CMC and repairs managed by the non-fault insurer) and write-offs. We estimate the higher costs faced by the at-fault insurer and the revenues generated by the non-fault insurer or broker. We also estimate the transactional and frictional costs which arise from separation, including the costs which insurers incur in managing non-fault claims.

6.24 We use data for 2012 claims, which reflects the effect that the agreements described above (see paragraphs 6.12 to 6.19) had in reducing costs in that year. It was not practicable to use more recent data because of the length of time taken to settle some claims and hence for accurate information on costs to become available. It was put to us that costs had decreased since 2012, for example because the impact of bilateral agreements had increased since that time, but it was also put to us that behaviour might have been modified because of our investigation and, once our investigation was finished, costs would be likely to increase again.

Cost and revenue effects: replacement cars

6.25 In most cases, non-fault insurers and brokers refer non-fault drivers to a CHC for a temporary replacement vehicle, which is then provided under a credit hire contract.[20] When a claim is captured by the at-fault insurer, or the same insurer insures both the at-fault and non-fault drivers, the non-fault replacement car is arranged directly between the at-fault insurer and a car hire company (ie direct hire).

6.26 We found that the average cost of a non-fault temporary replacement car paid for by the at-fault insurer was substantially greater when there was separation than when there was not (see Appendix 6.1, paragraphs 20 to 69). This was in part due to credit hires on average being longer (16 days compared with

[20] Not all insurers refer non-fault claimants to CHCs for a temporary replacement vehicle. For example, CISGIL only refers non-fault claimants to CHCs when the claimant has MLEI. However, most other large insurers and all major brokers refer non-fault claimants to CHCs unless there is a relevant bilateral agreement in place with the at-fault insurer.

13 days (see Appendix 6.1, paragraphs 26 to 29)) and in part due to higher daily hire rates.

6.27 Insurers and CHCs gave us different explanations for the longer average credit hire period than direct hire period. On the one hand, insurers suggested that credit hire periods were unnecessarily extended to inflate the sums claimed (see Appendix 6.1, paragraph 126). In this regard, we noted that at-fault insurers often challenged the sums claimed, subsequently agreeing a lower amount with the CHC, and that challenges were most common on the length of the hire (rather than, for example, on the daily rate), in particular for claims under the GTA. On the other hand, some CHCs told us that credit hires were more often used where a longer than average hire was needed, eg following more serious accidents requiring longer repairs. CHCs said that this was in part because courtesy cars were often used for short hires, and in part because captured claims had on average a lower value than non-captured claims (see Appendix 6.2). We also noted that another possible explanation for the longer credit hire length was the difficulties of coordinating the hire and repair process when two different companies were involved (ie the non-fault insurer managing the repair/write-off and the CHC providing the replacement vehicle). We saw some merit in all of these explanations.

6.28 Another reason why the average cost of credit hire is greater than that of direct hire is because a higher proportion of credit hires are in more expensive car classes. There are three possible reasons for this:

(a) There could be systematic differences[21] in the characteristics of credit hire and direct hire claimants, for example in the cars they drive (ie credit hire claimants might typically drive more expensive cars) or in their willingness to consider taking a temporary replacement car from a cheaper class.

(b) Direct hire claimants might on average receive a lower class of temporary replacement vehicle than is their legal entitlement under tort law (for example, because they are not made aware of their entitlement).

(c) Credit hire claimants might on average receive a higher class of replacement vehicle than is their legal entitlement under tort law (for example, because they are not adequately required to assess their need).

We noted that these were not mutually exclusive explanations as, in principle, all three factors could play a role. We did not find decisive evidence supporting or contradicting any of them. In regard to *(a)*, there seemed no obvious

[21] Although we only used one year's data (2012), the number of claims included was large (over 100,000 for both credit hire and direct hire). Consequently, we believed it was unlikely that the difference was due to random factors.

reason why there should be systematic differences of this sort between credit hire and direct hire claimants. In regard to *(b)*, we noted that the results of our survey suggested that a proportion of non-fault claimants were not aware of their entitlement to a replacement car,[22] but our survey did not provide much evidence to suggest that claimants with direct hire believed their replacement car to have fallen short of their needs.[23] In regard to *(c)*, our analysis of a small sample of call records indicated that, in the majority of cases, the claims handler did not appear to assess whether the driver required a like-for-like replacement car and/or whether a replacement car of a lower class would have met their needs,[24] but our survey did not provide much evidence to suggest that claimants with credit hire believed their replacement car to have exceeded their needs.[25]

6.29 Since we did not see clear evidence that the longer average duration and more expensive average car hire class of credit hire compared with direct hire could have been avoided, we adjusted our calculations to remove both effects from our comparison of the costs of credit hire and direct hire.[26] This was equivalent to assuming that credit hire claimants received no more than their legal entitlement. Our calculations are set out in Table 6.1. This table also sets out our other adjustments, which had a smaller impact on the overall comparison. We found that, after all these adjustments, the cost of credit hire was about double the cost of direct hire.

[22] See provisional findings, paragraph 7.9, and survey report (questions D28 & D29).
[23] 81% of non-fault claimants whose claims were managed by the at-fault insurer said that the replacement car exceeded or met their needs, though 14% said it fell slightly short of their needs and 5% said it fell well short of their needs (see paragraph 6.44 and Table 6.2).
[24] Our analysis of 37 call records of non-fault insurers and CMCs found that in 26 cases the claims handler did not appear to assess whether the driver required a like-for-like replacement car and whether a replacement car of a lower class would have met their needs (see Appendix 6.5, paragraph 69*(a)*). We noted however that such assessment might occur at a later stage in the process of delivering the service.
[25] 83% of non-fault claimants whose claims were managed by the non-fault insurer or CMC said that the replacement car met or fell short of their needs, though 6% said it exceeded their needs and 11% said it far exceeded their needs (see paragraph 6.44 and Table 6.2).
[26] Our comparison used standard car hire classes. Ideally, we would also have done a comparison using more granular GTA hire classes, but this was not possible due to data limitations (see Appendix 6.1, paragraphs 52 to 55).

TABLE 6.1 **Comparison of credit hire and direct hire costs (including VAT)**

	Credit hire	*Direct hire*
Average cost per day (£)	69.37	29.20
Average hire duration (days)	16.3	13.3
Average cost per hire (£)	1,130	389
Adjustment for average hire duration*		86
Adjustment for type of car†		69
Adjustment for payment delay‡	–25	
Adjustment for CDWs§	–5	
Adjusted average cost per hire (£)	1,100	545
Adjusted average cost per day (£)	67.52	33.46

Source: CMA calculations based on data submitted by credit and direct hire companies.

*Additional direct hire cost if average hire duration was the same as for credit hire.
†Additional direct hire cost if proportion of hires in each standard car class (and proportion of estate cars and automatics) was the same as for credit hire (calculated assuming average credit hire duration) – see Appendix 6.1, paragraph 64.
‡Average credit hire cost is reduced for benefit to insurers of delay in payment – see Appendix 6.1, paragraph 65.
§Average credit hire cost is reduced to allow for benefit to consumers of full CDW offered by two CHCs – see Appendix 6.1, paragraph 65.

6.30 Our main estimate of the extra cost of credit hire over direct hire was £555 (£1,100 – £545 in Table 6.1). We found that, on average, £328 was paid out in referral fees by CHCs/CMCs to non-fault insurers and brokers for each non-fault claim.[27] The remaining £227 (£555 – £328) was accounted for by higher costs in managing credit hire claims compared with direct hire claims and any profits that the CHCs make.

6.31 There are a number of reasons why the costs of CHCs in providing replacement cars under credit hire might be higher than the costs of direct hire incurred by an at-fault insurer. First, CHCs incur transactional and frictional costs (see paragraph 6.9); second, CHCs might have higher operating costs,[28] in particular they might not have the same negotiating power with suppliers as larger hire companies used for direct hire by insurers; and third, CHCs might incur costs in providing additional services (see paragraph 6.51).[29] With regard to CHCs' profits, we found no evidence that CHCs earned more than normal profits (after payment of referral fees). Indeed, as we found that barriers to entry were low and CHCs competed to obtain referrals by offering high referral fees, we believed it unlikely that CHCs earned more than normal profits.

[27] This reflects an average referral fee to insurers and brokers of £326 per credit hire, plus an average benefit to non-fault claimants from uninsured loss recovery provided by CHCs of £2 per credit hire (see Appendix 6.5, paragraph 97).
[28] One reason that credit hire is more expensive than direct hire is because of additional VAT. Car hire is subject to VAT, but because insurance is VAT-exempt, insurers cannot set the VAT they pay on car hire against any VAT charged. Therefore VAT on car hire is a real cost to an insurer. An at-fault insurer purchasing a direct hire vehicle will pay VAT on the direct hire cost. However, an at-fault insurer paying a non-fault claim under credit hire will pay VAT on the higher credit hire cost (which covers all the CHCs' additional costs, eg referral fees).
[29] CHCs also incur costs associated with additional working capital requirements due to being paid sometime after the service is provided. We adjusted our calculations for this by removing the benefit to insurers of the longer payment period for credit hire compared with direct hire (see Table 6.1).

6.32 We found that at-fault insurers also incurred transactional and frictional costs when dealing with CHCs (see Appendix 6.1, paragraphs 106 to 115). At-fault insurers monitor both the duration of repair and the hire period, and incur costs disputing and litigating some claims. We found that, on average, these costs exceeded the handling costs which at-fault insurers incurred when purchasing direct hire cars for captured claimants by £52 per claim. Allowing for this cost difference, our main estimate of the extra cost of temporary replacement vehicle provision attributable to separation increased from £555 to £607 (see Appendix 6.6).

Cost and revenue effects: repairs

6.33 Unlike replacement cars, where most non-captured claims are referred for credit hire, most non-fault repairs are managed by non-fault insurers themselves, with referrals for credit repair being made mainly by brokers (though we found that one large insurer referred some but not all non-fault claims for credit repair). Overall we estimated that in about three-quarters of non-captured claims requiring repair, the repairs are managed by non-fault insurers, and in the remaining one-quarter of cases credit repair is involved. In this subsection, we discuss the cost increase faced by at-fault insurers when they do not handle a repair directly. We then consider the revenues obtained by non-fault insurers or brokers.

6.34 We found that insurers and CMCs managed their non-fault repairs in many different ways, some of which had the effect of increasing their non-fault repair charges passed to at-fault insurers above the net costs they effectively incurred. Such practices included:

(a) performing non-fault repairs in repair subsidiaries at retail rates (eg by charging high labour rates) and extracting the profits from the subsidiary as dividends or referral fees ([✂]);

(b) making an upward adjustment to the sum claimed for repair, above the costs incurred ([✂]);

(c) requiring approved repairers to discount the repair bill (or to pay a parallel rebate), but not passing on this discount/rebate to the at-fault insurer ([✂]);

(d) including an administration fee and an engineering fee, and various other extras, in the sum claimed from the at-fault insurer in addition to the repair cost;[30] and

(e) taking rebates (which are not passed on to the at-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 and hence in the sums claimed for repair from the at-fault insurer ([✂]). In regard to paint, we found complex contractual arrangements involving paint manufacturers, paint distributors, repairers and insurers, involving list prices well in excess of the price actually paid by repairers; we found insurers usually earning rebates; and we found that since 2006 paint list prices had increased about three times as fast as prices generally.[31]

We noted that these practices meant that the amounts non-fault insurers claimed from at-fault insurers were more than the net effective costs they incurred in providing the repair service. However, non-fault insurers did incur some costs in managing non-fault repairs, which were not usually recovered from the at-fault insurer, and these also needed to be taken into account.

6.35 We observed that insurers' practices varied significantly with regard to how they managed non-fault repairs: seven of the ten largest insurers received referral fees from paint or parts suppliers; while five out of ten received rebates from their approved repairers which were not passed on to the at-fault insurer, or profits from their vertically-integrated repair networks, or directly added a mark-up to the invoice received by repairers. As a consequence, the total difference between the cost passed to the at-fault insurer and the net effective cost of repair incurred by the non-fault insurer varied significantly among insurers. We found that this difference averaged about £95 per claim across insurers (see Appendix 6.2, paragraph 15). However, against this, we found that, on average, non-fault insurers incurred costs of £115 per claim in managing repairs. Thus, on average, non-fault insurers' income from managing repairs was slightly less than their costs, though there was substantial variation around this average with some insurers making significant profits and others incurring significant losses from managing non-fault repairs. Allowing for the management costs saved by at-fault insurers and also for the transactional and frictional costs incurred, we found that the management of

[30] For example, the GTA allows CMCs providing credit repair services to make these additional charges.
[31] See our working paper: Theory of harm 5: Analysis of vertical agreements for the supply of paint (excluding foreclosure).

non-fault repairs by non-fault insurers resulted in at-fault insurers paying £20 more per repair than if they had managed the repair themselves.[32]

6.36 We found that repairs managed by CMCs tended to be more costly than those managed by non-fault insurers. On average, the difference was about £195 (see Appendix 6.2, paragraph 26), implying a credit repair price which was about £290 more than the average cost of repair by at-fault insurers. Allowing for the management costs saved by at-fault insurers and also for the transactional and frictional costs incurred (which were slightly greater for credit repairs than for non-fault insurer managed repairs), we found that credit repairs resulted in at-fault insurers paying £224 more per repair than if they had managed the repair themselves.

6.37 When insurers or brokers refer a repair to a CMC, they receive revenue in the form of a referral fee. We found that the average referral fee across credit repair and write-off was about £53 per claim (see Appendix 6.6, Annex B, Table 1).[33] We noted that this was considerably less than the average referral fee paid for credit hire.

Cost and revenue effects: write-offs and salvage

6.38 Cars are written off when it is not economic to repair them. As with repairs, claims resulting in a write-off can be captured by the at-fault insurer or managed by the non-fault insurer or a CMC. Therefore, our analysis of write-offs was similar to that for cars that are repaired.

6.39 As with repairs, currently there are differences in the practices of non-fault insurers managing write-offs. For some non-fault insurers, the difference between the cost charged to the at-fault insurer and the net effective cost incurred[34] exceeds the cost to the non-fault insurer of managing the write-off. For other non-fault insurers the reverse is the case. We estimated that, on average, non-fault insurers recovered from at-fault insurers just over £50 more than the net effective cost they incurred (see Appendix 6.6, paragraph 55), ie less than the cost they incurred in managing the write-off, which was similar to repair (ie £115 per claim (see paragraph 6.35)). Allowing for the management costs saved by at-fault insurers and also for the transactional

[32] We were unable to attach weight to direct comparisons of repair costs across different claim types. This was for two reasons: first, the data we obtained from insurers on average repair costs was difficult to interpret as insurers either were unable to provide any data or could not provide values for costs net of all the rebates and referral fees involved; and second, captured repairs might tend to require less extensive work than non-captured repairs and therefore not be directly comparable (and there is less data available on same-insurer repairs) (see Appendix 6.2).
[33] The referral fee for a credit repair or a write-off is the same because at the time of referral it is often not known whether the non-fault claimant's car will be repaired or written off.
[34] The net effective cost incurred is the car's pre-accident value less its salvage value, taking into account any rebates or referral fees paid separately to the non-fault insurer.

and frictional costs incurred, we found that the management of non-fault write-offs by non-fault insurers resulted in at-fault insurers paying £25 per write-off less than they would have paid if they had managed the write-off themselves.

6.40 We estimated that when write-offs were managed by CMCs the average cost charged to at-fault insurers was about £125 more than the net effective cost incurred. Allowing for the management costs saved by at-fault insurers and also for the transactional and frictional costs incurred (which were slightly greater for credit write-offs than for non-fault-insurer-managed write-offs), we found that credit write-offs resulted in at-fault insurers paying costs of £59 per write-off more than if they had managed the write-off themselves. Brokers and any non-fault insurers referring claims to CMCs earn revenue from referral fees, which we estimated to be about £53 per claim on average (see paragraph 6.37).

Summary of cost and revenue effects

6.41 We found that separation frequently results in the provision of a temporary replacement car on credit hire rather than direct hire terms, at an average extra cost to the at-fault insurer of at least £555 per claim. Allowing for the transactional and frictional costs incurred by the at-fault insurer, but taking off the management costs saved by the at-fault insurer from not handling the claim, we estimated the total cost as a result of separation in relation to non-fault replacement cars to be, on average, about £607 per claim. Against this, non-fault insurers and brokers earn revenues from referral fees of, on average, about £328 per replacement vehicle claim.

6.42 We found that separation results in at-fault insurers paying more than the net costs effectively incurred by either non-fault insurers or CMCs in relation to repairs and write offs:

(a) With regard to repairs, when the claim is managed by non-fault insurers this difference is about £95 on average; when the claim is managed by a CMC it is about £195 on average. Allowing for the transactional and frictional costs incurred by the at-fault insurer, but taking off the management costs saved by the at-fault insurer from not handling the claim, we estimated the total cost of separation in relation to repairs to be, on average, about £17 per claim when managed by the non-fault insurer and £224 when managed by a CMC.

(b) With regard to write-offs, when the claim is managed by non-fault insurers the difference is about £50 on average; when the claim is managed by a CMC it is about £125 on average. Allowing for the transactional and frictional costs incurred by the at-fault insurer, but taking off the management

costs saved by the at-fault insurer from not handling the claim, we estimated the total cost of separation in relation to write-offs to be, on average, about £59 per claim when managed by a CMC. There was no total cost arising from write-offs managed by non-fault insurers as in these claims we found that at-fault insurers paid on average £25 per write-off less than they would have paid if they had managed the write-off themselves.

Against these costs, non-fault insurers and brokers earn revenues from referral fees of, on average, about £53 per repair or write-off claim managed by a CMC. On the other hand, taking into account their management costs, non-fault insurers directly managing a claim incur, on average, a loss of £20 per repair claim and of £62 per write-off claim.

Quality and service differences associated with separation

6.43 Separation could have implications for the level of service received by non-fault claimants. In this subsection, we first summarise the evidence, from our non-fault survey and elsewhere, regarding quality of service differences according to which party manages a claim. We then discuss points made by CMCs/CHCs regarding service differences. We discuss these matters in more detail in Appendix 6.5.

Quality and service differences

Temporary replacement cars

6.44 Table 6.2 shows data from our non-fault survey relevant to assessing quality of service on replacement cars:

(a) Overall, around 15% of respondents said that their replacement car exceeded their needs, 70% said it met but did not exceed their needs and 15% said it fell short of their needs (in most of these cases only slightly).

(b) Comparing results according to which party managed the claim, the percentage saying the replacement car fell slightly short of their needs was six percentage points higher for claims managed by at-fault insurers, implying that respondents' average experience of the quality of

replacement car received was somewhat lower when the claim was managed by the at-fault insurer.[35,36]

(c) Even so, for respondents whose claims were managed by at-fault insurers, the proportion saying that the replacement car fell short of their needs was similar to the proportion saying it exceeded their needs. For other respondents (those whose claims were managed by non-fault insurers and CMCs), a slightly smaller proportion of respondents believed that the replacement car fell short of their needs than believed it exceeded their needs.

(d) The most common reasons for respondents saying that their replacement car did not meet their needs were that it was less spacious, it had a smaller engine, or it was a worse make or model than their own vehicle (see Appendix 6.5). The reasons given were similar irrespective of which party managed the claim.

TABLE 6.2 **Non-fault claimants' experience of replacement cars, analysed by which party managed the claim**

%

	All claims	*Managed by at-fault insurer*	*Managed by non-fault insurer*	*Managed by CMC*
How well the replacement car met respondents' needs				
Far exceeded needs	11	11	11	10
Somewhat exceeded needs	6	4	6	7
Met needs	68	66	69	72
Fell slightly short of needs	9	14	8	4
Fell well short of needs	5	5	5	7
Base (weighted)	1,191	345	487	170
Length of time respondents had access to replacement car				
A longer time than needed	3	3	1	6
As long as needed	88	88	90	87
A shorter time than needed	9	9	9	7
Base (weighted)	1,181	341	482	170

Source: CMA PMI non-fault survey, Questions D19 & D23.

6.45 Our non-fault survey also found that nine out of ten respondents had their replacement car as long as they needed it and there was no significant difference in this proportion depending on which party handled the claim (see Table 6.2). We also did not see evidence of a difference in the speed of replacement car provision under credit and direct hire (see Appendix 6.5, paragraphs 59 to 60).

[35] The difference is statistically significant at the 95% level.
[36] The results of our review of a sample of 100 electronic call records showed that a lower proportion of claimants whose claims were managed by at-fault insurers (70%) than of claimants whose claims were managed by non-fault insurers or CHCs (92%) received a replacement car similar to their own. This evidence supported the finding that the quality of replacement car received might be lower for claims managed by at-fault insurers than for claims managed by CHCs (see Appendix 6.5, paragraphs 65–72).

Repairs and write-offs

6.46 Table 6.3 shows data from our non-fault survey relevant to assessing quality of service on repairs:

(a) When asked about the extent of repair, about 93% of respondents told us that their car had been fully repaired. There was no significant difference between claims handled by the at-fault insurer, the non-fault insurer or a CMC.

(b) When asked about the condition of the car after the repair, slightly more respondents whose claims were managed by at-fault insurers said that the condition of their car was slightly worse after the repair[37] (though, even among those whose claims were managed by at-fault insurers, as many considered that the condition of the car was better as considered it worse). The reasons underlying any negative assessment of the vehicle condition, post-repair, were the same regardless of which party handled the claim, mostly relating to not all the damage having been repaired, or the quality or colour match of paintwork.

(c) In relation to satisfaction with the repair, slightly more respondents whose claims were managed by at-fault insurers were dissatisfied than those whose claims were managed by non-fault insurers (though not more than those whose claims were managed by CMCs).

(d) When respondents were asked about the post-repair value of their car, about 15% said that the value was lower than before the accident, but this percentage was similar irrespective of which party managed the claim.

[37] The difference is statistically significant at the 95% level.

TABLE 6.3 **Non-fault claimants' experience of repairs, analysed by which party managed the claim**

	All claims	*Managed by at-fault insurer*	*Managed by non-fault insurer*	*% Managed by CMC*
How much damage was repaired				
All of the damage was repaired	93	94	92	97
Most of the damage was repaired	5	5	6	0
Some of the damage was repaired	2	1	2	3
Base (weighted)	1,159	364	492	141
Condition of the car after the repairs were made				
In a lot better condition	5	4	4	5
In somewhat better condition	8	10	8	7
Same	75	73	79	78
Slightly worse	10	12	8	7
Much worse	1	1	1	3
Don't know	1	0	1	0
Base (weighted)	1,163	364	495	141
Satisfaction with the repair service analysed by who managed the claim				
Very satisfied	61	56	66	63
Fairly satisfied	28	30	27	25
Neither satisfied nor dissatisfied	4	6	2	1
Fairly dissatisfied	3	4	2	6
Very dissatisfied	4	3	2	6
Base (weighted)	1,159	364	492	141
Value of the vehicle after the repairs were made (compared to before the accident)				
Vehicle was worth more	1	0	0	0
Vehicle was worth the same	80	81	81	84
Vehicle was worth less	14	15	13	12
Don't know	5	4	6	3
Base (weighted)	1,163	364	495	141

Source: CMA PMI non-fault survey, Questions C11, C22 & C24.

6.47 This evidence suggested to us that differences in consumers' experiences of repair associated with separation were small. We recognised that there were limitations to consumers' ability to assess the quality of a repair and we found some concerns in relation to the quality of repairs provided (see paragraphs 5.7 to 5. 25). However, those concerns applied to claims managed both by at-fault insurers and by third parties (ie non-fault insurers and CMCs). Insurers told us that they managed non-fault repairs similarly, whether they were the non-fault insurer or the at-fault insurer having captured the claim, and this was supported by evidence from insurers and repairers on how insurers managed repairs, for example their approach to remuneration and auditing (see Appendix 5.3).

6.48 We noted that, in some respects, captured non-fault claimants might receive a better service than those whose repairs were managed by non-fault insurers. In particular, captured non-fault claimants, dealing only with the at-fault insurer, are not at risk of having to contribute to the cost of repairing their car (to the extent of their excess) or of losing their NCB for a period. By contrast, where claims are managed by non-fault insurers, there seemed to be real risks. Two insurers (Admiral and Zurich) told us that, when managing non-fault claims for claimants without MLEI, they sought to recover from the at-fault insurer only the repair cost *less* the non-fault claimant's excess.[38] This means that the non-fault claimant has to pay the excess (similar to an at-fault claim) and recover it themselves from the at-fault insurer. Similarly, non-fault claimants whose claims are managed by their own insurer might temporarily lose their NCB during the period before their claim is settled, though this should subsequently be restored if the claimant is confirmed not to have been at fault.[39]

6.49 Overall, we did not find a significant quality of service difference in repairs according to whether claims were managed by at-fault insurers, non-fault insurers or CMCs.

6.50 We also did not find evidence of service differences with respect to write-offs between claims managed by at-fault insurers, non-fault insurers and CMCs (see Appendix 6.3).

Evidence from CHCs/CMCs

6.51 CHCs/CMCs told us that they provided better or additional replacement vehicle services than insurers (both at-fault insurers and non-fault insurers) at no cost to the non-fault claimant. The services mentioned were extra insurance on replacement cars (ie better collision damage waiver (CDW) and other protection products),[40] collection and delivery of the replacement vehicle, uninsured loss recovery (which might include recovery of any excess paid if the non-fault insurer is managing the repair part of the claim),[41] and after-the-event insurance.[42] We discuss these services in more detail in Appendix 6.5. In summary:

(a) We found that two out of nine CHCs in our sample (Accident Exchange and Crash Services) offered full CDW (ie reducing the excess on the replacement car to zero) at no additional charge to their credit hire customers, whereas most others offered a CDW with an excess of £50, or

[38] Admiral told us that when managing non-fault claims for claimants without MLEI it was standard practice to request recovery from the at-fault insurer of the repair cost less the non-fault claimant's excess. However, Admiral said that some at-fault insurers would choose to send the excess cheque to Admiral along with the repair reimbursement and in these circumstances Admiral forwarded the cheque to the non-fault claimant.
[39] The risks of non-fault claimants having to pay their excess and of temporarily losing their NCB do not typically apply with credit repairs.
[40] We use the term CDW to refer to all protection against liability of the hirer to pay an excess on insurance of the hire car. Some level of CDW is often included in credit hire and direct hire, but this differs between providers and some providers offer customers an additional CDW for a fee.
[41] Uninsured loss recovery involves pursuing the at-fault insurer on behalf of the non-fault claimant for loss of earnings, loss of personal effects, loss of value to the vehicle, excess, etc.
[42] After-the-event insurance covers the non-fault driver in the event that the cost of the services provided to them by a CMC/CHC and other providers (eg engineers, investigators, lawyers and doctors) cannot be recovered from the at-fault insurer and, therefore, the providers pursue the driver for their costs.

higher if the customer's own insurance excess exceeded this figure.[43] Under direct hire, the CDW excess varied from £50 to £250 (and up to £500 on premium cars) depending on the agreement between the insurer and the direct hire provider.

(b) We found that delivery and collection were offered to non-fault claimants under direct hire as well as under credit hire. We noted that customers could sometimes choose to pick up the replacement vehicle from the site of the rental company instead of having it delivered to their own premises in order to obtain it more quickly and that this was more likely if the rental company had a dense network of outlets.[44]

(c) We found that six out of nine CMCs/CHCs provided uninsured loss-recovery services, but that these were provided to relatively few customers.

(d) We found that after-the-event insurance was not relevant to our assessment of separation as it was not needed when claims were managed by the at-fault insurer.[45]

6.52 Accident Exchange suggested that our analysis of direct hire as a counter-factual to credit hire had failed adequately to reflect the quality differences between these two services as it had not taken into account that direct hire did not deliver non-fault claimants' legal entitlements, instead imposing on them costs and liabilities with which they should not have to contend. As well as CDWs and the practice of requiring non-fault claimants to collect and return the temporary replacement vehicles themselves, Accident Exchange referred to terms in some direct hire companies' contracts which it said imposed a legal obligation on the non-fault claimant to pay for all charges arising from the rental. As set out above, we found that there were some differences in quality between individual suppliers and, on average, between credit hire and direct hire (including differences in CDW, with the average credit hire offering being better than the average direct hire offering because two CMCs/CHCs in our sample provided full CDW). However, beyond those two CMCs/CHCs, we did not find evidence that payments by non-fault claimants were greater under direct hire than under credit hire. Data from Enterprise (which accounts for a large share of direct hire and is also one of the largest providers of credit hire) showed a similar level of payment (in

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[43] This is the level stated in the GTA. The GTA also states that a higher level than £50 can apply if the customer does not have comprehensive insurance.
[44] See Appendix 6.1, paragraphs 37–40.
[45] After-the-event insurance is not required under direct hire as the at-fault insurer has (by capturing the non-fault driver) accepted responsibility for the payment of the costs incurred in providing post-accident services to them.

pounds per claim) by claimants under direct hire as under credit hire[46] as did evidence from Helphire (another of the largest providers of credit hire).[47]

6.53 CHCs also said that liability was resolved more often and more quickly under credit hire. Further, some CHCs said that they provided replacement cars to non-fault drivers when liability was uncertain or disputed by the at-fault insurer. We accepted that, particularly where a car was not driveable following an accident, CHCs were often willing to provide a replacement car to the apparent non-fault driver before all the information on liability was available. However, we noted that this might also be true of insurers providing direct hire. We found that, once a non-fault claim had been referred for credit hire, the at-fault insurer was unlikely to seek to capture the claim and nor did it then have an incentive to accept liability.[48] Consequently, we found that it was difficult to make an inference about whether an at-fault insurer would have been willing to capture a claim from the fact that liability was disputed at the time the CHC began to provide a replacement car.

6.54 In order to consider the points made by CHCs about the likelihood and speed of liability resolution and the provision of replacement cars, we compared experience for *(a)* claims where both drivers were insured by the same company or by companies which had bilateral agreements with each other (ie claims where a referral for credit hire was unlikely to be made); with *(b)* other claims where a referral for credit hire was likely to be made. We did not see evidence that liability was resolved more often or more speedily, or that replacement cars were provided more often, under *(b)* rather than under *(a)* (see Appendix 6.5, paragraphs 51 to 57 and 74 to 80).

6.55 CHCs also submitted that their presence acted as a deterrent to insurers providing poor-quality replacement car services. CHCs said that, in the absence of separation, an insurer's incentive would be to minimise its costs. They said that insurers would not have any incentive to provide non-fault claimants with a quality replacement car, or indeed with a replacement car at all. They pointed to the fact that, prior to the development of CHCs in the late 1980s, insurers did not provide replacement vehicles to non-fault claimants. At this time, non-fault claimants had to hire vehicles themselves and recover the cost themselves from the at-fault insurer. CHCs suggested that, in the absence of credit hire, non-fault claimants would receive a lower quality of

[46] See Appendix 6.1, paragraph 34.
[47] Data submitted by Helphire showed income from clients of £[✂] per claim for both direct hire and credit hire, see Appendix 6.1, Annex C.
[48] Members of the GTA agree that they will not seek to intervene if another member provides a replacement car to a customer ('first to the customer' provision, set out in section 3 of the GTA).

replacement car than they did now, for example a basic courtesy car, or no replacement car at all.

6.56 We accepted, as a general proposition, that the existence of CHCs/CMCs was likely to contribute to insurers having the incentive to provide a higher-quality service to non-fault claimants than they otherwise would, including in many cases the provision of a like-for-like replacement car. However, our concern was not with the costs and benefits of CHCs/CMCs but with the potential existence of adverse effects on competition. In that context, our focus was on the costs and benefits arising in the current market structure compared with a benchmark 'well-functioning market' in which consumers' legal entitlements were delivered in an efficient way (see paragraph 6.4). To that end, we compared the current cost of the provision of post-accident services to non-fault claimants with the efficient cost of providing consumers with their legal entitlements.[49] We noted that, to the extent that the current level of provision exceeded consumers' legal entitlements (see paragraph 6.51), we needed to take into account any resulting benefits to consumers.

Summary on quality and service differences

6.57 Based on the evidence from our non-fault survey and elsewhere, we found that there was a small difference in the quality of service on replacement cars depending on the party which managed the claim, with slightly more captured than non-captured respondents to our non-fault survey receiving a replacement car slightly below their own assessment of need. We also found that certain CHCs provided some services to consumers in addition to the replacement car. We did not find a service difference in relation to repair as the evidence indicated that insurers managed non-fault repairs similarly, whether or not they were captured.

6.58 Given that our benchmark was that consumers' legal entitlements were delivered in an efficient way, our approach was to compare the current cost of provision with the efficient cost of providing consumers with their legal entitlements, and to take into account any benefits to consumers which resulted from the current level of provision exceeding consumers' legal entitlements. We found that some non-fault insurers did not provide a full service to non-fault claimants to restore them to their pre-accident position, for example by requiring claimants to pay an excess but then not including it in the claim for recovery from the at-fault insurer (see paragraph 6.48), or by only providing some non-fault claimants with a courtesy car.[50] We found it

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[49] We discuss the benchmark further below – see paragraphs 6.97 & 6.98.
[50] [✂] told us that it provided non-fault claimants without MLEI with the replacement car to which they were entitled under their own policy, ie usually a courtesy car.

difficult to understand why insurers adopted these practices, which appeared to disadvantage their own customers by not delivering them their full entitlements under tort law, despite the non-fault insurer being able to recover the cost.

Implications for consumers of separation

6.59 In our view, the evidence set out above (see paragraphs 6.23 to 6.58) indicated that at-fault insurers were paying more than the efficient cost of providing consumers with their legal entitlements. In other words, it suggested that there were inefficiencies in the supply chain involving excessive frictional and transactional costs. We noted that the potential implications for consumers were complex as they could lead to both positive and negative benefits, as follows:

(a) higher costs for at-fault insurers could lead to higher PMI premiums;

(b) the revenue stream to non-fault insurers and brokers could lead to lower PMI premiums; and

(c) there may be direct benefits to consumers.

In this subsection we discuss these issues in turn and then estimate the net effects on consumers.

Impact of higher costs for at-fault insurers on PMI premiums

6.60 We were not able to observe a situation where there was no separation of cost liability and cost control but where consumers' legal entitlements were met. Hence, we were not able to make a direct comparison of PMI premiums without separation and with separation. However, we did make a detailed economic assessment of the factors affecting the extent to which cost changes were passed through into price changes which enabled us to infer the impact of higher costs on premiums. Our economic analysis (see Appendix 6.4) suggested that the main factors affecting the extent to which cost changes were passed through into price changes for consumers were:

(a) whether the cost change represented a change in marginal or fixed costs;

(b) the responsiveness of supply to cost changes (elasticity of supply);

(c) the effectiveness of competition in the market and the price elasticity of market demand; and

(d) whether the change in cost affected all firms in the market equally, or whether there were differences in the effect on different firms.

We summarise below how each of these factors relates to the higher costs faced by at-fault insurers as a result of separation.

Marginal and fixed costs

6.61 Economic theory suggests that changes in marginal cost (ie the cost of supplying one more unit) which affect all firms in the market are more likely to feed through into price changes than changes in fixed cost.[51]

6.62 The cost of insuring an individual driver depends on the expected cost of at-fault claims, ie the likelihood of the driver being at fault in an accident times the expected cost of handling the claims arising from any such accidents.[52] Since the cost increase that we found, which relates to the cost incurred by at-fault insurers in dealing with non-fault claims, affects the expected cost of handling at-fault claims, we believed this represented a change in marginal cost rather than a change in fixed cost.

Responsiveness of supply

6.63 If firms experience difficulties or incur additional costs in supplying more of a product, the constraint they impose on each other will tend to be weakened and the extent to which cost changes are passed through into prices will also tend to be reduced. This might be relevant, for example, if we are considering:

(a) the short-term impact of an unexpected cost change in a situation where it takes time for firms to change capacity. In these circumstances, the short-term constraint on each firm's prices is weakened and we would expect pass-through of cost changes into price changes to be lower in the short term than in the longer term, ie once there has been time for capacity to change; and

(b) a market where each firm's marginal cost increases as the amount it supplies becomes greater (ie decreasing returns to scale). In these

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[51] This is because the strength of the constraint on each firm's price depends at least to some extent on the marginal costs of the other firms in the market (because the lower the marginal cost of the other firms, the cheaper it is for them to attract the customers of the first firm). Hence, if the marginal cost of all firms changes, the constraint on each firm's existing price is weakened and the desire to maximise profits implies that it will increase its price. (In the limit, ie under perfect competition, price is equal to marginal cost.) In contrast, fixed costs do not affect directly the constraint on each firm's price; though, if a change in fixed costs prompts exit or entry or otherwise affects competition in the market, there will be an effect on market price.
[52] This assumes a comprehensive PMI policy. The price will also reflect the likelihood and expected cost of fire and theft claims.

circumstances, the amount supplied after the cost change is different from that before the cost change, the change in marginal cost is reduced and the impact on price lessened.[53]

6.64 However, we found that neither of these two situations applied to PMI non-fault claims. In relation to the first, we were seeking to compare the current situation where there is separation of cost liability and cost control with a benchmark situation where there is no such separation. Therefore we were not concerned with short-term effects, eg due to capacity limitations. In relation to the second, there was no evidence that PMI is characterised by marginal cost increasing with the amount supplied.

Competition and price elasticity of market demand

6.65 When competition in the market is strong and market demand is inelastic, each firm's price is constrained by customers switching to the products of other firms in the market, rather than by customers switching to different products outside the market or just deciding not to use the product. Hence, an increase in marginal cost affecting all firms in the market relaxes the constraint on each firm's price, enabling each firm to increase its price (and, similarly, a reduction in marginal cost intensifies the constraint on each firm's price, requiring it to reduce its price).

6.66 We found that, overall, rivalry in the PMI market was strong and that motor insurers' prices were constrained by rivalry from other motor insurers. In particular, we noted that:

(a) the market was fairly unconcentrated, with the largest firm having a [✄]% share of PMI premium income, the four largest having 46% and the ten largest having 67%;

(b) profitability data did not suggest that motor insurers had earned economic profits (ie profits in excess of the cost of capital) over the last few years, though there was fluctuation from year to year;

(c) switching between insurers was high relative to comparable products and there was no obvious obstacle to switching (with the possible exception of NCB protection (see Section 7)); and

(d) there was evidence that each motor insurer's demand was responsive to changes in its own price (with competitors' prices held constant), ie each

[53] Any such effect would only be material if both the change in marginal cost was relatively large and demand was relatively elastic, so that there was a material change in the total amount supplied.

individual firm's demand was price elastic; though this did vary between channels, being highest for PCWs and tending to be lowest for renewals.

6.67 As set out in Section 4, we noted that third party PMI was a legal requirement, and a change in average PMI premiums could only affect market demand if it induced changes in the number of cars insured. Therefore, we found that the market demand for PMI was likely to be very price inelastic. We noted that higher costs were likely to affect disproportionately the premiums of those drivers most likely to cause accidents and that demand from these drivers might be less price inelastic than the demand from all drivers,[54] but we believed that demand from such drivers was still likely to be price inelastic (even if not as price inelastic as demand from all drivers).

Differences in cost changes between insurers

6.68 As discussed above, a change in marginal cost that affects all firms in a competitive market with inelastic demand will tend to be passed through into prices. However, it is less clear that this is the case for a change in marginal cost that affects only a small proportion of firms. In imperfectly competitive markets, the extent of the impact on price of cost changes affecting only some of the firms in the market depends on the specific characteristics of the market and the change in costs (see Appendix 6.4).

6.69 With regard to non-fault PMI claims, we noted that there were some differences in the cost increase associated with non-fault claims handled or referred on by different insurers, in particular in the case of repair, including the use of credit repair.[55] However, the higher costs associated with non-fault claims handled or referred on by each insurer do not affect that insurer's own marginal cost, only the marginal cost of other insurers (in proportion to the extent to which the first insurer's drivers are not at fault in accidents where the other insurers' drivers were at fault). Since each insurer's drivers would be at-fault in accidents where drivers of many other insurers were not at fault, each insurer's marginal cost would be affected by the practices of many other insurers. Hence, the difference between insurers in cost impact is likely to be much less than the underlying difference in practices (we discuss this further in Appendix 6.4, paragraph 13).[56] We noted that there were some differences between insurers in the proportion of claims they captured and in the number

[54] Reasons for this included that the cost of PMI for such drivers would be higher relative to the total cost of motoring and that such drivers might tend to be younger drivers with lower than average income for whom insuring their own car could become unaffordable.
[55] There is less difference in replacement cars, although we note that among the largest ten insurers, [✂] does not use credit hire directly.
[56] Some claims are referred to CMCs/CHCs by brokers rather than insurers, and in a few cases referrals are made by other parties (eg dealerships, repairers, etc). This does not alter the underlying point.

of bilateral agreements they had with other insurers, but we did not believe these differences were likely to be of sufficient importance to lead to large differences in the expected marginal cost of at-fault claims.

Conclusion on impact of higher costs on PMI premiums

6.70 Our discussion suggests that: *(a)* higher costs result in a change in marginal cost that, for a given level of risk, is broadly similar across motor insurers in the market; *(b)* the market is characterised by strong rivalry with price-inelastic demand; and *(c)* as we are concerned with comparing situations with and without separation of cost liability and cost control, short-run capacity effects are not relevant. These circumstances are those in which we would expect the higher costs incurred by at-fault insurers to be reflected broadly pro rata in higher premiums. We would expect the effect on individual premiums to vary according to drivers' risk of being at fault in accidents, being highest for drivers with the greatest risk.

6.71 It appeared to us that evidence from insurers supported our expectation of broadly pro rata pass-through as they all told us that their PMI premium quotes reflected the expected cost of handling at-fault claims.

Impact of the revenue stream to non-fault insurers and brokers

6.72 In this subsection we discuss the revenue stream accruing to insurers and brokers as a result of the separation of cost liability and cost control (ie referral fees and similar income). We discuss first insurers and then brokers. We then discuss the implications of the higher sums claimed affecting the costs of at-fault drivers whereas the revenue stream offsets the costs of non-fault drivers.

Non-fault insurers

6.73 The factors which affect the extent to which cost increases are passed through into price increases for consumers are the same factors which affect the extent to which cost decreases, or additional revenues, are passed through into price reductions for consumers (see paragraph 6.60*(a)* to *(d)*). We considered each of these factors in relation to revenue streams to non-fault insurers:

- *(a)* The revenue accruing to insurers acts as an offset to the expected costs of insuring drivers in proportion to the likelihood of the driver being not at fault in an accident. Hence, it is similar to a reduction in the marginal cost of PMI. The logic is the reverse of that given above in relation to higher costs.

(b) The analysis in relation to responsiveness of supply is the same as in relation to higher costs.

(c) The analysis in relation to competition and price elasticity of market demand is also the same as in relation to higher costs.

(d) There is more difference between insurers in the impact of additional revenues than there is in the impact of higher costs because each insurer's revenue stream is affected by its own practices, whereas each insurer's additional cost is affected by the practices of all other insurers. We discuss the implications of the greater asymmetry between insurers' revenue streams than between their costs in Appendix 6.4 (see paragraphs 29 to 33). On balance, in our view, the pass-through of changes in an insurer's revenue into premiums was likely to be lower than for changes in an insurer's costs (which we considered would be fully, or close to fully, passed through (see paragraph 6.70)). However, we recognised that there was more uncertainty with regard to the extent of pass-through of revenues than costs.

6.74 This suggested that the revenue stream to insurers arising as a result of the separation of cost liability and cost control was likely to reduce PMI premiums, though this reduction was likely to be less than pro rata with the revenue stream.

6.75 The evidence from insurers did not persuade us that this view was wrong as insurers were somewhat less clear that the revenue stream was taken into account in setting premiums than was the case for costs.[57]

6.76 Overall, we found that the revenue stream (from referral fees etc) to non-fault insurers arising from separation was likely to reduce PMI premiums, but the effect was likely to be less than pro rata.

Non-fault brokers

6.77 We noted that brokers could generally be divided into two groups:

(a) brokers which paid an agreed net amount to the company providing insurance and in effect set their own premiums (this group included larger traditional brokers and online direct brokers); and

[57] Five out of the ten largest insurers told us that they treated referral fee and similar income as a negative expense; two said that they took it into account in determining target loss ratios or returns which would affect premiums over the longer term; and one said that such income was not factored into premiums. For the other two insurers, it was unclear to what extent this income affected premiums.

(b) brokers where the insurance company sets the premium and remunerates the broker at an agreed percentage commission rate (typically these would be smaller traditional brokers, operating on a local or regional basis).

6.78 The impact of revenues from referrals (etc) for the first group is similar to that for insurers (see paragraphs 6.73 to 6.76).

6.79 However, the impact for the second group is potentially different from that for insurers because, at least in the first instance, premiums are set by the insurers whose policies the brokers sell. Referral fee income to these brokers will only be reflected in lower premiums if, as a result of receiving the additional income, they set lower commission fees and the insurers then reflect these savings in lower premiums. Given that we found rivalry in the PMI market to be strong, we judged that this was likely, but we noted that there was more uncertainty about this pass-through than in relation to insurers and the first group of brokers).

6.80 Overall, we found that the effect on PMI premiums of the revenue stream (from referral fees etc) to non-fault brokers arising from separation was likely to be broadly similar to that arising from the revenue stream to non-fault insurers, but there were some additional uncertainties.

Conclusion on impact of revenue stream on PMI premiums

6.81 In our view, the revenue stream to non-fault insurers and brokers associated with the separation of cost liability and cost control reduces the PMI premiums charged by insurers, and therefore partially offsets the higher PMI premiums which flow from the higher costs resulting from this separation.[58]

Effects on different parties

6.82 The revenue stream arising from separation is associated with a reduction in PMI premiums in proportion to the risk of drivers being *not at fault* in accidents; however, the higher costs arising from separation are associated with an increase in PMI premiums in proportion to the risk of drivers being *at fault* in accidents. We noted that the consumers affected were unlikely to be the same since, when setting PMI premiums, insurers did not assume that the likelihood of a driver being at fault in an accident was similar to their risk of

[58] It partially, rather than fully, offsets the higher premiums attributable to higher costs because the revenue stream to non-fault insurers and brokers is less than the higher costs to at-fault insurers (see paragraph 6.41). Moreover the pass-through of the revenue is likely to be at a lower percentage than the pass-through of the costs (see paragraph 6.76).

being not at fault. In particular, drivers who were less experienced, less attentive and who engaged in more risky behaviour were relatively more likely to be at fault in accidents, and insurers proxied for these things by basing premiums on risk factors such as number of years of driving, age, occupation, postcode, etc. Since the effect of higher costs on PMI premiums varied with risk, having the greatest effect on the premiums of drivers with the most adverse risk factors, while the revenue stream affected all drivers much more equally, we found that an effect of separation was that prices to individual drivers were not fully reflective of underlying costs.

Direct benefits to consumers

6.83 Given that our benchmark involved consumers' legal entitlements being delivered in an efficient way (see paragraph 6.4), we considered what benefits to consumers resulted from the current level of provision exceeding their legal entitlements.

6.84 The evidence from our non-fault survey indicated that quality of service was slightly better in relation to replacement cars where there was separation, ie for claims managed by non-fault insurers and CMCs (see paragraph 6.57). However, the relevance of this finding to our assessment depended on the reasons for the difference: if it was due to class of car or length of hire, it was already reflected in our estimate of the cost difference between credit and direct hire (which was based on the pattern of credit hire provision (see paragraph 6.29)); if, however, it was due to other reasons, it was not reflected in our estimate of this cost difference. The evidence from the survey indicated that the main reasons for the replacement car not meeting customers' needs were that it was either *(a)* less spacious/smaller or *(b)* a worse make/model than their own vehicle.[59] It appeared to us that these reasons were likely to be related to class of car and hence had already been included within our estimate of the cost difference between credit and direct hire.

