

## Terms of reference and conduct of our investigation

### Terms of reference

1. On 28 September 2012, the OFT made the following reference:

A1. The OFT, in exercise of its powers under Section 131 and 133 of the Act, hereby makes a reference to the CC for an investigation into the supply or acquisition of private motor insurance and related goods or services in the UK.

A2. The OFT has reasonable grounds for suspecting that a feature or a combination of features of the market or markets for the supply or acquisition of private motor insurance and related goods or services in the UK presents, restricts or distorts competition in connection with their supply or acquisition.

A3. For the purposes of this reference, 'private motor insurance' means insurance cover against damage to property and personal injury that is supplied to or acquired by drivers of privately-owned motor cars designed and used for non-business (private) use. It excludes motorcycles.

Clive Maxwell  
CEO  
28 September 2012

### Conduct of our investigation

2. On 1 October 2012, we published on our website an [invitation](#) to express views to us, and on 12 December 2012, we published an administrative timetable (since revised) for our investigation.
3. We have gathered a wide range of information from relevant parties. We have:
  - requested initial submissions from interested parties
  - published an [issues statement](#) and received submissions on this document
  - issued many information requests to parties
  - attended site visits
  - held hearings with many parties at various stages in the process

- held staff-level meetings with some parties on specific topics at various stages in the process
  - consulted on and commissioned a consumer survey from IFF
  - consulted on and commissioned a study involving post-repair vehicle inspections from MSXI
  - published a number of working papers, together with an [annotated issues statement](#), and received submissions on these documents
  - published our [provisional findings](#) and a [notice of possible remedies](#) and received submissions on these documents
  - published our [provisional decision on remedies](#) and some further working papers and received submissions on these documents
4. We have published on our [website](#) non-confidential versions of the submissions we received as initial submissions and in response to our issues statement, annotated issues statement and working papers, provisional findings and notice of possible remedies, and provisional decision on remedies, along with summaries and transcripts of our hearings.
  5. We have published on our website a non-confidential version of our final report.
  6. We would like to thank all those who have assisted in our investigation.

## PMI price trends

### Introduction

1. This appendix sets out data on trends in the price of PMI. It considers four main sources of such data:
  - (a) Office for National Statistics (ONS) consumer price index;
  - (b) AA premium indices;
  - (c) Confused.com/Towers Watson car insurance price index; and
  - (d) ABI average motor insurance premium tracker.

### ONS consumer price index for transport insurance

2. The ONS publishes a monthly index of consumer prices (CPI), which is the main UK measure of inflation. The 'all-items CPI' reflects price changes across the economy weighted by expenditure. In the CPI, all categories of expenditure on which significant amounts of money are spent are arranged into 12 divisions, which are subdivided into groups and then into classes. Price indices are published for each class, one of which is transport insurance.
3. The transport insurance CPI reflects price changes in car insurance and travel insurance.<sup>1</sup> Within the transport insurance CPI, car insurance price changes are weighted by 95% and travel insurance price changes by 5%. Because of the very high weight of car insurance in the transport insurance CPI, it can serve as a proxy for trends in PMI prices. The ONS calculates the change in car insurance prices by comparing a large number of quotes on car insurers' websites.
4. Figure 1 shows the trend in the transport insurance CPI since January 1996 and compares it with the CPI for all items. Over the period as a whole, transport insurance prices (predominantly reflecting car insurance prices) have increased much faster than prices generally: compared with January 1996, the transport insurance CPI is now over twice the level of the all items CPI, with rapid increases during 1998 to 2001 and especially in 2009 to 2010. By contrast, the CPI for home contents insurance (also shown in Figure 1)

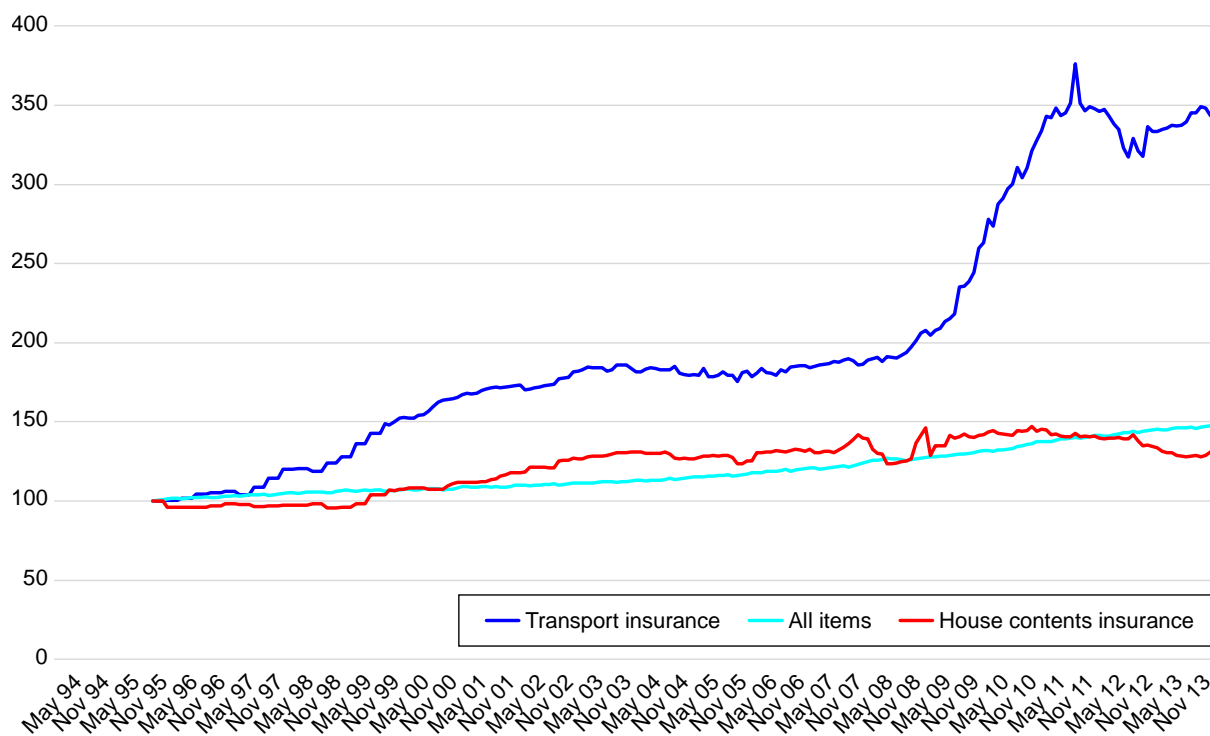
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<sup>1</sup> Travel insurance has been included in transport insurance since 2000.

has increased broadly in line with the all items CPI, suggesting that the longer-term increase in transport insurance prices has been driven by factors which have been specific to transport insurance (eg PMI claims costs) rather than general to insurance (eg administration costs). We discuss trends in PMI claims costs in paragraphs 2.42 to 2.46.

FIGURE 1

CPI, January 1996 = 100

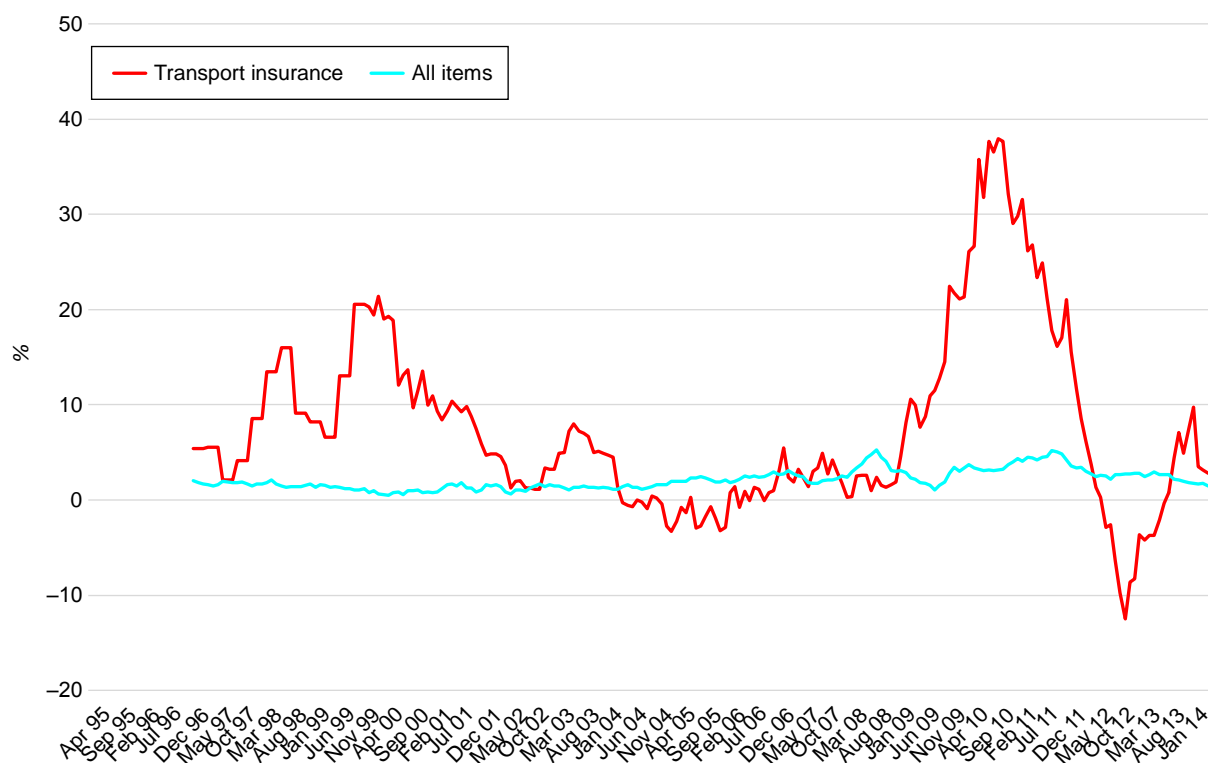


Source: ONS.

- Figure 2 shows the annual percentage change in the transport insurance CPI compared with the all items CPI. Figure 2 illustrates the significant fluctuations in the transport insurance CPI compared with the all items CPI.

FIGURE 2

**CPI, percentage change over 12 months**



Source: ONS.

**AA price indices for car insurance**

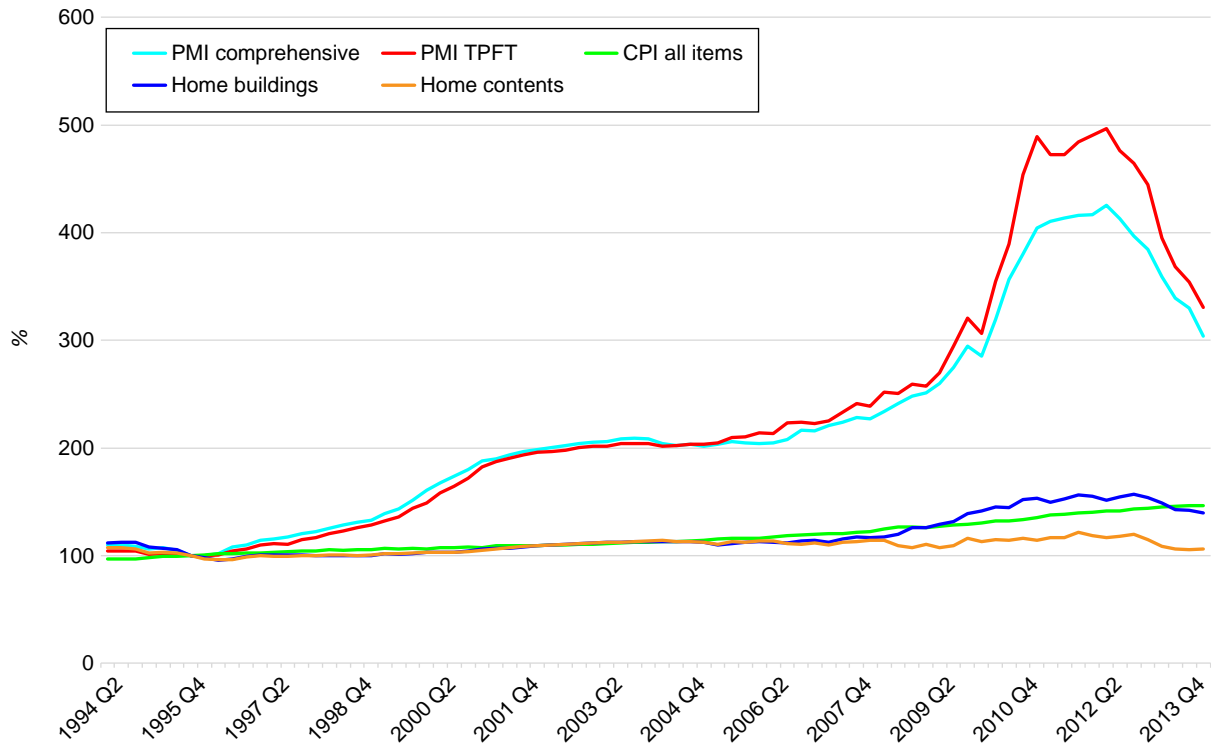
6. The AA publishes a British Insurance Premium Index, the purpose of which is to provide a general market overview of new policy premium movements. The AA said that its index recorded car insurance premium movements for 2,800 car insurance ‘customers’ throughout the UK, from the websites of around 80 providers. The premiums were averaged to provide a market ‘average quoted premium’. The AA’s premium data also covers home insurance, for which the AA stated that average movements were calculated from 750 customers, in each basket of risks separately for buildings, contents and combined covers, based on data from about 70 insurers, brokers and schemes.<sup>2</sup>
7. Figure 3 shows the AA indices together with the all items CPI. The overall pattern is similar to that shown in Figure 1, with car insurance prices having increased much more rapidly than prices generally over the longer term. The AA data shows more extreme movements than the CPI measure; in particular,

<sup>2</sup> AA British Insurance Premium Index.

it shows a larger increase in prices over 2009/10 and a larger decline in the last two years.

FIGURE 3

**AA insurance price indices (and CPI all items index), January 1996 = 100**

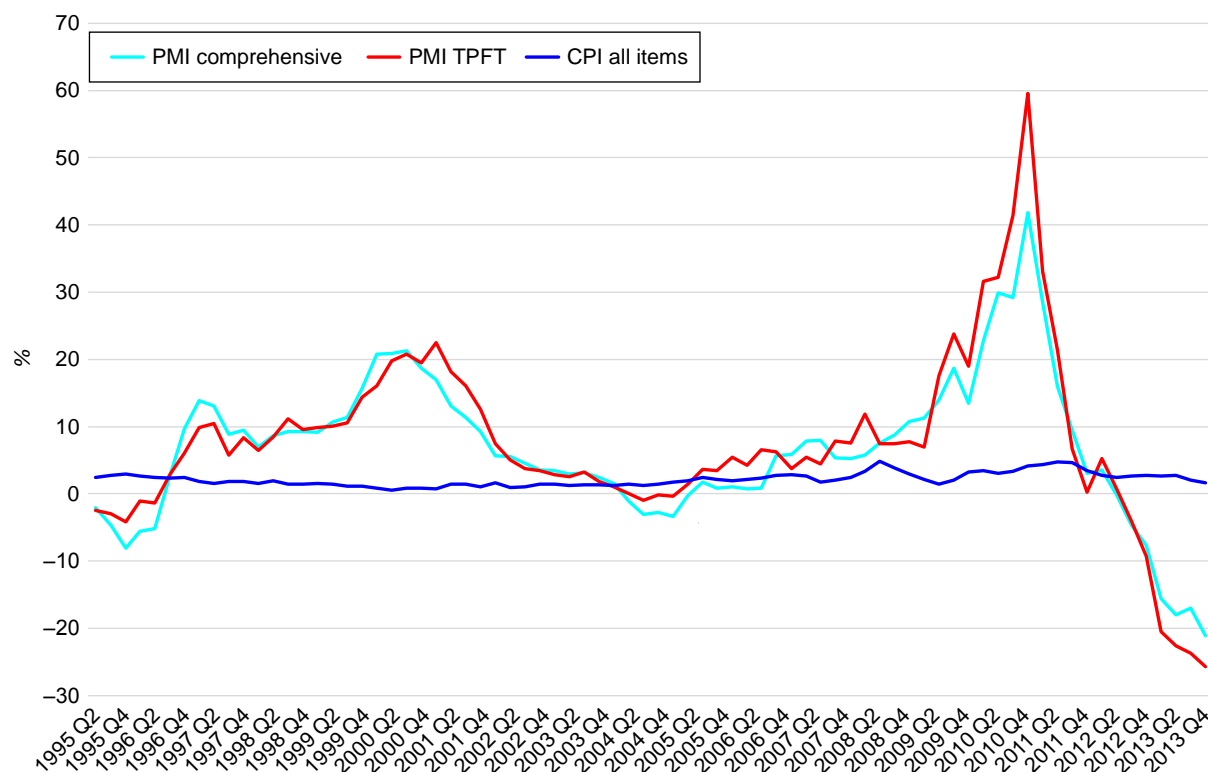


Source: AA (and ONS for the CPI).

8. Figure 4 shows the annual percentage change in the AA's car insurance price indices compared with the all items CPI.

FIGURE 4

**AA car insurance price indices (& CPI all items index):  
percentage change over 12 months**



Source: AA (and ONS for the CPI).

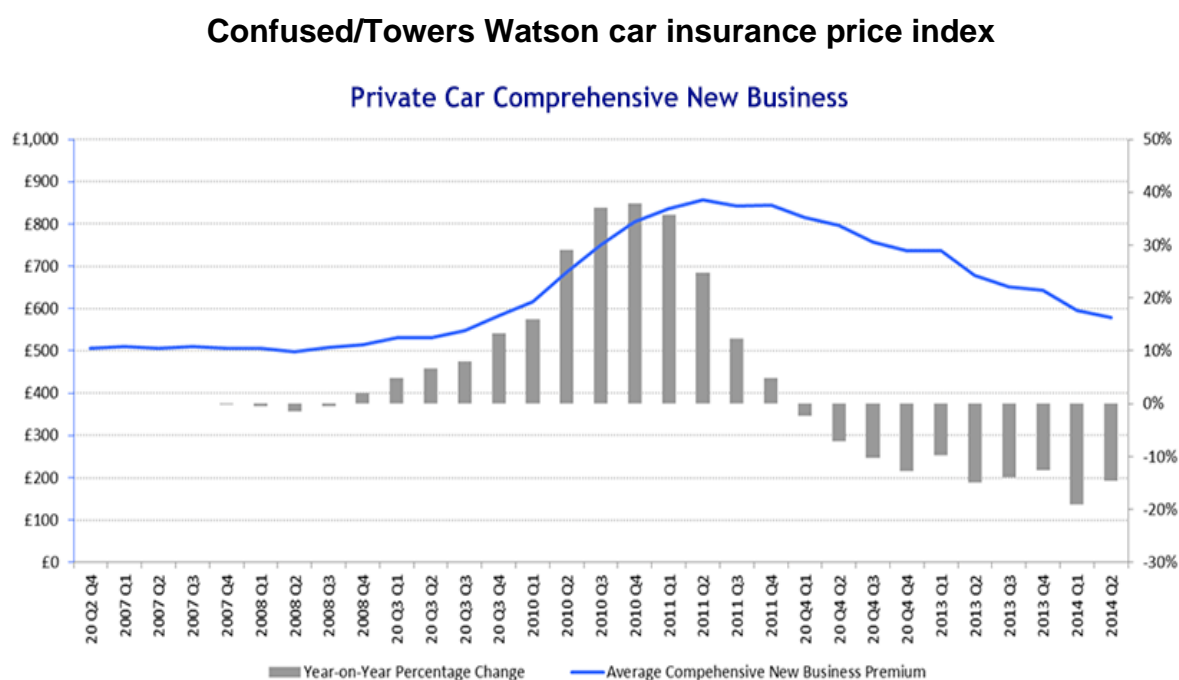
- The AA price indices shown in Figures 3 and 4 are calculated as an average across all providers for which data is available. The AA also published a 'shoparound' index, which was based on the average of the cheapest five premiums returned for each 'customer' in each basket of risks. The AA stated that this was closer to what customers paid for their cover. Additionally, the AA calculated prices from PCW data (whereas the price indices in Figures 3 and 4 were calculated from provider data). The overall trend suggested by the 'shoparound' and PCW indices in recent years appears similar to that suggested by Figures 3 and 4, though the recent price decline is slightly smaller (on comprehensive policies in Q1 2014 it is 15% for the PCW data<sup>3</sup> and 19% for the 'shoparound' data from providers' websites compared with 21% shown in Figure 4). The AA's data shows a 'shoparound' average premium in Q1 2014 of £663 based on provider data and £475 based on PCW data.

<sup>3</sup> The AA calculates both a market and a 'shoparound' average for the PCW data but they are similar.

## Confused car insurance price index

10. Confused, in association with Towers Watson (an insurance risk management specialist), has calculated a car insurance price index since 2009, covering the period since Q4 2006.
11. Confused said that its car insurance price trends were calculated from real quotes for comprehensive insurance given to its customers. The figures used were based on the average of the five lowest quotes received by the customer. Towers Watson then applied weightings to the data, so that the results reflected the entire market, rather than the particular demographic of Confused's customer base.
12. Figure 5 shows the Confused/Towers Watson data.<sup>4</sup> Figure 5 shows a broadly similar trend in car insurance prices since Q4 2006 to Figures 3 and 4 based on AA data.

FIGURE 5



Source: Confused/Towers Watson.

## ABI average motor insurance premium tracker

13. The ABI recently started publishing quarterly estimates of the average comprehensive PMI premium. The ABI tracker reflects average GWP per policy each quarter for comprehensive PMI policies, excluding optional policy

<sup>4</sup> [Confused.com car insurance price index trends.](#)

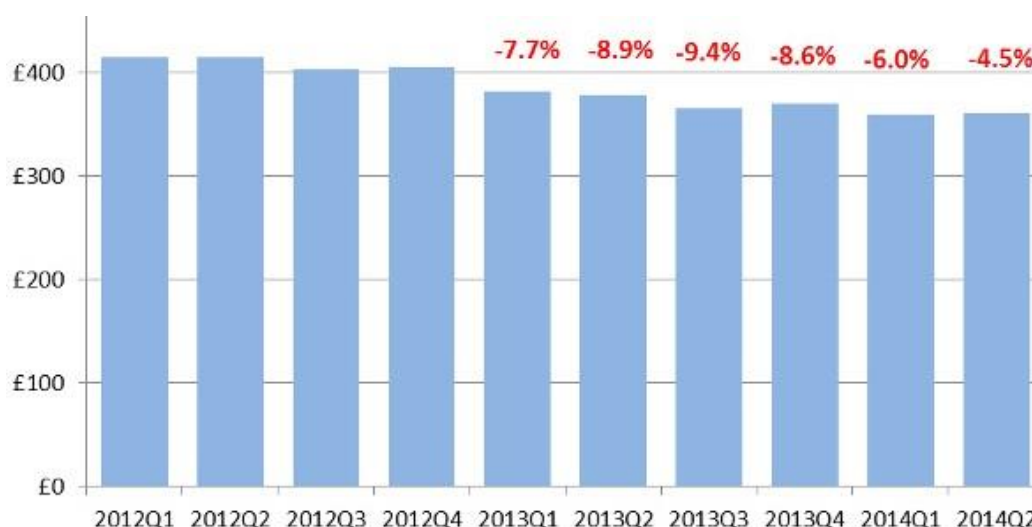


add-ons (such as breakdown cover and MLEI) and insurance premium tax.<sup>5</sup> The ABI told us that each ABI member which offers comprehensive PMI was requested to provide data. It estimated that the results covered around 90% of the PMI market written by insurance companies authorised in the UK (based on 2012 data).

14. Figure 6 shows the data published by the ABI, which covers the period since 2012. By comparison with the Confused/Towers Watson and AA data, the ABI data shows a somewhat lower decline in premiums since the second quarter of 2013 (though it also shows a lower level of average premium). This is likely to be because the ABI index is based on average prices paid, rather than quotations, and hence reflects movements in premiums for renewals as well as new policies.

FIGURE 6

**ABI average motor insurance premium tracker**



Source: ABI.

**Summary**

15. Data on PMI premiums suggests that over the longer term the price has increased faster than general inflation. There was a particularly rapid increase during 2009/10 but since 2011 there has been a fall in PMI premiums.
16. Similar data for house insurance shows that premiums have not increased faster than general inflation, suggesting that the longer-term increase in PMI prices has been driven by motor-specific factors (eg PMI claims costs) rather than factors general to insurance.

<sup>5</sup> [ABI average motor insurance premium tracker - Q2 2014 data.](#)

## Background to credit hire companies

### Introduction

1. CHCs are organisations which provide temporary replacement vehicles on a deferred payment basis.
2. Following an accident, a claimant may be referred to a CHC by their insurer or broker (or dealership, repairer, etc), or may engage with a CHC directly. The CHC will seek to assess liability for the accident (repeating some of the FNOL process which the claimant has already conducted with their insurer/broker). If the CHC believes that the claimant was not at fault, it may provide the claimant with a temporary replacement vehicle.
3. According to the Credit Hire Organisation (CHO), there are up to 100 CHCs in the UK, the majority of which are very small. We found that the five largest CHCs (Accident Exchange, Claimfast, Enterprise, Helphire and Quindell) accounted for about 80% of the credit hire market (by value of claims), while the ten largest CHCs (also including CCL Vehicle Rentals, Crash Services, EasiDrive, Kindertons and WNS) represented more than 90% of the market. More information on the number and value of the claims handled by CHCs is in the [annex](#).

### Services provided

4. A CHC provides a non-fault claimant with three services:
  - (a) vehicle hire, ie a temporary replacement vehicle;
  - (b) deferred payment, ie the claimant does not need to pay for the vehicle hire upfront but assumes liability for this cost; and
  - (c) claims handling, ie the CHC will pursue the at-fault insurer for the cost of the services provided to the non-fault claimant on the claimant's behalf.
5. The non-fault claimant customer enters into a credit hire agreement with a CHC. The terms and conditions of each credit hire agreement differ between CHCs but, typically, although the hirer remains liable to pay the credit hire charges, they authorise the CHC or a representative (eg a solicitor) to pursue the claim with the at-fault insurer. They also authorise any settlement monies to be paid to an account nominated by the CHC. CHCs told us that if the costs could not be recovered from the at-fault insurer (eg due to a change in the assessment of liability) it was very rare for a claimant to be asked to repay the

cost of hire themselves. Some CHCs told us that they avoided this by providing hirers with an insurance policy which would cover the hire charges and associated costs if the at-fault insurer did not pay.<sup>1</sup> Several CHCs told us that the only time they would seek payment directly from the hirer would be in the case of a fraudulent claim (ie where a misrepresentation of the accident caused the CHC to incorrectly assess liability).

6. Some CHCs operate more generally as CMCs, managing other aspects of a claimant's claim besides their need for a temporary replacement vehicle, eg repairs, personal injury, uninsured loss recovery, etc (see paragraphs 19 to 21). In some cases, CHCs fund repairs on a credit basis, recovering the costs in the same way as they recover the costs of credit hire.

### **Historical background**

7. Credit hire emerged in the late 1980s in response to the perceived failure of insurers to provide a temporary replacement vehicle to their policyholders when not at fault in an accident. CHCs told us that, at this time, insurers did not provide or assist non-fault claimants in securing their legal entitlement to a replacement vehicle following an accident, leaving claimants to source a replacement car themselves and to reclaim the cost from the at-fault insurer. Given the potential high cost and the risk of not fully recovering it, many non-fault drivers did not gain access to the temporary replacement vehicle to which they were legally entitled. CHCs told us that they responded to this situation by offering vehicles to non-fault claimants on credit and by handling this aspect (and sometimes other aspects) of the non-fault claimant's claim.
8. CHCs told us that there was often disagreement between CHCs and at-fault insurers about the charges for credit hire, sometimes resulting in litigation. They told us that this led, on 1 September 1999, to the launch of the GTA, which was an attempt to defuse the adversarial nature of claims settlement and to reduce some of the dispute-related costs. The GTA was initially limited to two national CHCs, but in 2000 it was extended to allow other CHCs to join.
9. The GTA is a voluntary agreement under which the terms, conditions and rates of credit hire to be applied by subscribing CHCs are decided by a Technical Committee comprising representatives of both CHCs and insurers. The GTA specifies procedures for claims handling and claims settlement, with any claim not handled in accordance with these rules 'falling out' of the GTA. Such claims typically give rise to higher credit hire charges but also a higher

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<sup>1</sup> This policy might also provide cover for legal costs and expenses which may be incurred in the event that formal legal proceedings need to be taken on the hirer's behalf to pursue the hirer's claim.

risk of non- or partial payment. Currently, most CHCs and insurers subscribe to the GTA.

10. Separately to the GTA, some of the large insurers and CHCs have formed bilateral agreements, which generally apply a lower level of credit hire charge in return for faster payment and less dispute.
11. According to the CHO's website, in 2006 only around 25% of credit hire claims resulted from a referral by an insurer; whereas, as shown in Table 1 below, in 2012 insurers were responsible for over a half of all referrals.

## Fleets

12. Different CHCs have adopted different ways of sourcing their vehicles. Some CHCs have their own fleets. In these cases, the CHC manages and maintains the fleet and bears the costs associated with any period of non-utilisation. This is the model adopted by Enterprise, Helphire and Kindertons. Other CHCs source their vehicles from external suppliers. In these cases, when the CHC agrees a hire with a customer, the CHC instructs one of its suppliers to provide the car and the supplier is responsible for delivering the vehicle to and collecting it from the customer. This is the model adopted by Claimfast and Quindell. In a third, hybrid model, the CHC acquires a proportion of its fleet from hire companies on a long term basis (eg six months or more). In these cases, the vehicles are delivered to a CHC's depot and controlled by the CHC during the course of the hire. [✂]

## Sources of customers

13. Table 1 summarises the sources of business in 2012 for six large CHCs, which together account for more than 80% of the credit hire market (by value of claims).

TABLE 1 Sources of business to CHCs in 2012

	%
Insurers	59
Brokers	18
CMCs	7
Dealers/manufacturers	9
Repairers	3
Recovery services	0
Solicitors	0
Own marketing	1
Other	2

Source: CHCs.

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14. In most cases, non-fault claimants are referred to a CHC by their insurer or broker. CHCs principally compete for referrals by offering referral fees, though

they also offer other services (eg uninsured loss recovery services, FNOL services). Referral contracts are tendered periodically by insurers and brokers and are typically two to five years in length. CHCs told us that, in awarding contracts, insurers took into account not only the amount of the referral fee but also quality indicators such as capacity and coverage of vehicle classes, adherence to vehicle safety and security requirements, time frames for provision, customer satisfaction and complaints ratios. We noted that some referral contracts were also negotiated in parallel with bilateral agreements (ie the insurer may accept a higher hire charge when it is the at-fault insurer if it earns a greater referral fee when it is the non-fault insurer, or vice versa).

15. We found that when other parties make referrals (eg dealerships and repairers), referral fees were still paid. In only a very small number of cases do CHCs acquire customers directly.
16. CHCs typically pay referral fees when a referral is converted into a hire. They are usually agreed as a fixed amount per hire, and do not depend on the model of the hired vehicle or on the duration of the hire. Sometimes higher fees are stipulated for prestigious cars, and a minimum hire length can be set, under which no referral fee is due.
17. We have estimated that in 2012 the average referral fee paid to insurers was £339, while the average paid to brokers was £308 (see Appendix 6.6).

### **The CHC process**

18. Following the referral of a claimant, the process of providing a temporary replacement vehicle and recovering the cost of the vehicle for the claimant from the at-fault insurer involves several typical steps:
  - (a) *Determination of liability.* The CHC first tries to decide whether there is a reasonable chance of success in recovering the cost from the at-fault insurer on the basis of the claimant being not at fault. It receives information from the claimant, identifies the at-fault insurer and makes a first enquiry on liability. It sometimes collects other information about the location and details of the accident, including police reports or witness statements. It also performs some checks to exclude the possibility of the claim being fraudulent. If the claimant's vehicle is roadworthy, the claim can remain pending until the CHC is more confident about the claimant being not at fault. However, if the vehicle is not roadworthy, a replacement may be provided while further enquiries are made.
  - (b) *Monitoring of repair.* After making a decision on the provision of a vehicle, the CHC notifies the at-fault insurer of the claim. The CHC will then keep

the insurer updated throughout the rest of the process. As the duration of a hire is linked to that of the repair, the CHC monitors the repair to ensure that there are no unnecessary delays. If the estimated completion date changes, the CHC informs the at-fault insurer of the reasons for the delay.

(c) *Termination of hire.* For claims under the terms of the GTA, the hire must terminate within one day from the completion of the repair or, in the case of a write-off, within seven days from when the claimant receives their compensation.

(d) *Payment.* For claims under the GTA, after the end of the hire, the CHC compiles a payment pack, including all the relevant information on the hire, and sends it to the at-fault insurer.

### **Additional services**

19. Some CHCs offer other services in addition to the provision of a temporary replacement vehicle on credit and the recovery of these costs. In around one-third of credit hire claims, credit repair is also provided, in most cases following a referral from a broker. (Where a non-fault insurer makes a referral, the insurer usually manages the repair, utilising its network of repairers.) When credit repair is provided, the CHC directly controls and manages the repair and pursues the claim for the cost of repair on behalf of the claimant to the at-fault insurer together with the cost of the temporary replacement vehicle.
20. Some CHCs also provide their customers with assistance for the recovery of other losses (eg damage to property, loss of earnings, excess, etc) from the at-fault insurer. Further details on uninsured loss recovery services can be found in Appendix 6.5.
21. Several CHCs also provide direct hire services. With the exception of Enterprise, direct hire is not a core business of credit hire providers, but it is a service that they provide to some insurers, in particular to those with which they have a referral contract.

### **Settlement of credit hire claims**

22. Less than 40% of the revenues for credit hire claims opened in 2012 were received within 30 days, and just 65% were received within 90 days. Almost 15% of revenues were received after more than six months. Moreover, the amounts charged are not always recovered in full, with an average recovery rate of about 90%. CHCs told us that this was due in part to successful

challenges by at-fault insurers and in part to discounts offered by CHCs to incentivise early payments.

23. Some CHCs and insurers have entered into bilateral agreements or equivalent protocols, in order to reduce operational and frictional costs.<sup>2</sup> For example:

(a) Enterprise has a 'subscriber' model under which, if the at-fault insurer accepts liability within five days, Enterprise pays the non-fault insurer a referral fee and it invoices the at-fault insurer for the cost of the hire at contracted direct hire rates plus the acquisition cost (including the referral fee) rather than at credit hire rates.

(b) Quindell has also adopted a collaboration protocol model with some insurers, obtaining a significant reduction in frictional costs.

(c) [REDACTED]

(d) Other CHCs have also signed bilateral agreements with some insurers, generally following the terms of the GTA and offering discounts off GTA rates in exchange for prompt and full payment.

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<sup>2</sup> See Appendix 6.1, paragraphs 18 & 117, for further details.

## Survey of credit hire companies

1. In order to obtain further information about credit hire and credit repair, we sent a questionnaire to CHCs.
2. The names and addresses of the CHCs were provided by the CHO. The questionnaire was also sent to one large CHC which is not a member of the CHO. We are very grateful to the CHO for its help in carrying out the questionnaire, including valuable advice on the drafting of the questionnaire and chasing the CHCs for a response.
3. The questionnaire was sent out in March 2014. A copy of the questionnaire is shown at the end of this annex.
4. We sent the questionnaire to 41 CHCs and received responses from 36. The results below are based on the 36 responses received. We have not attempted to estimate figures for non-respondents, though, as it is likely that the non-respondents are smaller CHCs. The exclusion of their numbers is unlikely to make much difference to the overall estimates. We have also not made any attempt to include data for any CHCs which were operating during 2011 to 2013 but have subsequently ceased trading (this would be most likely to affect the data for 2011).
5. Respondents were asked to provide their turnover,<sup>1</sup> and the number and value of closed claims, for credit hire and credit repair during 2011 to 2013. In relation to closed claims, respondents were asked to provide figures both for total credit hire/repair and for credit hire/repair where the client's vehicle was not privately owned and insured (ie where the client was a limited company or it was a commercial vehicle or part of a fleet).
6. We have used responses to estimate total credit hire and repair (see Table 1 below). The following points should be noted about these estimates:
  - (a) Many respondents did not have financial years ending in December and, in these cases, data is for the actual financial year ending during the year concerned. Hence, totals are aggregated across slightly different periods.

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<sup>1</sup> Respondents were requested to provide their turnover after provisions for under/non-recovery as shown in their accounts. Turnover is likely to differ from the value of closed claims because of a timing difference (turnover reflects claims for which revenue accrues during the year rather than claims closed during the year); because it includes an estimate of under/non-recovery which may turn out to be incorrect; and because it may include adjustments for under/non-recovery in previous years.



- (b) In some cases, respondents had individual financial years which were longer or shorter than 12 months. In these cases we pro-rated the data to calculate a 12-month financial year.
- (c) We requested turnover and value of closed claims excluding VAT. In some cases, companies provided the value of closed claims including VAT. In these cases, our estimates assume 20% VAT for privately-owned and -insured vehicles, and no VAT if the vehicle was not privately-owned and -insured.
- (d) Some respondents were unable to provide all the information requested. In these cases, we made estimates as follows:
- (i) Where respondents were unable to provide any data for 2011, we estimated 2011 figures by pro-rating 2012 aggregate totals for the bulk of companies which provided data for both 2011 and 2012.
- (ii) Where respondents were unable to provide any data on the value of closed claims or on turnover, we used turnover as an estimate of the value of closed claims or vice versa.
- (iii) Where respondents were unable to separate the number and value of closed claims according to whether they were on privately-owned and -insured vehicles, we pro-rated according to the aggregate proportion for respondents who did at least make an estimate of the number and value of closed claims according to whether they were on privately-owned and -insured vehicles.

TABLE 1 Results of questionnaire to credit hire companies

	2011	2012	2013
<i>Average month of year end*</i>	<i>June</i>	<i>July</i>	<i>July</i>
<i>Credit hire</i>			
Value of closed claims (total) £m†	380	387	405
Turnover £m†	379	350	373
Number of claims closed in year (total)	363,974	373,997	373,824
Of which: limited company or fleet	83,338	82,891	84,707
Number of closed claims – private	280,636	291,107	289,117
Average £ per closed claim (private)‡	1,208	1,188	1,235
<i>Credit repair</i>			
Value of closed claims (total) £m†	131	149	168
Turnover £m†	159	157	169
Number of claims closed in year (total)	106,125	116,478	123,367
Of which: limited company or fleet	22,958	24,582	25,719
Number of closed claims – private	83,167	91,897	97,648
Average value per closed claim (private)‡	1,461	1,501	1,601

Source: CMA based on information from respondents to the questionnaire.

\*Weighted average month of year end (weights used are number of credit hire closed claims).

†Excluding VAT.

‡Including VAT at 20%.

7. The estimated value of closed claims exceeds turnover in 2012 and 2013. There are a number of possible reasons for this, including timing differences and that turnover may be affected by adjustments for previous years.<sup>2</sup>
8. The most recent data (for financial years ended during 2013) suggests that there were about 370,000 closed credit hire claims, with a total value of about £460 million including VAT, and that just over 20% of these claims were where the client was a limited company or which concerned a commercial or fleet vehicle. The largest five CHCs accounted for about 80% of the total number and value of claims.
9. The comparable data for credit repair suggests that there were about 125,000 closed claims, with a total value of about £200 million including VAT. Again, just over 20% of these claims were where the client was a limited company or which concerned a commercial or fleet vehicle, and the largest five CHCs accounted for about 80% of the total number and value of claims.
10. Table 2 below compares the data we use in our main estimate of the detriment (see Appendix 6.6) with the results for closed claims in Table 1. The data we use in our main estimate of the detriment is for claims during the calendar year 2012. In our view, it is reasonable to compare these with estimates from the CHC questionnaire for claims closed during the financial year that ended during 2013. On average, CHCs' financial years ended on 4 July but typically claims are closed some considerable time after the accident concerned.<sup>3</sup> Thus many of the claims closed during the financial year that ended during 2013 will relate to accidents during calendar 2012, though some will relate to accidents during 2013 and some to accidents during 2011 and earlier years.

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<sup>2</sup> See previous footnote.

<sup>3</sup> See Appendix 6.1, paragraphs 56–60. The weighted average delay between issue of invoice and claim closure is around 170 days.

TABLE 2 Comparison of information used in main estimate of detriment with information from CHCs

	<i>Main estimate</i>	<i>CHCs</i>
<i>Credit hire</i>		
Number of claims ('000) – insurers'/brokers' data	301	
Number of claims ('000) – total		374
Number of claims ('000) – private clients		289
Average value per claim (£ including VAT)	1,105	1,235
<i>Credit repair</i>		
Number of claims ('000) – insurers'/brokers' data	106*	
Number of claims ('000) – total		123
Number of claims ('000) – private clients		98
Average value per claim (£ including VAT)	1,576*	1,601

Source: CMA based on information from insurers, brokers and CHCs.

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\*Includes write-offs.

11. In regard to credit hire, our figure of 301,000 claims used in our main estimate of the detriment is below the total number of claims handled by CHCs but slightly above the estimated number from private, rather than commercial, customers. The average value per claim used in our main estimate of the detriment is lower than the average value based on CHC data.
12. In regard to credit repair, our figure of 106,000 claims used in our main estimate of the detriment is below the total number of claims handled by CHCs and slightly higher than the estimated number from private, rather than commercial, customers. The average value per claim used in our main estimate of the detriment is similar to the average value based on CHC data.

## Copy of questionnaire sent to CHCs

In order to inform our statutory inquiry into private motor insurance, please would you provide the following basic information on your credit hire and credit repair business. You are required to provide a response by **Friday 4 April 2014**.

<b>Instructions for completion</b>				
Please fill in unshaded cells in the table below to the best of your ability.				
Name of credit hire company responding				
Name of audited company (if different)				
Name and telephone number for queries				
	<i>Accounting period ending</i>	<i>Month* 2011</i>	<i>Month* 2012</i>	<i>Month* 2013</i>
	<i>Length of accounting period†</i>			
<b>Turnover (£) after provisions for under/non-recovery (excluding VAT) as shown in accounts</b>				
Credit hire				
Credit repair				
Other‡				
Total from accounts				
<b>Further information on credit hire</b>				
Total number of claims closed in this accounting period				
<i>of which: limited company or fleet vehicles§</i>				
Total cash received for closed claims (all vehicles)				
<i>of which: limited company or fleet vehicles§</i>				
<b>Further information on credit repair</b>				
Total number of claims closed in this accounting period				
<i>of which: limited company or fleet vehicles§</i>				
Total cash received for closed claims (all vehicles)				
<i>of which: limited company or fleet vehicles§</i>				
<b>Notes</b>				
*Please replace "month" with actual month in which accounting period ended.				
†Please enter length of accounting period eg 12 months.				
‡Other turnover included in accounts. Please explain any significant sources of other turnover.				
§Please show claims closed where your client's vehicle was <b>not</b> privately owned and insured (ie where the client was a limited company or it was a commercial vehicle or part of a fleet). Please explain the basis of your data. The reason for requesting this information is that our terms of reference are limited to private motor insurance.				

It would be most convenient if you used the attached Excel spreadsheet for your response and emailed it to the CC. However, if you prefer, you may enter the answers in the table above.

Our purpose in obtaining this information is to estimate total credit hire and credit repair turnover of all companies. If you have already provided the information, please cross-refer as appropriate. The CC is under strict constraints regarding the disclosure of commercially sensitive information and it is not our intention to publish individual company figures, only aggregated figures for all companies.

Further information about the inquiry and our policy on information disclosure can be found on our website.

We are very grateful for your time in providing this information.

## Background to the provision of PMI

### Introduction

1. This appendix provides background information on:
  - (a) the ten largest motor insurers;
  - (b) selected PCWs; and
  - (c) selected brokers.

### The ten largest motor insurers

2. The ten largest motor insurers are: Admiral, Ageas, Aviva, AXA, CISGIL, DLG, esure, LV, RSA and Zurich.
3. Table 1 shows a summary of the companies owned by, or in the same group as, the ten largest motor insurers which provide services related to motor insurance.

TABLE 1 **Summary of companies owned by, or in the same group as, the ten largest motor insurers, which provide motor-insurance-related services**

Admiral	PCW: Confused (100%)
Ageas	Brokers: Ageas 50 Limited, Kwik-Fit Insurance Services Limited, Express Insurance Services Limited, The Green Insurance Company Limited, and UKAIS Limited
Aviva	Vehicle repairs: Solus
AXA	None
CISGIL	Co-operative Legal Services
DLG	Vehicle repairs: UKAARC
esure	PCW: GoCompare (50%) Brokers: esure broker and Sheilas' Wheels Broker
LV	None
RSA	Vehicle repairs: RSAAR
Zurich	Broker: Endsleigh

Source: Responses from the insurers.

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4. In the remainder of this section we present some brief details on each of the ten largest motor insurers: the type of company; its distribution channels and the brands under which it supplies PMI; the companies it owns which provide services related to PMI such as brokers or PCWs; and its GWP. [Annex A](#) 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 six years.<sup>1</sup>

### **Admiral**

5. Admiral launched in 1993 and floated on the London Stock Exchange in 2004. It is currently a FTSE 100 company. It specialises in motor insurance and does not sell other types of insurance.
6. Admiral operates 13 brands in seven countries. In the UK its brands are Admiral, Bell, Diamond and Elephant.co.uk.
7. Admiral also owns Confused.com, one of the four largest PCWs, which was launched in 2002.
8. In 2012, Admiral's total motor insurance GWP was over £1 billion, making it the fourth largest motor insurer in the UK. Over 80% of its sales are made via PCWs. Its other principal sales channels are direct (own websites and call centres).

### **Ageas**

9. Ageas is an international insurance group ranked among the top 20 insurance companies in Europe. Its activities are grouped in four geographic segments: Belgium, the UK, the rest of Europe and Asia. Ageas operates partnerships in Belgium, the UK, Luxembourg, Italy, Portugal, Turkey, China, Malaysia, India and Thailand and it has subsidiaries in France, Hong Kong and the UK. It is the market leader in Belgium of individual life and employee benefits, as well as the leading non-life insurer through AG Insurance. Ageas employs more than 13,000 staff and has annual revenues of more than €21 billion.
10. In the UK, Ageas (UK) Limited is a provider of life and non-life insurance products. It owns a 50.1% shareholding in Tesco Underwriting Limited.
11. Ageas has a different business model from the other ten largest motor insurers as it does not have any of its own brands and does not sell directly to customers, typically selling through the brands of others. 89% of its motor insurance policies are sold through brokers. It also sells through retailer partnerships (Age UK, General Motors, John Lewis, Lloyds Banking Group, Post Office Financial Services and Toyota). Ageas (UK) Limited owns a number of brokers: Ageas 50 Limited, Kwik-Fit Insurance Services Limited,

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<sup>1</sup> In [Annex A](#) we also comment on the suggestion made to us by some parties that the significant claims reserve releases made in 2013 by some insurers demonstrated that in some cases the pricing of risk has been overly prudent.

Express Insurance Services Limited, The Green Insurance Company Limited and UKAIS Limited.

12. In September 2012, Ageas (UK) Limited acquired Groupama Insurance Company Limited, boosting its presence in personal and commercial lines, and adding 1 million customers in the UK.
13. In 2012, Ageas's total motor insurance GWP was over £500 million, making it the sixth largest motor insurer in the UK.

### **Aviva**

14. Aviva is the UK's largest insurer and one of Europe's leading providers of life and general insurance. In the UK it provides home, motor, life and health insurance and annuities. The group was formed by the merger of CGU and Norwich Union in 2000. CGU came from the merger of Commercial Union and General Accident in 1998. It is a FTSE 100 company.
15. Aviva has three brands: Aviva, Quotemehappy (launched in August 2011) and General Accident (launched in April 2013). Aviva sells motor insurance via many distribution channels: direct, through brokers, corporate partners and PCWs (only using its Quotemehappy and General Accident brands). In 2012 approximately 50% of its sales came from the broker channel.
16. Aviva also owns a vehicle repair company, Solus Accident Repair Centres (Solus), which carries out vehicle repairs, including collection and delivery, and the provision of courtesy cars.<sup>2</sup> Solus also has some arrangements to carry out fleet repairs for the police and other repair networks.
17. Until September 2011 Aviva was also the owner of the RAC,<sup>3</sup> which it sold to Carlyle Group, a private equity group. Aviva continues to sell RAC breakdown cover to its customers and is an underwriter on RAC's panel of motor insurers.
18. In 2012, Aviva's total motor insurance GWP was over £1.1 billion, making Aviva the second largest motor insurer in the UK.

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<sup>2</sup> Aviva also had a salvage company, bluecycle.com, which was shut down in September 2013.

<sup>3</sup> The RAC motoring organisation no longer has any connection to its previous owners, the Royal Automobile Club.

## **AXA**

19. AXA SA is a French global insurance group headquartered in Paris and quoted on the Euronext Stock Exchange. In the UK, AXA specialises in wealth management, insurance and healthcare.
20. AXA sells motor insurance under two brands, AXA and Swiftcover, and through three channels: direct online (which is responsible for [X]), via brokers (responsible for [X]), and via PCWs (responsible for [X]). It operates call centres but these are only to assist customers as it does not sell motor insurance by telephone.
21. In 2012, AXA's total motor insurance GWP was over £[X] million, making it the fifth largest motor insurer in the UK.

## **CISGIL**

22. The Co-operative Group is the UK's largest consumer cooperative. It is owned by over 7.2 million consumers and approximately 80 independent cooperative societies. The Co-operative Group includes The Co-operative Banking Group, which in turn includes The Co-operative Bank and CISGIL, the general insurance company within the group. On 4 November 2013 The Co-operative Group announced a restructuring plan under which, inter alia, its shareholding in The Co-operative Bank will be reduced to 30%. It also stated that it was in discussions with various interested parties to sell CISGIL.<sup>4</sup>
23. CISGIL sells motor insurance under only one brand, The Co-operative Insurance, but it sells three different motor insurance products through different sales channels: 'Car Insurance' is sold direct, both online and via telephone, 'ecoinsurance' is only sold via PCWs, and 'Young Driver' is sold only direct online.
24. In 2012, CISGIL's total motor insurance GWP was over £[X] million, making it the ninth largest motor insurer in the UK.

## **DLG**

25. DLG is a leading general insurer and is the largest motor insurer in the UK. It also has businesses in Italy and Germany. Following an EU decision to separate DLG from the Royal Bank of Scotland Group plc (RBS) as a condition of the bank receiving state aid, DLG floated on the London Stock Exchange in October 2012 and has a FTSE 250 position. DLG is still 48.5%

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<sup>4</sup> [www.co-operativebankinggroup.co.uk/corp/pdf/recapitalisation-plan.pdf](http://www.co-operativebankinggroup.co.uk/corp/pdf/recapitalisation-plan.pdf).



owned by RBS, although RBS has committed to selling its entire shareholding by December 2014.

26. In personal lines insurance, DLG sells home insurance, breakdown cover, pet insurance, travel insurance, motor and income insurance. Its commercial business also offers a range of products primarily targeted at small businesses.
27. DLG offers motor insurance through the Direct Line, Churchill and Privilege brands, and also through the brands of a range of partners, including Sainsbury's Bank, RBS, Prudential and PSA (Peugeot/Citroen).
28. DLG uses different channels for its different brands of motor insurance: Direct Line is available only over the telephone or online, not through PCWs; while Churchill and Privilege are sold through PCWs, as well as being available directly by telephone or online. DLG also uses its partnerships with retailers, banks, building societies and motor manufacturers. Across all its brands, over three-quarters of its sales are made direct (either online or by telephone).
29. DLG owns UK Assistance Accident Repair Centres Limited (UKAARC), which provides vehicle repair services exclusively to DLG through a network of 16 sites.
30. In 2012, DLG's total motor insurance GWP was over £1.6 billion, making it the largest motor insurance provider in the UK.

### **esure**

31. esure only sells motor, home and travel insurance, and only to customers in England, Wales, Scotland and the Isle of Man. It was started in 2000 by the founder of Direct Line, and in 2010 was subject to a management buyout of the stake originally held by Halifax/HBOS and latterly Lloyds Banking Group. The company was floated on the London Stock Exchange in March 2013.
32. esure sells motor insurance under three brands: esure, Sheilas' Wheels (launched in 2005 to female drivers only) and First Alternative. It sells through PCWs (over [X] % of its sales), and direct to customers via telephone and online. It does not distribute motor insurance through partnerships with retailers, banks/building societies or other distribution channels. In the past, esure provided motor insurance under the Sainsbury's and Halifax brands, in partnership with these companies, but new business under these arrangements has now ceased.
33. esure launched an insurance broker at the end of 2011 under two brands: esure broker and Sheilas' Wheels Broker. esure does not distribute motor

insurance products through its insurance broking business but rather has a panel of other insurers which it believes complement esure's position in the market, enabling the group to offer services to all possible consumers.

34. esure owns 50% of GoCompare.com Holdings Limited, the parent company of GoCompare.com Limited, one of the four largest PCWs. It told us that GoCompare.com was independent and operationally separate from esure.
35. In 2012, esure's total motor insurance GWP was over £400 million, making it the seventh largest motor insurer in the UK.

## **LV**

36. LV is the UK's largest friendly society<sup>5</sup> and a leading financial mutual. A mutual organisation is owned by its members, with membership restricted to those who have certain types of policy, such as life insurance, or a retirement policy.
37. LV distributes motor insurance through the full range of distribution channels: direct (online or by telephone), affinity schemes, PCWs, corporate partners and brokers. The broker channel accounts for approximately half the policies sold by LV. It sells motor insurance only to customers in the UK.
38. LV sells motor insurance through three main brands: LV for direct sales, and both ABC Insurance and Highway Insurance for broker sales (Highway Insurance Group PLC was acquired by LV in 2008).
39. In 2012, LV's total motor insurance GWP was over £1.1 billion, making it the third largest motor insurer in the UK.

## **RSA**

40. RSA is a leading global insurance group and a FTSE 100 company. In the UK it is the largest commercial insurer and one of the largest personal lines insurers.
41. RSA has three motor insurance brands. It sells motor insurance directly (through its More Than and eChoice brands) and through intermediaries, including brokers and affinity partnerships. More Than is an online and telephone service provider which sells the full range of RSA's personal insurance products, including motor insurance, while eChoice is only sold

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<sup>5</sup> A friendly society is based on the principle of mutuality. Unlike a cooperative, members usually do not contribute to the capital of the organisation by direct investment but derive their right to profits and votes through their customer relationship with the organisation.

online (through a dedicated website launched in 2010) and is only a motor insurance brand.

42. RSA sells motor insurance through a wide range of distribution channels: directly, either online or by telephone; online via PCWs (representing [X]% of its sales); via brokers; and indirectly through affinity partnerships (Ford and Volvo). In 2012, [X]% of its motor insurance sales were made direct and [X] of its sales were made via PCWs, with [X] of its sales made via brokers. However, RSA told us that, in 2013, it expected to write [X]. RSA uses 'branded' and 'non-branded' brokers:<sup>6</sup> branded brokers include AA, Brightside, Budget, Castlecover, Endsleigh, Kwik Fit and Swinton; non-branded brokers tend to be RSA-branded, with the cover based on RSA's own policy wording.
43. RSA group owns RSA Accident Repairs Limited (RSAAR) which trades under the name of Motor Repair Network Management. RSAAR owns some repair garages, known as Quality Repair Centres (QRCs), which undertake repair work solely for RSA, and it also utilises a network of approved garages.
44. In 2012, RSA's total motor insurance GWP was over £[X] million, making it the eighth largest motor insurer in the UK.

### **Zurich**

45. Zurich is one of the world's largest insurance groups and is listed on the SIX Swiss Stock Exchange. In the UK, Zurich sells a range of general insurance products, including car, home, boat and high-net-worth insurance, as well as life insurance products such as life cover, pensions and retirement products, and investments.
46. Zurich sells motor insurance through two main sales channels: nearly [X]% of sales are made through brokers, with the remainder made through PCWs. It has not written new business through partnerships since 2010. A very small amount of motor insurance is sold directly online.
47. Zurich owns the broker Endsleigh Insurance (over which it acquired full control in 2007).

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<sup>6</sup> A branded broker leverages its brand name, customer loyalty and possession of customer data to obtain cheap quotations. The AA Insurance, part of the AA roadside breakdown organisation, is the UK's leading branded broker of motor insurance. It uses a 'Motor Insurance Deal Checker' system to compare insurance policies from a selected panel of over 15 insurers (including RSA). Other branded brokers include Kwik Fit Insurance (owned by Ageas), Endsleigh (owned by Zurich), BGL and RAC.

48. In 2012, Zurich's total motor insurance GWP was over £[redacted] million, making it the tenth largest motor insurer in the UK.

## PCWs

### *The four large PCWs*

49. The four largest PCWs are:

(a) Comparethemarket;

(b) Confused;

(c) GoCompare; and

(d) Moneysupermarket.

50. Table 2 presents a summary of the financial results of the four largest PCWs operating in the UK. Since all four companies promote other products in addition to motor insurance, the results do not reflect the size of their motor insurance business. Although none of the four companies publicly discloses financial results for its motor insurance activities, the turnover related to motor insurance is shown in the bottom half of the table for each PCW. None of the four PCWs discloses the operating profit related to motor insurance in its management accounts.

TABLE 2 Summary financial results of the four largest PCWs

	<i>Confused</i>		<i>Comparethemarket</i>		<i>GoCompare</i>		<i>Moneysupermarket</i>	
	2011	2010	2011	2010	2011	2010	2011	2010
Turnover (£m)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Operating profit (£m)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Operating profit (%)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
<i>Motor insurance only</i>								
Turnover (£m)	[redacted]		[redacted]		[redacted]		[redacted]	
Turnover as a % of company turnover	[redacted]		[redacted]		[redacted]		[redacted]	

Source: PCWs' published reports and accounts, and management accounts.

51. Three of the four large PCWs were able to provide us with some of their key performance indicators (KPIs) for their motor insurance business on a similar basis, as shown in Table 3. Conversion is calculated as the ratio of motor insurance policies sold to the number of unique customer quotes.

TABLE 3 KPIs for the three of the four largest PCWs

	<i>Confused</i>	<i>Comparethe market</i>	<i>GoCompare</i>
Fee per policy sold (£)	[X]	[X]	[X]
Unique customer quotes (m)	[X]	[X]	[X]
Number of motor insurance policies sold (m)	[X]	[X]	[X]
Conversion (%)	[X]	[X]	[X]

Source: PCWs' published reports and accounts, and management accounts.

Note: Moneysupermarket [X].

52. We discuss the profitability of the PCWs' motor insurance business further in Appendix 9.3, Annex I.
53. In the remainder of this section we provide some brief details on each of the four largest PCWs.

### **Comparethemarket**

54. Comparethemarket.com is an independent division of BISL Limited (BISL), which is part of the privately-owned BGL Group.
55. Motor insurance makes up [X] of Comparethemarket's business [X].
56. Comparethemarket is [X]. In 2011 it generated turnover from motor insurance of £[X] million, with an average income per sale of £[X].
57. Comparethemarket told us that it considered its closest competitors to be the other three large PCWs, plus Google and Tesco Compare which were of lesser but increasing significance.

### **Confused**

58. Confused is a wholly-owned subsidiary of Admiral. It promotes and compares a wide range of general insurance and finance products. It was launched in 2002, starting with motor insurance, and added its home insurance comparison service in 2005.
59. Confused is the [X] of the four large PCWs with regard to motor insurance, with turnover of £[X] million from motor insurance in 2011. This represented [X]% of its total turnover. Its average income per sale was £[X].
60. Confused told us that it considered its closest competitors to be the other three large PCWs, plus Google.

## **GoCompare**

61. GoCompare is 50% owned by esure.<sup>7</sup> GoCompare told us that it was operated independently of esure, with entirely different executive management.
62. GoCompare provides comparison services for other insurance products including home, motorbike, van and pet. It also has a number of 'white label' agreements for the provision of other products, such as travel insurance, utilities, and business/landlord insurance.
63. GoCompare is the [X] of the four large PCWs with regard to motor insurance, with turnover of £[X] million from motor insurance in 2011. This represented [X]% of its total turnover. Its average income per sale was £[X].
64. GoCompare told us that it considered its closest PCW competitors to be the other three large PCWs, Tesco Compare and Google.

## **Moneysupermarket**

65. Moneysupermarket was founded in 1999 and provides comparison services for a range of products including insurance, financial services and non-financial services. It is wholly owned by Moneysupermarket.com Group Plc, which is a FTSE 250 listed company. The group also owns Moneysavingexpert.com, which is a financial journalism website.
66. Moneysupermarket is structured into four 'verticals': money, insurance, home services and travel. Other than motor insurance, Moneysupermarket provides comparison services for a wide range of insurance products: home, travel, life, mortgage protection, income protection, breakdown, motorbike, business and van. Moneysupermarket also provides comparison services for a wide range of products, both financial and non-financial: travel, energy, mobile phones, shopping and broadband, as well as offering promotional deals and vouchers. Moneysupermarket appears to offer the widest range of product comparisons of the four largest PCWs.
67. Moneysupermarket is the [X] of the four large PCWs with regard to motor insurance, with turnover of £[X] million from motor insurance in 2011. This represented [X]% of its total PCW business.
68. Moneysupermarket told us that it considered its closest competitors to be the other three large PCWs, as well as Tesco Compare, Google, Tiger,

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<sup>7</sup> Via GoCompare.com Holdings Limited.

Quotezone, Moneyexpert, Uswitch, Lovemoney, Quidco and Soswitch. This longer list of competitors appears to be because of Moneysupermarket's wider product range than the other three large PCWs.

### **Google and Tesco Compare**

69. Google launched its current motor insurance price comparison service in the UK in September 2012 following its acquisition of Beatthatquote in March 2011, a company which was founded in 2005. Tesco Compare launched its motor insurance price comparison service in September 2007, initially as a 50:50 joint venture with RBS, though in 2008 Tesco bought the business in its entirety.

### **CompareNI**

70. CompareNI is a PCW operating only in Northern Ireland. It is part of Seopa Ltd, founded in 2003, and is still owned 100% by its founder. Although originally focusing mainly on search engine optimisation for the insurance industry, Seopa Ltd began to expand into the creation of price comparison technologies soon after incorporation. The company started price comparison activities in the UK with Quotezone and developed CompareNI in 2008/09.
71. CompareNI's primary revenue stream is from motor insurance, where it earns commission fees and click-through fees generated from customers clicking on advertisements placed on its website. The company includes links to other websites in order to give consumers a route to some of those motor insurers which do not participate on PCWs. Since 2008, CompareNI has also provided consumers with the telephone numbers of the brokers which quote on its site so that they can purchase their insurance or find out more details if they wish.
72. Table 4 summarises CompareNI's financial performance for the [REDACTED]. Compared with the four largest PCWs operating in the UK, [REDACTED].

TABLE 4 Summary financial results for CompareNI, [REDACTED]

	[REDACTED]	[REDACTED]	[REDACTED]
Company	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Motor insurance only	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: CompareNI management accounts.

Note: [REDACTED].

### **Selected motor insurance brokers**

73. In this section we provide information on six large motor insurance brokers:

- AA and Saga: which during the majority of our inquiry were owned by Acromas Holdings
- Ageas Retail: owned by Ageas Group (an insurance group)
- BISL: owned by BGL Group, which owns Comparethemarket
- Endsleigh: owned by Zurich (an insurance group)
- Swinton: owned by Covéa (an insurance group)

74. Table 5 summarises the motor insurance income of these six brokers.

TABLE 5 **Motor insurance income for selected brokers**

	<i>Year ended</i>	<i>£m</i>
AA	January 2012	[X]
Saga	January 2012	[X]
		[X]
Ageas Retail	December 2012	[X]
BISL (Frontline only)	[X]	[X]
Endsleigh	December 2012	[X]
Swinton	December 2012	[X]

Source: Management accounts.

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### **AA and Saga**

75. Saga and the AA are insurance brokers which during the majority of our inquiry were owned by Acromas Holdings, but which were floated in May and June 2014 respectively.

#### **AA**

76. Automobile Association Insurance Services Limited (AAISL) brokers motor insurance through two brands: AA Car Insurance and AA Drivesafe Insurance (the latter being the AA's telematics offering).

77. The AA also sells and administers a range of general insurance products, including home and breakdown assistance.

78. For motor insurance, the AA [X].

79. The AA told us that [X].

### **Financials**

80. Table 6 summarises the financial performance of the AA's motor insurance broking business for the three years to January 2012.



TABLE 6 Summary financials, AA, for the three years ended January 2012 – motor insurance only

	Years ended January		
	2012	2011	2010
Sales (£m)	[X]	[X]	[X]
Contribution (£m)*	[X]	[X]	[X]
Contribution (%)	[X]	[X]	[X]
Marketing costs (£m)	[X]	[X]	[X]
Total policies	[X]	[X]	[X]
GWP (£m)	[X]	[X]	[X]
Average per policy (£):			
GWP	[X]	[X]	[X]
Commission	[X]	[X]	[X]
Contribution*	[X]	[X]	[X]
Marketing costs	[X]	[X]	[X]

Source: AA management accounts.

\*After marketing costs.

81. Sales and GWP [X]. Commission and contribution per policy [X].

### Saga

82. Saga Services Limited, trading as Saga, is a general insurance intermediary business which sells and administers a range of general insurance products including motor, home, travel and private medical insurance. Saga only offers motor insurance policies underwritten by Acromas Insurance Company Limited (AICL).<sup>8</sup>

83. All of the broking activity, including the sale, renewal and administration of policies, is carried out by Saga; all claims handling is carried out by AICL.

84. Saga offers motor insurance exclusively to the over-50s market in the UK.

85. In 2011, Saga had the ninth biggest spend on advertising from among all motor insurance advertisers, with direct mail accounting for over 80% of its advertising spend.<sup>9</sup>

### Financials

86. Table 7 summarises the financial performance of Saga's motor insurance broking business for the three years to January 2012.

<sup>8</sup> AICL is a subsidiary of Saga plc which was floated in May 2104.

<sup>9</sup> Source: Datamonitor. [X] DLG, [X] in 2011, spent [X]% of its advertising expenditure on direct mail and [X]% on television advertising.

TABLE 7 Summary financials, Saga, for the three years ended January 2012 – motor insurance only

	Years ended January		
	2012	2011	2010
Sales (£m)	[X]	[X]	[X]
Contribution (£m)	[X]	[X]	[X]
Contribution (%)	[X]	[X]	[X]
Marketing costs (£m)	[X]	[X]	[X]
Total policies	[X]	[X]	[X]
GWP (£m)	[X]	[X]	[X]
Average per policy (£):			
GWP	[X]	[X]	[X]
Commission	[X]	[X]	[X]
Contribution	[X]	[X]	[X]
Marketing costs	[X]	[X]	[X]

Source: Saga management accounts.

87. [X], sales and contribution [X].

### Ageas Retail

88. Ageas Retail is the broking division of the Ageas group. Ageas Retail consists of the following companies which all sell motor insurance: Ageas 50 Limited, Kwik Fit Insurance Services Limited (KFIS), Express Insurance Services Limited (EIS), The Green Insurance Company (TGIC) and UK Ageas Insurance Solutions (UKAIS). KFIS was acquired by Ageas in 2010. KFIS is the parent company for EIS and TGIC and these three businesses are managed together. Ageas 50 Limited is the largest brand in the group, offering primarily motor and home insurance.

89. Ageas Retail's major specialisms are providing insurance to the over-50s, affinity partnerships and aggregator distribution.

### Summary financials

90. Table 8 presents the limited financial information available for all the Ageas Retail businesses for the three years ended December 2012.

TABLE 8 Summary financials, Ageas Retail, three years ended December 2012

	£		
	Years ended December		
	2012	2011	2010
<i>Whole business</i>			
Income	[X]	[X]	[X]
Operating profit	[X]	[X]	[X]
Operating profit (%)	[X]	[X]	[X]
Total motor insurance income	[X]	[X]	[X]
Average premium	[X]	[X]	[X]

Source: Ageas Insurance.

## **BISL**

91. BISL is an insurance broker [REDACTED].
92. BISL uses multiple distribution channels, including its own website and call centre, and PCWs.<sup>10</sup>
93. BISL is owned by BGL Group, which was established in 1992 as an insurer but changed strategy in 1997 to become an insurance intermediary.
94. BISL manages its direct brands within its Frontline business and manages its affinity and partner brand relationships within its Junction business.

## **Financials**

95. Table 9 summarises the financial performance of Frontline's motor insurance business [REDACTED].

TABLE 9 Summary financial performance, [REDACTED] – motor insurance only

[REDACTED]

Source: BGL management accounts.

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96. In 2012, [REDACTED].

## **Endsleigh**

97. Endsleigh is a group of companies wholly owned by Zurich.
98. Endsleigh Insurance Services Limited (EIS) was originally founded by the National Union of Students (NUS) in 1965 and is a UK insurance intermediary specialising in the provision of personal insurance products for students, graduates and the education sector. EIS is the primary brand under which Endsleigh markets and sells motor insurance.
99. EIS sells general insurance products to retail customers online via a direct website and through PCWs, via a call centre, and via introducer networks and partnerships. These include affinity relationships, such as with the NUS and the National Association of Schoolmasters Union of Women Teachers. EIS sells motor, home, travel and student possessions insurance.

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<sup>10</sup> Another division of BISL is Comparethemarket.com, [REDACTED].

100. EIS has delegated authority from its panel of insurers to sell and service insurance and, for most of the insurers on its panel, it also handles claims on their behalf.
101. Separate from this business, EIS also offers third party administration claims-handling services to a number of insurers and insurance risk capacity providers. This is distinct from the main EIS panel business as it handles policyholders who did not buy their policies from EIS. EIS is paid a fee for these services by the relevant insurer.
102. EIS operates a panel of 13 motor insurers. Its [REDACTED].

### Financials

103. Table 10 summarises Endsleigh's financial performance for the three years ended [REDACTED]. The management accounts are based on an analysis of income by product type (eg motor, home, travel). However, Endsleigh's expenditure is considered by category and is not linked back to the product to which it relates. As a result, although motor insurance [REDACTED], Endsleigh was not able to estimate the profitability of this business. Turnover and profits [REDACTED] over the three-year period to [REDACTED].

TABLE 10 Summary financial performance, Endsleigh, three years ended [REDACTED]

£ million

	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Endsleigh management accounts.

### Swinton

104. Swinton is a part of the Covéa group.<sup>11</sup> Swinton's primary brands for retail motor insurance broking are Swinton in mainland UK, and Open & Direct Insurance in Northern Ireland. Swinton also brokers many other insurance products, including household insurance and commercial vehicle cover.
105. Swinton brokers the majority of its motor insurance sales through its network of branches,<sup>12</sup> as well as through its call centres and online (new policies only). It has 512 branches in Great Britain and 16 in Northern Ireland. Swinton

<sup>11</sup> Swinton Holdings Limited is a sister company of Covéa Insurance plc. Covéa Insurance was created in the UK in October 2012 through the integration of three companies: Provident Insurance, MMA Insurance and Gateway, and is part of the French Covéa mutual insurance group.

<sup>12</sup> Approximately [REDACTED]% of Swinton's overall business is generated through these branches (no figure provided for motor insurance specifically).

has an inbound call centre which functions as an overflow unit in support of the branches and provides service outside branch opening hours. Swinton also has an outbound call centre which is used as a sales campaign unit, and sells core products, add-ons and monthly products.

106. Swinton has [X] main insurers on its motor insurance panel. The top ten insurers on its panel represent [X]% of Swinton's GWP, with the most important ([X]) representing [X]% of its GWP, and the second most important ([X]) representing [X]% of its GWP.

### Financials

107. Swinton does not allocate either divisional costs or central overheads to individual products and therefore financial data is only available at a high level. Table 11 shows the financial performance of the whole business for the three years ended December 2012. Income, contribution and operating profits [X] in 2011 [X] in 2012. Motor insurance has been an increasing part of Swinton's business, and in 2012 constituted [X] of its total business.

TABLE 11 Summary financials, Swinton, for the three years ended December 2012

	<i>£ million</i>		
	<i>Years ended December</i>		
	<i>2012</i>	<i>2011</i>	<i>2010</i>
Income	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
Operating profit	[X]	[X]	[X]

Source: Swinton Holdings Limited statutory accounts and Swinton management accounts.

108. Swinton provided us with a split of its income by product for the three years ended 31 December 2012, which is shown in Table 12. Total income [X]% over the three years, which appeared to be [X].

TABLE 12 Swinton, breakdown of motor insurance income, 2010 to 2012

	<i>£ million</i>		
	<i>2012</i>	<i>2011</i>	<i>2010</i>
[X]	[X]	[X]	[X]

Source: Swinton management accounts.

## High-level analysis of profitability for the ten largest PMI insurers, 2008 to 2013

	Claims ratio (%)							Expense ratio (%)						
	2008	2009	2010	2011	2012	2013	Average	2008	2009	2010	2011	2012	2013	Average
Admiral	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ageas	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
AXA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
LV	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Across all 10 providers	78	89	98	78	75	70	82	32	30	24	27	29	28	28

	Combined operating ratio (%)							Underwriting result plus investment income (£m)						
	2008	2009	2010	2011	2012	2013	Average	2008	2009	2010	2011	2012	2013	Average
Admiral	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ageas	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
AXA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
LV	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Across all 10 providers	110	119	123	105	104	98	110	596	-238	-334	888	984	1,082	375

Source: CC calculations based on data from the ten largest insurers.

Note: [REDACTED]

- We found that there are two key measures of profitability which are disclosed externally: the underwriting result and the combined operating ratio (COR):
  - The underwriting result is expressed as an absolute figure and is calculated as earned premiums (net of reinsurance),<sup>1</sup> plus other income (including referral fees), less incurred claims (usually net of any rebates), earned commission and expenses, and excludes investment income. As such, it is focused only on underwriting activities and not investment activities.
  - The COR expresses insurance outgoings as a percentage of premiums. Insurance outgoings are claims liabilities, commission payments and expenses. The lower the figure, the more profitable the business to the

<sup>1</sup> 'Reinsurance' is insurance purchased by an insurance company from one or more other insurance companies as a means of risk management. The function of reinsurance is to reduce an insurer's exposure to loss by passing part of the risk of loss on to a reinsurer.

- insurer, with any figure below 100% meaning that the insurer is profitable on its underwriting activities (before investment income).
2. Other financial performance measures used by motor insurers are:
- Based on premiums received: GWP, net written premium (NWP) and net earned premium (NEP). Each of these measures is expressed as an absolute figure. GWP is the amount of premium written in the year, gross of reinsurance, and regardless of when it was accrued; NWP is GWP net of reinsurance; NEP is the amount of premium accrued during the year, regardless of when it was written, net of reinsurance.
  - Based on profitability:
    - Return on capital/return on equity. This is typically profit after tax divided by total capital or equity capital, expressed as a ratio.
    - Profit before tax (also called portfolio insurance result, or technical or operating result). This is the underwriting result plus investment income, thus measuring all activities in the insurance business.
  - Based on claims costs:
    - Claims ratio (or loss ratio). This represents claims costs as a percentage of premiums.
    - Underlying or normalised measure of claims costs. This represents claims costs excluding very large individual claims, over a certain amount, eg very large personal injury claims. This is used in the calculation of a normalised claims ratio.
  - Based on expenses: expense ratio. This represents expenses as a percentage of premiums.
3. We asked the insurers how they accounted for referral fees and rebates from other firms, and amendment and cancellation fees from customers. We found that rebates are generally credited against the cost of claims, while referral fees and amendment and cancellation fees are generally included in 'other income'.

### **Claims reserves**

4. Some parties told us that significant claims reserve releases made in 2013 by some insurers demonstrated that in some cases the pricing of risk had been overly prudent.

5. We asked the insurers to describe their claims reserves policies. We found that the amount of reserves held by insurers is generally based on actuarial estimates of the cost of settling claims that have been reported but have not been paid at a financial reporting date. Some insurers explained that actuarial estimates took into account past trends in claims experience and known changes in the external claims environment. Some insurers told us that they also held additional reserves to cover risks that were not fully allowed for in the actuarial estimate, such as possible changes in the law and the discount rate used in determining lump sum settlements in personal injury claims, and to cover claims handling expenses.
6. We asked insurers to explain what factors had led to any material changes of reserves since 2008. Several insurers told us that their claims reserves increased between 2008 and 2011 and that the main two factors which accounted for this increase were the growth in GWP over that period and increases in the number, and average amount, of personal injury claims. We were also told that the trend towards periodic payment orders in large personal injury cases, rather than lump sum awards, had led insurers to hold larger reserves as there was greater uncertainty about the period over which insurers would have to make payments. Several insurers told us that they reduced claims reserves in 2013 because personal injury claims had fallen, which some insurers attributed to the impact of the Legal Aid, Sentencing and Punishment of Offenders Act 2013.
  - We noted that Admiral's 2013 annual report stated that its claims reserve release in 2013 was £53 million, compared with £16 million in 2012, which it attributed to positive claims experience during 2012 and 2013. The annual report also stated that Admiral had a conservative reserving policy and that reserve releases and commutation of quota share agreements were a long-term feature of Admiral's financial results. It also noted that a large proportion of car insurance claims costs related to bigger personal injury claims for which the final cost was impossible to predict accurately in the year in which the accident occurred.<sup>2</sup>
  - DLG told us that it released £292 million of reserves in 2013, primarily as a result of favourable personal injury claims experience for recent accident years.
  - esure's 2013 annual report stated that its prior year reserves release in relation to its motor insurance business in 2013 was £71 million, compared

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<sup>2</sup> [Admiral Group plc annual report and accounts 2013](#).



with £59 million in 2012. The annual report stated that the reserve releases reflected the favourable development of prior accident year reserves (across both motor and home insurance). The annual report also noted that esure looked to maintain a consistent and prudent reserving policy and this approach has meant that, historically, claims had ultimately settled at a lower cost than initially calculated for the purposes of esure's booked claims outstanding reserves and the reserves for claims incurred but not reported.<sup>3</sup>

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<sup>3</sup> [esure annual report and accounts 2013](#).

## Quality of service: replacement cars

### Introduction

1. In this appendix, we summarise evidence on the quality of replacement car provision. We focus on the provision of replacement cars to non-fault drivers. We are concerned in this appendix with the overall quality of service received by claimants rather than the differences between captured and non-captured claimants.
2. We do not consider in this appendix the overall quality of replacement car provision to at-fault drivers, as an at-fault driver's entitlement to a replacement car is based on their insurance policy. An at-fault driver is usually entitled to a courtesy car or, where the driver has purchased additional cover, a class of vehicle higher than a courtesy car or a like-for-like replacement car.
3. In this appendix, we examine:
  - (a) non-fault drivers' views on the type of replacement car provided and the hire duration;
  - (b) data on the provision of replacement car downgrades (where a non-fault driver receives a replacement car of a lower class than their own car); and
  - (c) evidence from electronic call records provided to us by the ten motor insurers and nine CMCs/CHCs in our sample.

### Non-fault drivers' views on the type of replacement car and the hire duration

4. Our survey of non-fault drivers investigated both the type of replacement car provided to non-fault drivers and the length of the hire duration. The results are set out in Appendix 6.5 but we summarise them here for convenience.
5. As shown in Table 1, 85% of respondents to our survey who received a replacement car stated that it at least met their needs. Of these, 17% said that it exceeded their needs (of which 11% said it far exceeded their needs). 14% of respondents said that the replacement car fell short of their needs (9% of respondents said it fell slightly short of their needs and 5% of respondents said it fell well short of their needs). The main reasons why these respondents felt that the replacement car they received fell short of their needs were that it was less spacious or smaller than their own car, it was a worse make/model than their own car and/or it had a less powerful or smaller engine than their own car.

TABLE 1 **Non-fault claimants' experience of replacement cars**

	<i>All claims</i> %
<i>How well the replacement car met respondents' needs</i>	
Far exceeded needs	11
Somewhat exceeded needs	6
Met needs	68
Fell slightly short of needs	9
Fell well short of needs	5
Base (weighted)	1,186
<i>Length of time respondents had access to the replacement car</i>	
A longer time than needed	3
As long as needed	88
A shorter time than needed	9
Base (weighted)	1,178

Source: CMA non-fault survey, questions D19 and D23.

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6. As also shown in Table 1, 90% of respondents to our survey who received a replacement car felt that they had access to the replacement car for at least as long as needed (of these, 3% felt that they had access to it for longer than needed). 9% of respondents felt they did not have the replacement car for long enough. The main reasons given by respondents for requiring the replacement car for longer than it was provided were that they did not have access to any other car or another suitable car during the repair and they needed time to find a car to purchase (ie where their car was written off).
  7. Overall, we considered that the survey results suggested that the vast majority of non-fault claimants were satisfied that the replacement car services they received following an accident met their needs (or exceeded them), both in terms of the quality of the replacement car provided and the hire duration.

### **Replacement car downgrades**

8. A non-fault driver is entitled to recover the reasonable costs of car hire, provided the reasonable need for an alternative car can be established. In practice, this usually involves the provision of a 'like-for-like' replacement car for as long as is reasonably necessary, subject to the non-fault driver's duty to mitigate their loss with consideration to their need.
9. However, sometimes non-fault drivers receive a replacement car of a lower class than their own car (ie a downgrade). This can occur when:
  - (a) The age of the driver's car does not justify a like-for-like replacement car. Where the driver's car is six years old or older, the GTA requires the CMC/CHC to provide a replacement car of a lower class than the driver's car (subject to the need for a replacement car at all). For example, [redacted] told us that, in certain GTA car groups, where the driver's car is over ten

years old, the replacement car provided was typically two vehicle groups lower than the driver's own vehicle, although the specific circumstances of a driver's need must also be considered.

(b) The driver is encouraged to accept a lower-class replacement car by the claims handler. [REDACTED] told us that, when direct hire customers were provided with a downgrade, it was the at-fault insurer which determined the category of replacement car to be supplied to the customer.

10. Table 2 sets out the proportion of replacement car downgrades to non-fault drivers for the nine CMCs/CHCs in our sample, in relation to both credit hire and direct hire customers in 2012. We noted that the proportion of replacement car downgrades to non-fault claimants under a direct hire agreement could be inflated by the inclusion of some at-fault claims, as an at-fault driver may be entitled to a replacement car on a direct hire basis under their motor insurance policy (subject to them purchasing the appropriate additional cover).

TABLE 2 Proportion of replacement car downgrades to non-fault drivers, 2012

CMC/CHC	%	
	<i>Proportion of credit hire customers provided with downgrades</i>	<i>Proportion of direct hire customers provided with downgrades*</i>
Accident Exchange	[REDACTED]	[REDACTED]
ACM†	[REDACTED]	[REDACTED]
Ai Claims Solutions	[REDACTED]	[REDACTED]
ClaimFast‡	[REDACTED]	[REDACTED]
Crash Services§	[REDACTED]	[REDACTED]
Enterprise	[REDACTED]	[REDACTED]
Helphire	[REDACTED]	[REDACTED]
Kindertons	[REDACTED]	[REDACTED]
WNS Assistance	[REDACTED]	[REDACTED]
<b>Unweighted average</b>	<b>15</b>	<b>30</b>

Source: CMCs/CHCs.

\*The direct hire data may include at-fault claims.

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

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

§Crash Services does not record the proportion of downgrades to credit hire customers (as they are infrequent) and does not provide direct hire services.

Note: N/A = not applicable.

11. Table 2 shows that between [REDACTED] and [REDACTED]% of direct hire customers were downgraded and between [REDACTED] and [REDACTED]% of credit hire customers were downgraded. We did not consider that the existence of downgrades indicated that there was any underprovision (because drivers may not have needed a like-for-like replacement car and because of the difficulty of interpreting the data – see paragraph 10).

## Review of motor insurer and CMC/CHC electronic call records

12. We reviewed a sample of electronic call records provided by the ten motor insurers and the nine CMCs/CHCs in our sample, in order to assess whether there was any evidence of differences in:

- (a) the type of replacement car provided to the driver by a non-fault insurer or CMC/CHC and an at-fault insurer; and/or
- (b) the assessment of the driver's need for that type of car;

and therefore, any indication that insurers or CMCs/CHCs provide non-fault drivers with replacement car services that are inferior to the services to which they are legally entitled. The results are set out in Appendix 6.5.

13. Our review did not provide evidence that non-fault drivers were being underprovided with replacement cars (see Appendix 6.5). Nevertheless, we noted that there was some variation in the quality and quantity of the information provided to non-fault drivers by claims handlers, irrespective of whether the claim was managed by the non-fault insurer or CMC/CHC or captured by the at-fault insurer. For example:

- (a) the driver's need for a like-for-like replacement car was rarely assessed;
- (b) the driver's duty to mitigate their losses was rarely explained in detail; and
- (c) the complexities of credit hire, such as the driver's obligation to enter into a rental agreement and a credit agreement and to sign a mitigation statement to confirm that they had not received a suitable offer of a replacement car from the at-fault insurer, were only explained to drivers at a high level.

## Quality of service: vehicle write-offs

### Introduction

1. This appendix examines evidence on whether the compensation or quality of service provided to at-fault and/or non-fault claimants when their vehicle is a write-off is lower than that to which they are entitled (either under contract or tort law) due to a lack of alignment between their interests and those of the parties which procure services on their behalf.
2. The process relating to vehicle write-offs as a result of a road traffic accident is described in Appendix 6.3.
3. In this appendix we examine the following ways in which claimants might receive lower compensation or a lower service than that to which they are entitled following a vehicle write-off:
  - (a) the pre-accident value being set too low;
  - (b) a replacement car being provided for an insufficient amount of time;
  - (c) a bias towards write-off rather than repair;
  - (d) the estimated salvage value being set too high when a customer chooses to retain the vehicle; and
  - (e) policy cancellation.
4. Some repairers told us that many of the vehicles which were written off and sold as salvage were then cheaply and badly repaired before re-entering the used car market. Although we received some anecdotal evidence indicating that consumers of used cars were often unable to detect when a vehicle had been in an accident, or to assess the quality of the repairs which had been conducted, we judged that this was an issue relating to the supply of used cars and was not related to the provision of PMI and related goods and services. Therefore we did not consider it further.

### ***Pre-accident value***

5. We found that information on the value of used vehicles is readily available to consumers, meaning that claimants are easily able to challenge a low pre-accident valuation of their vehicle.

6. Nine of the ten largest insurers told us that they gave their customers the opportunity to provide additional evidence in relation to the pre-accident value of the vehicle if they were not happy with the initial vehicle valuation, and the evidence we have received indicates that customers frequently make use of this opportunity. For example:
- (a) Admiral said that its initial estimate of the write-off value was disputed in [X]% of cases where it managed the write-off for its own customer, and in [X]% of cases where it was a captured non-fault claim.
  - (b) Ageas said that [X]% of its total loss valuations were disputed by its customers in 2012.
  - (c) CISGIL said that [X]% of its initial write-off estimates were rejected by the customer.
  - (d) DLG said that [X]% of its write-off decisions were disputed and [X]% of its valuation disputes were unresolved.
7. Customers who are not happy with their insurer's final decision on the write-off value can complain to the Financial Ombudsman Service, except for captured non-fault drivers and non-fault drivers who claim through a CMC.<sup>1</sup> esure said that it had had [X] valuation disputes with the Financial Ombudsman Service in 2012. Ageas Insurance said that only in a very small percentage of cases was the valuation not agreed and did the customer take the matter to the Financial Ombudsman Service.
8. We were told that:
- (a) there was a limited period in which claimants could dispute the pre-accident valuation;
  - (b) some claimants might not want to delay the receipt of funds while a pre-accident valuation was being disputed;
  - (c) some customers may not be aware of the Financial Ombudsman Service; and
  - (d) captured non-fault customers and customers of CMCs did not have access to the Financial Ombudsman Service.