6.85 We also found some other differences between credit and direct hire, in particular in the level of CDW offered free of charge to customers,[60] and in the provision of help with uninsured loss recovery (see paragraph 6.51*(c)*). We found that these features of credit hire represented additional benefits to

[59] See Appendix 6.5, Table 20.
[60] Two out of the nine CHCs in our sample offered a full CDW, reducing the customer's excess to zero, see paragraph 6.51*(a)*.

consumers.[61] We estimated the total value of these benefits to be about £3 million per year.[62]

Estimation of the effect of separation on consumers

6.86 Our approach was to compare the current cost of provision with the efficient cost of providing consumers with their legal entitlements, taking into account where relevant any additional benefits to consumers from the current provision (see paragraph 6.85). In this subsection, we set out our main estimate of the impact on PMI premiums of separation from the increase in costs to at-fault insurers and the revenue stream to non-fault insurers/brokers, after taking account of the additional benefits to consumers from the current provision, and estimate the net total impact on consumers. We then discuss issues raised and carry out an analysis of the sensitivity of the estimates to key assumptions (see paragraphs 6.94 to 6.103).

Higher costs and increased premiums

6.87 We estimated the effect of separation on costs as follows:

(a) Credit hire increases costs to at-fault insurers by an average of about £607 per hire compared with an equivalent direct hire (see paragraph 6.32).

(b) Credit repair increases costs to at-fault insurers by an average of about £224 per repair and non-fault insurer repair increases costs by an average of about £17 per repair compared with repairs managed by at-fault insurers (see paragraphs 6.35 and 6.36).

(c) For write-offs, cost is increased to at-fault insurers by an average of about £59 per write-off when a CMC is involved, but is decreased by an average of about £25 when a non-fault insurer is involved (see paragraphs 6.39 and 6.40).

6.88 Table 6.4 summarises the resulting calculation. Full details of our calculations are set out in Appendix 6.6.

[61] Some consumers purchase MLEI, which provides help with uninsured loss recovery. In these cases, the provision of help with uninsured loss recovery by a CHC would represent a benefit to the MLEI provider. This might be reflected in the CHC paying a lower referral fee to that insurer (see Appendix 6.5, paragraphs 91–92).
[62] We deducted from the cost of credit hire the estimated value of the full CDW which is provided by two CHCs (see Table 6.1). As the majority of non-fault claimants appear to have MLEI, we included the value of uninsured loss recovery services in referral fee income (see footnote to paragraph 6.30).

TABLE 6.4 **Total impact of separation on at-fault insurers' costs**

	Replacement car		*Repair*		*Write-off*		
	£ per claim	*No of claims ('000)*	*£ per claim*	*No of claims ('000)*	*£ per claim*	*No of claims ('000)*	*Total cost increase*
Credit hire/repair	607	301	224	85	59	21	
Non-fault insurer handling			17	240	(25)	64	
Total cost increase (£m)	183		23		(0)		206

Source: CMA.

6.89 On this basis, we estimated the total increase in costs to at-fault insurers arising from separation to be around £206 million per year, of which £183 million per year was due to credit hire. We believed that this cost increase would be reflected broadly pro rata in higher PMI premiums to consumers (see paragraph 6.70).

Higher revenue and lower premiums

6.90 We estimated the revenue stream to non-fault insurers and brokers to be £96 million per year (see Table 6.5). We estimated credit hire alone to generate a revenue stream of £99 million per year.[63] We believed that these revenues would be reflected in lower PMI premiums to consumers, though there was more uncertainty about the pass-through than in regard to higher costs and we expected that the effect was likely to be less than pro rata (see paragraph 6.76).

TABLE 6.5 **Total impact of separation on non-fault insurers' profits**

	Replacement car		*Credit repair & write-off*		*Insurer-managed repair & write-off*		*Total (£m)*
	£ per claim	*No of claims ('000)*	*£ per claim*	*No of claims ('000)*	*£ per claim*	*No of claims ('000)*	
Revenue to insurers	341	184	53	50	(29)	304	56
Revenue to brokers	310	117	53	57			39
Total revenues (£m)	99		6		(9)		96

Source: CMA.

Net effect on consumers

6.91 We calculated the net effect on consumers as the total of the effect on PMI premiums from the higher costs to at-fault insurers (see paragraphs 6.87 to 6.88) and the revenue stream to non-fault insurers and brokers (see paragraph 6.90), allowing also for the direct benefits to consumers (see

[63] In calculating the net impact on non-fault insurers' profits, we deducted from the revenue the costs that non-fault insurers incurred in managing repairs and write-offs.

paragraph 6.85). As discussed above, we believed that the higher costs to at-fault insurers were likely to be passed through pro rata into higher PMI premiums but the revenue stream to non-fault insurers and brokers was likely to be passed through less than pro rata, though we were not able to quantify to what extent less. In our main estimate, we assumed full pass-through of the revenue stream (as well as the higher costs), but we also looked at sensitivities with pass-through of the revenue stream at 80 and 90%.

6.92 Our main estimates were of a net detriment to consumers from credit hire of £84 million per year, and a total net detriment to consumers (including repairs and write-offs) of £110 million per year. These calculations are summarised in Table 6.6.

TABLE 6.6 **Estimated net detriment**

	Credit hire	*Insurer-managed repair & write-off*	*Credit repair & write-off*	*Total*
Cost difference—actual versus benchmark (£ per claim)	555	87	257	
At-fault insurer's average transactional/ frictional costs (£ per claim)	78	32	45	
At-fault insurer's average management costs saved (£ per claim)*	(27)	(111)	(111)	
Average cost of separation to at-fault insurer (£ per claim)	607	8	191	
Average revenue to non-fault insurer (referral fees etc, £ per claim)	328	(29)	53	
Net detriment (£ per claim)†	286	37	137	
Number of claims ('000)	301	304	107	
Net detriment (£m)*†	84	11	15	110

Source: CMA calculations.

We attributed any incremental costs of at-fault insurers which were not directly caused by either repair/write-off or replacement cars, for example the costs of capturing claims, to repair/write-off (see Appendix 6.6, paragraph 28). We did this because all relevant claims involve repair or write-off but not all involve provision of a replacement car. If, instead, such costs were allocated equally between repair/write-off and replacement cars, the net detriment associated with credit hire would reduce to £75 million (see paragraph 6.102(a)*).
†Net detriment is average cost of separation to non-fault insurer less average revenue to non-fault insurer.

6.93 We noted that not all drivers were affected in the same way by separation (see paragraph 6.82). We found that PMI premium increases were likely to be higher for drivers with a higher probability of being at fault, while PMI premium increases were likely to be lower for less risky drivers (and for the least risky drivers PMI premiums might even fall).[64]

Discussion and sensitivity analysis

6.94 In this subsection, we discuss several issues in relation to our estimate of the net detriment, under the following three headings:

[64]We discuss effects on consumer surplus in Appendix 6.7, finding that these effects are likely to be extremely small.

(a) issues associated with our terms of reference;

(b) issues associated with our benchmark; and

(c) reasons for transactional and frictional costs.

We recognised that there were a number of uncertainties associated with our estimate of the net detriment as we had inevitably had to make assumptions in some areas. Therefore we also set out in this subsection an analysis of the impact on the estimated net detriment of certain variations in key assumptions (a sensitivity analysis).

Issues associated with our terms of reference

6.95 In response to our provisional findings, several parties pointed out that our terms of reference were limited to PMI and said that we had overestimated the net detriment because we had included claims arising under insurance which was outside our terms of reference, eg commercial and motorcycle insurance. However, our estimate of the net detriment only includes claims where the non-fault driver had PMI. While it is true that some of these claims would be against drivers who did not have PMI, as defined in our terms of reference (eg drivers of fleet cars, commercial vehicles and motorcycles), in such cases the detriment would still be generated by the practices and conduct of the parties managing the non-fault claim. Consequently, the detriment for these claims still arises from the PMI market. The at-fault insurers experiencing higher costs would not be private motor insurers, and hence the detrimental effect would not be on customers with PMI (ie it would be on customers with commercial or motorcycle insurance) but the Act states that a detrimental effect on customers can occur in any market in the UK, whether or not it is the market to which the features relate.[65] Therefore, in our view detrimental effects on customers with commercial or motorcycle insurance should be included in our estimate of the net detriment.[66] We calculated that our estimate of the total net detriment to consumers of £110 million per year (see paragraph 6.92) could be split into a net detrimental effect on PMI customers of £58 million per year and a net detrimental effect on other motor insurance customers of £52 million per year.[67]

[65] Section 134(5)(a).
[66] We believed that similar considerations affect the pass-through of higher costs to commercial and motorcycle insurance premiums as affect the pass-through of higher costs to PMI premiums (see discussion in paragraphs 6.60–6.71).
[67] This is on the basis that non-PMI insurance accounts for 25% of motor insurance (see paragraph 2.4) and that the at-fault party is non-PMI in 25% of PMI non-fault claims.

6.96 A similar point was made in relation to referral fees paid to recovery agents, repairers etc, rather than to insurers and brokers. However, in our view, while these referral fees represent a revenue stream to companies other than private motor insurers, and would not be passed through to PMI customers via lower PMI premiums, they could nevertheless be passed through to customers in other markets. In principle, therefore, we believed that such referral fees should be included in the net detriment calculation. In practice, such referrals currently represent a small percentage of the total and, as a result of data limitations, we were not able to include claims involving such referral fees in our estimate of the net detriment.[68]

Issues associated with our benchmark

6.97 In response to our provisional findings, some CHCs told us that our bench-mark was an idealised scenario with no frictional costs, which did not constitute the market outcome which would arise in the absence of separation since, in that scenario, fault insurers would have at best limited incentives to provide direct hire. We discuss these issues in detail in Appendix 6.8. In summary, in our view the benchmark is just a tool for our analysis of potential adverse effects on competition. We recognised the point made in responses that, in the absence of separation (ie if at-fault insurers handled all claims from non-fault parties), insurers would have an incentive to underprovide on service as well as to control costs; and we also recognised that any remedy which addressed the AEC arising from separation would need to ensure that there was no underprovision of service, which would have some cost, such that the detriment estimated as arising from the AEC could only ever be partially removed. We chose to take account of the extent to which any remedy could address the detriment and any relevant customers' benefits arising from separation within our consideration of remedies rather than in the assessment of the AEC.

6.98 We believed that there were two important implications of non-fault claimants receiving their legal entitlements (ie our benchmark) for our detriment calculation:

(a) First, it meant that, in our main estimate of the detriment, we calculated the detriment on the basis of the current provision, including the class of vehicle and length of hire period currently provided under credit hire. In effect, we assumed that claimants currently receiving a credit hire car get their legal entitlement with regard to the class of vehicle and length of

[68] We have only been able to include in our calculations claims managed by insurers or brokers and/or claims referred by insurers or brokers to CHCs/CMCs.

hire, and no more than that (though we relaxed this assumption in our sensitivity analysis). We did not include in any of our calculations of the detriment any cost savings to insurers (and consequent benefits to consumers in lower PMI premiums) which could arise in a benchmark scenario in which there were fewer or lower-quality replacement cars.

(b) Second, consistent with *(a)*, it meant that we did not take into account in our main estimate of the detriment any quality differences between credit and direct hire associated with the class of vehicle or length of hire (though, again, we did in some of our sensitivity analyses).

Reasons for transactional and frictional costs

6.99 Some CHCs told us that a large proportion of the frictional costs which arose in the interactions between insurers and CHCs were due to inefficiencies in insurers' claim-processing procedures. CHCs said that these costs should not be seen as arising from separation.

6.100 We noted that the relationship between at-fault insurers and CHCs generated friction and that this increased costs for both parties, and ultimately for PMI consumers. However, it appeared to us that no party puts in place behaviours with the sole purpose of generating friction. We believed that the main cause of friction was the nature of the interaction and, in this context, even friction caused by the inefficiency of at-fault insurers when processing a claim must be considered in an estimation of the detriment arising from separation, as such inefficiencies, and the implied friction, would not be present under the benchmark. We acknowledged that some level of transactional and frictional costs were likely to be an unavoidable consequence of separation, and therefore that, without removing separation, the full detriment could not be addressed, but we considered these matters in our assessment of remedies.

Sensitivity analysis

6.101 Given the uncertainties around some of the data used in our detriment estimation, we tested the impact of using data from alternative sources and of varying key assumptions.

6.102 A detailed description of our sensitivity analysis is in Appendix 6.6.[69] In summary:

[69] See Appendix 6.6, paragraphs 63-81.

(a) Our main estimate of the net detriment assumes that all the management costs related to captured claims which cannot be directly attributed to the provision of replacement vehicles are allocated to repairs/write-offs.[70] Assuming instead that the non-attributed management costs of captured claims are allocated equally between repair/write-off and replacement vehicles reduces the estimated net detriment for credit hire from £84 million to £75 million, while increasing the net detriment for repairs and write-offs by a similar amount.

(b) Using the average credit hire revenue we obtained from a larger set of CHCs increases the net detriment for credit hire to a value between £99 million and £115 million, depending on how direct hire rates are adjusted.

(c) Using the number of credit hire claims (289,000) estimated using data from CHCs (see the annex to Appendix 2.2) decreases the credit hire detriment by £3 million to £80 million.

(d) If VAT on credit hire services is excluded in 5% of claims to account for VAT-registered claimants (see Appendix 6.1, paragraph 50), the net detriment is reduced by £3 million to £80 million.

(e) The benefit claimants get from the more granular vehicle classifications used under credit hire (see Appendix 6.1, paragraphs 52 to 55) is likely to amount to less than £2 million.

(f) If we do not adjust direct hire costs for the longer duration of credit hire (ie we adjust only for the type of car),[71] the net detriment for credit hire increases by £24 million to £108 million.

(g) If we do not adjust direct hire costs for the type of car (ie we adjust only for longer duration of credit hire),[72] the credit hire net detriment increases by £20 million to £103 million.

(h) Assuming a lower pass-through of the revenue earned by non-fault insurers and brokers significantly increases the net detriment, especially for credit hire. A pass-through of 90% leads to a net detriment for credit hire of £94 million. If pass-through is only 80%, the net detriment increases to £103 million.

[70] See Appendix 6.6, paragraph 28.
[71] Table 6.1 shows the adjustments made in our main estimate for duration and type of car.
[72] See previous footnote.

6.103 Table 6.7 shows the ranges of possible net detriment values obtained from the combination of different assumptions above. The high and low estimates in the table are based on sensitivities with all the assumptions generating the highest and lowest net detriments respectively.

TABLE 6.7 **Ranges of possible net detriment values**

£ million

	High estimate	*Low estimate*
Credit hire	178	67
Credit repair	18	15
Credit write-off	1	0
Insurer-managed repair	20	8
Insurer-managed write-off	5	2
Total	214	101

Source: CMA.

Note: Since the assumptions on the allocation of common costs have an impact on the estimated total detriment, the high and low estimates of the total detriment are not the sums of the high and low estimates for the various components.

Effects on competition

6.104 We have found that, for the majority of non-fault claims, cost liability is separate from cost control. This separation arises because the at-fault insurer is liable for the costs of meeting the claim but another party (typically the non-fault insurer, a CHC or a CMC) handles the claim, or aspects of it, and controls the costs.

6.105 Associated with this separation, the party handling the non-fault claim has the opportunity to earn a rent by charging the at-fault insurer more than the costs incurred. The amount of this rent is limited by the reasonable costs that can be recovered from the at-fault insurer under tort law (and, in practice for many replacement car claims, by the GTA), but is nevertheless significant.

6.106 We have found that the parties managing non-fault claims are able to earn a rent through the following practices and conduct:

(a) Claims handling and car hire intermediaries charge at-fault insurers more than the costs incurred and compete to obtain work via referral fees: this provides non-fault insurers and brokers (and others) with an opportunity to earn a revenue stream.

(b) Some, but not all, non-fault insurers directly charge at-fault insurers more than the cost of repairs incurred.

(c) When cars are written off, at-fault insurers may not receive the full salvage value of the car.

As a result of these practices and conduct, there is a higher potential for dispute over claims and an excessive level of frictional and transactional costs, representing inefficiencies in the supply chain.

6.107 We have found that the effects are currently greatest in relation to the provision of replacement cars, which is usually, when there is separation, via credit hire (see paragraph 6.92). The effects are currently smaller in relation to repairs and write-offs, where different non-fault insurers have different practices and where frictional and transactional costs are currently lower.

6.108 We considered the implications of separation for services. We identified some service differences but we found them to be small. CHCs/CMCs said that an at-fault insurer's incentive was to minimise its costs, ie an at-fault insurer did not have any incentive to provide non-fault claimants with a quality replacement car or indeed with a replacement car at all. They suggested, therefore, that, in the absence of credit hire, non-fault claimants would receive a lower-quality replacement car than they did now, eg a basic courtesy car or no replacement car at all. However, our concern was not with the existence of credit hire or credit repair as such but with the inefficiencies in the supply chain, involving excessive frictional and transactional costs, and other effects, which arose within the context of separation. In our view, it was these effects which were not consistent with a well-functioning market. Nevertheless, we recognised that the current existence of alternative providers as a result of separation was likely to provide at-fault insurers with an incentive to provide a good quality of service, and this was a factor which we considered in our assessment of remedies.

Conclusions

6.109 We have found that insurers and brokers are competing to find ways of earning a rent from their control of non-fault claims, rather than simply 'competing on the merits' (ie offering the lowest price and best-quality claims handling and other service to customers), and that there are inefficiencies in the supply chain, involving excessive frictional and transactional costs. These are not things we would expect to observe in a well-functioning PMI market. We have found that these effects represent a distortion of competition in the supply of PMI.

6.110 These effects result in higher PMI premiums to the detriment of consumers. This is because insurers pass on to customers their higher costs from at-fault claims and, while insurers and brokers also pass on their revenue stream from non-fault claims in lower premiums, the latter effect is considerably smaller than the former due principally to frictional and transactional costs.[73] We estimated the net detriment to consumers to be between £101 million and £214 million per year, though our main estimate, on which we put most weight, was £110 million per year, ie towards the lower end of this range. We found that the main cause of the detriment was in relation to replacement cars, where our main estimate was a net detriment of £84 million per year (in a range of £67 million to £178 million per year). We acknowledged that some level of transactional and frictional costs were likely to be an unavoidable consequence of separation, and therefore that, without removing separation, the full detriment could not be addressed, but we considered these matters in our assessment of remedies.

6.111 We identified the following two features of the supply of PMI and related services[74] as having, in combination, an adverse effect on competition:

(a) Separation, ie the insurer liable for the non-fault driver's claim (the insurer to the at-fault driver) is often not the party controlling the costs.

(b) Various practices and conduct of the parties managing non-fault claims, which (i) were focused on earning a rent from the control of claims rather than simply competing on the merits; and (ii) gave rise to inefficiencies in the supply chain involving excessive frictional and transactional costs.

We concluded that these features distorted competition in the PMI market.

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[73] Pass-through of the revenue stream may also be slightly less than that of costs (see paragraphs 6.71 & 6.76).

[74] The provision of claims services to non-fault drivers is related to the supply of PMI in a number of ways. It is the insurer to the at-fault driver who ultimately bears the costs of providing these services. Further, the party managing the provision of these services is often either the insurer to the non-fault driver or a third party to which the non-fault driver is referred by their insurer or broker.

7. Add-ons (theory of harm 4)

Introduction

7.1 PMI providers offer their customers a range of additional products known as add-ons. These products provide cover for various risks over and above the core risks covered by a basic PMI policy and are usually sold for an additional premium. The cover provided by any particular add-on may vary from insurer to insurer. Examples of PMI add-ons are MLEI, windscreen cover, breakdown cover, personal injury cover, courtesy car cover, key loss cover, extended foreign use cover and NCB protection. For convenience, we refer to this list of products as ‘add-ons’ even though some motor insurers include some of these products in their basic PMI policy with no additional premium being paid.

7.2 Our guidelines state that to ensure effective competition, consumers need to be both willing and able to: access information about the various offers available in the market; assess these offers to identify the good or service which provides the best value for them; and act on this assessment by switching to purchasing the good or service from their preferred supplier.[1] Information asymmetries between suppliers and consumers might have adverse effects on competition, particularly in markets for goods or services where consumers are not able to gauge the quality of a good or service when acquiring it.[2]

7.3 In this section, we analyse the transparency and complexity of various add-ons sold by motor insurers and the possible difficulties faced by consumers in trying to compare the aggregate price of a PMI policy and the price and terms of their chosen add-ons across different motor insurers when purchasing these add-ons. Further to our guidelines, consumer harm may arise when add-on products are complex and/or when 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 the products offered by different motor insurers.

7.4 We first provide some background to the sale of add-ons by motor insurers and then consider the work of the FCA, in particular its recent studies into MLEI and add-ons across general insurance.

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[1] *CC3*, paragraph 296.
[2] *CC3*, paragraph 311.

7.5 We then assess the two following features and test their competitive effects against ToH 4:

(a) the transparency and complexity of information provided to consumers by motor insurers at the point of sale of add-ons; and

(b) the difficulties faced by consumers in trying to compare the aggregate price and terms of their basic PMI policy and chosen add-ons across different motor insurers.

7.6 Finally, we discuss the outcomes of the sale of add-ons, including their profitability and their perceived value to consumers.

Background

7.7 We observed that motor insurers provided add-ons in two different ways depending on which party bore the underwriting risk:

(a) Some add-ons were designed, underwritten, supplied and managed by the motor insurer, eg NCB protection and extended foreign use cover. In these cases, the risk was borne by the motor insurer.

(b) Some add-ons were designed, underwritten and managed by a third party provider but supplied by the motor insurer, either under its name or under the name of the third party provider, eg breakdown cover. In these cases, the risk was borne by the third party provider and the motor insurer acted as a distributor. The retail price consisted of the unit cost (controlled by the third party), the margin (controlled by the motor insurer) and insurance premium tax (payable on the unit cost and margin). As this was risk-free income for the motor insurer, it was usually recognised as fee income. The third party provider was responsible for all claims handling in relation to these products.

7.8 Table 7.1 summarises the most common add-ons offered by the ten motor insurers in our sample. The information is based on data provided in December 2013 and products offered by the relevant insurers may have changed since then.

TABLE 7.1 **Summary of most common add-ons offered by motor insurers (based on information provided in December 2013)**

	MLEI	*Windscreen cover*	*Breakdown cover*	*Courtesy car cover*	*Enhanced courtesy car cover**	*Personal injury cover*	*NCB protection*	*Extended foreign use cover*	*Key loss cover*
Typical price (£)†	*15–40*	*Typically included in basic policy*	*25–70*	*15–25*	*Not comparable on PCWs*	*15–27*	*Driver specific*	*Not comparable on PCWs*	*Not comparable on PCWs*
Admiral	Included in basic policy	Included in basic policy	Yes (via third party)	Included in basic policy	No‡	Yes	Yes	No§	Yes
Ageas	Yes (via third party)	No	Yes (via third party)	Included in basic policy	No	Included in basic policy	Yes¶	No§	Included in basic policy
Aviva (Aviva Direct)	Yes	Included in basic policy	Yes	Yes	Yes#	Yes	Yes	Yes	Included in basic policy
AXA (AXA Direct)	Yes	Yes	Yes (via third party)	Included in basic policy	No~	Included in basic policy★	Yes	No§	Yes
CISGIL	Yes	Included in basic policy	Yes (via third party)	Included in basic policy♦	Yes	No	Yes¶	Yes▲	Included in basic policy
DLG	Yes	Included in basic policy	Yes	Yes✷	Yes⅄	Included in basic policy	Yes■	No	No
esure	Yes	Included in basic policy	Yes (via third party)	Included in basic policy	No	Yes	Yes¶	No§	Yes
LV	Yes	Included in basic policy	Yes	Yes	No	Yes	Yes	Yes	Included in basic policy
RSA	Yes	Yes◇	Yes	Yes◇	No☐	Included in basic policy	Yes	Yes	Included in basic policy
Zurich	Included in basic policy	Included in basic policy	Yes (via third party)	Included in basic policy	No	Yes	Yes	No§	Yes

Source: Motor insurers.

*By enhanced courtesy car cover, we refer to an add-on that provides the consumer with a like-for-like replacement car or a replacement car of a superior quality than the standard, Class A courtesy car typically provided under courtesy car cover.

†The typical price for each add-on was based on prices returned from random PMI searches on the four largest PCWs.

‡Admiral did not provide enhanced courtesy car cover. However, it did offer its customers a hire car add-on, which provided a hire car if the customer's car was either a total loss or stolen.

§Although these motor insurers did not explicitly offer extended foreign use cover as an add-on, they may provide cover (at a cost) if requested by their customers. Ageas Insurance provided free EU cover for 90 days in their basic PMI policy. Extension to the 90 days or request for cover outside the EU may or may not be granted but would attract an additional charge if granted.

¶These motor insurers did not treat NCB protection as a standard add-on, because it could only be purchased if certain criteria were met (ie not all consumers were eligible).

#Aviva provided its customers who have purchased the enhanced courtesy car add-on with a replacement car of a superior quality to a standard courtesy car (but not a like-for-like replacement car).

~AXA did not offer its customers an enhanced courtesy car add-on that provides a replacement car of a superior quality to a standard courtesy car. However, it did offer an add-on to extend the maximum duration for which a courtesy car was provided.

★AXA previously offered Driver Injury Cover under its AXA Direct policy, but this was recently withdrawn. AXA offered Personal Accident Cover, which was included within the basic comprehensive PMI policies. In addition, AXA provided the option of Personal Accident Plus as an add-on. This applied to both Swiftcover and AXA Direct brands.

♦A courtesy car was only provided if the customer used an approved repairer.

▲Extended foreign use cover was available as an add-on for the Co-operative Car Insurance product only.

✷DLG introduced a new courtesy car policy on 8 September 2013 and offered courtesy car cover as standard through its Privilege and Churchill brands. Provided the car was being repaired at one of DLG's approved repairers, a small hatchback would be provided for the duration of the repairs. Customers with Guaranteed Hire Car (GHC) or Guaranteed Hire Car Plus (GHC+) were not entitled to a courtesy car benefit. There were a very small number of DLG legacy policies which also provided a courtesy car under the basic PMI policy.

⅄DLG offered GHC and GHC+ as optional add-ons, which enabled customers to purchase hire car provision. However, DLG considered the GHC and GHC+ add-ons as distinct from the provision of a courtesy car, because customers opting for GHC or GHC+ were entitled to a hire car even if they used a non-DLG approved repairer and the length of hire was guaranteed for up to14 consecutive days for GHC and 21 consecutive days for GHC+.
▪DLG did not treat NCB protection as a standard add-on, but as a variation to the pricing on the basic PMI policy.
◇RSA included windscreen cover and courtesy car cover in the basic More Th>n PMI policy, but they were sold separately (and required to be purchased as add-ons) from the basic eChoice PMI policy.
☐RSA did not provide enhanced courtesy car cover. However, it did offer a courtesy car upgrade add-on on MoreTh>n policies, which covered courtesy car provision for up to 14 days where the customer did not use a recommended repairer or their vehicle had been lost or stolen.
Note: 'Yes' denotes that the add-on was sold separately from the basic PMI policy; 'No' denotes that the add-on was not included and not sold separately from the basic PMI policy (ie the add-on was not offered by that particular motor insurer); and 'Included in basic policy' denotes that these add-ons were included in the basic policy and cannot be removed.

7.9 Table 7.1 shows that some insurers include some covers under their basic PMI policy while other insurers offer the same type of cover as an add-on for an additional premium (eg windscreen cover). Table 7.1 also shows that insurers do not all offer the same add-ons. For example, some add-ons, such as enhanced courtesy car cover and extended foreign use cover, were neither included under the basic PMI policy nor sold as an add-on by some motor insurers. Of the add-ons listed in Table 7.1, we were only aware of breakdown cover which could be purchased separately from PMI, ie as a stand-alone product (for example, from the RAC, the AA or Green Flag). Some add-ons could also be purchased with other types of insurance (eg personal injury).

7.10 Table 7.2 shows a summary of the results of our customer survey in relation to the purchase of the most common PMI-related add-ons.

TABLE 7.2 **Customer survey results in relation to the purchase of most common add-ons**

%

Add-on	*Take-up**	*Percentage who compared motor insurers†*	*Good value for money*
MLEI	76	52	53
Windscreen cover	85	52	69
Breakdown cover	39	52	64
Personal injury cover	56	47	51
Courtesy car cover	70	53	54
Key loss cover	24	32	35
Extended foreign use cover	30	26	38
NCB protection	80‡	62	69

Source: CMA data from our customer survey of PMI policyholders. We noted that some respondents might have purchased certain add-ons as part of their basic cover and not separately for an additional premium.

*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.
†We noted that the customer survey results did not make clear the extent of the comparisons made by the respondents.
‡80% of customer survey respondents said that they had NCB protection; however, evidence from motor insurers showed that the actual take-up of NCB protection was much lower. This suggested some misunderstanding of the difference between NCB and NCB protection. Moreover, our customer survey found that only around 30% of those who claimed to have NCB protection correctly answered the question designed to test consumers' understanding of this product.

7.11 Our customer survey found that most PMI policyholders were covered by one or more add-ons.[3] Table 7.2 shows that windscreen cover was the most popular add-on, which appeared to be at least in part because it was included in many basic PMI policies. Our customer survey found that the majority of PMI policyholders preferred to be able to choose which add-ons to purchase, rather than having the relevant cover included in their basic PMI policy.[4]

[3] Our survey found that the modal number of add-ons taken up by respondents was five.
[4] 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%, said that they had either a slight or strong preference for add-ons to be offered separately, while 32% said that they preferred them to be included in the basic PMI policy.

7.12 Table 7.3 shows the aggregate net earned premiums (NEP)[5] for basic cover and each add-on product on a stand-alone basis for a five-year period for seven motor insurers ([✂]).

TABLE 7.3 **Analysis of NEP by type of risk**

	2008	2009	2010	2011	*£ million* 2012	*2012 share to total NEP %*
Basic cover	5,302.7	5,285.6	5,558.9	5,699.5	5,176.7	91.6
Breakdown	172.3	188.0	186.0	175.4	161.1	2.8
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*	40.7	44.1	39.5	36.5	0.6
Other	2.5	2.6	2.7	2.6	2.0	0.0
Total	5,713.0	5,739.5	6,024.3	6,204.1	5,659.8	100.0

Source: CMA analysis.

*The 2008 NEP for the courtesy car add-on did not include [✂] which could not provide a figure for this year.

7.13 Table 7.3 shows that basic cover and add-ons accounted for 92 and 8% of total NEP in 2012 respectively. Breakdown cover and NCB protection accounted for 2.8 and 2.7% respectively, and no other add-on accounted for more than 2%. Based on NEP across the whole PMI market of £7.9 billion in 2012,[6] this suggested that add-ons were worth around £630 million a year.

Financial Conduct Authority's study

7.14 The FCA is a regulator of the UK financial services industry. Its aim is to protect consumers, to ensure that the industry remains stable and to promote healthy competition between financial services providers. It has rule-making, investigative and enforcement powers which it uses to protect and regulate the financial services industry.

7.15 The FCA has undertaken two studies relevant to ToH4, into: *(a)* MLEI and *(b)* the sale of general insurance add-ons.

MLEI

7.16 In June 2013, the FCA published a report on MLEI.[7] The main conclusions were that:

[5] NEP was GWP, net of Insurance Premium Tax (IPT) and premiums ceded to reinsurers and any changes in provisions for unearned premiums.
[6] Datamonitor: *UK Private Motor Insurance: Market Dynamics and Opportunities*.
[7] See FSA: Motor legal expenses insurance: Consumer market research, 2013.

(a) MLEI was a product which could be useful in enabling policyholders to pursue their legal rights to recover uninsured losses;

(b) consumers had little understanding of what the product did and the benefits it provided; and

(c) the opt-out[8] selling of MLEI was not consistent with consumer protection principles (despite MLEI being the add-on most commonly sold with PMI on an opt-out basis).

7.17 The report recommended that firms should:

(a) provide consumers with better explanations of MLEI; and

(b) review the basis on which MLEI was provided, especially where this was on an opt-out basis.

7.18 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. In June 2014, the FCA told us that its business plan for 2014 included a review of the market for MLEI.[9]

General insurance add-ons

7.19 In July 2013, the FCA confirmed that it would undertake a market study into the sale of general insurance add-ons,[10] focusing on whether there was effective competition for add-on products. The FCA published its final report in July 2014.[11]

7.20 The FCA found that the way in which add-ons were sold had a clear impact on consumer behaviour and affected the way in which consumers made decisions. The FCA found that there was little pressure on firms to offer good value as buyers of add-ons were less likely to shop around and less sensitive to price than stand-alone buyers. The FCA also found that, when buying add-ons, consumers were focused on the primary product rather than the add-on, and as a result many consumers bought products they did not need or understand. The FCA's research also showed that consumers' understanding

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[8] Opt-out selling meant that the product was pre-selected by the provider rather than actively selected by the consumer and therefore the consumer was required to opt out from purchasing the product.
[9] FCA business plan 2014-15. Carryover work, intended to start in Q3.
[10] The term 'general insurance add-on' encompasses a large variety of products which are sold alongside another product which is considered to be the primary product. The primary product can either be a financial product, such as another insurance product (eg home or PMI) or a retail product (such as a holiday or mobile phone).
[11] See FCA: General Insurance Add-Ons: Final Report – Confirmed Findings of the Market Study, July 2014.

of policies and product cover was poor for both add-ons and stand-alone products.

7.21 The FCA concluded that weak consumer engagement increased the point-of-sale advantage held by firms selling add-ons, and that this could lead to firms selling products which might not meet consumers' needs, or charging high mark-ups, or both. The FCA also concluded that a lack of competition for add-ons could lead to consumers receiving poor value for money from many add-on products and that consumers could be significantly overpaying when they buy add-on products. Accordingly, the FCA stated that its view was that there was a clear case for it to intervene in the markets for general insurance add-ons to make competition more effective for consumers.

7.22 In its provisional findings report the FCA proposed several remedies which it believed would strengthen competition in the markets for add-ons:

(a) ban pre-ticked boxes ('opt-outs') for the sale of add-ons because of the negative impact they have on consumer behaviour and outcomes;

(b) require firms to publish claims ratios, which the FCA expected would 'shine a light' on low-value products and increase pressure on firms to improve product value;

(c) improve the way add-ons are offered through PCWs, focusing in particular on what information consumers can access about add-ons and when this information is introduced; and

(d) in relation to the add-on sale of Guaranteed Asset Protection,[12] require that the sale cannot be concluded at the point of sale of the car or car finance, but only at a later point to break the point-of-sale advantage enjoyed by those selling this product.

7.23 The FCA summarised the comments it received on its proposed remedies in its final report and said that it expected to undertake further consultation on remedies before the end of 2014.

Transparency and complexity of information provided to consumers

7.24 In this subsection, we discuss:

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[12] Guaranteed Asset Protection provides cover if a consumer's car is written off or stolen and the PMI payout is not sufficient to repay outstanding finance or to replace the car as new or with one of equivalent value to the original price.

(a) descriptions of add-ons (not included within a basic PMI policy) provided by motor insurers at the point of sale of PMI;

(b) evidence from our consumer survey on consumers' understanding of a selection of PMI-related add-ons; and

(c) the transparency of information and complexity of both NCB and NCB protection.

Descriptions of add-ons provided by motor insurers at the point of sale

7.25 We reviewed the descriptions of add-ons provided by the ten motor insurers in our sample on their websites in order to assess the quality and quantity of information made available to consumers at the point of sale.

7.26 We did not perform a separate analysis of the descriptions of add-ons provided to consumers who purchase PMI on the telephone because we found that the sales guides or scripts used by call handlers provided a similar level of information to that provided on the insurers' websites.

7.27 We focused on those add-ons which appeared complex and difficult for consumers to understand and evaluate: personal injury cover; NCB protection; extended foreign use cover; key loss cover; and courtesy car cover. We also considered enhanced courtesy car cover, given the importance of replacement car provision to our analysis of ToH 1 (see Section 6). We did not analyse windscreen cover because we found that it was included in the basic PMI policy offered by most of the ten motor insurers in our sample; and we did not consider breakdown cover because we found that there were many stand-alone products available for this type of cover.

7.28 When analysing the descriptions of add-ons provided by the ten motor insurers in our sample, we assessed whether the insurers provided sufficient information to allow consumers to make an informed decision as to the suitability of the add-on for their needs and whether the information was in plain English (ie it avoided unnecessarily complex language or terminology).

7.29 The descriptions of add-ons were typically accessed via help or information links from the main page of the insurer's website. The descriptions typically summarised the key elements of the cover and the level of cover provided. There was also usually a link to a more detailed description and/or the full policy wording if the consumer required further information, but we focused our analysis on the initial description provided by the insurer, as we considered this to be the information that consumers were most likely to use in making their purchase decision.

7.30 We found that the descriptions of add-ons provided by the ten motor insurers in our sample on their websites avoided the use of complex language or terminology and, on the whole, provided a comprehensible, high-level overview of the key features of each add-on. However, there was considerable variability in the level of detail provided. This variability suggested to us that it was particularly difficult to strike an appropriate balance between providing the relevant information to the consumer and ensuring the information was understandable and not unnecessarily complex.

7.31 Overall, it appeared to us that the current level of detail provided to consumers was often insufficient to enable a consumer to make an informed purchasing decision. Mostly, this was because the depth and detail of the information provided to consumers appeared insufficient for a consumer to be able reasonably to assess the suitability of the add-on for their needs or to be able to compare products between providers. Although the consumer would have recourse to the full policy wording for further information, or other more detailed explanatory help-guides, we found that these documents provided a great deal of information and were not always presented in easily comprehensible terms.

7.32 Our assessment of the descriptions provided by the ten motor insurers in our sample (and the descriptions themselves) are set out in Appendix 7.1.

Evidence from our customer survey

7.33 Our survey of PMI policyholders sought first to ascertain the take-up of different add-ons and then to assess the policyholders' understanding of a selection of add-ons. The approach for this assessment was first to ask consumers about their perceived level of understanding and then to ask one or more factual questions about the add-on to test their understanding.[13]

7.34 The results of our customer survey showed that there was a limited understanding of the add-ons. For example:

(a) In relation to personal injury cover, only 17% of respondents answered correctly that passengers, other than themselves and their spouse, were

[13] The response rate to our survey was 5%, giving rise to some concern about the potential for response bias in the results. We had no particular evidence of response bias, but we noted that there was a slightly higher response rate among older policyholders. As only 5% of the policyholders contacted were both available and willing to respond to the telephone interview, they were therefore unusual in this respect, which caused us to question the extent to which their survey answers could be considered to be representative of all PMI policyholders. The survey results were weighted to correct for oversampling in Wales, Scotland and Northern Ireland.

not covered by the add-on.[14] Only 5% answered all three customer survey questions correctly.

(b) In relation to NCB protection, a high proportion of respondents (77%) thought that they had a good understanding of this add-on. However, 59% 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. Only 29% of respondents who said that they were covered by this add-on answered this question correctly. The descriptions of NCB protection provided by motor insurers on their websites generally did not explain that an accident typically increased the consumer's PMI premium, irrespective of fault and regardless of their NCB years.[15]

(c) In relation to key loss cover, 67% of respondents with this product said that they had a good understanding of it. However, only 9% correctly answered both of the survey questions which tested their understanding of what it covered.[16] For example, only 14% correctly answered that it was the responsibility of the claimant (and not their motor insurer) to appoint a locksmith to resolve the problem. Our review of the descriptions of key loss cover provided by motor insurers on their websites revealed that none of the motor insurers explained this.

7.35 We recognised that any limitation in consumers' understanding of a selected add-on would, to some extent, be due to the time which had elapsed since the consumer had researched and purchased it. Therefore, we accepted that the evidence from our customer survey may not accurately represent consumers' understanding of add-ons at the point of purchase. However, we found that our review of the descriptions of the add-ons on the motor insurers' websites tended to explain and corroborate many of the findings from the survey and, for this reason, we did put weight on it despite the possible lack of accuracy of the customer survey.

Transparency of information and complexity of both NCB and NCB protection

7.36 In our analysis of add-ons, we focused especially on NCB protection as: *(a)* this was the add-on which generated the most NEP after breakdown cover (which was available separately and therefore of less concern) (see Table 7.3); *(b)* it appeared to be particularly poorly understood (see paragraph

[14] We noted that there was some variation in the coverage of this add-on. Some motor insurers provided personal injury cover for the driver, whereas others provided cover for the driver, their partner and any named drivers.
[15] Some insurers offer 'guaranteed' NCB protection which prevents premiums rising as a direct result of a claim.
[16] The respondents were asked the following two questions: 'Will this (cover) pay for replacement keys and locks to your car if you lose your keys?' and 'Will someone appointed by the insurance company come out to you and fix the problem if you lose your keys?'

7.34*(b)*); and *(c)* the descriptions of the product used by insurers were often not at all clear (see paragraph 7.30 and Appendix 7.1).

7.37 We noted that the informational asymmetries associated with NCB protection had the potential to be more severe than for the other add-ons we examined because the value of what was being insured (a certain number of NCB years) was uncertain. In order to make an informed NCB protection purchasing decision, a consumer would need to understand the likely percentage discount which would be earned by their NCB in the future, the likely monetary value of this percentage discount, and the effect on this percentage discount of making one or more claims. This information would also need to take into account the possibility of switching insurers at some point in the future. We recognised that this information was not easy to explain. Nevertheless, unless the impact on their premium of making a claim was clear, the consumer would be unable to assess the value of their NCB discount and unable to assess whether it was worthwhile protecting that discount by purchasing NCB protection.

NCB scale

7.38 We found that only one motor insurer (CISGIL) provided an NCB scale on its website (ie a mapping of the NCB discount to the number of NCB years). Six of the ten motor insurers in our sample (Admiral, Aviva, DLG,[17] esure,[18] RSA and Zurich[19]) told us that the NCB scale was not available on their website and was not provided to staff for the purposes of explaining NCB protection to consumers on the telephone. The remaining three motor insurers (Ageas, AXA and LV) told us that they did not display NCB scales on their website but they did provide details of the scale, and the 'step-back' procedures, which specify the number of NCB years a consumer loses in the event of one or more claims, when requested.

7.39 The majority of motor insurers told us that it was not practicable for them to publish an NCB scale showing the percentage discount applicable to each number of NCB years because they used a number of rating factors to determine a policyholder's NCB discount, with the result that one policyholder with a certain number of NCB years was likely to have a different NCB discount from another policyholder with the same number of NCB years.

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[17] DLG told us that it did not publish the scale of NCB for numbers of claim-free years on its website and did not provide this information over the phone for any of its brands.
[18] esure told us that the NCB scale was variable and was therefore not available on its website and was not provided to its staff for the purposes of explaining to consumers on the telephone.
[19] Zurich told us that publication of NCB scales was more likely to confuse than help consumers.

7.40 However, it appeared to us that without any indication of NCB scales it would be very difficult for consumers to assess accurately the value of NCB protection as they would be completely unable to understand the level of discount earned through their NCB years. This lack of transparency was compounded by the fact that the level of discount offered by insurers for a certain number of NCB years differed between consumers according to their other rating factors, and each insurer would make this calculation in a different way.

7.41 Although we understood the concerns of insurers about the accuracy of an NCB scale, for the reasons set out above, it appeared to us that without some indication of the different levels of NCB discount for each number of NCB years, consumers would be unable to make any sort of informed decision as to their need for NCB protection.

Qualitative consumer research

7.42 We engaged GfK NOP Social Research (GfK) to undertake qualitative consumer research to test different ways of providing consumers with information on NCB and NCB protection (among other things). We have published a report and a presentation by GfK on its research.[20] In summary, GfK's findings on NCB years/discounts and NCB protection were that:

(a) NCB years/discount had an assumed high value and was considered very important by consumers;

(b) NCB protection was not a key point of differentiation when purchasing PMI;

(c) consumers preferred to see NCB protection presented as an add-on, with a clearly marked price; and

(d) NCB protection was not well understood by consumers, because they:

(i) had limited knowledge of how it worked;

(ii) did not know how much it cost; and

(iii) thought that it provided greater protection than it actually did (eg that it would protect their NCB years irrespective of the number of claims they made in any given year).

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[20] See Survey of Private Motor Insurance Policyholders: Qualitative Research Findings.

We discuss the results of this research further in Section 11.

Possible difficulties faced by consumers in comparing add-ons

7.43 In this subsection, we discuss how add-ons are sold by examining consumers' experiences of:

(a) comparing add-ons on a PCW; and

(b) purchasing add-ons on a motor insurer's website following click-through from a PCW.

Comparing add-ons on a PCW

7.44 The four largest PCWs all display prices for basic PMI and the most commonly-purchased add-ons (eg breakdown cover, courtesy car cover, MLEI, personal injury cover and windscreen cover). However, the purchase of a basic PMI policy and any add-on is completed on the motor insurer's website following a click-through from the PCW. The four largest PCWs (Comparethemarket, Confused, GoCompare and Moneysupermarket) told us that they were not incentivised to sell add-ons, as their fee was based upon the sale of the basic PMI policy only.

7.45 We found that, to the extent that consumers found it difficult to compare add-ons on PCWs, they would be less likely to compare the price of add-ons from different providers once they had selected add-ons from their preferred provider of the basic PMI policy which in turn would reduce the incentive for PMI providers to compete on prices for add-ons and could lead to consumers paying higher prices for add-ons.[21] Therefore we considered the extent to which add-ons could be compared on PCWs.

7.46 We observed that each of the four largest PCWs typically displayed the most commonly-purchased PMI-related add-ons and, when quotes were returned, made it clear to consumers whether each add-on was included in the provider's basic policy or had to be purchased separately. If the add-on was available to be purchased separately, and if the cost was fixed, the quote screen typically displayed the price of the product. If the cost of the add-on was not fixed and instead was determined by the level of cover selected (eg breakdown cover), the quote screen typically displayed a representative or

[21] We assumed that this issue did not apply to brokers as they were able to compare add-ons on behalf of their customers.

indicative price[22] (usually a 'price from' on the basis of the lowest level of cover) and the consumer would have to select the level of cover when they clicked through to the provider's website.

7.47 We noted that, for each of the four largest PCWs, the quote screen ranked the search results according to the price of the basic PMI policy, without including the price of any add-ons which the consumer might wish to purchase (other than NCB protection (see paragraph 7.49)).

7.48 We found that the four largest PCWs displayed the following information:[23]

(a) Comparethemarket displayed the following add-ons on its price page: windscreen cover, courtesy car, breakdown cover and MLEI. Each add-on was represented with a tick if included within the basic PMI policy, an indicative price if it was not included under the basic policy but could be purchased separately, or a cross if it was not included under the basic policy and could not be purchased separately.

(b) Confused displayed the following add-ons on its price page: MLEI, courtesy car, breakdown cover and windscreen cover. As for Comparethemarket, each add-on was represented with a tick, an indicative price or a cross.

(c) GoCompare displayed the following add-ons on its price page: MLEI, courtesy car, windscreen cover, personal accident and breakdown cover. Each add-on was represented with a tick or a cross depending on whether it was included in the basic policy, but for those which could be purchased separately an indicative price was provided if the cursor was held over the cross.

(d) Moneysupermarket displayed the following add-ons on its price page: windscreen cover, courtesy car, breakdown cover, personal accident and MLEI. Again, each add-on was represented with a tick, an indicative price, or a cross, as for Comparethemarket and Confused.