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<sup>1</sup> Captured non-fault claimants are not claiming under an insurance policy; CMCs are regulated by the Claims Management Regulator (within the Ministry of Justice) rather than by the FCA. For these reasons, captured non-fault claimants and customers of CMCs do not have access to the Financial Ombudsman Service.

9. However, it appeared that these limitations for some customers were unlikely to give rise to pre-accident valuations generally being too low given the ready availability of used vehicle valuations to consumers.

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

10. We did not find any evidence that estimated salvage values were set too high.

### ***Replacement cars for insufficient time***

11. We found that when at-fault customers' vehicles were written off following an accident, the provision of a replacement car was often very limited. Zurich told us that it provided a replacement car for up to five days; RSA told us that it provided a replacement car for up to three days; and esure, Admiral and Ageas Insurance said that no replacement car was provided unless the customer had bought cover for a guaranteed courtesy car. RSA said that there was no contractual entitlement to a replacement car on claims where the vehicle was a write-off, although, in practice, a courtesy vehicle was provided until the decision on write-off was finalised.
12. We found that guaranteed courtesy car cover typically guaranteed the provision of a replacement car in the event of a vehicle write-off for a limited period, usually around 21 days.
13. We found that there was also generally limited replacement car provision for customers who were ultimately determined to be the non-fault party but whose liability had not been established at the time they needed the replacement car and who therefore claimed on their own insurance.
14. We found that captured non-fault claimants and non-fault claimants managed by a CMC/CHC typically received a replacement car for the entire period of the claim and for up to seven days after the funds were received from the insurer or CMC managing the claim.<sup>2</sup>
15. In relation to non-fault claimants whose claims were managed by their own insurer, AXA told us that its non-fault customers were allowed to retain the replacement car until such time as an offer was made for the pre-accident value of the written-off vehicle; while Aviva and LV told us that its non-fault customers could keep the replacement car for up to 14 days.

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<sup>2</sup> The duration of the replacement car hire to which a claimant is entitled under tort law is assessed on the facts in the light of the circumstances of each case. However, the practice by some CMCs/CHCs of extending the period of replacement car hire for up to seven days beyond the claim being settled appears to be intended to meet a customer's entitlement under tort law.



16. We asked insurers how long it typically took when they were managing the claim between agreeing the pre-accident value with the claimant and the claimant receiving the payment. RSA told us that, once settlement had been agreed with a claimant, the funds should be released within five days (in accordance with ABI requirements). LV said that on average it took ten days, AXA said eight days, and DLG said 10 to 14 days. DLG said that the time-frame could be influenced by factors such as delays by the customer in sending the required vehicle documentation or by outstanding settlement figures that needed to be provided by finance companies.
17. We also asked insurers how long it typically took between FNOL and a write-off claimant receiving payment. Zurich told us that, in 2012, it took on average 37 days from the FNOL to send out the payment for a total loss; Ageas Insurance and esure said that in 70% of cases its customer (whether at-fault or non-fault) would receive compensation within 21 days from the FNOL when their vehicle was a write-off; and Admiral told us that the average length of time between the report of the accident and payment in a vehicle write-off case was 20 days for at-fault claims and 19 days for non-fault claims.
18. Overall, we did not see clear evidence of underprovision against claimants' tort or contractual entitlement in regard to the length of time for which claimants had replacement cars.

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

19. We considered whether insurers and CMCs might have an incentive to favour write-offs over repairs, in particular in relation to non-fault claims, because of the referral fees that they might receive from salvage companies (see Appendix 6.3, paragraphs 29 to 38). We also considered whether non-fault insurers and CMCs might prefer write-offs to repairs in order to generate longer replacement car hire durations and higher CHC referral fees. However, we found no evidence to suggest that there was any preference for insurers or CMCs to write off rather than to repair vehicles.
20. We also found that customers generally appeared to prefer repairs over write-offs. LV told us that customer satisfaction scores for repair claims were much higher than for write-offs and we noted that many repairers (in conjunction with insurers) offered their customers cheaper repair alternatives (eg by using recycled parts) in order to avoid a write-off.
21. Although we found that there was a revenue opportunity for non-fault insurers and CMCs from a write-off, the amounts did not appear any greater than those which could be achieved through managing a non-fault repair (see Section 6). esure told us that the process of managing a non-fault write-off

was only slightly longer than the process of managing a non-fault repair, which appeared to be likely to be due to write-offs attracting more scrutiny from insurers due to their higher average value.

22. In the case of a captured claim, the evidence we received suggested that the at-fault insurer would be unlikely to prefer a write-off over a repair as the replacement car hire length was usually longer for write-offs than repairs.
23. Overall, we concluded that it was unlikely that the services received by claimants in relation to vehicle write-offs was lower than that to which they were entitled because of a preference by insurers or CMCs to write off rather than to repair a vehicle.

### ***Policy cancellations***

24. We found that some at-fault insurers cancelled the at-fault driver's PMI policy when the policyholder's vehicle had been written off. Likewise, some non-fault insurers cancelled the non-fault driver's policy if the claim was made under the customer's own policy. However, most insurers told us either that they did not cancel policies or that the policy could be amended and remain in force if the customer replaced the vehicle within a reasonable period.
25. Overall, it did not appear to us to be common practice for insurers automatically to cancel policies following a write-off. Moreover, when cancellation did occur, it appeared to be in accordance with the terms of the policy so any consumer harm would be due to either (a) consumers not understanding and/or appropriately valuing the terms of their motor insurance policy at the point of purchase; or (b) not appreciating the implications of claiming under their own insurance or not understanding their alternative options at the time of their claim.

## Quality of service: repairs

### Introduction

1. In this appendix we discuss evidence on the following points:
  - (a) whether there are differences in how repairs are handled and performed, depending on whether they are at-fault or non-fault repairs and, if non-fault, which party manages the repair;
  - (b) the strategies that at-fault and non-fault insurers and CMCs might take to reduce costs which would lead to lower repair quality;
  - (c) quality standards and the monitoring of those standards;
  - (d) levels of customer satisfaction with regard to vehicle repairs; and
  - (e) results of inspections of repaired cars to see whether they were repaired to the pre-accident standard (MSXI survey).

### Differences in how repairs are handled and performed

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

2. All of the ten largest insurers told us that their at-fault and non-fault repairs (including captured non-fault repairs) were managed in the same way and, if handled by the insurers' approved repair network, were performed in the same way. The only difference we found was that some insurers stipulated the use of non-OEM parts for some at-fault repairs and some own-insurer non-fault repairs (eg for certain parts in at-fault repairs of vehicles more than three years old), whilst on equivalent captured non-fault repairs, OEM parts were used. [X], [X] and [X] each told us that they differentiated their handling of repair claims in this way. However, we found that the use of non-OEM parts in insurer-managed repairs was small (between 2 and 15% of all parts used, by value).
3. All three of the large insurer-owned repairers confirmed that they repaired at-fault and non-fault vehicles in the same way.
4. Most of the largest insurers told us that they did not pay repairers differently for at-fault and non-fault repairs (eg in terms of the labour rate) and evidence from both insurer-owned and independent repairers confirmed this. The only exceptions we found were that one insurer used two different CMCs to handle

separately some of its at-fault and non-fault claims and one insurer paid its repairers a higher labour rate for non-fault repairs.

5. Repairers told us that the time allowed for a repair was the same regardless of whether it was an at-fault or non-fault repair, as this was determined by the repair cost estimation system (usually Audatex). Repairers also told us that if insurers and CMCs (together referred to as 'work providers') stipulated the use of a certain brand of paint, the same brand of paint would be used in the at-fault and non-fault repairs for that work provider.
6. Overall, it appeared to us that, for insurer-managed repairs, whether a repair was at-fault or non-fault made little difference to how it was performed.

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

7. We also considered whether there were any systematic differences between insurer-managed repairs and credit repairs. We asked both CMCs and insurers about the parts they used and the time they allowed for repairs.
8. We found that credit repairs were more likely than insurer-managed repairs to use OEM parts and more parts were likely to be replaced rather than repaired.<sup>1</sup> However, the use of non-OEM parts in insurer-managed repairs was small (see paragraph 2), so the effect from this difference was unlikely to be significant, and we did not receive evidence of a significant difference in whether parts were replaced rather than repaired depending on the work provider. We were also unable to assess whether the greater use by CMCs of OEM parts and replacement instead of repair was due to the repair being managed by a CMC rather than an insurer (as suggested to us by some repairers) or due to differences in the mix of repairs they handled (eg CMCs might handle on average more complex repairs).<sup>2</sup>
9. We did not find evidence of any difference in the time allowed for repairs as both insurers and CMCs told us that the time was determined by the repair cost estimation system (usually Audatex).
10. Kindertons told us that there was little difference between how it performed its credit repairs and how insurers performed their repairs, as both its repair network and those of insurers adhered to either PAS 125 (see paragraph 22) or manufacturer-approved guidelines.

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<sup>1</sup> This difference is also discussed in the working paper '[ToH 1: Overcosting and overprovision of repairs](#)'.

<sup>2</sup> [§] noted that in most cases where a repair was possible, it was better to repair a part rather than replace it as replacement could mean cutting into the shell of the vehicle, while repair retains the original structural integrity of the vehicle.

11. Overall, it appeared to us that there were no significant differences in how they were performed between credit repairs and insurer-managed repairs.

**Strategies at-fault and non-fault insurers and CMCs might take to reduce costs that would lead to lower repair quality**

12. We considered whether there were strategies at-fault and non-fault insurers and CMCs might take to reduce costs which would lead to lower repair quality. We identified the following two possibilities:
  - (a) Work providers could require their approved repairers to conduct low-quality repairs. For example, one independent repairer told us that there was constant pressure from insurers to repair rather than to replace parts, even where replacement would provide a better outcome; and another independent repairer told us that at-fault insurers often asked for cosmetic corners to be cut.
  - (b) Work providers could reduce the prices they pay to repairers, for instance under fixed-price contracts, to a level where the repairers could only afford to perform substandard repairs. One party told us that the cost pressures on repairers could potentially lead to poor repairs.
13. In considering these possibilities we examined the relative bargaining positions of work providers and repairers. We found that repairers competed aggressively to become part of an insurers' network of approved repairers, which resulted in insurers and CMCs having a strong bargaining position relative to them. NAB told us that repairers received about 80% of their work from insurers, with the remainder made up of consumer retail work (which was increasing due to higher excesses in motor insurance policies), self-insured fleet work and credit repair work (for CMCs). NAB said that insurers typically tendered for repairers to become their preferred repairer in a defined geographic area (by postcode), and thereby established their approved networks. It told us that contracts were typically for five years but could be cancelled by the insurer at any time for many reasons. NAB said that tenders were usually awarded by reverse auction, focusing particularly on the labour rate. The result was that insurers, through their buying power, had squeezed labour rates to just £23 to £25 per hour, compared with £18 per hour in 1991 and the £45 to £50 per hour which garages could earn for mechanical repair work. NAB said that the labour rate on credit repair work was generally higher (at £32 to £35 per hour), which meant that, even after paying a referral fee to a CMC to gain the work, credit repairs were usually more profitable for repairers than insurer work. NAB noted, though, that any repairer which took on more than a small amount of credit repair work was likely to be ostracised by insurers. NAB also told us that the body repair sector had been in decline

for 20 years due to fewer accidents, safer cars and, more recently, reduced car usage.

14. WNS told us that there was some overcapacity in accident repairers, which had driven labour costs down; and Helphire said that it believed that the labour rates which insurers agreed with their network repairers were often so low as to be almost uneconomic for repairers.
15. We recognised that such strong price competition between repairers would increase the incentive for repairers to reduce their costs. However, we noted that this incentive might be offset by repairers having to satisfy the repair requirements of work providers and consumers and the audits by work providers and other monitors (eg for PAS 125 accreditation) (see paragraphs 18 to 47).
16. We found that some insurers had moved to agree repair bills with repairers on a fixed price average repair basis, whereby the repairer received the same income for each repair regardless of its costs in performing the repair. In our view, these arrangements gave a greater incentive for repairers to cut corners where possible, particularly in relation to more expensive repairs. One repairer ([REDACTED]) told us that fixed average price contracts (and also average repair cost penalty contracts) between insurers and repairers encouraged repairers to perform minimal repairs, which could compromise safety, quality and post-repair vehicle values. We also noted that *Post* (an insurance industry magazine), quoting an industry source, said that insurers were unlikely to mandate an unsafe repair but unsafe repairs could happen if an approved repairer had to work to an average repair cost contract.<sup>3</sup>
17. On the other hand, both work providers and repairers told us that they were incentivised to conduct good-quality repairs. Work providers told us that they were keen to keep customer complaints low in order to retain customers and to build a good industry reputation for claims management; and repairers told us that they were keen to remain an approved repairer for work providers, not to have to carry out expensive post-repair remedial work, to sustain their reputations and not to lose any accreditations they may have (eg PAS 125 or manufacturer accreditations – see paragraphs 21 to 25).

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

18. We considered the quality of vehicle repairs, the standards applied by work providers and the monitoring of those standards. This section summarises the evidence we received on these issues relating to insurers, brokers, CMCs and

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<sup>3</sup> *Post* magazine, 28 February 2013.

repairers, on the quality of materials used, and on the time taken for repairs. We also discuss the main relevant responses we received to our working paper on the under-provision of repairs.

### **Insurers**

19. We found that there were several ways in which insurers could seek to ensure that vehicle repairs were performed to certain standards:
  - (a) requiring repairers to have PAS 125 accreditation, or at least requiring them to aspire to this accreditation (in order to receive this accreditation, repairers need to demonstrate that they carry out vehicle repairs using certain processes and procedures);
  - (b) specifying the repair methods to be followed (eg manufacturer methods or Thatcham methods);
  - (c) monitoring repairers through audits (eg by the insurer's engineers), and setting performance targets (eg low levels of customer complaints, adherence to timelines for repairs, etc);
  - (d) monitoring customer complaints and gathering evidence through customer surveys; and
  - (e) requiring repairers to provide a warranty for their repairs, putting the financial burden on repairers for any post-repair remedial work.
20. We considered each of these measures in turn.

### *PAS 125 and manufacturer approvals*

21. [REDACTED] of the ten largest insurers told us that they required repairers to have PAS 125 accreditation (or at least to be working towards this accreditation). [REDACTED] insurers ([REDACTED], [REDACTED] and [REDACTED]) said that they did not require their approved repairers to have PAS 125 accreditation.
22. The PAS 125 standard is owned and maintained by the British Standards Institution (BSI) as the National Standards Body of the UK.<sup>4</sup> The BSI told us that PAS 125 was a technical specification, which provided repairers with the requirements for processes and procedures related to the safe repair of accident-damaged vehicles.

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<sup>4</sup> [www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/](http://www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/).

23. PAS 125 details minimum requirements for:
  - (a) competent personnel;
  - (b) appropriate and well-maintained equipment;
  - (c) suitable repair methods; and
  - (d) the quality of repair materials.
24. In order to gain and retain PAS 125 accreditation, repairers must adhere to the PAS 125 repair standards and have this adherence certified by a provider of accreditation services. BSI is the largest provider of PAS 125 accreditation, in the form of a Kitemark (a mark owned by BSI), but other providers also offer accreditation. Once BSI has certified a provider, it will undertake two unannounced audits per year (or one for repairers with fewer than seven employees). [Annex A](#) provides more details on the PAS 125 standard and PAS 125 accreditation.
25. Some repairers have manufacturer approvals (either in addition to or instead of being PAS 125 accredited). When a repairer has such an approval, it is required to adhere to the repair methods and standards set out in its agreement with the manufacturer (eg to use OEM parts and the manufacturer's recommended paint brand, and to comply with the manufacturer's warranty requirements). Aviva told us that it required some repairers to have manufacturer approvals in order to handle prestige vehicle repairs (eg Mercedes, BMW and Porsche). AXA GB told us that its approved repairers had to have either PAS 125 accreditation (or be working towards it) or equivalent manufacturer approvals. It said that manufacturer approvals would override PAS 125. The Institute of Automotive Engineer Assessors (IAEA) told us that, in practice, the requirements of PAS 125 and manufacturer approvals were quite similar.

#### *Specifying repair methods*

26. We found that PAS 125 and manufacturer approvals required repairers to adhere to certain vehicle repair methods. These methods were usually either Thatcham methods or manufacturer methods.
27. Thatcham is a not-for-profit organisation, established in 1969. It is independently operated with a board of directors drawn from around 30 insurer members which fund its work. We were told that its main purpose was to carry out research targeted at containing or reducing the cost of motor insurance claims, whilst maintaining safety and quality standards. Thatcham methods



are specific to each make and model of vehicle and set out the process by which each part of those vehicles should be repaired.

28. Manufacturer methods are similar to Thatcham methods in that they also prescribe the way in which each damaged part of a vehicle should be repaired.
29. We found that while some insurers did not stipulate that repairers needed to have PAS 125 accreditation or manufacturer approvals, they might specify in their repair contracts that repairers had to adhere to Thatcham or manufacturer methods. For example, Admiral told us that it required its approved repairers to adhere to manufacturer methods.

### *Monitoring the quality of repairs*

30. All of the ten largest insurers told us that they monitored the performance of their approved repairers. For example, [redacted] told us that it audited the compliance of its approved repairers with PAS 125. It said that in 2012 it performed more than [redacted] audits and found that [redacted]% of repairs were PAS 125 compliant. We found that most of the ten largest insurers carried out checks on a sample of vehicles at their repairers' premises (in addition to investigating specific customer complaints).
31. We asked the insurers and some independent repairers what the insurers' repair quality checks involved and we found that these checks were typically part of repair audits, the main purpose of which was to control costs rather than to ensure a high quality of vehicle repairs. [Annex B](#) sets out available information on the extent of monitoring by insurers and CMCs. We found a mixed picture in regard to 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, it appeared to us that some insurers were not monitoring repair quality sufficiently to ensure that consumers received the standard of repair to which they were entitled and that some insurers left it largely and unduly to claimants to identify repair deficiencies.
32. We found that insurers which referred non-fault repairs to CMCs monitored the performance of their preferred CMCs, and in some cases also monitored the quality of some of the repairs those CMCs handled (eg Aviva told us that it monitored the quality of repairs undertaken by its CMC partner).

### *Monitoring customer complaints and customer surveys*

33. Eight out of the ten largest insurers told us that they monitored the level of customer complaints in order to identify any systematic problems with repair quality. Six of the ten insurers told us that they conducted customer surveys.

### *Requiring repairers to provide warranties*

34. The insurers told us that they usually provided claimants with a warranty for vehicle repairs undertaken by their approved repairers. However, insurers usually required their approved repairers to carry out any rectification work in relation to repairs they had performed at their own expense. Warranties were typically for five years, though some insurers provided a warranty for three years and some provided a lifetime warranty (as long as the vehicle was not sold).

### **Brokers**

35. All of the brokers in our sample told us that they either passed claimants to the underwriting insurer or to a CMC to manage vehicle repairs. None of the brokers which provided us with information had its own approved repairer network.
36. The brokers told us that they monitored the performance of the CMCs to which they referred claimants (eg in terms of call answer times, complaints, customer survey data) but they did not monitor the quality of repair services.

### **CMCs**

37. Four of the seven CMCs in our sample told us that the majority or all of the repairers in their networks were PAS 125 accredited and/or had manufacturer approvals.
38. Five<sup>5</sup> out of the seven CMCs from which we gathered evidence said that they monitored the performance of their approved repairers. Four CMCs told us that they carried out audits of repairers, of which one told us that it did this solely through the appointment of independent engineers. Five CMCs told us that they reviewed or investigated complaints received and two CMCs told us that they solicited customer feedback on repairs.

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<sup>5</sup> [REDACTED], but not [REDACTED] and [REDACTED] which relied solely on independent engineers.

39. Three CMCs told us that they provided a five-year warranty on the repairs they managed and another CMC said that it provided a three-year warranty.

## **Repairers**

### *Insurer-owned repairers*

40. Two of the three insurer-owned repairers in our sample either had PAS 125 accreditation or were working towards it, and one of them told us that it also had manufacturer approvals. Two of these repairers told us that they had service level agreements with their related insurers, against which each insurer monitored the repairer's performance, including through audits and inspections. Two of the three repairers told us that their related insurer also conducted customer surveys. All three of the repairers said that they were required to use Thatcham or manufacturers' methods. One of the repairers said that it was required to comply with manufacturers' warranty requirements.
41. UKAARC told us that its related insurer (DLG) was keen to ensure that costs were kept to a minimum, but not at the expense of repair quality or the safety of the customer. Solus (owned by Aviva) told us that it had never been asked by a work provider to carry out a repair in a way which would compromise vehicle safety and it would not allow this to occur.

### *Independent repairers*

42. Nine independent repairers told us about the standards to which they conducted repairs and how they were monitored ([REDACTED]). Six of these repairers ([REDACTED]) told us that they performed repairs to PAS 125 or manufacturer standards, while two of the remaining three repairers ([REDACTED]) told us that all repairs were carried out in accordance with Thatcham methods.
43. Evidence from these nine repairers indicated that their repairs were monitored mostly through PAS 125 audits (for PAS 125 accredited repairers), internal checks and/or checks by work providers. They told us the following:
- (a) [REDACTED] said that the quality of its work was checked through PAS 125 bi-annual unannounced audits, manufacturer annual audits at approved sites, an internal audit performed quarterly, and work-provider audits on an ad-hoc basis.
- (b) [REDACTED] said that its repairs were all subject to internal quality control checks before the vehicle was released to the customer, and all its sites were subject to periodic audits by BSI to maintain their PAS 125 accreditation.

- (c) [REDACTED] said that it was audited by some insurers, but mainly for cost control purposes. It said that insurers did very little monitoring of repairers' repair quality, giving, as an example, [REDACTED].<sup>6</sup> However, [REDACTED] added that the BSI PAS 125 Kitemark was a rigorous standard, with twice-yearly unannounced audits which drilled down into the repair process. It said that credit repair work providers (CMCs) did not do any quality control checks.
- (d) [REDACTED] said that the quality of all the repairs it performed was checked internally, regardless of the source of work, through stage checks and final checks by a quality control manager. In addition, insurance repairs were subject to external audits by the insurers. [REDACTED] said that BSI also audited its repair sites.
- (e) [REDACTED] said that the primary methods used by work providers to ensure repair quality were insisting on PAS 125 accreditation and analysing customer feedback.
- (f) [REDACTED] said that the quality of repair was self-monitored by repairers and that insurers and CMCs only became involved if there was a customer complaint.
- (g) [REDACTED] said that an insurer only found out about a repairer cutting corners if a customer complained. It said that the audits conducted by insurers were primarily desktop exercises which went through a repairer's files rather than involving any physical inspections looking at quality. [REDACTED] said that [REDACTED] did some inspections, but these were announced in advance and focused on an analysis of paperwork.<sup>7</sup> [REDACTED] said that inspections by work providers did not focus on the quality of the vehicle repair and sometimes the inspectors were not even engineers.
- (h) [REDACTED] said that the majority of insurers rarely came out to check on repair quality. It said that insurer audits were more about whether the assessment and invoice reflected the work carried out rather than the quality of the repair.
- (i) National Accident Repair Group, a marketing association for repairers, said that larger insurers (eg [REDACTED] and [REDACTED]) had teams of engineers which audited repairs, though these audits were mainly either in relation to customer complaints or to check that a repair was done in line with the repair estimate.

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<sup>6</sup> [REDACTED] told us that it did not agree with this view.

<sup>7</sup> [REDACTED] told us that it did not agree with this view.

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

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

46. In our view, the information provided by insurers, brokers, CMCs and repairers indicated that work providers often required repairers to adhere to an independently-audited PAS 125 quality standard and/or to manufacturer standards. [X] of the ten largest insurers told us that they performed repair quality audits, including physical checks of vehicle repairs performed by their approved repairers, without being prompted by customer complaints.
47. Submissions from some parties suggest that insurers' incentives are to keep their costs as low as possible which can lead to 'corner cutting' in the repairs they approve. We also found that the main purpose of repair audits was to control costs rather than to ensure high-quality repair standards, and several repairers suggested that there was limited monitoring of actual repair quality.

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

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

#### *Quality of parts*

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

#### *Non-OEM parts*

51. Several repairers raised concerns about non-OEM parts, which related mainly to difficulties in fitting such parts. For example:
- (a) [redacted] said that the labour time required to fit non-OEM parts in order to achieve an acceptable fit and finish was typically longer than for OEM parts and hence resulted in a higher labour cost.
  - (b) [redacted] said that non-OEM parts were cheaper than OEM parts but were often of poorer quality. It said that this meant that additional time was required to make them fit, though insurers did not pay for this additional time.
  - (c) Solus (owned by Aviva) said that using non-OEM parts could reduce the cost of the repair, but could cause fitting difficulties.
52. Some repairers also told us that the use of non-OEM parts could impact on the look and value of the repaired vehicle. For example:
- (a) [redacted] said that using non-OEM parts often made achieving a good fit very difficult, which could affect repair quality. This was because repairers were not given extra time by insurers to correct misshapen or badly moulded parts, which incentivised them to undertake 'rushed' work and potentially resulted in poor-quality repairs. For example, shut lines and fit

lines could be affected, which impacted on the vehicle's appearance and could affect its value.

(b) [REDACTED] said that panels which fitted poorly could reduce a car's value by 5%.

(c) [REDACTED] also said that the use of non-OEM parts could impact the resale price of a repaired vehicle.

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

54. Both insurers and repairers told us that non-OEM parts were mainly used for the standardised, non-safety-critical parts of a vehicle. For example:

(a) Aviva said that safety-related parts were often not available from non-OEM suppliers, due to the high development cost of these parts.

(b) QRC (owned by RSA) said that non-OEM parts accounted for [REDACTED]% of the total number of parts it purchased, and were generally used only for non-structural elements of repair work.

(c) [REDACTED]

55. We found that insurers did not typically use non-OEM parts in repairs of vehicles less than three years old.

#### *Repair or replace*

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

#### *Quality of paint*

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

### *Time taken for repairs*

58. We found no evidence to suggest any difference in the time taken for repairs between at-fault and non-fault repairs or between insurer-managed and CMC-managed repairs. In all such repairs, we found that the allocated time was usually determined by the repair cost estimation system (ie usually Audatex).

### ***Responses to our working paper***

59. In response to our working paper on the under-provision of repairs,<sup>8</sup> insurers said they did not believe that poor-quality repairs were common. Both insurers and CMCs said that they invested to provide high-quality repair services, as follows:
- (a) Aviva said that it endorsed PAS 125 standards with two unannounced BSI audits a year and also engaged in progress audits at intervals throughout the year. It said that the combination of PAS 125 standards and each insurer's own audit functions mitigated the risk of lower repair quality.
  - (b) Zurich required its repairers to adhere to either PAS 125 or manufacturer-approved guidelines. It said that it did not encourage or accept 'corner cutting' and it was not aware of this practice in the market as a whole.
  - (c) DLG explained that its ability to own its repair network and control its approved network of third party repairers allowed it to provide customers with a high-quality repair service whilst ensuring that DLG could control costs. DLG was confident that any criticism in relation to DLG-managed repairs would be entirely unjustified.
  - (d) Zurich stated that its approved repairers were required to provide a warranty for their repairs. Similarly, RSA noted that repairs conducted by RSA's authorised repairers came with a lifetime guarantee. Allianz said that the fact that long-term warranties were provided on repairs performed via insurer networks was indicative that insurers had faith in the quality and longevity of the work performed.
  - (e) Allianz said that substandard cosmetic repairs would be immediately obvious and would result in complaints, rework and significant frictional costs and cause reputational damage; while substandard mechanical repairs might result in an unsafe vehicle being returned to the road with

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<sup>8</sup> Working paper '[Theory of harm 2: Underprovision of repairs](#)', 1 August 2013.



potentially unthinkable consequences. It said that the risks of systematically and consciously providing substandard repairs did not make any sense from an insurer's perspective.

(f) Kindertons said that prior to being invited to join its network a repairer must have either PAS 125 or manufacturer approval. It said that, in addition, it monitored the repair process to ensure that it was appropriate and efficient.

(g) WNS said that the comment that CMCs did not monitor the quality of repairs was unsubstantiated.

60. A manager of fleet repairs [redacted] told us that, [redacted] in 2012, it managed the post-accident repair of [more than 3,000] fleet vehicles. It said that the repairs [redacted] went through rigorous de-fleet inspection. It said that, of those vehicles, [less than 10%] failed. It added that the main reasons for failure were cosmetic issues, though some also failed due to the use of non-OEM parts [redacted]. It said that no vehicle failed for a mechanical issue. [redacted]

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

61. We reviewed survey evidence relating to customers' satisfaction with the quality of vehicle repairs. We looked at the results of our survey of non-fault claimants and the GIMRA<sup>9</sup> motor claims satisfaction survey, particularly with regard to at-fault claims. We also considered customer complaint evidence provided by some insurers, CMCs and repairers.

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

62. Our survey found that four-fifths of vehicles involved in accidents leading to non-fault claims were repaired, with a fifth written off. Of respondents whose cars were repaired, 93% said that all the damage was repaired and only 7% were dissatisfied with the repair service (see Table 1). Overall, the majority (75%) of respondents said that their vehicle was in the same condition after the repair as it was prior to the accident, with 13% saying that it was in a better condition and 11% saying that it was worse. Though a small proportion of respondents did not think all their damage had been repaired, these results did not in themselves suggest that insurers generally failed to provide non-fault claimants with the quality of service to which they were legally entitled.

63. When respondents were asked about the post-repair value of the vehicle, the majority (81%) said that the vehicle was worth the same or more compared

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<sup>9</sup> General Insurance Market Research Association.

with before the accident, though 14% of respondents thought that their vehicle was worth less. Non-fault claimants have a legal entitlement to be put back into the position they would have been in if the accident had not occurred, which in relation to damage to a vehicle means an entitlement to receive damages for the diminution in value of the vehicle as a result of the collision. However, the survey results did not indicate the extent of perceived loss of value, or whether any diminution in value was due to repair quality or simply to a perception that being involved in an accident reduced a car's value. Hence it was difficult to draw firm conclusions from this evidence.

TABLE 1 **Non-fault claimants' experience of repairs**

	<i>All claims %</i>
<i>How much damage was repaired</i>	
All of the damage was repaired	93
Most of the damage was repaired	5
Some of the damage was repaired	2
Base (weighted)	1,159
<i>Satisfaction with the repair</i>	
Very satisfied	61
Fairly satisfied	28
Neither satisfied or dissatisfied	4
Fairly dissatisfied	3
Very dissatisfied	4
Base (weighted)	1,159
<i>Condition of the vehicle after the repairs were made</i>	
In a lot better condition	5
In somewhat better condition	8
Same	75
Slightly worse	10
Much worse	1
Don't know	1
Base (weighted)	1,163
<i>Value of the vehicle after the repairs were made (compared with before the accident)</i>	
Vehicle was worth more	1
Vehicle was worth the same	80
Vehicle was worth less	14
Don't know	5
Base (weighted)	1,163

Source: PMI non-fault survey, questions C11, C22, C24 and C26.

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64. Further results of our survey of non-fault claimants in relation to repairs are set out in Appendix 6.5.

### **GIMRA survey**

65. On behalf of a significant number of GIMRA members (about 14 insurers), research firm Harris Interactive contacts on a quarterly basis around 2,500 PMI claimants whose claims have settled in the last three months. Claimants must have had comprehensive cover and have claimed on their own

insurance. Also, the claim must have been settled within six months of it being lodged, and no serious personal injury must have been involved.

66. We reviewed GIMRA's survey from December 2012, covering claims settled in the period April to September 2012.
67. The results of the GIMRA survey indicated that the quality of repair was the second most important aspect of the claims-handling experience for claimants (with communication throughout the claim being the most important). The third most important aspect was the time taken from FNOL to the car being returned post-repair (or a cheque being received if the vehicle was written off).
68. [X] % of respondents to the GIMRA survey said that the quality of the repair they received was at least of 'good' quality, ie it restored the vehicle to at least its pre-accident condition. [X] % of respondents said that the repair left their vehicle in a better condition than prior to the accident.<sup>10</sup>
69. The GIMRA survey also found that only [X] % of respondents were dissatisfied with the overall repair experience, compared with [X] % who were either very satisfied or extremely satisfied.
70. [X] % of respondents to the GIMRA survey made a complaint about their claim and, of these complaints, [X] % were because of poor-quality repairs. This means that complaints in relation to the quality of repairs were made in less than [X] % of claims.<sup>11</sup>

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

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

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<sup>10</sup> It appears to us that the number of respondents stating that the repair left their vehicle in a better condition was high in comparison with our survey results (see Table 1). We noted that the GIMRA survey appeared to be focused mainly on the quality of customer communication and the customer service experience and it might be that responses to this question to some extent reflected the overall customer service experience in relation to the repair.

<sup>11</sup> Not all claims had an associated vehicle repair (the base for the total percentage of complaints was 2,512 claims, of which 1,708 claims involved a vehicle repair).

in 4% of the claims it managed; and [redacted] said that, in 2012, it received complaints in 6% of the repairs it had managed.

72. Repairers also told us that complaint rates were low and generally in a range of between 1 and 5% of repairs. For example:
- (a) QRC (owned by RSA) said that it received complaints in 0.6% of its repairs; and RSA told us that it received FSA-reportable complaints in 0.2% of repairs carried out by QRC.
  - (b) Solus (owned by Aviva) said that it received complaints via Aviva in less than 1% of its repairs (though we noted that such complaints might only arise if earlier attempts to resolve issues had failed).
  - (c) UKAARC (owned by DLG) said that DLG had received complaints in [redacted]% of its repairs in 2012 and, of these complaints, around half were in relation to [redacted]. UKAARC said that, in addition, some customers complained directly to UKAARC.
  - (d) Independent repairers (eg [redacted]) also told us that complaint rates were low. [redacted] said that it received complaints in 3% of its repairs, [redacted] said 5% of repairs, [redacted] said 1 to 2% of repairs, and [redacted] said in less than 1% of repairs.
73. [redacted], [redacted] and [redacted] provided data which showed that they received reportable customer complaints (ie complaints which had not been resolved by close of business on the business day following receipt of the complaint) with respect to between 1 and 4% of total motor claims managed. Of these complaints, between 9 and 27% related to repair quality, with the result that repair complaints arose in 0.25 to 0.7% of all motor insurance claims (although not all motor claims involve repairs, eg vehicle write-offs).
74. We calculated that a 2% complaint rate relating to repairs would equate to approximately 40,000 complaints a year (assuming a basis of around 2 million accident repairs paid for by insurers a year).
75. Repairers told us that customer complaints related mostly to:
- (a) [redacted];
  - (b) the scope of the service received (eg the exclusion of damage caused by wear and tear, additional work not being authorised, the courtesy car being insufficient, or the excess being higher than expected);
  - (c) delays in booking the repairs; and/or

(d) a lack of communication with the customer.

## **MSXI survey**

76. We commissioned MSXI to perform audits of vehicles which had been repaired after an accident. The objective of MSXI's vehicle inspection study was to look into the quality of repairs to vehicles which had been involved in accidents by comparing the pre-accident condition with the post-accident condition of the parts of the vehicle which had been repaired; and to identify any parts damaged through the accident which had not been repaired.

## **Sample**

77. The sample of vehicles to be inspected was derived from respondents to our non-fault consumer survey who had said that they were prepared to have their vehicle inspected by a professional assessor. A database of contact details of these owners, together with repair estimate documentation, were provided to MSXI for review. MSXI prioritised inspections according to its ability to assess the repairs from evidence on the type and scale of repairs undertaken in the documentation provided.
78. MSXI carried out inspections initially for respondents whose claim was handled by the other driver's insurer (Stage 1) and subsequently for respondents whose claim was handled by their own insurer (Stage 2). In Stage 1, MSXI had a database of 270 cars, made contact with 95 owners and completed 77 inspections. In Stage 2, MSXI had a database of 90 cars,<sup>12</sup> made contact with 51 owners and completed 27 inspections. Insurers told us that they handled repairs in the same way irrespective of whether or not the claim was captured (see Appendix 6.2). Therefore we believed it valid to consider the MSXI results across both Stage 1 and Stage 2 (101 cars).<sup>13</sup>
79. We noted that respondents' own assessment of the condition of these cars post-repair was worse than the average across all cars in our survey: 20% of vehicles inspected by MSXI were considered by respondents to be in a worse condition post-repair than before the accident, compared with 11% for all respondents (see Table 1). We also noted that nearly half of the inspected vehicles had been previously returned to the repairer for rectification. In light of these points, and the composition of the sample (see previous two paragraphs), we did not consider the MSXI inspections to cover a representative sample of non-fault repairs.

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<sup>12</sup> Acquiring repair estimates was more problematic for Stage 2 than Stage 1 and so the database was smaller.

<sup>13</sup> The total of 101 excludes three claimants who took cash in lieu of repair.

## **Results**

80. The results of MSXI's inspections are summarised in Table 2.<sup>14</sup> MSXI found that nearly half (45 out of 101) of the vehicles inspected were not returned to their pre-accident condition. However, in only 12 of these 45 cases did the original survey response indicate that the respondent considered their car's condition to be worse than before the accident. Many of the vehicles in the sample had already been returned to the repairer for rectification. Of the 101 vehicles inspected, MSXI found that only 18 were returned to their owner in their pre-accident condition without any need for rectification,<sup>15</sup> while a further 38 vehicles were returned to their owner in their pre-accident condition after they had been rectified. MSXI found that 10 of the 101 vehicles were still not in their pre-accident condition after rectification. The MSXI survey did not provide any reasons but we noted that the inconvenience of going through the rectification process might discourage some drivers from returning their vehicle to the repairer, in particular if they perceived the defects as minor.

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<sup>14</sup> Full results of the MSXI survey are set out in our working paper '[ToH 2: MSXI vehicle inspection report](#)' (31.10.2013), and also [Appendix 7.4 to our provisional findings](#).

<sup>15</sup> Rectification happens when, after the initial repair, the vehicle owner highlighted 'faults' on its vehicle and returned the vehicle to the repairer in order to have these remedied.

TABLE 2 Results of MSXI study

Number of vehicles inspected

**Was the vehicle returned in pre-accident condition at the time of inspection and had it previously been rectified?**

	<i>All</i>	<i>Respondents considered condition to be better than prior to the accident*</i>	<i>Respondents considered condition to be the same as prior to the accident</i>	<i>Respondents considered condition to be worse than prior to the accident†</i>
Not rectified and in pre-accident condition	18			
Rectified and in pre-accident condition	<u>38</u>			
Total in pre-accident condition	56	11	37	8
Not rectified and in non-pre-accident condition	35			
Rectified and in non-pre-accident condition	<u>10</u>			
Total in non-pre-accident condition	45	4	29	12
Base (unweighted)	101	15	66	20

**Number of vehicles in pre-accident condition and in non-pre-accident condition split by who made the final decision as to who would carry out the repairs and how the decision was taken**

	<i>All</i>	<i>Choice made by you: repairer you knew of</i>	<i>Choice made by you: options provided by insurers/CMC‡</i>	<i>Choice made by insurers/CMC‡</i>	<i>Other*</i>
Pre-accident condition	56	15	9	31	1
Non-pre-accident condition	45	4	5	35	1
Base (unweighted)	101	19	14	66	2

Source: MSXI study, CC PMI non-fault survey, questions C6, C8 and C22.

\*Either a lot better/worse or somewhat better/worse.

†Two claims where 'Who made the final decision?' was reported as being 'the repairer' and 'don't know'.

‡MSXI findings did not provide us with direct evidence about the differences and similarities between repairs managed by CMCs and those managed by insurers.

81. The most common reasons why the vehicle was not returned to its pre-accident condition were related to paint finish, panel misalignment and the repair being clearly visible. Many vehicles had multiple issues. MSXI's inspectors did not consider that any of the defects could be considered as dangerous, but stated that all would have had a negative effect on the car's valuation. MSXI also stated that all of the defects could have been detected during an efficient quality control process, prior to the car being handed back to the customer.
82. Table 2 shows that the proportion of vehicles that were not returned to their pre-accident-condition was lower when the repairer was chosen by the claimant rather than when the repairer was chosen by the insurer. However, we noted that the results from the consumer survey indicated the opposite: ie that when the respondent chose the repairer there was a higher proportion of vehicles where the respondent believed that not all the damage was repaired and that the condition was slightly worse than before the accident than when the insurer chose the repairer (see Appendix 6.5, Tables 3 and 10). It

appeared to us that a possible explanation for these results was that respondents choosing the repairer themselves were more knowledgeable about car repairs and better able than other respondents to assess the condition of their cars.

### ***Comments on MSXI study***

83. We received a large volume of responses to the MSXI study.<sup>16</sup>
84. The most important points made by respondents were that:
- (a) The sample of cars inspected was small and unrepresentative and inferences should not be drawn from such a sample. Some respondents suggested that to do so was out of line with CMA guidance on consumer survey evidence in merger inquiries, which they considered ought to be equally applicable to the MSXI study.
  - (b) MSXI had not adequately taken into account in its assessments, eg by using a consistent benchmark for comparing pre-accident and post-repair condition, that:
    - (i) Many of the cars were quite old with high mileage and hence may have had pre-accident damage.
    - (ii) In many cases, significant time and mileage had elapsed between the date of the repair and the date of the MSXI inspection and during this time there could have been wear and tear to the cars.
    - (iii) The documentary and photographic evidence available was in many cases insufficient to establish that the cars had not been repaired to their pre-accident condition and/or the faults were minor and would not have affected the car's resale value. Moreover, there was no clear causal link between repair defects and insurer conduct.
85. Some respondents said that many of the MSXI inspection reports were of poor quality, incomplete and/or inconsistent.

### ***Assessment***

86. We recognised that the results of the MSXI study were subject to significant uncertainties, including that:

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<sup>16</sup> Non-confidential responses to the MSXI working paper and our provisional findings are available on our website and are summarised in our working paper '[Revised evaluation of the possible under-provision of post-accident repair services \(theory of harm 2\)](#)'.



- (a) The sample of cars inspected by MSXI was small and was not representative of the generality of repairs.
  - (b) While the MSXI inspections showed that a higher proportion of cars were not in their pre-accident condition than consumers themselves believed to be the case (based on the results of our non-fault consumer survey), this result needed to be interpreted with caution due to uncertainties around the MSXI sample.
  - (c) MSXI itself stressed that its inspection reports were opinion based and were not carried out under scientific or workshop conditions.
  - (d) Although MSXI's view was that all the defects would have had a negative effect on car valuations, there was uncertainty about the size of any such effect on car values.
87. It appeared to us that the effects on consumers of cars not being repaired to the pre-accident standard were likely to depend on whether or not consumers were aware that the repair was not to the pre-accident standard. Consumers aware of a poor-quality repair would experience detriment immediately. However, there are relatively few respondents in this category. Indeed, the results of our non-fault survey suggested that slightly more respondents considered their car was in a better condition after their repair than in a worse condition. Consumers not aware of the poor-quality repair would only experience detriment when they sold their car if at the time of sale the quality of repair reduced the car's value. On the basis of the MSXI study, it appeared that there were more claimants in this category, but we recognised that the results of the MSXI study were uncertain, in particular as to the effect of an inadequate repair on car values (especially if the car was sold a considerable time after the repair).
88. In light of these points, it appeared to us that the extent of any detrimental effect on consumers was highly uncertain, and we did not believe that we could place much weight on the findings of the MSXI study in reaching our conclusions.