7.49 In addition, the four largest PCWs enabled the consumer to modify the quotes returned to include or exclude the price of NCB protection, with the price of the basic PMI policy changing accordingly. If a consumer conducted a search

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[22] A representative or indicative price provided the customer with an estimate of the likely price of an add-on (eg from £25) specific to that motor insurer, but not to an individual consumer's own risk profile. However, the actual price was only confirmed upon click-through from the PCW to the insurer's website.
[23] This assessment is based on the approaches used by the PCWs in June 2014. Presentations may have changed since then.

with and without NCB protection they could thus reveal the effective cost of this add on.

7.50 This review suggested that, on the four largest PCWs, consumers could compare whether the most commonly-purchased PMI-related add-ons, with the exception of key loss cover and extended foreign use cover (which amounted to less than 0.1% of total NEP generated in 2012), were included in the basic PMI policy for the quotes returned and, if not, whether they could be added to the basic policy for an additional premium. However, we observed that the PCWs only provided a generic description of each add-on and, where the cost of the add-on was not fixed but determined by the level of cover selected, the quote screen displayed only the price for the add-on with the most basic level of cover, making a comparison between insurers for this add-on difficult. Moreover, we observed that, for each of the four largest PCWs, the quotes returned were ranked based on the price of the basic PMI policy, without including the price of any add-ons, even if the customer was able to state prior to searching that they intended to purchase one or more particular add-ons. It appeared to us that this limitation would make it difficult for consumers to compare the combined price of a basic PMI policy with their desired add-ons across insurers.

Purchasing add-ons on an insurer's website following click-through from a PCW

7.51 We considered what choices a consumer was given upon click-through from a PCW to a motor insurer's website.

7.52 We found that the insurers in our sample had responded to the recommendation in the FCA's report on MLEI and no longer automatically included add-ons in the price of the basic PMI policy, with the exception of RSA (which included two add-ons, in respect of courtesy car and windscreen cover, under its eChoice brand).[24] Therefore, in general consumers were no longer required to 'opt out' from purchasing add-ons (where those add-ons were not sold as an integral part of a basic PMI policy).

7.53 GoCompare told us that, upon click-through to an insurer's website, add-ons could be added to the price, and that it was working closely with insurers to make sure that such practices were clear and that it was easy for the consumer to select the options they wanted.

7.54 Our survey of PMI policyholders found that most respondents who said they had compared add-ons offered by different insurers believed that they were easy to compare, particularly windscreen cover and NCB protection (73 and

[24] RSA ceased writing new business through its eChoice brand in March 2014.

65% of respondents respectively). However, the survey results showed that, with the exception of NCB protection, almost half of respondents did not make any such comparison (see Table 7.2). In relation to NCB protection, it was not clear how consumers could easily make effective comparisons between insurers, given that the price of NCB protection was incorporated into the overall price of the basic PMI policy and not displayed separately.

Outcomes of the sale of add-ons

Profitability of add-ons

7.55 Tables 7.1 and 7.3 respectively showed that add-ons tended to be relatively low-priced products compared with the price of a basic PMI policy (eg MLEI typically costs between £15 and £40, and courtesy car cover costs between £15 and £25 per year) and that add-on premiums accounted for only about 8% of total PMI premiums in 2012.

7.56 Table 7.4 shows a summary of our analysis of the profitability of certain add-ons. The details of our analysis are set out in Appendix 7.1.

TABLE 7.4 **Profitability of add-ons, 2012**

	Unweighted average claims ratio
Basic cover	82
MLEI	7
Windscreen cover	84
Breakdown cover	38
Personal injury cover	5
Courtesy car cover	51
Key loss cover	25
Extended foreign use cover	29
NCB protection	Not available*

Source: CMA calculations based on responses from the motor insurers in our sample.

*We were told that it was not possible to assess the profitability of NCB protection because there was no clear cost of a 'claim' against this add-on.

7.57 Table 7.4 shows that, with the exception of windscreen cover, the unweighted average claims ratios of each add-on were below that for basic PMI cover, some considerably below (eg MLEI and personal injury cover), which suggested that motor insurers generated greater profitability from the sale of add-ons than from the sale of basic PMI.

7.58 In response to our provisional findings:

(a) CISGIL told us that the low loss ratios attributed to certain add-ons were not indicative of prices being above a competitive level because the expense ratios for add-ons (eg the costs of providing the policy and administering claims, expressed as a proportion of the premium) were likely to be higher than for basic PMI. This would indicate that the profitability of an add-on overall (taking into account both the cost of claims and the cost of providing the policy) might not be dissimilar to the profitability of basic PMI. CISGIL also told us that, as add-on products were supplied only with the main PMI product and the market for PMI was extremely competitive, any profits would be used to ensure overall competitive market prices to customers.

(b) DLG also told us that the expense ratio associated with managing and selling add-ons (and related overheads) was likely to be higher than for basic PMI as premiums for add-ons tended to be materially lower than for the basic PMI policy. DLG added that there was also an opportunity cost associated with creating, managing and selling add-ons. It told us that if add-ons had margins which were as low as basic PMI, the overall profit margin on them would be extremely low (eg [✂]), rendering the sale of add-ons unsustainable, with the result that either add-ons would be incorporated into the core PMI policy, reducing consumer choice and increasing premiums for customers, or add-ons would be removed from sale altogether, leaving consumers potentially under-insured.

7.59 We recognised that the expense ratio on most add-ons was likely to be higher than for basic PMI; however, given that some of the claims ratios in Table 7.4 were extremely low (notably MLEI, personal injury cover, key loss cover and extended foreign use cover), it appeared to us that the explanations provided by CISGIL, DLG and other insurers were unlikely to explain this difference fully. We also noted that rivalry between motor insurers could mean that higher prices on add-ons enabled motor insurers to offer lower prices on the basic PMI policy.

Perceived value of add-ons

7.60 Our customer survey found that, although consumers had a limited understanding of add-ons, the majority of policyholders perceived most add-ons to be good value for money (see Table 7.2). Respondents to our customer survey perceived key loss cover and extended foreign use cover to be less good value than other add-ons and we found that these products had the lowest take-up rates.

7.61 The motor insurers in our sample told us that because the cost of add-ons was low (relative to the cost of a basic PMI policy):

(a) some consumers might be willing to pay the price of add-ons to have 'peace of mind', in particular where the potential loss being covered could be very large; and

(b) some consumers might not consider it worthwhile comparing add-ons, in order to achieve, at most, a small saving, and so they might be willing to pay a slightly higher price for add-ons.

Conclusion

7.62 Overall, we found that:

(a) Our review of the descriptions of add-ons provided by motor insurers on their websites suggested that the level of information provided to consumers varied significantly. It appeared to us that, in many cases, insufficient information was provided to consumers at the point at which they choose to purchase add-ons for them to be able to make informed purchasing decisions.

(b) The results of our customer survey suggested that consumers did not understand fully the cover which was provided by some add-ons. This lack of understanding would seem to be partly explained by the limitations of the descriptions of these add-ons provided by insurers.

(c) With the exception of CISGIL, the motor insurers in our sample did not provide consumers with an NCB scale at the point of sale of NCB protection. Further, our customer survey results showed that 59% of those respondents who claimed to understand NCB protection well wrongly thought that it would prevent their PMI premium going up as a result of a claim. We noted that it was not made explicit by any of the ten motor insurers in our sample that NCB protection protected the driver's NCB years but was not an absolute protection of the customer's current percentage discount (which could be affected by at-fault and non-fault claims even if a driver's NCB years were maintained).[25]

(d) Our customer survey indicated that there was sometimes confusion about the difference between NCB years and discount on the one hand and NCB protection on the other. We also found that consumers thought NCB protection would protect their NCB years irrespective of the number of claims made in a given year

[25] Some insurers offer 'guaranteed' NCB protection which prevents premiums rising as a direct result of a claim. In our view, the existence of such products makes it more important that the 'normal' NCB protection is clearly explained.

(e) The results of our customer survey suggested that most policyholders thought that add-ons were easy to compare across motor insurers, although it appeared that, with the exception of NCB protection, almost half of respondents did not make any such comparison.

(f) PCWs enabled consumers to identify whether the most commonly-purchased PMI-related add-ons were included in a basic PMI policy or whether they could be purchased on top of the basic policy for an additional premium, but the information provided when making comparisons was only a generic description of each add-on and, for those add-ons which did not have a fixed cost, the price was only indicative based on the minimum level of cover. Further, consumers were unable to compare on PCWs the total price of their preferred PMI policy, including their desired add-ons.

(g) The premiums which motor insurers earned in relation to the sale of add-ons accounted for less than 10% of total premiums, in part due to add-ons being relatively low-priced products compared with basic premiums. However, motor insurers experienced lower claims ratios (and hence generated greater profits)[26] from the sale of add-ons than from the sale of basic PMI and, for some add-ons, claims ratios were extremely low.

7.63 Based on the evidence above, we concluded that:

(a) Consumers had a limited understanding of many PMI-related add-ons. Although there were significant differences between insurers, the quality and quantity of information provided to consumers about add-ons was in many cases insufficient for consumers to be able to make informed purchasing decisions. This led to consumers demonstrating a willingness to pay prices for add-ons which were higher (or lower) than their value to the consumer. We recognised that, given the complexity of the add-ons offered by motor insurers, it was difficult for them to strike an appropriate balance between providing the relevant information to the consumer and ensuring the information was understandable and not unnecessarily complex. However, even taking this into account, our view was that the current level of detail provided to consumers was in many cases insufficient. The problem was particularly acute for NCB protection, because of the nature of the product. The lack of NCB scales, the different NCB discounts applied by motor insurers due to the use of risk-based assessments, the lack of clarity on the difference between NCB years/discounts and NCB protection, and the fact that NCB protection did

[26] With the exception of windscreen cover. Also, we did not have data relating to NCB protection.

not provide an absolute protection of premiums, meant that consumers were unable properly to evaluate the protection on offer. This informational asymmetry between insurers and consumers resulted in a weakening of competition as it meant that it was more difficult for consumers to identify the best-value offers in the market for their needs.

(b) In addition, for all add-ons, other than for NCB protection, this meant that it was difficult and time consuming for consumers to compare the aggregate price of a basic PMI policy and their desired add-ons across different providers at the point at which the purchasing decision was made. Because of this consumers were less likely to compare the price and terms of add-ons from different providers once they had selected add-ons from their preferred provider of the basic PMI policy which could lead them to pay higher prices for add-ons than would otherwise be the case or to buy products that they would not have bought otherwise. Further, searching through a PCW did not significantly diminish this effect as the quotes returned by a PCW were ranked based on the price of the basic PMI product only, not including the desired add-ons, such that the ability of consumers to make comparisons across insurers for their desired total policy remained limited.

7.64 We noted that our conclusions were consistent with the results of the FCA's market study. The FCA found that consumers' understanding of those products it considered in its market study was poor for reasons that were similar to those we have identified. The FCA also noted there was little pressure on insurers to offer good value as buyers of add-ons were less likely to shop around and less sensitive to price than stand-alone buyers. The FCA concluded that these factors could lead to firms selling products which might not meet consumers' needs and that consumers could be significantly overpaying when they buy add-on products.

7.65 Based on these findings, we concluded that two features of the supply of PMI[27] together gave rise to an AEC:

(a) information asymmetries between motor insurers and consumers in relation to the sale of add-ons; and

(b) difficulties faced by consumers in trying to compare the aggregate price of a PMI policy and the price and terms of their chosen add-ons across different motor insurers.

[27] The supply of PMI included the supply of add-ons. For the reasons set out in Section 4, we did not find it necessary to define a separate market for any add-on product and therefore included them in the PMI market.

7.66 We concluded that these two features distorted competition in the market for the supply of PMI as they meant it was more difficult for consumers to identify the best-value offers in the market and to make informed purchasing decisions. As a result, these features were likely to reduce the incentive for motor insurers to compete on the price and terms of add-ons. This in turn could lead to consumers making a decision to purchase (or not to purchase) a policy package on the basis of an incorrect understanding of the products, when a correct understanding might have led to a different outcome (ie the purchase of a different product from the same insurer or from a competing insurer or a decision not to purchase at all).

7.67 We believed that the detriment arising from these features was likely to be most significant in relation to the sale of the following commonly-purchased PMI-related add-ons: courtesy car cover, MLEI, NCB protection and personal injury cover. The detriment was likely to be less significant for less-commonly-sold add-ons, such as enhanced courtesy car cover (offered by only three of the ten motor insurers in our sample) and extended foreign use cover (explicitly offered as an add-on by only four of the ten motor insurers in our sample). We believed that the features were less pronounced for breakdown cover, as there were many stand-alone products available for this type of cover; for windscreen cover, as this cover was typically included in the basic PMI policy and therefore was not purchased for an additional premium; and for key loss cover, which was included in the basic PMI policy by five of the ten motor insurers in our sample and only accounted for a very small proportion of add-on premiums (see Table 7.3).

7.68 We found that the customer detriment arising from the AEC was particularly difficult to quantify. We noted that, given many consumers' limited understanding of add-ons, as indicated by our customer survey, the level of consumer detriment could be material even though these products were low priced compared with basic PMI premiums. Add-ons generated an NEP of about £630 million a year (see paragraph 7.13). Excluding breakdown cover, windscreen cover and key loss cover (for the reasons given in paragraph 7.67), this amounted to an NEP of about £390 million a year. However, it was not clear what proportion of this NEP was the result of the sale of add-ons at a higher price due to distorted competition. While we also noted that rivalry between motor insurers could mean that higher prices on add-ons enabled motor insurers to offer lower prices on the basic PMI policy, we considered that competition and consumer decision-making could be distorted if the price for some products was too high while the price of other products was too low compared with normal competitive conditions. The lack of transparency on pricing could mean that consumers would not make fully informed decisions and that their biases might be exploited. In this way, competitive pressure on prices and costs would not be equally effective across products or markets.

7.69 The quantification of the detriment was particularly difficult for NCB protection as insurers were not able to explain clearly the effect of NCB protection on the price of insurance or quantify precisely the value of the product to consumers. We found that consumers were unlikely to be able to provide us with relevant information to quantify the detriment because many had a limited understanding of the cover provided by the add-on and did not know how much it cost.

7.70 Nevertheless, we noted that:

(a) In 2012, the aggregate NEP for NCB protection for seven of the ten largest insurers was £152 million, which equated to 2.7% of their total NEP (see Table 7.3). This suggested that the total cost of NCB protection across the whole PMI market was approximately £210 million in 2012.

(b) While a high proportion (77%) of respondents to our customer survey thought they had a good understanding of this product, 59% 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. In addition, our assessment of the descriptions of NCB protection given by providers on their websites found that none of the providers explained that the effect of an accident typically increased a consumer's risk premium, irrespective of fault and regardless of their level of NCB. GfK's market research (see Section 11) reinforced these findings, demonstrating a lack of consumer understanding about how NCB protection works and what value it has.

7.71 Based on this evidence, it appeared to us that the premiums spent on NCB protection by consumers who had a limited understanding of the product were likely to amount to over £120 million a year.[28] We did not place significant weight on this figure but it suggested to us that consumers were currently paying substantial amounts (in aggregate) on a product many did not understand.

[28] 59% of £210 million. We have used 59% on the basis that those who said they understood the product well were most likely to consider purchasing it. However, in addition, 23% of respondents to our survey admitted that they did not understand NCB protection well. Therefore we believe our estimate is conservative and the figure could be higher.

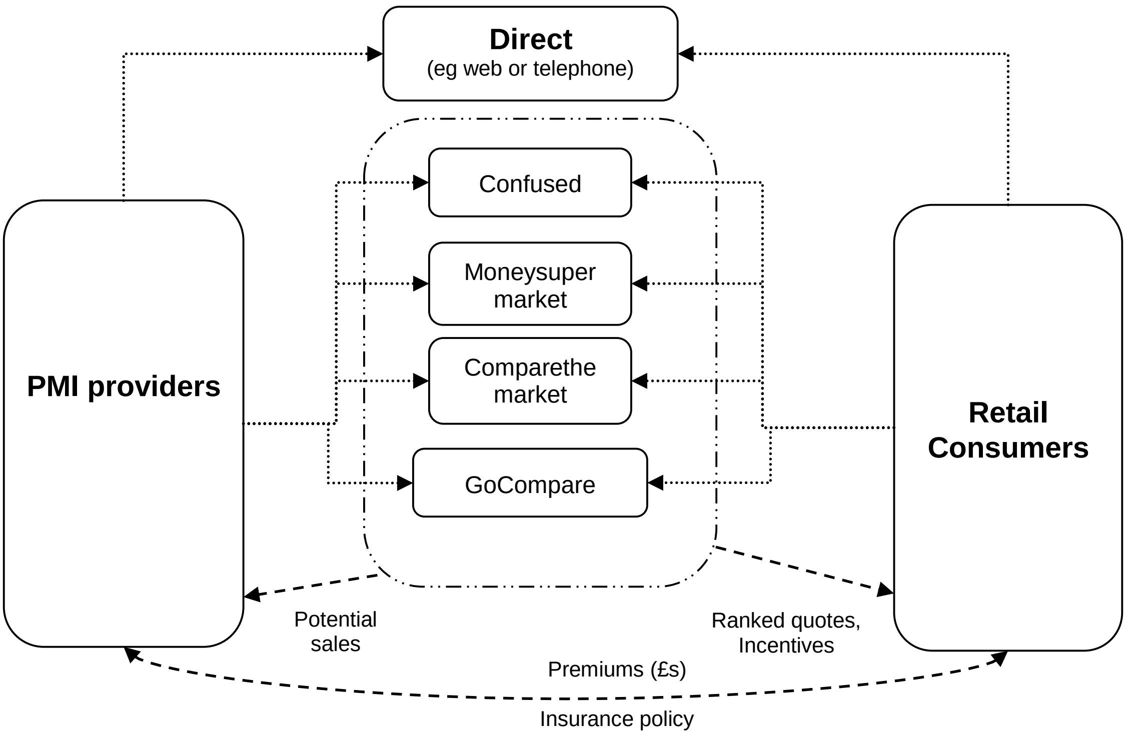
8. MFN clauses in price comparison website contracts (theory of harm 5)

Background to PCWs

8.1 PCWs provide a platform for buying and selling car insurance. They are a 'two-sided market': one set of customers are the PMI providers (insurers and brokers) and the other are retail consumers. The interactions of the four largest PCWs are shown in Figure 8.1, with 'attention' (in the form of qualified sales leads[1]) flowing from retail consumers to PMI providers, and quotes flowing from insurers to retail consumers. PCWs are paid by insurers mostly on a commission fee basis[2] and do not charge retail consumers for using the search services or for purchasing a product, although some of them reward retail consumers with loyalty gifts (like soft toys) when they purchase through their platform.

FIGURE 8.1

Interaction between PCWs and their customers



Source: CMA.

8.2 PCWs are not wholesalers of insurance. They do not buy the PMI policy and resell the policy to consumers, and therefore they do not set the retail price of

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[1] A 'qualified sales lead' is a potential customer who has been through some selection (or qualification) process which is meant to make it more likely that they are genuinely interested in purchasing the product.
[2] The commission fee, also known as a CPA fee, is a fixed sum per sale rather than a percentage of the premium (ie it is not a commission in the same way as brokers earn commission).

policies. Rather, PCWs are intermediaries, ‘matching’ the two sets of customers (PMI providers and retail consumers). Therefore, they seek to attract both sides to use their PCW. To attract PMI providers, PCWs need to bring consumer traffic to their websites. To attract retail consumers, PCWs need to advertise and have an attractive proposition including a wide portfolio of PMI providers for consumers to compare. Almost all insurers seek listings on all the major PCWs (they are said to ‘multi-home’); while only some consumers use multiple PCWs in their search for insurance.

8.3 PCWs have become an increasingly important sales channel for PMI (see Figure 8.2). In 2012, they accounted for [55–65]% of all new business sales.

FIGURE 8.2

Distribution of PMI by origination channel (new business only)*

[✂]

Source: Ebenchmarkers.
*This data excludes branch sales as Ebenchmarkers does not collect data on branch sales. However, other than for in Northern Ireland, only one of the PMI providers we contacted still made significant branch sales.

8.4 As PCWs have grown in importance and increased their advertising expenditure, some insurers have reduced their own advertising and become more focused on providing the best price through PCWs. In this way, PCWs have been a technological innovation in the advertising of insurance policies. New PMI providers have been able to enter the market and have attracted customers by posting competitive prices on PCWs rather than by spending money on advertising. PCWs have, for the most part, been an efficient and competition-enhancing advertising medium.[3]

8.5 Some PMI providers, in particular DLG [✂], which appeared to be leaders in direct telephone sales (the previously predominant sales technology), have chosen not to list some of their brands on PCWs. We found that they had continued to advertise [✂] and sold significant volumes through their own websites and over the telephone.[4] Thus, whilst PCWs advertise PMI products, PCWs are also in competition with some of those PMI providers which seek to attract customers to their own direct-sales channels.

8.6 We found that PCWs had increased competition between PMI providers. Table 8.1 shows the price elasticity of demand for a number of PMI providers

[3] See Appendix 8.1, Annex L, which shows that for most of the significant PMI advertisers, the costs of acquiring customers on PCWs have been lower than the costs of acquiring customers through direct advertising.
[4] To a lesser extent, Saga and CISGIL (under the brand Co-operative Insurance) also advertise significantly off PCWs. [✂]

through different channels. It shows that the volumes that these PMI providers sell are more sensitive to price when they are selling through PCWs than alternative channels. The profit margins that PMI providers can earn are likely to be negatively related to the price sensitivity of demand,[5] so, at these high levels of price sensitivity, PCWs can be expected to be reducing PMI provider's margins.

TABLE 8.1 **Price elasticity of demand for various sales channels*†**

		Own channels		
	PCW	*Website*	*Phone*	*Renewal*
1st Central	6	N/A	N/A	N/A
AA	[✂]	[✂]	[✂]	[✂]
Saga	[✂]	[✂]	[✂]	[✂]
Admiral	[✂]	[✂]	[✂]	[✂]
Ageas Retail	[✂]‡	[✂]	[✂]	[✂]
Aviva	[✂]	[✂]	[✂]	[✂]
AXA	[✂]	[✂]	[✂]	[✂]
BGL	[✂]	[✂]	[✂]	[✂]
CISGIL	[✂]	[✂]	[✂]	[✂]
DLG	[✂]§	[✂]	[✂]	[✂]¶
Endsleigh	[✂]	[✂]	[✂]	[✂]
esure	[✂]	[✂]	[✂]	[✂]
Hastings	6.2–8.6	6	7	N/A
LV	[✂]	[✂]		[✂]
RSA	[✂]	[✂]#	[✂]#	[✂]#
Swinton	4.2–16	N/A	N/A	N/A

Source: PMI providers.

*All elasticities are expressed in their absolute value – but are all negative.
†We have not included the responses regarding insurers' sales via the broker channel. For those insurers which provided data, the elasticity was typically closer to those for sales through PCWs than the provider's website.
‡Price elasticity of demand figures for PCWs relate only to RIAS and not Ageas Retail as a whole.
§Combined elasticity based on customer behaviour when Churchill and Privilege prices are moved in parallel, thus neutralising the effect of customers moving from Churchill to Privilege and vice versa.
¶DLG does not have precise estimates for the elasticity in relation to renewals. However, it estimates the lowest bound to be [✂] and the upper bound to be closer to [✂].
#In respect of RSA's direct offerings through its More Than and eChoice branded products.
Note: N/A = not available.

8.7 However, the degree to which the benefits of competition are being passed to consumers depends also on the nature of competition in the PCW market itself. If the PCW market is competitive, then the benefits of increased provider-to-provider (or interbrand) competition will flow through to retail consumers; but if it is not, the increased competition among PMI providers on PCWs is likely to be associated not with lower consumer prices but with higher commission fees, higher PCW profits, higher levels of advertising and higher PMI premiums.

8.8 We analysed PCW profitability (see Appendix 8.1, Annex H) and found that the [✂] PCWs were highly profitable, with aggregate operating margins

[5] The more sensitive demand is to price, the greater the sales lost from increasing prices; therefore the lower the margin that will maximise profits. Evidence provided by PMI providers also showed that margins earned on PCWs were lower than margins on other sales channels.

around 25% and low capital costs. This indicated that the full benefits of interbrand competition might not be passed on to consumers.

Competition on the two sides of the PCW market

8.9 In this subsection we examine the determinants of competitiveness on the two sides of the PCW market and find that the degree to which a PCW can provide exclusive access to a subset of retail consumers is a source of market power against PMI providers.[6] We also consider the extent to which entry and expansion in the PCW market is a threat to the exercise of this market power.

Retail consumer behaviour on PCWs

8.10 In two-sided markets, an important determinant of competition is the degree to which consumers use a single platform ('single-home') or use several platforms ('multi-home'). In the context of PCWs, 'single-homing' occurs when a consumer uses a single PCW to compare policy prices and does not compare prices across several PCWs for a given transaction. 'Multi-homing' occurs when consumers compare prices on more than one PCW in parallel for the same transaction.

8.11 The extent of single-homing and multi-homing is likely to affect the way in which PCWs compete for retail consumers. If a large proportion of consumers tend to single-home, PCWs will have incentives to compete for direct consumers to their website (competition for consumers' attention), but their incentives to compete on prices with other PCWs may be limited to the extent that single-homers do not compare prices across several PCWs.[7] On the other hand, if a large proportion of consumers multi-home, there will be increased incentives for PCWs to compete on prices with each other in order to be selected by consumers for the policy purchase. There are some costs to multi-homing for consumers as a search for PMI on a PCW might take around 10 to 20 minutes to complete. Another search on a different PCW would require the same time again. However, we noted that all the large PCWs saved a consumer's specific details for subsequent searches (eg for PMI one year later), which reduced the cost of searching over time.

8.12 We found that there was a mix of both single-homing and multi-homing on PCWs. It appeared that many consumers checked several PCWs in their search for insurance, but a material number of consumers appeared only to

[6] PCWs can have market power in their negotiations with PMI providers but compete heavily on the consumer side for consumers' attention.
[7] Although PCWs might advertise their price competitiveness to attract consumers to their website.

check one PCW and hence were accessible only through that PCW. The evidence on this issue was as follows:

(a) Our consumer survey found that, of consumers who used PCWs the last time they shopped around for PMI:

(i) on average they searched on 2.2 PCWs; but

(ii) 33.5% used only one PCW.[8]

(b) 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 [✄]% of enquirers compared two PCWs or more.

(c) PMI providers' estimates of single-homing were between 50 and 80%, measured as the proportion of consumers who requested a quote from an insurer on one PCW and did not make a quote request from another PCW within a short time period.[9]

8.13 If PMI providers' experience of single-homing is high, they are more likely to need to be on each major PCW. The evidence from our consumer survey and Moneysupermarket suggested a single-homing rate of between 33.5 and [30–40]%.[10] The PMI providers we contacted provided evidence of higher single-homing rates, between 50 and 80%.[11] The differences between our survey results and the data from PMI providers could have been due to consumers tending to over-report their shopping-around behaviour in a survey or by PCWs generating indicative renewal quotes to customers which customers do not consider to be part of their search activities. However, as shown in Appendix 8.1, Annex K, the levels of single-homing observed in both our survey and by PMI providers were high enough for insurers to want to be listed on all the major PCWs. Therefore, it appeared to us that these levels of single-homing were likely to be a material source of market power for the PCWs in their negotiations with PMI providers.[12]

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[8] BGL and GoCompare raised concerns about the level of this single-homing rate given consumers on average use more than one PCW. This apparent discrepancy can be explained by a smaller number of consumers using multiple PCWs and a larger number of consumers using only one. The average (mean) number of PCWs a consumer researches is a construct of all consumers, both those who are single-homing and those who are multi-homing.

[9] When asked to provide estimates of single-homing rates, PMI providers used their own methodologies. The exact time periods used to check whether there was a requote varied between providers, though most were for quotes within about a month.

[10] The single-homing rate was calculated by dividing the number of customers who only used that PCW by all customers who used that PCW.

[11] The differences in the rates between PMI providers may be due to both the different methodologies used to calculate single-homing rates by the providers and actual differences in single-homing rates.

[12] BGL told us that our findings on single-homing should be discredited because of the findings of *Consumer Futures: Price comparison websites: consumer perceptions and experiences – A report by RS Consulting for*

8.14 The level of multi-homing, of between 20 and 67% depending on the estimate used, suggested that there could be direct price competition for retail consumers between PCWs. However, we did not see much evidence of price competition between PCWs, though, as we discuss below, this was likely to be the result of the existence of wide MFN clauses.

8.15 However, we did find evidence of competition between PCWs for consumers' attention. We found that PCWs invested significantly in advertising, in particular on television, and offered various inducements to retail consumers in the form of free toys or loyalty card points. This indicated extensive rivalry on the retail side of the market.

8.16 We found that the PCWs viewed themselves as being engaged in competition for customers who actively shop around and are not loyal to a particular PCW. For example, [✂]. We also found that the target of instilling loyalty among customers [✂]. For example, we saw in [✂]. We noted that this figure could be interpreted as a target level of single-homing for [✂].

8.17 Overall we found that there was a significant degree of single-homing among PCW users. Nevertheless, many consumers seemed able and willing to multi-home. Moreover, they did this despite the fact that there was very little premium variation between PCWs. We noted that multi-homing rates could be higher if it were generally known that shopping around on different PCWs yielded lower prices.

PMI provider behaviour on PCWs

Listing and multi-homing

8.18 We found that most PMI providers sought to be listed on all four large PCWs. One large insurer told us that, in order to remain competitive, it was necessary to quote on a minimum of three of the four large PCWs, but it was desirable to quote on all four. We noted that a small number of brands chose not to list on any PCW but instead sold through their own direct channels.

8.19 Most PMI providers told us that, in order to reach consumers, they had to list on PCWs. They said that each of the four large PCWs commanded access to a set of retail consumers whom they otherwise could not reach. This was consistent with some consumers single-homing (see paragraphs 8.11 and 8.13). PMI providers told us that single-homing by some consumers gave PCWs considerable market power against PMI providers. We assessed PMI

Consumer Futures, published on 22 July 2013. However, we noted that shoppers in that report were asked about their use of PCWs in general and not about their use of PCWs when purchasing PMI only. Indeed, PMI providers' data suggested that single-homing rates were higher than in the survey results shown in that report.

providers’ abilities to resist commission fee increases from PCWs in the face of delisting (see Appendix 8.1, Annex K) and found that in most cases, under current market conditions, it appeared better for the PMI provider to accept a price increase from a PCW than to be delisted.

8.20 PCWs compete with other sales channels for retail customers. To assess the importance of the different channels for the sale of PMI we looked at market research reports and responses to our survey. In our survey of PMI policy-holders we asked what sales channel respondents used when they first purchased their PMI policy from their current provider. 42% said that they purchased ‘over the phone’; 33% said they purchased online via a PCW; 9% said they purchased through an insurer’s or broker’s website;[13] and 7% purchased the policy in person. Survey results presented in Moneysupermarket’s Strategic Plan for 2012–2014 showed that among the most common reasons for people not buying through a PCW (despite using it to compare prices) was a preference for talking through options with someone and the possibility of discounts or cashback when contacting an insurer directly.[14]

8.21 We found that an estimated 23% of PMI policy sales were through PCWs.[15] However, the total base from which this 23% was derived included sales to customers who opted to renew their policy with their current provider, and renewals accounted for about 59% of all policies sold. Therefore PCWs accounted for a greater proportion of new business (ie customers purchasing PMI for the first time or switching from their previous provider). Figure 8.2 shows that in 2012 [55–65]% of new PMI business was sourced through PCWs.

8.22 We examined the negotiating position of PMI providers and PCWs by looking at the discounts which larger PMI providers were able to negotiate on the commission fees offered by PCWs. We found that larger providers tended to be able to negotiate lower commission fees. Appendix 8.1, Annex G, provides the detailed results. We found that not all of the bargaining power in the negotiations between PMI providers and PCWs was with PCWs as PCWs were, to an extent, dependent on carrying important brands in order to maintain the quality of their offering.[16]

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[13] In total, 46% of respondents said that they first purchased their PMI policy from their current provider ‘online’.
[14] Some PMI providers told us that some PCWs had complained that cashback offers violated the terms of their MFN agreements.
[15] Source: Datamonitor.
[16] We also examined the extent to which the ownership structure of PCWs might affect competition between PMI providers on PCWs. We did not find evidence that the ownership of a PCW currently affected competition between PMI providers. Appendix 8.1, Annex J, provides the detailed results.

Entry

8.23 Entry or the threat of expansion by new or small PCWs could restrict the market power of each of the incumbent large PCWs against PMI providers. We examined the business plans of Tesco, Google and Covea SGAM. We found that Tesco had scaled back its involvement in the PCW market in the last five years;[17] [✂] had considered entry but had decided not to do so. [✂][18] Tesco and Covea SGAM told us that advertising costs were a barrier to entry in the market. Covea SGAM noted also that the major risk of entry was the difficulty of differentiating its proposition where this could only be achieved on the basis of marketing.

8.24 We found that PCWs invested heavily in advertising and marketing. Comparethemarket told us that [✂]; and Moneysupermarket's 2011 annual report showed that its marketing investment amounted to £78 million in that year, corresponding to around 43% of its revenue.[19]

8.25 We concluded from this evidence that there was some constraint on the four large PCWs from potential entry or expansion but it was limited due to both the need for a new entrant to invest in high levels of advertising and the difficulty of creating a new differentiated offering.[20]

Conclusion on competition on the two sides of the PCW market

8.26 Overall we found that PCWs appeared to enjoy a significant degree of market power against PMI providers by virtue of their single-homing consumers. These consumers appeared to be accessible to PMI providers only through each specific PCW. Entry and expansion appeared to offer a limited threat to the four large incumbent PCWs. In the remainder of this section, we consider in detail one use of this market power: the negotiation and enforcement of MFN clauses in contracts with PMI providers.[21]

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[17] Tesco Compare has since closed its business.
[18] In a report commissioned by Tesco Compare, the analysis suggested that Tesco would need to incur similar levels of advertising expenditure as its competitors in order to achieve a similar market share.
[19] We examined the suggestion that advertising by PCWs might be excessive and used as a barrier to entry (see Appendix 8.1). However, we did not conclude on this possibility because of the difficulties of establishing a competitive benchmark for the level of advertising.
[20] We noted that the inability to enter with a differentiated offering was likely also to be the result of the operation of wide MFN clauses (see paragraphs 8.69–8.71).
[21] Harm identified below from MFN clauses would still be relevant even without market power, although the motivation for MFN clauses to be implemented might be explained by other factors.

MFNs

8.27 PCWs can constrain the prices which a PMI provider can charge through alternative sales channels (including other PCWs) by using 'most favoured nation', or 'price parity' clauses (MFNs). We observed two broad types of MFNs between PCWs and PMI providers, with significantly different impacts on competition:[22]

(a) *Narrow MFNs.* These clauses state that the price quoted through the PCW to consumers will always be competitive with the price on the PMI provider's own website, ie the price on the PMI provider's own website will never be cheaper than the price on the PCW.

(b) *Wide MFNs.* These clauses state that the price quoted through the PCW to consumers will always be competitive with any of the prices available, whether on the PMI provider's own website (as for narrow MFNs) or on other PCWs[23], ie the price on other sales channels will never be cheaper than the price on the PCW.

8.28 Table 8.2 shows that, of all the PMI policies sold via the four largest PCWs in 2012, the vast majority ([80–90]%) were sold when there was one of the two types of MFN clause in the contract between the PCW and the PMI provider. Just under half of all sales ([40–50]%) were sold under narrow MFNs, and slightly fewer ([40–50]%) were sold under wide MFNs. However, we noted that [40–50]% was an underestimate of the impact of wide MFNs because a single wide MFN clause had a 'network' effect. A wide MFN would stop any other PCW offering cheaper policies, so effectively excluding them as a source of price competition. A significant majority ([70–80]%) of policies sold through all PCWs were covered by at least one wide MFN clause with one PCW.[24]

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[22] We have previously identified three types of MFNs, but the effects of online-sales and all-sales MFNs are considered under wide MFN clauses as their impact on competition between PCWs is similar.
[23] Some wide MFNs also include offline sales channels too.
[24] The difference between the [✄]% of policies under wide MFNs and the [✄]% of policies covered by at least one wide MFN is because the agreement between a PMI provider and the four main PCWs may contain three narrow MFN clauses and one wide MFN clause. All policies sold by this PMI provider are potentially affected by the wide MFN clause.

TABLE 8.2 **Percentage of PMI policies sold under MFN clauses, 2012**

Sales by PMI providers with	*Sales volume %*
An MFN	[✂]
Narrow	[✂]
Wide	[✂]
At least one wide MFN	[✂]

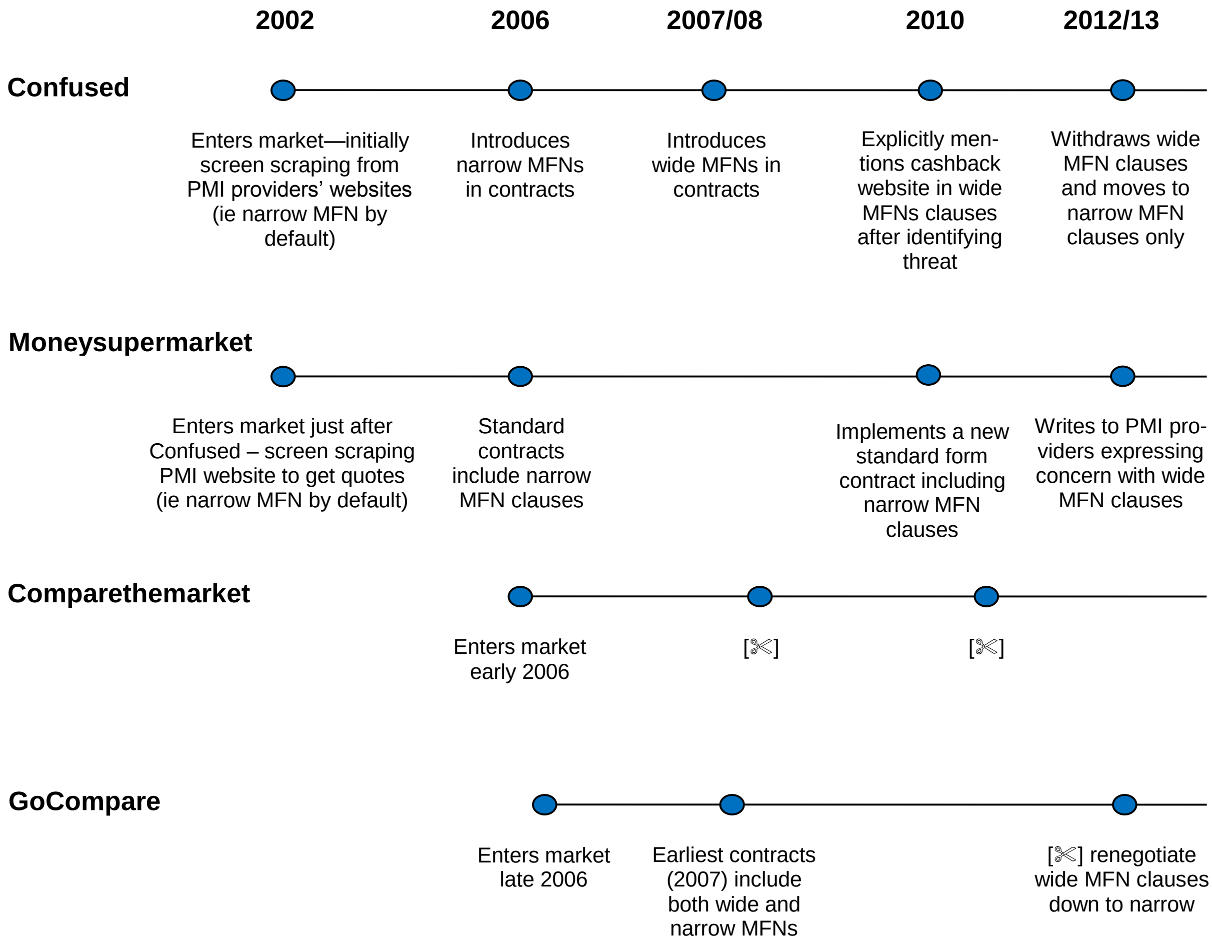
Source: CMA calculations and parties' data.

8.29 PCWs' use of MFN clauses has evolved as the market has developed (see Figure 8.3). The first PCWs gathered prices by 'screen-scraping'[25] from PMI providers' websites, which is equivalent to a narrow MFN, ie the price reported on the PCW was the price that could be found by going directly to the PMI provider's website. As relationships with PMI providers developed, PCWs linked into the back-office systems of PMI providers to obtain quotes. At this point, narrow MFNs started to be introduced into standard contracts with PMI providers. As the market developed further, MFN clauses were then sometimes widened[26] to include sales through other PCWs and other sales channels. However, in late 2012, this trend began to reverse as Confused narrowed its MFN clauses and a small number of larger insurers negotiated a narrowing of clauses with GoCompare. These moves towards narrowing did not indicate that the market influence of wide MFNs was falling, though, as one wide MFN with a single PCW would continue to constrain policy pricing on all PCWs.[27]

[25] 'Screen-scraping' is the term used for the practice of a server, or 'crawler', visiting a web page and extracting information from that page algorithmically.
[26] GoCompare [✂] had wide MFN clauses in contracts from their earliest contracts with PMI providers.
[27] The phenomenon of wide MFNs constraining prices on other PCWs is a 'network effect' because it affects prices across the network of PCWs. This is different from the use of the term network effects in platform markets, which describes the increased benefits to all or some users from the network expanding.

FIGURE 8.3

Evolution of PCWs and MFNs



Source: PCWs.

8.30 In the following subsections, we first discuss whether the incentives that narrow and wide MFNs place on PCWs and PMI providers are likely to lead to harm to competition. We then present evidence on the effects of narrow and wide MFNs. Finally we assess whether there are any pro-competitive effects from narrow and wide MFNs.

8.31 Throughout this discussion, we distinguish between two sources of competition which might constrain policy premiums: interbrand competition and intrabrand competition. Interbrand competition refers to competition between PMI providers and is driven by consumers switching or threatening to switch between different PMI providers. We found that this type of competition was strong, especially when selling through PCWs (see paragraph 8.6). Intrabrand competition refers to competition between different sellers of a given policy and is driven by consumers switching or threatening to switch between different channels of sales for a given policy, eg switching from one PCW to another or between a PCW and a PMI provider's own website. We found that intrabrand competition was likely to be the main driver of competition between PCWs via commission fees charged to PMI providers (with indirect effects on policy prices). We judged that, if any competition was harmed by MFNs, it was this source of competition (intrabrand competition) which was likely to be harmed.

Harm arising from incentives

Wide MFNs combined with the 'agency' pricing model softens competition between PCWs

8.32 The 'agency' pricing model, which we observe with PCWs, is where PMI providers set prices to final consumers, while PCW-to-PMI provider negotiations set commission fees. Under this model, MFNs directly constrain the prices consumers pay.

8.33 The agency model can be contrasted with a 'wholesale' model, under which MFNs might constrain the prices at which PMI providers sell to intermediaries, but intermediaries would continue to be free to set different retail prices when competing for final consumers.

8.34 We considered whether wide MFNs in combination with the agency model were likely to harm competition between PCWs. We discuss two ways in which this might happen:

(a) by reducing entry and innovation; and

(b) by increasing commission fees and policy premiums.

Reduced entry and innovation

8.35 A common strategy for entry into many markets is for a new entrant to offer cheaper prices than the incumbents. We found that PMI consumers are price sensitive, and those shopping through PCWs can be expected to be particularly price sensitive (see Table 8.1). Therefore, we would expect that a new entrant PCW could grow its market share by offering lower PMI premiums to consumers.

8.36 A new entrant PCW might offer lower PMI premiums by, for example:

(a) reducing the commission fee to a PMI provider in exchange for lower premiums;[28] and/or

[28] Assuming constant margins for the PMI provider.

(b) providing more profitable business to PMI providers, eg by offering better fraud prevention measures or reducing cancellation rates.

8.37 Entry and the threat of PCW entry would have a number of pro-competitive consequences:

- potentially lower PMI premiums (to the extent that lower prices are used to gain market share)
- increased consumer choice of PCW
- increased PCW innovation

8.38 However, wide MFNs undermine an entry strategy based on lower premiums. An entrant cannot offer consumers lower policy prices as long as those policies are covered by a wide MFN.[29]

8.39 Wide MFNs also reduce the incentives for incumbents and entrants to innovate. PCWs could innovate in ways which lower the costs of business for a PMI provider selling through their PCW, eg by offering better fraud detection measures. Without wide MFN constraints, such innovation would lead to the PMI provider offering lower premiums through that PCW, reflecting the cost savings to the provider of the PCW's innovation. However, if the PMI provider cannot offer policies cheaper to innovative PCWs because of wide MFN clauses with other PCWs, this would reduce the incentive for the PCW to innovate as it would not receive any advantage over its competitors.[30] PMI providers could still reward innovative PCWs with higher commission fees in exchange for a better quality sales channel, but not with higher market share. Retail consumers would have no price inducement to use the better technology.[31]

Increased commission fees and policy premiums

8.40 In the absence of wide MFNs, PCWs can compete with one another on the commission fees they charge to PMI providers. This is because PMI providers can offer lower premiums on the PCW and the PCW can grow its sales.

[29] We considered whether PCWs could offer inducements, such as cashback, encouraging consumers to switch (see Appendix 8.1, paragraphs 63–66 and Annex F). However, we did not find these inducements to be effective, and sometimes, as in the case of cashback, they appeared to be covered by some MFN clauses.
[30] Comparethemarket told us that it had directly offered insurers the opportunity to review and improve fraud detection initiatives and controls in the past, although there had not been any substantive take-up of these opportunities and the vast majority did not respond to its approach. We took from this evidence that PCWs believed that it was possible to offer some technological improvements.
[31] GoCompare told us that wide MFNs did not preclude innovation, eg it had introduced Defaqto ratings into its search results so customers could better assess the quality of the product they were purchasing. However, this type of innovation would not lead to lower costs and therefore lower premiums and is the type of innovation we could expect to see irrespective of MFNs.

Equally, PMI providers can threaten to increase premiums on a PCW which increases its commission fees, leading to a potential loss of sales for the PCW. These are the competitive mechanisms which, in the absence of wide MFNs, could be expected to restrain commission fees.

8.41 When there is a wide MFN between a PCW and a PMI provider, the PCW does not face the same restrictions to increasing its commission fee. This is because the PMI provider cannot increase premiums on that PCW relative to premiums offered on other PCWs. In addition, other PCWs (without wide MFNs) no longer have the incentives to decrease their commission fees to PMI providers as doing so would not allow them to pass on savings and gain market share. In this respect, wide MFNs have a 'network effect' as they affect the prices and behaviours of other PCWs.

8.42 Generally, we expected that higher commission fees would lead to higher policy premiums because there was likely to be some pass-through of costs to premiums.[32,33] If commission fees rose on a PCW that had a wide MFN, it might be possible for a PMI provider to absorb a part of the increase through price rises on other sites, and therefore not to pass through the cost increase fully.

8.43 However, irrespective of the rate of pass-through, the PCW with the wide MFN could continue to increase commission fees until the price of the policy was too high *from the point of view of the PCW.* Premiums across the market might increase up to the point at which PMI providers exercised their 'outside option', which would be to withdraw from listing on the PCW with the wide MFN and to seek to attract customers from other sources, ie by becoming more reliant on other PCWs, by advertising to increase direct sales, or by a combination of both.[34]

Narrow MFNs

8.44 In this subsection, we discuss whether and if so how narrow MFN clauses might cause harm to competition. We considered two possible ways:

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[32] In Johnson, J, *The Agency Model and MFN clauses* (2013), the author develops a formal model with many similarities to the current case in which wide MFN clauses in combination with the agency model lead to the emergence of high industry prices. Boik, A and K S Corts (2013) *The Effects of Platform MFNs on Competition and Entry* find similar results to Johnson.
[33] In Appendix 6.4 we discuss the impact of cost increases and pass-through to premiums in relation to post-accident services.
[34] This point may be reached sooner for some PMI providers than for others, especially those with a strong existing brand.

(a) A collection of narrow MFNs could have a 'network effect' similar to wide MFNs, so restricting competition between PCWs. This could lead to increases in commission fees, a reduction in innovation on PCWs and increases in barriers to entry for other PCWs.

(b) Narrow MFNs remove a PMI provider's own website as a constraint on a PCW's behaviour. This could lead to increased commission fees and a loss of innovation by PMI providers on their own website.

8.45 We discuss these possibilities in turn.[35]

Do narrow MFNs have a 'network effect'?

8.46 We considered the interaction between PMI providers' behaviour and competition amongst PCWs. We considered the ability and the incentives of PMI providers to behave in a way that fostered competition between PCWs under narrow MFNs. A narrow MFN ensures that the direct online channel cannot undercut a PCW channel. From a contractual point of view, a narrow MFN (or a collection of narrow MFNs) permits different prices on different PCWs and therefore should permit price competition between PCWs. However, if a PMI provider's website is an important and attractive sales channel for the provider, several (or even just one) narrow MFNs might have a wider impact by constraining competition between PCWs (we refer to these as 'network effects').

8.47 Consider an insurer with a product, Brand A, which has 50% sales on PCWs, 50% direct sales, and is covered by at least one narrow MFN (but no wide MFNs). The narrow MFN prevents the direct channel from undercutting the PCW. If the insurer wants to maintain the competitiveness of Brand A through its direct channel because this generates the most profitable sales (ie it has no commission to pay and, on average, it gains customers who are more likely to renew in future years) and it also advertises significantly to consumers to encourage them to come directly to Brand A's website, it would not want any PCW to offer Brand A's policies cheaper than they are on its own website.

8.48 A series of narrow MFNs in this context imposes a floor price for Brand A's policies on any PCW that is *equal* to the own-website price, similar to a wide

[35] Acromas told us that we had used the wrong counterfactual. It said that, were we to remove wide MFNs, not only would wide MFNs be renegotiated as narrow MFNs but firms with no MFNs in their contracts would be forced to sign narrow MFNs. Acromas also said that insurance providers would be forced to sign narrow MFNs on other insurance lines. In our analysis of narrow MFNs, we considered which brands would be affected by narrow MFNs regardless of whether they had narrow, wide or no MFN clauses in their contracts. Therefore, we effectively considered the impact of narrow MFNs proliferating following a prohibition of wide MFNs. In addition, as demonstrated in Table 8.2, MFN clauses (both wide and narrow) are widespread in the market already.

MFN. If a low-commission-fee entrant (or incumbent) PCW wished to list Brand A's policies at a lower premium than other PCWs, even if it is lower cost to the insurer, they would not want to reward that PCW by quoting lower premiums than on the other PCWs. This is because its MFN clause with the other PCWs would then require it to maintain its direct sales price above the price on the low-commission-fee PCW and that would take sales away from its own direct channel. Thus, through this 'network effect', low-commission-fee entry would have been discouraged, much as under wide MFNs.

8.49 In a similar way, if there were a commission fee increase on the part of the PCW with the narrow MFN clause, then the insurer would want to increase the premiums shown on that channel; but it would also have to increase premiums on its own channel, and on any other PCWs which would otherwise be lower cost than the direct channel, because of its desire to maintain the attractiveness of its direct channel. The cost to the PCW of increasing commission fees is reduced as premiums on other PCWs also rise. Thus, through the 'network effect', there is a weakened constraint on commission fees, much as under wide MFNs.

8.50 Brand A provides an example of the network effect for narrow MFNs. However, it does so only when direct sales are so substantial as to lead to the self-imposed constraint that the own-channel's attractiveness must be maintained. In Appendix 8.1, we explore the parameters which are important in determining whether a brand will fall into the category of Brand A. The critical factors are whether the PMI provider's own website is worth protecting as much as in Brand A's case. This depends on:

(a) the strength of the brand: the stronger the brand, the higher the value of sales on the own website because they can be achieved at lower incremental cost; and

(b) the margins available on alternative PCWs with which the brand has no narrow or wide MFNs: the lower the commission fees on these alternative PCWs, the less worth protecting the own website becomes.

8.51 In examining empirically the importance of the direct channel, we found that the brands where the direct channel was highly significant (and which had the most advertising) were often not listed on PCWs (eg the Direct Line brand). In these cases, narrow MFN considerations were irrelevant because there are no contracts between PCWs and the PMI providers.

8.52 We examined PMI providers' advertising expenditure and their share of direct sales and considered their explanations of their strategies (see Appendix 8.1, paragraphs 29 to 41). We concluded that there were just a few brands which had significant direct sales and were seeking to maintain this direct presence (as well as the PCW presence). In these cases, competition between the direct channel and the PCW was substantial, and narrow MFNs might lead to the same sort of harm to competition as with wide MFNs. However, the proportion of such cases was limited: we estimated the number of brands affected to be between three and six, accounting for between [0–10]%[36] and [10–20]%[37] of the policies sold on PCWs, and likely to be on the lower side of these ranges.

8.53 Moreover, when we modelled PMI pricing behaviour (see Appendix 8.1, Annex D), we found that, even if the PMI provider did not have any MFN clauses, PMI providers with a strong direct sales channel would still be unlikely to have an incentive to sell through a low commission fee PCW at lower prices. This result did not depend on the presence of narrow MFNs.

8.54 For these reasons, we concluded that, narrow MFNs were unlikely to have a network effect which impacts on competition between PCWs.[38]

Do MFNs have anti-competitive effects by reducing the constraint on a PCW from the PMI provider's website

8.55 Narrow MFNs prevent the PMI provider's website from being cheaper than the PCW with the narrow MFN. Some PMI providers told us that this removed a *significant* constraint on commission fees, reduced incentives for PMI providers to innovate on their own websites and thus led to higher prices.

8.56 As narrow MFNs are prevalent in the PMI market, PMI provider's websites are, to a degree already constrained. Therefore, we looked at two indirect measurements of the constraint PMI providers' websites place on PCWs: *(a)* the effectiveness of advertising expenditure by PMI providers; and *(b)* the price elasticity of demand of different sales channels. We also considered PCWs' monitoring behaviour of their competitors.

[36] This includes [✂], [✂] and [✂], but excludes [✂] for reasons outlined in Appendix 8.1, paragraph 36.
[37] This includes [✂], [✂], [✂], [✂], [✂] and [✂].
[38] Our findings mainly related to a series of narrow MFNs, but in our view the findings for a single narrow MFN were unlikely to be different in the light of the evidence (and in any event single narrow MFNs would not be more restrictive than a series of narrow MFNs).

- *Effectiveness of advertising expenditure*

8.57 Traditionally PMI providers have attracted customers through direct advertising but, more recently, this has also involved quoting a price on a PCW, which requires a combination of low prices and brand recognition.

8.58 We found that, in general, attracting customers through PCWs was cheaper for PMI providers than direct customer acquisition (see Appendix 8.1, Annex L), ie for most PMI providers, the costs of acquiring a customer directly were higher than the commission fees per sale on PCWs. We found that [✂].[39]

8.59 This evidence suggested that PCWs had had the overall effect of lowering the costs of business for PMI providers, which we expected to have led to lower PMI prices. Moreover, we noted that PCWs had lowered the barriers to entry for new PMI providers as providers did not need to spend significant sums on advertising in order to attract customers but instead could focus on being price competitive.

8.60 In our view, for these reasons, PMI providers' websites were less likely to be a significant constraint on PCWs.

- *Price elasticity of demand of different sales channels*

8.61 The price that a PMI provider quotes on its own website will reflect the costs of acquiring and insuring that customer as well as the customer's likely responsiveness to changes in price.

8.62 The best measure for responsiveness to changes in pricing is given by the price elasticity of demand. In Table 8.1, we show price elasticity of demand data for a sample of different PMI providers on different sales channels.The data shows that customers' price responsiveness on PCWs was higher than on PMI providers' own websites. This indicated that the ability of consumers

[39] There might be some brands which can acquire customers directly more cheaply, for which narrow MFNs might present a bigger problem. It appeared to us that [✂] and [✂] might be in this position. These brands have an incentive to negotiate not to be constrained by narrow MFNs. Indeed we found that [✂] had often been successful in resisting them. We found that [✂] negotiating strength would depend, among other things, on the proportion of sales for which it was dependent on PCWs and the credibility that it brought to PCWs by being present in their listings. [✂] told us that if we were to permit narrow MFNs, it would make it harder for [✂] to resist them in negotiations because any uncertainty over their legality would have been lifted. However, we did not see any evidence which suggested that PCWs had agreed not to include narrow MFNs for this reason in the past (see Appendix 8.1, paragraphs 42–44).

to compare directly the prices of different policies on PCWs was likely to be a major driver of interbrand competition.[40]

8.63 We found that, in such circumstances, whilst narrow MFNs limited competition between the own website and the PCW, this was unlikely to have much of an impact on competition between brands.[41]

8.64 We recognised that it was possible that, in some cases, intrabrand competition might be reduced if the direct channel was constrained by a narrow MFN and, in their absence, policies would have been sold cheaper on the direct site. One could expect intrabrand competition (ie the price at which you can find the same good in different outlets) to be the main constraint on commission fees.

8.65 However, it appeared to us that, in the PMI market, intrabrand competition driven by competition between PCWs was more effective overall than intrabrand competition driven by own-website to PCW competition. This is because the former included much stronger elements of interbrand competition which compelled PMI providers to price competitively on PCWs. This suggested that, other things being equal, the incentives for PMI providers to reduce prices on PCWs are higher than on the direct sales channels. This is because of the higher degree of interbrand competition faced by PMI providers on PCWs. This indicated that the pricing on a PMI provider's website, other things being equal, would not be a strong constraint on the PCW.

- *PCWs monitoring behaviour*

8.66 Our review of PCW internal documents suggested that PCWs monitored one another's behaviour much more than they monitored direct insurers' behaviour and that, more generally, they considered other PCWs to be their closest competitors. Again, this suggested that PMI providers' websites were a weak constraint on PCWs' behaviour.

[40] Acromas and CISGIL told us that narrow MFNs caused harm to brand loyal consumers. Although we had no way of measuring directly the brand loyalty of consumers, we noted that customers who renewed (and who therefore had expressed some degree of brand loyalty) had much lower elasticity of demand. If we assume that brand-loyal customers have a low acquisition cost, then we might expect the price to brand-loyal customers to be lower, but their lower price sensitivity would have a countervailing effect. If a provider has low-cost brand-loyal customers, then we might expect that provider to try to negotiate a carve-out from the application of narrow MFNs to this group of customers. It appeared to us that [✂] was in this position and we noted that it had sometimes successfully resisted entering narrow MFN agreements.

[41] Some PMI providers told us that the elimination of the direct channel would lead to less diversity in available PMI policies. However, we believed it was more likely that the emergence of PCWs had led to less diversity as PMI providers had sought to offer lower prices and policies had become increasingly homogenised. Diversity was still possible, as shown by the emergence of multi-car products, but the focus of PCWs on price made distinguishing individual policies difficult.

- *Summary of effects from the reduced constraint on a PCW from the PMI provider's website*

8.67 Overall, we found that the loss of competition on prices from the direct channel was unlikely to have a large impact on intrabrand competition because, in the absence of any MFN clauses, the main constraints on the setting of commission fees (with knock-on effects on the pricing of policies) on PCWs would be likely to come from other PCWs.

8.68 The websites of PMI providers would be unlikely, even in the absence of narrow MFNs, to be a significant constraint on PCWs' behaviour. This is because, in general, the cost of acquisition of customers was generally lower for PMI providers on PCWs than on their own websites, and because PCWs had increased interbrand competition between PMI providers. This meant that PMI providers had stronger incentives to price competitively on PCWs than on their own websites, leading to lower prices on PCWs. For these reasons, we found that the restriction on competition imposed by a narrow MFN was unlikely to be significant. It followed that narrow MFNs should not restrict the ability of PCWs to enter the market, nor significantly reduce the incentives for PCWs to innovate in ways which might reduce PMI premiums.

Evidence on the effects of wide MFNs

Entry and innovation

8.69 Our analysis above suggested that wide MFNs will make it hard for an entrant to adopt a differentiated, low-premium entry strategy and that this will reduce consumer choice and competition in the PCW market. In general, it is very hard to find direct evidence of entry having been restricted or of innovation not having occurred, because what is required is evidence of an absence. Nevertheless, we identified an instance of failed entry by Covea SGAM, which had put effort into considering whether or not to enter the PCW market in the UK in 2012.

8.70 Covea SGAM commissioned consultants to investigate the opportunities in the UK. They concluded as follows:

> Unless the [Covea SGAM] team can demonstrate tangible reasons that differentiate the business model from the existing players, therefore allowing them to consistently beat the average over an extended period, then we see the downside risks as too high to justify the significant investment required to launch a full scale aggregator into the UK.

In other words, the difficulty of launching with a differentiated offering, as identified in our analysis (see paragraphs 8.35 to 8.39), seemed to have been a key limitation which deterred entry.

8.71 Covea SGAM told us that the existence of MFNs prevented it from differentiating itself with a low-premium entry strategy. Therefore the alternative entry strategy evaluated by Covea SGAM was entirely based on competing on marketing, not price, and, on this basis, Covea SGAM considered the venture too risky.[42]

Higher premiums and commission fees

8.72 We examined the relationship between commission fees, PMI provider size and the type of MFN. The aim of this analysis was to assess whether wide MFNs (and to an extent narrow MFNs) were associated with higher commission fees and higher PMI premiums.

8.73 This analysis found that there was some evidence that, on average, wide MFNs were associated with higher commission fees (see Appendix 8.1, Annex G). However, we could not exclude the possibility that this was mainly an effect due to the size of the PMI providers which engaged in these arrangements rather than due to the presence of wide MFNs. The data was consistent with smaller PMI providers having less bargaining power, making it more likely that they would sign wide MFNs *and* that they would pay higher commission fees. We could not separate the two effects because the data set was small and there was little variation in the bargaining strength of PMI providers over time.

8.74 Our analysis of incentives suggested that some PCWs might wish to offer reduced premiums through reduced commission fees but, in the presence of wide MFNs, would be unable to do so. Several PMI providers gave us specific examples of when this had occurred. In these cases both commission fees and premiums would have been lower had it not been for the presence of one or more wide MFN. Several PMI providers told us either that they had entered these agreements and subsequently withdrawn from them as they were warned they were in breach of their contractual (MFN) obligations with another PCW, or that they did not consider taking up these offers for fear of being in breach of their wide MFN clauses. One PMI provider told us that wide MFNs reduced significantly the incentives to engage in commission sacrifice

[42] This might not have been the only reason, especially as we identified that barriers to entry were likely to remain even without wide MFNs (see paragraph 8.25). However, the inability to differentiate on price was clearly a factor.

offers and/or price promotions, as well as the incentives of PCWs to offer them.

8.75 Moneysupermarket provided information about PMI providers which had accepted and rejected commission sacrifice offers with it. Its offer was that it would lower its fee, by, for example, £5, and the PMI provider would provide a matching PMI price reduction. Overall, retail consumers would gain lower PMI prices.

8.76 Table 8.3 shows the number of PMI providers which agreed, which did not agree and which initially agreed but then withdrew, and the number of wide MFNs held, on average, by each group. [✄] PMI providers which refused the deals had a wide MFN clause with [✄]. [✄] PMI providers initially agreed to reduce premiums but later withdrew, which, Moneysupermarket told us, was because concerns related to wide MFNs. [✄] PMI providers had a wide MFN clause in its contract with [✄]. Two-thirds of the PMI providers which agreed to the deals did so despite [✄]. We noted that these providers tended to be larger, and therefore had greater negotiating power.

TABLE 8.3 **Analysis of PMI providers who were offered a commission exchange by Moneysupermarket**

	PMI providers who have:		
	Agreed	*Not agreed*	*Withdrawn*
Number	[✄]	[✄]	[✄]
Average number of wide MFNs in place	[✄]	[✄]	[✄]

Source: CMA analysis and data from the parties.

*Confused told us that it had withdrawn the wide MFN clauses (or would not enforce these clauses) in its contracts with PMI providers and we calculated the average number of wide MFN clauses on this basis.

8.77 PMI providers also told us more generally about the impact of wide MFN clauses on their ability to agree special offers with PCWs. [A PMI provider] was offered a commission sacrifice agreement by [one PCW]. [✄] described the commission sacrifice agreement as potentially very desirable. It welcomed the opportunity to be able to offer lower premiums through [✄] and hoped to win business mainly from rival brands on the same PCW rather than from consumers who would otherwise have purchased from [✄] through other sites (ie it expected the offer to increase competition more between insurers than between PCWs). [✄] told us that it did not go on to negotiate a deal because of the wide MFN that it had with [✄].

8.78 [Another PMI provider] told us that it had taken part in price-based offers with both [✄] and [✄] in the past. However, as these offers affected the price quoted on the relevant site, it received complaints from another PCW[43] asserting that it was in breach of its MFN clause with that PCW. [✂] said that the offers were eventually removed. [✂] told us that it had not been able to offer lower prices on one PCW (whether funded entirely by that PCW or co-funded between the PCW and [✂]) as its MFN clauses with other PCWs restricted the final price it was able to offer.

8.79 [✂] This suggested that the purpose of wide MFN clauses was to ensure that PMI providers quoted their best prices on [✂] even if [✂] did not offer the lowest commission fees.

Summary of anti-competitive effects of MFNs

8.80 Overall for narrow MFNs:

(a) In general, we did not find that narrow MFNs in the PMI market reduced competition between PCWs due to the network effect. Examples where PMI providers appeared to be affected by the network effect of narrow MFNs were due to the PMI provider's commercial strategy (ie its desire to have its direct sales channel always cheapest) and therefore the incentive for those specific PMI providers not to offer lower prices to consumers on low commission fee PCWs was independent of the presence of narrow MFNs and would still be present absent narrow MFNs.

(b) Whilst narrow MFNs reduced the own-website channel as a competitive constraint on PCWs, the constraint the PMI providers' own-website would impose on PCWs absent narrow MFNs was unlikely to be significant given the cost of acquisition of customers which was generally lower for PMI providers on PCWs than on their own websites, the incentives due to interbrand competition for PMI providers to price more competitively on PCWs than on their own website, and the remaining intrabrand constraint from other PCWs.

For these reasons, we found that if there were any anticompetitive effects from narrow MFNs in the PMI market, they were unlikely to be significant in the context of the whole PMI market.

8.81 Overall for wide MFNs we found:

(a) strong incentives explaining why wide MFNs reduced PCW entry and innovation and softened competition between PCWs, leading to higher

[43] Internal documents from PCWs indicated that they monitored providers' prices on other PCWs and on other channels.

commission fees and PMI premiums than we would expect to be the case in a competitive market; and

(b) evidence of wide MFNs having reduced entry and innovation and having prevented commission fees and PMI premiums being lowered.

For these reasons we found that wide MFNs were likely to have an anti-competitive effect both in the PCW market and in the PMI market.

Do MFNs enhance competition?

8.82 Having found that some MFNs had anticompetitive effects, we next considered whether they might also have some pro-competitive effects, in particular given our finding that PCWs had, in general, enhanced competition between PMI providers (see paragraph 8.6). We considered two possible ways:

(a) Without MFNs, PCWs' existence might be threatened, with a consequent reduction in PMI provider competition.

(b) MFNs reduce search costs for consumers, meaning that consumers are able to compare a greater proportion of the market, making PMI providers compete against more competitors than if consumers were searching just a few brands (ie they enhance interbrand competition).

8.83 We noted that these two points were linked as, if consumers did not trust PCWs to compare prices, they would stop using them as a time-saving tool. The combination of these factors would lead to the increase in search costs, less comparisons and less interbrand competition.

8.84 We discuss first whether MFNs are necessary for the survival of PCWs and then discuss whether MFNs help reduce consumer search costs.

Are MFNs necessary for PCWs to survive?

8.85 PCWs told us that without MFNs they would eventually be marginalised and the PMI market would be dominated by a few of the largest insurer brands, leading ultimately to higher PMI premiums. MFN clauses, they said, were necessary for the existence of a competitive PMI market.

8.86 We considered whether MFNs were necessary for PCWs to exist, looking first at narrow MFNs and then at the incremental effect of wide MFNs.

Narrow MFN clauses

8.87 All the PCWs told us that narrow MFNs were essential to their business model, identifying two reasons:

(a) Narrow MFNs provided reassurance to consumers that the prices they found on PCWs could not be beaten by searching directly on PMI providers' websites. Without such reassurance, the credibility of PCWs, and demand by consumers for their services, would be lower.

(b) Narrow MFNs prevented PMI providers free-riding on the advertising of PCWs.

8.88 We discuss these two reasons in turn. In particular, we considered whether there were alternative, less restrictive, mechanisms which PCWs could use to achieve the same benefit.

- *Credibility*

8.89 Narrow MFNs provide credibility to PCWs by allowing consumers to compare the prices which are actually available on PMI providers' websites. Without narrow MFNs, a PMI provider could undercut the PCW and undermine the premise that PCWs are comparing the prices of around 100 providers.

8.90 PCWs told us that if consumers did not have confidence that PCWs were comparing prices, consumers might stop using them altogether, leading to increased search costs for consumers and, eventually, to PMI prices rising as PMI providers would begin to extract the 'search rent'[44] from consumers.

8.91 We also considered how the freedom to price lower (and advertise the fact) on a PMI provider's own website would change competition for consumer attention. We expected that if PMI providers began pricing lower on their own websites and telling customers 'you always get our cheapest price coming directly to us rather than through a PCW', consumers' trust in PCWs would be undermined, leading to reduced use of PCWs and less interbrand competition.

8.92 BGL provided us with a quote from an insurance industry consultancy which described the incentive that the insurance industry as a whole might have to undermine the credibility of PCWs: 'Focusing on the period 2002 and subsequent, the conclusion is obvious and rather damning: aggregators have

[44] The search rent is the additional profit achievable due to consumer inertia because consumers stop shopping around before finding the best price available to them.

encouraged greater price competition … Aggregators cost the UK insurance industry £1 billion in unnecessary price competition, last year ….'[45]

8.93 We noted that Italy and the USA provided two examples of markets where PCWs had not (yet) become established for the sale of PMI as they had in the UK.[46,47] We did not conduct a detailed study of why PCWs had not emerged in these markets but their existence, in the presence of similar technological possibilities as in the UK, indicated that PCWs were not the only possible outcome of a market process. In the case of Italy, the Autorità Garante della Concorrenza (Italian competition authority) investigated car insurance 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.[48] As a consequence, PCWs offered a lower-quality search experience.

8.94 DLG told us that, from its experience in Italy, brokers dominated the market and direct sales accounted for only 10% of all policies sold.[49] Both DLG and Acromas told us that any comparison of Italy with the UK was inappropriate, because, among other differences, PCWs were a well-established part of the sales process in the UK, whereas they were not in Italy.[50,51] However, it seemed to us that, while this was true, if there was a risk that PMI providers could actively undermine the credibility of PCWs, then the use of PCWs might not remain an established part of consumers' shopping behaviour in the UK. We did not believe that the current strong use of PCWs (with its consequent positive effect on competition for PMI) should be taken as a guarantee of their strong use in the future, irrespective of the regulatory environment.

8.95 Some PMI providers told us that most PCWs did not advertise the effect of their narrow MFNs to consumers, suggesting that the ability to guarantee to consumers that the prices they quoted were not higher than providers' own website was not an important aspect of a PCW offering[52]. However, it

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[45] Source: Towers Watson, insurance consultancy: 'Why aren't we making money …', December 2010.
[46] We noted that PCWs in PMI appeared not to have become established to an appreciable extent in any country other than the UK, although we did not conduct an in-depth comparison of international markets.
[47] Oxera, on behalf of DLG, told us that it was very likely that a combination of factors, which might not include the presence of MFNs, was responsible for this finding. It said that there was therefore no clear indication that the removal of narrow MFNs would undermine the important role of PCWs in PMI distribution in the UK.
[48] Final Report of the Autorità Garante dellla Concorrenza, 22 February 2013.
[49] DLG also pointed out that, within the direct channel, PCWs were now growing, [✂].
[50] Acromas also argued that, while a narrow MFN would prevent the insurance provider from offering the policy more cheaply directly, the Autorità Garante della Concorrenza was mainly interested in ensuring that the insurance provider did not offer the policy at a more expensive premium.
[51] DLG said that direct insurance sales were much lower in Italy than in the UK. It also said that because Italian consumers were far less likely than UK consumers to purchase insurance products online, they were less likely to use PCWs.
[52] Oxera, on behalf of DLG, provided us with evidence which it said contradicted our analysis. Oxera said: 'first, DLG consumer survey data indicates that the most popular reason for using PCWs was ease of use and

appeared to us that consumers expected PCWs to return the prices which would be available on the provider's website and, therefore, although this guarantee might not be stated, it remained important. We noted that Mintel, in its report on financial aggregators, stated:

> A quarter of those who have bought insurance through a site say that the accuracy of the prices is a key factor: were inaccurate quotes a widespread problem in the industry, then this figure would certainly be considerably higher ...
>
> There has always been an uneasy relationship between the aggregators and the firms that provide the products that they sell. Most banks and insurers recognise they can't afford to ignore this new distribution channel, but there are also reservations about the impact on margins and the commoditisation of financial products … It's clear that among consumers there are also reservations, and some of these reservations are intensified by use of the sites, rather than being alleviated … These reservations suggest ways in which product providers can head off the challenge posed by aggregators. The financial services giants may not be wholeheartedly loved by consumers, but they do have a brand heritage that the aggregators can't match. This heritage can be leveraged to capitalise on the apparent lack of trust in the aggregators.[53]

8.96 This evidence suggested that, whilst consumers currently trusted PCWs to return accurate prices (which we took to mean prices which were available on providers' own websites), there remained the possibility for that trust to be lost. This loss of trust could arise if PCWs began not to show accurate prices, undermining the basis on which consumers use PCWs.

8.97 It appeared to us that narrow MFNs were a legitimate tool used by PCWs to engender consumer trust in their service offering. We believed that, without narrow MFNs, there would be a material risk that consumers might use PCWs

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convenience rather than finding the lowest price; second, around half the customers on PCWs do not choose the cheapest quote but consider other factors such as trust or quality; additionally, PCWs cannot guarantee the lowest price with narrow MFNs in place'. On the first point, Oxera highlighted that 'it may be the case that, in the current situation where narrow MFNs are commonplace, many respondents simply assume that PCWs offer the same prices as insurers' direct websites and so treat this as a 'hygiene factor' and do not mention it explicitly in their responses'. We noted that other evidence (see paragraph 8.95) suggested that this may well be true. On the second point, we noted that this did not stop consumers wanting to be able to compare accurately the prices of the various providers, even if they did not ultimately choose the cheapest provider. On the third point, we did not dispute that PCWs could not guarantee the lowest price with narrow MFNs in place. In order to find the cheapest price, consumers would have to search between PCWs, but with narrow MFNs in place consumers could be confident that the prices they found were not available cheaper directly.

53 [✂], extracts from pp8–11.

less and that PCWs would be undermined as a distribution channel. We did not assess whether the competitive pressures between PMI providers might lead them individually to have an incentive to price in a way that maintained PCW credibility, but the fact that PCWs did not appear to be a significant part of the sales process in most other countries gave us cause for concern that a market structure without PCWs could arise, with consequent worse outcomes for consumers.

8.98 We did not find there to be any obvious alternative mechanism, in place of a narrow MFN, which a PCW could use to ensure that the prices it quoted reflected the prices available on PMI providers' own websites.[54]

- *Free-riding*

8.99 Narrow MFNs prevent a PMI provider free-riding on a PCW's advertising investment. If it were widely known by consumers that the best prices were available directly, consumers might still use PCWs to narrow their search but then purchase from a PMI provider's own website. PCWs would be providing a service to consumers and PMI providers but not be rewarded for it. PCWs told us that they might go out of business.

8.100 In our view, some degree of free-riding would not necessarily lead to the failure of the market, as the market might find other solutions, such as:

(a) PCWs could rely on loyal customers to generate revenue (ie customers who transact through the PCW rather than just using it as a search tool).

(b) PCWs could provide anonymous quotes, which allowed consumers to compare products and features but without knowing the PMI provider's brand. This would force consumers to progress with the transaction on the PCW before discovering the provider's identity.

(c) PCWs could move to an alternative charging model with PMI providers.

(d) PCWs could implement quote-poaching clauses.[55]

8.101 We discuss these alternative mechanisms in detail in Appendix 8.1. We found that alternative charging models and quote-poaching clauses might provide mechanisms by which PCWs could overcome the problems of free-riding, although they might cause other distortions. However, given our findings on

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[54] PCWs could revert to screen scraping but this would be a regressive technological step and one which the PMI providers could block if they wished.

[55] A quote-poaching clause would ensure that a PMI provider would pay a PCW in each instance that a quote led to a sale, even if the final price paid was different from the initial quote. In essence, the PCW would be paid for each successful lead, including indirect leads.

the lack of harm from narrow MFNs, we did not investigate these options further.

- *Summary*

8.102 We identified two ways in which narrow MFNs might be essential for a PCW, ie to protect its credibility and to prevent free-riding. We then identified two potential alternative mechanisms by which a PCW might prevent a PMI provider from free-riding. However, we were unable to identify an alternative mechanism for PCWs to protect their credibility as a comparison tool. Rather it appeared to us that the ability to offer prices which were the same as those available online directly was part of the essential, customer-attracting proposition of a PCW. Overall, we found that even if narrow MFNs had some anti-competitive effects, they might be necessary for PCWs to survive.

Wide MFN clauses

8.103 Having looked at narrow MFNs, we then looked at the incremental effect from wide MFNs in order to assess whether they were necessary to the existence of PCWs. Again, we first discuss credibility and then discuss free-riding, this time relating to other PCWs rather than to the PMI provider.

- *Credibility*

8.104 [✂] However, we noted that [✂] did not prominently advertise this fact (eg through a 'never knowingly undersold' promise).[56] Moreover, it was not clear to us that consumers expected this to be the case. We found that almost all PMI providers listed on all the four largest PCWs and that many consumers searched for PMI on multiple PCWs (see paragraph 8.12), suggesting that they did not expect the prices returned through each PCW to be the same. Indeed, [✂] submitted a survey [✂] which showed that consumers moved from one PCW to another in search of the lowest quote. In our view, the fact that PCWs had been very successful in establishing a market for their product, despite consumers not expecting the prices returned to be the lowest possibly available, undermined [✂] claim that if PCWs did not return such prices their credibility would be eroded.

8.105 Moreover, Moneysupermarket and Confused both told us that they did not believe that wide MFNs were necessary for their business models and, in fact,

[56] For a PCW to be always the cheapest, it would need to have a wide MFN with all the insurance providers it listed. Currently none of the PCWs have this so it is questionable whether this claim could be legitimately made. Nevertheless, we might expect [✂] to put up a price promise in relation to those PMI providers with which it does have wide MFNs when those providers appear at the top of a search result.

interfered with their ability to compete with other PCWs. In addition, as Moneysupermarket had never operated with wide MFNs, it was clearly possible to operate successfully without them.

- *Free-riding*

8.106 For narrow MFNs, free-riding by PMI providers was possible because the PCW made clear which PMI provider had provided the quote, enabling the consumer to go directly to the provider without the PMI provider needing to invest in advertising. However, as PCWs do not provide a link to other PCWs when they produce their search results, there was not the same possibility for another PCW to free-ride on the first PCW's investment as other PCWs would still need to invest in advertising to attract customers. Therefore, we did not see that a wide MFN added any protection from free-riding to that provided by a narrow MFN.

- *Summary*

8.107 Overall, we found that, in the absence of wide MFNs, there was little danger of free-riding from other PCWs and, if competition were to make one PCW cheaper than another, PCWs would still be used.

Do MFNs reduce search costs?

Narrow MFNs

8.108 PCWs aim to compare prices of many insurance products. If a PCW has narrow MFNs with all its partners, it means that consumers are comparing the prices which are available directly from each of the brands listed. Consumers do not have to search each brand's website in order to find the best deal. This means that consumers can search a larger proportion of the market than they would if either *(a)* PCWs did not exist or *(b)* consumers believed PCWs were not providing an appropriate comparison of providers' prices.

8.109 In our view, narrow MFNs can ensure that PCWs maintain their credibility and continue to provide this time-saving service. In doing so, they maintain the reduction in search costs brought about by PCWs, which enhances interbrand competition and increases customer price sensitivity.

Wide MFNs

8.110 The benefit of wide MFNs over and above narrow MFNs, in the context of search costs, is that they could mean that a consumer has a one-stop shop which provides the lowest possible online prices for the listed providers. For this to be true, a PCW would need a wide MFN with all the providers it lists. However, as this is not the case, wide MFNs do not currently achieve this benefit and consumers currently have an incentive to search on multiple PCWs. Even if there were some incremental benefits, we would need to balance these against the harm identified from wide MFN clauses.

Europe Economics report on the benefits of wide MFNs

8.111 BGL provided us with a report from Europe Economics, which it said set out the benefits of wide MFNs. The report presented a model which weighed the pro- and anticompetitive effects of wide MFNs by looking at their direct and indirect impacts. The model compared a scenario with wide MFNs to a scenario without any MFNs. It assumed that commission fees did not vary between the two scenarios. It also assumed that, in the context of indirect effects, consumers would use PCWs less in the scenario without wide MFNs.

8.112 The report, noting that the overall welfare effect of wide MFNs changes from neutral (where the focus is only on direct effects) to positive (where indirect effects are included), concludes:

> In terms of the direct effect alone, the adoption of MFN clauses has a neutral effect: the net direct impact of MFN clauses on average market prices and aggregate consumer welfare is neutral. If even a marginal indirect impact of MFN clauses is also taken into account, we find that the adoption of MFN clauses leads always to a decrease in the average price and an increase in welfare. This welfare improvement increases as the indirect impact of MFNs increases.

8.113 However, the report also states:

> The model's results identify a motivation for consumers to use PCWs for search. (NB Whilst the proportion of consumers using PCWs to do research has increased in the past (and may well continue to do so) we emphasise that our model is only that (ie it is by definition, like all economic models, an abstraction from reality) and also that it was designed to investigate the impact of PCWs and of MFN clauses – it was not intended to forecast the future evolution of distribution channel choice.)

8.114 However, in our view, the report failed to demonstrate the claimed benefits of wide MFNs for three key reasons:

(a) It failed to explain the incremental benefits of wide MFNs over and above narrow MFNs. Given our reasoning as set out in this section, if the model

had compared a scenario with narrow MFNs against a scenario with wide MFNs, it is unlikely that the results would have been as strong.

(b) It failed to take into account the impact of wide MFNs on commission fees. Again, given our reasoning in this section, commission fees are unlikely to be the same in the two scenarios. Rather, wide MFNs are likely to lead to upward pressure on them.

(c) The outcome of the model is an assumption of the model, not a result proved by it. It is a key assumption of the model that consumers use PCWs less without wide MFNs. This leads to the finding that, due to the indirect effects of wide MFNs, the welfare effect of wide MFNs is positive. However, this reasoning begs the question at issue as it demonstrates the benefits of PCWs, not the benefits of wide MFNs. The model does not prove that consumers would use PCWs less in the absence of wide MFNs so the welfare benefits are also assumed.

8.115 For these reasons, in our view, the Europe Economics report failed to demonstrate any benefits of wide MFNs over and above narrow MFNs.

Summary on pro-competitive effects of MFN clauses

8.116 Overall, we found that, without narrow MFN clauses, there was a risk to the credibility of PCWs and therefore a risk to PCWs maintaining their pro-competitive effects of driving interbrand competition between PMI providers. We found that narrow MFNs also reduced PMI providers free-riding on PCWs' investment, though there could be other mechanisms to prevent this. We found that wide MFNs provided no pro-competitive effects over and above the effects of narrow MFNs. We found that narrow MFNs helped a PCW to reduce consumers' search costs but, if wide MFNs were to extend this benefit to make a PCW a one-stop shop, they would need to be agreed with all partners, which was not currently the case in the market (and, even if it was, such incremental benefits would be unlikely to outweigh the anticompetitive effects of wide MFNs).

Do MFNs lead to an AEC?

8.117 Our assessment of the pro- and anticompetitive effects of both narrow and wide MFNs in the PMI market was based on the actual conditions in which these MFN clauses operated, in particular the factual and economic context in which PMI providers and PCWs operate, eg consumer behaviour in this market, the relative bargaining positions of PMI providers and PCWs, and the availability of alternative channels by which PMI providers can reach consumers. For these reasons, our analysis of MFNs in relation to PMI should be understood in the context of this market.

8.118 For narrow MFNs we found that:

(a) If there are any anticompetitive effects from narrow MFNs in the PMI market, these effects are unlikely to be significant:

(i) With regard to the network effects, we found the few cases where PMI providers would not offer lower prices to consumers on low commission fee PCWs were independent of the presence of narrow MFNs and would still be present absent narrow MFNs. (see paragraphs 8.46 to 8.54).

(ii) With regard to the loss of a competitive constraint on PCWs, we found that, in general, PMI providers' websites did not appear to be a significant constraint on PCWs. This was because the cost of acquisition of customers was generally lower for PMI providers on PCWs than on their own websites (see paragraphs 8.57 to 8.60) and because customers' price responsiveness on PCWs was higher than on PMI providers' own websites which meant that PMI providers had the incentives to price more competitively on PCWs than on their own websites (see paragraphs 8.61 to 8.65). This indicated that providers' websites would not provide a strong competitive constraint on PCWs, and the intrabrand constraint from other PCWs would remain.

(b) There was a risk to PCWs' ability to drive interbrand competition without narrow MFNs. The main risk related to the credibility of PCWs. Without narrow MFNs, the proposition of PCWs would be significantly weakened, possibly affecting the viability of their business model. Also, narrow MFNs were a tool (possibly among others) to reduce free-riding by PMI providers.

(c) Competition in the PMI market would be weaker without PCWs, in particular as price elasticity of demand was greater on PCWs than on direct channels.

Overall, we did not find there to be an AEC arising from narrow MFNs.

8.119 For wide MFNs we found that:

(a) Wide MFNs reduced entry, innovation and competition between PCWs (see paragraphs 8.32 to 8.42).

(b) Wide MFNs harmed competition between PCWs by preventing price competition, leading to higher commission fees and PMI premiums than we would expect in a competitive market. Notably, one PCW had tried to reduce its commission fees with PMI providers in exchange for lower premiums but PMI providers were unable to accept the offer due to the presence of wide MFNs in their contracts with other PCWs. Several PMI providers also told us that they had, as a result of wide MFNs, withdrawn from, or did not consider, taking up such offers from PCWs (see paragraphs 8.72 to 8.78).

(c) The implementation of wide MFNs over and above narrow MFN clauses was not necessary in order to achieve the pro-competitive effects of MFNs, in particular the ongoing viability of the PCW business model (see paragraph 8.116).

Overall, we found there to be an AEC arising from wide MFNs.

8.120 We noted that the PCW market in relation to PMI was characterised by a significant level of single-homers (see Appendix 8.1, Annex K). This affected the relative negotiating positions of PCWs and PMI providers, and explained the limited options available to PMI providers when seeking to avoid wide MFN clauses in their contracts with PCWs.

Conclusion

8.121 Based on the findings above, we have identified a feature in the supply of PMI and related services which gives rise to an adverse effect on competition: wide MFN clauses in contracts between PMI providers and PCWs.

8.122 We concluded that this feature distorted competition in the market for the supply of PMI and related markets as it prevented price competition between PCWs, and thus ultimately restricted entry to the PCW market, reduced innovation by PCWs and increased premiums for PMI to consumers above levels we would expect in a competitive market. We also noted that there was a significant level of single homers in the PMI market (see paragraph 8.120.)

8.123 We found it difficult to determine what the outcomes (eg on commission fees and PMI premiums) were of this feature against the benchmark of a well-functioning market (ie one that did not involve wide MFNs). Therefore it was hard to calculate the detriment resulting from the AEC we had found. This calculation was particularly difficult in relation to assessing how much the

AEC increased barriers to entry and reduced innovation, and the consequences therefrom. For these reasons, we did not estimate the detriment to consumers caused by wide MFNs. However, in our view, the detriment we identified was likely to be significant as wide MFNs effectively prevented price competition between PCWs. We believed it was likely that they thereby led to significant detriment, ultimately in the form of higher PMI premiums to consumers.

9. Framework for the assessment of remedies

Introduction

9.1 In this section we set out our framework for the assessment of the measures needed to remedy, mitigate or prevent the AECs and/or the resulting customer detriment we have found.

9.2 Our assessment and conclusions on remedies follow our consultations on *(a)* our Remedies Notice, published on 17 December 2013; *(b)* our provisional decision on remedies and further working papers, in particular a working paper revising our estimate of the detriment arising from ToH 1, published on 12 June 2014; and *(c)* a further consultation on Remedy 1C, published on 28 July 2014. In reaching our final decision on the appropriate packages of remedies, which is set out in Sections 10 to 12, we have taken into consideration the views and further evidence we received from the relevant parties in their responses to these three consultations, responses from parties to our further information requests, and additional submissions provided to us by parties.[1]

Framework for consideration of remedies

9.3 If the CMA finds that there is an AEC, it is required under the Act[2] to decide whether action should be taken by it, or whether it should recommend the taking of action by others, for the purpose of remedying, mitigating or preventing the AEC, or any detrimental effect on customers (the customer detriment) so far as it has resulted from, or may be expected to result from, the AEC.

9.4 If the CMA decides that action should be taken, it must then decide what action should be taken and what is to be remedied, mitigated or prevented. In deciding these questions, the Act requires the CMA 'in particular to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effect on customers so far as resulting from the adverse effect on competition'.[3] To satisfy this requirement, the CMA considers how comprehensively potential remedies (or packages of remedies) address the AECs and the

[1] Responses to these three consultations have been published on our website. We have also published the full transcripts of our multilateral response hearings and summaries of our bilateral hearings.
[2] Section 134(4) of the Act.
[3] Section 134(6) of the Act.

resulting customer detriment, and whether they are effective and proportionate.[4]

Structure of Sections 10 to 12

9.5 In Sections 10 to 12, we discuss respectively remedies for each of the three AECs we have found. In each section we set out:

(a) A summary of the remedies we have consulted upon.

(b) Our assessment of each individual remedy measure which we have included within our package of remedies, including a discussion of how each measure addresses the AEC and/or customer detriment, and its design and implementation. Our discussion for each remedy measure is therefore set out under the following headings:

(i) a description of the remedy;

(ii) how the remedy addresses the AEC and/or resulting customer detriment;

(iii) a summary of the views of the parties;

(iv) the key considerations relating to the design of the remedy; and

(v) how the remedy should be implemented.

(c) The remedy measures which we have considered but have decided not to pursue further, and our reasons for this.

(d) Our consideration of any potential relevant customer benefits (RCBs) within the meaning of the Act,[5] and whether some or all of any such RCBs would be lost if we implemented our package of remedies.

(e) Our assessment of the effectiveness and proportionality of our package of remedies in addressing the AEC and/or customer detriment. Given the independence of each AEC we identified, we considered effectiveness

[4] Section 134(6) of the Act.
[5] Section 134 of the Act. In deciding the question of remedies, the CMA may also in particular 'have regard to the effect of any action on any relevant customer benefits of the feature or features of the market concerned'. RCBs are defined in the Act and are limited to benefits to relevant customers in the form of *(a)* lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or *(b)* greater innovation in relation to such goods or services. The Act provides that a benefit is only an RCB if the CMA believes that: *(a)* the benefit has accrued as a result (whether wholly or partly) of the feature or features concerned or may be expected to accrue within a reasonable period of time as a result (whether wholly or partly) of that feature or those features; and *(b)* the benefit was, or is, unlikely to accrue without the feature or features concerned.

and proportionality separately for each package of remedies addressing each AEC. In assessing proportionality, we considered the following key questions:[6]

(i) Is the package of remedies effective in achieving its aim?

(ii) Is the package of remedies no more onerous than necessary to achieve its aim?

(iii) Is the package of remedies the least onerous if there is a choice?

(iv) Does the package of remedies produce adverse effects which are disproportionate to the aim?

[6] *CC3*, paragraph 244.

10. Remedies to address the separation of cost liability and cost control (theory of harm 1)

Summary of remedies we consulted upon

10.1 In our Remedies Notice we consulted on eight measures which we said could potentially address the AEC and/or customer detriment we had provisionally found under ToH 1:

(a) Remedy A: Measures to improve claimants' understanding of their legal entitlements.

(b) Remedy 1A: First party insurance for replacement vehicles.

(c) Remedy 1B: At-fault insurers to be given the first option to handle non-fault claims.

(d) Remedy 1C: Measures to control the cost of providing replacement vehicles to non-fault claimants.

(e) Remedy 1D: Measures to control non-fault repair costs.

(f) Remedy 1E: Measures to control non-fault write-off costs.

(g) Remedy 1F: Improved mitigation in relation to the provision of replacement vehicles to non-fault claimants.

(h) Remedy 1G: Prohibition of referral fees.

10.2 We noted that Remedies A, 1F and 1G were supporting measures which might enhance the effectiveness of other ToH 1 remedies if adopted in combination with them.

10.3 On 12 June 2014, we published our provisional decision on remedies,[1] in which we proposed to pursue remedies A, 1C and 1F. On 28 July 2014 we consulted on a revised version of Remedy 1C.[2]

10.4 We considered carefully the submissions received in response to the Remedies Notice, the provisional decision on remedies and our additional consultation on Remedy 1C. In addition, we carried out additional analysis to assess the likely effectiveness and proportionality of the remedy options. We took into account the extent to which each remedy could be expected to reduce the customer detriment identified, as well as the potential costs of

[1] Provisional decision on remedies.
[2] Notice of further consultation on Remedy 1C.

each remedy, both financial and in terms of the likely impact on the quality of services received by claimants.

10.5 Although we did not change our opinion that the issues we had identified constituted an AEC, we concluded that there were no remedies available to us which would be both effective and proportionate in addressing the AEC arising from the separation of cost liability and control, and the various practices and conduct of the parties managing non-fault claims.

10.6 In this section we set out our consideration of each of the remedies listed in paragraph 10.1 in turn, providing a description of the remedy and the views of the parties on it, as well as our reasons for deciding not to proceed with it.

10.7 In our Remedies Notice, we set out our reasons for not pursuing remedies concerning: *(a)* first party insurance for all PMI; and *(b)* the prohibition of credit hire. We received limited responses and comments in relation to these remedy options, and found no compelling reason to overturn our initial thinking. Therefore we do not revisit these arguments here.

Possible remedy measures

Information on consumers' rights (Remedy A)

Description of remedy option

10.8 We found that consumers have a poor understanding of their legal entitlements following an accident (see paragraph 5.9). This affects how they are able to access their legal entitlements under both tort law and their own insurance policy.

10.9 We set out in our provisional decision on remedies a remedy which was designed to provide better information to consumers about their rights following an accident at two points:

(a) with the annual policy documentation; and

(b) at FNOL, following an accident.