## PAS 125 and the BSI Kitemark

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

### PAS 125

3. BSI told us that, about six years ago, it was commissioned by Thatcham, insurers and insurance-related parties to set up PAS 125 as a publicly available standard. This was undertaken by BSI's standard-setting division, being the National Standards Body of the UK, which also maintains and updates this standard. QRC told us that the PAS 125 scheme was UKAS-accredited.<sup>2</sup>
4. BSI told us that the PAS 125 standard prescribed the process by which a vehicle was repaired, including requiring competent personnel, quality repair materials, appropriate and well-maintained equipment, and appropriate repair methods.
5. Aviva told us that the materials requirements in the original PAS 125 2009 standard were that parts, components and fasteners should be either:
  - (a) OEM branded, with the vehicle manufacturer's trademark;
  - (b) OEM branded, with the component manufacturer's trademark and independently certified under a recognised conformity certification scheme;
  - (c) of matching quality independently certified under a recognised conformity certification scheme; or
  - (d) an alternative part (including recycled parts) of a non-safety-related status, supplied under a work provider agreement.

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<sup>1</sup> [www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/](http://www.bsigroup.com/en-GB/our-services/product-certification/industry-sector-schemes/automotive-product-certification-and-kitemark-schemes/vehicle-damage-repair-kitemark-pas-125/pas-125-faqs/).

<sup>2</sup> The United Kingdom Accreditation Service (UKAS) is the sole national accreditation body recognised by the Government to assess, against internationally agreed standards, organisations that provide certification, testing, inspection and calibration services: [www.ukas.com/about-accreditation/about-ukas/](http://www.ukas.com/about-accreditation/about-ukas/).

## The BSI (PAS 125) Kitemark

6. BSI told us that, separately from setting the PAS 125 standard, it also provided certification of the PAS 125 standard in the form of a Kitemark pursuant to BSI's PAS 125 Kitemark scheme. The scheme was owned and operated by a separate company falling within the BSI group. BSI operated a strict observance of separation of business function between the National Standards Body and the company that promoted the Kitemark, enforced through law by agreement with the Government. The Kitemark service was provided through BSI's certification division. BSI said that it competed for this work against other certifying organisations. It said that around 860 repairers had the BSI (PAS 125) Kitemark and this level had remained stable for the last three years.
7. BSI said that the difference between PAS 125 and the associated Kitemark was that the Kitemark was awarded to those repairers who were PAS 125 certified by BSI. BSI said that, to achieve this certification, PAS 125 had to be followed according to a scheme set down by BSI. BSI told us that other certifiers had their own schemes, but it believed that its scheme and its audit process were among the most robust.<sup>3</sup> For example, PAS 125 would set out that a repair needed to be done using appropriate methods but BSI would check what those appropriate methods were, eg to follow either manufacturer methods or Thatcham methods. BSI said that a repairer could follow PAS 125 without being certified by anyone.
8. BSI said that, to be certified by BSI (and awarded the Kitemark), repairers were audited twice yearly through unannounced audits. In a typical audit, BSI would work back through a sample of repair records to check that the appropriate processes had been followed, and look at some vehicles (which included vehicles in various stages in the repair and finished vehicles). BSI said that quality was not audited directly (as the auditors were not usually engineers) but if the processes were being followed properly, repair quality should be maintained. BSI also said it checked that finished vehicles had been repaired as per the work instructions to identify whether vehicles had been repaired to the pre-accident condition. BSI added that, during an audit, it would look at the complaints register of the repairer. It said that it would also consider any complaints it received directly from customers relating to vehicle repairs conducted by a BSI-certified repairer, though the number of such complaints was very low.
9. BSI said that, in addition, it performed in-depth audits of repairers, in particular where the initial audit indicated possible weaknesses. BSI said that non-

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<sup>3</sup> BSI said that its certification was the strongest, in part because, unlike the other certifiers, BSI did unannounced audits of repairers.

compliance with the Kitemark requirements was usually higher when a repairer was seeking to gain the Kitemark for the first time rather than when it had become accustomed to the required processes.

10. We were told that if BSI found non-compliance through its audit processes, an agreed action plan was put in place, which was managed within certain service level agreement time frames. If the repairer did not respond with an acceptable action plan or keep to it, non-conformities could result in the repairer being suspended or, in more serious cases, removed from the Kitemark.

## Analysis of inspection reports

### Introduction and summary

1. This annex describes the content of some insurers and CMCs' inspection reports.
2. Inspection reports were provided to us by seven of the ten largest insurers (Admiral, Ageas Insurance, Aviva, DLG, esure, RSA and Zurich) and two CMCs (Ai Claims and Helphire). As regards the other three of the ten largest insurers, [redacted] provided only a summary of its audit reports while [redacted]<sup>1</sup> and [redacted] told us that they did not perform repair quality checks. We did not have information from other insurers and CMCs.
3. Admiral, Ageas Insurance, Aviva, DLG and esure's inspection reports suggest that physical repair inspections are carried out, both for completed and ongoing repairs. It was not clear to us from RSA and Zurich's inspection reports how or the extent to which repair quality was audited, though these parties told us that repair quality was assessed.
4. Our review of Ai Claims and Helphire's inspection reports suggests that both CMCs inspect repair quality principally in response to customers' complaints. It was unclear to us whether they carried out their own auditing of repair quality.
5. The remainder of this annex summarises the information provided by these insurers and CMCs in relation to their repair quality audits and provides examples of the content of their inspection reports.<sup>2</sup>

### Insurers

#### *Admiral*

6. Admiral told us that, [redacted].<sup>3</sup>
7. Admiral told us that random quality checks were carried out as part of its audit.

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<sup>1</sup> [redacted]

<sup>2</sup> In the case of insurers, these tend to be small parts of much longer reports covering all aspects of relations with repairers.

<sup>3</sup> [redacted]

8. Figure 1 shows an extract from one of Admiral's repair audits.

FIGURE 1

**Extract from Admiral repair audit**



Source: Admiral.

**Ageas Insurance**


9. Ageas Insurance told us that it performed repair quality checks even in the absence of customer complaints. It said that its field staff were required to complete an inspection form when auditing a repair site.
10. Ageas Insurance inspection forms ask inspectors to check: .
11. The assessment of the workmanship requires inspectors to record comments on the quality of repairs. Figure 2 shows an example completed inspection form.

FIGURE 2

**Example of Ageas Insurance's inspection form**



Source: Ageas Insurance.

**Aviva**

12. Aviva told us that its audit team made unannounced visits to its network of repairers. It said that its inspectors carried out quality checks on a sample of random vehicles up to whatever stage of repair the vehicle had reached.
13. Aviva's inspection forms set out a list of items the inspectors must check when auditing repair quality. Inspectors are required to verify the repair methodology and identify any defects in the repairs. Figure 3 shows an example of an Aviva inspection report.

FIGURE 3

**Example of Aviva's inspection form**



Source: Aviva.

## **DLG**

14. DLG told us that it physically checked a sample of the repairs it managed, whether the repair was conducted by its own repair business, its network of repairers or by non-approved repairers. It said that it performed such checks on an ad-hoc basis and monitored compliance against DLG's requirements.
15. DLG said that it performed two different types of repair audits: quality repair inspections for completed and ongoing repairs, and 'Tier A plus' audits. The former are physical audits carried out at a repair centre; the latter are remote audits carried out by DLG engineers using imaging.
16. DLG's inspection reports indicate that engineers are required to report repair costs as well as the level of satisfaction for a list of items related to repair quality, eg paint finish, fitment of parts and panel alignment. Figure 4 shows a completed DLG inspection report.

FIGURE 4

### **Example of DLG's inspection form**



Source: DLG.

## **esure**

17. esure told us that it undertook both remote audits and onsite physical audits using a team of external regional repair controllers. It said that the audits did not differentiate between fault categories or depend on whether it was for a customer or third party. It said that the audits were carried out on a random sample of vehicles in line with the volume referred to each repair site.
18. esure's quality inspection form addresses a series of quality categories, within which its auditor can determine whether the quality of a repair has been satisfactory and, if not, identify the failure area. The first level of quality categories are:
  - panel
  - refit
  - paint/spray
  - mechanical
  - cleanliness

19. Figure 5 shows an example of the quality section of an esure inspection report. The form requires inspectors to report any defects in the repair process and, if needed, to recommend rectification of the damages identified.

FIGURE 5

**Example of esure's inspection form**

[✂]

Source: esure.

**RSA**

20. RSA told us that the main way in which RSAAR reviewed the quality of repairs was through 'open file review' audits conducted by the RSA Audit/Performance Team on a needs basis. Audits were carried out at repairers by the performance team across the RSAAR network, covering all aspects of the repair journey from customer communication to invoice validation, including adherence to quality requirements. RSA said that, although every audit included considering quality, and the factors which may affect quality, its audits did not measure the quality of repair alone.
21. [✂] it was unclear to us which of these performance indicators directly assessed the quality of the repair. Figure 6 shows [✂].

FIGURE 6

**Example of RSA's inspection form**

[✂]

Source: RSA.

**Zurich**

22. Zurich told us that its field engineers were responsible for conducting post-repair inspections on a sample of vehicles repaired by its approved repairers. However, it appears to us that Zurich's inspection reports indicate that Zurich monitors mainly the costs of the repair service. It was unclear to us what elements of repair quality are checked by Zurich's field engineers. Figure 7 shows an example of a Zurich inspection report.



## FIGURE 7

### Example of Zurich's inspection form



Source: Zurich.

## CMCs

### *Ai Claims*

23. Ai Claims told us that it commissioned approximately 100 post-repair inspections each year. It said that it had also recently introduced an internal audit of post-repair vehicles, carried out by Ai staff, with the aim of ensuring a quality repair.
24. Ai Claims' inspection forms indicate that it carries out post-repair inspections principally in response to customers being unhappy with the quality of their repair. It was unclear to us whether Ai Claims monitored repair quality in the absence of such complaints. Figure 8 shows an example of an Ai Claims inspection report.

## FIGURE 8

### Example of Ai Claims' inspection form



Source: Ai Claims.

25. Ai Claims told us that it had recently implemented a trial with several of its repairing garages whereby on completion of the vehicle repairs, the customer and the repairer collaboratively complete an Approved Repair Guarantee form (see Figure 9). Ai Claims said that the intention of the form was to provide the customer with peace of mind that repairs had been carried out effectively and to the required standards. Copies of the form are given to the customer, stored at the repairer (for audit purposes) and also sent to Ai Claims as part of the repair invoice bundle. Ai Claims told us that once this was rolled out across its network, it was intended that a copy would also be shared with the PAS 125 regulating body.

## FIGURE 9

### Example of Ai Claims' Approved Repair Guarantee form



Source: Ai Claims.

## **Helphire**

26. Helphire told us that post-repair inspections were performed in response to customers' complaints. Figure 10 shows an example of a Helphire inspection form.

FIGURE 10

### **Example of Helphire's inspection form**



Source: Helphire.

## Horizontal concentration in PMI in Northern Ireland

### Introduction

1. The average price of a PMI policy in Northern Ireland is higher than in Great Britain. This may be the result of a number of differences between the two territories. One possible factor leading to higher prices in Northern Ireland compared with Great Britain is a higher level of concentration in PMI providers.
2. The purpose of this section is to assess the level of horizontal concentration in PMI providers in Northern Ireland, both overall and for specific types of driver. We discuss to what extent the level of concentration of PMI providers in Northern Ireland may explain the profitability of insurers in Northern Ireland. In [Annex A](#) we present an analysis comparing PMI profitability in Northern Ireland with PMI profitability in Great Britain.
3. The appendix is structured as follows:
  - background to the supply of PMI in Northern Ireland
  - horizontal concentration of PMI providers in Northern Ireland
  - why some PMI providers are not active in Northern Ireland or only to a limited extent
  - why there are fewer PMI providers offering policies for young and high-risk drivers
  - evidence of entry and expansion in PMI provision in Northern Ireland
  - PMI profitability in Northern Ireland

### Background to the supply of PMI in Northern Ireland

#### *Estimated market size*

4. A number of PMI providers active in Northern Ireland provided us with estimates of the size of the PMI market in Northern Ireland. In terms of the number of private vehicles, these estimates ranged from 570,000 to 880,000, typically based on figures sourced from the Department for Regional Development Northern Ireland, although the estimates varied depending on the base year and the types of vehicles included. A number of the higher

estimates included light goods vehicles. Based on 2011 statistics provided by the Department for Regional Development Northern Ireland, we estimate that around 610,000 to 650,000 vehicles are covered by PMI in Northern Ireland.<sup>1</sup>

5. In terms of the market value, PMI providers estimated that the total GWP of PMI in Northern Ireland is between £282 million and £500 million. However, some of the higher-end estimates either did not have a robust methodology supporting them, or they included light goods vehicles as well as private motor vehicles so we put less weight on these estimates. Several PMI providers estimated the PMI market to be worth around £300 million. Based on our estimate of the number of vehicles covered by PMI in Northern Ireland (see paragraph 4) and the average GWP per policy in Northern Ireland,<sup>2</sup> it appeared to us that this estimate of around £300 million seemed reasonable.

### ***Distribution of PMI in Northern Ireland***

6. Consumers in Northern Ireland predominantly purchase PMI policies through brokers. RSA estimated that around 60% of PMI sales were made through brokers in Northern Ireland and a number of other insurers estimated that the four or five leading brokers in Northern Ireland had a collective retail market share of between 40 and 60%. Most broker sales are made by telephone through local branches rather than face-to-face or online.
7. Several parties gave us possible reasons why brokers had such a significant role in the distribution of PMI in Northern Ireland:
  - RSA said that because claims rates in Northern Ireland were, on average, higher than Great Britain, PMI providers had felt more comfortable using the broker's personal relationship with their customers as a method of controlling fraud at the point of claim as well as at the point of sale.
  - AXA told us that the three main brokers had branch networks which contributed to their brand strength.
  - Allianz said that many Northern Ireland customers preferred to purchase PMI via intermediaries in person or over the phone and were less inclined (than in Great Britain) to buy insurance directly from insurers. They said

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<sup>1</sup> 650,000 is based on the number of diesel cars and petrol cars in Northern Ireland (categories 48 and 49) found in [Northern Ireland Transport Statistics 2011–12](#), Table 1.3, p25. However, some of these vehicles are likely to be fleet vehicles. [REDACTED] However, on the basis of the data we received from parties, we calculated that there are at least 610,000 policies.

<sup>2</sup> In 2011, this was £[REDACTED] per policy, based on information from PMI providers.

that this was partly due to Northern Ireland having an abundance of small intermediaries.

- Several parties noted that PCWs had less of a presence in Northern Ireland compared with Great Britain. Allianz told us that some PCWs had only recently removed an exclusion relating to Northern Ireland, which had been in place because many insurers did not cover Northern Ireland. In addition, First Central (an insurer selling predominantly through PCWs) said that none of the PCWs included a list of the separate Northern Ireland driving endorsement codes and even the Northern Irish comparison website 'Compare Northern Ireland' did not cater for the Northern Ireland driving conviction codes.
8. Many PMI providers mentioned Hughes, Open & Direct (Swinton) and Abbey as the leading brokers in Northern Ireland. Several also named Autoline and three named Provincewide as being significant brokers in Northern Ireland.
  9. We noted that PCWs appeared to be growing in importance as a sales channel in Northern Ireland. Both LV and RSA told us that sales via PCWs had increased over the last year, though RSA also told us that the use of PCWs in Northern Ireland had not grown as rapidly as in other parts of the UK.
  10. Hughes told us that the introduction of PCWs had had a major impact on the supply of PMI in Northern Ireland. It told us that 61% of its new business for drivers under 30 now began with an online quote. Hughes said that, although Northern Ireland consumers valued being 'local' as an important component of a PMI provider's brand, it believed this aspect to be weakening as the younger population became more confident about buying online.
  11. However, we also noted that AXA Northern Ireland (the largest PMI provider in Northern Ireland) did not sell under the AXA brand via PCWs, and Allianz told us that any change in consumer behaviour from buying via brokers was likely to be slow.
  12. Overall, we found that although the broker channel remained strong in Northern Ireland, the PCW channel was growing. Given our finding that premium competition between insurers is intensified when sales are conducted through PCWs (see Section 8), we expected that the increasing adoption of PCWs in Northern Ireland, particularly among the young, would increase rivalry in the supply of PMI.

## ***Differences in legal structure***

13. There are several important differences with relevance to PMI between the legal system in Northern Ireland compared with the legal systems which operate in England and Wales and Scotland. The OFT, in its summary of responses to its call for evidence, identified two aspects of the Northern Ireland legal system which may be responsible for PMI premiums being higher in Northern Ireland than in Great Britain, as follows:
- First, the levels of compensation for personal injury claims are higher in Northern Ireland than in Great Britain. Insurers pointed to differences in the levels of compensation set out in the relevant guidelines<sup>3</sup> and told the OFT that, as a result, personal injury settlements were higher. The OFT heard that the gap between Northern Ireland and Great Britain had narrowed recently, although the submissions indicated that compensation levels continued to be higher in Northern Ireland than in England and Wales.
  - Second, insurers told the OFT that differences in the legal processes also appeared to be leading to higher legal costs in Northern Ireland compared with Great Britain. In particular, the absence of a compulsory pre-action protocol in Northern Ireland<sup>4</sup> at the time of the OFT call for evidence was cited as potentially having the effect of making litigation more prevalent in Northern Ireland than in Great Britain as the applicable procedures did not appear to provide the same incentive to settle cases quickly.<sup>5</sup>
14. We noted that on 18 January 2013, D K McFarland, Presiding Judge of the County Courts in Northern Ireland, issued a practice decision that came into operation on 25 February 2013: the 'Pre-Action Protocol for Personal Injury Litigation and Damage-only Road Traffic Accident Claims'.<sup>6</sup> However, as this protocol had only fairly recently come into operation in Northern Ireland, we were not able to assess its impact on PMI in Northern Ireland.

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<sup>3</sup> Guidelines for compensation levels in Northern Ireland are set by the Judicial Studies Board for Northern Ireland. See: *Guidelines for the Assessment of General Damages in Personal Injury Cases in Northern Ireland* (Third Edition), Judicial Studies Board for Northern Ireland, 2008.

<sup>4</sup> The [Civil Procedure Rules 1998](#) (SI 1998/3132 as amended) in force in England and Wales contain a Pre-Action Protocol for Low Value Personal Injury Claims in Road Traffic Accidents. The pre-action protocol for road traffic accidents is set by the Ministry of Justice. It describes the behaviour the court will normally expect of the parties prior to the start of proceedings where claims damages are valued at no more than £10,000.

<sup>5</sup> Respondents to the OFT call for evidence indicated that while claimant and defendant legal rates are not higher in Northern Ireland than in Great Britain, settlement often takes place close to a hearing, resulting in higher costs. The practice of retaining counsel for valuation and negotiation is apparently more prevalent in Northern Ireland than in Great Britain which adds to the overall litigation costs. However, in their submissions to the OFT, legal associations did not agree that the legal process in Northern Ireland was more expensive than in Great Britain.

<sup>6</sup> See [judicial decision](#).

15. Several PMI providers told us that the legal differences between Northern Ireland and the rest of the UK made very little difference in practice to the provision of PMI. However, we were told that there was a lower prevalence of CMCs and CHCs in Northern Ireland.

### ***Insurers active in Northern Ireland***

16. We asked both insurers and brokers for a list of the main insurers active in Northern Ireland. AXA Northern Ireland, Allianz and Prestige Underwriting (Prestige)<sup>7</sup> were named by most PMI providers as being the main underwriters in Northern Ireland. Several parties estimated AXA to have a market share of between 30 and 40%. Aviva, RSA and Zurich were also mentioned by some parties. DLG, Admiral, Liberty (formerly Quinn), NFU Mutual, Equity and Marker Study (Zenith) were mentioned by one or two providers. We found that, in 2013, at least 45 insurers offered PMI policies in Northern Ireland. Most had a share of supply under 5%. The market shares for 18 of them, for which we had detailed data for 2011, are presented in Table 1.

### **Concentration of PMI providers**

17. We estimated shares of supply using both the volume and value of PMI policies underwritten in Northern Ireland in 2011, based on information supplied by PMI providers. Table 1 shows the results.

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<sup>7</sup> Prestige Underwriting states on its [website](#) that it is a delegated underwriter 'acting on behalf of a number of large, financially strong insurance companies'.

TABLE 1 Market shares

	GWP £'000	Share of supply Value (%)	Number of policies active	Share of supply Volume (%)
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]*	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]†	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]‡	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]§	[REDACTED]
[REDACTED]	[REDACTED]¶	[REDACTED]	[REDACTED]#	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total (known)	c295,000		c610,000	
Market size (estimate)	295,000– 315,000~		610,000– 650,000★	

Source: PMI providers.

\*CMA estimate.

†CMA estimate based on [REDACTED] average GWP of £[REDACTED].

‡[REDACTED]

§CMA estimate based on estimated average GWP of around £[REDACTED].

¶CMA estimate based on [REDACTED] GWP for young drivers in Northern Ireland and proportion of PMI volume being from young drivers (4.5%).

#CMA estimate based on methodology in previous footnote.

~See paragraph 12.

★See paragraph 11.

18. Our survey of PMI policyholders<sup>8</sup> found that 19% of Northern Ireland PMI policyholders had their policy underwritten by AXA. However, a very high proportion (around 45%) of Northern Ireland respondents did not know which insurer had underwritten their PMI policy. Of those Northern Ireland respondents who did know which insurer had underwritten their policy, 35% had a policy underwritten by AXA.<sup>9</sup> This result is [REDACTED] the market share estimate shown in Table 1.
  
19. Based on the above market shares, we calculated the Herfindahl-Hirschman Index (HHI) for the supply of PMI in Northern Ireland to be between 2,000 and 2,200 (based on value) and 1,500 and 1,800 (based on volume). The CMA's guidelines state that a market with an HHI over 1,000 is likely to be considered concentrated whilst a market with an HHI over 2,000 is likely to be considered highly concentrated.<sup>10</sup> On this basis, we noted that the HHI for

<sup>8</sup> See [survey](#).

<sup>9</sup> Responses to question S11 (see footnote 8), with broker responses and 'don't know' answers excluded.

<sup>10</sup> See [CC3](#), Annex A, paragraph 7.



PMI in Northern Ireland (when calculated on the basis of value) was indicative of a highly concentrated market.<sup>11</sup>

20. However, we found that this high concentration was largely the result of AXA's recent growth in the market, which even its competitors appeared to agree had been the result of AXA's competitive offering and well-managed strategy of expansion. AXA told us that its growth had now gone into reverse as other insurers had expanded in the market.
21. Furthermore, we noted that some PMI providers did not underwrite policies for certain types of driver in Northern Ireland. For example, Saga and Allianz told us that they did not underwrite policies for policyholders under 21 years old; and DLG and Zurich told us that they only wrote business for young drivers through certain brands and sales channels respectively. Some other insurers told us that they wrote few policies for young drivers. Tesco Underwriting, Groupama and AXA<sup>12</sup> told us that they would not underwrite policies for some high-risk drivers. This, however, is not a strategy that is specific to Northern Ireland as there is specialisation in the types of risks that insurers seek to cover across the UK market.

### **Why are some PMI providers not active in Northern Ireland or only to a limited extent?**

22. We found that several PMI providers active in the rest of the UK were not active in Northern Ireland, whilst others did not appear actively to seek business in Northern Ireland. PMI providers cited three barriers to entering or expanding within Northern Ireland, which we discuss in turn.

### ***The Northern Ireland market is small***

23. There are specific investments which an insurer might need to make in order to underwrite (or to underwrite significant numbers of) policies in Northern Ireland. For example, Allianz told us that an insurer might need a local approved repair network<sup>13</sup> and there was a need for local solicitors who knew the differences in the court system, Northern Ireland legislation and the level of personal injury awards. LV told us that, due to the legal differences, an insurer would need an effective claims network in order to control costs.

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<sup>11</sup> CMA estimate based on data provided in Table 1.

<sup>12</sup> Although AXA told us that it provided quotes to the vast majority of consumers.

<sup>13</sup> Allianz said that this type of investment was not critical where an insurer wished to underwrite young drivers whose decisions were more likely to be driven by, for example, the premium level rather than whether there was a local approved area network.

24. Allianz said that, while the hurdles to entering Northern Ireland were not difficult to overcome, because the market was small it might not be worth the investment. Similarly, esure said that Northern Ireland was not considered to be economically viable for it to enter as a start-up insurer and, given the need to establish local infrastructure and esure's current business strategy, esure did not currently have any appetite to enter the Northern Ireland market.
25. Both LV and First Central told us that, because Northern Ireland was a small market, claims costs could be volatile. Aviva told us that its business in Northern Ireland had had unpredictable results, with some large claims.
26. It appeared to us that the size of the PMI market in Northern Ireland, and the fact that insurers were likely to need to make some investments in order to operate (or at least to operate at significant scale) there, could inhibit new entry or expansion. However, it did not appear to us that the costs of entry were significantly different from those which would be incurred when entering other regions of the UK. We noted that there had been recent entry and expansion in Northern Ireland.

#### ***Lack of underwriting experience***

27. We noted that some insurers might not be active in Northern Ireland due to a lack of claims experience within Northern Ireland on which to base their risk modelling. A few insurers told us that a lack of previous underwriting experience was a bigger barrier to entry in Northern Ireland than it was in the rest of the UK. For example, Aviva told us that some sources of third party socio-demographic data, which could be accessed in Great Britain to aid risk pricing, were not available in Northern Ireland.
28. However, RSA told us that a new entrant could choose to pay another party (eg a broker or another partner) which did possess learned experience within the market in terms of allocating risk and pricing to build up a body of knowledge within a shorter time frame. RSA told us that, alternatively, a new entrant could delegate underwriting authority to a broker or other partner in order to enter the market more quickly. LV told us that it used Prestige, which was established in the market, to influence its rating model based on Prestige's prior experience. Information obtained from brokers may not be a perfect substitute for the information gained from experience, but it appeared to us that the need for prior experience in order to enter the market was reduced by the presence of long-established broker networks in Northern Ireland.
29. esure said that an insurer required specialist underwriting and pricing knowledge of the Northern Ireland client base in order to operate in the

market; and Aviva told us that the greater underwriting experience of AXA gave it a competitive advantage. We noted in some AXA internal documents that it considered some UK competitors to be setting prices without reference to specific Northern Ireland factors.

30. Overall, we concluded that whilst PMI providers with little underwriting experience in Northern Ireland may be at some competitive disadvantage to those with more experience in the market, broker-based information offered considerable reduction to this barrier to entry.

### ***Strength of the broker channel***

31. Some insurers indicated that the significance of brokers as a sales channel for PMI in Northern Ireland restricted entry. Aviva told us that expanding its market share beyond its broker business was harder in Northern Ireland than in other parts of the UK as customers in Northern Ireland had a stronger preference for buying through a broker. Covea told us that Northern Ireland was a broker-led market, which it was not focused on serving because the market was dominated by large insurers which had existing relationships with brokers.
32. On the other hand, RSA and AXA both told us that the predominance of the broker channel in Northern Ireland made entry easier, not harder. An insurer could gain market information and access to customers through agreements with brokers and did not have to develop their own direct sales channels. Thus, unless they were committed to a vertically integrated model, entry into Northern Ireland should be easier than entry into other areas which did not have such well-defined routes to market.

### **Why are there fewer PMI providers offering policies for young and high-risk drivers?**

#### ***Young drivers***

33. We found that not all PMI providers in Northern Ireland provided policies for young drivers (see paragraph 21), although the definition of 'young' varied slightly between insurers.
34. Saga told us that its decision not to underwrite policies for young drivers was related to its brand positioning rather than being an underwriting choice. Tesco Underwriting told us that [redacted].
35. NFU Mutual, RSA, First Central and Zenith all told us that they wrote relatively few policies for young drivers. NFU Mutual told us that, in its experience, price

was the major factor for young drivers when selecting an insurance provider so fewer young drivers were attracted to its brand and customer proposition, which was focused on product and service quality. First Central said that its internal reinsurance costs were dependent on the proportion of young drivers underwritten, which caused it to keep this percentage low in order to maintain acceptable reinsurance costs. Zenith told us that it would be at a disadvantage writing PMI policies for younger drivers due to its lack of knowledge and experience in this area.

36. While acknowledging that there were fewer insurers actively underwriting PMI policies for young drivers in Northern Ireland, RSA told us that there were no specific barriers to insurers doing so. It said that, consequently, firms active in supplying policies to young drivers remained subject to potential competition from PMI providers not currently active in that segment.

### ***'High-risk' drivers***

37. We found that some PMI providers in Northern Ireland did not provide PMI policies to drivers considered to be 'high risk' (see paragraph 21). PMI providers did not have a specific definition of what constitutes a 'high-risk driver', although certain characteristics appeared to contribute towards this assessment. These characteristics included drivers:

- with a poor credit history
- who had been previously disqualified from driving
- who had made multiple claims
- with excess penalty points or Road Traffic Act convictions
- in high-risk occupations
- previously convicted of drink-driving

38. Both Tesco Underwriting and Groupama identified that some risks were outside their underwriting risk appetite and they would not write PMI policies for such drivers. AXA also said that drivers who had excessive claims, previous convictions or were employed in certain high-risk occupations might not represent an acceptable risk which it would be willing to underwrite.<sup>14</sup>
39. Allianz said that it would write PMI policies for some higher-risk drivers but they would be rated at a higher premium than the standard rating levels and

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<sup>14</sup> Although AXA told us that it provided quotes to the vast majority of consumers.

might have bespoke terms and conditions applied. Similarly, [REDACTED] identified drivers with poor driving records as a segment where it would not be able to offer competitively-priced policies.

40. However, we found that it was not only in Northern Ireland that insurers chose the specific risk categories to which they most wished to sell. Specialisation in provision is a common form of market segmentation all over the UK. We did not identify any significant specific barriers to entry or expansion for any particular risk class of customer in Northern Ireland.

### **Evidence of entry and expansion in PMI provision in Northern Ireland**

41. We considered evidence of recent expansion in Northern Ireland by [REDACTED], [REDACTED], Midas, Liberty and AXA.
42. AXA told us that, in the last six to nine months, [REDACTED], Midas, Liberty and RSA had become much more active in the market. This activity involved offering new products, and pricing to gain market share. AXA said that both [REDACTED] and RSA were gaining business and, as a result, [REDACTED].
43. Liberty had benefited from its rights over the PMI renewals book of Quinn, which, together with its own growth, was forecast to put it in the top ten insurers in Northern Ireland. Liberty's growth was forecast to be through direct telephone sales, PCWs and brokers. We found that Midas, a new entrant in the market, was expected to follow a similar penetration strategy and was also expected to enter the top ten in 2013.
44. [REDACTED]
45. [REDACTED]
46. Despite noting that both [REDACTED] and AXA had recently gained business in Northern Ireland (see paragraph 47), Allianz told us that it did not believe it likely that the position of the three largest underwriters in Northern Ireland (Allianz, AXA and Prestige) would change significantly in the foreseeable future. However, it noted that the impact of the pending launch/relaunch of [REDACTED] in the broker market was unknown.
47. We noted that AXA had achieved the most significant recent expansion in Northern Ireland, growing its business there from around [REDACTED] policies in 2006 to [REDACTED] policies in 2011. [REDACTED] It appeared to us that there were a number of factors which had underpinned its previous growth, including:
  - winning business as a result of Quinn going into administration in 2010

- establishing a strong local focus, in part by transferring its business to be managed from the Republic of Ireland in 2007
- successful branding and pricing
- some of its competitors being less focused on this market

48. It appeared to us that AXA's market share was the result of a process of rivalry and seemed to have arisen from AXA taking a number of risks over the past seven years. Overall, we concluded that its current position was unlikely to be protected by significant barriers to entry or expansion.

## PMI profitability in Northern Ireland

### Introduction

1. This annex presents an analysis of PMI profitability in Northern Ireland compared with PMI profitability in Great Britain.

### Theoretical background

#### *Why profitability is a useful indicator*

2. The CMA's Guidelines state that outcomes of the competitive process in their different forms in a market, eg prices and profitability, can provide evidence about its functioning.<sup>1</sup>
3. The Guidelines<sup>2</sup> state that, in practice, a competitive market would be expected to generate significant variations in profit levels both between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. The profitability of some firms may exceed what might be termed the 'normal' level, for example as a result of past innovation or superior efficiency, but a situation where the profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process. Examples of these limitations could be the presence of entry barriers, or the existence of significant market power.
4. The Guidelines mention<sup>3</sup> four possible types of analysis of prices and profitability: pricing patterns; price cost margins; price comparisons; and profitability. Annex A of the Guidelines states<sup>4</sup> that where capital employed cannot be reliably valued, the CMA may consider alternative measures, such as the return on sales or other relevant financial ratios.

#### *Measures of profitability*

5. We looked at the claims ratio and the combined operating ratio as basic measures of profitability.

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<sup>1</sup> CC3, paragraph 103.

<sup>2</sup> CC3, paragraphs 117 & 118.

<sup>3</sup> CC3, paragraph 107.

<sup>4</sup> CC3, Annex A, paragraph 15.

6. The claims ratio is calculated as claims expense divided by NEP. Claims expense is the total of claims paid, net of any recoveries from reinsurers, and any change in provision for claims, net of reinsurance; NEP is GWP net of IPT, premiums ceded to reinsurers and any change in provision for unearned premiums. Thus, both parts of the calculation take into account the potential need to spread premiums and claims expenses over more than one period (that is, the amounts are accounted for on an accruals, not cash, basis (ie premiums received but not yet earned; and claims incurred but not yet paid out)).
7. The claims ratio, which is presented as a percentage, essentially measures the proportion of premiums paid out in claims. A low claims ratio indicates that only a small amount is paid out compared with the amount customers are charged in premiums; a high claims ratio would indicate that a large amount is paid out. All things being equal, a lower claims ratio indicates higher profitability.
8. However, the claims ratio does not take into account the expenses incurred in the sale of insurance such as commission paid to brokers, fees to PCWs, advertising costs, other customer acquisition costs and administration expenses. Therefore we also looked at:
  - (a) the expenses ratio: total expenses divided by NEP; and
  - (b) the combined operating ratio: total claims costs and expenses divided by NEP.
9. We looked at weighted average claims ratios, expenses ratios and combined operating ratios over a five-year period. This was in order to smooth out most fluctuations in claims costs due to any build-up and subsequent release of provisions. We also thought that, given the smaller book size in Northern Ireland, a five-year period would be long enough for a representative number of large claims to occur, and thus reduce the amount of variability in claims costs and profitability.

## **The data**

### ***Data requested from the parties***

10. We asked providers to complete a template spreadsheet for the five years 2008 to 2012, splitting their data between Great Britain and Northern Ireland. The spreadsheet was a standard profit and loss account for insurance providers, showing GWP, premiums written net of reinsurance, NEP, investment income, fee and commission income, and total income; claims paid and any movement in claims provision; and expenses such as fees and commissions



to brokers, advertising costs, and administrative and finance costs. The template spreadsheet also asked for the number of policies, split by type of policy (comprehensive; third party, fire and theft; and third party).

### **Data provided**

11. Of the ten largest insurers in the UK, seven were able to provide us with figures enabling us to compare claims ratios for Northern Ireland and Great Britain: [REDACTED].<sup>5</sup> Five of these insurers provided us with figures enabling us to compare expenses ratios and combined operating ratios for Northern Ireland and Great Britain: [REDACTED].
12. Of these five, we excluded [REDACTED] figures for the reasons set out in paragraphs 16 to 22.
13. esure told us that it did not operate in Northern Ireland. Two insurers (Aviva and CISGIL) told us that they carried out a very small amount of business in Northern Ireland and did not provide us with any data on Northern Ireland. [REDACTED] did not provide any data on its broker commissions in Northern Ireland and [REDACTED] did not provide a split of its broker commissions between Northern Ireland and Great Britain.
14. We also asked the ABI to tell us which other insurers, outside of the ten largest insurers in the UK, were active in Northern Ireland. In response, the ABI said that Allianz, First Central, Groupama and Tesco Underwriting all operated in Northern Ireland.<sup>6</sup> We found that these insurers (in aggregate) made up approximately one-quarter of total NEP from PMI in Northern Ireland for the insurers in our analysis (ie the total for these insurers and the Northern Ireland businesses of the four large insurers which provided sufficient data). Although we recognised that these other insurers sold PMI in the rest of the UK, we called them the ‘Northern-Ireland-only insurers’ to distinguish them from the ‘large insurers’.
15. Some of the insurers provided us with commentary and explanations for the differences in their profitability between the two territories (see paragraphs 37 to 43).

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<sup>5</sup> [REDACTED]

<sup>6</sup> Tesco Underwriting started trading in October 2010. We included data for 2012 but not for 2010 or 2011 as Tesco Underwriting told us that its results in 2010 and 2011 were not representative of its current trading levels.

*Data provided by [REDACTED]*

16. [REDACTED] provided us with data which enabled us to compare its profitability in Northern Ireland and Great Britain. [REDACTED]
17. Overall, [REDACTED] average claims ratio over the five-year period was [REDACTED]% (with [REDACTED]% for Great Britain and [REDACTED]% for Northern Ireland). However, [REDACTED] claims ratio for Northern Ireland over the five-year period fluctuated considerably [REDACTED].
18. [REDACTED] told us that [REDACTED].
19. [REDACTED] also told us that [REDACTED].
20. We asked [REDACTED] if it could suggest a method of ‘smoothing’ the large fluctuations in claims costs other than simply taking a five-year average. [REDACTED] provided us with an analysis which showed the claims ratio split for both Northern Ireland and Great Britain by accident year rather than by financial year. This had the effect of removing the distortions to the results caused by movements in prior year claims and showed average claims ratios of [REDACTED]% for Northern Ireland and [REDACTED]% for Great Britain. We noted that these figures were [REDACTED].
21. However, [REDACTED] also told us that, [REDACTED].
22. Because we considered [REDACTED] data to be anomalous and because it made up only a small percentage of the total data provided, we decided to exclude [REDACTED] original data from our analysis. We also did not include [REDACTED] accident year data as it was not comparable with the data provided by the other large insurers.

**Analysis of the data**

***Total NEP in our sample***

23. Over the five years 2008 to 2012, the four large insurers and the Northern-Ireland-only insurers in our sample achieved an aggregate Northern Ireland PMI NEP of £732 million. Table 1 below shows how this level of NEP was split between the insurers in the sample. [REDACTED], while the Northern-Ireland-only insurers (in aggregate) were responsible for one-quarter.

TABLE 1 Northern Ireland NEP, 2008 to 2012, four large insurers and Northern-Ireland-only insurers

	Northern Ireland NEP %
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]
Northern-Ireland- only insurers	[REDACTED]
Total	100

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

### Claims ratios

24. Table 2 below shows the claims ratios for the four large insurers and the Northern-Ireland-only insurers in our sample for Great Britain and Northern Ireland for 2008 to 2012.<sup>7</sup> Slightly more detailed information is in [Annex B](#).

TABLE 2 Claims ratios for Great Britain and Northern Ireland, 2008 to 2012

	Total UK excluding Northern Ireland						Northern Ireland only					%	
	2008	2009	2010	2011	2012	Average (weighted by NEP)	2008	2009	2010	2011	2012		Average (weighted by NEP)
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Northern- Ireland-only insurers							[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total							[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
To note:	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

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

25. Overall, for these insurers, the weighted average claims ratios over the five-year period was eight percentage points higher in Great Britain than in Northern Ireland ([REDACTED]% compared with [REDACTED]%). The average claims ratios of two of the four large insurers were lower in Great Britain than Northern Ireland [REDACTED].<sup>8</sup>

<sup>7</sup> The claims ratio is calculated as claims expense divided by NEP. Claims expense is the total of claims paid, net of any recoveries from reinsurers, and any change in provision for claims.

<sup>8</sup> We also calculated the weighted average claims ratio using data provided by the six large insurers noted in paragraph 11, excluding [REDACTED]. For the six large insurers and the Northern-Ireland-only insurers, the weighted average claims ratio over the five-year period was 11 percentage points higher in Great Britain than in Northern Ireland ([REDACTED]% compared with [REDACTED]%) (see [Annex B](#)).

26. The data also showed that:
- For the four large insurers, the weighted average claims ratios over the five-year period were [REDACTED]% for Great Britain and [REDACTED]% for Northern Ireland. In each of the five years except 2009, the weighted average claims ratio was higher in Great Britain than in Northern Ireland.
  - For the Northern-Ireland-only insurers, the weighted average claims ratio over the five-year period was [REDACTED]%, ranging between [REDACTED]% (2012) and [REDACTED]% (2011).
27. We considered each of the four large insurers individually:
- Two of the four large insurers had average claims ratios over the five-year period greater in Great Britain than in Northern Ireland ([REDACTED] and [REDACTED]).
  - [REDACTED]
  - [REDACTED]

#### ***Ratio of broker commission to NEP***

28. One explanation given to us for the lower claims ratio in Northern Ireland was that more PMI business is written through brokers in Northern Ireland than Great Britain and that, because distribution costs might be higher in Northern Ireland due to the payment of broker commissions, premiums might be higher to compensate for the higher cost, resulting in a lower claims ratio.
29. AXA Ireland told us that in Northern Ireland [REDACTED]. AXA Ireland noted that in Northern Ireland:
- brokers sold additional products such as motor legal expenses insurance and breakdown cover and had their own premium finance facilities and therefore the income from these products accrued to brokers rather than insurers
  - in addition to commission on policy sales, brokers could earn administration fees from customers for renewals, and from insurers for mid-term adjustments and claims management
30. Aviva [REDACTED] told us that claims ratios in Northern Ireland might be lower than in Great Britain because most Northern Ireland business was written through brokers, where distribution costs might be higher due to the payment of broker commissions. Aviva said that, whilst commissions were generally paid in lieu of marketing and operational costs, there would be an element of broker margin which would result in an overall higher cost than if business was sold

directly to a customer. As such, premiums may be slightly higher to incorporate the higher cost, resulting in a lower claims ratio.

31. In order to examine the explanation that claims ratios in Northern Ireland were lower because premiums were higher to compensate for the higher cost of the broker distribution channel, we looked at the ratio of broker commission to NEP for the insurers for which we had data. The results are shown in Table 3.

TABLE 3 **Broker commission/NEP for Great Britain and Northern Ireland, 2008 to 2012**

	Total UK excluding Northern Ireland						Northern Ireland only					%	
	2008	2009	2010	2011	2012	Average (weighted by NEP)	2008	2009	2010	2011	2012		Average (weighted by NEP)
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Northern-Ireland-only insurers							[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total							[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
To note: [redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

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

32. We found that the data (as shown in Table 3) appeared to be consistent with the explanation. It showed that overall the average ratio of broker commission to NEP over the five-year period 2008 to 2012 was four percentage points higher in Northern Ireland than Great Britain and also that in Northern Ireland the ratio was similar for the large insurers and the Northern-Ireland-only insurers. [redacted], while [redacted], which in the UK sells most of its PMI policies through brokers, had a similar ratio in Northern Ireland and Great Britain.<sup>9</sup> [redacted], which in the UK also sells the majority of its PMI policies through brokers, also had a similar level of broker commission to NEP in Northern Ireland and Great Britain.<sup>10</sup>

### Expenses ratio

33. We next looked at the ratio of total expenses (including broker commission, fees paid to PCWs, advertising, other customer acquisition costs, administration and other expenses) to NEP. The results are shown in Table 4 below.

<sup>9</sup> See our working paper 'Background to private motor insurance (insurers, brokers and PCWs)', paragraph 32.

<sup>10</sup> *ibid*, paragraph 67.

TABLE 4 Expenses ratio for Great Britain and Northern Ireland, 2008 to 2012

	Total UK excluding Northern Ireland						Northern Ireland only						%
	2008	2009	2010	2011	2012	Average (weighted by NEP)	2008	2009	2010	2011	2012	Average (weighted by NEP)	
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Northern Ireland-only insurers							[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total							[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
To note: [redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

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

34. We found that the average ratio was similar in Great Britain and Northern Ireland, which indicated that, if broker commission was higher in Northern Ireland than in Great Britain, other expenses were lower in Northern Ireland than in Great Britain (eg PCW fees). This pattern was confirmed by examining individual insurers' data:

- (a) In the financial information provided by [redacted].
- (b) Similarly, in Northern Ireland [redacted] allocated [redacted] to fees to PCWs or advertising and other customer acquisition costs, whereas in Great Britain these expenses amounted to an average of [redacted]% of total NEP for Great Britain and Northern Ireland combined over the period 2008 to 2012.

**Combined operating ratio**

35. Finally, we looked at the combined operating ratios for these insurers. This ratio expresses the total claims costs, commission payments and expenses as a percentage of NEP. The lower the figure, the more profitable is the insurer, with any figure below 100% meaning that the insurer is profitable on its underwriting activities (before investment income). The ratios are shown in Table 5 below.

TABLE 5 Combined operating ratio for Great Britain and Northern Ireland, 2008 to 2012

	Total UK excluding Northern Ireland						Northern Ireland only						%
	2008	2009	2010	2011	2012	Average (weighted by NEP)	2008	2009	2010	2011	2012	Average (weighted by NEP)	
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Northern Ireland-only insurers							[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total							[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
To note: [REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

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

36. Overall, the weighted average combined operating ratio for this group of insurers over the five-year period 2008 to 2012 was nine percentage points lower in Northern Ireland than Great Britain ([REDACTED]% compared with [REDACTED]%) which indicated that PMI business was more profitable in Northern Ireland than Great Britain. However, the average combined operating ratio in Northern Ireland of [REDACTED]% indicated that the underwriting activities (before investment income) only broke even over the five-year period.

**Insurers' comments on profitability in Northern Ireland compared with Great Britain**

37. [REDACTED] AXA Ireland noted that [REDACTED], which it cited as evidence of the competitive nature of the market.

38. [REDACTED] told us that its profitability [REDACTED]. In these years [REDACTED] combined operating ratio in Great Britain was [REDACTED], while in Northern Ireland it was [REDACTED] noted that its combined operating ratios for Great Britain and Northern Ireland were similar in 2012 and suggested that the main reason for the difference we had found in the five-year averages was that the data for the period was not representative.

39. We noted that the data in Table 5 supported the contention by [REDACTED] and [REDACTED] that the difference in profitability between Great Britain and Northern Ireland reduced in 2012. This data showed that for the large insurers the weighted average combined operating ratio was higher in Great Britain than Northern Ireland by 14 percentage points in 2010 and 15 percentage points in 2011 and that the difference narrowed to seven percentage points in 2012.

40. [REDACTED] told us that, anecdotally, it would not be surprised if direct insurers with no specialist knowledge of the market in Northern Ireland experienced lower

claims ratios in Northern Ireland than in the rest of the UK, as insurers with any disadvantage in risk pricing in Northern Ireland could not afford the risk of adverse selection which followed from being too price competitive.

41. CISGIL [REDACTED] told us that, based on its indirect assessment of market conditions rather than directly on data, it believed that claims costs had been historically higher in Northern Ireland than in Great Britain, primarily as a result of differences in the personal injury claims process, as a result of which premiums in Northern Ireland were typically higher than for the equivalent risks in Great Britain. However, CISGIL told us that claims ratios might be lower in Northern Ireland than Great Britain because:
- (a) Over the last four years, personal injury claims costs in Great Britain had increased rapidly and to a large extent unexpectedly, driven by an increase in low-value whiplash-type claims and the prevalence of CMCs, which had caused claims ratios to rise, particularly in 2009 and 2010, before improving somewhat in 2011 and 2012 as premium increases caught up.
  - (b) The same rapid increase in claims costs had not been observed in Northern Ireland as CMCs did not exist in the same way, meaning that claims ratios in Northern Ireland had not seen the same increase and had remained at a more sustainable long-term level.
  - (c) Expense ratios were higher in Northern Ireland as insurers writing business in Northern Ireland would typically need to maintain some local infrastructure, such as claims repair networks, and would not achieve the same economies of scale as in Great Britain, due to the relatively small size of the Northern Ireland market, resulting in a relatively higher level of expense which would need to be covered by a lower claims ratio to achieve the same level of profitability.
42. RSA noted that there were several characteristics specific to the Northern Ireland market, as follows:
- (a) Historically, there was a higher incidence of fraud at the point of claim in Northern Ireland than in Great Britain.
  - (b) Although the frequency of claims was low (due to Northern Ireland being largely a rural area with fewer road traffic accidents), the amounts paid out in claims was typically higher than in other UK regions, driven by higher payouts for personal injury and solicitors' fees relating to personal injury claims.



- (c) Because drivers in Northern Ireland tended to cross the border into the Republic of Ireland, RSA was frequently in a position of dealing with claims in a jurisdiction in which it did not operate which increased its overall costs of handling claims (and anecdotal evidence suggested that the average payout for personal injury claims was even higher in the Republic of Ireland than in Northern Ireland, with an average whiplash claim costing £3,500 in Great Britain, £5,000 in Northern Ireland and £10,000 in the Republic of Ireland).
43. Admiral told us that it aimed to price its policies to maintain a broadly consistent claims ratio across all segments in its portfolio. It said, however, that the underwriting result for Northern Ireland had been much more variable over the period as a result of the volatility which arose from a smaller book size.

**Claims ratios for each insurer in our sample, split between Great Britain and Northern Ireland, five years 2008 to 2012**

	Total UK						Total UK excluding Northern Ireland						Northern Ireland only						%
	2008	2009	2010	2011	2012	Average	2008	2009	2010	2011	2012	Average	2008	2009	2010	2011	2012	Average	
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
Total	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
Northern-Ireland-only insurers													[X]	[X]	[X]	[X]	[X]	[X]	
Total	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	
To note: [X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	

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

## Cost of replacement cars

### Introduction

1. In this appendix, we assess the cost implications of the separation of cost liability and cost control. As discussed in Section 6, this is the case when non-fault claims are managed by the non-fault insurer or by a CMC/CHC, rather than by the at-fault insurer itself.
2. The appendix is structured as follows:
  - (a) comparison of credit hire and direct hire costs;
  - (b) analysis of the cost of credit hire, including (i) the payment of referral fees by CHCs to non-fault insurers and brokers (and others) in order to provide credit hire services; and (ii) the frictional costs incurred by both insurers (at-fault and non-fault) and CHCs in relation to the provision of credit hire services; and
  - (c) analysis of the duration of credit hire.

### Credit hire

3. If a non-fault insurer or broker controls a non-fault driver's claim, the driver often receives a replacement car from a CHC under a credit hire agreement, following a referral to the CHC from the broker or insurer (for which the broker or insurer earns a fee). Assuming that the CHC also assesses the driver to be non-fault, the CHC typically provides a like-for-like replacement car, subject to the driver's duty to mitigate their loss with consideration to their need, and will recover the cost from the at-fault insurer.
4. Nine of the ten motor insurers in our sample told us that they usually referred their non-fault drivers, with the driver's consent, to a CMC or CHC for the provision of replacement car services under a credit hire agreement.<sup>1</sup>

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<sup>1</sup> CISGIL told us that it did not refer its non-fault drivers directly to CHCs. However, it said that it referred its non-fault drivers with MLEI to Co-operative Legal Services (CLS) in respect of their uninsured losses. CLS managed these drivers' claims against the at-fault driver, including the provision of a replacement car. CISGIL said that around [§<] % of these drivers were referred, on the basis of need, by CLS to [§<] for the provision of a replacement car on credit hire terms.

## *The GTA*

5. Nine of the ten motor insurers in our sample subscribe to the GTA.<sup>2</sup>
6. The GTA is a voluntary non-binding protocol which sets out the arrangements between insurer and CHC subscribers for replacement car provision under credit hire to non-fault drivers. It was established with the intention of removing confrontation, avoiding costly litigation and encouraging collaboration in the management and settlement of credit hire claims.
7. Although subscription to the GTA is voluntary, the CHO told us that it estimated that CHCs/CMCs and insurers subscribing to the GTA accounted for about 90% of the credit hire market in the UK. We noted that the percentage of claims subject to GTA terms may be lower as claims initially within the GTA may subsequently 'fall out' and be settled through negotiation or litigation.<sup>3</sup>
8. The GTA covers the terms, conditions and rates of credit hire for replacement cars provided to non-fault customers in the UK. The overriding principle of the GTA is that whoever is first to a customer and obtains their agreement should provide the service and no other subscriber should seek to intervene. 'First to a customer' is defined as the receipt and acceptance by the customer of a suitable and clear offer. The GTA also applies pre-agreed administrative processes and pre-agreed maximum daily hire rates.<sup>4</sup> The GTA hire rates are agreed between the insurance industry and the CHCs by a technical committee, which is constituted with equal representation by insurers and CHCs and an independent Chairman.
9. The GTA Technical Committee is currently conducting a feasibility study into the establishment of a GTA portal, which would be an online tool to improve the management of credit hire claims and reduce administrative and frictional costs for both insurers and CHCs. The concept has received backing from both insurers and CHCs. Insurer and CHO members of the GTA have, through the Technical Committee, prepared a detailed technical specification for the portal and conducted a competitive tendering process which is nearing completion. Tender responses are in the final stages of evaluation following which members will be asked to carry out a cost benefit analysis in respect of the proposed portal as it relates to their own organisation.

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<sup>2</sup> [X] told us that all but one of its brands subscribed to the GTA (the exception being [X]).

<sup>3</sup> Under the GTA, a CHC can pursue payment outside the terms of the GTA for claims not settled within 90 days.

<sup>4</sup> The GTA is intended to apply to situations where a CHC feels the non-fault driver has the prospect of full recovery against the at-fault insurer and, in such cases, all subscribers are required to follow the GTA. In all other cases (ie where full recovery is not anticipated), subscribers may elect to follow the same principles, provided that they comply with the spirit and terms of the GTA, including by applying the relevant settlement rates.

## Direct hire

10. Direct hire replacement cars are often supplied to non-fault drivers when the at-fault insurer captures and controls the non-fault claim or where there is a bilateral agreement in place between the at-fault insurer and the non-fault insurer or when the at-fault insurer is also the non-fault insurer.
11. Under a direct hire agreement, the insurer managing the claim arranges and pays for a replacement car through its contracted direct hire provider at pre-agreed rates. Six of the nine CHCs in our sample (Accident Exchange, Ai Claims Solutions, Enterprise, Helphire, Kindertons and WNS Assistance) told us that, as well as providing credit hire services, they also provided direct hire services to at-fault customers and captured non-fault customers (following a referral from the at-fault insurer).

## Non-fault party capture

12. Insurers told us that, when they were the at-fault insurer, they often attempted to capture the non-fault driver, in order to control the costs of the claim, including the cost of replacement car provision. Table 1 shows the varied success of insurers in capturing non-fault drivers.

TABLE 1 Insurers' non-fault driver capture rates, 2012

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

Source: Insurers.

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

13. At-fault insurers capture non-fault drivers by contacting them directly as early as possible following an accident where their customer appears to be at fault. They usually obtain the contact details of the non-fault driver from their customer during the FNOL process. Where the customer cannot provide full contact information, the insurer will use a range of easily available data sources to obtain or verify the details. For example, [X].

14. The majority of the insurers in our sample told us that [REDACTED].<sup>5</sup>
15. Insurers told us that the main cost incurred in non-fault driver capture arose from employing claims handlers to try to identify and contact these drivers. [REDACTED] told us that this claims-handling cost was around £[REDACTED] per claim. LV told us that it estimated that it cost around £[REDACTED] to capture a non-fault driver.

### *Bilateral agreements*

16. Five of the ten motor insurers in our sample ([REDACTED]) told us that they had bilateral agreements in relation to replacement car provision with one or more of the other motor insurers in our sample (see Table 2).

TABLE 2 **Motor insurer bilateral agreements**

[REDACTED]

Source: Insurers.

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

17. Where such bilateral agreements exist, at-fault insurers can avoid the referral of a non-fault driver to a CHC by the non-fault insurer and can reduce frictional costs by, typically, mutually agreeing to provide a replacement car to non-fault drivers at rates agreed between the at-fault insurer and the non-fault insurer.<sup>6</sup>

### *Alternative credit hire model*

18. Enterprise told us that it offered a ‘subscriber model’ for the provision of replacement cars to non-fault drivers under credit hire. Enterprise told us that, where both the at-fault insurer and non-fault insurer were subscribers to its model and where the at-fault insurer accepted liability within five working days, it would pay the non-fault insurer a referral fee for referring the non-fault driver to Enterprise and it would invoice the at-fault insurer for (a) the cost of the hire at contracted direct hire rates, plus (b) the referral fee it had paid and a charge for ‘first notification of loss’.<sup>7</sup> The at-fault insurer would be required to pay the invoice within [REDACTED] days, as under direct hire. If the at-fault insurer did not accept liability within five working days, it would be billed at Enterprise’s normal credit hire terms.

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<sup>5</sup> [REDACTED]

<sup>6</sup> We note that the rates of bilateral hire are based on agreement between the two insurers that are party to the bilateral agreement and this agreed rate is not necessarily the rate that has been agreed between the insurer and their chosen replacement car provider.

<sup>7</sup> [REDACTED]

## **Northern Ireland**

19. There are several commercial and legal differences between Northern Ireland and the rest of the UK in relation to replacement car provision. The main differences appear to be:
- (a) CMCs/CHCs are less prevalent in Northern Ireland than in the rest of the UK. It has been put to us that this might be due to:
    - (i) The effective ban of the payment of referral fees by solicitors in Northern Ireland.<sup>8</sup>
    - (ii) Means-tested legal aid for personal injury cases.<sup>9</sup> The Belfast Solicitor's Association told us that 45% of people were financially entitled to legal aid in Northern Ireland (although we understand that this entitlement is currently under review). Consequently, non-fault drivers pursuing compensation were less likely to require the services of a CMC/CHC in order to negate the risk of having to bear the costs, should they be unsuccessful in their claim.
  - (b) The GTA is not used as much in Northern Ireland. For example, Crash Services, a leading CHC in Northern Ireland, does not subscribe to the GTA.
  - (c) The Ministry of Justice, which includes the Ministry of Justice's Claims Management Regulator, does not have jurisdiction in Northern Ireland, meaning that CMCs/CHCs in Northern Ireland are not regulated.

## **Comparison of the cost of credit hire and direct hire**

20. We asked the ten largest motor insurance providers to provide us with data on replacement car costs between 2010 and 2012. Five of the ten insurers provided us with data which we could aggregate and compare. We compared 'third party non-fault' data (ie the costs passed on under subrogation to at-fault insurers) with two benchmark scenarios: (a) captured claims; and (b) claims where the at-fault and non-fault insurers were the same. [Annex A](#) explains the reasons for our choice of data.

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<sup>8</sup> Although referral fees are not explicitly prohibited in Northern Ireland, they are effectively banned by the operation of Article 28 of the Solicitors (NI) Order 1976, which prohibits the sharing of profits or fees with an unqualified person. In England and Wales, the growth of the claims management industry coincided with the lifting of the ban on referral fees to solicitors in 2004.

<sup>9</sup> We note that personal injury cases were within the scope of the England and Wales legal aid scheme prior to the introduction of Conditional Fee Agreements in 1998.

21. Figure 1 shows the average replacement car costs by insurer and claim type in 2012.<sup>10</sup>

FIGURE 1

**Average replacement car cost by claim category and insurer, 2012**

[X]

Source: Insurers and CMA analysis.

Notes:

1. [X]'s and [X]'s number of observations for 'same insurer' costs are very low so these results should be interpreted with caution.
2. [X]'s figures are for 2011 to enable better comparability.

22. Subtracting the average costs in the benchmarks without the separation ('captured' and 'same insurer') from the costs in the scenario with this separation ('third party non-fault'), we found that the average cost where there is separation was higher than in the cases without. Figure 2 illustrates these differences.

FIGURE 2

**Average cost difference, 2012**

[X]

Source: Insurers and CMA analysis.

Notes:

1. [X]'s and [X]'s number of observations for replacement car costs and 'same insurer' are very low. Results should be interpreted with some caution.
2. [X]'s figures are for 2011 to enable better comparability.

23. Figure 2 suggests that the average increase in replacement car costs associated with the separation is between £570 and £1,400. The result is broadly consistent across the two alternative benchmarks used. The data provided indicates a similar result for 2011 and 2010 (see [Annex A](#)).

24. However, we noted two problems with using these values as estimates of the effects of the separation in relation to temporary replacement vehicle provision:

- (a) The data on the 'captured' and 'same insurer' scenarios might include cases in which a courtesy car was provided so the comparison with credit hire might therefore not be 'like-for-like'.
- (b) The cars in captured claims might tend to have a lower level of damage than in non-captured claims (see Appendix 6.2, paragraph 27), which could suggest that captured claims might on average require the provision

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<sup>10</sup> The third party non-fault category represents replacement car bills received by the five insurers from other parties.



of a replacement car for shorter periods, so, again, the comparison with credit hire might therefore not be 'like-for-like'.<sup>11</sup>

25. Given these caveats, we decided to use data supplied by credit hire and direct hire providers to analyse costs further, including an analysis of both hire duration and daily hire rates. This data showed an average credit hire cost of £1,130 and an average direct hire cost of £389 per hire. In the next sections, we discuss hire duration and daily rates.

### **Hire duration**

26. The evidence provided by eight hire providers showed that the average credit hire duration was about three days longer than the average direct hire duration. The evidence provided by the ten motor insurers in our sample suggested a slightly larger difference in duration – see Table 3. We put more weight on the evidence from providers as we could directly estimate the average durations from detailed data on the number of hires and hire days for different classes of vehicle in 2012.

TABLE 3 **Average credit hire and direct hire durations**

<i>Motor insurer/CHC/ direct hire provider</i>	<i>Average credit hire duration (days)</i>	<i>Average direct hire duration (days)*</i>	<i>Difference (days)</i>
<i>Motor insurer</i>			
Admiral	[REDACTED]	[REDACTED]	[REDACTED]
Ageas	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]
AXA	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]	[REDACTED]
LV	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]
Unweighted average	15.5	11.8	3.7
<i>CHC/direct hire provider</i>			
Accident Exchange	[REDACTED]	[REDACTED]	[REDACTED]
Ai Claims Solutions	[REDACTED]	[REDACTED]	[REDACTED]
ClaimFast†	[REDACTED]	[REDACTED]	[REDACTED]
Crash Services‡	[REDACTED]	[REDACTED]	[REDACTED]
Enterprise	[REDACTED]	[REDACTED]	[REDACTED]
Europcar§	[REDACTED]	[REDACTED]	[REDACTED]
Helphire	[REDACTED]	[REDACTED]	[REDACTED]
Kindertons	[REDACTED]	[REDACTED]	[REDACTED]
Weighted average	16.3	13.3	3.0

Source: Motor insurers and CHCs.

\*The direct hire data might include at-fault claims.

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

‡Crash Services does not provide direct hire services.

§Europcar does not provide credit hire services.

<sup>11</sup> A detailed econometric analysis, which could have controlled for the differences in service, was not possible for lack of suitably disaggregated data.

27. The difference between the average credit hire and direct hire duration could in principle be due to:
- (a) the mix of claims, eg more replacement cars for more complex claims requiring longer repair periods being provided under credit hire;
  - (b) the underprovision of replacement car services under a direct hire agreement in relation to duration (though we have not found evidence to support this view – see Appendix 6.5); and/or
  - (c) unnecessarily lengthening credit hire durations (eg by disproportionately booking in cars for repair on Fridays or returning them on Mondays, or by extending repair durations).
28. The first hypothesis was consistent with our finding that the average level of damage was lower for captured claims than for non-captured ones. Since direct hire is mainly provided in the case of captured claims and credit hire for non-captured ones, we believed it was reasonable to expect higher average duration for credit hire.
29. Evidence on point (c) is set out later in the appendix (see paragraphs 123 to 133).

### ***Daily hire rates***

30. In this subsection we discuss the comparison of daily rates for credit hire and direct hire. We discuss:
- (a) average credit hire rates;
  - (b) average direct hire rates, including additional charges which might not be included in basic rates, and the issue of whether current rates are kept artificially low;
  - (c) the treatment of VAT;
  - (d) the implications of the main direct hire provider using a different vehicle categorisation; and
  - (e) the difference in timing of payments between credit hire and direct hire.

### ***Credit hire rates***

31. For credit hire claims, the GTA sets the maximum daily rate for each car class. This, however, is not necessarily the rate charged to insurers. For claims settled under the terms of the GTA, a CHC can choose to apply a lower rate.

On the other hand, at-fault insurers might pay more if they do not comply with the GTA timeline for payment. The GTA's guidelines specify that payment in settlement of a credit hire claim should be made within 30 days of the dispatch of the claim to the at-fault insurer. If payment is late, the outstanding amount incurs a late payment penalty at both 30 days (12.5%) and 60 days (20%). A CHC is entitled to progress settlement outside the GTA (eg through litigation) if a claim has not been settled after 90 days from the dispatch of the claim to the at-fault insurer.<sup>12</sup> Finally, some hire claims are managed from the outset outside the GTA; in these cases the daily rate is usually higher than the relevant GTA rate.

32. We derived an average credit hire rate by dividing the total revenues received (or expected to be recovered) from a sample of seven CHCs for hire claims opened in 2012 by the number of those claims. By using the actual revenues, we took into account the fact that recovered amounts were often different from initially claimed amounts, because of discounts, late payment penalties, or partial or total write-off of challenged claims.

#### *Direct hire rates*

33. We used the same approach for the calculation of average direct hire rates, using data on the revenues that four direct hire providers ([REDACTED]) received for direct hire claims opened in 2012. The rates so computed included any additional charges above the basic direct hire rates.<sup>13</sup> However, as discussed in [Annex B](#), some additional services were not supplied with the same frequency under direct as under credit hire. We calculated that, if they were supplied with the same frequency, the effect would be to increase the average direct hire rate by £0.37 per day per claim.
34. We did not include in the rates additional payments made by claimants for additional collision damage waivers, upgrades or additional rental days. Some CHCs suggested that these revenues affected the comparison of credit hire and direct hire rates.<sup>14</sup> [REDACTED], however, [REDACTED]. We found that some other CHCs also charged customers if they wanted to reduce the excess on the replacement vehicle's insurance policy. Overall, though, we found that the excesses provided to credit hire customers were on average lower than those provided to direct hire customers. Therefore, we adjusted the comparison by including the savings to drivers from lower credit hire excesses (see Appendix

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<sup>12</sup> Helpfire told us that [REDACTED]% of its credit hire claims were not settled within 90 days.

<sup>13</sup> In particular, they include the amounts charged to at-fault insurers when the direct hire provider also provides insurance for the replacement vehicle.

<sup>14</sup> For example, Kindertons told us that revenues from upselling were substantial in the case of direct hire and Quindell said that direct hire rates were artificially low and were offset by additional income generated directly from consumers in the form of upselling (insurance, excess waivers etc).

6.5, paragraphs 81 to 84). Given this adjustment, we believed that including the actual charges paid by claimants would not alter the results of our analysis.

#### *Delivery and collection*

35. Some CHCs told us, with specific reference to Enterprise, that delivery and collection services were not usually provided under direct hire. They said that, since such services were always provided by CHCs, direct hire rates should be increased to cover the cost of the services.
36. However, Enterprise told us that its approach for direct hire was similar to its approach for credit hire, ie that it always offered claimants a variety of options for the provision of the rental vehicle to suit the claimant's needs and that in roughly 50% of direct hires the replacement vehicle was delivered to the claimant. Enterprise said that many of its customers chose to pick up the replacement vehicle at the site of the rental company instead of having it delivered to their own premises because they could obtain the car more quickly. [✂]
37. We noted that there would still be an issue if the time Enterprise needed to arrange a delivery were much longer than for other CHCs. If so, although the service would be available in theory, it would not be offered in practice. However, this did not seem to be the case. Other CHCs told us that they needed between 2 and 4 hours to arrange a delivery. This suggested that, with respect to delivery and collection, credit and direct hire provided a similar level of service.
38. We also noted that Enterprise operates from nearly 400 branches across the UK, and so many customers were located fairly close to one of its sites, making the 'pick-up' option not inconvenient.

#### *Profitability of direct hire*

39. CHCs said that direct hire rates were kept artificially low, with companies using these contracts to make a non-fault credit hire referral relationship more attractive to insurers. According to this view, direct hire is an ancillary service to credit hire. The implication was that current direct hire rates could not be compared directly with credit hire rates. However, most insurers disagreed.
40. To test this hypothesis, we focused on Enterprise, which currently has a large share of direct hire. We noted that Enterprise faces competition from other large car hire companies (eg Avis, Hertz and Europcar) and that, despite its

large share of direct hire, insurers did not consider that there was a lack of competition in direct hire.<sup>15</sup>

41. We asked other car hire companies whether any factors impeded them from increasing their provision of direct hire to motor insurers. [redacted] of those responding (Hertz [redacted]) mentioned that Enterprise's existing relationships with insurers made it more difficult to win direct hire business, particularly since some insurers sought a single supplier for both direct hire and credit hire. Hertz said that it had identified a lack of specialist systems, process and support services needed to manage insurance business; that it had sought to address this through the acquisition of a credit hire company (CCL Vehicle Rentals) in June 2013; and that it planned to increase its direct hire provision through this business.
42. We noted that Enterprise had a large share of direct hire and a smaller share of credit hire. Though we noted the possible attraction to some insurers of having a single supplier for both direct hire and credit hire, we did not see why Enterprise should price direct hire low and credit hire high. Rather, it seemed to us that Enterprise's incentives would be to keep its credit hire rates low in order to build its share of credit hire (which is much lower than its share of direct hire). However, we considered the available evidence on Enterprise's pricing.
43. Enterprise told us that it did not cross-subsidise between credit and direct hire. It said that it offered the same direct hire rates irrespective of whether an insurer tendered for direct hire only or jointly for direct and credit hire. [redacted], as shown in Table 4.

TABLE 4 Enterprise's data on the profitability of its hire services

	£	
	<i>Third party direct hire</i>	<i>Credit hire</i>
Average daily rate	[redacted]	[redacted]
Non-essential functions, referral fees and uncollectable debts	[redacted]	[redacted]
Net daily rate	[redacted]	[redacted]

Source: Enterprise.

44. We also noted that there was at least one provider of direct hire, Europcar, which did not offer credit hire services. We found that [redacted].

<sup>15</sup> Three insurers referred to the fact that there were only four large car hire companies. None suggested that Enterprise's large share of direct hire itself limited competition.

45. Overall, we found no evidence that Enterprise was pricing direct hire low in order to increase its credit hire prices.
46. We also considered whether Enterprise could be pricing direct hire below cost in order to gain a monopoly position in direct hire. However, this seemed to us implausible since we did not see how Enterprise could derive a long-term advantage from it. While Enterprise might temporarily obtain a large share of direct hire by pricing below cost, if it subsequently tried to increase its prices, insurers would have both the incentive and the ability to induce more competition from other large hire companies.
47. Considering all the evidence, we saw no reason to believe that current direct hire prices were unsustainably low.

#### *VAT on hire services*

48. In our comparison of credit hire and direct hire rates, we included VAT. Since motor insurance is VAT-exempt, insurers cannot reclaim from HMRC the VAT paid on hire services.
49. Insurers are required to pay the full VAT on hires unless the claimants are VAT registered. In this case, however, credit and direct hires may be treated differently. For credit hire, if the claimant is VAT registered, CHCs do not claim the full VAT from the at-fault insurer. Rather, all or some of the VAT is paid by the claimant who can then reclaim it, at 100% for vehicles which are solely for business use and at 50% for a standard company car. The same can in principle happen under direct hire, but in practice might not. For example, [REDACTED].
50. We did not make any adjustment for this issue as it appeared to us that the proportion of PMI replacement vehicle cases in which VAT was not paid by the insurer was uncertain and very small (vehicles used solely for business use would not have PMI).<sup>16</sup>
51. Some CHCs argued that, even if motor insurance is VAT-exempt, it would be more correct to exclude VAT. They submitted that, as a result of more VAT being paid to the Exchequer, other taxes were lower. However, our concern was with effects on customers,<sup>17</sup> and we did not think it necessary or appropriate to attempt an analysis of consequential effects which we noted could go far beyond VAT to include other taxes, for example corporation tax, income tax and national insurance contributions.

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<sup>16</sup> Zurich estimated that this happened in less than 5% of hires.

<sup>17</sup> The Enterprise 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 ([section 134\(5\)\(a\)](#)).

### *Different categorisations*

52. Enterprise, the largest direct hire provider, does not categorise cars according to the classes used for credit hire under the GTA. Enterprise uses its standard car hire classes, some of them corresponding to more than one GTA class, and it applies a single direct hire rate for all the models in the same class.<sup>18</sup> Our estimates of the extra cost of credit hire over direct hire are based on the standard car hire classes used by Enterprise for direct hire.<sup>19</sup>
53. In estimating the cost difference between credit and direct hire, the different categorisations gave rise to two issues:
- A business model based on a smaller number of classes might be more efficient, even in the absence of systematic differences in the quality of service. The larger flexibility allowed by a less granular classification is likely to reduce costs for direct hire since it is easier and less costly to source a car quickly within a larger group than to do so under a more constrained model.
  - The quality of service provided under credit and direct hire might not be the same if credit hire claimants get a more directly comparable vehicle to their own than direct hire claimants.
54. On the first issue, any such cost savings would be reflected in our estimates of the difference between the cost of credit hire and that of direct hire.
55. On the second issue, we believed that any benefit claimants received from a finer classification was quite small. The difference in classification affects mainly the 'premium' and 'sport' segments. While the more granular GTA classification could mean that some claimants needing replacement cars in these segments get a replacement more similar to their own model, evidence from our survey suggested that the total impact of quality differences was small (affecting no more than 6% of non-fault claimants).<sup>20</sup> We also did not find that the cost difference between credit hire and direct hire was proportionately larger for standard hire classes that corresponded to more than one GTA class than it was for standard hire classes that corresponded with a single GTA

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<sup>18</sup> Some other direct hire providers use the more granular GTA classification.

<sup>19</sup> We were not able to make a similar comparison using GTA classes due to the necessary data not being available from Enterprise.

<sup>20</sup> We investigated the sensitivity of our estimates to possible quality differences associated with the greater granularity of GTA classes (see Appendix 6.6, paragraphs 71–73).

class, as would be expected if the greater granularity of GTA classes led to credit hire claimants receiving replacements more similar to their own cars.<sup>21</sup>

### *Timing of payments*

56. Payments for direct hires are quicker than those for credit hires, as shown in Table 5. The longer payment period for credit hire than direct hire results in additional costs for CHCs (because they have to finance the additional debt) and a benefit to at-fault insurers (because they have an additional source of funds and hence require less debt than would otherwise be the case). The benefit to at-fault insurers of lower debt offsets to some extent the higher price of credit hire. Therefore, we believed that the comparison between the average bills for credit and direct hires needed to be corrected for the benefit to at-fault insurers from the difference in the timing of payments.

TABLE 5 **Timing of payments for credit hire and direct hire services in 2012**

<i>Number of days between invoicing the bill and receiving the payment</i>	<i>Percentages of payments for credit hires in 2012 %</i>	<i>Percentages of payments for direct hires in 2012 %</i>
0–30	38.90	98.14
31–60	17.73	0.18
61–90	8.59	0.66
91–120	5.11	
121–150	3.10	1.03
151–180	2.33	
181+	14.71	
Outstanding debt at March 2014	9.52	0

Source: CHCs and insurers.

*Notes:*

1. We have assumed a recovery rate on outstanding debt equal to that of bills recovered in more than 180 days (this is probably an overestimate). The percentages in the table are with respect to total payments received, including expected payments for outstanding debts.
2. The data provided by two CHCs include revenues from credit repair. The weight assigned to these CHCs is therefore too high. The effect is a slight increase in the average delay.

57. Table 5 divides the payments for credit and direct hire services according to when the providers receive them. Almost all direct hire bills are paid within 30 days; the average delay is approximately 13 days. On the other hand, in 2012 less than 40% of revenues from credit hires were received by CHCs within 30 days of issuing the invoice. A substantial debt from 2012 claims was still outstanding in March 2014.

58. Figure 3 suggests that the percentage of payments received within 30 days increased in the first six months of 2013. This may have reflected an increase

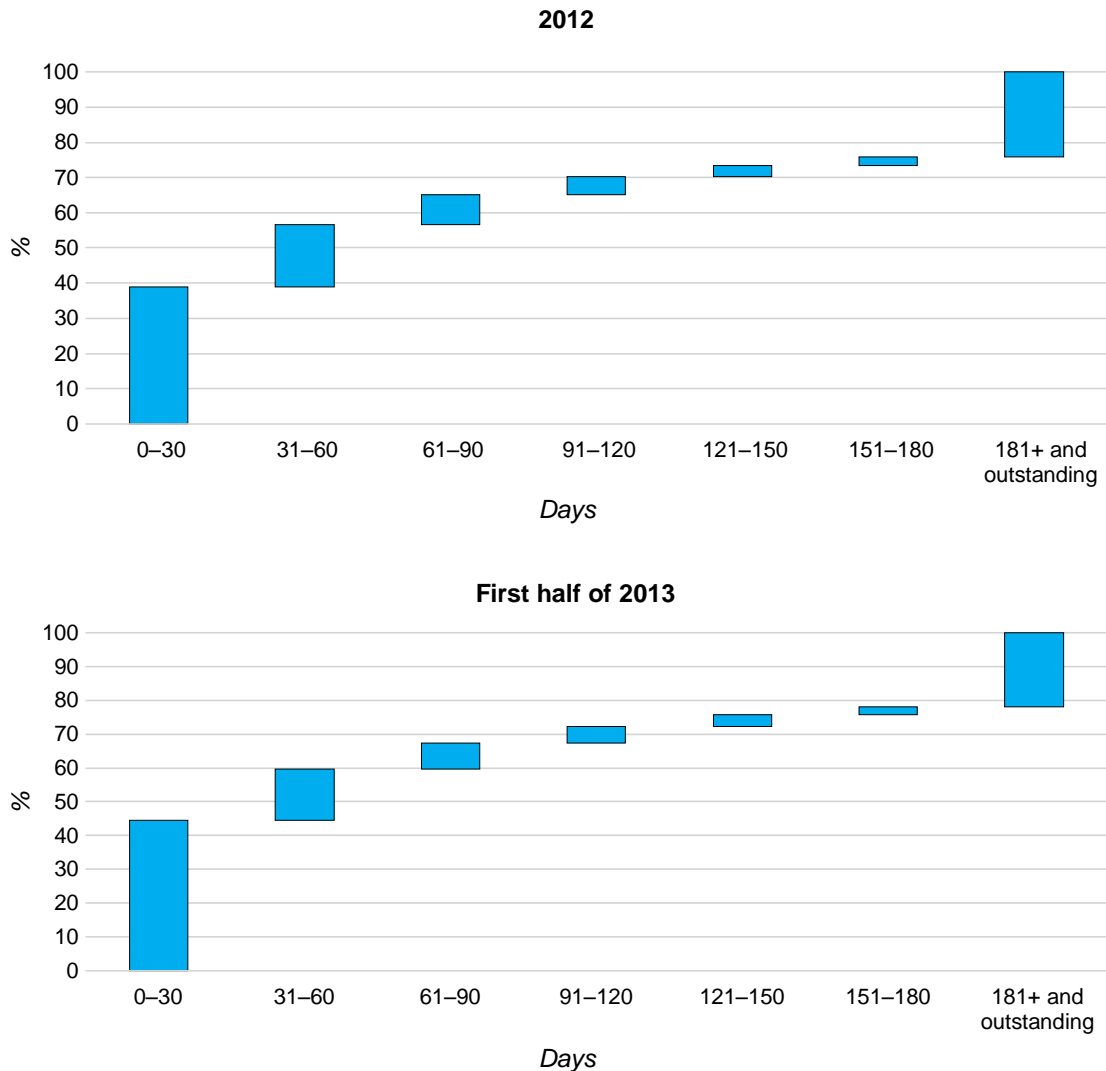
<sup>21</sup> The weighted average ratio of credit hire for standard hire classes A–D (which are similar to GTA classes S1–S4 respectively) was 2.32, while it was 2.04 for the other classes (where the standard hire classes are less granular than the GTA classes). The comparable overall weighted average ratio of credit hire was 2.10 – see Table 7.



in the efficiency of GTA arrangements, or the introduction of new bilateral agreements between CHCs and insurers.

FIGURE 3

**Timing of payments for credit hire services**



Source: CMA.

59. In order to compare the timing of payments between credit hire and direct hire, we also took into account the difference in the average number of days between the end of a hire and the issue of a request for payment. This took an average of 7 days for direct hire and 11 days for credit hire.
60. Therefore, the average total delay for direct hire was around 20 days (7 days between the end of the hire and the request for payment, plus 13 days for the payment). Not all CHCs could provide detailed information about the day on which payments were received. We computed the average day within each of the categories in Table 5 using daily data from one CHC. We found that, for most categories, we could take the midpoint, though the average within the 0–

30 category was higher (18 days for the CHC concerned). We used 20 days as a reasonable average. The average for the 180+ category was around 330 days for the CHC we considered. For the outstanding debt, we assumed a recovery rate of 85% and an average delay of 900 days.

61. The delay in payments associated with credit hire reduces insurers' debt. Table 6 summarises our calculations on the benefit of delayed payments, assuming an approximate cost of debt of 5%.<sup>22</sup> It shows that the benefit is approximately equivalent to a 2.2% discount on the overall payments. Therefore, we discounted the average credit hire rate by 2.2%.

TABLE 6 **Benefit from delays in the payment of credit hire services**

<i>Number of days between invoicing the bill and receiving the payment</i>	<i>Fraction of credit hire payments (%)</i>	<i>Average delay between invoicing the bill and receiving the payment (days)</i>	<i>Average difference between total delays for credit and direct hire (days)</i>	<i>Benefit from delay (as a percentage of overall payments) (%)</i>
0–30	38.90	20	11	0.06
31–60	17.73	45	36	0.09
61–90	8.59	75	66	0.08
91–120	5.11	105	96	0.07
121–150	3.10	135	126	0.05
151–180	2.33	165	156	0.05
181+	14.71	330	321	0.65
Outstanding	9.52	900	891	1.16
				<b>2.20</b>

Source: CMA.

### *Cost difference between credit hire and direct hire*

62. In order to compare credit hire and direct hire rates, we aggregated the data into the standard car hire classes used by Enterprise (see paragraphs 52 to 55). We excluded the most prestigious vehicles (GTA classes F9, P11, P12, P13, SP11, SP12, and SP13) because several insurers had specially contracted on on-demand rates. For the purpose of the calculation, we assumed that there was no difference between credit and direct hire rates for these classes of vehicles.

<sup>22</sup> We estimated from insurers' reports and accounts that their approximate average cost of debt was 5%. We valued insurers' delayed payments under credit hire at their cost of debt because the delay in payments reduced the amount of debt insurers needed to hold. Two parties disagreed with this approach, which we set out in our [working paper](#) on this issue. Allianz said that there were no benefits from delayed payments as the costs were held in reserves; and Accident Exchange said that the benefits from delayed payments should be valued at insurers' weighted average cost of capital as they contributed to insurers' working capital. We did not agree with either party's point. In our view, insurers require a certain level of capital which they finance through a mixture of debt and equity and the delay in payments associated with credit hire reduces the amount of debt that insurers require but does not affect the amount of equity they require. Hence, the benefit to insurers should be valued at insurers' cost of debt, not the interest rate on cash (as would be implied by Allianz's point) nor the weighted average cost of debt and equity (as would be implied by Accident Exchange's point).

63. Table 7 shows the average credit hire rates for a sample of seven large CHCs and the average direct hire rates for our sample of providers.

TABLE 7 Comparison of credit hire daily rates and insurer direct hire daily rates

Vehicle class	GTA class	Credit hire average £	Direct hire average £	Credit hire to direct hire ratio	Weights (number of credit hire days) %
A	S1	39.87	[REDACTED]	[REDACTED]	4.83
B	S2	42.90	[REDACTED]	[REDACTED]	17.77
C	S3	46.45	[REDACTED]	[REDACTED]	14.23
D	S4	47.95	[REDACTED]	[REDACTED]	13.88
E	S5, P1, SP1	59.90	[REDACTED]	[REDACTED]	9.85
F	S6, S7, P2, SP2	63.82	[REDACTED]	[REDACTED]	13.57
MMPV	M, M1, M2	65.70	[REDACTED]	[REDACTED]	7.28
MPV	M3–M6	89.05	[REDACTED]	[REDACTED]	1.47
SPREM	P3–P5, SP3–SP6	130.86	[REDACTED]	[REDACTED]	9.37
MPREM	P6, P7, SP7, SP8	204.88	[REDACTED]	[REDACTED]	1.96
EPREM	P8–P10, SP9, SP10	274.02	[REDACTED]	[REDACTED]	0.66
S4X4	F1, F2	107.78	[REDACTED]	[REDACTED]	2.38
L4X4	F3-F5	154.83	[REDACTED]	[REDACTED]	2.00
E4X4	F6-F8	229.19	[REDACTED]	[REDACTED]	0.61
F9, P11–P13, SP11–SP13		492.97	492.97		0.15
Weighted average		69.37	33.09	<b>x2.10</b>	

Source: CHCs and direct hire companies.

64. We computed both the average direct hire and the average credit hire rates over multiple car categories using as weights the relevant numbers of credit hire days in our sample of CHCs. This implied that the comparison between credit and direct hire rates was based on the assumption that claimants were provided in both cases with the same cars for the same duration. It was therefore a like-for-like comparison. On this basis, credit hire rates were 2.1 times higher than direct hire rates.
65. We then compensated for the difference in the timing of payments between credit hire and direct hire bills by decreasing credit hire rates by 2.2% (see paragraph 61). When we adjusted also for the fact that additional services were provided more frequently with credit hire and that collision damage waivers (CDW) were on average better under credit hire (see paragraphs 33 and 34), credit hire rates were 2.02 times higher than direct hire rates.
66. We noted that hire periods were on average shorter under direct hire than credit hire. Since the daily cost of hire tends to be lower the longer is the hire period, applying current direct hire rates to the number of credit hire days might therefore slightly overestimate the cost of direct hire. In other words, if the average length of direct hires was the same as for credit hire, direct hire rates would be lower than those used in our calculation. However, we were not able to adjust for this.
67. Dividing the total revenues for the CHCs in our sample by the total number of credit hire claims managed by them, the adjusted average credit hire revenue

was £1,100. Since credit hire rates were about 2.02 times higher than direct hire rates, we estimated that under direct hire the same services could be provided for about £545. The average cost difference was approximately £555 per claim.

68. One CHC observed that we should have separately estimated the cost difference between direct hire claims and credit hire claims within the GTA, and the difference between the latter and credit hire claims outside the GTA. However, we did not seek to do this for two reasons: first, our concern was with the overall effects including claims both within and outside the GTA; and second, claims may be initiated within the GTA and later fall outside of it if payments are not received within 90 days but it would not be meaningful to aggregate such claims with those where the CHC and/or the insurer are outside the GTA.<sup>23</sup>
69. We compared our estimate of credit hire and direct hire bills with that provided by a CHC (Helphire) – see [Annex C](#). This CHC’s figures showed [✂].