10.10 The aim of this informational remedy was to give claimants a better understanding of their entitlements under their own insurance policy and under tort law. We intended this remedy to support the measures we had proposed under ToH 1 and ToH 2, ie it would ensure that claimants were aware of their rights when making claims under tort law (ToH 1), and would enable at-fault and non-fault claimants to recognise better when they were provided with a level of service which did not meet their entitlements (ToH 2). Following our revised finding that there was no AEC in relation to ToH 2, the remedy focused on ensuring that consumers were aware of their options when making a non-fault claim, addressing ToH 1 only.

Views of parties

10.11 We set out in detail in Appendix 10.1 the views of the parties on this remedy. In summary, most parties supported this remedy with a preference for standardised information being provided with annual policy documentation and at FNOL. There were some concerns about information overload to consumers and that increased knowledge of rights could lead to an increase in tortious claims (and hence premiums). We held roundtable discussions with insurers, brokers and CHCs on 29 July and 5 August 2014 in order to refine the information to be provided. Our final version is set out in Appendix 10.2.

CMA's ability to implement Remedy A

10.12 We stated in our provisional decision on remedies that Remedy A was primarily a supporting measure to Remedy 1C. However, as set out in paragraphs 10.68 to 10.89, we decided not to proceed with Remedy 1C and, consequently, the primary basis for requiring this remedy no longer applied.

10.13 We considered the extent to which Remedy A would, in the absence of Remedy 1C, address the AEC we had identified. However, although we found that consumers had a poor understanding of their legal entitlements following an accident, we did not identify this lack of understanding as a feature giving rise to an AEC. Therefore, while this remedy would serve to make consumers more aware of their legal entitlements, which we believed to be beneficial, we concluded that Remedy A would not serve to mitigate, remedy or prevent the AEC we had found, and, on this basis, there was no basis for us to require it.

10.14 The two roundtable discussions described in paragraph 10.11 were held before our decision not to pursue Remedy 1C, and at these meetings there appeared to be industry-wide support for additional information to be given to consumers concerning their rights following an accident. In particular, the ABI told us that it believed insurers would be willing to adopt a statement similar to that in Remedy A (see Appendix 10.2), at least with policy documents. Although some insurers told us that they supported the proposed disclosure at FNOL as well, the ABI said that it believed insurers generally would resist this, preferring instead to tell claimants at FNOL that they had received a statement of their rights with their policy documentation and asking them if they wanted this information to be resent. We believed that this proposal would go a long way to ensuring that customers were aware of their legal entitlements. Although not pursuing this as a remedy, we encourage insurers, the ABI, brokers, BIBA and others to continue with the process of seeking a standard-ised form of words and disclosure practice which will provide consumers with information on a timely basis about their post-accident entitlements.

First party insurance for replacement cars (Remedy 1A)

Description of remedy option

10.15 This remedy would require replacement vehicles, but not repairs, to be insured on a first-party basis so that, in the event of an accident, a policy-holder, whether or not at fault, would be provided with a replacement car by their own insurer. Non-fault claimants would lose their tortious right to recover the cost of a replacement car from the at-fault driver.

10.16 Because of the removal of this tortious right, the non-fault insurer would be unable to pursue a subrogated claim against the at-fault insurer for the cost of the replacement car. Insurers would be responsible for bearing the cost of providing a replacement car to their own policyholders, whether the policy-holder was at fault or not in the accident. The level of coverage would be chosen by the policyholder. In the event of a non-fault accident, individuals would receive a level of provision equivalent to their current entitlement under tort law only if they had paid for this level of coverage; they could choose to pay less and would receive less, eg courtesy car provision or no replacement car provision at all.

10.17 This remedy would address directly the AEC we have found by removing the separation of cost liability and cost control in the provision of replacement cars to non-fault claimants, and thereby address completely the detriment relating to transaction and frictional costs, which we estimated to be about £84 million per year (see Table 6.6). As the non-fault insurer would both control and bear the cost of providing the replacement car to its policyholder, it would be incentivised to procure a car for the lowest cost. Transactional and frictional costs would be largely removed as the claimant’s own insurer would be the only party involved in the replacement car element of their claim. There would be some scope for dispute between insurers and policyholders, as exists currently in relation to at-fault claims, but if the policyholder has purchased the same replacement car provision regardless of fault in an accident (ie whether at fault or not at fault), the issue of liability would be irrelevant to the replace-ment car element of the claim. Overall, we would expect much reduced transactional and frictional costs, resulting in lower PMI premiums.

10.18 We noted that this remedy would affect different individuals differently. Currently, the non-fault claimant’s tortious right to a temporary replacement vehicle (subject to their need) is borne by the at-fault insurer, meaning that insurers of those drivers who cause more accidents (eg young drivers) bear more of the inflated cost; while the benefits to insurers of the referral fees from providers of temporary replacement vehicles are shared more equally. Therefore, under Remedy 1A, premiums would fall for all PMI policyholders, but most for those drivers who cause more accidents, from the reduced cost of non-fault claims; but premiums would rise for all PMI policyholders from the loss of referral fee income to insurers. Overall, given that considerable transactional and frictional costs would have been removed, we would expect the total effect on consumers to be positive, with a net fall in PMI premiums, with the greatest benefit being for higher-risk drivers.

Other effects of this remedy

10.19 We observed that an additional attractive feature of this remedy option was its effectiveness in indicating a consumer's 'need' for a replacement vehicle. In a claim under tort law, we found that the threshold for a non-fault driver to establish need was not particularly high (though the threshold for a 'like-for-like' vehicle was clearly higher than for any vehicle), and the cost of the replacement vehicle's provision was irrelevant to that particular question. We found that, subject to reasonable need, the replacement car was the non-fault driver's tortious right regardless of its cost (which would then be assessed separately). However, under the first-party insurance remedy, the replacement car provision would be determined not by the application of tort law but by the insurance contract which the policyholder had chosen. A driver who expected to have little need for a replacement car in the event of an accident would not buy replacement car insurance; and a driver who expected to need a replacement car, but not a like-for-like car, would buy only courtesy car cover. In this way, through the purchasing of specific insurance, we would expect a consumer's 'need' for a replacement vehicle to be indicated by their willingness to pay.

10.20 We noted that, on the at-fault side, some PMI policies currently make no provision for replacement cars while most provide only for a courtesy car. We found that only a small minority of policyholders chose to buy like-for-like replacement car cover. This suggested to us that, on the non-fault side, the current entitlement under tort law, under which most non-fault claimants are provided with a like-for-like replacement car, was greater than that for which most customers had demonstrated that they were willing to pay themselves, and all PMI customers effectively pay for this higher provision under tort law through their PMI premiums. We expected that, with first-party insurance for replacement cars, most drivers would choose to pay for less than like-for-like replacement and, overall, PMI premiums would fall. We recognised that the purchase of insurance cover to provide a like-for-like replacement car in the case where a policyholder is at fault in an accident was unlikely to be a perfect predictor of the provision which consumers would make in relation to being not at fault, but the fact that most consumers prefer not to incur the cost of at-fault like-for-like insurance suggested to us that many would make the same choice when contemplating their need for a vehicle in the event of a non-fault accident if they had to pay for it.

Views of parties

10.21 We set out the views of parties on this remedy in Appendix 10.1.

10.22 Seven of the ten largest insurers were supportive of Remedy 1A in principle, telling us that it had the potential to assist the insurance industry in managing the cost of credit hire effectively. However, they had reservations about the timeliness of the remedy, its effectiveness and the risk of unintended adverse effects. Three of the ten largest insurers (Admiral, DLG and esure) were clearly opposed to Remedy 1A.

10.23 The CHCs were strongly opposed to Remedy 1A.

10.24 The principal areas of concern with this remedy focused on the replacement of rights under tort with contractual rights under an insurance policy:

(a) The remedy would change the long-established principle of tort law which entitles the non-fault party to look to the at-fault party in order to be put back into the position they would have been in without the accident. Consequently, non-fault claimants would be in a worse position as they would be required to pay for something which currently is the liability of the at-fault party. This would represent a fundamental shift in law.

(b) The removal of non-fault claimants’ tortious rights would result in a lower-quality outcome for non-fault claimants who were either unable or unwilling to bear the extra cost of replacement car cover.

10.25 Other key points made were:

(a) Premiums might rise if replacement car cover were sold as an add-on, in particular for safer drivers, or if it led to greater provision of replacement cars to at-fault drivers.

(b) Costs could be duplicated if the non-fault insurer did not also control the non-fault repair because another party would have no incentive to control the repair duration. This could give rise to additional costs and would create the potential for duplicated management processes.

(c) CHCs/CMCs were concerned that the proposed remedy would lead to their disappearance and the quality of post-accident services provided to non-fault claimants would deteriorate as non-fault insurers would seek only to minimise the cost of claims. The main point made by CHCs was that they could provide a replacement vehicle to a non-fault claimant within a few hours of being notified of a claim, whereas non-fault insurers did not have the resources or incentive to determine liability so quickly.[3] CHCs/CMCs also noted that they assisted non-fault claimants in other ways (eg to recover any excess that had been paid and other losses (such as loss of earnings), to ensure that a claimant's NCB years were reinstated, to monitor the progress of the repair, and to negotiate the pre-accident value of the car in a write-off) and if CHCs/CMCs did not exist, claimants would have to deal directly with their insurer on these matters.

(d) The remedy would not be timely as legislation would be required to implement it and, consequently, there would be no certainty about when it would come into effect and what the enabling legislation would look like.

(e) If the remedy applied only to PMI, there would be different arrangements for commercial vehicles and motorcycles, which might lead to different levels of quality of supply.

(f) The proposed remedy would create a new add-on and policyholders would have to be provided with a clear explanation of the terms of the cover to enable them to make an informed choice about what to purchase. Consequently, consumers would be faced with a more complicated choice than at present.

10.26 In our provisional decision on remedies we said that we were not going to pursue Remedy 1A, but two parties nevertheless said that we should:

(a) Allianz told us that Remedy 1A was a potential wholesale solution to the AEC in relation to temporary replacement vehicles.

(b) AXA maintained that Remedy 1A was the only remedy to address the AEC linked to separation of cost liability and cost control.

Our reasons for not taking the remedy option forward

10.27 Given that this remedy would require a recommendation to be made to government to legislate, we judged that government would need to consider

[3] We noted that Remedy 1A did not require the assessment of liability as both at-fault and non-fault drivers would be entitled to a replacement vehicle according to the terms of their insurance policy.

its effects beyond temporary replacement vehicles, and beyond the PMI market. In our view, this made the likelihood and timeliness of implementation, and so the effectiveness of the remedy, more uncertain.[4]

10.28 Although, in our view, Remedy 1A would address the features giving rise to the AEC we had found under ToH 1, we recognised that it would represent a significant intervention. It would remove a non-fault claimant's fundamental right under tort law to a temporary replacement vehicle (subject to their need). Given the size and nature of the detriment we had found (see paragraph 10.17) and the fundamental intervention represented by this remedy, we did not believe this remedy was proportionate.

10.29 For these reasons we decided not to pursue this remedy further.

First party insurance for replacement cars – variants (Remedy 1A variants)

Description of remedy options

10.30 We received proposals for three variants of Remedy 1A:

(a) Aviva proposed that insurers should be required to provide claimants with a temporary replacement vehicle as a standard policy cover. The replacement vehicle would be required to be equivalent or similar to the policyholder's vehicle, subject to a maximum size (eg 2.0-litre engine). Under this proposal, non-fault insurers would continue to submit subrogated claims for their costs to the at-fault insurer. Aviva envisaged that its proposal would be combined with informational remedies (eg our Remedy A) and a ban on referral fees (eg Remedy 1G).

(b) CISGIL proposed that a minimum level of replacement vehicle cover should be made mandatory in all insurance policies, covering both fault and non-fault situations. CISGIL said that, under its proposal, there would be no subrogation.

(c) Enterprise proposed that insurers should be required to provide a like-for-like replacement vehicle to all non-fault policyholders. (In contrast to Aviva's proposal, the remedy would apply to non-fault claims only and there would be no maximum size.) Enterprise proposed that there would be controls on the amount of the subrogated claim.

[4] For the avoidance of doubt, if we had decided that Remedy 1A was both an effective remedy, notwithstanding the time that it would take and the potential uncertainty which would exist around its implementation, and a proportionate remedy, we would have made a recommendation to government to legislate.

10.31 Aviva and Enterprise told us that their variants would not require a change in law:

(a) Aviva said that this was because the remedy would be drafted so that there was no restriction on the level of recovery.

(b) Enterprise said that this was because non-fault claimants would be provided with the same level of replacement car to which they would be entitled under tort law.

10.32 CISGIL said that its variant would require significant revisions to the existing legislative framework for motor insurance. However, it said that the Road Traffic Act 1988 and the EU Directive 2009/103/EC relating to insurance against civil liability in respect of the use of motor vehicles and the enforcement of the obligation to insure against such liability did not appear to constitute obstacles to the implementation of the remedy. It said that a baseline level of compulsory cover would ensure that consumers' legal entitlements under tort law would be met, though it acknowledged that non-fault claimants who had a need for a bigger vehicle than the basic provision would be disadvantaged compared with the current situation, unless they opted to pay an additional premium to receive a larger vehicle or a like-for-like vehicle. In its view, however, the removal of excess costs would result in lower premiums for all motorists, thereby outweighing this disadvantage.

10.33 Each party considered that its variant had benefits:

(a) Aviva submitted that, combined with informational remedies, its proposal would be likely to result in the non-fault insurer providing a like-for-like replacement vehicle (except above the size limit where claimants, if they wished to have a like-for-like replacement vehicle, would need to make their own arrangements to obtain one). It said that, since insurers would procure replacement vehicles at direct hire rates, frictional and transactional costs would reduce.

(b) CISGIL said that its proposal would have the advantage of spreading the cost of providing replacement vehicles among all policyholders.

(c) Enterprise said that its amendments to Remedy 1A would ensure that there was no additional cost to consumers, while maintaining their current legal entitlement.

Views of parties

10.34 Some insurers supported Aviva's proposal in general terms but other insurers opposed it. For example, [✂] told us that CHCs would be able to find other means of capturing non-fault claimants (eg through breakdown assistance companies). [✂] also stated that a ban on referral fees could increase the net consumer detriment if there were not a cap on credit hire rates.

10.35 The CHCs strongly opposed all three variants of Remedy 1A. Their concerns included:

(a) individuals’ tortious rights would be lost under the Aviva and CISGIL variants;

(b) there would be no mitigation under the Enterprise variant, hence increasing costs;

(c) premiums would increase as universal cover would be more expensive;

(d) costs would be redistributed to lower-risk drivers;

(e) Enterprise’s variant also needed Remedy 1C in order to be effective; and

(f) Enterprise’s variant would create confusion in cases of split or disputed liability.

10.36 Enterprise told us that not pursuing remedies which tackled the separation directly would be a missed opportunity to remove unnecessary frictional costs within the market.

Our reasons for not taking the remedy option forward

10.37 In our view, none of the three variants of Remedy 1A provided an effective or proportionate remedy to the AEC and/or the customer detriment resulting from it.

- *Aviva’s variant*

10.38 By requiring insurers to provide a similar-sized replacement car to all claimants (not just non-fault claimants), Aviva’s proposal would increase insurers’ costs of providing comprehensive insurance (taken by over 90% of customers). This would be because at-fault and split-liability claimants would receive a similar quality replacement car, whereas currently most at-fault and split-liability claimants receive something less (usually a courtesy car). While Aviva’s proposal would benefit at-fault and split-liability claimants to the extent that they get a better-quality replacement car than currently, it would have the disadvantage of requiring consumers to purchase a higher-quality product than they appear to want (eg we found that [✂]% of DLG’s Direct Line new customers who are not currently offered a courtesy car as standard pay extra for like-for-like temporary replacement vehicle cover as an add-on).

10.39 We would expect that, if all insurers experienced higher costs, this would result in higher premiums. The overall impact of Aviva's proposal on premiums therefore depends on the balance between, on the one hand, lower frictional and transactional costs and, on the other hand, higher costs of providing replacement vehicles to at-fault and split liability claimants. Initial modelling submitted by Aviva showed that premiums could reduce, but might increase. In its modelling, Aviva assumed a substantial fall in frictional and transactional costs as it expected insurers to arrange direct hire for non-fault as well as for at-fault claimants, and also to agree bilaterally to recover from each other via subrogation only the direct hire costs. In our view, these assumptions appeared to represent a 'best-case scenario', and there was a significant risk that a less favourable outcome might result, ie significantly higher costs and PMI premiums.

10.40 Even on the basis of Aviva's own assessment of the effects of its proposal, the additional costs would be significant as it would provide at-fault and split-liability claimants with a costly service of unknown value, for which most consumers appeared currently not willing to pay. With such uncertainty and concern over the potential effects, we concluded that this remedy variant did not represent an effective and proportionate remedy, and we decided not to pursue it further.

- *CISGIL's variant*

10.41 The implementation of the CISGIL variant would require a change in law, given the proposal not to allow subrogation and to cap non-fault claimants' rights at a specified maximum size vehicle, giving rise to some uncertainty about the timeliness and likelihood of implementation (see paragraph 10.27). Moreover, we found that CISGIL's variant suffered from the same concern as Aviva's proposal, ie that it would be likely to increase PMI premiums, because the mandatory cover would relate to both fault and non-fault situations. On this basis, we concluded that CISGIL's variant did not represent an effective and proportionate remedy and we decided not to pursue it.

- *Enterprise's variant*

10.42 Enterprise said that the key elements to its solution were:

(a) compulsory PMI should include a direct indemnity for a like-for-like replacement vehicle (and repair) when the policyholder is not at fault;

(b) insurers should be able to bring a subrogated claim for the replacement vehicle costs against the at-fault insurer;

(c) mandatory fault determination rules would be required to determine non-fault entitlement at FNOL;

(d) subrogation controls would be needed through an enforcement order to ensure that non-fault insurers do not inflate costs; and

(e) robust regulation of insurer conduct would be needed through existing structures, eg the FCA and Financial Ombudsman Service.

10.43 Enterprise said that, by putting insurers rather than CHCs in charge of replacement vehicles (and repairs), this remedy would ensure that there was no additional cost to consumers from maintaining their current entitlement. Furthermore, unlike the original version of Remedy 1A, it would not require changes to the law. Rather, it would require only an enforcement order and/or regulation. Enterprise told us that it believed credit hire and repair did not need to exist within the UK insurance market and, in its view, other models and other jurisdictions had proved that drivers who were not at fault in an accident could still receive a suitable replacement vehicle and repair without the need for frictional costs.[5]

10.44 Enterprise's variant of Remedy 1A was not supported by other parties, even insurers. By contrast, some insurers supported Aviva's variant of Remedy 1A.

10.45 In our provisional decision on remedies, we noted that Enterprise's variant of Remedy 1A envisaged controls on replacement vehicle subrogated claims to insurers, similar to our proposed Remedy 1C. At that time, we therefore focused on whether the additional requirement in Enterprise's proposal (ie that insurers provide non-fault claimants with a like-for-like replacement vehicle) aided the effectiveness of the remedy, in particular by ensuring that non-fault claimants continued to obtain their tortious rights, and whether this was practicable. We took the view that requiring insurers to provide non-fault claimants with a like-for-like replacement vehicle went further than was necessary to achieve an effective remedy. As regards practicability, we noted that it was not clear in Enterprise's proposal what would happen in cases where it was initially unclear whether a claimant was not at fault. For these reasons, we provisionally decided to proceed with Remedy 1C and not to proceed with the Enterprise variant of Remedy 1A.

[5] Enterprise response to provisional decision on remedies.

10.46 However, we have now found that we cannot place a cap on subrogated claims (see paragraph 10.70), which affects both Remedy 1C and Enterprise's proposed variant of Remedy 1A. Therefore, we considered again Enterprise's proposed variant of Remedy 1A but without controls on subrogated claims. As in our original consideration, we focused on Enterprise's proposal in relation to replacement vehicles since this was where the majority of the detriment arose.[6]

10.47 We noted that removing the feature of having a control on the cost of replacement vehicles recovered from at-fault insurers altered substantially Enterprise's proposal. In particular:

(a) Non-fault insurers would have the incentive and ability to claim at high rates for replacement vehicles. If they did so, at-fault insurers would have the incentive to challenge those claims and transactional and frictional costs associated with replacement vehicles would be likely to remain. The evidence in relation to non-fault repairs suggested that transactional and frictional costs tended to be lower in insurer/insurer transactions than where CMCs were involved (see paragraph 6.36), but without a control on subrogated claims the benefit from lower transactional and frictional costs would be uncertain.

(b) Although insurers would have little reason to refer the provision of replacement vehicles to CHCs, the CHCs would in principle still be able to obtain replacement vehicle referrals from other sources (eg brokers, dealerships, repairers and breakdown companies), and directly from non-fault claimants. For example, DLG drew our attention to a recent proposed agreement between the RAC and Quindell, under which it was expected that the RAC would provide Quindell with access to non-fault claimants.[7] Though the number of referrals to CHCs would be lower than at present, CHCs would have a continuing incentive to seek to attract non-fault claimants to their services, so limiting the effectiveness of the remedy.

10.48 Overall, we found that, without a control on subrogated claims, there was significant uncertainty about the effectiveness of Enterprise's proposed variant of Remedy 1A.

10.49 We also had concerns about the proportionality of this remedy variant. Although some CHCs might continue in the market, winning business from

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[6] We noted that Enterprise's proposal envisaged that non-fault insurers provide repair as well as replacement vehicles, but the detriment in relation to repair was considerably less than in regard to replacement vehicles; and, additionally, most insurers already provide repair but not replacement vehicles.
[7] We noted that, in this case, the agreement was not put into place between RAC and Quindell.

brokers, dealerships, etc, we expected that this remedy would lead to a significant reduction in the scale of CHC activities. Indeed, without this reduction the remedy would be ineffective (see paragraph 10.47*(b)*). In our view, in this way this remedy variant represented a significant intervention in the market. We believed that, in order to impose a remedy which would so significantly change the shape of an industry, we needed to be particularly confident in its benefits.

10.50 Overall, in light of both the uncertainties surrounding the effectiveness of the Enterprise proposal without a control on subrogated claims and the significance of its intervention on existing CHCs, we decided, on balance, not to pursue this remedy. Nevertheless, we noted that if there were grounds for the CMA to review this market in the future, we would suggest that it consider this remedy closely again.

At-fault insurers to be given first option to handle non-fault claims (Remedy 1B)

Description of remedy option

10.51 In our Remedies Notice, we proposed a remedy which would give at-fault insurers the first option to handle either the whole of a non-fault claim or only the replacement vehicle part of a non-fault claim. The aim would be to introduce competition from at-fault insurers at FNOL, placing a greater constraint on the behaviour of non-fault insurers and other parties (such as CMCs). In our provisional decision on remedies we set out our reasons for not pursuing this remedy and, in response, no party put forward the view that we should pursue this remedy.

10.52 We identified a few variants of this remedy, which we said could be applied to replacement vehicles (and in the case of *(a)* and *(b)* potentially to repairs as well), as follows:

(a) allow the non-fault claimant to choose between the at-fault insurer, their own insurer or broker, or a CMC to handle their claim;

(b) remove the choice of the customer, giving the at-fault insurer the option to capture the claim; and

(c) provide the at-fault insurer with the option to provide a replacement vehicle to the non-fault claimant.

Views of parties

10.53 Parties generally did not support Remedy 1B. The main reasons for opposing the remedy were that it would remove a claimant's right to choose their provider for post-accident services. Parties were also concerned that practical aspects of the various variants of the remedy could lead to unintended consequences. CMCs/CHCs and some third parties also told us that Remedy 1B might have limited impact, adversely affect consumers' rights to choose their service provider for post-accident services, result in a reduction in service provision due to the lack of incentive for at-fault insurers to meet claimants' entitlements and add complexity to the claims process. In addition, they highlighted practical difficulties in situations where liability was uncertain or split.

Our reasons for not taking the remedy option forward

10.54 We observed that insurers could already seek to capture non-fault claims via issuing Copley-compliant[8] letters to non-fault claimants who had received an offer of a temporary replacement vehicle from a CHC. However, we found that insurers generally did not do this, in part because under the GTA, subscribing insurers and CHCs had agreed to a 'first to the customer' principle.

10.55 Although we identified some potential benefits from this remedy option, as it would better enable the service providers to control costs, we recognised the concerns raised by parties and did not believe that it would be possible to design the remedy in ways which would overcome these problems.

- *Delays in replacement vehicle provision*

10.56 This remedy necessarily involves delay as, in order to be effective, at-fault insurers must be given sufficient time to understand the circumstances of the case, decide whether to accept liability and make an offer to the non-fault claimant. During this period, claimants would not be provided with a replacement vehicle and, assuming their vehicle is not roadworthy, their legal entitlement would not be met. Under the third variant of this remedy, the delivery of the replacement vehicle would be further delayed as the offers of different parties would have to be compared with regard to their quality and costs.

10.57 Although some insurers told us that a short time frame (some suggested no longer than 24 hours from FNOL) would be required for at-fault insurers to take a decision on provision, with few disadvantages to claimants, others

[8] A 'Copley-compliant' letter is one from an at-fault insurer to a non-fault claimant offering to provide a replacement vehicle and which contains all the information specified by the Court of Appeal in *Copley v Lawn [2009] EWCA Civ 580, [2010] 1 All ER (Comm) 890*. The Court of Appeal decided that any offer made by the defendant's insurers must contain all such information as would be relevant to the claimant and his representatives in making a reasonable response, including the cost to the defendant of hiring the car. At paragraph 32, Lord Justice Longmore said: '… the general rule that the claimant can recover the "spot" or market rate of hire for his loss of use claim is upheld, unless and to the extent that a defendant can show that, on the facts of a particular case, a car could have been provided even more cheaply than that "spot" or market rate'. Source: Law Gazette.

suggested that it could take longer. We noted that, although a longer time frame would increase the effectiveness of the remedy, this would risk lowering the quality of service to the non-fault driver.

- *Added complexity to the claim process*

10.58 We were also concerned that the procedures required by this remedy might increase the costs incurred by parties and claimants, eg through increased management costs and litigation relating to compliance. We noted that the additional procedures at the start of the claims process might also be more confusing for claimants.

- *Loss of choice of service provider*

10.59 In relation to the second and third variants, we noted that the claimant would be obliged to accept the at-fault insurer managing the claim and arranging the provision of services, such as a replacement vehicle and repairs. This variant would remove the legal entitlement which the non-fault claimant currently has to choose their service provider. It appeared to us that this risk was more acute for repairs given that some claimants like to choose their repairer.

- *Risk of underprovision*

10.60 While we recognised the benefit of at-fault insurers having a strong incentive to control the costs of non-fault claims, we were concerned that this also created a risk of reduced service provision because at-fault insurers would have less incentive to meet claimants' legal entitlements. This risk would be particularly high for the variant of the remedy which removed the claimant's right to choose the service provider as, in that variant, at-fault insurers would not be constrained by the threat of claimants choosing another provider.

- *Conclusion*

10.61 Overall, we concluded that the three variants of Remedy 1B were not sufficiently practicable and hence would be ineffective in addressing the AEC and/or the customer detriment which we had identified.

Measures to control the cost of providing replacement vehicles to non-fault claimants (Remedy 1C)

Description of the remedy option

10.62 In our provisional decision on remedies, we set out a remedy to control the cost of providing a replacement vehicle to non-fault claimants (Remedy 1C).

The aim of the remedy was not to eliminate the separation between cost liability and cost control but rather to mitigate the detriment by reducing the amount of transactional and frictional costs arising from it.

10.63 We found that disputes between at-fault insurers and CHCs (and hence frictional costs) typically related to one or more of the following aspects of replacement vehicle provision:

(a) liability;

(b) hire rate;

(c) hire duration; and

(d) need.[9]

10.64 In our provisional decision on remedies, we took into account each of these sources of friction in our design of Remedy 1C. In summary, the proposed Remedy 1C comprised:

(a) a dual rate price cap, applied to all replacement vehicle providers,[10] at the point of the presentation of the claim to the at-fault insurer, whether it be by CHCs on behalf of non-fault claimants or on a subrogated claim made by the non-fault insurer; with

(b) the low rate cap being based on average direct hire daily rates plus a fixed cost element to cover the replacement vehicle arrangements costs, and the high rate cap being set as a multiple of twice the low rate cap. The former would apply where the at-fault insurer accepted liability for the accident within three days of being notified that a replacement vehicle was being provided and the high rate cap would apply otherwise.

10.65 We reasoned that this rate structure would reduce frictional and transactional costs by:

(a) removing the scope for disputes over the rate charged for hire vehicles (by setting a maximum rate);

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[9] Disputes over the claimant's 'need' for the replacement vehicle may relate to whether the claimant needed the size/type of car they hired or, in some cases, whether a replacement vehicle was required at all.

[10] We did not propose that the rate cap be extended to cover replacement vehicle claims issued to at-fault insurers directly by non-fault claimants who organised the hire of a replacement vehicle themselves, without the assistance of an insurer, broker, CMC or CHC. We noted that to do so would require a change in the law.

(b) reducing the incentive to dispute other aspects of replacement vehicle provision by reducing the daily rate charged (and thereby, the overall cost of replacement vehicle provision);[11] and

(c) giving a prospective at-fault insurer the incentive to accept liability if its initial assessment suggested that the probability of its driver being at fault was over 50%. In addition to reducing disputes over liability, we judged that this should also serve to ensure that claimants received a replacement vehicle when it was more likely than not that they were not at fault.

10.66 In addition, we specified that:

(a) insurers should tell claimants promptly if they believe them to be not at fault in order to facilitate the claimant in obtaining their legal entitlements;

(b) the hire duration should end no later than 24 hours after completion of the repair or, in the event of a write-off, seven days after the receipt of the total loss payment (which we believed would reduce further the scope for disputes over the length of hire periods);

(c) the rate cap should be set by the CMA and reviewed periodically; and

(d) all financial inducements from replacement vehicle providers where such inducements were to encourage claimants to take a replacement vehicle at rates above the rate cap should be prohibited (which we reasoned would be necessary to limit the opportunities for circumvention of the remedy).

Views of parties

10.67 We received a large number of submissions on Remedy 1C in response to both the Remedies Notice and our provisional decision on remedies. We set out these views in more detail in Appendix 10.1. In summary, the following key points were made:

(a) *Use of our powers.* CHCs and some insurers told us that we did not have the power directly to limit the damages for loss of use of a vehicle that non-fault parties could seek to recover in court. They said that claims brought by CHCs/CMCs on claimants' behalf could not be capped directly as this would be an attempt to regulate a claim in tort against an at-fault

[11] In the provisional decision on remedies, we noted that while a rate cap lowers the hire rate and so reduces friction from disputes over hire rates, it would not directly address frictional costs resulting from disputes over liability, hire duration and/or need. However, we expected that disputes over these other matters might also reduce because the lower hire rate payable was expected to reduce overall disputes.

party. Similarly, claims brought by the non-fault insurer once the claimant has been indemnified under their contract of insurance are subrogated claims and any arrangements by insurers to reduce the costs incurred are not relevant to a court in assessing the ‘reasonable costs’ to which the claimant is entitled (in this case, the cost of the temporary replacement vehicle). This would also be attempting to regulate a claim in tort against an at-fault party.

(b) *Effectiveness of the remedy in reducing frictional and transactional costs.* Several parties, including both insurers and CHCs, questioned the extent to which the remedy would reduce frictional and transactional costs. They highlighted that, while the remedy might reduce frictional costs in respect of the hire rates charged, there remained scope for friction over the issues of acceptance of liability, mitigation and duration. In particular, some said that we had underestimated the risks associated with hire duration when credit repairs were involved.

(c) *Exit of CHCs from the market*. Many CHCs told us that Remedy 1C would be very likely to lead to the elimination of the credit hire market, as provision of vehicles at the lower capped rate (assuming this was set at around direct hire rates) would not be profitable. Kindertons said that the remedy would ultimately eliminate referral fees, which would prevent CHCs from generating a sufficient volume of business to operate at an efficient scale. The CHCs told us that the elimination of the credit hire market would be detrimental to consumers. In particular, they suggested that:

(i) In the absence of the availability of credit hire, many consumers would not obtain their legal entitlements, because insurers would not have an incentive to ensure that consumers obtained them. For example, the CHO said that the only reason why at-fault insurers procured direct hire services was to avoid credit hire claims. It was therefore foreseeable that, if credit hire ceased to exist following implementation of the remedy, insurers would withdraw from direct hire arrangements and refer non-fault claimants to ‘the outside world’ where, in the absence of credit hire, consumers’ ability to realise their legal entitlements might as well have been eradicated. DAML told us that certain groups of customers were particularly expensive to serve given their risk profiles, including those between the ages of 17 and 20 and those with previous driving bans. It said that our proposed price cap would make it uneconomic to serve these customers such that they would not receive their legal entitlements and would be left without mobility.

(ii) Consumers would not receive the assistance they currently get from CHCs/CMCs with the claims process, for example in recovering uninsured losses.

(d) *Risk of circumvention.* Many insurers raised concerns over possible circumvention strategies which could be adopted by CHCs, including:

(i) vehicle providers which also controlled the repair process shifting their attention to maximising income from repairs, or extending the repair duration so as to increase hire costs; and

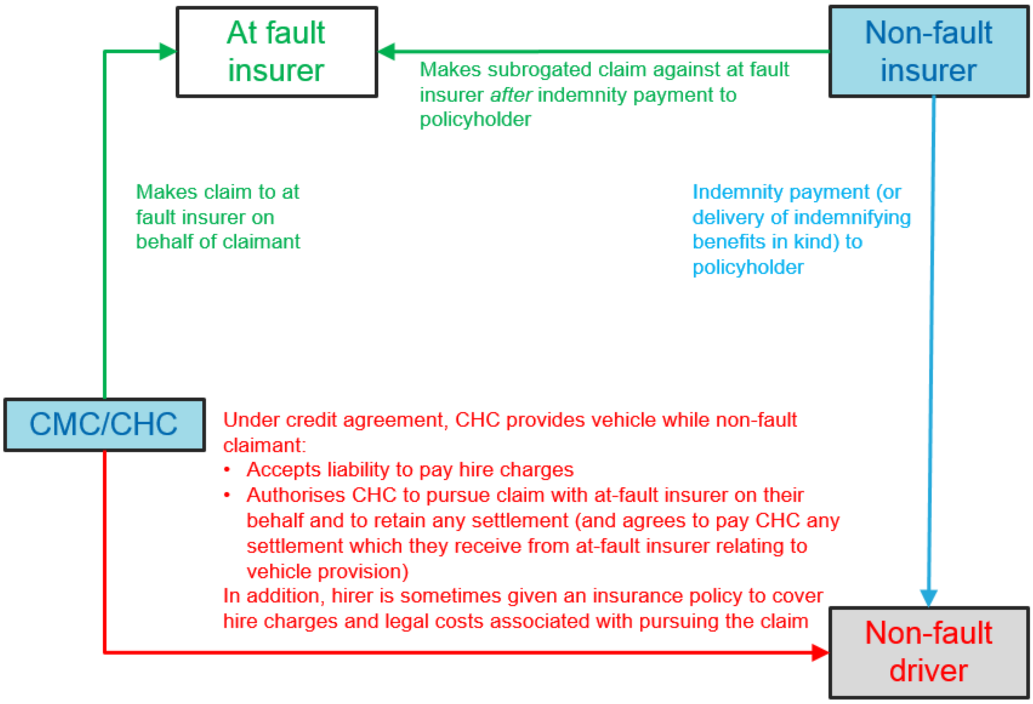
(ii) vehicle providers causing delays to insurers in deciding whether or not to accept liability for hire charges, so that the higher rate would become payable.

Our reasons for not taking the remedy option forward

10.68 In our provisional decision on remedies, we said that we intended Remedy 1C to cover all replacement vehicle provision to non-fault PMI claimants and to apply to all those involved in the provision of replacement vehicles to these claimants. Our intention was to impose a cap on temporary replacement vehicle costs from *(a)* CMC/CHC claims recovered from at-fault insurers on behalf of non-fault claimants; and *(b)* subrogated claims submitted by non-fault insurers to at-fault insurers. We also stated that the remedy would apply 'at the point a claim is submitted by the replacement vehicle provider to the at-fault insurer'. Figure 1 is a stylised diagram of the provision of a temporary replacement vehicle to a non-fault claimant and the cost recovery flows which follow. The processes where we intended the remedy to have effect are represented by the green arrows in the figure.

FIGURE 1

Routes for making a PMI claim for provision of a temporary replacement vehicle to a non-fault claimant



Source: CMA.

10.69 Many responses to our provisional decision on remedies raised concerns about the way in which we had proposed to apply the rate cap to these flows (see paragraph 10.67*(a)*). CHCs told us that, in general, when a vehicle was provided on credit hire, although the contractual liability to pay for the vehicle remained with the claimant, this liability was deferred and the contract authorised the replacement vehicle provider (or an appointed representative) to pursue the claim on the claimant's behalf. The replacement vehicle provider was then authorised to retain any settlement money offered in full or part settlement of the claim (and/or the claimant would pay to the replacement vehicle provider any settlement payment they received).

10.70 In proposing to pursue Remedy 1C we had relied on the power in paragraph 8(1) of Schedule 8 of the Act, which provides that an order may regulate prices charged. However, in view of the responses to the provisional decision on remedies, we concluded that we could not implement the remedy in the way in which we had intended. Although we had the power to cap the amount a CHC charged the non-fault claimant customer, we agreed with the CHCs that it was not possible for us to cap the level of claims represented by the green arrows in Figure 1 since these were not 'prices'.

10.71 However, although we did not have power to impose this remedy, we considered whether we should make a recommendation to government to legislate to introduce such a price cap. As with Remedy 1A, this would be to vary the application of tort law in the specific area of temporary replacement vehicle provision to non-fault claimants. We considered both the effectiveness and proportionality of making such a recommendation.

- *Effectiveness*

10.72 We noted that, for a price cap to be an effective remedy, it would need to ensure that claimants continued to receive their legal entitlements, whilst reducing materially frictional and transactional costs. If the rate were set too low, there would be an insufficient incentive for parties to provide claimants with replacement vehicles in line with their legal entitlements, causing detriment to consumers; but, if the rate were set too high, the remedy would be ineffective in changing practices and so fail to reduce significantly frictional and transactional costs.

10.73 Using the benchmark of a situation in which there was no separation between the control of costs and liability for those costs, we calculated a total consumer detriment arising from the provision of replacement vehicles of £84 million per year, equating to a cost per claim of £278 (based on 301,000 credit hire claims per year).[12] This figure assumed that claimants' tortious rights continued to be met in the absence of separation.

10.74 Table 1 shows the calculation for this net detriment per claim. The table shows that we found the average difference between a credit hire and a direct hire bill (adjusted to hold the quality of replacement vehicle and period of hire constant) to be £555. The average referral fee paid by a CHC to a non-fault insurer or broker was £328. As explained in paragraph 6.76, we concluded that this referral fee was largely passed back to PMI policyholders via lower premiums. We added the transactional and frictional costs incurred by at-fault insurers in managing claims, which the insurers estimated to be £78 per claim, on the basis that if the at-fault insurer managed the claim itself, it would not incur these costs. Finally, we recognised that, by managing the provision of a replacement vehicle to a non-fault claimant, CHCs saved at-fault insurers a cost of around £27 per claim.

[12] See Section 6 for a detailed assessment of the customer detriment arising from separation and the conduct and practices of the companies involved in managing non-fault claims for replacement vehicles.

TABLE 1 **Estimate of detriment per non-fault claim**

	£
Difference between credit and direct hire bill	555
Less average referral fee	–328
Net difference	**227**
At-fault insurer's transactional/frictional costs	78
Less at-fault insurer's management costs saved	–27
Total net detriment (per claim)	**278**
Total net detriment (301,000 claims)	84m

Source: CMA.

10.75 Since this remedy would not remove separation and there would still be two parties handling each claim, we found that it could not address all of the detriment and there would still be some costs on both sides which would remain. The at-fault insurer would still need to monitor and validate claims, meaning that some proportion of its transactional costs would remain. Also, because the price cap would only reduce the rate of the hire, some disputes (eg in relation to the length of hire, type of vehicle, etc)[13] would not be addressed and the associated frictional costs would remain. On the at-fault side, we would therefore expect some considerable proportion of the transactional/frictional costs which would be saved without separation (£78) not to be addressed by this remedy, while some proportion of the frictional costs incurred on the non-fault side would also remain.

10.76 Although we could not quantify the total transactional and frictional costs which would remain under the remedy, we accepted that the amount of the detriment which we would expect the remedy to address would be significantly reduced.

10.77 We also recognised that there were risks to setting the price cap too low (see paragraph 10.67*(c)*). It appeared to us that if it were to become uneconomic for parties other than insurers (such as CHCs) to provide temporary replacement vehicles to non-fault claimants,[14] the competitive constraint which these parties provided on insurers, in particular in relation to quality of service, would be lost.[15] We recognised that, in the absence of competition from such parties, there was a risk that insurers would have less incentive to provide replacement vehicles to non-fault claimants in line with their tortious rights. Therefore, in order to maintain competitive pressure, we believed it would be necessary to set the price cap at a higher level, thereby further reducing the

[13] In designing the remedy, we intended that it would improve the speed of an at-fault insurer's assessment of fault, but there would still be several other issues of potential conflict.
[14] For example, if the non-fault insurer handles the claim, there is some efficiency from only one FNOL process being carried out, removing duplication with a CHC.
[15] We noted that, in order for CHCs to remain in business, the price cap needed to allow for some duplication of costs, in particular in relation to the assessment of liability (as both the non-fault insurer and the CHC would need to make this assessment). This would reduce the addressable detriment further.

proportion of the detriment that would be addressed and limiting the effectiveness of the remedy.

10.78 Overall we found that it was not possible to quantify precisely the extent to which the remedy might address the detriment, while maintaining a level of service provision in line with claimants' tortious rights. However, if we assumed that the remedy were to remove half of it, and if all this benefit were passed through to customers in lower premiums, consumers would benefit by £42 million per year.

10.79 We also noted that, given that this remedy would require a recommendation to be made to government to legislate, it was likely that government would need to consider its effects beyond temporary replacement vehicles, and beyond the PMI market. In our view, although the legal intervention under this remedy would be less than under Remedy 1A, the requirement for legislation, and further government consideration, made the likelihood and timeliness of implementation, and so the effectiveness of this remedy, more uncertain.

- *Proportionality*

10.80 Although Remedy 1C, applied through a change in the law, would not be expected to cause the immediate reduction in the CHC industry to the extent caused by Remedy 1A (or its variants), particularly if the level of the price cap were set with the intention of maintaining the competitive constraint from such providers (see paragraph 10.77), we recognised that this remedy would still represent a significant intervention in the market, which required us to be confident in its benefits.

10.81 We also recognised that a price cap remedy was likely to result in some distortions in the provision of temporary replacement vehicles and/or other costs to some non-fault claimants. For example, we were concerned that some customers, who were more expensive than others to serve (eg because of their location, their risk profile, or their specific needs), might become uneconomic to serve under a price cap. While we believed it might be possible to set a cap which varied according to all the various cost factors which might be relevant in different cases (eg different locations, different days of the week, different customer risk profiles, etc), it appeared to us that it could become inordinately complex, increasing the cost of implementation and possibly increasing the scope for circumvention. However, we observed that to the extent that the price cap did not adequately take into account such factors, some high-cost claimants might either not be served or not receive a replacement vehicle in line with their tortious rights. Overall, we concluded that there was a substantial risk that this remedy would create distortions in the provision of temporary replacement vehicles, with the result that some claimants might not receive their tortious entitlement.

- *Conclusions on Remedy 1C*

10.82 We found that we could not implement Remedy 1C in the way in which we had intended (see paragraph 10.70). When we considered whether we should make a recommendation to government to legislate in order to introduce the remedy, we concluded that, for the reasons set out above, this would not be an effective and proportionate remedy. Therefore, we decided not to pursue it further.

DLG variant of Remedy 1C

10.83 In its response to our provisional decision on remedies, DLG made an alternative proposal to address the concern about whether we had powers to implement the remedy as we had intended. Under this proposal, instead of capping the claims made by CMCs/CHCs on behalf of claimants and the subrogated claims made by non-fault insurers, the amount which would be capped would be that which a replacement vehicle provider charged its customers for the vehicle hire (ie the red flow in Figure 1). DLG said that, by capping the contractual liability of the claimant for the vehicle, the amount which the replacement vehicle provider (or a solicitor) would be able to claim in tort on behalf of the claimant would also be capped. However, this alternative implementation approach would not apply to insurers providing their non-fault claimants with a replacement vehicle on an indemnified basis as, in such cases, there would be no charge for the vehicle provided which could be capped.

- *Parties' views on DLG variant of Remedy 1C*

10.84 On 28 July 2014, we published a further consultation on this alternative proposal. In response to this consultation, parties raised the following main points:

(a) *Use of our powers.* Several parties told us that it was doubtful whether we would have the power to enforce the remedy because it would amount to an attempt to use competition law to control settlements under tort law.

(b) *Risk of distortions.* Several parties told us that the remedy would give rise to distortions between (i) CHCs and non-fault insurers in relation to post-accident temporary replacement vehicle provision, as CHC prices would be capped while non-fault insurers would be able to continue to bring subrogated claims for costs at higher retail rates; and (ii) CHCs and retail hire companies in relation to vehicle hire as it would only be the purpose for which the customer wanted the vehicle which would determine whether the cap applied.

(c) *Risk of circumvention.* Insurers told us that this remedy would be effective, so long as (according to many) the low rate cap was set at a level close to direct hire rates. In contrast, all the CHCs told us that it would not be effective, for example because it would be easy to circumvent by establishing alternative ways to meet customers' needs (see paragraph 10.86).

(d) *Exit of CHCs.* CHCs told us that, under this remedy, there was a significant risk that they would cease to exist. Some said that, as a result of the remedy, non-fault claimants would receive a worse service, ie reduced like-for-like provision or no provision of a temporary replacement vehicle. Redde said that insurers had shown again and again that they had no interest in providing third party mobility.

- *Our reasons for not taking the remedy option forward*

10.85 Under the DLG variant of Remedy 1C, only the price charged by the CHC to the claimant, ie the red arrow in Figure 1, would be capped. As highlighted by several of the parties, this variant of the remedy would allow insurers to continue to submit subrogated claims for replacement vehicles which they had provided to non-fault claimants at a rate that was not affected by the price cap. In our view, for the reasons set out below (see paragraphs 10.86 to 10.88), this limited fundamentally the effectiveness of the remedy in dealing with the AEC and the customer detriment we had identified.

- *Effectiveness*

o *Risk of circumvention*

10.86 We considered the arguments put forward by the parties regarding the potential risk of the remedy being circumvented. In particular, Accident Exchange told us that a CHC could circumvent the remedy very easily by issuing mobility insurance policies to customers. As a result, its provision of a temporary replacement vehicle to a non-fault claimant would become an indemnified provision under an insurance policy and the rate cap could not apply. The claim against the at-fault insurer would become a subrogated claim. It told us that the remedy would be wholly ineffective if the ability to recover basic hire rates via subrogated claims remained since replacement vehicle providers would simply adapt their business models to circumvent it.

10.87 We recognised that this means of providing replacement vehicles would fall outside the scope of the DLG variant of Remedy 1C. We also saw few barriers to CHCs revising their business models to provide temporary replacement vehicles under an insurance contract in this way. For this reason, we concluded that there was a very high risk of the remedy being circumvented in a way which would fundamentally remove its effectiveness.