### **Analysis of the cost of credit hire**

70. In seeking to analyse the higher daily hire rate of credit hire compared with direct hire, we considered the underlying costs borne by replacement car providers under the two models. In this subsection, we discuss the following costs, which contribute to and/or reflect the cost differences set out above:
- (a) referral fees;
  - (b) bad debt provision;
  - (c) credit risk; and
  - (d) administration costs (both duplicated costs and frictional costs).
71. Frictional costs are also borne by at-fault insurers when dealing with temporary replacement car providers. These costs do not contribute to the cost difference we estimated, but are in effect an additional source of cost to at-fault insurers.

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<sup>23</sup> We asked CHCs submitting data to distinguish between claims within the GTA and those outside the GTA. The data submitted by CHCs to us indicated that about 85% were within the GTA. However, the interpretation of this (and any further comparison of GTA and non-GTA claims using this data) was unclear as CHCs submitting data might have adopted different approaches from claims settled after 90 days.

## **Referral fees**

72. A CHC usually pays a referral fee to the referring non-fault insurer or broker (or other party), in order to secure the provision of credit hire services to the non-fault driver.
73. Nine of the ten largest insurers told us that they received fees for credit hire referrals,<sup>24</sup> of which [redacted].<sup>25</sup>
74. Table 8 shows the average referral fee for a credit hire replacement car paid by each of the nine CHCs in our sample and received by each of the ten motor insurers and ten brokers in our sample. These averages are between £[redacted] and £[redacted].

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<sup>24</sup> CISGIL told us that it did not refer its non-fault drivers directly to CHCs. However, it said that it referred its non-fault drivers with MLEI to CLS in respect of their uninsured losses. CLS managed these drivers' claims against the at-fault party, including the provision of a replacement car. CISGIL said that around [redacted]% of these drivers were referred, on the basis of need, by CLS to [redacted] for the provision of a replacement car on credit hire terms.

<sup>25</sup> [redacted]

TABLE 8 Credit hire referral fees received/paid by motor insurers/brokers/CHCs

Motor insurer/broker/CHC	Average referral fee paid/received per referral £
<i>Motor insurers</i>	
Admiral	[REDACTED]
Ageas	[REDACTED]
Aviva	[REDACTED]
AXA UK	[REDACTED]
AXA Northern Ireland*	[REDACTED]
CISGIL	[REDACTED]
DLG	[REDACTED]
Esure	[REDACTED]
LV	[REDACTED]
RSA	[REDACTED]
Zurich	[REDACTED]
<i>CHCs</i>	
Accident Exchange	[REDACTED]
ACM	[REDACTED]
Ai Claims Solutions	[REDACTED]
ClaimFast	[REDACTED]
Crash Services	[REDACTED]
Enterprise	[REDACTED]
Helphire	[REDACTED]
Kindertons	[REDACTED]
WNS Assistance	[REDACTED]
<i>Brokers</i>	
AA	[REDACTED]
Ageas Insurance 50†	[REDACTED]
BISL‡	[REDACTED]
Castle Cover†	[REDACTED]
Endsleigh	[REDACTED]
Express Insurance†	[REDACTED]
Kwik Fit Insurance†	[REDACTED]
Swinton	[REDACTED]
The Green Insurance Company†	[REDACTED]
UKAIS†	[REDACTED]

Source: Motor insurers, CHCs and brokers.

\*AXA Northern Ireland [REDACTED].

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

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

75. The significant variation in the estimates of the referral fees paid by CHCs and received by motor insurers and brokers provided in Table 8 reflects:

- (a) the different forms in which referral fees can be structured;<sup>26</sup>
- (b) the importance of the referring party to the CHC in securing credit hire revenue (motor insurers typically handle more non-fault claims than brokers and therefore have more bargaining power against CHCs); and

<sup>26</sup> Referral fees can take several forms, like (a) a flat fee per hire, (b) a variable fee depending on hire duration and on the class of the replacement car, or (c) a fee based on a percentage of the credit hire invoice recovered from the at-fault insurer.

(c) the competitive pressure between CHCs in securing referrals from all referring parties.<sup>27</sup>

76. We calculated that the weighted average referral fee paid by insurers was £338 and that paid by brokers was £309 per successful referral, giving an overall weighted average referral fee of £326.

### ***Bad debt provision***

77. Bad debts arise under credit hire when:

(a) there is a dispute over a credit hire bill;

(b) subsequent evidence suggests that the non-fault driver was at fault; and/or

(c) the non-fault driver is found to have submitted a fraudulent claim.

78. Under the terms of a credit hire agreement, the customer is ultimately liable for the costs of the provision of replacement car services should the CHC be unable to recover the costs from the at-fault insurer. However, the nine CHCs in our sample told us that they rarely sought to recover costs from non-fault drivers.

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

79. The risk of non-recovery or only partial recovery of the costs incurred by CHCs under credit hire is reflected in the high level of debt write-offs recognised by CHCs. Table 9 shows the credit hire debt write-offs for the nine CHCs in our sample. The table shows that, in 2012, CHCs wrote off between [X] and [X]% of their gross revenue, with an unweighted average write-off of 20%.

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<sup>27</sup> Despite the considerable referral fees earned by almost all of the ten motor insurers in our sample, these motor insurers all told us that the size of the referral fee was only one of the factors they considered when establishing or renegotiating an agreement with a CHC for the provision of credit hire services, and that they also considered the quality of the services provided.

TABLE 9 Credit hire debt write-offs, 2012

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

Source: CHCs.

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

†ACM does not provide credit hire services.

‡Crash Services does not subscribe to the GTA.

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

80. [redacted] told us that write-offs were driven by the severe cash-flow pressures on CHCs, caused by lengthy settlement periods, which often required them to accept lower settlement payments than were justifiable.

81. Table 9 also shows that, in 2012, the level of write-offs was significantly higher for credit hire claims outside of the GTA than for claims within the GTA, which suggested to us that the GTA played a significant role in providing a framework for the efficient negotiation and settlement of credit hire claims.<sup>28</sup>

82. [redacted] told us that the likelihood of full recovery from the at-fault insurer fell as the size of claim increased, as shown in Table 10.

TABLE 10 [redacted] claims recovery (last three years)

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

Source: [redacted].

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

<sup>28</sup> However, since the 'non-GTA' category includes claims that fell outside of the GTA because of litigation, part of the difference in write-offs may be due to selection bias.



84. Table 11 shows the proportion of full and partial write-offs recorded by the CHCs in our sample in relation to credit hire bills in 2012.

TABLE 11 Full and partial credit hire write-offs, 2012

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

Source: CHCs.

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

†ACM does not provide credit hire services.

‡Crash Services does not subscribe to the GTA.

85. We found that the vast majority of debt written off by CHCs in relation to credit hire was due to partial write-offs, ie a settlement discount being agreed with the at-fault insurer, rather than a full write-off, which only tended to occur when subsequent evidence suggested that the non-fault driver was actually at fault. We noted that [REDACTED].

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

86. Table 12 shows that the termination of a credit hire claim due to a change in the initial assessment of liability (from non-fault to at-fault) only occurs, on average, in between [REDACTED] and [REDACTED]% of cases. This appeared to us to be due to the significant time and resources spent by CHCs in establishing liability.

TABLE 12 Termination of credit hire claims due to a reassessment of liability, 2012

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

Source: CHCs.

87. Accident Exchange told us that, in cases where the non-fault driver's car was not roadworthy as a result of an accident (and therefore, the driver required a replacement car immediately), it might make an initial assessment of liability and agree to provide a car on that basis pending further investigation. In cases where Accident Exchange subsequently changed its initial assessment, the hire might have to be terminated. Accident Exchange said that this was rare but, if it did happen, then it would bear the hire costs incurred up to that point. Kindertons described its practices in a similar way.
88. [X] told us that, if a CHC changed its initial assessment of liability, it could only recover its costs from the non-fault driver if the driver had deliberately misled it or made a fraudulent claim. It said that the costs of pursuing such drivers and the likelihood of not making any meaningful recovery meant that it would usually suffer the loss.

### **Cost of credit**

89. A CHC incurs a working capital cost in providing credit hire services because it does not receive immediate payment.
90. The cost of credit incurred by CHCs depends both on the cost of the service provided and the time taken to recover that cost from the at-fault insurer. CHCs told us that this time was often significant. For example, Helphire told us that its debtor days were around [X] days, whereas its typical credit period under a direct hire agreement was [X] days. Ai Claims Solutions told us that, although it recovered over [X]% of its invoices in full, it took on average [X] days to receive payment.

### **Administrative costs**

91. Motor insurers and CHCs incur administrative costs in the management of a credit hire claim, eg in the setting up of the claim, the assessment of liability and the processing and submission of documentation to the at-fault insurer (in line with GTA guidelines, such as the mitigation statement).<sup>29</sup>
92. We considered two categories of administrative costs which were relevant to assessing the effects of the separation: (a) duplicated administrative costs,

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<sup>29</sup> Under the terms of the GTA, a mitigation statement signed by the non-fault driver must be provided by the CHC to the at-fault insurer. This statement should set out the reasons why the non-fault driver requires a replacement car.

which arise from having two parties (rather than one) involved in the management of a non-fault claim; and (b) frictional costs, which arise from having two parties with different interests involved in a non-fault claim.

93. In this subsection we discuss both the costs borne by CHCs and those borne by at-fault insurers. While the former contribute to the difference between credit hire and direct hire daily rates, the latter constitute an additional component of the costs to at-fault insurers not captured by the difference in rates.

#### *Duplicated administrative costs*

94. Duplicated administrative costs are those costs which arise from both the CHC managing the provision of a replacement car and the at-fault insurer, which will ultimately pay for it, conducting some similar activities. These costs primarily include the employment of claims handlers to:

- (a) assess all circumstances relating to the provision of replacement car services, including the accident circumstances and the non-fault driver's need for a replacement car;
- (b) assess (prior to the commencement of the hire period) whether the non-fault driver's car is roadworthy;
- (c) assess whether the non-fault driver's car is economical to repair<sup>30</sup> and the repair methodology and cost is reasonable;
- (d) ensure that the non-fault driver has entered into a binding and enforceable contract for the supply of replacement car services;
- (e) monitor actively the repair of the non-fault driver's car during the hire period or the total loss settlement process (for write-offs), in order to keep the hire costs to a minimum; and
- (f) manage the recovery/payment of claims.

#### *Frictional costs*

95. Frictional costs arise from the party controlling the replacement car provision under credit hire (the CHC) having a different interest from the party paying for

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<sup>30</sup> The assessment of whether a car is economical to repair is determined by comparing the likely cost of repair with the pre-accident value of the car.

it (the at-fault insurer). They are incurred by both the CHC and the at-fault insurer.<sup>31</sup>

### *Frictional costs incurred by CHCs*

96. The frictional costs incurred by a CHC in the provision of credit hire replacement car services to non-fault drivers include:
- (a) administrative costs to increase the likelihood of the claim being settled by the at-fault insurer, including the costs of complying with the obligations of the GTA; and
  - (b) costs of pursuing and recovering credit hire claims, including litigation.
97. Table 13 sets out the frictional costs incurred by the nine CHCs in our sample. It suggests that a CHC incurs, on average, £[redacted] to £[redacted] of frictional costs per credit hire claim.<sup>32</sup>

TABLE 13 Frictional costs incurred by CHCs, 2012

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

Source: CHCs.

\*ACM told us that [redacted].

†Crash Services told us that [redacted].

98. Five of the nine CHCs in our sample were able to provide us with an estimate of their overall frictional costs. However, there was significant variation in these estimates, with these costs representing between [redacted] and [redacted]% of the average credit hire bill. It appeared to us that this reflected the difficulty for

<sup>31</sup> We have not analysed in this appendix the frictional costs incurred by non-fault insurers, as non-fault insurers usually refer their non-fault drivers to CHCs for the provision of replacement car services under a credit hire agreement and therefore incur minimal frictional costs (though they do incur some duplicated administrative costs).

<sup>32</sup> Many of the CHCs in our sample found it difficult to distinguish between duplicated administrative costs (which relate to having two parties involved in managing a claim) and frictional costs (which relate to those two parties having different interests in the claim).

CHCs to distinguish frictional costs from their general claims management costs.

99. In [Annex D](#), we present an analysis of the different cost elements which are included within the frictional costs incurred by CHCs. Administrative costs, in particular the cost of employing claims handlers to manage credit hire claims and to process documentation in line with the GTA, and litigation costs incurred in pursuing the at-fault insurer for settlement of credit hire claims were the largest elements of the frictional costs incurred by CHCs.
100. The level of frictional costs incurred by CHCs suggested to us that considerable resources were expended in order to achieve the settlement of credit hire claims. We also found that claims often lasted a long period. Accident Exchange told us that its debtor days were [redacted] days and that it spent on average around [redacted] resolving each claim.<sup>33</sup> Similarly, Ai Claims Solutions told us that its debtor days were over [redacted] days and each claim required, on average, [redacted] actions from the point of referral to the ultimate recovery of the claim.
101. Only two of the nine CHCs in our sample ([redacted] and [redacted]) were able to provide a breakdown of their frictional costs between GTA and non-GTA credit hire claims. Based on [redacted] evidence, frictional costs incurred in relation to non-GTA claims (£[redacted] on average per claim) were significantly higher than those incurred in relation to GTA claims (£[redacted] on average per claim). It appeared to us that, although the GTA was not binding and was to some extent open to interpretation, it provided some efficiencies in the negotiation and settlement of credit hire claims. However, we found that the large discrepancy between GTA and non-GTA claims was explained in part by many claims which were initially submitted under the GTA falling outside of this system when they were not settled within 90 days. As these tended to be the claims which were most likely to be subject to dispute, they often required substantial cost in reaching settlement.
102. Ai Claims Solutions told us that the GTA facilitated a collaborative negotiation process and the GTA settlement guidelines were beneficial in providing higher industry standards, better relationships between CHCs and motor insurers, and fewer frictional exchanges. Ai Claims Solutions told us that a claim process not under the GTA tended to be more combative. Accident Exchange told us that claims settled outside the GTA generally involved additional costs

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<sup>33</sup> Accident Exchange told us that this was a rough estimate based on the number of claims settled 'in-house' and the number of people employed exclusively in the settlement of claims. It excluded, for example, the time spent by external solicitors in settling claims.

(such as legal costs, which were not usually fully recoverable) and took longer to settle, adversely impacting cash flow.

103. We noted that the frictional costs incurred by CHCs were to some extent offset by (a) late payment penalties paid by the at-fault insurer to the CHC in respect of GTA claims not settled within 30 days of the claim being submitted by the CHC to the at-fault insurer (as set out in the GTA); and (b) the reimbursement of legal fees by the at-fault insurer in relation to successfully litigated credit hire claims.

104. Table 14 sets out the extent of this offsetting income for CHCs. In 2012, late payment penalties amounted to between [X] and [X]% of the frictional costs incurred by CHCs.

TABLE 14 Offsetting income received by CHCs, 2012

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

Source: CHCs.

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

†ACM [X].

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

105. Table 15 sets out the frictional costs incurred by CHCs net of offsetting income. It shows net frictional costs of £[X] to £[X] per credit hire claim, representing, on average, between [X] and [X]% of the average credit hire bill issued by a CHC to the at-fault insurer.

TABLE 15 Net frictional costs incurred by CHCs (net of offsetting income), 2012

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

Source: CMA analysis.

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

†ACM [redacted].

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

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

### Frictional costs incurred by at-fault insurers<sup>34</sup>

106. An at-fault insurer incurs frictional costs in relation to the verification, negotiation and settlement of credit hire claims. These costs include:

- (a) administrative costs to verify and negotiate credit hire claims;
- (b) costs relating to the establishment and maintenance of mitigation strategies to reduce the cost of credit hire claims (eg non-fault party capture and bilateral agreements); and
- (c) costs of challenging credit hire claims, including litigation.

107. Table 16 shows the frictional costs incurred by the ten motor insurers in our sample. The table suggests that an at-fault insurer incurs on average £[redacted] to £[redacted] of frictional costs per claim in verifying, negotiating, challenging (where necessary) and settling credit hire claims.

<sup>34</sup> In this subsection, we set out the initial information we obtained on frictional costs from insurers. Subsequently, we obtained additional information from insurers on their management and frictional costs, which we used to estimate their weighted average cost per claim – see Appendix 6.6, paragraphs 21–30.

TABLE 16 Frictional costs incurred by motor insurers, 2012

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

Source: Insurers.

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

†DLG was unable to provide the relevant data, [redacted].

108. Nine of the ten motor insurers in our sample were able to provide us with an estimate of their overall frictional costs. However, there was significant variation in these estimates, with these costs representing between [redacted] and [redacted]% of the average credit hire bill. This reflected the difficulty for insurers to distinguish frictional costs from their general claims management costs. For example, CISGIL told us that it could not quantify the costs it incurred in setting up and maintaining bilateral and third party capture agreements, as these activities involved numerous CISGIL staff, who spent only a small amount of their time doing these things and the associated costs were therefore absorbed as part of their roles.
109. In [Annex E](#) we present an analysis of the different cost elements which are included within frictional costs for insurers. Administrative costs, in particular the cost of employing claims handlers to manage non-fault claims, and the payment of late payment penalties in relation to GTA credit hire claims were the largest elements of the frictional costs incurred by insurers.
110. Six of the ten motor insurers in our sample ([redacted]) were able to provide a breakdown of their frictional costs between GTA and non-GTA credit hire claims, but only two were able to estimate a cost per claim. According to the evidence from these two motor insurers, frictional costs incurred in relation to non-GTA claims were higher than those incurred in relation to GTA claims for one motor insurer and they were almost identical between the two categories of claims for the other motor insurer.
111. Six of the ten motor insurers in our sample (Admiral, Ageas Insurance, Aviva, CISGIL, DLG and esure) told us that the level of disputes tended to be higher



for non-GTA claims than for GTA claims.<sup>35</sup> For example, Aviva told us that it took about [X] to handle a non-GTA claim than a GTA claim. CISGIL told us that CHCs which did not subscribe to the GTA were more difficult to negotiate with and usually presented higher credit hire claims (CISGIL's experience was that the daily rates charged by non-GTA-subscribing CHCs were typically [X]% higher than the maximum GTA daily hire rates). In 2012, [X]% of its credit hire claims were outside the GTA, but these claims accounted for [X]% of its litigation costs.

112. Despite the significant frictional costs incurred by at-fault insurers, it appeared to us that, overall, they achieved significant costs savings from challenging credit hire bills:

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

113. Table 17 compares the total credit hire bills received by six of the ten insurers in our sample ([X]) and the costs paid out in relation to these bills.

TABLE 17 Credit hire bills received and costs paid out by motor insurers, 2012

Car type	Example car	GTA claims			Non-GTA claims		
		Total value of credit hire bills received £	Total credit hire costs paid out £	Difference %	Total value of credit hire bills received £	Total credit hire costs paid out £	Difference %
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Total		104,873,135	92,464,351	12	22,688,663	13,762,735	39

Source: Insurers.

<sup>35</sup> Of the remaining four motor insurers in our sample, AXA does not subscribe to the GTA, RSA told us that it was unable to compare the level of disputes in GTA and non-GTA cases, and both LV and Zurich told us that subscription to the GTA did not affect the level of disputes they experienced with CHCs.

114. Table 17 shows that the six motor insurers saved, on average, 12% against credit hire claims within the GTA through challenging the bills they received, and 39% against non-GTA claims. The significantly lower savings made against GTA claims compared with non-GTA claims suggested to us that:
- (a) the GTA was effective to some extent in providing a framework for the efficient negotiation and settlement of credit hire claims, such that fewer disputes arose; and/or
  - (b) there was significant friction in non-GTA claims, in part because this category included claims which began under the GTA but fell out of that system.
115. We noted that the cost savings to motor insurers through challenging bills were partially offset by the payments made by insurers to CHCs in relation to late payment penalties under the GTA. For example, RSA told us that it achieved an average saving of [X]% of the total credit hire bill through challenging the bill, but incurred an average late payment penalty of [X]% under the terms of the GTA.

*Mitigation strategies*

116. We found that the GTA reduced frictional costs for both insurers and CHCs (see paragraphs 101 and 114). However, we found that the GTA did not eliminate friction. Other mitigation strategies included bilateral agreements between insurers (see paragraphs 16 and 17) and an alternative credit hire model (see paragraph 18).
117. We found that bilateral agreements between motor insurers and CHCs were a further form of mitigation strategy. These agreements typically specified the claims management and settlement process and the terms of credit hire, including the daily hire rate. The claims management and settlement process was usually simpler than in the GTA and the hire rate was below the GTA rate. Six of the nine CHCs in our sample ([X]) told us that they had such agreements or protocols in place with some insurers. For example:
- (a) Accident Exchange told us that it currently had a non-GTA protocol arrangement with [X], whereby it accepted a fixed amount per claim, regardless of the recoverable value of each claim. This arrangement currently covered around [X]% of Accident Exchange's credit hire revenue.

- (b) Helphire told us that it had bilateral protocols with several insurers, covering nearly 60% of its credit hire claims. [REDACTED]<sup>36</sup> Instead of a detailed payment pack, a simple computerised billing statement was sent to the insurers on a weekly basis and paid promptly.
- (c) Kindertons told us that it had 'specialised relationship' agreements with [REDACTED], [REDACTED] and [REDACTED]. These agreements were inside the GTA but were in place to expedite payments, minimise frictional cost and reduce litigation. Kindertons said that it also had 'working benefit relationship' agreements with [REDACTED], [REDACTED] and [REDACTED]. These agreements were outside the GTA and were created to remedy a past adverse relationship.

118. It appeared to us that the benefits of these agreements to CHCs were:

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

119. Despite these benefits, Accident Exchange told us that [REDACTED].

120. Six of the ten motor insurers in our sample ([REDACTED]) told us that they had bilateral agreements with CHCs:

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

121. It appeared to us that the benefits of these agreements to motor insurers were:

- (a) fewer disputes and fewer claims requiring litigation, resulting in reduced frictional costs;

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<sup>36</sup> [REDACTED]

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

### **Analysis of credit hire duration**

122. Credit hire duration tends to be longer than direct hire duration (see paragraph 26 and Table 3). In this subsection, we discuss the factors affecting credit hire duration.

#### ***Repair duration***

123. Hire duration is largely determined by repair duration.<sup>37</sup> Table 18 sets out the average credit hire durations for the nine CHCs in our sample under three scenarios: (a) where a car is repairable and roadworthy; (b) where a car is repairable but not roadworthy; and (c) where a car is not repairable (ie a write-off). The repair duration, and therefore the credit hire duration, is longer if a car is not roadworthy, as (a) the driver is likely to require a replacement car immediately (often before the repair of their car has commenced); and (b) non-roadworthy cars typically have more significant damage than roadworthy cars and therefore require more extensive repair. Credit hire durations are longest where the car is a write-off, as a pre-accident valuation needs to be agreed and, under the GTA, the non-fault driver is entitled to a replacement car for up to seven days following receipt of the settlement payment.

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<sup>37</sup> Repair duration is the length of time taken to repair a car. The repair duration commences on the booking-in date and concludes when the car is returned to the customer. This is sometimes referred to as the 'key-to-key' period.

TABLE 18 Average credit hire durations for repairable cars and write-offs, 2012

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

Source: CHCs.

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

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

124. Our survey of non-fault drivers found that 73% of respondents who received a replacement car had the use of it for seven days or more, and 22% had it for three weeks or more. The survey found that 41% of respondents with a high level of damage to their car received a replacement car for three weeks or more compared with only 8% of respondents with a low level of damage. This supported the view that credit hire durations were typically longer when the car had sustained more damage.
125. We asked repairers whether their processes for conducting repairs varied according to the work provider or the at-fault status of the driver. The majority of the repairers in our sample told us that they did not differentiate between at-fault, non-fault and captured claims in how they conducted repairs, including in the time taken to complete the repair. They told us that usually they did not know the at-fault status of the driver. [redacted] told us that it managed at-fault repairs to completion as quickly as possible but non-fault repairs were not as fast, as it was in the interest of the non-fault insurer or CMC/CHC to delay repair authorisation and car inspection, in order to extend the hire period.
126. All of the ten motor insurers in our sample told us that a CHC could employ a number of methods in order to extend the credit hire period, including:
  - (a) Arranging for the collection and delivery of a roadworthy car to the repairer prior to either the authorisation of the repair or the repairer being ready to perform the repair (eg on a Friday afternoon). However, [redacted] told us that the practice of booking in non-fault repairs on a Friday was not now as common as it used to be. Table 19 presents the proportion of hire commencements by day of the week for the nine CHCs in our sample and shows that, in 2012, on average 15% of credit hires and direct hires

commenced on a Friday. This evidence supported the view that disproportionately booking in cars for repair on a Friday to extend a credit hire was not common.

TABLE 19 Hire commencement, 2012

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

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

Source: CHCs.

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

†The direct hire data may include at-fault claims.

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

§Crash Services does not provide direct hire services.

- (b) Delaying the process for the authorisation and completion of the repair, eg by delaying the appointment of an engineer to inspect the car, delaying the submission of evidence to the at-fault party or sending it to the wrong address, and not monitoring the repair closely or resolving delays. [redacted]<sup>38</sup> told us that CMCs/CHCs could delay the start of the repair by instructing the engineer to wait up to five days before inspecting the car, and could delay the authorisation of the repair once the engineer had provided a repair cost estimate.
- (c) Delaying the return of a repaired car to the driver.
- (d) Denying the at-fault insurer access to the car.
- (e) Failing to monitor expeditiously and progress total loss claims.

<sup>38</sup> [redacted]

127. The ten motor insurers in our sample told us that they monitored closely the hire and repair period (for repairable cars) or total loss settlement process (for write-offs) by:
- (a) verifying with the repairer and/or non-fault insurer the date on which the non-fault driver lost use of their car;
  - (b) monitoring the progress of the repair against the estimated repair period;
  - (c) regularly communicating with the CHC in relation to the repair; and
  - (d) validating parts delays with the repairer and parts suppliers.
128. Five of the nine CHCs in our sample ([REDACTED]) told us that they could not influence the credit hire period, as the key determinant of the hire duration was the repair duration (if the car was repairable) or the time taken to remit the settlement payment to the non-fault driver (if the car was a total loss). They added that the commencement and termination of hire periods was governed by the GTA.<sup>39</sup>
129. Two of the nine CHCs in our sample told us how they tried actively to minimise credit hire periods:
- (a) [REDACTED] told us that where a driver's car was not roadworthy, it would provide a replacement car immediately (subject to the driver meeting the relevant criteria); and, where a driver's car was roadworthy, it would look to provide a replacement car from the date the car was booked in for repairs. All scheduling of repairs was undertaken by the repairer. Where [REDACTED] provided credit repair through its own repairer network, the selection of the repairer was based on geographical location and performance but, if the selected repairer was too busy, an alternative repairer was selected. [REDACTED] said that it liaised with the repairer and/or engineer to ensure that the repair process was completed as quickly as possible, and it informed both the customer and the at-fault insurer of progress.
  - (b) [REDACTED]
130. The nine CHCs in our sample also mentioned the following as influencing the length of the repair period:
- (a) the extent of the damage to the car;

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<sup>39</sup> The GTA stated that the car requiring repair should be inspected and authorised for repair on day one of the hire period, repairs should commence on day two and the hire period must end not later than 24 hours after repairs to the car had been completed.

- (b) parts delays;
- (c) the acceptance of liability by the at-fault insurer (as a failure to accept liability could lengthen the hire period by delaying the commencement of repairs);<sup>40</sup> and
- (d) the speed with which repairs were authorised or the claim settled (where the car was a write-off) by the at-fault insurer.

### ***Role of the GTA***

131. Table 20 sets out the average credit hire durations for GTA and non-GTA claims for four of the ten motor insurers in our sample ([§]) and seven of the nine CHCs in our sample ([§]). We found that the average duration of a non-GTA credit hire claim was almost three times the average duration of a GTA credit hire claim when the claim had been referred to the CHC by a motor insurer. However, looking at credit hire services provided by CHCs to all work providers, we found that the average hire duration was actually slightly lower for non-GTA claims than for GTA claims.
132. We noted that a comparison between GTA and non-GTA credit hire durations was affected by the composition of the two categories. The 'non-GTA' category includes not only the claims which are handled from the outset outside the GTA, but also those that fall outside of the GTA because the bills are challenged by the at-fault insurers. In the second case, we noted that it would be reasonable to expect higher average hire durations, because one of the most common circumstances in which insurers challenge a hire bill is when they perceive duration to be unjustifiably long.

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<sup>40</sup> We noted that, under direct hire, the at-fault insurer accepted liability prior to the commencement of the hire period and therefore the repair and hire duration were not delayed by the replacement car provider awaiting acceptance of liability from the at-fault insurer prior to providing the replacement car to the driver.



TABLE 20 Average credit hire durations for GTA and non-GTA claims, 2012

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

Source: Insurers and CMCs/CHCS.

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

## Notes and data tables on the statistical analysis of the cost of replacement cars

### The choice of the appropriate scenario

1. There are various ways in which a non-fault claimant might receive a replacement car, eg on a credit hire basis, a direct basis, or as a courtesy car. Although concerns about differing levels of efficiency might have suggested that we should have used first party non-fault costs for replacement cars (as we did for repairs), we noted that this would have risked giving a distorted view due to different insurers providing non-fault claimants with a replacement car in different ways. We were interested in the costs incurred across the industry, reflecting these different practices, as the choice of practice might itself be driven by the separation, and this concern outweighed our concern about efficiencies. For this reason, we used in this analysis third party non-fault replacement car costs to represent the scenario where there is the separation.

### Other issues with the data

2. [X] told us that, when it controlled both the at-fault and non-fault claims arising from an accident (ie in both of our two alternative benchmark scenarios), it did not record separately in its systems the costs of the two claims. Rather, it recorded the costs together. Therefore, to answer our data request, [X] provided an estimate of its non-fault claims costs in our benchmark scenarios by allocating 53% of its total costs in these scenarios to the non-fault party.
3. [X] told us that it did not record claims data in its systems in such a way as to be able to identify which claims had been processed under the terms of a bilateral agreement. Therefore, its data for first party non-fault claims might be understated as some claims in this category might have been handled in a way to limit costs to some extent.
4. [X] told us that some of its 'same insurer' claims might have included some elements which were managed, at least initially, by another party. Therefore, its costs in this category might be overstated since it might not have been able to exercise control over all areas.
5. Finally, the summary statistical analysis we have conducted does not control for all other possible factors which might give rise to differences in claims costs between the scenarios we have considered. Therefore, there may be other

factors which explain some of the differences we have found, which we have not analysed.<sup>41</sup>

## Data tables

TABLE 1 Average replacement car costs by claim category and insurer, 2012

	<i>Third party non-fault</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]
Average	1,413	N/A	478	369

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 2 Average replacement car costs by claim category and insurer, 2011

	<i>Third party non-fault</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]
Average	1,372	N/A	486	447

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 3 Average replacement car costs by claim category and insurer, 2010

	<i>Third party non-fault</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]
Average	1,326	N/A	504	470

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

<sup>41</sup> We note also that summary statistical analysis can be sensitive to the techniques used to clean the data (ie removing mistaken entries and outliers).

**TABLE 4 Average cost of separation of liability and control – replacement cars, 2012**

<i>Benchmark</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]
esure	[X]	[X]	[X]
LV	[X]	[X]	[X]
RSA	[X]	[X]	[X]
DLG	[X]	[X]	[X]
Average	N/A	934	1,044

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

**TABLE 5 Average cost of separation of liability and control – replacement cars, 2011**

<i>Benchmark</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]
esure	[X]	[X]	[X]
LV	[X]	[X]	[X]
RSA	[X]	[X]	[X]
DLG	[X]	[X]	[X]
Average	N/A	886	925

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

**TABLE 6 Average cost of separation of liability and control—replacement cars, 2010**

<i>Benchmark</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]
esure	[X]	[X]	[X]
LV	[X]	[X]	[X]
RSA	[X]	[X]	[X]
DLG	[X]	[X]	[X]
Average	N/A	822	856

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purpose only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

## Charges for additional services by replacement vehicle providers

1. The charges made by replacement vehicle providers may be divided between basic and supplementary charges, and we included both in our estimates of the cost of credit hire and direct hire. Additionally, customers may pay for optional additional services. We did not include these costs in our estimates.
2. Kindertons told us that the most common supplementary charges were for young or high-risk drivers, automatic cars and estate cars. There were also charges for tow bars, baby seats, roof racks, etc, but such services were provided in few cases. Table 1 shows a list of the more important charges and the proportion of claims handled by Kindertons and Enterprise on which the additional services were supplied. The Enterprise data shows that the additional services (in particular, estate cars) were supplied more often under credit hire than under direct hire.

TABLE 1 Frequency of major extras in credit hire (percentage of claims)

Extra	Kindertons credit hire (2012)	Enterprise credit hire (2013/14)	Enterprise direct hire (2013/14)
Young/high-risk driver*	[X]	[X]	[X]
Automatic	[X]	[X]	[X]
Estate	[X]	[X]	[X]
Tow bar	[X]	[X]	[X]
Child seat	[X]	[X]	[X]
Roof rack	[X]	[X]	[X]

Source: Kindertons. Enterprise.

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\*Kindertons defined young/high-risk driver on the basis of the GTA definition, which is 'under 25 or over 70 years old, a lack of driving experience (held a full driving licence for less than 12 months), occupation (limited to: Professional Sportsmen/Women, Actors, Entertainers, Gamblers and Musicians, Publicans, Journalists) and/or convictions resulting in an unspent ban or 7 or more outstanding points in the last 4 years'. Enterprise defined young/high-risk driver as under 21 years old.

3. There are several other services which are also sometimes charged to insurers under direct hire. These include additional driver, after-hours collection, one-way rental, delivery at airports, etc. However, each of these services is provided in a very limited number of cases. Therefore we focused our analysis on the six extras listed in Table 1. Table 2 shows the amounts charged for each of these services to the ten insurers in our sample.

TABLE 2 Daily charges for major extra services under direct hire (VAT included)

	Admiral	Ageas	Aviva	AXA*	CISGIL	DLG	esure	LV	RSA	Zurich
Young/high-risk driver		[redacted]	[redacted]		[redacted]	[redacted]	†			[redacted]
Automatic Estate	[redacted]	[redacted]			[redacted]	[redacted]	[redacted]†	[redacted]†	[redacted]	[redacted]
Tow bar or roof rack					[redacted]			[redacted]†		
Child seat					[redacted]					

Source: Insurers.

\*[redacted]  
†[redacted]

4. From this (incomplete) information, we estimated an approximate average daily charge of £8 for young/high-risk drivers, and of £6 for each of the other services. Using the data provided by Enterprise, we then computed the effect on daily rates of the difference in frequencies between credit and direct hire, as shown in Table 3.

TABLE 3 Average increase in daily direct hire rates due to extra charges

	Frequency in credit hire %	Frequency in direct hire %	Difference in frequency	Average cost per day under direct hire £	Average increase of daily rates due to additional services £
Young/high-risk driver	[redacted]	[redacted]	[redacted]	8.00	[redacted]
Automatic Estate	[redacted]	[redacted]	[redacted]	6.00	[redacted]
Tow bar	[redacted]	[redacted]	[redacted]	6.00	[redacted]
Child seat	[redacted]	[redacted]	[redacted]	6.00	[redacted]
Roof rack	[redacted]	[redacted]	[redacted]	6.00	
Total average charge					0.37

Source: CMA (based on Enterprise frequencies, see Table 1).

5. Finally, we noted that CDW was an additional protection included in both credit hire and direct hire and on similar terms. We found that, in most cases, the customer must pay the first £x of any claim, though some replacement vehicle providers gave customers the option of reducing the excess on the CDW for a fee. However, some CHCs include a full CDW which reduces the excess to zero. CDW is discussed further in Appendix 6.5, paragraphs 81 to 84.

## Data provided by Helphire

1. Helphire provided us with a breakdown of its credit hire and direct hire revenue (see Table 1 below). Helphire's figures suggest that its credit hire revenue was [redacted]<sup>1</sup> than our estimate of £585 (this figure is slightly greater than the £555 quoted elsewhere because, for comparison with Helphire's figure, the adjustments have been ignored). We noted that Helphire quoted an average referral fee of [redacted] than our figure.

TABLE 1 Comparison of average credit hire and direct hire charge excluding timing differences

	<i>£ including VAT</i>			
	<i>Credit hire</i>	<i>Direct hire</i>	<i>Difference</i>	<i>Ratio</i>
<i>Figures from provisional findings</i>				
Adjusted average (incl VAT) 2012	1,130*	545	585*	2.1
<i>Helphire figures (see PMI 291)</i>				
Average (excl VAT) 2012	[redacted]			
Average (incl VAT) 2012	[redacted]			
Average (excl VAT) 2014 budget	[redacted]	[redacted]		
Like-for-like adjustment		[redacted]		
Hire length adjustment		[redacted]		
Adjusted average (excl VAT) 2014	[redacted]	[redacted]	[redacted]	[redacted]
Adjusted average (incl VAT) 2014	[redacted]	[redacted]	[redacted]	[redacted]

Source: Helphire.

\*Figures exclude the timing benefit to insurers of longer payment period on credit hire and adjustments for CDWs. Including these adjustments reduces the difference to £555.

Note: Figures include supplementary charges such as CDW; adjusted average charge is for average credit hire length and vehicle.

2. Helphire also provided some data on its costs of credit and direct hire – see Table 3 at the end of this annex. We used this data to analyse the difference between credit and direct hire charges – see Table 2 below. There are four columns in this table, as follows:
  - The first column shows our analysis of the £[redacted] difference between credit hire and direct hire charges. This was based on Helphire's information on costs and revenue.
  - The second column adjusts the first column so that it reflects our own data on average referral fees (£327) and the adjusted difference between credit hire and direct hire charges (£462 excluding VAT, and £555 including VAT). We did this by adjusting the acquisition cost per claim to our average referral fee of £327 and by adjusting the contribution to overheads and

<sup>1</sup> Helphire's direct hire revenue for 2012 was not available. As shown in the table, its budgeted 2014 direct hire revenue was slightly [redacted] our 2012 revenue.

profits so that the total summed to the difference between credit hire and direct hire charges of £462 excluding VAT. [REDACTED]

- The third column adds VAT to the second column, so that the total sums to the gross difference between credit hire and direct hire charges including VAT.
- The fourth column removes the average referral fee, so that the total sums to the difference between credit hire and direct hire charges net of the referral fee. The reason for this further analysis was that it was the difference net of the referral fee which drove our main estimate of the net detriment (see Appendix 6.6). In this analysis, the VAT on the referral fee continued to account for part of the difference between credit hire and direct hire charges. This was because insurers are VAT-exempt and hence pay VAT on credit and direct hire charges but cannot recover VAT on referral fee income.

TABLE 2 Analysis of difference between credit and direct hire charges

	<i>£ per claim</i>			
	<i>Helphire excl VAT</i>	<i>Adjusted excl VAT</i>	<i>Adjusted Plus VAT</i>	<i>Adjusted net of referral fee incl VAT</i>
Acquisition costs (referral fees)	[REDACTED]	327	392	65
Sales overhead	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Liability and claims	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Collection/recovery	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Litigation costs	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Other allocated costs	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total allocated costs	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Contribution to fixed overheads*	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	462	555	228

Source: CMA calculations based on Helphire data.

\*Includes profit.

3. The final column suggests that, of the £228 net difference between credit and direct hire including VAT, about £65 is due to VAT on referral fees, £[REDACTED] to other costs incurred on credit, but not direct hire, plus VAT on those costs (though readily identifiable items [REDACTED] of this) and [REDACTED].



TABLE 3 Information on Helphire's costs

Revenue less fleet costs, 2014 (excluding VAT)	£ per claim		
	Credit hire	Direct hire	Difference
Hire revenue	[X]	[X]	[X]
Settlement adjustments	[X]	[X]	[X]
Net hire revenue	[X]	[X]	[X]
CDW & FSC	[X]	[X]	[X]
Salvage	[X]	[X]	[X]
Total hire-related income	[X]	[X]	[X]
Fleet costs*	[X]	[X]	[X]
Total	[X]	[X]	[X]
<i>Other costs and contribution, 2014 (excluding VAT)</i>			
Acquisition costs	[X]	[X]	[X]
Sales overhead	[X]	[X]	[X]
Litigation costs	[X]	[X]	[X]
Operational overheads (allocated)	[X]	[X]	[X]
Other overheads (allocated)	[X]	[X]	[X]
Total allocated costs	[X]	[X]	[X]
Contribution to fixed overheads†	[X]	[X]	[X]
Total	[X]	[X]	[X]
<i>Breakdown of additional credit hire costs, 2012 (excluding VAT)</i>			
Referral fees			[X]
Sales – staff costs			[X]
Liability assessment/claims management			[X]
Claim recovery management system			[X]
Overhead of claims management			[X]
Collection costs – Staff costs			[X]
Overhead cost of recovery (PPS/IT/Tel)			[X]
Litigation costs			[X]
Additional legal costs			[X]
Staffing – compliance/technical			[X]
Additional operational staff costs			[X]
CHO subscription			[X]
Regulatory subscriptions			[X]
Unrecoverable disbursements			[X]
Finance costs			[X]
Total			[X]
Contribution to fixed overheads†			[X]
Total			[X]

Source: Helphire.

\*Includes contracted vehicle purchasing.

†Includes profit.

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

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

Source: CHCs.

\*ACM [X].

†Crash Services [X].

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

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

Source: CHCs.

\*ACM [REDACTED].

†Crash Services [REDACTED].

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

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

Source: Motor insurers.

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

†DLG was unable to provide the relevant data, [X].

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

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

Source: Motor insurers.

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

†DLG was unable to provide the relevant data, [X].

## Cost of repairs

### Introduction

1. This appendix discusses evidence on whether, as a result of the separation of cost liability and cost control, there is an increase in the cost of post-accident vehicle repair services.
2. This appendix sets out:
  - (a) an overview of different approaches to managing vehicle repairs;
  - (b) the differences in the cost of non-fault vehicle repairs depending on which party provides the repair service (ie captured non-fault repairs managed by at-fault insurers, credit repairs managed by CMCs and repairs managed by non-fault insurers); and
  - (c) the cost of managing repair services.

### Different approaches to managing repairs

3. Post-accident vehicle repairs are managed by a number of different accident management service providers. The most common providers are:
  - (a) insurers (either as the non-fault or at-fault insurer); and
  - (b) CMCs, which provide claims management services mostly to claimants who have been referred to them by insurers and brokers. CMCs can operate either as credit repairers or on behalf of an insurer (where the insurer has outsourced some or all of its claims management function). Some CMCs also provide credit repair services directly to non-fault claimants.
4. In some cases, repair services are also provided by a dealership or repairer directly to the customer without being managed by a CMC or insurer.
5. In most cases, non-fault claimants have the option either to use a repairer which is in the approved network of their repair services provider (ie an insurer or CMC) or to use a repairer of their own choice.<sup>1</sup>

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<sup>1</sup> Insurers and CMCs might encourage customers to use repairers within their networks, eg by not guaranteeing the repair if it is conducted by a non-approved repairer.

### ***At-fault and non-fault repairs***

6. At-fault repairs are managed either by the insurer or by a CMC on an outsourced basis.
7. Non-fault repairs are usually managed by the non-fault claimant's insurer (the non-fault insurer), by a CMC or by the at-fault insurer (if the non-fault claimant is 'captured'). Where a CMC manages the repairs, this could be on a credit repair basis or on an outsourced basis where the CMC acts as the insurer would. Nine of the ten largest motor insurance providers ([REDACTED], AXA, Aviva, DLG, esure, RSA, LV, CISGIL and Zurich) told us that they made no referrals to credit repairers and managed the repairs of their non-fault claimants themselves. Admiral told us that it referred its non-fault claimants to a CMC which then offered credit repair services (as part of a broader uninsured loss recovery service). esure told us that until [REDACTED] it offered its non-fault claimants the option of being referred to a CMC which then provided credit repair services.
8. We found that brokers usually referred non-fault claimants either to the non-fault insurer or to a CMC which then provided credit repair services. For example, BGL told us that it referred its non-fault claimants to a CMC which might then offer credit repair. Swinton said that its non-fault claimants could have the repair managed by the non-fault insurer or through a credit repairer; similarly Endsleigh told us that non-fault claimants were offered the option either of a credit repair managed by a CMC or to claim on their own policy, in which case the repairs would be managed by Endsleigh. Ageas Retail (ie the broking part of Ageas) said that its non-fault claimants [REDACTED].