- *Risk of distortions*

10.88 In addition to the potential for circumvention, we found that the DLG variant of Remedy 1C would create some distortions, in particular between insurers and CHCs in the provision of replacement vehicles to non-fault claimants following an accident, and between CHCs and retail hire providers. In the former case, we believed that the remedy would favour significantly one business model (insurer provision) over another (CHC provision). It appeared to us that this type of distortion would simply encourage circumvention rather than changes in behaviour which would address the AEC or the detriment arising from it. In the latter case, we considered carefully how the industry might distinguish between the provision of replacement vehicles following an accident and the provision of hire cars for any other purpose. We concluded that it was not clear how this could be achieved so that a retail hire customer could not obtain a vehicle at a cheaper rate simply by claiming that it was a post-accident temporary replacement vehicle. We were concerned that any attempt to enforce such a difference in rates would encourage circumvention, with uncertain effects in both the post-accident temporary replacement vehicle sector and the standard hire car sector.

- *Conclusions on Remedy 1C (DLG variant)*

10.89 We concluded that the DLG variant of Remedy 1C was unlikely to be an effective remedy for the AEC we had identified or the detriment arising from it, due to both a fundamental risk of circumvention and a risk of creating additional distortions. We noted that an ineffective remedy would also, necessarily, be disproportionate. For these reasons, we decided not to pursue this remedy further.

Measures to control non-fault repair costs (Remedy 1D)

Description of remedy option

10.90 In our Remedies Notice we proposed a remedy which aimed to prevent claims for repair costs, whether under subrogation or made by a CMC on behalf of a claimant, being marked up above the costs incurred, with the aim of reducing frictional costs. We said that, if claims amounts were lower, there should be fewer disputes and the frictional costs associated with repair claims should reduce.

10.91 We set out two possible ways in which these aims might be achieved:

(a) *Remedy 1D(a):* require that the repair costs recoverable through claims be limited to the 'wholesale price' paid by non-fault insurers to repairers, plus, possibly, an allowance for an administration charge.

(b) *Remedy 1D(b):* require that the repair costs recoverable through claims be limited to standardised costs. If the actual repair cost were higher than the standardised cost, then the non-fault insurer would not be able to recover that cost and would incur the costs. Conversely, if the actual repair cost were lower than the standardised cost, the benefit could be retained by the non-fault insurer.

Views of parties

10.92 The majority of the ten largest insurers supported Remedy 1D. They said that, if the remedy could be implemented effectively, it would address the issues we had identified. There was more support for Remedy 1D*(a)* than 1D*(b)*. One insurer (RSA) told us that it would be disproportionate to impose remedies in respect of repair and total loss given the extent of the detriment we had found.

10.93 In response to our provisional decision on remedies, several insurers told us that if Remedy 1D were not implemented the detriment arising from repair costs would be likely to increase. The reasons given were:

(a) more insurers would adopt the practice of marking up subrogated claims for repair costs above the costs incurred (in particular, consequent to the recent judgement in the case of *Coles v Hetherton*[16]);

(b) there would be a shift from insurer-managed repairs to credit repairs; and

(c) there would be an increase in referral fees paid in relation to repairs if Remedy 1C were implemented, assuming this led to a reduction in referral fees paid in relation to temporary replacement vehicles.

10.94 However, the parties which supported the remedy, as well as those which did not, identified some potential difficulties with the design and implementation of the remedy. These concerns are summarised below.

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[16] See paragraphs 3.13–3.15.

- *Remedy 1D(a)*
  - *Definition of wholesale costs*

10.95 Many parties (including insurers and repairers) told us that wholesale costs could not be defined clearly, which would make the remedy impractical and difficult to enforce. Parties also said that, because the remedy did not envisage an objective benchmark for wholesale costs, repair costs could still be inflated in the subrogated claim.

  - *Reduced incentive to minimise repair costs*

10.96 Some insurers said that a requirement for repair costs to be equivalent to the wholesale costs incurred would lead to an increase in wholesale repair costs. They said that this would arise because the remedy would reduce the incentive for non-fault insurers or CMCs to negotiate with repairers and parts/paints suppliers to minimise repair costs.

  - *Circumvention*

10.97 Some insurers raised the concern that Remedy 1D*(a)* could be circumvented by insurers or CMCs which are vertically integrated with repairers. This could be achieved by the repairer artificially increasing the wholesale repair cost charged to the insurer or CMC and rebating the excess profit to the parent company of the insurer or CMC by way of a dividend or other monetary transfer.

- *Remedy 1D(b)*
  - *Determination of standardised costs*

10.98 Many parties (including insurers, brokers and CHCs/CMCs) told us that it would be very complex and impractical to set standardised repair costs and, if the remedy were implemented, an independent body would have to be established to set these costs. One difficulty would be the number of parts used in repairs. While some parties said that the use of cost estimating systems might facilitate the remedy, they told us that these systems did not cover all aspects of repair costs. In particular, labour rates would also have to be set, taking account of regional variations and the different types of labour needed for different tasks. In addition, discounts would have to be applied to parts and paint supplies from the standard system rates in order to reflect the market rates actually paid. Identifying these discounts would be complicated by the number of parts involved, the number of suppliers and the variety of pricing arrangements which insurers and repairers have in place with suppliers. An additional complexity would be that guidelines would need to be set governing the circumstances in which parts should be repaired rather than replaced and whether OEM parts or non-OEM parts should be used.

- *Distortion*

10.99 Another concern which some insurers and CHCs identified with the use of standardised costs was that it could benefit larger insurers as these insurers could negotiate bigger discounts with suppliers. Either larger insurers would make a profit compared with the standardised costs or smaller insurers would not be able to recover the full amount of the costs they incurred. Some respondents told us that this could reduce PMI competition if it enabled the larger insurers to offer lower PMI premiums than smaller insurers. However, we noted that it was a normal result of competition that some companies benefited from buying at lower prices than others.

Our reasons for not taking the remedy option forward

10.100 In the same way as with Remedy 1C, Remedy 1D*(a)* or *(b)* would require the imposition of a price cap. For non-fault insurers, this cap would be on the amount of the subrogated claim. However, as discussed in relation to Remedy 1C, we found that we did not have power to implement such a cap, as a subrogated claim did not represent a 'price' which could be capped (see paragraph 10.70). Although we could cap the amount of a credit repair charge to a customer (as with the DLG variant of Remedy 1C), the same risk of circumvention and similar risks of distortion would apply. Therefore we did not consider a DLG-style variant of Remedy 1D further. Rather, we found that, in order to impose Remedy 1D*(a)* or *(b)*, we would need a recommendation to government to introduce new legislation. In our view, this created uncertainty about the timely implementation of this remedy. Nevertheless, we considered the effectiveness and proportionality of this remedy option.

10.101 We estimated that the total detriment associated with non-fault repair was around £24 million per year, of which £9 million was from insurer-managed repairs and £15 million from credit repairs. The net detriment associated with repair was considerably smaller than that associated with credit hire, principally because: *(a)* subrogated repair claims submitted to at-fault insurers are, on average, closer to cost than credit hire bills; and *(b)* most non-fault repairs tend to generate lower frictional and transactional costs than non-fault credit hires, in particular when the repair is insurer-managed rather than CMC-managed.

10.102 We also recognised that some transactional and frictional costs were an inevitable result of separation and that such costs would not be addressed by the remedy. It appeared to us that, given that frictional costs were already relatively low, it would be very difficult to make substantial further reductions without requiring claimants to have their claims managed by the at-fault insurer (which we considered under Remedy 1B (see paragraphs 10.51 to 10.61)). Nevertheless, we considered the extent to which either Remedy 1D option was likely to address the detriment we had identified.

- *Remedy 1D(a)*

10.103 We noted that bilateral agreements between some insurers required that subrogated repair claims be charged at the actual repair costs incurred by the non-fault insurer, taking into account any discounts and rebates. These agreements indicated to us that the objective of this remedy option to reduce costs to a ‘wholesale level’ was feasible, at least when parties were mutually willing to operate under these terms. We also noted that the GTA credit repair agreement set out procedures for managing repair costs and required that CMCs pass on standard discounts to at-fault insurers (although the GTA credit agreement applies only to those GTA subscribers which have elected to apply it). We were not aware of any bilateral agreements between CMCs and insurers relating to repair costs.

10.104 However, we found that there were some important differences between parties entering into bilateral agreements voluntarily and a remedy which would be mandatory. In particular, bilateral agreements relied on each party trusting the other to calculate accurately the wholesale cost of repairs, taking into account all discounts and rebates, with there being a mutually detrimental response from either party of withdrawing from the agreement in the event of non-compliance. This would not be the case if the remedy were mandated. For this reason, a mandatory regime would require significantly greater monitoring to ensure compliance.

10.105 We noted that the remedy could increase frictional costs as it could lead to an increase in disputes, with at-fault insurers challenging whether the repair claims submitted to them properly reflected the wholesale cost of repair.

  - *Insurer-managed repairs*

10.106 Given the low level of transactional and frictional costs in insurer-managed non-fault repairs, and the potential for these costs to increase as a result of this remedy (see paragraph 10.105), we concluded that Remedy 1D*(a)* was not likely to be effective in addressing the detriment arising from insurer-managed repairs.

- *CMC-managed repairs*

10.107 In our view, there was more possibility of Remedy 1D*(a)* reducing the existing level of detriment in relation to CMC-managed non-fault repairs. However, we noted that:

(a) the remedy would remove the incentive for CMCs to control their repair costs as they would not derive any benefit from any discounts and rebates they achieved (see paragraph 10.96); and

(b) there could be an increase in frictional costs (see paragraph 10.105).

10.108 For these reasons, we concluded that Remedy 1D*(a)* would be impracticable and most likely ineffective in addressing the detriment arising from CMC-managed repairs.

10.109 Therefore, we decided not to pursue this remedy option further.

- *Remedy 1D(b)*

10.110 In light of the responses we received on this remedy option, we judged that the design of the remedy was likely to be complex and it would be costly to regulate. This was because of the very high number of different parts which would need to be captured (the Audatex cost estimating system has a parts database of over 4 million items), the difficulties of setting the appropriate labour rates and discounts, and the likelihood that a new body would have to be established to update the standardised costs on a regular basis.

10.111 We noted also that at-fault insurers currently conducted checks on repair bills from non-fault insurers and CMCs by using cost estimating systems. In our view, a remedy requiring the price to be set for all repair component costs (on an annual basis) and then monitored was likely to add significantly to the costs of the checks which were (and would probably continue to be) performed by at-fault insurers.

10.112 It also appeared to us that the remedy would address only the net detriment we found in relation to CMC-managed repairs, which we estimated to be around £15 million per year. This was because the remedy would be unlikely to reduce significantly transactional and frictional costs on insurer-managed repairs, which were already low. We also did not expect the remedy to eliminate entirely the £15 million detriment we had identified.

10.113 For these reasons, we concluded that Remedy 1D*(b)* would be likely to be impracticable and disproportionate and therefore we decided not to pursue this remedy option further.

Measures to control non-fault write-off costs (Remedy 1E)

Description of remedy option

10.114 In our Remedies Notice we proposed a remedy which aimed to ensure that claims in relation to write-offs, whether under subrogation or made by a CMC on behalf of a claimant, reflected the actual salvage proceeds received by the non-fault insurer rather than an estimated value.

10.115 We set out two possible ways in which this aim might be achieved:

(a) Remedy 1E*(a)*: require that at-fault insurers be given the option to handle the salvage of non-fault vehicle write-offs in non-captured claims; and/or

(b) Remedy 1E*(b)*: require that all write-off claims handlers either (i) use actual salvage proceeds (including any referral fee paid by the salvage company to the claims handler), or (ii) submit the claim to the at-fault insurer based on the estimated salvage value but adjust it (up or down) once the actual salvage proceeds (and any referral fee) have been received from the salvage company.

Views of parties

10.116 The majority of the ten largest insurers told us that they supported Remedy 1E in principle. There was more support for Remedy 1E*(b)* than 1E*(a)*. However, these parties, as well as those parties which did not support the remedy, identified some potential difficulties with design and effectiveness. Parties also told us that very few claims for write-offs were challenged by at-fault insurers, though a higher proportion of claims handled by CMCs were challenged than claims handled by non-fault insurers.

- *Remedy 1E(a)*

10.117 Many parties (including insurers, CHCs/CMCs and salvage companies) told us that this remedy option would not be effective because at-fault insurers would not take up the option of handling the salvage of non-fault vehicle write-offs. This was because they would not want the additional costs of handling the salvage (eg storage of vehicle, transfer of ownership, etc).

- *Remedy 1E(b)*

10.118 A majority of the ten largest insurers told us that this remedy option was similar to their current practice. Other parties told us that an adjustment mechanism could increase administration costs and delay the final settlement between insurers.

10.119 In response to our provisional decision on remedies, in which we said that we did not intend to pursue Remedy 1E*(a)* or *(b)* further, no party encouraged us to reconsider this view. Only Allianz said that, in the situation where the CMA chose to revisit Remedy 1D (which we had indicated we also did not intend to pursue), we may also wish to include Remedy 1E as a matter of completeness.

Our reasons for not taking the remedy option forward

10.120 We estimated that the net detriment arising from non-fault write-offs was approximately £2 million per year, relating almost entirely to insurer-managed write offs.

- *Remedy 1E(a)*

10.121 In light of the responses which set out why at-fault insurers would not take up the option of handling the salvage of non-fault vehicle write-offs, we judged that this remedy option was unlikely to be effective and decided not to pursue it further.

- *Remedy 1E(b)*

10.122 In the same way as with Remedy 1C, Remedy 1E*(b)* would require the imposition of a price cap. For non-fault insurers, this cap would be on the amount of the subrogated claim. However, as discussed in relation to Remedy 1C, we found that we did not have power to implement such a cap, as a subrogated claim did not represent a 'price' which could be capped (see paragraph 10.70). Therefore, we found that, in order to impose Remedy 1E*(b)*, we would need a recommendation to government to introduce new legislation. In our view, this created uncertainty about the effective timely implementation of this remedy.

10.123 We found that some insurers and CMCs received profit shares or volume commissions from salvage companies, the benefit of which was not always reflected in the claims they submitted to at-fault insurers (see Appendix 6.3). In our view, this issue was very similar to the issue in relation to non-fault repairs, where some claims for repair costs did not reflect the discounts and rebates received by non-fault insurers or CMCs. For this reason, we considered a variant of Remedy 1E*(b)* which was similar to Remedy 1D*(a)*, ie that write-off claims submitted by non-fault insurers or CMCs should take account of any profit share, volume commission and/or any other similar payment received from a salvage company, either at the time of making the claim or via an adjustment to the claim once the salvage proceeds were known.

10.124 However, in view of the small scale of the net detriment we had identified in relation to write-offs, and given the similarities between Remedy 1D*(a)* and this variant of Remedy 1E*(b)*, we judged that this variant of Remedy 1E*(b)* should only be considered for implementation as a package with Remedy 1D*(a)*. In our view, without a system to monitor the profit shares, volume commissions and any other similar payments insurers and CMCs received from salvage companies, such as would be required in relation to Remedy 1D*(a)*, this remedy option would be unlikely to be effective. In addition, we found that there was a risk of introducing new frictional costs (see paragraph 10.105).

10.125 Therefore, given our decision not to pursue Remedy 1D*(a)*, we concluded that we should also not pursue Remedy 1E*(b)* (or any variant of it).

Improved mitigation in relation to the provision of replacement vehicles (Remedy 1F)

Description of the remedy option

10.126 In our provisional decision on remedies, we proposed a remedy which would require replacement vehicle providers to ask non-fault claimants standard questions about their need for a replacement car (Remedy 1F).[17] Replacement vehicle providers would be required to provide the at-fault insurer with adequate documentation showing that the appropriate vehicle had been provided by completing a ‘mitigation declaration’. This declaration would set out details of the claimant’s responses, and so confirm that the cost of the replacement car had been appropriately mitigated. The at-fault insurer would be entitled to be sent the mitigation declaration.

10.127 We explained that Remedy 1F was expected to:

(a) Reduce frictional costs incurred by insurers and CHCs which arise when there is a dispute over the replacement vehicle provided to a non-fault claimant where the at-fault insurer alleges that the replacement vehicle exceeds the non-fault claimant’s needs. The completion and signing of a mitigation declaration by the replacement vehicle provider prior to the provision of a replacement vehicle to the non-fault claimant, in addition to the review and countersigning of the mitigation declaration by the non-fault claimant upon delivery of the replacement vehicle, would provide greater transparency over the assessment of need and the claimant’s mitigation of their loss, thereby reducing the likelihood of dispute.

[17] A non-fault claimant is entitled to a broadly equivalent replacement car while their own vehicle is unavailable subject to a duty to mitigate their loss with consideration to their need. We found that often replacement vehicle providers do not enquire in detail about a non-fault claimant’s need for a broadly equivalent replacement car.

(b) Support Remedy 1C by ensuring that the hire rate cap proposed under Remedy 1C could not be circumvented by providing the non-fault claimant with a replacement vehicle in excess of their needs.

Views of parties

10.128 We set out in detail in Appendix 10.1 the views of the parties on this remedy.

10.129 In addition to considering the responses we received to our Remedies Notice and provisional decision on remedies on this remedy, we also held two roundtable discussions with insurers, brokers and CHCs on 29 July and 5 August 2014 in order to refine the wording of the mitigation declaration.

Our reasons for not taking the remedy option forward

10.130 Remedy 1F was originally intended to support Remedy 1C in reducing frictional costs between replacement vehicle providers and at-fault insurers (see paragraph 10.127*(b)*). However, having decided not to pursue Remedy 1C, we considered the extent to which Remedy 1F would be effective in reducing frictional costs on its own.

10.131 We noted that the GTA already required the completion of a mitigation questionnaire, which must be signed by the claimant on receipt of the replacement vehicle. However, in our provisional decision on remedies, we reasoned that requiring the replacement vehicle provider to assess need fully, and to state that this had been done, and asking a claimant to confirm the answers they provided when the car was provided to them, would result in a more effective fulfilment of the legal duty of mitigation.

10.132 We believed that our version of a mitigation declaration (see Appendix 10.3), and the mitigation process which we had proposed, represented a thorough means by which to assess a non-fault claimant's need and would provide at-fault insurers with some confidence in a claimant's legal entitlement to the vehicle provided. Nevertheless, compared with the existing mitigation statements and processes used by CHCs, we found that the benefit of Remedy 1F on its own was very small. For this reason, we found that the costs of imposing a formal obligation to complete a prescribed mitigation declaration and to follow prescribed processes, although relatively small, would be likely to outweigh the benefits, such that the remedy would not be proportionate.

10.133 Therefore, we decided not to pursue this remedy further.

Prohibition of referral fees (Remedy 1G)

Description of remedy option

10.134 In our Remedies Notice we said that a prohibition of referral fees might be an appropriate remedy to support other remedy options (eg Remedy 1D*(a)*) where usage of referral fees might otherwise undermine the effectiveness of the remedy.

10.135 This remedy would prohibit:

(a) referral fees or commissions paid by CMCs/CHCs/repairers/others to non-fault insurers/non-fault brokers/others for referring non-fault claimants in relation to the provision of temporary replacement cars and repairs; and

(b) referral fees or commissions paid by salvage companies to non-fault insurers.

Views of parties

10.136 Of the parties which supported this remedy, the majority told us that it could not operate in isolation, as it would not directly address the AEC or consumer detriment which we had identified under ToH 1, and would be more effective as a measure to support the other remedies we had proposed, which could be undermined or circumvented if the payment and receipt of referral fees continued.

10.137 Several parties told us that the other remedies proposed under ToH 1, which were intended to reduce the cost of non-fault claims (most notably Remedies 1C, 1D and 1E), would restrict the ability of post-accident service providers to pay referral fees by reducing the margin they generated from the provision of these services. As a result, the need for an outright ban on referral fees would be removed.

10.138 There was a range of views on the likely impact of the remedy on PMI premiums. Some parties told us that a prohibition of referral fees would result in an increase in premiums because, under the current system, referral fees gained from post-accident service providers were (at least to a significant extent) passed from insurers to consumers in the form of reduced premiums. However, other parties, including insurers, suggested that the remedy could reduce the incentive to refer for costly credit hire and hence could reduce the overall cost of non-fault claims, thus resulting in a reduction in premiums. Some insurers noted that to the extent that referral fees were paid to repairers, salvage companies, recovery agents or other companies rather than insurers, they could not be passed from insurers to consumers in the form of lower PMI premiums.

10.139 Several CMCs/CHCs told us that the prohibition of referral fees would have an adverse impact on their business model, as it would reduce their ability to obtain referrals from insurers and other parties. They said that any weakening of the CMC/CHC sector would reduce the competitive constraint which they imposed on insurers in the servicing of non-fault claims.

10.140 Several parties told us that the remedy would require a broad definition of referrals fees (ie including rebates, profit shares and other financial mechanisms) in order to minimise the risk of circumvention. Several parties suggested that the remedy would encourage vertical integration or the formation of alternative business structures by insurers to extract referral fee income through other means.

10.141 In response to our provisional decision on remedies several insurers told us that all referral fees should be banned (not just in relation to temporary replacement vehicles) as otherwise it was likely that a consequence of Remedy 1C would be an increase in referrals for credit repair, which would increase the overall cost of claims.

Our reasons for not taking the remedy option forward

10.142 We considered first whether we should prohibit referral fees in relation to temporary replacement vehicles. We judged that, in the absence of Remedy 1C, the likely impact of such a ban would include one or more of the following:

(a) non-fault insurers supplying temporary replacement vehicles as a cover under an insurance policy (eg Enterprise's variant of Remedy 1A (see paragraph 10.30*(c)*)); and/or

(b) vertical integration of CHCs/CMCs with insurers, brokers and other sources of referrals; and/or

(c) CMCs/CHCs seeking other means of marketing to customers (which were likely to be more expensive per claim captured than referral fees).[18]

10.143 It appeared to us that under all three of these possibilities, there would still be separation and, without measures to address the level and/or nature of claims, transactional and frictional costs would remain.

[18] If CMCs/CHCs had lower-cost methods of attracting customers available to them, they would use these rather than paying referral fees to insurers.

10.144 With regard to the third possibility, we found also that this was likely to increase the detriment by reducing the proportion of claims costs which were returned to insurers and brokers, consequently increasing PMI premiums.

10.145 We also recognised that if, under any of these possibilities, it were to become uneconomic for parties other than insurers (such as CHCs) to provide temporary replacement vehicles to non-fault claimants, the competitive constraint which these parties provided on insurers, in particular in relation to quality of service, would be weakened or lost.

10.146 We noted that the payment of large referral fees might be associated with distorted effects on competition since the temporary replacement vehicle provider offering the highest referral fee might not be the most efficient or effective service provider (and we also found that referral fees might not be passed on fully to consumers in the form of lower PMI prices (see paragraph 6.76)). However, we regarded referral fees as a symptom of the AEC we had identified rather than as the source of it, and we believed that a prohibition of referral fees without addressing the underlying causes of the AEC was likely to have complex and highly uncertain effects (see paragraphs 10.142 to 10.145). In our view, given this significant uncertainty, a prohibition of referral fees on temporary replacement vehicles did not represent an effective and proportionate remedy.[19]

10.147 We considered next whether we should prohibit referral fees in relation to repairs and write-offs. We found that this would not be an effective or proportionate remedy for similar reasons to temporary replacement vehicles. Additionally, we noted that referral fees were not common in relation to write-offs and were small in relation to repairs (see Section 6).

10.148 For these reasons we decided not to pursue this remedy.

Our decision

10.149 As set out in Section 9, the Act requires the CMA to achieve 'as comprehensive a solution as is reasonable and practicable to the AEC and any detrimental effect on customers'.[20] To satisfy this requirement, the CMA considers how comprehensively potential remedies (or packages of remedies) address the AEC and the resulting customer detriment, and whether they are effective and proportionate.[21]

[19] We noted that a ban on referral fees might reduce some of the distributional effects we had identified as arising from the AEC due to different effects on low-risk and high-risk customers (see paragraph 6.82).
[20] Section 134(6) of the Act.
[21] Section 134(6) of the Act.

10.150 With regard to the AEC and the resulting customer detriment which we had found in relation to ToH 1, we concluded that there were no remedies within the mechanisms and powers available to us that represented an effective and proportionate solution.

10.151 In our view, there was some merit in a variant of Remedy 1A which ensured that non-fault claimants received a like-for-like replacement vehicle without increasing costs excessively. Similarly, we thought that there was some merit in Remedy 1C. However, we found flaws with both of these remedies, in particular with regard to our legal powers to cap the amount of a subrogated claim.

Observations and encouragements

10.152 Having found that the separation of cost liability and cost control and various practices of the parties involved in the management of non-fault claims gave rise to an AEC and a significant customer detriment, we found it deeply unsatisfactory that we were unable to find an effective and proportionate remedy to address these problems. In particular, given that the majority of the detriment related to temporary replacement vehicle provision, we found it frustrating that we were unable within the current legal framework to change either the structure of the market or the practices of parties in providing these services to non-fault claimants.

10.153 However, notwithstanding our inability to remedy the AEC and customer detriment we had found, we did identify various actions which were within the power of those involved in the provision of temporary replacement vehicles to non-fault claimants, or those making determinations in relation to them, which we believed would help to reduce the detriment we had identified, and so reduce PMI premiums. We were keen to encourage these actions and list them below.

- *Comments in relation to the cost of provision of temporary replacement vehicles to non-fault claimants*

10.154 We have found that the methodology used to calculate the award of damages under tort law in relation to the provision of post-accident services to non-fault claimants has enabled those providing these services often to recover an amount significantly above the actual costs incurred, leading overall to inefficient market outcomes and some consumer detriment. In the case of the provision of temporary replacement vehicles by CHCs, this difference is indicated by the substantial referral fees paid to non-fault insurers, brokers and others sources (see paragraph 6.30).

10.155 In the case of repairs, we have found that non-fault claimants can, and some do, choose their repairer, with the amount of the claim being based on the retail cost of the repair. Therefore, we could understand why the courts used the retail cost of repair as a benchmark for the reasonable cost of repair when making a determination of damages. However, in the case of temporary replacement vehicles, we observed that there was a virtual absence of retail market transactions to provide evidence of the reasonable cost. We found that, although it was possible, non-fault claimants did not, other than in exceptional circumstances, hire a temporary replacement vehicle from a retail hire company, meaning that rates sourced from this market represented a much less appropriate benchmark.[22]

10.156 Although we could understand why historically the basic hire rate (BHR), which is the retail hire rate for the type of vehicle hired in the location of the claimant, had become the established benchmark in case law, we questioned whether this was still the most appropriate benchmark given that, following the establishment and expansion of the credit hire industry, very few non-fault claimants now sourced their temporary replacement vehicles in the retail hire market. In our view, the BHR was, accordingly, artificial.

10.157 It appeared to us that the artificiality of the benchmark used in determining non-fault temporary replacement vehicle claims was demonstrated, for example, by the difference in the amounts awarded to impecunious and non-impecunious claimants where both used credit hire. Both claimants might receive the same service from the temporary replacement vehicle provider (ie the same vehicle for the same period on credit) and at the same cost to the provider, but the amount awarded in damages (and received by the temporary replacement vehicle provider) would differ based on an artificial difference in the cost of the hire, which in one case but not the other would nominally reflect the additional costs of hiring the vehicle on credit.

10.158 In our view the high level of referral fees paid by CHCs to insurers, brokers and other sources were significantly above what we would expect to see as the cost of winning contracts in a business-to-business market, and this indicated that the BHR was significantly higher than the necessary costs incurred by CHCs in providing temporary replacement vehicles.

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[22] Another significant difference we observed between determining the reasonable amount of damages for repairs and the reasonable amount of damages for a temporary replacement vehicle was that, in the case of repairs, most were managed by the non-fault insurer, and, as reaffirmed in *Coles v Hetherton*, the courts take the view that the claimant's insurance arrangements should play no role in determining the amount of the allowable claim, on the grounds that the at-fault driver should not benefit from the claimant's expenditure on insurance; however, most temporary replacement vehicle claims do not involve the non-fault claimant's pre-accident insurance arrangements. For this reason, in our view, there should be no barrier to the courts considering the costs reasonably incurred in providing credit hire.

10.159 We recognised both that: *(a)* in an individual case it was not practicable for a court to base damages on the underlying efficient cost of providing a temporary replacement vehicle as this would require investigatory powers; and *(b)* it was not desirable for damages to be based on the actual cost incurred by a CHC or another provider as this would remove the incentive for providers to operate efficiently and create an incentive to transfer costs to other companies within the same ownership. Nevertheless, in our view, there was a question to be asked about whether the BHR, without any adjustment, was still the right benchmark.

10.160 For the reasons set out above, in our view the BHR is an artificial benchmark and is too high.

- *Insurer-provided temporary replacement vehicle provision to non-fault claimants*

10.161 We observed that most insurers did not provide temporary replacement vehicles (other than, on occasion, courtesy cars) to their policyholders who were not at fault in an accident, unless their policy specifically provided for such cover (usually purchased as an add-on). However, it appeared to us that insurers could offer this cover, either as part of a PMI policy, or as a complementary non-fault temporary replacement vehicle policy (ie similar to the cover typically provided as part of an MLEI policy). It appeared to us that, although there would remain separation in this situation, we would expect lower frictional costs as insurer–insurer transactions generally generate less friction than insurer–CHC transactions (see paragraph 10.47*(a)*). Moreover, we might expect some insurers to form bilateral agreements to agree lower rates of claim and simplified administrative processes in order to reduce costs further, as we have seen them do in other circumstances (see paragraph 10.163).

10.162 In the absence of a remedy from us to address the separation of cost liability and cost control, we did not wish to go so far as to advocate insurers moving to the self-provision of temporary replacement vehicles, but we did wish to note that it was within their power to do so.

- *Benefits of bilaterals*

10.163 We found that the bilateral agreements which existed between some insurers, and between some insurers and some CMCs/CHCs, provided benefits in reducing transactional and frictional costs.[23] Whilst they involved some set-up and monitoring costs, it appeared to us that they had the potential to deliver significant reductions in overall costs, in particular for those parties where there were substantial volumes of transactions between them.[24] It appeared to us that an increase in such agreements would have the effect of reducing transactional and frictional costs.

10.164 We recognised that there were some risks to bilateral agreements between insurers as there was a possibility that insurers might reach a mutual understanding to underprovide in order to benefit from lower costs. While we did not find that existing bilateral agreements between insurers in relation to temporary replacement vehicles had had this effect (see paragraph 6.21), we accepted that a major expansion in such bilaterals would reduce the number of non-fault claimants being referred to CHCs, which provide some competitive constraint on insurers in particular in relation to quality of service, and hence would increase this risk.

- *Benefits of a portal*

10.165 In our view, the GTA has generated some savings in transactional and frictional costs (see paragraph 6.20). Many insurers and CHCs told us that a GTA portal for the administration of CHC claims would enhance these savings and we noted that some progress had been made in developing such a portal. It appeared to us that both CHCs and insurers had the incentive to create a portal which would reduce transactional costs, and some frictional costs, on both sides, and therefore we saw no reason for us to intervene to enforce it. Rather, we would simply encourage CHCs and insurers within the GTA to continue with their work on a portal.

- *Future review*

10.166 The CMA has an ongoing duty to keep markets under review, and will continue to monitor the PMI market. We noted, in particular, that the provision of post-accident services to non-fault claimants was in a state of flux. We found, for example, that insurers handled non-fault repair claims very differently, and many were considering changing their current practices. Insurers told us that significant changes might flow from the recent (February 2014) Court of

[23] We noted that, for those insurers which were not currently adopting the practice of marking repair bills up to retail rates and were therefore suffering from receiving non-fault repair bills from other insurers which were higher than the non-fault repair bills they submitted, the solution to removing this asymmetry was in their own hands through reaching bilateral agreements with the other insurers.
[24] We noted that, if there were to be an increase in the number of bilateral agreements between insurers, it might be helpful for the industry to develop a standardised template for such agreements, which could then be adapted during negotiations to reflect the terms agreed between the parties. It appeared to us that this might help to reduce the costs involved in establishing bilateral agreements.

Appeal decision in *Coles v Hetherton* (see paragraph 3.13). It appeared to us that the judgment in this case might lead to substantial changes in the market for vehicle repairs if more insurers decided to claim at retail rates rather than on the basis of the costs actually incurred (‘wholesale rates’). It also appeared to us that if practices changed in relation to repairs, they might also change in relation to the provision of temporary replacement vehicles.

10.167 Overall, while we cannot commit the CMA to a future review, we noted that, if the problems we observed were to increase over time and the size of the consumer detriment were to increase, there would be a strong case for the CMA to revisit this industry, and possibly to reconsider some of the remedies which we have decided not to pursue, in the future.

11. Remedies to address the AEC arising in the sale of add-on products (theory of harm 4)

Summary of remedies we consulted upon

11.1 In our Remedies Notice and provisional decision on remedies, we consulted on measures to give consumers more transparent information about NCBs and NCB protection (Remedy 4B), and on recommendations to the FCA regarding:

(a) provision of add-on pricing by PMI providers to PCWs (Remedy 4A); and

(b) clearer descriptions of add-ons (Remedy 4C).

We set out in Appendix 11.1 the views of parties in response to these consultations.

Remedy measures that we have decided to take forward ourselves

11.2 In this section we first set out those measures which we have decided to take forward ourselves. These measures are in relation to Remedy 4B, which concerns giving consumers more transparent information about NCBs and NCB protection. We decided to take forward these measures ourselves because we considered the issues relating to NCB and NCB protection to be particularly significant. Moreover, the issues we identified relating to PMI-related add-ons more generally apply also, to some extent, to add-ons across all general insurance products. We discuss later those measures in relation to PMI-related add-ons more generally which we have decided to recommend to the FCA to take forward.

Transparent information concerning no-claims bonus (Remedy 4B)

Description of the remedy

11.3 In our provisional decision on remedies we proposed that insurers and brokers should be required to provide the following information at the time when the decision to purchase NCB protection is made:

(a) the implied price of NCB protection;

(b) the step-back procedures, ie what happens to the number of NCB years with and without NCB protection in the event of one or more claims; and

(c) the average NCB discount according to the number of NCB years.

11.4 We also proposed that the statements set out in paragraph 11.48 are presented on PCWs when consumers seek more information about NCB protection, and provided by insurers and brokers at the point at which consumers purchase NCB protection.

How the remedy addresses the AEC and/or resulting customer detriment

11.5 The aim of this remedy is to reduce the significant informational asymmetries between insurers and consumers when purchasing NCB protection. Better information relevant to the purchase of NCB protection will allow consumers to understand and assess better the costs and benefits of taking out this product. This would reduce the risk of customers deciding to purchase (or not to purchase) NCB protection on the basis of an incorrect understanding. This will also improve competition constraints on insurers when selling NCB protection, which we would expect to lead to a reduction in prices for NCB protection to reflect more closely the value of the product to consumers.

Views of parties

11.6 The majority of parties supported the principle of providing better explanations to consumers of the benefits of NCB protection. However, specific concerns were raised about how this information should be provided, which we discuss in the relevant subsections below.

Design issues

11.7 In determining the design of this remedy, we considered several different options, which we grouped into three different areas, as follows:

(a) provision of information on PCWs (when comparing products):

(i) require quotes on PCWs to include the insurance premium before and after the NCB discount is applied; and/or

(ii) require PCWs to set out separately the insurance premium with and without the cost of NCB protection;

(b) provision of information by an insurer/broker (at the point at which consumers purchase NCB protection):

(i) require disclosure of the insurer's NCB scales or typical NCB discounts (ie the percentage discount for each number of NCB years, on average for that insurer); and/or

(ii) require disclosure of the insurer's 'step-back procedures' (ie what would happen to a consumer's number of NCB years as a result of one or more claims), with and without NCB protection; and

(c) provision of clearer statements by PCWs and insurers/brokers to inform consumers about how NCB protection works.

11.8 We discuss each of these areas in turn.

11.9 To assist us in our consideration of these options, we engaged GfK to undertake qualitative consumer research to test different ways of providing consumers with information on NCB and NCB protection. Our assessment was informed by the results of this research.[1]

- *Provision of information on PCWs*

11.10 We considered whether, when consumers obtain a quote for PMI from a PCW and are considering taking out NCB protection, it would be helpful for them to be provided with:

(a) the premium before and after the NCB discount is applied (ie showing the benefit of their NCB); and/or

(b) the premium with and without NCB protection (ie showing the implied price of NCB protection).

11.11 We considered whether this information would enable consumers to compare the cost of NCB protection with the value of the NCB discount and so be able to make better purchasing decisions.

11.12 However, some insurers told us that this information might give consumers a misleading impression of the value of NCB protection as a consumer might not lose all their NCB discount in the event of a claim. Insurers also told us that quotes for PCWs would have to be generated up to three times, ie *(a)* the premium with no NCB discount; *(b)* the premium with the relevant NCB discount but without NCB protection; and *(c)* the premium with the relevant NCB discount and with NCB protection. Some insurers told us that there was not necessarily a separate 'price' for NCB protection as the selection of NCB protection by a consumer provided information about the consumer's risk profile and so could be used by an insurer in determining the consumer's PMI

[1] See Survey of Private Motor Insurance Policyholders: Qualitative Research Findings.

quote. There was therefore an implied price for NCB protection but not a stand-alone price.

11.13 Some insurers told us that PCWs would need to gather all three quotes from each of the PMI providers on their panel, which would increase the cost of providing quotes to PCWs and could increase the time taken by consumers to search for PMI quotes. Several insurers told us that significant changes to systems would be required to implement this proposal.

11.14 GfK found that if we were to require PCWs to present consumers with their PMI quote before and after their NCB discount had been applied, this would not be well understood and would not be considered by most consumers to be of much help in their purchasing decision. GfK found that consumers were primarily interested in the final price they paid for their PMI and they saw their NCB discount as one input into that price. GfK found that the extent of the NCB discount was more relevant when considering whether to purchase NCB protection.

11.15 We also recognised that the information in paragraph 11.10 was likely to be only partially effective because it would not provide the consumer with any information about what would happen to their NCB years (or discount) in the event of one or more claims (so-called ‘step-back procedures’).

11.16 In our view, as NCB protection cannot be sold separately from the PMI policy (because it is only sold as an add-on), there would be limited value in enhancing comparability on a PCW. Instead, consumers need to understand the value of NCB protection when deciding whether or not to purchase it through their chosen insurer or broker. As the purchasing decision is typically made on the insurer’s/broker’s website (or over the telephone with the insurer/broker), this would seem the more appropriate place to require the provision of better information.

11.17 Therefore, we decided not to pursue further the provision of pricing information on PCWs (though we are proposing that the descriptions of NCB protection available on PCWs include specific statements (see paragraphs 11.45 to 11.54)).

- *Provision of information by an insurer/broker (at the point at which consumers purchase NCB protection)*

11.18 We considered two options for providing consumers with more information about the costs and benefits of NCB protection at the point of purchase:

(a) disclosure of the insurer’s NCB scales or typical NCB discounts; and/or

(b) disclosure of the insurer's step-back procedures.

We considered whether some or all of this information, in parallel with informing consumers about the implied price of NCB protection (see paragraph 11.10*(b)*), would help consumers to understand what NCB protection is protecting and how much it costs, and would enable them to make better-informed purchasing decisions. This information would be provided when NCB protection is being offered to the consumer by the insurer/broker or, if NCB protection has already been selected, prior to confirming the purchase of this product.

- *NCB scales or typical NCB discounts*

11.19 It appeared to us that without information about the NCB discount which their number of NCB years had earned, consumers were unable to value NCB protection. However, the majority of insurers who responded to the Remedies Notice told us that it was not practicable for them to publish an NCB scale showing the percentage discount applicable to the number of NCB years. Many insurers told us that they used a number of rating factors to determine a policyholder's NCB discount with the result that two policyholders with the same number of NCB years might not have the same NCB discount.

11.20 We did not find any competition issues arising from the way in which insurers competed in pricing basic PMI policies and, for this reason, we did not wish to interfere in this process. We also did not identify an AEC due to the design of NCB protection as a product. However, we did find an AEC due to the asymmetry of information between consumers and PMI providers. Consumers do not have a good understanding of the value of their NCB years and are often provided with little information about the discount their number of NCB years has earned. Therefore, GfK explored in its research whether it would be helpful to consumers to require each insurer to publish a table showing a 'typical' NCB discount for each number of NCB years. Figure 11.1 illustrates this information.

FIGURE 11.1

Example disclosure of typical NCB discounts

Number of years No Claims Bonus at this renewal	Typical NCB discount
One year NCB	5%
Two years NCB	10%
Three years NCB	20%
Four years NCB	30%
Five years NCB	40%
Six years NCB	45%
Seven years NCB	50%
Eight years NCB	55%
Nine years or more NCB	60%

Source: CMA.

11.21 This information would be specific to each insurer and would be updated by the insurer annually. By 'typical', we meant the average (mean) NCB discount which was awarded by the insurer across the PMI policies it had written in the last year for each number of NCB years.

11.22 We would expect this average to be a reasonable guide for many consumers when deciding whether to purchase NCB protection, while not preventing insurers from determining the level of NCB discount they award to each individual customer differently, according to their specific risk factors.

11.23 GfK found that there was a very positive response from its sample of consumers to this information. It said that consumers found this information helpful and easy to understand. GfK found that there was some confusion over the phrase 'typical discount', so we would propose instead to refer to it as the average discount from that insurer.

11.24 In response to our provisional decision on remedies, the ABI and most of the ten largest insurers told us that a table showing average discounts could easily lead consumers into thinking that they would receive a discount similar to the one provided in the table, and while this might be true for some consumers, it would not apply to all. DLG said that, for this reason, providing a table showing average discounts would almost certainly conflict with the FCA's requirements that any communications made to customers should be 'clear, fair and not misleading'. Aviva noted that the range around the average percentage NCB discount was large, [✂]. DLG also suggested that if insurers were able to disclose a range of discounts it would be more likely that the information would be meaningful to consumers.

11.25 The ABI also said that it might be preferable for insurers to publish average NCB discounts on their generic website pages rather than to disclose them at the point of sale of NCB protection, as many consumers researched PMI products outside the purchase process. DLG told us that providing consumers with information on average NCB discounts during the telesales process would cause confusion for consumers and be likely either to trigger a number of additional questions or, because of the volume and complexity of the information being provided, to be largely ignored by consumers. The ABI and DLG also told us that a requirement to provide annual historical averages, including the previous year's average discount could increase the risk of the information being provided to consumers being inaccurate if an insurer changed its NCB pricing. They suggested that insurers should therefore be free to alter the information on average discounts provided to consumers.

11.26 Overall, we expected that this measure would lead to consumers making better-informed purchase decisions, improving competition in the sale of NCB protection. We recognised that this measure would not completely remove the information asymmetry between insurers and consumers because an average discount would not reflect perfectly the discount which an individual consumer would actually receive. We accepted that this might cause some consumers not to purchase NCB protection when, with better information relevant to them, they might do so, and might cause other consumers to purchase NCB protection when, with more relevant information relevant to them, they might not. While we recognised that this continuing information asymmetry was not ideal, in our view it was important that consumers were given some information when purchasing NCB protection about the value of what the product protected. At present, consumers are given little or no such information and, in our view, the disclosure of average NCB discounts, while imperfect, would represent a significant, easily-understandable improvement. We considered the proposal to provide consumers with a range of discounts for each NCB year but did not believe that this would be any more informative to consumers than the average and was more likely to be less informative, particularly if the range was very wide.

11.27 We discussed this measure with the FCA which told us that, in complying with our proposed measure, firms should consider how best to present the information in a way which supported consumers' decision-making. The FCA said that the way information was provided had to be in line with requirements in ICOBS and its Principles for Businesses, which stated that a firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

11.28 Overall, we concluded that insurers and brokers should make available to consumers a table showing the average NCB discount applicable to each NCB year at the point of sale of NCB protection.

11.29 Figure 11.1 indicates how the information could be presented in a table. Although the final format will be a matter for consultation with the parties, we expected that the table would be provided in a format similar to, if not the same as, Figure 11.1. The discounts should be based on the insurer's average for each NCB year, reflecting the policies written in the previous calendar year, and should be updated annually.

11.30 We decided to leave it to insurers and brokers to decide whether and, if so, how to make this information available on their website prior to the point of sale. For telesales, insurers and brokers would be required to provide to individuals the average discount for that individual's current NCB years. They would also be required to direct consumers to where they can find the table of information so that they can consider it in the cooling-off period.

11.31 Although we believed that the disclosure of average NCB discounts for each NCB year would be a significant improvement compared with the current information available to consumers on NCB protection, we did not believe that this on its own would be particularly informative, as, although it would give some indication of the value of NCB years, it would not give the value of protecting these NCB years. Therefore, we considered the need to require disclosure also of *(a)* each insurer's step-back procedures (see paragraphs 11.32 to 11.1), and *(b)* the implied price of NCB protection (see paragraph 11.37).

- *Stepback procedures*

11.32 We considered whether, when consumers obtain a PMI quote and are considering taking out NCB protection, it would be helpful for them to be given information as to what would happen to their NCB years and NCB discount in the event of one or more claims in both the situations where NCB protection had been bought and the situation in which NCB protection had not been bought.

11.33 GfK's research found that there was a strong desire for information on an insurer's step-back procedures. Some respondents said that this information was essential for consumers as it challenged the perception that NCB protection provided unlimited protection. Other respondents said that it helped them understand how many claims they could make in a year before their NCB years would be affected. However, it was also evident from this work that the way in which this information was presented was very important in helping consumers understand the value of the product. In particular, we found that showing the average NCB discount applicable to each NCB year in the same table as the step-back procedures could be confusing and respondents preferred to see information on average NCB discounts presented separately.

11.34 The ABI and most of the top ten insurers told us that they supported the disclosure of step-back procedures as they believed this information would help customers to understand what would happen to their number of NCB years in the event of a claim with and without NCB protection. However, the ABI and several insurers told us that each insurer should have flexibility to determine how to present this information, in order to make the information easy for consumers to understand and without overloading them. The ABI noted that the FCA's ICOBS rules required insurers to provide consumers with clear information to help them make informed decisions and that insurers would have to comply with this in their presentation of their step-back procedures.

11.35 Overall, we decided that an insurer's step-back procedures should be provided to consumers. We judged that it would be most effective for the step-back procedures to be set out according to each individual consumer's circumstances so as to avoid a complex table of step-back procedures for different NCB years. Therefore, we concluded that at the point at which NCB protection is purchased, each consumer should be shown what would happen to their NCB years in the event of one or more claims in both the situation where NCB protection had been bought and the situation in which NCB protection had not been bought. Figure 11.2 indicates how the information could be presented in a table for a consumer with three NCB years. Although the final format will be a matter for consultation with the parties, we expected that the table would be provided in a format similar to, if not the same as, Figure 11.2. We decided to leave it to insurers and brokers to decide whether and, if so, how to make this information available on their website prior to the point of sale.

FIGURE 11.2

Example disclosure of step-back procedures

	No Claims Bonus at next renewal date <u>without</u> NCB protection			No Claims Bonus at next renewal date <u>with</u> NCB protection		
Number of years No Claims Bonus at this renewal	1 claim in next 12 months	2 claims in next 12 months	3 claims in next 12 months	1 claim in next 12 months	2 claims in next 12 months	3 claims in next 12 months
Three years NCB	One year	Nil	Nil	Three years	One year	Nil

Source: CMA.

11.36 In our view, while on its own information on how an insurer's step-back procedures affected a consumer's NCB years would be partially helpful, it was likely only to be really effective in informing consumers' decision-making when combined with an indication about the level of NCB discount earned by the NCB years and the implied price of NCB protection. We therefore decided that the information on an insurer's step-back procedures should be provided to consumers together with a table of the insurer's average NCB discounts (see paragraphs 11.19 to 11.31), but not in the same table (see paragraph 11.33). Although the final format will be a matter for consultation with the parties, we expected that the table would be provided in a format similar to, if not the same as, Figure 11.2 (see paragraph 11.35). We also considered the need to provide information relating to the implied price of NCB protection (see paragraph 11.37).

- *Implied price of NCB protection*

11.37 Although aware of the challenges of finding a price for NCB protection (see paragraph 11.12), it appeared to us that information about an insurer's step-back procedures and average discounts according to a consumer's number of NCB years would need to be presented alongside a 'price' in order for consumers to be able to make an informed purchasing decision. In our view, a statement explaining how much purchasing NCB protection had added to the price of the consumer's PMI premium was the most appropriate price to show. This implied price would be the difference in the cost of the same PMI policy with NCB protection and without it. We recognised that this would require an insurer or broker to make two quotations and to calculate and present an implied price on the basis of the difference between them.[2] However, as currently if a consumer requests an initial quote and then subsequently adds NCB protection the insurer or broker has to recalculate the premium, the only additional requirement introduced by this measure is that insurers and brokers would be required to calculate the difference in all cases.

- *Summary of the information we are requiring to be presented to consumers*

11.38 We concluded that a consumer should be provided with the following statement (using illustrative figures in this example):

> You are considering whether to purchase NCB protection. This would increase your premium by [£20]. You have a current NCB of [3] years. The tables below show: (i) the average NCB discount we

[2] The alternative for an insurer would be to cease using a consumer's decision to purchase NCB protection as a risk factor. If that were the case, one quotation could be provided with a simple add-on price for NCB protection.

awarded to our motor insurance policyholders last year according to their number of NCB years; and (ii) what would happen to your NCB years if you were to make one or more claims in the next 12 months with and without this protection.

We decided not to specify exactly how insurers should present the information on average NCB discounts and step-back procedures. However, we expected that the tables which would be set out below the statement above would be provided in a format similar to, if not the same as, Figures 11.1 and 11.2 (respectively), although the final format will be a matter for consultation with the parties.

11.39 This information would be provided to the consumer by the insurer/broker when making the offer of NCB protection; or, if NCB protection has already been selected by the consumer, prior to confirming the purchase of the product.

11.40 We believed that this package of information would ensure that consumers had the three pieces of information they most needed when assessing the value of NCB protection and making their purchase decision:

(a) the implied price of NCB protection;

(b) the average NCB discount according to the number of NCB years; and

(c) the step-back procedures, ie what would happen to the customer's number of NCB years with and without NCB protection in the event of one or more claims.

11.41 For telesales, we concluded that the provision of information should be broadly the same, but would need to reflect the fact that it was being provided orally rather than visually. We decided that insurers and brokers should be required to tell consumers prior to purchasing NCB protection:

(a) the implied price of NCB protection;

(b) the customer's current number of NCB years;

(c) the average NCB discount for that number of NCB years; and

(d) how many claims could be made before the customer's number of NCB years would be affected, both with and without NCB protection.

In this case, for *(c)* and *(d)*, because this was a subset of the information provided in paragraphs 11.38 to 11.40, insurers and brokers would also be required to direct consumers to where they could find the fuller set of information so that the consumer could consider it in the cooling-off period following the receipt of the policy documents.

11.42 We believed that these measures would be practicable and effective. We did not require insurers to apply standard NCB scales when pricing PMI policies, nor to disclose a stand-alone price for NCB protection. We believed that the information we were requiring to be displayed was information which was either currently available to insurers or should be easily available to them.

- *Rejection of a proposed alternative version of this remedy*

11.43 In response to the provisional decision on remedies, one insurer proposed an alternative version of the statement in paragraph 11.38, as follows:

> Your premium is [£1,000]. This reflects your current NCB of [3] years. If you had no NCB your premium would have been [£1,200]. You have opted to include NCB protection. This has increased your premium by [£20] which is included in the premium above. NCB protection means that, as long as you have no more than [2] accidents over a [3] year period, you will retain your current NCB.

11.44 The main differences in this proposed version compared with our measure were in the third and last sentences. We did not adopt this alternative version for the following reasons:

(a) On the third sentence:

(i) GfK's research showed that consumers did not understand well or did not find it helpful to be told what their premium would be with 'no NCB' because of the confusion between NCB years/discounts and NCB protection.

(ii) Showing the price with and without the NCB discount was likely to be misleading if a consumer made a claim and the step-back procedures meant that they did not lose the whole of their NCB discount.

(b) On the last sentence:

(i) The statement could be taken to imply that the monetary value of the NCB discount would be protected.

(ii) For some insurers, the step-back procedures would be more complex to describe and would be better set out in a separate table or statement.

- *Clearer statements to inform consumers about how NCB protection works*

11.45 GfK's research confirmed that there was a general lack of understanding among consumers about what NCB protection protects. We found that many consumers did not appreciate that their premiums might increase following the submission of a non-fault claim (as it affects their risk profile) and others did not appreciate that NCB protection did not provide unlimited protection (ie against all claims made in any given year).Therefore we considered two further ways in which we could improve consumers' understanding:

(a) by explaining what factors affect an NCB discount; and

(b) by explaining the benefits of NCB protection.

11.46 Insurers told us that a consumer's NCB discount was based on their number of NCB years and their risk profile, and therefore was affected by similar variables to those which were considered in determining their PMI premium. We believed that it would improve consumers' understanding of NCB protection if this were known. We believed this could be achieved through a short specific disclosure statement.

11.47 We also thought that, at the same time, it should be possible to explain to consumers clearly the benefits of NCB protection.

11.48 Accordingly, we prepared short statements which we believed could be displayed on PCWs' websites and on insurers' and brokers' websites, and which we believed could be read out by call handlers in telesales or sales staff when purchases are made in person:

(a) a statement about what NCB protection protects:

(i) to appear on a PCW: 'No Claims Bonus protection varies between insurers but in general it allows you to make one or more claims before your number of No Claims Bonus years falls (please consult the insurer's website for details of its policy)'; and

(ii) to appear on an insurer's and broker's website: 'No Claims Bonus protection allows you to make one or more claims before your number of No Claims Bonus years falls (please see our step-back procedures for details' [with a link to these step-back procedures]); and

(b) a statement about what NCB protection does not protect, to be provided on a PCW, on an insurer's/broker's website and to be read out by call handlers in telesales: 'No Claims Bonus Protection does not protect the overall price of your insurance policy. The price of your insurance policy may increase following an accident even if you were not at fault.'

11.49 In response to our provisional decision on remedies, the ABI and most of the ten largest insurers told us that these statements should not be prescribed and that insurers should be allowed to decide how best to provide information on NCB years/discounts and NCB protection to consumers in line with the FCA's rules. While there were no specific objections to the statement in paragraph 11.48*(a)*, two insurers told us that they had concerns with the statement in paragraph 11.48*(b)*:

(a) DLG told us that the use of accident history as a risk factor was a separate matter from NCB protection. It said that the statement did not make it clear that there were many factors which were taken into account in pricing risk and that the statement might not be accurate for all insurers.

(b) Aviva told us that it would not be accurate for it to give a statement saying 'The price of your insurance policy may increase following an accident even if you were not at fault' for all its policies as its guaranteed no claims discount cover guaranteed that a customer's premium would not increase as a direct result of a claim (fault or non-fault).

11.50 The ABI proposed an alternative version of the statement in paragraph 11.48*(b)*: 'No claims bonus protection does not protect the overall price of your insurance policy. The price of your insurance premium could still increase in the event of a claim.'

11.51 Overall, despite the concerns raised, we continued to believe that the statements in paragraph 11.48*(a)* and *(b)* would be effective in helping consumers understand better the value of NCB protection. We believed that these statements expressed simple facts which would explain to consumers something about which many are unaware, and would provide information which could be significant to consumers when making purchasing decisions in relation to NCB protection. Therefore, we believed that they would make a helpful contribution to a package of remedies seeking to reduce the extent of the information asymmetry between PMI providers and consumers in relation to NCB and NCB protection. We also thought the use of standardised statements would be helpful as it would ensure that a clear and consistent message was delivered to all consumers.

11.52 Accordingly, we decided to require that the statements in paragraph 11.48*(a)* and *(b)* are:

(a) included on PCWs when consumers click for more information on NCB protection; and

(b) presented by insurers and brokers to consumers before NCB protection is purchased.

11.53 We decided that the statements should be presented as set out in paragraphs 11.48*(a)* and *(b)*, although PCWs, insurers and brokers would be free to add further explanations if they wished.

11.54 We decided that if any PCW, insurer or broker believed it could not truthfully make any of these statements it would be able to submit an alternative form of words to us for approval.

- *Summary of proposed remedy*

11.55 We decided that the following information should be provided by insurers and brokers at the point at which NCB protection is purchased:

(a) the implied price of NCB protection;

(b) the average NCB discount according to the number of NCB years; and

(c) the step-back procedures, ie what would happen to the customer's number of NCB years with and without NCB protection in the event of one or more claims.

For telesales, the information set out in paragraph 11.41 should be provided.

11.56 We also decided that the statements in paragraph 11.48*(a)* and *(b)* should be presented on PCWs when consumers seek more information about NCB protection, and provided by insurers and brokers before NCB protection is purchased.

11.57 We believed that the various elements of this remedy would work in combination to increase consumers' understanding of NCB and NCB protection, enabling them to understand better the costs and benefits of purchasing this product. We expected this to reduce the information asymmetry between insurers and consumers and so increase competition between insurers when selling NCB protection. We expected this to lead to a reduction in prices for NCB protection so that they more closely reflected the value of the product to consumers. For these reasons, we believed that this remedy would comprehensively and effectively address the AEC we had identified.

Implementation issues

11.58 In assessing the effectiveness of Remedy 4B we also considered the following factors:

(a) the means by which the remedy would be implemented;

(b) the timeliness of the remedy;

(c) the consistency of the remedy with other laws and regulations; and

(d) the means by which the remedy would be monitored and enforced.

- *Implementation*

11.59 In our view, as this package of remedies in relation to NCB protection would need to cover insurers, brokers and PCWs, and potential new entrants, we would need to implement it by an enforcement order.

- *Timeliness*

11.60 The main factor which would affect the timeliness of the remedy is the period of time required by insurers and brokers to amend their systems to generate the necessary information. In its response to our provisional decision on remedies, the ABI told us that this could take more than six months. One insurer told us that the implementation of this remedy could take up to 12 months from the date of an enforcement order.

11.61 We noted that there would be a period between the publication of our final report and the making of an enforcement order (a statutory maximum of six months, extendable by four months) during which any administrative and IT changes could be initiated in advance of the enforcement order being made. Since all of the information we are requiring to be disclosed should already be available to insurers and brokers, we decided that these remedy measures should be implemented within six months from the date of the order.

11.62 We found that changes to call centre scripts for telesales did not require substantial time and therefore we did not believe this should extend the timescale for the implementation of the remedy.

- *Laws and regulations*

11.63 We did not identify any inconsistency between this remedy and other relevant laws and regulations.

- *Monitoring and enforcement*

11.64 The CMA will assume responsibility for monitoring compliance with this remedy. To assist it with monitoring the accurate calculation of average NCB discounts, we decided that insurers and brokers should be required to submit an annual compliance statement setting out the information on their average NCB discounts for the previous year.[3]

11.65 In light of the FCA's ongoing development of remedies to address concerns in general insurance add-ons (see paragraph 11.99), we recommend that the FCA reviews the proposed remedy within two years of the date of the order in order *(a)* to assess how well the remedy is working in meeting consumers' needs; and *(b)* to ensure consistency with its wider regime. In the event that the FCA, in its review, identifies aspects of the remedy which are not working well, or which it believes need to be varied or revoked, it can report its findings to the CMA, which can then consider whether a change of circumstances has resulted such that a review of the remedy is necessary.

Conclusions on the effectiveness of Remedy 4B

11.66 Overall, we concluded that the measures summarised in paragraphs 11.55 and 11.56, supported by the monitoring requirements described in paragraph 11.64, would be effective in remedying the AEC which we had found in relation to NCB protection (under ToH 4).[4]

Assessment of relevant customer benefits (Remedy 4B only)

11.67 In deciding the question of remedies, the CMA may 'have regard to the effect of any action on any relevant customer benefits (RCBs) of the feature or features of the market concerned'.[5] RCBs are defined in the Act and are limited to benefits to relevant customers in the form of *(a)* lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or *(b)* greater innovation in relation to such goods or services. The Act provides that a benefit is only an RCB if the CMA believes that: *(a)* the benefit has accrued as a result (whether wholly or partly) of the feature or features concerned or may be expected to accrue within a reasonable period of time as a result (whether wholly or partly) of that feature or those features; and *(b)* the benefit was, or is, unlikely to accrue without the feature or features concerned.

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[3] These compliance statements would be in a standard format and would be required to be submitted at the same time each year. They would be required to be signed off by a nominated compliance officer.
[4] The asymmetry of information is the main feature which affects NCB protection. The other feature that we identified as leading to an AEC under ToH 4 (difficulties faced by consumers in trying to compare the aggregate price of the PMI policy and the price and terms of their chosen add-ons across different motor insurers) is much less significant to NCB protection given that this product can only be purchased from the same insurer as the PMI policy and PCWs do enable comparison of the aggregate price of the PMI policy with and without NCB protection.
[5] The Act, section 134(7).

Views of parties

11.68 No party made explicit reference to RCBs but many insurers and brokers said that consumers valued highly their NCB years/discounts and NCB protection.

Our assessment of RCBs

11.69 We did not identify any RCBs arising from the information asymmetry between PMI providers and consumers for NCB protection. We expected our remedy measures to lead to better-informed purchasing decisions for this product.

Proportionality of the remedy (Remedy 4B only)

11.70 In this subsection, we set out our views on the proportionality of our remedy measures in relation to NCB protection. This section relates only to Remedy 4B as the FCA will have to consider the proportionality of any remedies it wishes to implement pursuant to considering our remedies 4A and 4C (see paragraphs 11.84 to 11.110).

Effective in achieving its aim

11.71 For the reasons set out in paragraph 11.57, we believed that Remedy 4B would comprehensively and effectively address the AEC we had identified in relation to NCB protection.

No more onerous than necessary

11.72 We considered whether the remedy could be effective without all of the proposed measures but, in our view, it would not be possible to achieve an effective solution without all elements. We noted that we had not included certain possible measures (such as the provision of information on PCWs) where we believed these measures did not add to the effectiveness of the remedy. We also noted that the measures we had included were all needed to provide consumers with information necessary to make an informed decision. In our view, a remedy with only some of these measures would not be effective (see paragraph 11.31).

Least onerous if there is a choice

11.73 We did not identify any alternative effective remedies and, therefore, we believed we had identified the remedy which imposed the least cost and was the least restrictive.

Does not produce disadvantages which are disproportionate to the aim

11.74 We considered whether our remedy was likely to produce disadvantages (ie costs) which were disproportionate to the aim of remedying the AEC and the resulting customer detriment (ie benefits).

Benefits

11.75 We noted that, in 2012, the aggregate NEP for NCB protection for seven of the ten largest insurers was £152 million, which equated to 2.7% of their total NEP (see Appendix 7.1, Table 3). This suggested that, in 2012, total annual premiums for NCB protection across the whole PMI market were approximately £210 million.

11.76 We also found that there was a limited understanding of NCB years/discounts and how NCB protection worked. We noted that, while a high proportion (77%) of respondents to our customer survey thought they had a good understanding of this product, 59% 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 (see paragraph 7.34*(b)*). In addition, our assessment of the descriptions of NCB protection given by providers on their websites found that none of the providers explained that the effect of an accident typically increased a consumer's risk premium, irrespective of fault and regardless of their level of NCB. GfK's market research reinforced these findings, demonstrating a lack of consumer understanding about how NCB protection worked and what value it had.

11.77 Based on the evidence in paragraphs 11.75 and 11.76, it appeared to us that the premiums spent on NCB protection by consumers who had a limited understanding of the product were likely to amount to over £120 million a year.[6] We did not place significant weight on this precise figure but it suggested to us that consumers were currently paying substantial amounts (in aggregate) on a product many did not understand. In our view, by improving consumers' understanding of NCB protection, the asymmetry of information would be reduced and consumers would be better able to make informed purchasing decisions.

[6] 59% of £210 million. We have used 59% on the basis that those who said they understood the product well were most likely to consider purchasing it. In addition, 23% of respondents to our survey admitted that they did not understand NCB protection well. Therefore we believed our estimate was a conservative estimate and the figure could be higher.

Costs

11.78 We identified two costs arising from the remedy: *(a)* costs incurred by insurers, brokers and PCWs in updating their websites and telephone scripts to reflect the information required; and *(b)* costs arising due to consumers, with more information, taking longer to purchase NCB protection.

11.79 Insurers and brokers did not provide us with evidence on the costs of updating their websites or call scripts but in our view they were likely to be substantially less than the costs of providing the required information to PCWs (which insurers said would be substantial (see paragraph 11.13)). The remedy required only the generic descriptive statements about NCB protection to be provided on PCWs (see paragraph 11.48), which we did not expect to be costly, with the remaining information provided by the insurer directly to the consumer using mainly electronic systems.

11.80 With regard to the cost of additional consumer search time, we noted:

(a) For insurers and brokers, adding 1 minute to a call was likely to cost around £1.6 million per year across the industry.[7]

(b) For consumers, we used our estimate of the value of time in Section 12 (10p per minute) (see paragraph 12.125) to estimate that for every extra minute on average taken by consumers in making their NCB protection purchase decision, the cost would amount to around £1.4 million per year.[8] However, it was difficult to predict how much extra time consumers would spend making this decision in light of the additional information. In Section 12 we note evidence from a PCW which suggested that searches took an average of 5 minutes. As NCB protection was only one part of the PMI purchasing process and the information required by our remedy was designed to be relatively simple to understand, it seemed to us unlikely that consumers on average would spend more than 1 or 2 minutes extra due to the additional information. Therefore we thought that the additional

[7] We estimated this cost on the following basis: approximately 25 million PMI policies are purchased every year (see paragraph 2.4); actual take-up rates of NCB protection are between [✂] and [✂]%, with an unweighted average of 49% (Appendix 7.1, paragraph 74), suggesting that some consumers might not even consider purchasing NCB protection though, in our calculations, we have assumed conservatively that all consumers consider the information presented; according to our survey, approximately 50% of policyholders purchased their current insurance policy either by phone or in person and, on average customers carry out a comparison of policies and/or providers every 1.8 years; the cost of employing a call centre worker is approximately £25,000 per year, which, on the basis of working 240 days per year and 7.5 hours per day, means that the total cost of increasing call lengths by one minute per call was: 25 million (policies) x 50% (by phone or in person) x 55% (every 1.8 years) x (£25,000 / 240 days / 450 minutes) = £1.6 million.

[8] Approximately 25 million PMI policies are purchased every year (see paragraph 2.4). Actual take-up rates of NCB protection are between [✂] and [✂]%, with an unweighted average of 49% (see Appendix 7.1, paragraph 74). Therefore, some consumers might not even consider purchasing NCB protection. However, in our calculations, we have assumed conservatively that all consumers consider the information presented. In addition, we have taken account of the fact that, on average customers carry out a comparison of policies and/or providers every 1.8 years.

cost of time to consumers would be unlikely to be much more than £1.4 million per year.

Balance of benefits and costs

11.81 Having evaluated the potential benefits and costs of Remedy 4B, we considered whether the costs were likely to be disproportionate to the benefits. We found that our estimate of the costs was low (see paragraphs 11.78 to 11.80). When set against an uncertain but potentially high detriment (see paragraphs 11.75 to 11.77), which we believed would be effectively addressed by the remedy (see paragraph 11.66), we judged that the benefits of the remedy were likely significantly to outweigh its costs.

Conclusions on proportionality of the remedy

11.82 Based on our assessment in paragraphs 11.70 to 11.81, we concluded that the beneficial effects of Remedy 4B were likely significantly to outweigh its costs. Therefore we concluded that this package of remedies represented a proportionate solution to the AEC and the resulting customer detriment we had found in relation to NCB protection.

Remedy measures for which we have decided to make recommendations

11.83 We have decided to make recommendations to the FCA in relation to Remedies 4A (provision of add-on pricing by PMI providers to PCWs) and 4C (clearer description of add-ons). In this subsection, we explain our reasons for this decision.

Provision of add-on pricing by PMI providers to PCWs (Remedy 4A)

Description of the remedy

11.84 In the Remedies Notice we suggested that a possible remedy would be to require each PMI provider which wishes to offer add-on products to provide pricing information on all the add-ons it offers to the PCWs which list its PMI policies. The PCWs would then be able to display the full range of add-ons available from each PMI provider with prices, so that a consumer could compare the total price of the policies offered by different PMI providers including the add-ons they want. A PCW could choose to rank the policies available by the total price of the package selected by the consumer.

How the remedy addresses the AEC and/or resulting customer detriment

11.85 In Section 7, we identified two features of the market which distorted competition by making it more difficult for consumers to identify the best-value offers in the market and to make informed purchasing decisions (see paragraph 7.67).[9] This remedy would enable consumers to compare more easily the total prices offered by different PMI providers for their desired package of products and so would help them to identify the best-value offers available. This would, at least in part, address the feature we identified in Section 7 of the difficulties faced by consumers in trying to compare the aggregate price of the PMI policy and the price and terms of their chosen add-ons across different motor insurers.

Views of parties

11.86 The majority of parties who commented on this remedy supported it. However, one insurer told us that it was not persuaded that the additional information proposed under this remedy would generate better outcomes for consumers as the diverse nature of add-on products would make it difficult or impossible for customers to make meaningful comparisons between policies. There was also some concern that the remedy might lead to a standardisation of add-on products, thereby reducing innovation and consumer choice.

11.87 In addition, Aviva told us that the remedy should be applied only to the most commonly sold add-ons. It said that it might not be practical to cover all add-ons as some might not be available across the market or might have multiple cover options. Allianz told us that a consequence of the remedy might be that insurers reduce the cover provided by add-on products in order to offer the lowest overall price.

11.88 Insurers provided us with estimates of the time it would take and the costs they would incur in adapting their systems to provide pricing on all their add-ons to PCWs. These estimates ranged widely from one week to 18 months, and from £300 to £4 million, with most insurers estimating up to 12 months and up to £500,000. The PCWs told us that, while it could take several months to adapt their systems, they were dependent on receiving the necessary information from the PMI providers whose products are listed on their sites.

[9] We believed that the detriment arising from these features was likely to be most significant in relation to the sale of courtesy car cover, MLEI, NCB protection and personal injury cover and less significant for less commonly-purchased PMI-related add-ons, such as enhanced courtesy car cover and extended foreign use cover. We believed that the features were less pronounced for breakdown cover, windscreen cover and key loss cover.

Design issues

11.89 We considered the following issues relating to the design of this remedy:

(a) whether the remedy should apply to the provision of information to PCWs by brokers as well as insurers;

(b) whether the remedy should require that:

(i) insurers and brokers provide pricing on add-ons to PCWs (with no additional requirements on how PCWs should use the information); and

(ii) in addition, PCWs should use the information to rank search results by the total cost of policies, including the add-ons selected by a consumer; and

(c) whether the remedy should apply to all add-ons or the most commonly-purchased add-ons only.

- *Brokers and insurers?*

11.90 As both brokers and insurers sell PMI through PCWs, we saw no reason why the remedy should not cover brokers as well as insurers. Brokers did not raise any concerns with us on this point.

- *Requirements on PCWs*

11.91 We found that the four largest PCWs (Comparethemarket, GoCompare, Moneysupermarket and Confused) received pricing information from insurers and brokers on the five most commonly-sold add-ons: breakdown cover, courtesy car cover, MLEI, personal accident cover and windscreen cover.[10] However, for those add-ons which had options for the level of cover the consumer could select (eg an insurer might offer several options for breakdown cover), the PCWs typically received only a price for the basic (and cheapest) level of cover.

11.92 We found that the four largest PCWs displayed the pricing of add-ons in similar ways, as follows:

- If the add-on could be purchased separately and the cost was fixed, the quote screen showed the price provided to the PCW by the provider.

[10] Some receive pricing on other add-ons too (see Appendix 11.1).

- If the cost of the add-on was not fixed and was determined by the level of cover selected (eg breakdown cover), the quote screen showed only a 'price from', where the price quoted was typically the price for a basic level of cover. In this case, consumers selected the level of cover they required for the add-on when they clicked through to the provider's website.

- The quote screen ranked the search results according to the price of the core PMI policy, not including the price of the add-ons selected by the consumer.

○ *Provision of pricing information to PCWs*

11.93 It appeared to us that it would be feasible for insurers and brokers to provide PCWs with more detailed pricing information on the add-ons which have optional levels of cover, although in order to utilise this information in compiling search results PCWs would have to ask consumers to select in advance the level of cover they wanted for each of these add-ons. We were told by insurers and PCWs that they would incur costs to develop this capability (see paragraph 11.88).

○ *Need to require PCWs to use the information in a certain way*

11.94 It appeared to us that, if insurers and brokers were required to provide more pricing information on add-ons to PCWs (to include all the add-ons they offered and different prices for different levels of cover), the factors which should be taken into account in deciding whether and how PCWs might be required to use that information would include:

(a) what incentives PCWs have to use the information they are provided with in displaying the search results; and

(b) the implications of PCWs being required to use the information they are provided with to rank policies by total cost.

11.95 In our view, if the remedy were to require insurers and brokers to provide pricing information on the add-ons they offer to PCWs but did not specify how the PCWs were to use that information, there would be a risk that the PCWs would not use the information at all because:

(a) If one PCW were to rank policies by total price, including add-ons, but other PCWs did not, the first PCW would be expected to lose market share because its policy prices would appear to be more expensive.

(b) As PCWs do not (currently) generate income from the sale of add-ons, they have little incentive to display information on all add-ons.

(c) In order to allow consumers to select the level of cover wanted from add-ons which offer different levels of cover, PCWs would have to include additional questions which would increase the time it would take to complete the process of obtaining quotes.

(d) Incorporating information on many add-ons would complicate the presentation of the search results on quote screens, possibly confusing some customers.[11]

11.96 We also considered whether requiring PCWs to rank policies by total cost, including those add-ons selected by a consumer, might give rise to some adverse effects. We identified the following concerns:

(a) Add-ons might become standardised with diminished (ie 'hollowed-out') cover. If offering an add-on with enhanced features at a higher price led a provider's total package of PMI and add-ons to be ranked lower on a PCW's quote screen, the provider would have an incentive to reduce the cover provided by the policy, leading overall to reduced differentiation in the add-on products available.

(b) Consumers might not understand that the cover provided by add-ons offered by different insurers and brokers might vary if they looked only at the description of the add-ons on the PCW's website when making their purchasing decision and not at any information from the add-on providers.

(c) The quote process could become longer and more complicated if a consumer had to answer more questions before the search results were returned in order to specify the level of add-on cover they wanted.

(d) It might become more difficult for a consumer to compare the search results from PCWs with the renewal quote they received from their current PMI provider as the renewal quote might be stated without any add-ons, or with only those add-ons that the consumer previously selected, which might not be the same as the add-ons the consumer might want to select on the new occasion.

11.97 We concluded that these issues needed careful consideration in deciding whether and how PCWs should be required to display search results including the price of add-ons.

[11] We noted that this might be particularly true for consumers who access a PCW through a handheld device.

- *All add-ons or most common add-ons?*

11.98 In our view, whether the remedy should apply to all add-ons or only the most commonly-purchased add-ons was likely to depend on whether PCWs were required to use the information provided. If it were left to PCWs to decide how to use the information, it might be appropriate to require PMI providers to provide to PCWs their pricing on all the add-ons they offer. However, if PCWs were required to display information in a certain way, the remedy might be better implemented by requiring PMI providers to provide only pricing for the most commonly-purchased add-ons so that there would be consistency between PCWs and to limit the amount of information displayed on quote screens. In this case, the list of add-on products falling within the remedy would need to be specified and periodically reviewed. PCWs would clearly be able to state prices for other add-on products if they wished, assuming they managed to obtain the necessary pricing information from providers.

Conclusion

11.99 We identified several factors which we believed needed to be taken into account in the design of this remedy (see paragraphs 11.89 to 11.98). However, we were very mindful that the FCA was in the process of developing remedy proposals following its market study into general insurance add-on products, and that the FCA had recently published a report on its thematic review of insurance PCWs. In the thematic review the FCA found that PCWs did not present sufficient product information in a clear and consistent way to ensure that consumers were given appropriate information to enable them to make informed decisions. The FCA stated that it expected PCWs and providers to consider the findings of its review and to take appropriate action, and that it would follow up with the PCWs covered in its review by January 2015 to ensure that they had addressed the specific issues it had identified.

11.100 We were concerned that if we were to implement a form of Remedy 4A it might not be consistent with the outcome of either or both of the FCA's reports. Such an inconsistent outcome would not be in the interests of consumers as it would lead to a confusing display of information for different types of insurance products. Moreover, the FCA has responsibility for ensuring that when insurance products are sold by firms regulated by it, consumers are provided with appropriate information in good time so that they can make informed buying decisions. Therefore, we believed that the FCA was in a better position to ensure that an effective and proportionate remedy was implemented in relation to the concerns we had identified.

11.101 Overall, we decided not to implement this remedy ourselves but instead to recommend that the FCA considers further whether this remedy should be implemented. We recommend that the FCA considers:

(a) whether insurers and brokers should be required to provide their prices for all or certain add-ons they offer to PCWs and, if so, whether this should be for all PMI-related add-ons or only for the most commonly-purchased add-ons; and

(b) how consumers' information needs in relation to PMI-related add-ons can best be met on PCWs, in particular in relation to enabling consumers to compare prices across providers for their desired package of PMI and PMI-related add-ons.

11.102 Notwithstanding our views on these questions, as set out above, we chose, in light of the FCA's ongoing work, to express openly the questions for the FCA to consider. We hoped that our findings in Section 7 and our discussion of the design issues would assist the FCA in its process.

11.103 In light of this approach, we did not undertake significant work in assessing the effectiveness of these measures or their proportionality. We noted that, when the FCA considers the proportionality of this remedy, it might take into account:

(a) the benefit consumers would derive from the pricing of more add-ons being displayed on PCWs and/or the search results being ranked by the total cost of packages, including the add-ons selected;

(b) whether the provision of this information would reduce the asymmetry of information between insurers and consumers in relation to add-ons;

(c) the possible disadvantages to consumers in the additional time it might take to obtain quotes on PCWs and any added complexity in the display of the search results; and

(d) the cost to insurers, brokers and PCWs of developing their information technology systems to implement the remedy.

Clearer description of add-ons (Remedy 4C)

Description of the remedy

11.104 In the Remedies Notice we proposed that this remedy would require all insurers and brokers to provide descriptions of add-ons which are written in plain English[12] and which strike an appropriate balance between providing the relevant information to the consumer and ensuring that the information is understandable and not unnecessarily complex.

How the remedy addresses the AEC and/or resulting customer detriment

11.105 The aim of this remedy would be to improve the quality of add-on descriptions so that consumers could better understand the cover provided by different insurers and brokers and make better-informed purchasing decisions.

Views of parties

11.106 In general, parties supported the principle of providing clearer descriptions of PMI-related add-ons but told us that this was something which should be considered and developed by the FCA.

Design issues

11.107 We found that there were two design aspects to this remedy:

(a) *The generic descriptions of add-ons provided by PCWs:* PCWs typically provide a generic description of the add-ons displayed on their websites, with more information being available to consumers when they click through to individual providers' websites. In our view, the remedy needed to try to avoid specifying the number or form of generic descriptions provided by PCWs as these descriptions change over time to reflect product developments.[13]

(b) *The description of individual add-ons provided by insurers and brokers:* In our view, the remedy would need to cover the descriptions of add-ons offered by all insurers and brokers, and would need to accommodate changes to those descriptions to reflect product developments and the introduction of new products. These descriptions would need to meet the rules set out in the FCA's ICOBS, which require that, where a firm sells a product, it must give the customer information about the firm, its services and the product. Specifically, firms must provide appropriate information

[12] www.plainenglish.co.uk. The Plain English Campaign promotes the use of clear and concise language in documents.
[13] Our remedy to require statements about what NCB protection protects and does not protect (see paragraph 11.48) does not prevent PCWs from giving further information on this product. Rather, it requires specific statements to be added to the product descriptions in order to reduce the significant information asymmetry we identified.

about the policy so that the customer can make an informed purchasing decision.

Conclusion

11.108 In light of the role of the FCA in regulating the sale of add-on insurance products, including the descriptions provided by insurers, brokers and PCWs for those products, we did not think it would be appropriate for us to pursue this remedy ourselves. Therefore, we decided to recommend that the FCA works with insurers, brokers and PCWs to consider if and how these providers might improve their descriptions of all or certain PMI-related add-ons, either as part of the FCA's general supervisory work or as part of its remedy proposals resulting from its market study into general insurance add-ons.[14]

11.109 In Appendix 7.1 we have set out some examples of add-on descriptions. Among the wide variety of descriptions which exists, we have highlighted some examples which we believe are clear and others which are not.

11.110 In light of this proposed approach, we did not undertake significant work in assessing the effectiveness of the remedy or its proportionality. In our view, based on the responses of parties, we would not expect the costs of this remedy to be material, but this would be a matter for the FCA to consider in its assessment.

Our decision

11.111 We decided that the following information should be provided by insurers and brokers at the point at which NCB protection is purchased:

(a) the implied price of NCB protection;

(b) the average NCB discount according to the number of NCB years; and

(c) the step-back procedures, ie what would happen to the customer's number of NCB years with and without NCB protection in the event of one or more claims.

For telesales, the information set out in paragraph 11.41 should be provided.

11.112 We also decided that the statements in paragraph 11.48*(a)* and *(b)* should be presented on PCWs when consumers seek more information about NCB

[14] In Section 7 we identified specific concerns with courtesy car cover, MLEI, NCB protection and personal injury cover, and to a lesser extent with less commonly-purchased add-ons, such as enhanced courtesy car cover and extended foreign use cover. We believed that the features were less pronounced for breakdown cover, windscreen cover and key loss cover.

protection, and provided by insurers and brokers before NCB protection is purchased.

11.113 We also decided to make two recommendations to the FCA:

(a) that it considers:

(i) whether insurers and brokers should be required to provide their prices for all or certain add-ons they offer to PCWs and, if so, whether this should be for all PMI-related add-ons or only for the most commonly-purchased add-ons; and

(ii) how consumers' information needs in relation to PMI-related add-ons can best be met on PCWs, in particular in relation to enabling consumers to compare prices across providers for their desired package of PMI and PMI-related add-ons; and

(b) that it works with insurers, brokers and PCWs to consider if and how these providers might improve their descriptions of all or certain PMI-related add-ons, either as part of the FCA's general supervisory work or as part of its remedy proposals resulting from its market study into general insurance add-ons.

11.114 In our judgement, this represented as comprehensive a solution as was reasonable and practicable to the AEC and customer detriment which we had found.

12. Remedies to address the AEC from price comparison websites and MFN clauses (theory of harm 5)

12.1 In this section we outline our package of remedies to address the AEC identified in Section 8.

Summary of remedies we consulted upon in our Remedies Notice and provisional decision on remedies

12.2 We consulted upon a prohibition of wide MFN clauses. We said that the aim of this remedy was to strengthen rivalry over premiums offered on different PCWs. This remedy would prohibit the use of wide MFN clauses in agreements between PCWs and PMI providers. It would require all PCWs to stop using MFN clauses which restricted a PMI provider from offering a PMI policy more cheaply on other PCWs or through any other channel than on the PCW's own website. However, a PCW and a PMI provider could still agree that the provider would not offer a PMI policy more cheaply on its own website than on the PCW, ie narrow MFNs would not be prohibited.

12.3 As a prohibition of wide MFN clauses relates only to the contractual arrangements between PCWs and PMI providers, we said that we would also want to ensure that PCWs could not use other mechanisms or strategies which seek to replicate the same anticompetitive effects as a wide MFN clause ('equivalent behaviours'), for example threatening to delist a PMI provider if it offered PMI policies more cheaply on other PCWs.

Summary of views of parties

General views

12.4 Eighteen out of 19 insurers or brokers which responded to our Remedies Notice supported the proposal to ban wide MFNs. The one party which disagreed was the broker BGL, which owns (via BISL Limited) 100% of Comparethemarket, one of the four largest PCWs. Of the 18 PMI providers which supported the proposal, seven wanted the ban to be extended to narrow MFNs.

12.5 The two insurers with ownership interests in PCWs (esure (50% owner of GoCompare) and Admiral (100% owner of Confused)) agreed with our proposed remedy to prohibit wide but not narrow MFNs.

12.6 Of the four largest PCWs, two supported our proposed remedy and two opposed it. All of the four largest PCWs opposed the extension of the remedy to include banning narrow MFNs.

12.7 BGL (the owner of Comparethemarket) told us that its agreements with insurers and brokers were exempt under EU competition law.[1] It also told us that it was important to its business model always to be able to state that its search results represented the best prices available online for those products. BGL believed wide MFNs to be a key means of securing this end.

12.8 We have summarised below the responses to each question asked in our Remedies Notice.

Specification

12.9 Most insurers and brokers told us that the remedy should ban all MFNs and carve out the permitted exceptions. Supporters of this view included Ageas, Aviva, esure, LV, Zurich and the ABI. Admiral told us that 'in terms of specifying this remedy, potentially the absence of the cross-PCW MFN clause from a contract is sufficient. Alternatively, a standardised clause could be added to specify that this does not apply, but we would have thought the former should be sufficient.' Acromas emphasised that, however the remedy was specified, it should prohibit MFNs from being extended to new channels like social media.

Timeliness

12.10 Several insurers and brokers told us that the remedy could be implemented either immediately or very swiftly. These included Acromas, Ageas, Allianz, Aviva, LV and the ABI. Zurich pointed out that renegotiation would be needed but would occur in whatever time period was permitted under the remedy. [✄] told us that it would require substantial and onerous renegotiation of all contracts.

Circumvention risks through equivalent behaviours

12.11 Several insurers (including Zurich, RSA, First Central, Aviva, Allianz, Ageas and [✄]) and the ABI said that there was a threat of achieving price parities through 'equivalent behaviours'. Several other insurers (including CISGIL and DLG) told us that the absence of a prohibition of narrow MFNs constituted a circumvention risk in that a collection of narrow MFNs was equivalent to a wide MFN.[2]

[1] This view is discussed in paragraphs 12.65–12.68 and Appendix 12.1.
[2] This view is discussed in Section 8, paragraphs 8.46–8.54.

12.12 To mitigate these risks, the ABI thought that a regime of fines and legal recourse should be sufficient.[3] DLG suggested some form of price monitoring to ensure that PCW commission fees were kept within reasonable bounds (eg linked to inflation), and that, if rates increased beyond these levels, the MFN would no longer be enforced. Aviva suggested that a prohibition of narrow MFNs would mitigate the risk of equivalent behaviours by increasing competition faced by PCWs. Allianz suggested that PCWs should be required to display quotes on fair terms.

Distortions

12.13 [✂] told us that ordinary commercial relations between PMI providers and PCWs would be distorted by a prohibition of equivalent behaviours because PMI providers would refer spuriously to it.

12.14 Acromas said that, by not prohibiting narrow MFNs, its negotiations would be distorted in that narrow MFNs would be considered to be without legal risk and therefore no longer resistible. Acromas told us that the remedy could cause PCW advertising costs to go up and premiums might therefore rise.

12.15 Admiral said that an unintended consequence of the remedy would be more price dispersion and therefore a need to educate consumers that, by shopping around between PCWs, they might be able to find better deals. AXA told us that the increase in competition brought about by the remedy could lead to consolidation among PCWs.

12.16 CISGIL said that the incentive to create brands which were not listed on PCWs would continue to be present under the remedy, with associated costs.

Package of remedies that we have decided to take forward

12.17 In this subsection we set out the package of remedies which we have decided to take forward to address the AEC and/or the resulting customer detriment under ToH 5. The remedy is a prohibition on wide MFNs and ‘equivalent behaviours’ between PCWs and PMI providers in the PMI market (as described in the remainder of this section). We explain in paragraphs 12.86 to 12.89 why we have not extended the prohibition to narrow MFNs.

[3] Although the ABI also said that it had not had time to evaluate the most effective solution.

Design issues

12.18 In our provisional decision on remedies we identified two main design issues: first, how to define wide MFNs in the PMI market; and second, whether to adopt measures which discouraged or prohibited equivalent behaviours in the PMI market (and, if so, what measures).

Definition of prohibited MFNs

12.19 Based on our findings, we believed that the prohibition needed to cover wide MFNs only and exclude narrow MFNs in the PMI market. We identified two ways to do this:

(a) prohibit all MFN clauses in the PMI market and list the exceptions; or

(b) prohibit specific types of MFN clauses in the PMI market.

12.20 We noted that the first approach ran the risk of prohibiting MFN clauses which might not give rise to consumer detriment in the future but it mitigated against the risk of circumvention by PCWs. The second approach left a risk of new types of wide MFN clause emerging in the future. In the first approach, we would need to define what we meant by narrow MFNs, whereas in the second approach we would need to define wide MFNs.

12.21 Under the first approach, which requires a definition of narrow MFNs (eg those clauses which require that the price on the PMI provider's own website (the 'direct channel') is never cheaper than the price on the PCW), there is a specification risk, ie the direct channel is defined too widely. If the definition of permitted MFNs is too wide, the remedy may be neither comprehensive nor effective.

12.22 For example, imagine that a PMI provider's customer acquisition costs remain at around £50 per customer through PCWs but reference selling through, say, the PMI provider's Facebook page acquires customers at a cost of £10 per customer.[4] If the PMI provider's Facebook page is included in the definition of the direct channel, then PMI providers which are bound by a narrow MFN would not have a strong incentive to explore these potentially cheaper ways of selling because they would not be able to gain market share through sharing the cost saving with consumers. Aviva told us that social media might become the most efficient way of acquiring and pricing to customers in the future, while Acromas said that technological innovations

[4] This is where the purchase of insurance is made through the PMI provider's Facebook page rather than linking through to the PMI provider's website.

made it difficult to know what medium might become the most efficient way of acquiring and pricing customers. It said that social media, for example, had the potential to become a significant route to market.

12.23 However, under this first approach, if the direct channel is defined too narrowly, there might be a risk of prohibiting MFNs in the PMI market which do not give rise to an AEC and the customer detriment we have identified. We also believed that narrow MFNs in the PMI market protected the credibility of PCWs and that PCWs increased competition in the market, such that limiting the effectiveness of narrow MFNs could potentially represent an adverse consequence of the remedy. To extend the example above, if 'direct channel' were defined so as *not* to include social media, consumers might learn to use PCWs for preliminary research but, before buying, would check the PMI provider's Facebook page to see if there were a cheaper deal. Use of the Facebook page in this way could undermine the business model and the credibility of the PCWs, leading to a risk to their continued existence in the market.

12.24 Under the second approach, though, there is the problem of not knowing how PMI will be sold in the future, or how MFN clauses will develop in the PMI market, such that excluding only certain MFNs could be ineffective. It is also much harder to define something broad, such as a wide MFN, when the channels over which it applies might vary from provider to provider, rather than something narrower.

12.25 Taking all these considerations into account, we concluded that we should take forward the first approach, ie to prohibit all MFNs in the PMI market except for narrow MFNs. However, responses to our provisional decision on remedies highlighted the need for the definition of 'narrow MFNs' to be clear.

- *Definition of a narrow MFN (non-prohibited MFNs)*

12.26 In our provisional decision on remedies we defined narrow MFNs as covering the PMI provider's website (but excluding potential aggregator platforms like Facebook). PCWs told us that this definition was too narrow and PMI providers asked us to provide clarification on a number of points of scope.

12.27 GoCompare told us that the definition of narrow MFNs must include all forms of direct sales by the PMI provider, whether by way of their website, through direct telesales or elsewhere as a result of an introduction facilitated by the PCW.

12.28 We examined the way in which wide and narrow MFNs had been defined in existing contractual arrangements between PCWs and PMI providers. For example, one PCW's narrow MFN clause with a PMI provider is worded as follows: 'The Insurance Provider[5] warrants that it will not provide a quotation … that has a higher premium payable than would be payable by that potential customer should they have accessed the relevant Insurance Provider Website directly …'. The contract defines the 'Insurance Provider Website' as 'the Internet websites operated by or on behalf of the Insurance Provider … which provide quotations for and the facility to purchase Products'.

12.29 The same PCW's wide MFN clause, in a contract with another insurer, simply appends to the wording of the narrow MFN clause: '… than would be payable by that potential customer should they have accessed the relevant Insurance Provider Website directly *or via a different source of introduction*' (our emphasis added).

12.30 The MFN clauses in contracts between other PCWs and PMI providers appeared to be essentially similar. Current narrow MFN clauses did not refer to other direct sales channels other than the providers' website. We judged that, as PCWs had not generally sought to include other direct sales channels (such as telesales or sales through social media) in their current narrow MFN clauses, there were no strong reasons to include other direct sales channels in our definition of narrow MFNs.[6,7]

- *How to prohibit wide MFNs*

12.31 On balance, given the anticompetitive effects of wide MFNs, we decided that all MFN clauses should be prohibited except for narrow MFNs as defined in paragraph 12.33 (because we found no AEC in relation to narrow MFNs (see Section 8)), ie option *(a)* in paragraph 12.19. We decided that this prohibition should apply to all PCWs.

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[5] Insurance provider refers to the PMI provider.
[6] BGL told us that if the direct channel were defined too narrowly there would be a risk of prohibiting legitimate MFNs which protect the credibility of PCWs and the benefits to competition that PCWs deliver. For example, if the 'direct channel' were defined so as *not* to include social media, BGL said that there would be a risk that consumers would begin to use PCWs for preliminary research but, before buying, would check the PMI provider's Facebook page to find whether there was a cheaper deal. The use of social media in this way would seriously undermine the PCW business model and would jeopardise their continued existence in the market. However, we found that, in the current market, PMI providers were not using social media (or other sales channels) in such a way as to circumvent PCWs' MFN clauses, even though, with wide MFN clauses being prevalent, there would be greater incentives to do so than if only narrow MFNs were permitted.
[7] Other points of clarification requested by PMI providers in relation to narrow MFNs will be provided in the guidance to the order. The principle of the narrow MFN is that the price available on the PMI provider's website should not be less than that on the PCW to allow consumers to compare policies appropriately. This price may include add-ons or instalment charges.

12.32 To the extent there is a risk that the definition 'over-prohibits', we believed this was preferable to 'under-prohibiting' because:

(a) this is likely to result in a more effective remedy because it does not require the anticipation of all possible ways in which wide MFNs could be designed so as to circumvent it;

(b) it does not require us to anticipate future different sales channels; and

(c) although it may result in certain types of MFNs not being allowed even though they could have limited anticompetitive effects, we would expect PCWs to alert us to a change in the ways in which PMI is bought and to seek a variation to the remedy if appropriate (ie they will have an incentive to maintain the effectiveness of their narrow MFNs).

12.33 The prohibition of wide MFNs will apply to the entry into or the performance of contracts between PCWs and PMI providers (ie insurers or brokers) which prevent PMI providers from quoting for PMI at a cheaper price through any other distribution channel. This prohibition will then exclude 'narrow MFNs', defined as covering the PMI provider's own website only. The relevant price on the PMI provider's own website is the one a consumer would receive if they went to that provider's website directly with the same risk profile and for the same deal (eg if a consumer requests to pay in instalments, the price on the PCW should be the same as that on the provider's website).