### ***Managing non-fault repairs***

9. Under tort law, a non-fault party is entitled to be put back into as good a position as they were in before the accident occurred and the at-fault party is therefore liable to cover the reasonable cost of repair.
10. Under the principle of subrogation, an insurer has a right to be subrogated to the rights of its insured (ie its policyholder) when the insurer indemnifies its policyholder pursuant to the policy of insurance. Essentially, this means that, once the non-fault insurer has put the non-fault party back into the position they were in before the accident, the non-fault insurer is able to exercise its policyholder's rights in relation to the underlying tort law claim. The non-fault insurer usually does this by pursuing the at-fault party's insurer in order to recover the costs that have been incurred. We understood that insurance policies (as well as contracts between CMCs and claimants) typically include

a clause entitling the insurer (or CMC) to take control of the proceedings on indemnifying the non-fault driver.

11. The case of *Coles v Hetherington* considered subrogated claims brought by the non-fault insurer in the name of its policyholders. It was held that where a vehicle is negligently damaged the loss the claimant suffers is the diminution in value of the vehicle and the practical way that the courts have assessed this diminution in value is the reasonable cost of repair so as to put the vehicle back to its pre-accident condition. The 'reasonable cost of repair' is therefore not necessarily the repair cost actually incurred by either the non-fault claimant or the non-fault insurer. The court noted that the 'reasonableness' of the repair charge is to be assessed from the position of the individual non-fault claimant (without reference to the non-fault insurer or to any benefits the claimant obtains under the insurance policy). This means that it is not relevant whether the cost of the repair could have been lower by virtue of the non-fault insurer's bargaining power.
12. The effect of this judgment, in practice, would appear to be that, where a non-fault insurer or CMC repairs the vehicle, that party has the opportunity to charge the at-fault insurer more than the repair costs it actually incurred, provided the sum claimed does not exceed the reasonable cost of repair to the individual claimant (ie the cost that the non-fault driver would have reasonably incurred had he/she managed the repair).
13. The at-fault insurer can challenge the value of subrogated claims (eg if the costs are not related to the accident or are unreasonable).

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

14. We have identified a number of ways in which the non-fault repair charges that can be recovered by non-fault insurers and CMCs from at-fault insurers may be increased above the net costs which they incur. These include:
  - (a) performing non-fault repairs in repair subsidiaries at retail rates (eg by allowing high labour rates) and extracting the profits as dividends or referral fees ([REDACTED]);<sup>2</sup>

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<sup>2</sup> Three of the ten largest insurers have their own repair subsidiaries (DLG, Aviva and RSA). Total motor-insurance-related repairs performed by these subsidiaries generated around £[REDACTED] million in revenues in 2012 (£[REDACTED] million for QRC (RSA), £[REDACTED] for Solus (Aviva) and £112 million for UKAARC (DLG)). On the assumption that around [REDACTED]% of repairs are non-fault repairs, these three repairers conducted non-fault repairs worth about £[REDACTED] million in 2012.



- (b) making an upward adjustment to the repair bill received from the repairer to inflate it above the costs incurred ([REDACTED]);
- (c) requiring approved repairers to discount the repair bill they charge (or to pay a parallel rebate), but not passing on this discount or rebate to the at-fault insurer ([REDACTED]);
- (d) charging an administration fee and an engineering fee, and various other extras, to the at-fault insurer in addition to the repair bill;<sup>3</sup> 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 (with the likelihood of higher repair bills) ([REDACTED]).

15. Table 1 summarises our findings. This illustrates that there is considerable variation between insurers in the mark-ups that they earn from non-fault repairs. We calculated that the weighted average increase is about £95.

TABLE 1 Average mark-up on non-fault repairs

	Average mark-up (excluding referral fees) £	Method adopted	Referral fees for paint or parts £	Total average mark-up £
Admiral	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Ageas	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
AXA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
LV	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Average	[REDACTED]		[REDACTED]	95

Source: Insurers.

16. Where non-fault brokers or insurers do not manage the repair but act as an intermediary, they can extract referral fees from the party managing the repair (usually a CMC performing a credit repair). Such payments are part of the costs incurred by a CMC in managing the repair (see paragraph 72).

### Differences in repair costs

17. We considered four different ways of assessing the cost increase for non-fault repairs managed by third parties (eg CMCs or non-fault insurers):

<sup>3</sup> For example, the GTA allows CMCs providing credit repair services to make these additional charges.

- (a) average repair bills paid by insurers;
- (b) discounts received by insurers in bilateral agreements;
- (c) differences in the repair bill sent to the at-fault insurer and the actual repair costs incurred by CMCs providing credit repair; and
- (d) repair bills from repairers.

We discuss each in turn.

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

18. To test the presence of cost increases under ToH 1 and to estimate their extent, we needed to compare the cost of post-accident services where there was the separation of cost liability and cost control (ie the more common situation) with the costs of these services in a scenario where there was no separation (ie our benchmark).
19. We noted that at-fault repairs were on average more expensive than non-fault repairs. Insurers told us that this was because at-fault damage was more often at the front of the vehicle and non-fault damage was more often at the rear of the vehicle, which was typically cheaper to repair. Also, we were told that there are more low-value claims for non-fault repairs than for at-fault repairs as non-fault drivers do not typically have to pay their excess, or can claim it back from the at-fault insurer. For these reasons, we decided that at-fault claims would not constitute an appropriate benchmark.
20. In our view, there were two conditions which needed to be met for the benchmark:
  - (a) The claimant should receive post-accident services which are comparable with those which a non-fault claimant managed by a party which is not liable for the cost (eg a non-fault insurer or CMC) would receive, assuming that there is neither overprovision nor underprovision in those services provided.
  - (b) The non-fault claim handler should have the incentive to keep the costs of post-accident services to a minimum.
21. There are three scenarios in which a non-fault claim might be managed by a party which satisfies condition (b). These are: (i) where it is the at-fault insurer and it has captured the non-fault claim; (ii) where it is both the at-fault insurer and the non-fault insurer; and (iii) where it is the non-fault insurer but it has a bilateral agreement with the at-fault insurer. However, each of these possible

benchmarks gives rise to some concerns. In particular, in all cases (especially scenario (i) where the claimant is not the at-fault insurer's PMI customer), there is a tension between conditions (a) and (b) such that condition (a) might not be satisfied. In addition, we noted that, under scenario (iii), bilateral agreements were likely only to align imperfectly the interests of the at-fault and non-fault insurer so that there was likely to remain some scope for additional costs being incurred because of the separation of cost liability and cost control.

22. Since few insurers provided data for repairs managed under bilateral agreements, we considered only two possible benchmarks: captured claims and claims where the at-fault and non-fault insurers were the same. Table 2 summarises the initial information we received from the ten largest insurers operating in the UK on the cost of different categories of non-fault repairs. The benchmark we adopted was the average cost of captured repairs.

TABLE 2 Average repair bills for non-fault repairs paid by the at-fault insurer

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

The average repair bill in (e) covers those bills received by the at-fault insurer from non-fault insurers that have managed the non-fault repair. These average bills exclude repair bills that have been settled under bilateral agreements. However, it appears that the overall prevalence of bilateral agreements is low (see paragraphs 35 and 36). Therefore, we do not think that including repairs performed under bilateral agreements would significantly change this number.

Source: CMA.

23. As a cross-check to the figures in Table 2, Table 3 shows the average credit repair revenues per repair as provided to us by those CMCs in our sample which provide credit repair services.

TABLE 3 Average credit repair revenues

Average repair revenues per repair, including VAT	Average	Low	High	Number of replies
Average credit repair revenue per repair, 2012	1,594	[redacted]	[redacted]	7
Average credit repair revenue per repair, 2011	1,515	[redacted]	[redacted]	7
Check: average credit repair bill received by at-fault insurers, 2012 (see Table 2, row (c))	1,576	[redacted]	[redacted]	8

Source: CMA.

24. Table 3 shows that the average credit repair bill reported to us by paying insurers (see Table 2, row (c)) was similar to the average credit repair revenue reported to us by CMCs.
25. The comparison between lines (c) and (e) in table 2 provided an estimate of the average difference between costs recovered by CMCs and by non-fault insurers (£229). Whatever the higher cost to at-fault insurers when repairs are managed by non-fault insurers, the table shows that the costs claimed by CMCs are on average £229 higher than the costs claimed by non-fault insurers. This estimate was lower than those provided to us by some insurers. In particular, [redacted] reported a value around £[redacted], while CISGIL considered the total average cost increase in the case of credit repair to be £[redacted].
26. On the other hand, there are on average longer delays in paying credit repair bills than bills from non-fault insurers. Therefore, when comparing the two, we had to take into account the benefit at-fault insurers received from delayed payments. We did not collect data on the timing of payments for credit repair. However, the factors which cause delay in relation to credit hire apply also to credit repair. Therefore, we applied the same discount of 2.2%<sup>4</sup> to the average credit repair bill of £1,576. With this adjustment, the average difference between costs claimed by CMCs and by non-fault insurers is approximately £195.
27. We saw two problems with a comparison between lines (a) and (d) in Table 2. First, we did not know whether the costs provided by the insurers included rebates from repairers and/or referral fees from suppliers. Second, the severity of damage in captured and non-captured claims cannot necessarily be assumed to be similar. Three insurers (DLG, esure and RSA) told us that captured claims tended to have a lower value than non-captured ones, and our consumer survey also showed that the level of damage was on average

<sup>4</sup> See Appendix 6.1, paragraphs 56–61.

lower for captured claims.<sup>5</sup> The second issue also affects a comparison of lines (a) and (b) with line (e) in Table 2.

28. To get more robust information, we attempted an econometric analysis of claim costs. This turned out not to be feasible because of the different methods adopted by insurers in collecting and categorising data. We therefore turned to an analysis of summary statistics. We asked the largest insurers to provide us with data on total repair costs over the past three years for three categories of non-fault claims: non-fault claims managed by the non-fault insurers ('first-party non-fault'), captured claims ('captured'), and claims where the at-fault and non-fault insurers were the same ('same insurer').<sup>6</sup> Five out of the ten insurers provided us with data which we could aggregate and compare.
29. Figure 1 shows the average repair costs by insurer and claim type in 2012.

FIGURE 1

**Average repair cost by claim category and insurer, 2012**



*Source:* Insurers and CMA analysis.

*Note:* [✂] figures are for 2011 to enable better comparability.

30. Subtracting the average costs in the benchmarks without the separation of cost liability and cost control ('captured' and 'same insurer') from the costs in the scenario with this separation ('first party non-fault'), we found that the average cost where there is the separation is higher than in the cases without, in accordance with our hypothesis. Figure 2 illustrates these differences.

FIGURE 2

**Average cost differences, 2012**



*Source:* Insurers and CMA analysis.

*Note:* [✂] figures are for 2011 to enable better comparability.

31. Figure 2 shows that the average cost increase arising from the separation of cost liability and cost control in repairs is different according to the benchmark used. When compared with 'captured' claims, the cost increase averaged

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<sup>5</sup> Of the respondents whose claim was captured, 47% reported low severity of damage, 35% medium severity and 18% high severity. For claims handled by non-fault insurers, these percentages were 31, 46 and 23% respectively.

<sup>6</sup> We also asked for data on non-fault claims managed under bilateral agreements, but most insurers could not provide the data at the desired level of granularity.

£104; when compared with the ‘same insurer’ claims, the cost increase averaged £55. The data provided indicated similar ranges for 2011 and 2010 (see [Annex A](#), Tables 4 to 6).

32. We found that these findings were compatible with the results of our consumer survey and with the views of insurers which said that it was generally harder to capture a non-fault claim when the damage incurred was substantial (which suggested that captured repair costs would, on average, be somewhat lower than first party non-fault repair costs). This effect resulted in an overstatement of the cost difference arising from the separation of cost liability and cost control for some insurers, and suggested that differences calculated against the same insurer benchmark might be more robust.
33. There was also some variation between insurers. We believed that several factors might explain this variation, including differences in the customer bases and the typical accident damage their customers incur, differences in the insurers’ claims handling efficiency, and various confounding factors. In particular, we noted that, in all scenarios, some insurers might have netted off the referral fees, rebates and other sources of income which they received in relation to repairs, while others might have provided us with the gross cost.<sup>7</sup> Other issues with the data are discussed in [Annex A](#).
34. In the light of these points, we did not attach weight to the comparisons in Figures 1 and 2. Instead, we used the estimates of average mark-up set out above (see Table 1 and paragraph 15, in effect a ‘bottom-up’ rather than ‘top-down’ approach to the estimation of cost differences).

### ***Discounts received by insurers in bilateral agreements***

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

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<sup>7</sup> Moreover, where an insurer is the first party non-fault insurer, it may or may not charge its customer their contractual excess, at least until liability is settled, and, where this is charged, the income may or may not be netted off the cost of the claim. [X] and [X] told us that their first party non-fault repair costs were stated net of the excess amount they received on some non-fault claims. As a result, we expected some first party non-fault repair costs to be understated (resulting in an understatement of the cost difference arising from the separation of cost liability and cost control for some insurers).

36. Table 4 sets out the discounts off the repair bills insurers with bilateral agreements give to and receive from each other. [redacted] and [redacted] are not included as they were unable to provide this data. ([Four] do not have bilateral agreements with other insurers in relation to vehicle repairs.)

TABLE 4 Discounts to repair bills passed on to at-fault insurers under bilateral agreements

Discount from	Discount to					%
	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: CMA.

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

37. Table 4 shows that [redacted].

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

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

39. Table 5 shows the additional charges CMCs add to their repair bills, the discounts CMCs receive off repair bills and the rebates they receive from repairers and suppliers to their repairers.

TABLE 5 Discounts and additional charges for CMCs\*

CMC	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Average discount given to CMCs per repair	[redacted]			[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Discount given to CMCs as a % of repair bill	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Rebates and commissions (paint etc)	[redacted]	[redacted]		[redacted]		[redacted]	[redacted]	[redacted]	[redacted]
Admin and engineering fees		[redacted]	[redacted]				[redacted]	[redacted]	

Source: CMA.

\*[redacted]  
[redacted]

40. All the CMCs which responded to our information request told us that they earned discounts from repairers, ranging from [redacted]% of the repair bill to around [redacted]%. These discounts allowed the credit repairer to pass on a higher bill to the at-fault insurer than the net bill incurred (see paragraph 14(c)).
41. Three of the eight CMCs in our sample ([redacted]) told us that they charged the at-fault insurer an administration fee in addition to the repair bill, as permitted under the terms of the GTA. However, this fee varied from £[redacted] ([redacted]) to £[redacted] ([redacted]). One CMC ([redacted]) said that it also added an engineering charge, which insurers told us was common practice among CMCs. Two CMCs ([redacted] and [redacted]) told us that they received a referral fee from [redacted] (worth up to £[redacted] per repair).
42. Five CMCs ([redacted]) provided us with an analysis of how an average credit repair bill was made up. This showed that the invoice from the repairer accounted for around 90 to 95% of the total repair bill (net of write-offs and discounts), engineering charges accounted for around 3 to 5% and the remainder was made up mainly of administration charges, storage charges and penalty charges for late payment of invoices.
43. Four CMCs in our sample ([redacted]) told us that they received rebates from paint suppliers of between £[redacted] and £[redacted] per repair; one CMC ([redacted]) told us that it received rebates from parts suppliers ([redacted]); and one CMC ([redacted]) told us that it received a rebate from Audatex ([redacted]). In all these cases, the rebate payment was likely to increase the cost of the repair to the repairer, and ultimately to the at-fault insurer.
44. Overall, taking all sources of income together, we found that the CMC with the highest income from the repair management process (ie through discounts and other rebates and charges) received around £300 per repair in 2012 ([redacted]). We found that [redacted] earned about £265 per repair, and both [redacted] and [redacted] earned about £[redacted] per repair.

#### *Referral fees*

45. We found that CMCs typically paid referral fees to work providers (ie non-fault insurers or brokers) to gain referrals of non-fault claimants to whom they could then provide credit repair (and in most cases also replacement car) services. Table 6 summarises the evidence we received from CMCs on the amounts paid in relation to credit repair.



TABLE 6 Referral fees paid by CMCs for credit repair

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

Source: CMA.

[REDACTED]

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

46. From this data, it appeared to us that the typical referral fee paid by a CMC in order to provide credit repair services was around £33 to £80. This represented a marketing cost for CMCs in order to win business but, as they competed by paying higher referral fees, it was also the means by which non-fault insurers and brokers, which 'control' the claimant at FNOL, could extract profits earned by CMCs through the credit repair process.

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

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

### ***Labour costs***

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

### ***Part and paint costs***

51. We understood that, for most repairs, the repair cost estimation system would specify which parts were needed and would calculate a repair cost based on a

recommended retail price for each part. However, work providers and repairers, in reaching their agreements, would agree a discount off the recommended retail price for parts which would then be reflected in the repair bill.

52. Similarly for paint, the repair cost estimation system would usually specify the quantity of paint and materials which are needed in a repair and would calculate an invoice value based on the price of paint in a paint basket. We understood that the paint basket in Audatex (the most commonly used repair cost estimation system) was based on the weighted average retail paint price for a range of brands of paint and, therefore, a work provider specifying the use of a certain paint would not be able to change the base price used in negotiations. Rather, work providers, in their contracts with repairers, would agree discounts off the paint basket (known as the paint index), which would then be reflected in their repair bills.

#### *Variables in a repair bill*

53. The following elements of a repair bill therefore represented the key variables which created differences in repair bill prices between repairers: the labour rate per hour, the discount for parts and the paint index. We saw no evidence to suggest that the time taken for a repair (ie the number of hours billed) and/or the amount of paint used varied according to which party manages the repair.
54. We did see some evidence of differences in parts used. We found that some insurers stipulated the use of some non-OEM parts or sometimes required the repairing of a part rather than replacing it; while, in contrast, some CMCs used only OEM parts and, according to some repairers, were more inclined to replace parts. However, these differences appeared small. We found that, across all post-accident repairs, the amount of non-OEM parts used was a small fraction of all parts, representing between 2 and 15% of total parts costs (ie no more than 6% of total repair costs); and we did not receive evidence indicating a significant difference in the choice of replacement or repair between work providers. Therefore, in our analysis, shown in Tables 7, 8 and 9, we made the simplifying assumption that the parts and paint used for different work providers were the same.

#### *Repairer data*

55. [REDACTED] provided us with an explanation of how it charges labour, parts and paint costs, which enabled us to calculate indicative differences in repair bills for at-fault and non-fault claims for different work providers, as set out in Table 7.

TABLE 7 Repair costs by category: [REDACTED]

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

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

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

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

56. [REDACTED] provided similar information, as set out in Table 8.

TABLE 8 Repair costs by category: [REDACTED]

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

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

Note: See notes to Table 7, which apply also to this table.

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

58. We noted that, [REDACTED], as shown in Table 9.

TABLE 9 Repair costs by category: [REDACTED]

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

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

Note: See notes to Table 7, which apply also to this table.

59. The data provided by [redacted], [redacted] and [redacted] showed that average repair bills could vary by up to around 30% between a captured non-fault repair and a non-fault insurer or CMC-managed non-fault repair. The data submitted by [redacted] suggested that, [redacted], this equated to around £390 per repair.<sup>8</sup> However, we found that repairers did not retain all the benefits of a higher repair bill as it appeared that repairers passed most of the extra income back to the work provider in the form of a discount or referral fee (see paragraph 45). For example, [redacted] told us that it discounted its repair bills [redacted]%, [redacted] told us that it discounted its repair bills by around [redacted]%, and [redacted] told us that it applied a discount of [redacted]%. [redacted] said that [redacted].

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

60. The average cost of a captured non-fault repair in Table 2 did not include the administrative cost incurred by the at-fault insurer in managing the repair (eg the need to record the claim, instruct the repairer, approve the repair cost estimate and deal with customer complaints). In most cases, other than where an administration or engineering fee had been added, these costs were also not included for non-fault insurers or credit repairers (though in these cases Table 2 shows the amount claimed from the at-fault insurer, which may be in excess of the actual cost incurred). In this subsection, we discuss the costs of managing repairs. We discuss in turn the costs for at-fault insurers in managing captured non-fault repairs, the costs for non-fault insurers in managing non-fault repairs, and the costs for CMCs in managing credit repairs.

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

61. Early in the investigation, CISGIL and esure provided us with their estimates of the costs of managing a captured non-fault repair. esure estimated these costs at £[redacted] per repair and CISGIL estimated them at £[redacted] per repair.<sup>9</sup>

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

62. We considered the costs incurred by a non-fault insurer in managing a non-fault repair. In this scenario, the claimant will have claimed under his own insurance, and the non-fault insurer will seek to recover the costs of the claim from the at-fault insurer.

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<sup>8</sup> [redacted]

<sup>9</sup> We subsequently obtained further information from insurers on the costs involved in managing captured claims – see Appendix 6.6, paragraphs 21–30.

63. The costs of managing a non-fault repair include:
- (a) the cost of setting up a claim, paying independent engineers who provide repair cost estimates, monitoring the repair, liaising with the customer and recovering the costs from the at-fault insurer;
  - (b) the cost of administering and setting up a network of repairers, including monitoring quality; and
  - (c) the business overheads required to operate a repair business (rents, rates, utilities, management, etc).
64. The costs in (a) vary pro rata with the number of repairs managed, while (b) and (c) are less likely to do so. Generally, we were most interested in variable costs as these costs were most likely to be passed through into premiums (see Appendix 6.4).
65. We asked non-fault insurers to estimate their costs of handling claims involving repairs. We requested the average incremental cost that would be determined by a significant number (1,000) of extra claims, including both the internal handling costs and any external cost due to litigation.
66. We calculated that the average incremental handling cost per claim involving repair or write-off incurred by non-fault insurers was £115.<sup>10</sup> Of this about £53 was associated specifically with the repair (or write-off) process and the remaining £62 was associated with other costs, in particular the costs of dealing with the customer.<sup>11</sup>

### ***Credit repairs***

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

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<sup>10</sup> This represented a weighted average across insurers providing data – see Appendix 6.6, paragraphs 21–30. It was not practicable to calculate the costs separately for claims involving repair and those involving write-off.

<sup>11</sup> These estimates are based on a fuller understanding of insurers' costs than earlier estimates in our working paper on '[Overcosting and overprovision of TRVs](#)' and our provisional findings.

(d) some other costs.<sup>12</sup>

### *Invoicing and recovering repair bills*

68. The costs of recovering credit repair claims from the at-fault insurer include:
- (a) the cost of liaising with the at-fault insurer about the repair;
  - (b) the cost of putting together the payment pack (including all necessary supporting documentation); and
  - (c) the cost of chasing unpaid claims and litigation, and the costs to minimise collection costs (eg the cost of establishing and operating bilateral agreements and the cost of GTA membership).
69. None of the CMCs provided a direct estimate of these costs. However, [redacted], and we estimated that [redacted] incurred recovery costs for credit repair in 2012 of about £[redacted] per repair.
70. These invoicing and recovery costs included the frictional costs<sup>13</sup> associated with credit repair. Overall, we found that frictional costs and the mitigation of these costs,<sup>14</sup> were low in relation to credit repair, for the following reasons:
- (a) Six out of the seven CMCs in our sample said that credit repair bills were rarely disputed, except for liability issues. [redacted] estimated that frictional costs for credit repair averaged about £[redacted] per repair.
  - (b) At-fault insurers provided a wide range for their estimates of the frictional costs they incurred per credit repair; however, it appeared to us that some included the cost of establishing liability disputes which was not related to the repair. Five insurers provided estimates of the total frictional costs they incurred in 2012 in relation to credit repair, which ranged from approximately £0.1 million to £1.2 million per insurer.

### *Non-recoverable bills*

71. Non-recoverable bills arise most often in cases where the credit repair provider incorrectly assumes that the customer was not at fault (ie the driver turns out to be at fault or the claim is shown to be fraudulent). At-fault insurers

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<sup>12</sup> This includes, for example, the cost of capital and overheads not captured in the other cost categories. We did not seek to estimate these other costs as it appeared that they were unlikely to be significant.

<sup>13</sup> By frictional costs, we mean the costs that arise from both the monitoring and challenging by the at-fault insurer of non-fault claims which have been managed by non-fault insurers and CMCs, and the costs of defending and supporting claims by non-fault insurers and CMCs.

<sup>14</sup> Mitigation costs are costs incurred to mitigate frictional costs (eg through third party capture, bilateral agreements and litigation).

also sometimes challenge credit repair bills with regard to particular costs incurred (eg if the insurer believes that there are excessive costs for valeting or vehicle collection and delivery), but both insurers and CMCs told us that successful challenges to credit repair bills for such reasons were rare. On the basis of estimates provided to us by CMCs, we estimated that the cost of unrecoverable bills was, on average, around £15 per repair, ie about 1% of the average credit repair bill.

### *Referral fees*

72. We found that referral fees paid by CMCs providing credit repair services were between £[redacted] and £[redacted] per repair (see Table 6). Endsleigh told us that it received referral fees from CMCs in relation to credit repair services of around £65 per repair, and [redacted] told us that, [redacted], it received [redacted]. Admiral (the only insurer in our sample which told us that it made referrals to credit repairers) said that it received a referral fee of between £30 and £65 per credit repair.

### *Summary of credit repair costs*

73. Table 10 summarises our assessment of the costs of providing credit repair services.

TABLE 10 **Costs of providing credit repair services**

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

Source: CMA.

74. In total, we estimated that the cost of managing a credit repair service was likely to be around £180 per repair. This figure was based, in particular, on evidence from [redacted], [redacted] and [redacted], each of which indicated that the total cost of managing a repair and invoicing and recovering repair bills was around £100 per repair, together with the average cost of unrecoverable bills of £15 (see paragraph 71) and a typical referral fee of £65 (see paragraph 72).

75. However, we noted that there were some uncertainties around these estimates, due principally to the wide range of figures provided by insurers and CMCs for some elements of the total cost. We noted also that credit repair was usually not offered on a stand-alone basis but rather in conjunction

with credit hire, which meant that the costs of a stand-alone credit repair business could be higher.



## Notes and data tables on the statistical analysis of repair costs

### The choice of the appropriate scenario

1. We asked the insurers for data on the costs of non-fault repairs which they managed for their own customer, ie 'first party non-fault' repair costs, rather than the bills they received as the at-fault insurer, ie 'third party non-fault' repair costs. If we had used third party non-fault costs for repairs, these costs would have aggregated the actual costs incurred by various parties (eg non-fault insurers, CMCs, car dealerships, etc), which could have operated with differing levels of efficiency in handling their repair claims. In seeking to identify the presence and extent of a cost increase arising due to the separation of cost liability and cost control, we wished to compare equally efficient repair claims handlers, and this would not have been the case if we had used third party non-fault repair costs. For this reason, we used first party non-fault repair costs to represent the scenario where there is the separation of cost liability and cost control (as described in this appendix).

### Other issues with the data

2. [REDACTED] told us that, when it controlled both the at-fault and non-fault claims arising from an accident (ie in both of our two alternative benchmark scenarios), it did not record separately in its systems the costs of the two claims. Rather, it recorded the costs together. Therefore, to answer our data request, [REDACTED] provided an estimate of its non-fault claims costs in our benchmark scenarios by allocating 53% of its total costs in these scenarios to the non-fault party.
3. [REDACTED] told us that it did not record claims data in its systems in such a way as to be able to identify which claims had been processed under the terms of a bilateral agreement. Therefore, we noted that its data for first party non-fault claims might have been understated as some claims in this category might have been handled in a way to limit costs to some extent.<sup>15</sup>
4. [REDACTED] told us that some of its 'same insurer' claims might have included some elements which were managed, at least initially, by another party. Therefore,

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<sup>15</sup> [REDACTED] also told us that it had assumed that a non-fault claim was 'captured' if the replacement car element of the claim was captured. It said that it believed this to be a good indicator of whether a claim was captured, despite not being accurate in all cases.

we noted that its costs in this category might have been overstated since it might not have been able to exercise control over all areas.

- Finally, the summary statistical analysis we conducted did not control for all other possible factors which might give rise to differences in claims costs between the scenarios we considered. Therefore, we noted that there might be other factors which explain some of the differences we found, which we did not analyse.<sup>16</sup>

## Data tables

TABLE 1 Average repair costs by claim category and insurer, 2012

	<i>First party non-fault</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]
Average	1,271	N/A	1,167	1,216

Source: Insurers.

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*Notes:*

- [X] figures are for 2011 to enable better comparability.
- The averages presented in the table are simple averages of the each insurer's individual average. We present this information for exposition purposes only.
- N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

TABLE 2 Average repair costs by claim category and insurer, 2011

	<i>First party non-fault</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]
Average	1,243	N/A	1,135	1,198

Source: Insurers.

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*Notes:*

- The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purposes only.
- N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

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<sup>16</sup> We note also that summary statistical analysis can be sensitive to the techniques used to clean the data (ie removing mistaken entries and outliers).

**TABLE 3 Average repair costs by claim category and insurer, 2010**

	<i>First party non-fault</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]	[X]
esure	[X]	[X]	[X]	[X]
LV	[X]	[X]	[X]	[X]
RSA	[X]	[X]	[X]	[X]
DLG	[X]	[X]	[X]	[X]
Average	1,193	N/A	1,096	1,158

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purposes only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

**TABLE 4 Average cost of separation of liability and control – repairs, 2012**

<i>Benchmark</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]
Esure	[X]	[X]	[X]
LV	[X]	[X]	[X]
RSA	[X]	[X]	[X]
DLG	[X]	[X]	[X]
Average	N/A	104	55

Source: Insurers.

*Notes:*

1. [X] figures are for 2011 to enable better comparability.
2. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purposes only.
3. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

**TABLE 5 Average cost of separation of liability and control – repairs, 2011**

<i>Benchmark</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]
Esure	[X]	[X]	[X]
LV	[X]	[X]	[X]
RSA	[X]	[X]	[X]
DLG	[X]	[X]	[X]
Average	N/A	108	45

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purposes only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

**TABLE 6 Average cost of separation of liability and control – repairs, 2010**

<i>Benchmark</i>	<i>Bilateral</i>	<i>Captured</i>	<i>Same insurer</i>
Admiral	[X]	[X]	[X]
Esure	[X]	[X]	[X]
LV	[X]	[X]	[X]
RSA	[X]	[X]	[X]
DLG	[X]	[X]	[X]
Average	N/A	97	35

Source: Insurers.

*Notes:*

1. The averages presented in the table are simple averages of each insurer's individual average. We present this information for exposition purposes only.
2. N/A = not applicable (because there are no bilateral agreements) or not available (because the data was not provided).

## Cost of vehicle write-offs

### Introduction

1. This appendix examines evidence concerning the impact of the separation of cost liability and cost control on vehicle write-offs, ie when a vehicle is deemed uneconomical to repair following a road traffic accident. We considered whether at-fault insurers, which pay for the post-accident services received by non-fault claimants, paid higher prices when these services were managed by another party than when they managed them, and whether there were differences in the service received by claimants according to whether or not the at-fault insurer managed the write-off.
2. This appendix sets out:
  - (a) the number of vehicle write-offs and average payments by insurers;
  - (b) salvage categorisation and the write-off decision;
  - (c) pre-accident value;
  - (d) the salvage process;
  - (e) salvage business models;
  - (f) usage of actual and estimated salvage values and the prevalence of profit-share arrangements;
  - (g) subrogated claim amounts; and
  - (h) differences in the service received by non-fault claimants and the timing of payments.

### Vehicle write-offs

3. According to Trend Tracker,<sup>1</sup> around 600,000 cars were written off in 2012 (out of a total of around 4 million repair claims for private and fleet cars).
4. We gathered data in relation to vehicle write-offs from seven of the ten largest insurers, which together were responsible for around half of the GWP for PMI in 2012.<sup>2</sup> These insurers, in aggregate, managed in 2012 around 183,000

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<sup>1</sup> The Future of the Car Body Repair Market in the UK 2012–2017.

<sup>2</sup> See Section 2.

PMI-related write-offs. This figure is made up of 106,000 write-offs for at-fault claimants, 56,000 write-offs for non-fault claimants managed by the non-fault insurer and 21,000 write-offs for captured non-fault claimants. This data would suggest that there were around 365,000 PMI-related write-offs in 2012 managed by insurers.<sup>3</sup>

### Payments for vehicle write-offs

- We received data from seven of the ten largest insurers in relation to payments for vehicle write-offs, as summarised in Table 1.

TABLE 1 Average payments for vehicle write-offs by insurers

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

Source: CMA.

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

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

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

- Only one insurer ([REDACTED]) provided us with average write-off values where a claim was managed by a CMC. The average cost was £[REDACTED], which was slightly higher than that insurer's average write-off value for captured non-fault claimants.
- Table 1 shows that the weighted average payments for non-fault insurer-managed write-offs were 15% (or around £300) more expensive than for captured non-fault write-offs (ie where there was no separation of cost control and liability). However, nine out of ten of the large insurers told us that, in their write-off decision-making, they did not distinguish between at-fault, non-fault or captured non-fault customers (see paragraph 17).
- DLG, esure and RSA told us that captured third party write-off payments were typically lower in value than other non-fault write-offs because a claimant was more likely to deal with a third party insurer (rather than their own insurer) where the claim involved a less valuable car (ie an older or smaller car).

<sup>3</sup> We understood from data provided to us by CMCs that the number of write-offs managed by CMCs was small relative to the number managed by insurers.

9. Table 1 also shows that average write-off payments were significantly higher for at-fault write-offs.

### **Salvage categorisation and the write-off decision**

10. In general, a vehicle is deemed to be beyond economic repair (and hence a write-off) when:
- (a) the estimated cost to repair the vehicle exceeds the pre-accident value of the vehicle less any costs that could be recovered for its salvage (the estimated salvage value); or
  - (b) the vehicle is so significantly damaged to render the vehicle unable to be repaired (eg flood damage or in some cases where a vehicle has rolled over).

### **Salvage categorisation**

11. In the 1990s the ABI issued a Code of Practice for the handling and disposal of salvage vehicles as part of efforts to reduce vehicle crime. Under the Code of Practice, vehicles which are written off are categorised by insurers into one of four categories (A to D) and should be registered on the Motor Industry Anti-Fraud and Theft Register (MIAFTR):
- Category A: the vehicle is so damaged that it is valued only as scrap metal and should be crushed.
  - Category B: the vehicle cannot be repaired economically; it can be used as a source of parts but the body shell should be crushed.
  - Category C: the vehicle is repairable but the repair costs (including VAT) exceed the pre-accident value.
  - Category D: the vehicle is repairable and the repair costs (including VAT) do not exceed the pre-accident value (but the insurer decides not to repair the vehicle).
12. The insurance industry has also issued a technical guide to insurance engineers on how to apply the Code of Practice. This guide was written by the Engineers Technical Committee and is now maintained by Thatcham.
13. The Code of Practice is voluntary and there is no legal requirement for damaged vehicles to be notified to the MIAFTR. However, under The Road Vehicles (Registration and Licensing) (Amendment) Regulations 2002, when

there is a change in ownership of a substantially damaged<sup>4</sup> vehicle the owner is legally required to destroy V5 registration documents and notify the DVLA. The vehicle is then required to undergo a Vehicle Identity Check before a replacement V5C is issued.

### ***The write-off decision***

14. When a vehicle is substantially damaged in an accident it may not be drive-able. In this case, it is likely to be recovered from the roadside, usually by the police or a recovery agent, and will be stored pending repair or disposal. Storage at recovery agents is expensive so the insurer is incentivised to move the vehicle as quickly as possible, either to a repairer for repair or to a salvage yard if the vehicle is likely to be a total loss. In the past, vehicle damage assessments were carried out on site by trained inspection engineers but, in order to reduce costs, inspections are now generally performed remotely using digital images. The recovery agent, repairer or salvage agent takes digital photos of the vehicle and emails them to the insurer's engineer who then decides on the course of action.
15. Some insurers generally write off vehicles when the cost of repairs exceeds a specified percentage of the pre-accident value (less than 100%). The pre-accident value is the cost of purchasing an equivalent vehicle of a similar age and condition at the time of the accident, which is usually based on published price guides (see paragraphs 20 to 22).
16. However, some insurers use slightly different criteria. For example, [redacted] told us that a vehicle was usually deemed a total loss if repair costs exceeded 80% of the pre-accident value of the vehicle, and it would also take into account other factors. It said that each claim was treated on its own merits. DLG told us that it took into account the cost of replacement car hire when assessing whether a car should be written off or repaired in two circumstances: [redacted].
17. Nine out of the ten largest insurers (Ageas, Aviva, AXA, CISGIL, DLG, esure, LV, RSA and Zurich) told us that they did not differentiate between at-fault and non-fault claims in how they determined whether a vehicle was a write-off.

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<sup>4</sup> Where 'substantially damaged' is defined as where the cost of repair is greater than the pre-accident market value of the vehicle.

18. However, most of the insurers<sup>5</sup> told us that they considered the cost of replacement car provision when determining whether to repair or write off a non-fault driver's car in circumstances when:
- (a) the repair duration was likely to be lengthy due to the vehicle having sustained significant damage or the repair was complex; or
  - (b) there was a significant extension to the repair duration (eg due to a delay in obtaining a replacement part).

Some of the insurers noted that these circumstances were more relevant when the non-fault claimant's car was a prestige car or a rare car, as the daily rate would be higher (particularly under credit hire).

19. AXA also noted that if the difference between the repair cost and market value of a car was less than the likely cost of hire taking into account the possible repair period, it would be in all parties' interests, and in keeping with the claimant's duty to mitigate loss, to deal with the claim on a total loss basis. However, AXA told us that it did not insist that this approach was accepted by the non-fault driver, and that it would explain its approach and allow the non-fault driver to decide whether the vehicle was repaired or written off.

### **Pre-accident value**

20. Insurers told us that they usually used valuation guides (eg Glass's Guide) to establish a damaged vehicle's pre-accident value, though they might make adjustments to guide prices to take account of other factors, eg local market variations<sup>6</sup> or the condition of the damaged vehicle before the accident (eg its mileage, service history, pre-existing damage, etc). LV said that it would take into account where the customer would normally buy the vehicle (eg a main dealer or auction) when making a write-off decision.
21. [REDACTED] told us that, where it was acting as the at-fault insurer, the estimated pre-accident value of a written-off vehicle from the non-fault insurer was rarely contested. esure said that, where it was the at-fault insurer and it received a claim for a vehicle write-off from a non-fault insurer or CMC, its internal engineers would review the estimate to ascertain that the costs reflected a fair market value. However, LV told us that CMCs would often make it very difficult for LV to inspect the vehicle which they proposed to write off as the longer the CMCs could make the process last, the longer the credit hire would

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<sup>5</sup> RSA told us that it never took into account the cost of a temporary replacement vehicle when deciding whether to write off or repair any customer's car.

<sup>6</sup> Insurers told us, for example, that they sometimes checked vehicle values in *Autotrader*.



last. LV said that it therefore had to balance how much time it spent validating the cost of a claim.

22. If, when a write off is managed by a non-fault insurer or CMC, the pre-accident value is set too high, the claim cost borne by the at-fault insurer could be higher than if it managed the write-off itself. However, it appeared to us that non-fault insurers and CMCs managing a write-off had little incentive to inflate the pre-accident value in relation to the claim cost that is passed to the at-fault insurer for the following reasons:
  - (a) Given that the non-fault insurer or CMC managing a write-off pays the pre-accident value of the written-off vehicle to the claimant, it does not gain directly from setting a higher pre-accident value.
  - (b) As the pre-accident value is usually determined by reference to publicly available data such as used-car price guides and adverts for used cars, it was highly likely that the at-fault insurer would be able to challenge successfully any inflated valuation of the pre-accident value presented by a non-fault insurer or CMC managing a non-fault write-off claim.

### **The salvage process**

23. When an insurer has made the decision that a vehicle will be written off (in an at-fault or non-fault claim), the vehicle will usually be collected by the insurer's appointed salvage company which will store the vehicle until it is eventually sold. Alternatively the policyholder may elect to retain the vehicle.
24. The MVDA told us that on average 45 days elapsed before an insurer was in a position to authorise the salvage company to sell the vehicle. During this period the insurer would settle any outstanding hire purchase, agree the pre-accident value with the claimant and deal with transferring personalised number plates.
25. The MVDA told us that, once the insurer had authorised the sale of the vehicle by the salvage company, the vehicle would generally be sold to a vehicle dismantler by Internet auction within seven days. The vehicle dismantler was responsible for dismantling the vehicle and selling the parts for scrap, etc. We noted that the vehicle dismantler was typically different from the salvage company but there could be some vertically integrated vehicle salvage and dismantling firms. Our focus was on the interaction between the salvage company and the insurer and not on the interaction between the salvage company and the vehicle dismantler.
26. When a vehicle has been written off, the payment made to the policyholder by the insurer or CMC managing the claim differs according to whether the

policyholder has elected to give up the vehicle to the insurer or CMC or retain the vehicle, as follows:

- (a) If the policyholder has given up the vehicle, they will receive a payment of the agreed pre-accident value of the vehicle.
- (b) If the policyholder has chosen to retain the vehicle, they will receive a payment of the agreed pre-accident value of the vehicle less the estimated salvage value.
- (c) In an at-fault claim, the claimant will receive either of the payments above, as appropriate, less the amount of the excess in their PMI policy (this may also apply in some non-fault claims managed by the non-fault insurer though in these cases claimants may then themselves recover their excess from the at-fault insurer).

### **Salvage business models**

- 27. Insurers generally choose salvage companies on the basis of competitive tendering and will enter into contracts lasting one to five years. There are two main forms of business model for salvage companies:
  - (a) the salvage company buys the vehicle from the insurer and takes the commercial risk on the profit it is able to make on the eventual disposal – this is the traditional model; and
  - (b) the insurer retains ownership of the vehicle while the salvage company acts as an agent and receives a fee for providing a collection, storage and sales service.
- 28. The MVDA told us that it estimated that each of these business models accounted for approximately 50% of write-offs, but it said that the split could not be ascertained with precision.

### ***Salvage company takes ownership of the vehicle***

- 29. In the traditional model, when the salvage company purchases the vehicle from the insurer, the price paid by the salvage company is typically determined according to a framework agreed at the outset of the contract. In its simplest form this will be a percentage of the pre-accident value according to the category, with Category A vehicles attracting the lowest percentage and Category D vehicles attracting the highest percentage. However, the framework might be more complicated with the percentage also varying within the salvage category depending on the amount of the pre-accident value (typically the percentage increases the greater the pre-accident value).

30. The MVDA told us that a salvage company would be unlikely to dispute the salvage categorisation applied by the insurer for fear of jeopardising the renewal of its contract.
31. In addition, the contract may include a profit-sharing arrangement under which the insurer receives a share of the profit made by the salvage company on its disposal of the vehicle.
32. The contract is also likely to include a separate allowance for the salvage company to recover its costs, typically set at 5 to 10% of the pre-accident value.
33. In this model, the insurer has certainty over the amount of the fixed payment that it will receive from the salvage company once the pre-accident value has been agreed (because it is set out in the contract). The fixed payment is made by the salvage company to the insurer once the insurer has transferred ownership of the vehicle to the salvage company and cleared the vehicle for disposal (which may take around 45 days (see paragraph 24)). Any profit share is paid once the vehicle has been sold by the salvage company (which, if by auction, should be within the following seven days (see paragraph 25)).