12.34 Our approach permits MFNs where we have not found an AEC and where we believed their absence potentially threatens the credibility and long-term viability of PCWs. It would be open to PCWs to request a review of the remedy to reconsider the definition of the channel to which an MFN can legitimately relate if, for instance, consumer behaviour should change to such an extent that PCWs' existence should become endangered.

Measures to prohibit equivalent behaviours

12.35 We recognised that this remedy, by itself, might not comprehensively and effectively address the AEC and/or the customer detriment we had identified as resulting from wide MFNs if PCWs could circumvent it by enforcing non-contractual price parity, eg by threatening to delist PMI providers which price cheaper on other PCWs (or engaging in other such activities).

12.36 In this subsection, we discuss whether and how the effects of wide MFNs could be reproduced without resorting to contractual agreement, and in particular whether it would be possible for PCWs to use the power derived from the number of single-homers to achieve equivalent results? For the purposes of our analysis, we call such behaviours 'MFN-equivalent behaviours’, or just ‘equivalent behaviours’. We considered whether measures to discourage or prevent such behaviours would be necessary alongside a prohibition of wide MFNs in order to comprehensively and effectively remedy the AEC and/or the customer detriment we had found.

- *Effectiveness and credibility of ‘MFN-equivalent behaviours’*

12.37 If a PCW sees that a PMI provider has listed a lower premium on a competing PCW, it might seek price parity by asking the PMI provider for an equivalent price. Failing that, the PCW could threaten to delist the PMI provider.

12.38 Several insurers and brokers described to us certain ‘commission sacrifice deals’, which had been offered by Moneysupermarket (see Section 8, paragraphs 8.75 to 8.76). Under these deals, Moneysupermarket offered to reduce its commission in exchange for a matched reduction in premium from the PMI provider on the basis that the posted premium on Moneysupermarket would reflect the combination of the two savings. However, as a result of these deals, some PMI providers were threatened with delisting by another PCW.

12.39 [✄] said that it would be an option not to list the price of the PMI provider if its products were available more cheaply on another PCW. Indeed it said that it would be in the consumer’s interest for the PCW not to list the provider when that provider is providing a cheaper price to another PCW.

12.40 We received anecdotal evidence from some PMI providers that some PCWs had threatened to delist them if they did not get the best price, even if the PMI provider was not constrained by a contractual wide MFN. For example, one insurer [✄] told us:

> We have been verbally advised by senior executives at one PCW, since the publication of the Competition Commission’s provisional findings, that it is the PCW’s own choice who they have on their panel and they can delist a provider if they feel they are not offering, what is, in their view, the ‘best customer proposition’. We have been advised that if we present cheaper prices on a rival PCW that this *may* be considered that we are not offering their customers the best proposition and they would consider whether we were an appropriate partner for their panel.

12.41 We examined if single-homing by consumers made the threat of delisting more effective. If the PCW commands a sufficient number of single-homers, the delisting threat may be effective in dissuading the PMI provider from accepting commission sacrifice agreements. The costs to the PMI provider from being delisted will depend on the proportion of consumers who single-home on that PCW: if all consumers check many PCWs before buying then the threat of delisting would have little consequence, but if many consumers only search on one PCW then some customers would become beyond the reach of the PMI provider.

12.42 We used our estimates of single-homing rates and the price elasticity of demand to assess how PMI providers might weigh up the costs and benefits of delisting (or a threat to delist) (see Appendix 8.1, Annex K). We found that single-homing rates were sufficiently high at the four largest PCWs to make delisting an effective threat under current market conditions.[8] Indeed we found that even for single-homing rates much lower than those reported by PMI providers, the threat of delisting would still be effective.

12.43 However, the credibility of the threat depends also on the incentives of the PCW. The possible costs for a PCW from delisting a given PMI provider are likely to depend on the importance of the brands of this provider: if a PCW feels that the quality, reputation and attractiveness of its platform reduces from losing the given PMI provider from its offering, delisting will be more costly to the PCW and the threat of delisting will be less credible.

12.44 We reviewed some of the negotiations around commission sacrifice deals and noted two ways in which these negotiations had occurred:

(a) A more expensive PCW (ie the one not making the commission sacrifice deal) had tried to negotiate a similarly good PMI policy price with the PMI provider but had been unwilling to cut its own commission fees. In these cases, we observed that the PMI provider, faced with a threat of delisting from the more expensive PCW, had abandoned the commission sacrifice deal with the lower-commission PCW. We saw three instances in which this had happened.

(b) A more expensive PCW (ie the one initially not making the commission sacrifice deal) had asked for price parity and had been willing to cut its own commission fee to achieve it. Delisting did not occur and lower PMI premiums were achieved for consumers on both PCWs. We saw one instance in which this had happened.[9]

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[8] BGL told us that 'single homing rates did not reflect any entrenched position on the part of any PCW. It is not the case that consumers are bound – contractually, technologically or financially – to one PCW over another; the ability to switch between PCWs is easy and the cost is negligible'. However, whilst this is true, we noted that it did not stop even moderate single-homing rates being a material source of negotiating power for a PCW.
[9] [✂]

In the first case, the high-commission PCW successfully prevented commission-rate competition between PCWs; in the second case, competition worked to deliver lower prices to consumers.

- *Are wide MFNs and selective delisting equivalent?*

12.45 If the threats were fully effective and PMI price parity was maintained by this sort of mechanism then the effect would be equivalent to that of a wide MFN. The power over single-homing consumers would have been extended to affect other consumers and the PMI prices they face.

12.46 However, there are three clear differences between the operation of wide MFNs and of selective delisting:

(a) When a delisting has to be carried out, it will harm the PCW that is delisting in the form of lost sales and commissions, though gaining a reputation for delisting might reduce this cost. A wide MFN, on the other hand, does not require any costly behaviour (beyond monitoring). Overall, we can expect delisting to be a less efficient mechanism for maintaining price parities because of some greater costliness.

(b) When a PMI provider cuts its retail price through one PCW, consumer incentives would move in the direction of reducing single-homing rates across PCWs, ie the incentive to search several PCWs would increase. Moreover, delistings might reduce single-homing rates since they would worsen the quality of the search results returned by the PCW. In contrast, a wide MFN, by maintaining price parities, would be likely to increase single-homing rates as there would be little point to multi-homing if prices were all the same. Overall, we can expect wide MFNs to maintain a PCW's market power, while selective delisting would to some extent reduce it.

(c) In the case of delisting or its threat, PMI providers are free to negotiate a case-by-case settlement, whereas the only way out of an MFN is to renegotiate the entire clause. One insurer ([✂]) told us [✂].[10] This was an example of the threat of delisting leading to competition over commission fees between PCWs, and such competition would not have arisen with a wide MFN because the initial price cut would have been impossible.

12.47 We found that actual delistings were not currently prevalent, though one reason for this could be because wide MFNs were prevalent and

[10] [✂]

represented an effective price-controlling mechanism. Notwithstanding the differences between delisting practices and wide MFNs, in our view, where delisting practices occurred by PCWs with sufficient numbers of single-homing retail customers, they came very close to replicating the effects of wide MFNs.

12.48 Therefore, we decided that it was necessary to complement a prohibition of wide MFNs with a prohibition of equivalent behaviours in order to comprehensively and effectively remedy the AEC and/or the customer detriment we had found.

- *Measures to prevent MFN-equivalent behaviours*

12.49 In order to prevent MFN-equivalent behaviours, we could either prohibit directly the behaviours or address the underlying causes which made such equivalent behaviours effective and credible. We considered three possible approaches:

(a) measures to decrease consumer single-homing rates;

(b) measures to increase the negotiating power of PMI providers in delisting negotiations with PCWs; and/or

(c) measures which prohibit equivalent behaviours when they are seeking to replicate the same anticompetitive effects as a wide MFN, ie stopping PMI providers from pricing differentially based on different commission rates and other costs of doing business.

12.50 We decided to adopt approach *(c)* for the reasons explained below (see paragraphs 12.51 to 12.59). We explain in paragraphs 12.91 to 12.98 why we have decided not to adopt approaches *(a)* or *(b).*

  - *Prohibition of equivalent behaviours*

12.51 The aim of a prohibition of equivalent behaviours is to prevent PCWs from using behaviours against PMI providers if this behaviour is intended to reduce competition between PCWs.

12.52 Delisting is not the only behaviour which could be used to create MFN-equivalent effects. Aviva highlighted that PCWs may use other methods such as:

(a) less favourable commission terms;

(b) less favourable solicitation rights for PMI providers with customers introduced by the PCW;

(c) unreasonable IT change lead times;

(d) changes to the timeliness, cost and quality of market intelligence; or

(e) other additional charges.

12.53 Each of these behaviours are ways in which a PCW could reduce the value to a PMI provider of being listed on the PCW. To that extent, they may be effective in dissuading a PMI provider from accepting commission sacrifice deals (or equivalent) from another PCW. For this reason, our view was that 'equivalent behaviours' needed to be sufficiently flexibly defined to cover these (and other possible) practices, and to make circumvention as hard as possible.

12.54 However, there are some legitimate reasons for a PCW to delist a PMI provider or to engage in any of the practices listed in paragraph 12.52. For example, a PCW might choose to delist a PMI provider if it found the provider referring customers to an unregulated underwriter or if there were legitimate fears about the financial future of the PMI provider. Evidence submitted to us by the PCWs showed that around 15 delistings occurred each year. A prohibition preventing all delistings, or all or some of the other behaviours, could limit legitimate competitive actions.

12.55 In our view, the key distinction between anticompetitive equivalent behaviours and normal commercial practices is the context of the behaviour, ie whether the behaviour is seeking to replicate the same anticompetitive effects as a wide MFN (ie dissuading a PMI provider to post a lower price on a competing online channel). For example, if a PCW responded to a PMI provider agreeing a commission sacrifice deal and lowering its premiums on another PCW by delisting that PMI provider from its website, this behaviour would be akin to a wide MFN and harmful. However, we would not wish to restrict a PCW's ability to negotiate with PMI providers and to sanction them where appropriate, eg if the PMI provider has undermined the business model of the PCW by not declaring leads from the PCW, or if the PMI provider has committed some other material breach of contract, or if the PCW has legitimate concerns about the financial future or regulatory compliance of the PMI provider.

12.56 We found that competition between PMI providers (interband competition) was strong (see Section 8), especially when selling through PCWs, and it was this competition which provided the strongest pressure on PMI providers to offer competitive PMI premiums to PCWs' customers net of any

PCW commission fee. The concern with PCWs seeking price parity was that it softens competition on the proportion of the premium which is unaffected by interbrand competition, ie the PCW's commission fee. The discipline on this comes from intrabrand competition, competition between PCWs, and, to an extent, competition between different channels. The behaviour to prohibit is therefore delisting, or other behaviours, which have the effect of maintaining price parity between PCWs.

12.57 In light of this evidence and reasoning, we decided to prohibit behaviours which seek to replicate the same anticompetitive effects as a wide MFN, ie preventing prices being quoted lower on competing sales channels other than a PMI provider's own website. We intend to provide guidance to accompany the enforcement order setting out examples of the sorts of behaviours and effects which are of concern and which we believe would amount to a breach of this remedy.

12.58 We considered whether this equivalent behaviours measure needed to be applied to all PCWs. In contrast to the prohibition on wide MFNs (which applied to all PCWs), we judged that it did not as the threat of delisting or other equivalent behaviours was only credible when a PCW was above a certain size, as the size of a PCW was a likely proxy for its number of single-homing customers from whom it derived its market power. This was not the case with wide MFNs as any wide MFN in effective operation in relation to PMI would soften competition between PCWs, with associated anti-competitive effects. Therefore we decided that the equivalent behaviours remedy should apply only to those PCWs which generate more than 300,000 PMI sales per year.[11]

12.59 Taken together with a remedy prohibiting wide MFNs, we believed that a remedy prohibiting MFN-equivalent behaviours would comprehensively and effectively address the AEC and/or the customer detriment which we had found.

[11] BGL told us that this threshold would 'create a differentiation in the operating position between some PCWs and others which is not reflective of their influence or market position. For example, Google Compare would be unaffected by this element of the remedy'. The figure of 300,000, however, represents approximately 5% of all PCW sales. Our modelling of single-homing (see Appendix 8.1, Annex K) found that delisting was no longer a credible threat when market shares were below 5% as, even with complete single homing, the number of single homers for a PCW with market shares below 5% was insufficient. Currently, only Comparethemarket, Confused, GoCompare and Moneysupermarket would be above this threshold. If any PCW's sales increased beyond 300,000, they would have to comply with this element of the remedy, reflecting their greater influence in the market.

Implementation issues

12.60 In this subsection, we address the effectiveness of our package of remedies by focusing on the following factors:

(a) the means by which the package of remedies would be implemented;

(b) the timeliness of the remedy;

(c) the consistency of our remedy with other laws and regulations; and

(d) the means by which the remedy will be monitored and enforced.

Implementation

12.61 As this package of remedies needs to cover both existing PCWs and potential future entrants we will implement it using an enforcement order.

Timeliness

12.62 In our provisional decision on remedies we suggested that this prohibition should take effect immediately following the making of any enforcement order. In response, only two parties told us that it would take considerable time to renegotiate contracts, with all other parties telling us that such renegotiation, if necessary, would not be burdensome. We noted that most contracts between PMI providers and PCWs contained severability clauses, stating that, if a provision of the contract were to be held invalid, illegal or unenforceable, the remaining provisions would continue in full force and effect. Some contracts further provided that provisions which were held unenforceable would be construed so as to most closely reflect the original intent of the parties but only to the extent that to do so would be legally enforceable. Other contracts provided that, if any provision or any part of any provision of the contract were held invalid or unenforceable, the remainder of the provisions in the contract would not be affected and each remaining provision or part thereof would be valid and enforceable to the full extent permitted by law. Overall, it did not appear to us that the removal of wide MFNs (or their enforcement as narrow MFNs) would fundamentally change the character, purpose, scope, substance or intention of the contracts between PMI providers and PCWs.

12.63 However, both BGL and GoCompare told us that they would need more time to renegotiate contracts with PMI providers beyond the date of the enforcement order. BGL added that it would not be sufficient simply to agree to the removal of the relevant wide MFN clause. In light of these submissions, we decided that it was appropriate for PCWs to have a period of one month from the effective date in the order to conclude any negotiations. The enforcement order will specify that PCWs will need to amend (or terminate) any existing commercial arrangements with PMI providers to ensure that these arrangements comply with the principles set out in the enforcement order without undue delay and in any event within one calendar month from the effective date.

12.64 Any remaining wide MFN clauses in relation to the provision of PMI would be void and unenforceable as from one calendar month after the date of the order. Validity and enforceability of the remainder of the contract would be a matter of English Contract law.

Laws and regulations

12.65 One party, BGL, told us that Article 3(2) of EU Regulation 1/2003[12] (the Modernisation Regulation) prevented the CMA from prohibiting wide MFN clauses. BGL said that this was the case '… even if [MFNs] were held to have any effect on competition … and considered to fall within the scope of Article 101(1) of the Treaty on the Functioning of the EU'.

12.66 BGL told us:

> [MFNs] are permissible under Article 101(3), whether because of a lack of impact or by reason of justification or exemption (including under the vertical agreements block exemption). It follows that irrespective of the Competition Commission's inability to demonstrate any real adverse effects associated with such clauses (notwithstanding the positive benefits connected to them), it is not legally open to the Competition Commission to prohibit such clauses as part of any possible remedies in the light of Article 3(2) of the Modernisation Regulation (EU Regulation 1/2003).

12.67 However, BGL did not set out any analysis to support its assertion that MFNs were permissible under Article 101 TFEU. It did not, for example, make representations on any the following:

- Why the MFNs would not be prohibited under Article 101(1) TFEU.

[12] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, *OJ* L 1, 04/01/2003, pp1–25.

- Why the agreements in question would meet each of the four conditions set out under Article 101(3) TFEU so as to benefit from individual exemption.

- Why the agreements in question would benefit from exemption under the Vertical Block Exemption Regulation.

- Why Article 3(2) of the Modernisation Regulation would preclude a prohibition of the relevant clauses under the CMA's powers under Part 4 of the Act.

12.68 We have set out in Appendix 12.1 our analysis of the interaction between our remedies and EU law. In this investigation, we have found that wide MFNs in contracts between PMI providers and PCWs give rise to an AEC. It is this problem we have sought to remedy. While we are satisfied that there is no conflict between our remedies in this regard and EU law, we have not conducted any enforcement investigation under Article 101 TFEU, which would require separate analysis.

Monitoring and enforcement

12.69 A clearly defined prohibition of wide MFNs is likely to be simple to monitor because PMI providers, which have told us repeatedly of their objections to wide MFNs, would be swift to inform the CMA of any breaches.

12.70 However, the prohibition of equivalent behaviours would be more complex to monitor and enforce. For any case of delisting or contract termination, it would not necessarily be immediately apparent whether the action taken was to limit competition between PCWs or for some other legitimate reason. The flexibility required for this behavioural prohibition means that disputes may arise.

- *Monitoring*

12.71 In order to monitor the prohibition of equivalent behaviours, we will require compliance statements from those PCWs caught by the order (ie those above the threshold in paragraph 12.58), stating that they have not engaged in equivalent behaviours which would be in breach of the order. These compliance statements would be submitted every quarter for the first two years following the order and once per year thereafter. We would require that they also list all delisting actions during the relevant period, setting out the reasons for the delisting.

12.72 The CMA may also decide, from time to time, to give PCWs directions as to compliance with the order, ie to take certain actions or to refrain from taking certain actions for the purpose of carrying out, or ensuring compliance with, the order. Directions for compliance could include the appointment of a monitoring trustee to supervise compliance with the order, in particular, to investigate any behaviour which is of concern to the CMA.

12.73 Some insurers responded to the provisional decision on remedies by querying whether PMI providers could comment on PCWs' compliance statements and whether compliance statements should include behaviours other than delisting. We recognised that behaviours other than delisting might have an equivalent effect to wide MFNs but, in our view, requiring compliance statements to include information on all behaviours was likely to prove excessive. Moreover, PMI providers could make representations to the CMA if they believed that PCWs had engaged in equivalent behaviours or sought to retain wide MFNs. We believed that such submissions would help the CMA to give directions to PCWs to ensure compliance with the order.

- *Enforcement*

12.74 Enforcement could be done either through:

(a) use of the general judicial procedures implied by CMA enforcement orders; or

(b) setting up an adjudication process.

12.75 We discuss the relative merits of each of these options in turn.

- *Use of civil proceedings*

12.76 Under this option, we would publish an explanatory note setting out the scope and purpose of the order, with the aim of facilitating its interpretation by parties and by the courts. In particular, this explanatory note would include illustrative examples of the types of behaviours which would cause us concern.

12.77 In the event that a PMI provider (or any interested party) believed that a PCW were in breach of the order, it could seek to enforce the order by civil proceedings and obtain compensation for the losses it had suffered as a consequence of the alleged breach. Similarly, pursuant to section 167 of the Act, the CMA could seek to enforce the order by civil proceedings within the context of its duty to monitor orders. The relevant court for enforcing orders would be the High Court.

12.78 In order to obtain a temporary remedy against an alleged breach of an order, and to prevent certain behaviours until the dispute had been resolved, a PMI provider could also apply for an interim injunction.

12.79 Some PMI providers told us that insurers were risk averse and were unlikely to seek to enforce provisions, or only when the issue was clear-cut (ie delisting). However, in our view, it was the clear-cut cases where enforcement by parties would be most appropriate. Where actions were more nuanced we would expect parties to raise their concerns with the CMA. The CMA will have responsibility, alongside the courts, for ensuring compliance with the order, which it will achieve through monitoring the market, giving directions and, if appropriate, taking enforcement action itself.

- *Adjudication*

12.80 An alternative option would be the appointment of an adjudicator.[13] If a PMI provider believed that behaviour adopted by a PCW were in breach of the order, it would be able to submit a notice of adjudication to an appointed independent adjudicator. The PCW would be given a right to issue a notice of reply and the adjudicator would then be given a specified period of time in which to make its decision. The adjudicator would need to have information-gathering rights and enforcement powers.

12.81 The cost of the adjudicator would depend on the frequency of recourse to it. If the adjudicator is effective and has sufficient deterrence power then recourse should be infrequent. However, setting up an adjudicator would entail certain fixed costs which would have to be paid for even if it were to have no cases. On the other hand, if cases brought to the adjudicator were frequent, the cost of the remedy would increase.

- *Conclusion on enforcement options*

12.82 We judged that compliance statements, complemented with directions given by the CMA and recourse to civil proceedings, would be an effective enforcement mechanism. In our view, this option was likely to incur lower

[13] The Enterprise and Regulatory Reform Act 2013 has amended Schedule 8 to the Act, which sets out the kinds of provisions which can be included in remedies orders made by the CMA. The new paragraph 20C enables the CMA to appoint a third party expert to monitor the implementation of remedies, including compliance with orders and to determine disputes. This type of mechanism had already been used in the past by the CC in relation to mergers.

costs than an adjudicator[14] and therefore appeared to be more proportionate whilst being as effective.

Conclusion on the effectiveness of the remedy

12.83 In summary, we believed that the following package of remedies would be an effective solution to the AEC and/or the customer detriment which we had found in relation to ToH 5:

(a) A prohibition on all PCWs and PMI providers entering into or performing agreements which include an MFN relating to the sale of PMI, except narrow MFNs, where 'narrow MFNs' are defined as covering the PMI provider website only.

(b) A prohibition on behaviours which seek to replicate the same anti-competitive effects as a wide MFN (namely, preventing prices being quoted lower on other PCWs or other sales channels other than the PMI provider's own website). This measure will apply to those PCWs which generate more than 300,000 PMI sales per year.

(c) PMI providers and PCWs will be required to comply without undue delay following the making of the order and, in any event, within one calendar month from the effective date of the order.

(d) In order to monitor equivalent behaviours, those PCWs above the 300,000 PMI sales per year threshold will be required to submit compliance statements to the CMA every quarter for the first two years following the order and then once per year. These compliance statements will state that parties have not engaged in equivalent behaviours which would be in breach of the order and will list all delisting actions during the relevant period, setting out the reasons for the delisting.

Remedies we are not taking forward

12.84 We are not taking forward the following measures:

(a) a prohibition on all MFNs;

(b) measures to decrease retail consumer single-homing rates; and

[14] The exception would be if there were lots of lengthy appeals with high legal costs, which might outweigh the costs arising from the shorter timescale of adjudication. However, we did not believe this was likely.

(c) measures to increase the negotiating power of PMI providers in delisting negotiations.

We set out below our reasons for not pursuing each of these remedies in turn.

Prohibition on all MFNs

Description of the remedy

12.85 This remedy would extend the prohibition on wide MFN clauses to all MFN clauses.

Our reasons for not taking the remedy forward

12.86 We could not extend the ban to narrow MFNs unless *(a)* we had identified within the context of our investigation an AEC in relation to narrow MFNs; and/or *(b)* if the costs of banning wide MFNs and not narrow MFNs were excessive, which meant that it should be extended to narrow MFNs.

12.87 Many PMI providers told us that narrow MFNs did give rise to an AEC, and we discuss these arguments in Section 8. However, we found that if there were any anticompetitive effects from narrow MFNs in the PMI market, they were unlikely to be significant in the context of the whole PMI market and, by prohibiting them, we could potentially undermine the PCWs' ability to serve consumers effectively and drive interbrand competition.[15]

12.88 In relation to point *(b)*, there did not appear to be any costs arising from the ban on wide MFNs which meant that it should be extended to narrow MFNs.

12.89 For these reasons we decided not to adopt this remedy.

12.90 Several parties told us that the market should be reviewed in two years' time to ensure that narrow MFNs were not causing harm. However, we noted that MFNs in the context of online platforms (like PCWs) had featured in certain recent cases of European competition authorities and we expected the CMA to keep such markets under review. Moreover, the CMA would have a continuing responsibility in the monitoring of equivalent behaviours in relation to the PMI market.

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[15] Similarly, several parties proposed other remedies to address narrow MFNs but we have not considered these further as we have not found an AEC in relation to narrow MFNs (see Section 8).

Measures to decrease single-homing rates

Description of the remedy

12.91 The aim of this measure would be to reduce single-homing by informing consumers that policies from the same PMI provider could be available through alternative channels at a cheaper price. One version of this remedy would be to require PCWs to include such a message on their websites.

Our reasons for not taking the remedy forward

12.92 The advantage of such a remedy is that it goes to the root cause of the problem. Without single-homing, PCWs would have less market power, they would be less likely to be able to negotiate wide MFNs into their contracts with PMI providers, and any delisting threats would be less effective. However, the disadvantage of this remedy is that it may not be effective. We found that the critical levels to which single-homing rates must fall in order for delisting threats to be ineffective are typically significantly below the rates which PMI providers currently report or those found in our consumer survey (see Appendix 8.1, Annex K). In our view, such a large change in consumer behaviour seemed unlikely from a relatively minor increase in consumer information. In addition, when we asked PCWs what retail consumers typically believed they were getting from the use of a PCW, it seemed to be 'money savings compared with renewal quotes'.[16] If so, it was unclear whether notifying consumers of possible cheaper prices elsewhere would change behaviour. Lastly, we noted that this remedy could also undermine trust in PCWs, which would undermine one of our reasons for not prohibiting narrow MFNs.

12.93 For these reasons we decided not to adopt this remedy.

Measures to increase the negotiating power of PMI providers in delisting negotiations

Description of the remedy

12.94 A PCW might hesitate to delist a PMI provider if it believed that such a delisting would reduce the perceived quality of the PCW and drive consumers to alternative PCWs offering PMI from more providers.

[16] See transcript of response hearing with PCWs.

12.95 One remedy to increase the cost to a PCW of delisting a PMI provider and encourage this effect might be to require that PCWs state the size and composition of their panel of PMI providers at the point of choice. This would make a delisting more visible to consumers than it otherwise would be, and so increase the cost to the PCW. Moreover, if the information on panel composition were publicly available, delistings could be used in the advertising campaigns of competing PCWs. If this measure increased the cost to a PCW of delisting a PMI provider it might reduce the number of cases in which commission sacrifice agreements from one PCW were refused by PMI providers for fear of a retaliatory delisting from another PCW.

Our reasons for not taking the remedy forward

12.96 In our view, the effectiveness of this remedy rested on whether PCWs would perceive the size and composition of their panel to be an important factor to consumers. This may not be the case if consumers are in fact just seeking to save money rather than to find as many different quotes as possible (see paragraph 12.92). It appeared to us that, given all of the large PCWs search around 100 PMI brands, removing one or two brands from that list would be unlikely to cause most consumers much concern.

12.97 We had three particular concerns with this remedy:

(a) Specification: We would need to specify what information on panel composition would be made available. If we focused on only the top 20 PMI providers, this might provide more relevant information for consumers but it would be distortionary in favour of these providers and fail to enhance the negotiating position of all other PMI providers. It would also require the PCWs to understand by what measure to define the top 20 PMI providers each year. An alternative would be for the PCW to state how many PMI providers, or PMI brands, were listed on its site. However, as these numbers would be large, the information would be of far less value to consumers, and therefore of less value to PMI providers in enhancing their negotiating positions with PCWs.

(b) Distortion: This measure could have the unintended consequence of interfering with legitimate delistings as it would alter the balance of power in PCW/PMI provider negotiations.

(c) Circumvention: Delisting is only one of a number of courses of action which might be used to dissuade a PMI provider from pricing differently through different PCWs and this measure would not address any of these other behaviours.

12.98 For these reasons we decided not to adopt this remedy.

Assessment of relevant customer benefits

12.99 In deciding the question of remedies, the CMA may 'have regard to the effect of any action on any relevant customer benefits of the feature or features of the market concerned'. Relevant customer benefits (RCBs) are defined in the Act and are limited to benefits to relevant customers in the form of *(a)* lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or *(b)* greater innovation in relation to such goods or services. The Act provides that a benefit is only an RCB if the CMA believes that: *(a)* the benefit has accrued as a result (whether wholly or partly) of the feature or features concerned or may be expected to accrue within a reasonable period of time as a result (whether wholly or partly) of that feature or those features; and *(b)* the benefit was, or is, unlikely to accrue without the feature or features concerned.

Views of parties

12.100 No party made explicit reference to RCBs but GoCompare told us that MFNs were essential for the existence of PCWs. [✂] said that wide MFNs were critical to the positive operation of the market and the development of effective PCWs which supported more competitive pricing for consumers.

Our assessment of RCBs

12.101 We did not identify any RCBs arising from wide MFNs or equivalent behaviours, and hence we believed that a prohibition of wide MFNs and equivalent behaviours would not give rise to RCBs which might be lost. Wide MFNs had limited pro-competitive effects over and above narrow MFNs and any incremental benefits were unlikely to be material. In particular, we did not find that wide MFNs were necessary for PCWs to survive (see Section 8, paragraphs 8.103 to 8.116).

Proportionality

12.102 In this subsection, we set out our views on the proportionality of our package of remedies.

Effective in achieving its aim

12.103 For the reasons set out in paragraphs 12.113 to 12.118, we found that our package of remedies would be effective in its legitimate aim of remedying the AEC and/or the customer detriment we had found.

No more onerous than necessary

12.104 We considered whether it would be possible to achieve a comprehensive solution without implementing all of the measures in our package of remedies.

12.105 In our consideration of the remedy measures, we ruled out a number of options which we did not believe added to the effectiveness of the remedy. These included the use of an adjudicator (see paragraphs 12.80 and 12.81), extending the prohibition to all MFNs (see paragraphs 12.86 to 12.89), informational measures to reduce single-homing (see paragraphs 12.91 to 12.93), and informational measures to increase the negotiating power of PMI providers in delisting negotiations (see paragraphs 12.94 to 12.98).

12.106 We did not believe that our package of remedies would remain effective if we were to dispense with any part of it. Therefore, we concluded that the package of remedies was no more onerous than necessary.

Least onerous if there is a choice

12.107 If we are choosing between two remedy measures which appear to be equally effective, we should choose the remedy measure which imposes the least cost or is the least restrictive.

12.108 In addition to the measures included in our package of remedies, we considered a variety of other possible ways by which we might address the AEC and/or the customer detriment. These included measures which we set out in the Remedies Notice and our provisional decision on remedies and measures which were put to us by parties in response to these consultations.

12.109 Our consideration of these alternative measures is set out in paragraphs 12.84 to 12.98. We found that each of these alternative measures was of limited effectiveness and/or was not needed to remedy the AEC if the measures in our package of remedies were pursued. We were not able to identify an alternative package of measures which would be effective in remedying the AEC and less onerous. However, we took care to avoid including measures in our package of remedies which did not make a material contribution to remedying the AEC (see paragraph 12.105).

12.110 We concluded that, to the limited extent we had a choice between effective remedies, our package of remedies imposed the least cost and was the least restrictive.

Does not produce disadvantages which are disproportionate to the aim

12.111 We considered whether our package of remedies, or any specific measure within it, was likely to produce disadvantages which were disproportionate to the aim of remedying the AEC and the resulting customer detriment.

12.112 In reaching a judgement about whether to proceed with a particular remedy, we consider its potential effects (both positive and negative) on those persons most likely to be affected by it. We pay particular regard to the impact of remedies on customers but we also have regard to the impact of remedies on those businesses subject to them and on other affected parties, such as other businesses (eg potential entrants, or firms active in upstream or downstream markets), government and regulatory bodies, and other monitoring agencies.

Benefits

12.113 We found that the benefits of banning wide MFNs and equivalent behaviours were commensurate with the harm of wide MFNs. In our view, these remedies will be effective because they will lead to the harm being eliminated.[17]

12.114 We expected that, consequent to our package of remedies, commission fees would fall as rivalry between PCWs for market share would lead to price cutting. Given that the PMI market has become more price competitive as a result of PCWs, we expected that greater price competition between PCWs would feed through to lower PMI premiums to consumers.

12.115 We expected that PMI providers would have more flexibility to price differ-entially according to the different terms which they would agree with different

[17] BGL challenged this view, stating:

> The provisional decision on remedies also fails to explain why [the CMA's] provisional remedy package would bring about the sorts of changes it assumes. As BGL has explained, while wide MFNs prevent insurers from offering precisely the same product to precisely the same customer at different prices on different platforms, this does not in practice prevent price cutting strategies, for example based on differentiating products between platforms. This is elaborated in BGL's response to the CMA's Notice on Possible Remedies (at page 21). Similarly, PCWs can achieve results equivalent to price cuts using mechanisms such as cashback and customer gifts.

We disagreed with these views for the reasons set out in Appendix 8.1, paragraphs 63–66, and Annex F.

PCWs, eg with regard to which party bears the risk in the case of mistakes or fraud. The absence of wide MFNs should provide opportunities for PCWs to differentiate themselves, using all the contract terms which have an impact on PMI premiums, not simply commission rates. We expected that, if competition between PCWs were based on price as well as advertising expenditure, the incentive to spend as much as currently on advertising might fall. For example, Moneysupermarket told us that, because of wide MFNs, it was currently unable to invest its marketing funds into lower prices, which could be done if wide MFNs were banned. In our view, PMI price reductions could be expected from both profit reductions and cost reductions by PCWs in the face of greater competition.

12.116 We also expected PCWs to seek to innovate more, especially to lower the costs for a PMI provider. Currently, a PCW cannot be rewarded with market share for such innovations but, in the absence of wide MFNs, this would be possible. These types of innovations would be likely to lead to lower PMI premiums overall.

12.117 We also identified that, due to wide MFNs, the barriers to entry for a low-cost PCW entrant were increased as its lower costs could not be reflected in lower PMI premiums to customers. In the absence of wide MFNs, these barriers to entry would be reduced. However, the extent to which actual entry or the credible threat of entry would increase consequent to our package of remedies was difficult to assess as other significant barriers to entry, such as advertising, would remain.

12.118 Estimating the value of all these potential benefits of our package of remedies was impossible. However, we calculated that, if CPA fees were to fall from current levels of around £50 by between £5 and £10,[18] and if this

[18] This was based on the level of CPA reduction seen in some commission sacrifice agreements. BGL told us that there was no good basis for imagining that all PCWs would follow this type of price-cutting behaviour. According to BGL, this conclusion was based on very limited anecdotal evidence that some commission sacrifice agreements at this level had been discussed between PCWs and insurers. BGL told us that there was no good basis to imagine all PCWs would follow this route. BGL observed that the view that price cutting was a means for a new entrant to establish itself was at odds with the notion that all PCWs would pursue it. Finally, BGL commented that our theory failed to recognise the limited extent of wide MFNs in the market and the fact that a number of the major PCWs did not operate any at all. However, in our view, if PCWs were competing with one another on price, we would expect (absent other behaviour) all PCWs to engage in this type of behaviour. As identified in Section 8, some PMI providers have been reluctant to accept commission sacrifice offers because of wide MFNs, and PCWs' incentives to continue to make offers to PCWs have thereby been diminished. As noted in Section 8, the number of policies affected by wide MFNs was much greater than the actual number of wide MFNs because of their effect on other PCWs' behaviour. As a result, even a relatively limited number of wide MFNs have an adverse effect on competition.

value was passed through to customers, the resulting benefit to PMI consumers would be worth around £31–£62 million per year.[19]

Costs

12.119 We identified the following costs as likely to arise from our package of remedies: *(a)* contract renegotiation costs; and *(b)* consumer search costs.[20]

- *Contract renegotiation costs*

12.120 PMI providers told us that the implementation costs of the remedy would be very small as existing wide MFN clauses would simply be rendered unenforceable.

12.121 However, [✂] told us that a prohibition would require a renegotiation of many of its contracts with PMI providers, and that this would be lengthy and costly. [✂] said:

> Any proposed prohibition would need to allow for the individual renegotiation of in excess of [✂] provider agreements. The terms of each agreement relating to price were not negotiated separately from the other operative terms and, accordingly, each of those terms would be the subject of a fresh negotiation if [✂] is not to be significantly commercially disadvantaged. This would involve very considerable time and cost.

12.122 We found that most of the contracts affected by wide MFN clauses contained severability clauses pursuant to which the wide MFN clause could be severed from the contract or construed as a narrow MFN (see paragraph 12.62). This suggested that, in these circumstances, any renegotiation of such contracts would be a choice.

[19] BGL also told us that there was no justification or analysis supporting the assumption that insurers would pass on commission fee savings to consumers. However, our price elasticity of demand data (see Table 8.1) showed that PMI consumers are highly price elastic on PCWs and therefore we believed it was highly likely that cost savings would be passed through.

[20] BGL said that we had failed to take into account other costs, namely *(a)* the impact on PCW credibility (the adverse effects on which are supported by some third party research, including that conducted by the European Commission); *(b)* costs of regulation and associated uncertainty, which would jeopardise the benefits that PCWs had brought to consumers; and *(c)* the impact of narrow MFNs (in the sense that the proposed remedy was so wide that it would allow insurers to circumvent narrow MFNs and undermine PCWs). However, in the design of the remedy we considered the impact on PCW credibility and the impact on narrow MFNs. We concluded that banning wide MFNs and equivalent behaviours would not be detrimental to PCWs' credibility, or the viability of their business model, and narrow MFNs, which had pro-competitive effects in sustaining the business model of PCWs, would be unaffected. On point *(b)*, BGL told us that our remedies were likely to dissuade investment in new and existing PCWs. However, we found that other PCWs welcomed our remedies, telling us that they were able to operate effectively with just narrow MFNs and the ability to price differentiate following our remedies would encourage new investment.

12.123 We also noted that contract terms (eg commission fees) were typically renegotiated annually. Therefore, if our prohibition triggered a renegotiation, we expected that it would occur in place of the next annual renegotiation and not represent a significant additional burden. The cost would be that of bringing forward the next annual negotiation, which we would not expect to be significant.

- *Consumer search costs*

12.124 We recognised that our remedy was, in the short term likely to increase the dispersion of PMI prices available across different PCWs, and could lead to an increase in the number of consumers searching multiple PCWs. Under our remedy it was likely that more consumers would spend more time searching for PMI, representing a cost of the remedy.[21]

12.125 In order to gain a broad estimate of this cost, we performed a simple calculation of search costs. If we assume that searches take 20 minutes[22] and the value of non-work time is 10p/minute,[23] each search costs a consumer £2. In the scenario in which the impact of our remedy was to induce all those who searched just one PCW (approximately 33% of consumers) to now search two PCWs, then the additional search cost for 33% of consumers would be £2, ie about 5% of current commission fees. The search cost increase for the average consumer would be around 66p. We took from this calculation that the increased search cost arising from our remedy was likely to be a trivial proportion of PMI premiums. Moreover, we noted that unless the additional search cost generated at least as much saving in the cost of PMI for consumers as a result of the greater price dispersion then consumers would not undertake it.

- *Balance of benefits and costs*

12.126 Based on this analysis (see paragraphs 12.113 to 12.125), we concluded that the benefits of the remedy were likely significantly to outweigh the costs, such that the remedy would not produce disadvantages which were

[21] We note that, in equilibrium, because of competition between PCWs there might be no more dispersion of prices than currently, as competition would tend to equalise prices, albeit at a lower level than under wide MFNs. Therefore, the increased dispersion might only be a temporary effect.
[22] Moneysupermarket told us that, in its modelling of search costs, it assumed an average of 5 minutes per search. Therefore 20 minutes was a highly conservative assumption.
[23] An academic study for the DfT from 2003 recommended using 6p/min for non-commute transport times. The Value of Travel Time Savings in the UK, Institute of Transport Studies, University of Leeds, January 2003. By using 10p/min, we both adjusted for inflation (which raised the value to 7.6p) and sought to provide a conservative estimate.

disproportionate to its aim.[24] Given the significant difference in the benefits and the costs and the timely implementation of the remedies, we did not consider it necessary to conduct a detailed net present value analysis.

Conclusions on proportionality

12.127 We concluded that our package of remedies represented a proportionate solution to the AEC and/or the resulting customer detriment.

Our decision

12.128 We have decided to introduce the following package of remedies:

(a) A prohibition on all PCWs and PMI providers entering into or performing agreements which include an MFN relating to the sale of PMI, except narrow MFNs, where ‘narrow MFNs’ are defined as covering the PMI provider website only.

(b) A prohibition on behaviours which seek to replicate the same anti-competitive effects as a wide MFN (namely, preventing prices being quoted lower on other PCWs or other sales channels other than the PMI provider’s own website). This measure will apply to those PCWs which generate more than 300,000 PMI sales per year.

(c) PMI providers and PCWs will be required to comply without undue delay following the making of the order and, in any event, within one calendar month from the effective date of the order.

(d) In order to monitor equivalent behaviours, those PCWs above the 300,000 PMI sales per year threshold will be required to submit compliance statements to the CMA every quarter for the first two years following the order and then once per year. These compliance statements will state that parties have not engaged in equivalent behaviours which would be in breach of the order and will list all delisting actions during the relevant period, setting out the reasons for the delisting.

[24] BGL told us that our analysis of consumer search costs was superficial. BGL explained that it was based on an unjustifiable assumption that all customers who currently single-homed would in future search on two PCWs. BGL said that we had failed to assess the potential that some or all consumers would, as a result of the impact of our proposed MFN remedy, give up on using PCWs altogether and revert to time-consuming and inefficient searches direct with individual insurers. However, our analysis was only intended to provide a rough order of magnitude of these costs. As the benefits of the remedy so clearly outweighed these costs on the basis of our ‘order of magnitude’ calculation, we did not believe it was necessary to be more precise.

12.129 In our judgement, this package of remedies represented as comprehensive, effective and proportionate a solution as was reasonable and practicable to the AEC and/or the resulting customer detriment which we had found.

13. Statutory questions

13.1 As described in paragraph 1.1, on 28 September 2012 the OFT referred to us the supply or acquisition of PMI and related goods or services in the UK for investigation under section 131 and 133 of the Act.

AEC findings

13.2 Section 134(1) of the Act requires us to decide whether 'any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK'. A feature, for the purposes of section 134(1) of the Act, can relate to the structure of the market and/or the conduct of market participants, including customers.[1] If we decide that there is such a feature or combination of features then there is an AEC.

13.3 For the reasons given in Section 5 we did not find any features giving rise to an AEC in relation to:

(a) any systematic underprovision in relation to repairs, replacement cars or write-offs (ToH 2) (see paragraphs 5.15, 5.24 and 5.25);

(b) the supply of PMI in Northern Ireland or cost estimation systems (ToH 3) (see paragraphs 5.29, and 5.41 and 5.42);

(c) PMI providers' strategies to soften competition through influence over switching (ToH 4) (see paragraphs 5.34 and 5.35); and

(d) vertical issues in relation to inputs to post-accident services (ToH 5) (see paragraphs 5.41 and 5.42).

13.4 As noted in our guidance on market investigations, the CMA recognises that the theoretical benchmark against which to measure an AEC can never be a 'perfectly competitive' market. In past market investigations the CMA (or CC) has used the term 'a well-functioning market' in the limited sense, generally, of a market without the features causing the AEC. This has been our approach in this investigation.

13.5 For the reasons given in Section 6 we found that there was a combination of features relating to the resolution of post-accident non-fault claims which gave rise to an AEC in the PMI market. These features were:

[1] See section 131(2) of the Act.

(a) separation, ie the insurer liable for the non-fault driver's claim (the at-fault insurer) is often not the party controlling the costs; and

(b) various practices and conduct of the parties managing non-fault claims, which (i) were focused on earning a rent from the control of claims rather than simply competing on the merits; and (ii) gave rise to inefficiencies in the supply chain involving excessive frictional and transactional costs.

13.6 We found that the likely effect of this AEC was higher PMI premiums than would otherwise be the case. We found the effect was greatest in the provision of replacement vehicles but also applied to some extent in relation to repairs and write-offs.

13.7 For the reasons given in Section 7 we found that there was a combination of features relating to the sale of PMI-related add-ons which gave rise to an AEC in the PMI market. These features were:

(a) information asymmetries between motor insurers and consumers in relation to the sale of add-ons; and

(b) difficulties faced by consumers in trying to compare the aggregate price of a PMI policy and the price and terms of their chosen add-ons across different motor insurers.

13.8 We were particularly concerned about the sale and purchase of NCB protection.

13.9 For the reasons set out in Section 8 we found that the following feature gave rise to an AEC in the PMI market and in related services, and distorted competition between PCWs:

(a) wide MFN clauses in contracts between PMI providers and PCWs.

13.10 We found that the likely effect of this AEC was higher PMI premiums and possibly less choice from entry and innovation by PCWs than would otherwise be the case.

Remedies findings

13.11 If the CMA finds that there is an AEC, it is required under the Act to decide whether action should be taken by it, or whether it should recommend the taking of action by others, for the purpose of remedying, mitigating or preventing the AEC, or any detrimental effect on customers (the customer detriment) so far as it has resulted from, or may be expected to result from, the AEC. If the CMA decides that action should be taken, it must then decide what action should be taken and what is to be remedied, mitigated or prevented (see Section 9).

13.12 We have decided that in response to our finding of an AEC in relation to ToH 1 (see paragraph 13.5) no remedy can be applied as we have found no remedy within our powers nor a remedy we could recommend which would be both effective and proportionate (see paragraph 10.150). Nevertheless, we have made some observations about the functioning of the industry, and some encouragements to parties to amend their behaviour in ways which we believe will enhance competition (see paragraphs 10.152 to 10.167).

13.13 We have decided that in response to our finding of an AEC in relation to ToH 4 (see paragraph 13.7), the following information must be provided by insurers and brokers at the point at which NCB protection is purchased (see paragraph 11.111):

(a) the implied price of NCB protection;

(b) the average NCB discount according to the number of NCB years; and

(c) the step-back procedures, ie what would happen to the customer's number of NCB years with and without NCB protection in the event of one or more claims.

In addition, two specified statements (see paragraph 11.48) must be presented on PCWs when consumers seek more information about NCB protection, and provided by insurers and brokers at the point at which NCB protection is purchased.

13.14 We also decided to make two recommendations to the FCA (see paragraph 11.113):

(a) That it considers:

(i) whether insurers and brokers should be required to provide their prices for the add-ons they offer to PCWs and, if so, whether this should be for all PMI-related add-ons or only for the most commonly-purchased add-ons; and

(ii) how consumers' information needs in relation to PMI-related add-ons can best be met on PCWs, in particular in relation to enabling consumers to compare prices across providers for their desired package of PMI and PMI-related add-ons.

(b) That it works with insurers, brokers and PCWs to consider if and how these providers might improve their descriptions of PMI-related add-ons,

either as part of the FCA's general supervisory work or as part of its remedy proposals resulting from its market study into general insurance add-ons.

13.15 We have decided that in response to our finding of an AEC in relation to ToH 5 (see paragraph 13.9) to introduce the following package of remedies (see paragraph 12.128):

(a) A prohibition on all PCWs and PMI providers entering into or performing agreements which include an MFN relating to the sale of PMI, except narrow MFNs, where 'narrow MFNs' are defined as covering the insurance provider website only.

(b) A prohibition on behaviours which have as their effect the elimination or reduction of competition between PCWs in a similar way to wide MFNs (namely, preventing prices being quoted lower on other PCWs or other sales channels other than the PMI provider's own website). This measure will apply to those PCWs which generate more than 300,000 PMI sales per year.

13.16 In our judgement, for the reasons set out in Sections 10, 11 and 12, we believed that this package of remedies represented as comprehensive a solution as was reasonable and practicable to remedy the AECs and resulting customer detriment that we had found.