### ***Salvage company as agent***

34. When the salvage company acts as an agent, the insurer retains ownership of the vehicle until its eventual disposal by the salvage company. The salvage company receives a fee from the insurer for the services it provides. Depending on the contract with the insurer, the fee can be a fixed fee or a fee that is calculated as a percentage of the sale price of the vehicle at auction.
35. As in the traditional model, it may take around 45 days before the insurer is in a position to authorise the salvage company to sell the vehicle. The vehicle is usually then sold by auction within seven days.
36. The insurer will receive the salvage proceeds from the salvage company, less the salvage company's fees, once the vehicle has been sold at auction.
37. Copart, which is the largest provider of salvage services in the UK, operates only as an agent. Copart entered the UK market in 2007 and told us that it now dealt with a substantial proportion of the total annual write-offs in the UK.<sup>7</sup> Copart told us that this model increased the proceeds to insurers compared with the traditional model and therefore reduced claims costs. Copart

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<sup>7</sup> MVDA estimated that Copart had over [redacted]% of the UK salvage market. However, we noted that this was inconsistent with its estimate that 50% of salvage was handled under agency contracts.

also told us that this model reduced cycle times for claims and reduced the insurers' costs of processing claims.

38. Copart told us that it did not pay referral fees to insurers for salvage vehicles. It told us that referral fees might be paid to third parties such as CMCs and CHCs but this related to no more than approximately 10% of the salvage vehicles it handled.

## **Usage of actual and estimated salvage values and prevalence of profit-share arrangements**

### ***Insurers***

39. Five of the ten largest insurers told us that they sold written-off vehicles to a salvage company. These insurers all told us that the proceeds they received from the salvage company for each vehicle were a percentage of the pre-accident value determined according to the salvage category:
  - (a) Two of the insurers ([REDACTED] and [REDACTED]) told us that they also received a profit share from the salvage company.
  - (b) One insurer ([REDACTED]) told us that it also received volume-related rebates/ commission from the salvage company.
  - (c) One insurer ([REDACTED]) told us that it received a commission payment for reaching a contracted volume threshold from the salvage company.
  - (d) One insurer ([REDACTED]) told us that it did not receive any profit share or rebates.
40. The profit-share and rebate arrangements of these five insurers are described in Table 2. We found that the arrangements of these five insurers covered around 122,000 vehicles sold to salvage companies in 2013.

TABLE 2 Insurers' profit-share and volume rebate arrangements with salvage companies

[REDACTED]

Source: Insurers.

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[REDACTED]

41. The other five of the ten largest insurers<sup>8</sup> told us that they retained ownership of written-off vehicles and the salvage company acted as an agent and received a fee for providing a collection, storage and sales service. These

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<sup>8</sup> [REDACTED]

insurers told us that the fee was either fixed or calculated as a percentage of the sale price of the vehicle at auction.

42. The number of salvage vehicles sold by these five insurers in 2013 was around 112,000, split as follows: [REDACTED].
43. The insurers all told us that they had the same arrangements for non-fault and at-fault write-offs. We understood that the figures they gave us for their number of written-off vehicles were for non-fault and at-fault write-offs.

### **CMCs**

44. The responses we received from CMCs indicated that CMCs managed fewer claims for write-offs for non-fault claimants than insurers. We were told that in 2013 there were fewer than 10,000 write-off claims managed in aggregate by three of the largest CMCs, split as follows: [REDACTED].
45. CMCs described their role in write-off claims as being to assist non-fault claimants in negotiating with the at-fault insurer to agree the pre-accident value and to chase for settlement. In some cases they also arrange for the salvage of the vehicle.
46. CMCs told us that, when they were involved in managing the salvage process, the salvage value at which the vehicle was sold to a salvage company was determined by an independent engineer as a percentage of its pre-accident value based on the salvage categorisation.
47. CMCs told us they received administration or referral fees as follows:
  - [REDACTED] told us it received £[REDACTED] per vehicle (2013: £[REDACTED])
  - [REDACTED] told us it received £[REDACTED] in 2013
  - [REDACTED] told us it received £[REDACTED] per vehicle (2013: £[REDACTED])
48. [REDACTED] told us that it received a profit share on the surplus achieved by the salvage company after taking account of the salvage value paid to the claimant and all the salvage company's costs.

### **Subrogated claim amounts**

#### **Insurers**

49. [REDACTED]

50. However, with the exception of one insurer, all of the ten largest insurers told us that they used 'actual salvage proceeds' when making a subrogated claim for write-offs against at-fault insurers (with the amount claimed being equal to the pre-accident value less the salvage proceeds).
51. Four insurers told us that they considered 'actual salvage proceeds' to mean the sale proceeds they received from the salvage company (ie the agreed percentage of pre-accident value set out in the contract), as follows:
  - [REDACTED] and [REDACTED] told us that they did not take account of any profit-share payments when making the claim to the at-fault insurer.
  - [REDACTED] said it did not take account of the volume commission it received when making the claim to the at-fault insurer.
  - [REDACTED] said it did not receive any profit share or other commissions.
52. For the five insurers which retain ownership of the vehicle until it is sold at auction, 'actual salvage proceeds' means the auction sale proceeds less the salvage agent's costs.
53. The other top ten insurer, [REDACTED], told us that it received the salvage proceeds from the salvage company as a percentage of the pre-accident value, which it described as the 'estimated salvage value'. The subrogated claims made by [REDACTED] reflect the pre-accident value paid out to the claimant less the 'estimated salvage value' and any vehicle recovery and storage costs. [REDACTED] does not adjust the amount of subrogated claims for the reconciliation and profit-share payments that it receives or pays (since the total combined value of reconciliation and profit-share arrangements might be positive or negative), unless it has an accidental damage bilateral agreement with the at-fault insurer.
54. We found that the different models by which the non-fault insurer/CMC might claim from the at-fault insurer did not appear to result in a difference in the number of claims being challenged by at-fault insurers. Nine of the ten largest insurers told us either that they did not record the number of challenges or that the number of challenges was minimal. [REDACTED]

### **CMCs**

55. CMCs told us that the amount of the claim submitted to the at-fault insurer was the pre-accident value less the salvage value.
56. CMCs told us that some of the write-off claims they managed were challenged by at-fault insurers:

- [REDACTED] estimated that approximately 10% of salvage claims were challenged.
- [REDACTED] estimated that 15 to 20% of claims were challenged.
- [REDACTED] estimated that 3% of claims were challenged.
- [REDACTED] told us that it was very rare for claims to be challenged.

### **Services received by non-fault claimants**

57. To the extent that CMCs and non-fault insurers earn revenue from write-offs, they might have an incentive to provide non-fault claimants with a better service than the at-fault insurer does when managing a captured write-off. We did not see evidence that at-fault insurers were providing captured non-fault claimants with compensation below the level to which they were entitled (see Appendix 5.2). However, there could still be a difference in service levels if CMCs and/or non-fault insurers provided non-fault claimants with better services than those to which they were entitled. This could be the case if the pre-accident value were set too high, or if the estimated salvage value were set too low when the claimant retains the vehicle, or if a replacement car was provided for too long during the write-off process.
58. On the basis of our assessment in paragraph 22(b), it appeared to us highly unlikely that pre-accident values would be systematically overstated. We did not find any other evidence of an overprovision of services to claimants in the event of non-fault write-offs.

### ***Timing of payment to non-fault claimants***

59. All of the ten largest insurers told us that they paid non-fault claimants when the pre-accident value was agreed. Therefore, it did not appear to us that different contractual arrangements between insurers and salvage companies made a difference to the timing of the payment to non-fault claimants.

## The effect on PMI premiums of changes in cost and revenue

### Introduction

1. In this appendix we discuss the pass-through of cost and revenue changes to PMI premiums. We consider:
  - (a) to what extent higher costs to at-fault insurers lead to higher premiums;  
and
  - (b) to what extent the revenue stream to non-fault insurers and brokers leads to lower premiums.

We are concerned specifically with the cost and revenue changes associated with the separation of cost liability and cost control (the separation). Our assessment of these cost and revenue changes is set out in Section 6 and the calculations are described in more detail in Appendix 6.6.

2. Our analysis follows several steps:
  - (a) We first note that the separation affects the marginal cost of PMI policies. We can therefore apply the insights from the economic literature on the pass-through of changes in marginal costs.
  - (b) We describe the model of competition we used to analyse the market, namely a Bertrand model with differentiated products.
  - (c) We describe the incidence of the increase in costs to at-fault insurers and the revenue stream to non-fault insurers (and brokers) and show that the latter is more asymmetrically distributed than the former.
  - (d) We analyse the pass-through of changes in at-fault insurers' costs. By presenting evidence on the relevant characteristics of demand and supply, we are able to reach a provisional view on the likely effect on premiums.
  - (e) We consider the further issues involved in the determination of the pass-through of non-fault insurers' (and brokers') revenues and assess their impact on premiums.
  - (f) Finally, we discuss how the changes in premiums affect different groups of drivers in different ways.



## Fixed and marginal costs

3. A standard assumption in economic analysis (including its application to competition issues) is that firms seek to maximise profits. We adopt that assumption here. When setting the prices of its products (in our case, PMI policies), a profit-maximising firm does not take into account costs which do not depend on the quantity produced (ie fixed costs). These costs have an impact on the firm's profitability, but not on optimal prices (and quantities). Therefore, changes in fixed costs do not have an effect on prices in the short run.<sup>1</sup> Changes in variable costs, on the other hand, do affect prices in the short run. Formally, the profit-maximising price is the one at which marginal costs equal marginal revenue, ie the cost of producing an additional unit of output is equal to the additional revenue that would be gained. Marginal costs are clearly independent of fixed costs.
4. The costs and revenues we have identified as due to the separation constitute changes in marginal costs. The higher costs claimed from at-fault insurers are marginal costs; and the same tends to be true for the revenue that accrues to non-fault insurers/brokers (either directly if they manage the non-fault claim or indirectly if the claim is managed by another party which pays the non-fault insurer/broker a referral fee). These costs and revenues are not fixed, but depend on the number of at-fault or non-fault claims handled. This, in turn, depends on the number of policies sold (and on customers' risk profile). An additional policy sold determines additional (expected) costs due to the increased cost of at-fault claims and additional revenues (or negative costs) due to the rebates and referral fees received if the new policyholder happens to make a non-fault claim. Similarly, the administrative and legal costs involved in the process of making and defending or receiving and disputing claims are for the large part marginal costs.
5. We can therefore apply the insights from the economic literature on pass-through, which mostly deal with changes in marginal costs.

## The model of competition

6. Drivers consider policies sold by different insurers as substitutes, but not perfect substitutes. Insurance policies are not a homogeneous good. They can differ in the level of cover offered and in the service provided in case of an accident. Moreover, consumers may attach value to particular brands. As a result, price is not the only determinant of consumers' choices.

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<sup>1</sup> In the long run, however, there might be an impact, because the effect on profitability may determine the entry of new competitors or the exit of some firms from the market, with implications on equilibrium prices.

7. The PMI market can be described as one in which firms with similar, but not identical, products compete on prices. The market can therefore be analysed using a model of price competition (Bertrand model) with differentiated products. In our analysis, we have specifically considered the economic literature on pass-through in markets for differentiated products. The [technical annex](#) to this appendix includes a short review of the literature.

### **The incidence of higher costs and revenues among insurers**

8. One of the factors affecting pass-through is how many firms are affected by the changes in costs and revenues, ie whether they are symmetrically or asymmetrically distributed. We have described in Section 6 how, because of the separation, insurers bear higher costs when their customers are at fault and earn revenues when their customers are not at fault. In this subsection, we discuss how far different insurers experience different changes in cost and revenue. We discuss costs first and then revenues. We then discuss two other aspects of the market: the role of brokers and possible differences between insurers in their customer risk profiles.

#### **Costs**

9. We noted that there were some differences in the cost increase associated with non-fault claims handled or referred by different insurers, in particular in the case of repair. However, the subrogated non-fault claims do not affect the non-fault 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.<sup>2</sup>
10. In relation to captured claims and bilateral agreements, we noted that:
  - (a) There were some differences in insurers' ability to capture non-fault claims (see Table 1). Since inflated costs are avoided when a non-fault claim is captured, a higher proportion of captured claims implies lower costs.

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<sup>2</sup> Some claims are referred to CMCs/CHCs by brokers rather than insurers, and in some cases other parties (eg dealerships and repairers) refer non-fault claimants to CMCs/CHCs. This does not alter the underlying point.

TABLE 1 Proportion of captured claims

	<i>Admiral</i>	<i>Ageas</i>	<i>Aviva</i>	<i>AXA</i>	<i>CISGIL</i>	<i>DLG</i>	<i>esure</i>	<i>LV</i>	<i>RSA</i>	<i>Zurich</i>	%
Some component is captured	[X]	[X]		[X]	[X]		[X]	[X]	[X]		
Repair is captured	[X]		[X]		[X]	[X]	[X]	[X]	[X]	[X]	
Replacement car is captured	[X]		[X]		[X]	[X]	[X]	[X]	[X]	[X]	

Source: Insurers.

(b) Some insurers had signed bilateral agreements with the aim of reducing the claims made against each other. We found that the number and nature of agreements which insurers had entered into varied considerably (see Table 2). All other things being equal, insurers which are party to bilateral agreements will receive subrogated claims which are on average lower than insurers without bilateral agreements.

TABLE 2 Bilateral agreements

[X]

Source: Insurers.

Note: 'Replacement car' indicates bilateral agreements relating to replacement car services, and 'repair' indicates bilateral agreements relating to repair services. Some of the insurers in the table have also signed bilateral with smaller insurers.

11. We did not consider these differences to be of sufficient importance to lead to large differences between insurers in expected marginal costs.

### Revenues

12. We now discuss the effect of separation on revenues. We found that insurers' practices were quite similar for replacement cars, as nearly all insurers receive fees for referring non-fault claimants to CMC/CHCs. However, we found that revenues from non-fault repairs varied significantly. In particular, there are differences in how non-fault repairs are handled and claims are recovered from at-fault insurers (see Appendix 6.2, Table 1). Moreover, the rebates which can be obtained from repairers, CMCs, and parts and paint manufacturers may depend on the bargaining power of the insurer. Larger insurers may be in a better position to extract revenues.

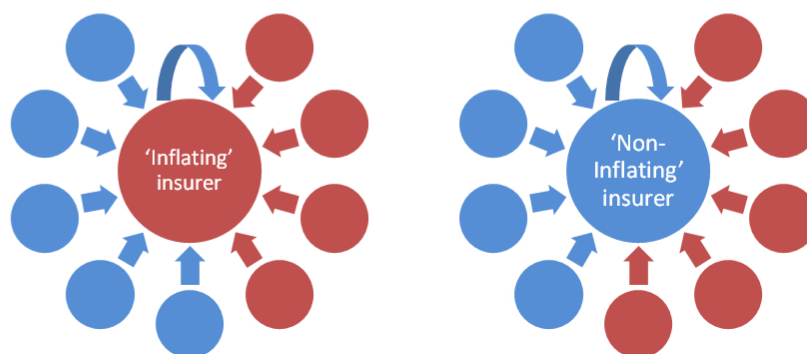
13. We can show that non-fault revenues are likely to be more asymmetric than at-fault costs using a simple example. Suppose that, out of ten insurers, five inflate claim costs while the others do not. For simplicity, if the ten insurers have the same market shares and their customer populations have the same distribution of risks, the asymmetry in revenues is evident. What about higher costs for at-fault claims? In any car accident, the non-fault party has the same probability of being a customer of each insurer. Therefore, as shown in Figure 1, when an insurer that does not inflate costs is in an at-fault position, it will

receive an inflated claim in 50% of the claims it handles (when the non-fault driver is insured by one of the five cost-inflating insurers). An at-fault cost-inflating insurer, on the other hand, will pay an inflated claim in 40% of the cases (when the non-fault driver is insured by one of the other four cost-inflating insurers). The asymmetry of costs is therefore much less pronounced than the asymmetry of revenues.<sup>3</sup>

FIGURE 1

**Asymmetry of costs and revenues**

	'Inflating' insurer	'Non-inflating' insurer
Percentage of non-fault claims handled by the insurer that are overcosted	90%	0%
Percentage of fault claims paid by the insurer that are overcosted	40%	50%



Source: CMA analysis.

Note: We are assuming no cost inflation when the same insurer represents both the at-fault and the non-fault drivers.

- Differences in practices between insurers are therefore more important for the pass-through into premiums of non-fault insurers' revenue streams than the pass-through of at-fault insurers' higher costs.

**Possible differences between insurers in their customer risk profiles**

- Insurers sometimes focus on different groups of drivers, with the result that one insurer's customers might be on average riskier than those of another. On an aggregate level, insurers with riskier customers will be affected more by cost increases. Nevertheless, any such differences between insurers in the distribution of risks among their customers are of limited relevance to pass-through as long as policies are priced according to a driver's individual risk

<sup>3</sup> Cost asymmetry depends on the degree of market concentration. The more concentrated the market is, the higher the probability that the at-fault and non-fault parties are insured by the same insurer.

profile. We can view policies associated with different levels of risk as different products sold to mutually exclusive groups of customers. Therefore, when we consider changes in marginal costs, we can consider separately each risk profile. Given a driver's riskiness, the impact of the separation on their policy's marginal cost does not depend on the distribution of risks among the insurer's customers.

### ***Role of brokers***

16. In this subsection, we discuss whether the distinction between insurers and brokers has an impact on pass-through. Both insurers and brokers can receive an income when handling non-fault claims. However, only insurers are affected by the additional costs associated with at-fault claims. At first sight, we might say that the cost increase for at-fault claims is more asymmetrically distributed than the revenue increase for non-fault claims. However, the gross premium that brokers' customers pay may be regarded as the sum of a 'net premium' received by the underwriting insurer and the brokers' commission. The gross premium is therefore potentially influenced by both higher costs and higher revenues whether a broker is involved or not.
17. 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);<sup>4</sup> and
  - (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).
18. In the case of the first group, both higher costs and revenue will affect premiums (similar to insurers selling directly).
19. In the case of the second group, higher costs will increase premiums, and referral fee revenues will reduce premiums if lower commission rates are agreed and the underwriting insurers reflect these lower commission rates in lower gross premiums. Given that we found rivalry both between insurers and between brokers and direct-selling insurers (see Section 5), it appeared to us that this condition was likely to be met, ie there was likely to be pass-through of both costs and revenues for regional brokers. We also noted that regional

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<sup>4</sup> [§] It appeared to us likely that this would be the case for other national brokers. We were told that, if brokers relied on add-ons or referral fees for their profits, commissions could even be negative.

brokers were less likely to deal directly with a claim and therefore less likely to receive income from referral fees.

20. In our view, the distinction between brokers and direct-selling insurers was of limited importance to our analysis of pass-through, though it did introduce some additional uncertainty into the analysis.

### **Pass-through of the costs to at-fault insurers**

21. We define pass-through as the ratio between a change in the price of a good and a change in its marginal cost. For example, if a £1 rise (fall) in marginal costs determines a £1 increase (decrease) in price, we say that pass-through is 1, or 100% (we also say that the cost is fully passed through).
22. In a Bertrand model with differentiated goods, economic theory suggests that pass-through of a market-wide cost change depends on:<sup>5</sup>
- (a) the elasticity of the firms' individual supply functions, ie the responsiveness of the quantity supplied by each firm to changes in its own price; pass-through is higher for higher levels of the elasticity of firms' supply;
  - (b) demand-side factors and competition:
    - (i) the elasticity of market demand, ie the responsiveness of the quantity demanded to changes in price; pass-through is higher for lower levels of the elasticity of market demand;
    - (ii) the curvature of demand; this is a description of how the slope of market demand changes at different price levels; and
    - (iii) the extent of the constraint firms within the market impose on each other, which depends on rivalry within the market and substitutability between the products of the different firms; in general, pass-through can either increase or decrease with the level of competition.
23. The [technical annex](#) to this appendix provides a more formal treatment of the determinants of pass-through under imperfect competition. In general, in a model of price competition with differentiated products, pass-through can be lower, equal or higher than 1.
24. However, if:

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<sup>5</sup> The analysis is based on Weyl, E G and M Fabinger (2013), 'Pass-through as an economic tool: Principles of incidence under imperfect competition', *Journal of Political Economy*, 121(3), 528–583.

- (a) firms can supply any quantity of the products at current prices (perfectly elastic individual supply functions); and
- (b) rival products are good substitutes;
- (c) then pass-through approaches 1.

A similar result is obtained if:

- (d) firms can supply any quantity of the products at current prices; and
- (e) market demand is very inelastic (the total quantity demanded does not change much with the overall price level).<sup>6</sup>

25. In relation to the elasticity of supply, it is possible that, in the short run, a significant increase in the number of PMI policies supplied would be associated with a higher marginal cost. It might be necessary, in fact, to implement some organisational changes in order to deal with larger volumes. However, here we are seeking to compare the current situation where there is the separation of cost liability and cost control with a benchmark situation where there is no such separation. Therefore, we are not concerned with short-term effects. In our model, we can assume that firms can supply any quantity of the products at current prices. Moreover, empirical studies have suggested that most motor insurers in competitive regimes operate under increasing returns to scale.<sup>7</sup>
26. We believe that rivalry in the PMI market is strong. Switching between PMI providers is high relative to comparable products and there are no obvious obstacles to switching.<sup>8</sup> Moreover, there is evidence that each PMI provider faces a very elastic demand, ie sales volumes are very sensitive to price changes. All this suggests that consumers see the products of different providers as good substitutes.
27. This view is supported by assessments of demand elasticity made periodically by most of the large PMI providers. Although there are differences between providers, all told us that elasticity was high. Elasticity depends on the

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<sup>6</sup> These results are linked because, if the products of the different firms within a market were weak substitutes and market demand was very inelastic, each firm would face inelastic demand for its own product; but in these circumstances profit maximisation implies that each firm would increase its price up to the point where demand for its own product becomes elastic (in the absence of price regulation, profit maximisation and marginal cost above zero imply a price elasticity of firm demand of more than 1). In other words, we would not observe a situation of weak competition within the market and price inelastic demand, except for instances when firms' prices are regulated to below the profit-maximising price.

<sup>7</sup> See Weiss, M A and B P Choi (2008), 'State regulation and the structure, conduct, efficiency and performance of US auto insurers', *Journal of Banking & Finance*, 32(1), 134–156; and Fenn, P et al (2008), 'Market structure and the efficiency of European insurance companies: A stochastic frontier approach', *Journal of Banking & Finance*, 32(1), 86–100.

<sup>8</sup> See Section 5.

strength of a brand and varies between different distribution channels, customer segments and price levels (see Section 8 Table 8.1). Demand on PCWs is characterised by very high levels of elasticity. Elasticity is lower on the providers' own website or on call centres, with a range of estimates between [x] and [x]. However, these are still relatively high figures and are indicative of strong rivalry. Reported elasticities are lower for renewals.<sup>9</sup>

28. The low profitability of insurers is also consistent with a high level of rivalry. Profitability data does not suggest that car insurers 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 (see Appendix 2.3, Annex A).
29. Although each PMI provider faces elastic demand, market demand is very price inelastic, ie the total number of policies sold in the market is not sensitive to changes in the overall prices. Third party car insurance is a legal requirement, and a change in average car insurance premiums can only affect market demand if it induces (a) changes in the number of cars insured (eg a reduction in price might induce some young drivers to insure their own cars rather than use their parents' cars); or (b) a change in the type of insurance taken by some drivers (eg a reduction in price might induce some drivers to take out comprehensive rather than third party, fire and theft insurance). However, for the majority of the population, the cost of PMI has little impact on demand, because the cost of it is small compared with the total cost of vehicle ownership. Admiral and DLG told us that elasticity might be somewhat higher for young drivers, although there was no firm evidence of this.
30. In our view, the combination of a high level of substitutability, inelastic market demand and highly elastic individual supply suggests a pass-through ratio close to 1.

### **Pass-through of the revenues to non-fault insurers and brokers**

31. The pass-through of the revenues to non-fault insurers and brokers depends on the same characteristics of demand and supply as the pass-through of the costs to at-fault insurers. Therefore, a high level of substitutability, inelastic market demand and highly elastic individual supply suggest a high pass-through ratio also for revenues.

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<sup>9</sup> Different insurers might adopt different estimation methods. Some might compute the elasticity of demand in a channel to a change in price in all channels, while others might consider channel-specific price changes. The figures, therefore, might not be directly comparable. Moreover, all estimates are obtained through small price changes around current prices. Therefore, the output values have only local validity. At very different price levels, or for large price changes, elasticity might be different. Finally, some insurers told us that elasticity was higher for high-premium consumers.



32. However, revenues to non-fault insurers and brokers resulting from the separation are more asymmetric than costs to at-fault insurers (see paragraph 13). In general, providers which are in a better bargaining position with their suppliers can retain higher revenues. In this subsection we therefore discuss the effect of these asymmetries.
33. To study pass-through in this case, we need to take into account that changes are firm-specific and correlated with a firm's 'strength'. With asymmetric changes, the definition of pass-through must be modified. When a firm experiences a cost change, we must consider not only the direct effect of the change in the firm's own price, but also the indirect effect on the prices set by the other firms in the market. The sum of direct and indirect effects gives the total impact of the change in costs on consumers.
34. Under the assumptions of inelastic market demand and constant marginal costs, our further analysis of pass-through with asymmetric firms and firm-specific cost changes (see the [technical annex](#)) suggests that:
  - (a) in the case of identical firms, pass-through of firm-specific cost changes is generally slightly higher than 1; and
  - (b) when firms are asymmetric, pass-through can exhibit significant variation: in general, cost changes are not fully passed through if they mostly affect firms with a stronger market position (less elastic individual demand), while they are potentially passed through more than fully when targeted on weaker firms.
35. Since we expect stronger firms to be in a better bargaining position and therefore to get higher revenue, we believed that pass-through was likely to be lower than 1. In other words, we expected the decrease of premiums to be somewhat smaller than the value of the revenues generated by the separation.

### **The impact on different groups of consumers and its relevance to pass-through**

36. Since higher costs affect insurers only when at fault, while additional revenues accrue when insurers (or brokers) are in a non-fault position, the net change in expected costs depends on the risk profile of consumers. The higher costs are taken into account by insurers in their risk models and their impact on premiums depends on the risk profile of each customer, which seeks to reflect the likelihood of being at fault in accidents. The additional revenues, however, are allocated according to the estimated likelihood of being not at fault in

accidents, or simply pro rata with overall revenue.<sup>10</sup> As a consequence, the harm from increased costs is likely to affect mostly high-risk drivers, while the benefit from additional revenues is likely to be distributed more widely across all customers (since all customers have some risk of being not at fault in accidents). The precise impact is likely to depend on the correlation between the probabilities of drivers being in a fault and in a non-fault position.<sup>11</sup>

37. Pass-through should therefore be evaluated taking into account the characteristics of the consumers whose policies are likely to be affected by the cost changes. If, for example, demand elasticity for risky drivers is higher than the average (which seems plausible, given that they pay higher premiums for their policies), then, all other things being equal, pass-through of costs would be less complete than pass-through of revenues. However, in the case of highly elastic supply and strong rivalry, the impact of a difference in demand elasticities would be negligible and would not materially change the conclusion we have reached in paragraph 35.

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<sup>10</sup> esure told us that [REDACTED], LV said that it did not consider claims-related income when estimating claims costs. RSA told us that it treated 'the income generated from not-at-fault customers [REDACTED],' and that expenses were allocated '[REDACTED]'. [REDACTED] told us that its statistical estimate of claims risk cost was augmented for any expected claim-related income at a channel level. [REDACTED]

<sup>11</sup> We do not have information on this, though we note that both at-fault and non-fault probabilities are likely to be correlated with the number of miles driven per year.

## Theoretical analysis of the determinants of pass-through

### General framework

1. Although there is a rich economic literature on the pass-through of changes in marginal costs in imperfectly competitive markets with homogeneous products,<sup>1</sup> few authors have studied pass-through in markets with differentiated products. The question was first addressed by Anderson, de Palma and Keider.<sup>2</sup> Their results have been expanded and integrated within a general theoretical framework for the analysis of pass-through by Weyl and Fabinger.<sup>3</sup> In this annex we will draw extensively from their work.
2. We are interested in determining the ratio between marginal cost changes and price changes. For the moment we consider a market-wide cost change: the marginal costs of all the firms in the market change by the same amount. Formally, we want to find the determinants of the pass-through ratio  $\equiv \frac{dp}{dmc}$ , ie the derivative of price with respect to marginal costs. A pass-through ratio equal to 1 means that an increase (decrease) in marginal costs determines an equal increase (decrease) in price. When  $\rho < 1$ , pass-through is less complete: price changes less than marginal costs; if  $\rho > 1$ , a change in marginal costs implies an even larger change in price.
3. Under perfect competition, the pass-through ratio depends on the elasticities<sup>4</sup> of supply  $\epsilon_S$  and demand  $\epsilon_D$  according to the formula:

$$\rho = \frac{1}{1 + \frac{\epsilon_D}{\epsilon_S}}.$$

Two things should be noticed. First, under perfect competition pass-through can never be larger than 1: the change in price is at most equal to the change in marginal costs. Second, a higher elasticity of demand determines, other things being equal, a lower pass-through ratio, while a higher elasticity of supply is associated with a higher pass-through ratio. In the limit, pass-

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<sup>1</sup> For a non-technical review, see Keen, M (1998), 'The balance between specific and ad valorem taxation', *Fiscal Studies*, 19(1), 1–37.

<sup>2</sup> Anderson, S P, A de Palma, and B Keider (2001), 'Tax incidence in differentiated product oligopoly', *Journal of Public Economics*, 81(2), 173–192.

<sup>3</sup> Weyl, E G and M Fabinger (2013), 'Pass-through as an economic tool: Principles of incidence under imperfect competition', *Journal of Political Economy*, 121(3), 528–583.

<sup>4</sup> The elasticity of supply is defined as the ratio between the percentage change in the quantity supplied and the percentage change in price. Similarly, the elasticity of demand is the ratio between the percentage change in the quantity demanded and the percentage change in price, with its sign changed.

through is complete ( $\rho = 1$ ) when supply is perfectly elastic, which is the case, for example, when marginal costs do not depend on the quantity supplied.

4. When competition is imperfect, the determination of the pass-through ratio is in general more complicated, as it may depend on more subtle characteristics of the demand function. Weyl and Fabinger provide a general formulation that can be applied to a wide range of forms of competition between identical firms. In this annex we will only present pass-through ratios in three special cases: Cournot competition (with homogeneous products), Bertrand competition (with homogeneous products), and Bertrand competition with differentiated products.<sup>5</sup> It will be apparent that the different expressions are special cases of a single general formula.

### Cournot competition

5. In the Cournot model, firms produce a homogeneous product and compete by setting quantities. All firms simultaneously decide which quantity to produce and the equilibrium price is the one that clears the market. This is a widely used model of oligopoly. Although this is not the most appropriate framework to be used when modelling the PMI market, it is useful as a benchmark.
6. If there are  $N$  firms in the market, the pass-through ratio is given by:

$$\rho = \frac{1}{1 + \frac{\epsilon_D - 1/N}{\epsilon_S} + \frac{1/N}{\epsilon_{ms}}},$$

where  $\epsilon_{ms}$ , formally defined as the inverse of the elasticity of marginal consumer surplus, is a measure of the curvature of the demand function. In particular,  $\frac{1}{\epsilon_{ms}} < 1$  if demand is convex and  $\frac{1}{\epsilon_{ms}} > 1$  if demand is concave.<sup>6</sup> To understand better the effect of the curvature of the demand function on pass-through, we consider the special case of constant marginal costs, ie perfectly elastic supply ( $\epsilon_S = \infty$ ). In this case, the formula reduces to:

$$\rho = \frac{1}{1 + \frac{1/N}{\epsilon_{ms}}}.$$

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<sup>5</sup> Under Cournot competition, firms set output levels (and prices emerge from competition in the market), while under Bertrand competition, firms set price levels (and outputs emerge from competition in the market).

<sup>6</sup> As the number of firms approaches infinity, the formula reduces to the one we have seen in the case of perfect competition (see paragraph 3), as is to be expected. The special case of  $N = 1$  gives the pass-through ratio for a monopolist.

If demand is linear (ie  $\frac{1}{\epsilon_{ms}} = 1$ ), then pass-through is equal to  $\frac{N}{N+1}$ : it only depends on the number of firms and it is larger the more numerous the firms in the market are. In other words, pass-through increases with the level of competition. If the demand is convex, as is often assumed, pass-through is higher than  $\frac{N}{N+1}$ . Contrary to the case of perfect competition, pass-through can be larger than 1 if  $\frac{1}{\epsilon_{ms}} < 0$ . In that case, pass-through is decreasing in N, ie it decreases for higher levels of competition.

7. We can therefore draw two conclusions for the case of Cournot competition:
  - (a) pass-through can be larger than 1, ie price can change more than marginal costs; and
  - (b) there is no clear relationship between pass-through and the level of competition; however, in the special case of perfectly elastic supply, pass-through tends towards 1 as the level of competition increases.

### **Bertrand competition with differentiated products**

8. Another traditional model of oligopoly is the Bertrand model with homogeneous products, in which firms compete by simultaneously setting prices. In this case, it is possible to show that the pass-through ratio is the same as in a perfectly competitive market (see paragraph 3). In the standard Bertrand model, where marginal costs are assumed to be constant, pass-through is equal to 1.
9. In the PMI market, insurers compete in prices, as in the Bertrand model. However, products are not homogeneous, or are not perceived as such by consumers. The products of different firms are still substitutes, but not perfect substitutes. For the moment, we assume that firms have the same cost functions and face the same individual demands. We therefore look for a symmetric equilibrium in which all firms set the same price p.
10. In this case, pass-through for any firm  $i$  is given by:

$$\rho = \frac{1}{1 + \frac{\epsilon_D - \theta}{\epsilon_S} + \frac{\theta}{\epsilon_{ms}} + \frac{\theta}{\epsilon_\theta}},$$

where  $\theta = 1 + \sum_{j \neq i} \frac{\partial q_j}{\partial p_i} / \frac{\partial q_i}{\partial p_i}$  and  $\epsilon_\theta$  is formally defined as the inverse of the elasticity of  $\theta$  with respect to the quantity supplied by the firm. The first three components of the denominator are the same as in the Cournot case (see paragraph 6), with the difference that, instead of  $1/N$ , we now have  $\theta$  (1 plus

the aggregate diversion ratio for good  $i$ ). The term  $\sum_{j \neq i} \frac{\partial q_j}{\partial p_i} / \frac{\partial q_i}{\partial p_i}$ , in fact, is the ratio between the cumulative change in the quantities supplied by all other firms and the change in the quantity supplied by firm  $i$  when the price for the product of firm  $i$  changes. This term is always negative: if the price of good  $i$  increases, the quantity of good  $i$  decreases, but the other firms will sell more, because their products are substitutes for  $i$ . Therefore,  $\theta$  is always smaller than 1 (as was the case for the  $1/N$  term in the Cournot case). The closer substitutes the different goods are, the closer the diversion ratio approaches  $-1$ . In the limit, when goods are perfect substitutes ( $\theta = 0$ ), we revert to the standard Bertrand case with homogeneous goods and the pass-through ratio is the same as in perfect competition. A similar result is obtained if market demand is highly inelastic, since in this case (almost) all sales lost by one firm are gained by its competitors ( $\theta$  approaches 0).

11. Compared with the Cournot model, the new term is the last component of the denominator,  $\frac{\theta}{\epsilon_\theta}$ . Within this term,  $\epsilon_\theta$  measures how the diversion ratio changes if all quantities change by the same amount. It is possible to show that, under quite general conditions, this term is negative, so that pass-through is generally higher than it would be if the cumulative diversion ratio were constant.
12. Abstracting from the technicalities of the formula, we can reach some broad conclusions for the case of Bertrand competition with differentiated goods:
  - (a) The exact determination of pass-through involves a detailed analysis of the supply function, of the market demand function (elasticity and curvature) and of aggregate diversion ratios (and of how they change when all quantities, or all prices, change).
  - (b) Pass-through can be smaller or larger than 1 and there is no clear relationship between pass-through and the level of competition; however, in the special case of perfectly elastic supply, pass-through tends towards 1 as the level of competition increases.
  - (c) When the different goods are very close substitutes, the pass-through ratio approaches that which emerges in the case of perfect competition; a similar result is obtained if market demand is highly inelastic.

### Asymmetries

13. Allowing for asymmetric firms, ie firms with different marginal costs or facing different residual demands, or for firm-specific cost changes, makes the model substantially more complicated. First of all, the definition of pass-

through must be modified. There is no longer a single  $\rho$ , but each firm reacts to its own costs change and to the changes in the marginal costs of each other firm. The impact on consumers depends not only on the direct pass-through of a firm's own costs changes, but also on the indirect effect on the prices set by all other firms. Formally, pass-through ratios must be expressed as an  $N \times N$  matrix  $P$  in which the generic element  $P_{ij}$  represent firm  $i$ 's response to a change in firm  $j$ 's costs.

14. As an example, we consider the case of Cournot competition with identical firms, constant marginal costs and linear demand introduced in paragraph 6.<sup>7</sup> We have seen that, in the case of a market-wide cost change, the pass-through ratio is  $\frac{N}{N+1}$ . If only one firm (firm  $i$ ) experiences a change in marginal costs, it is possible to show that the impact on its own price is given by a pass-through ratio of  $\frac{1}{N+1}$  (formally,  $P_{ii} = \frac{1}{N+1}$ ). However, all the other firms will react in a similar way, changing their prices by the same amount, even if they have not directly experienced any costs change (formally,  $P_{ji} = \frac{1}{N+1}$  for any  $j$ ). The total fraction of firm  $i$ 's cost change that is passed to consumers is, therefore,  $\frac{N}{N+1}$ , which is the same ratio we have determined in the case of a market-wide change.
15. The equivalence between firm-specific and market-wide cost changes that emerges in the Cournot model does not hold for other models of competition. For example, in a Bertrand model with more than two identical firms, cost changes that affect only one firm have no impact on prices.<sup>8</sup> In the next subsection, we discuss pass-through in a market with differentiated products.

### **A duopoly model of Bertrand competition with differentiated goods**

16. We consider a market in which two firms compete in prices. The products of the firms are substitutes, but not perfect substitutes. Demand for each good is decreasing in the price of the good and increasing in the price of the substitute. We assume demands are linear. Formally:

$$Q_1(p_1, p_2) = \alpha_1 - \beta p_1 + \gamma p_2$$

$$Q_2(p_1, p_2) = \alpha_2 - \gamma p_2 + \beta p_1$$

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<sup>7</sup> For a detailed analysis of this model, see Ten Kate, A and G Niels (2005), 'To what extent are cost savings passed on to consumers? An oligopoly approach', *European Journal of Law and Economics*, 20, 323–337.

<sup>8</sup> There is no impact in the case of a cost increase, while for a cost decrease the impact is infinitesimal.

where  $Q_1$  and  $Q_2$  are the quantity demanded of good 1 and good 2 and  $p_1$  and  $p_2$  are the respective prices. We also assume that market demand is perfectly inelastic (it does not depend on prices):  $Q_1 + Q_2 = \alpha_1 + \alpha_2$ .

17. We assume that the firms have constant marginal costs (so that demand is perfectly elastic), denoted as  $c_1$  and  $c_2$ . Each firm simultaneously chooses the price that maximises its profits, taking the price of the rival firm as given. Solving for the equilibrium, we get:

$$p_1 = \frac{2\alpha_1 + \alpha_2 + 2\beta c_1 + \gamma c_2}{3\beta} \quad q_1 = \frac{2\alpha_1 + \alpha_2 + \gamma c_2 - \beta c_1}{3}$$

$$p_2 = \frac{2\alpha_2 + \alpha_1 + 2\gamma c_2 + \beta c_1}{3\gamma} \quad q_2 = \frac{2\alpha_2 + \alpha_1 + \beta c_1 - \gamma c_2}{3}$$

The effects of cost changes can be easily determined by changing the values of  $c_1$  and  $c_2$  in the formulas above.

18. We consider first the case of identical firms. In this case,  $\alpha_1 = \alpha_2 = \alpha$ ,  $\beta = \gamma$  and  $c_1 = c_2 = c$ . In equilibrium,  $q_1 = q_2 = \alpha$  and  $p_1 = p_2 = \alpha/\beta + c$ . Identical firms charge the same price and split demand equally between them. Moreover, if there is a market-wide cost change, the price changes by exactly the same amount, ie pass-through is 1. This is a result that we already know from the theory.
19. When the firms are not identical, pass-through can be different from 1. Before giving some examples, it is useful to specify what we mean by pass-through in this context. When firms are asymmetric or cost changes are firm-specific, the equilibrium after the changes will exhibit not only new prices but also new quantities. We need therefore to clarify the definitions of cost change and of impact on consumers. We define cost change as the difference between total production costs after and before the change in marginal costs. The total impact on consumers is given by the difference between the total amounts spent by consumers after and before the change. We define pass-through as the ratio between impact on consumers and cost change.
20. Table 1 shows the results in two special cases. In both, firm 1 is in a stronger position than the rival: before the cost changes it produces a higher volume and gets higher profits. The demand it faces shows a lower level of elasticities, both with respect to its own price and to the price of the substitute good. In the first case, a cost increase affects mostly the strong firm, while in the second the weak firm is affected most. The table shows that pass-through is below 1 in the first case, but higher than 1 in the second case. This result is quite general and extends to the case of cost decreases.



TABLE 1 **Examples of pass-through**

$\alpha_1$	400	$\alpha_2$	400
$\beta$	10	$\gamma$	12
$c_1$	200	$c_2$	200
Initial $p_1$	253.33	Initial $q_1$	533.33
Initial $p_2$	222.22	Initial $q_2$	266.66
Price elasticity of good 1 at initial prices			4.75
Cross-price elasticity of good 1 at initial prices			5
Price elasticity of good 2 at initial prices			10
Cross-price elasticity of good 2 at initial prices			9.5
	<i>Case 1</i>		<i>Case 2</i>
Cost increase for firm 1	7	Cost increase for firm 1	2
Cost increase for firm 2	2	Cost increase for firm 2	7
Total cost increase	4190	Total cost increase	2826.66
Total impact for consumers	3279.02	Total impact for consumers	4237.51
Pass-through	0.783	Pass-through	1.499

Source: CMA analysis.

21. This model suggests that, in a market with perfectly elastic supply and perfectly inelastic demand where asymmetric firms selling differentiated products compete in prices, costs are passed through less than fully if they mainly affect the strongest firms, but more than fully if they mainly affect the weakest firms.

## Separation of cost liability and cost control and quality of services

### Introduction

1. This appendix discusses evidence on the impact of separation of cost liability and cost control on the quality of service provided to non-fault claimants in relation to repairs and replacement cars. In particular, we consider the differences between services provided by parties liable for the costs (at-fault insurers) and those without cost liability (non-fault insurers and CMCs/CHCs).
2. We discuss first repairs and then replacement cars.
3. Our evidence comes from responses to our survey<sup>1</sup> and from the parties to our investigation, including insurers and CMCs/CHCs.

### Provision of repairs

#### *Evidence from consumers*

4. The following tables set out the key survey results which provide an indication of respondents' perceived quality in relation to repairs. As explained in the [annex](#), we analysed the survey results according to the main organisation handling the claim.
5. Table 1 shows that for all claims where there was a repair, respondents said that all the damage to vehicles was repaired in 93% of cases. In the remaining 7% of cases, respondents said that some or most of the damage was repaired (but not all).

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<sup>1</sup> Survey report.

TABLE 1 How much damage was repaired, analysed by who managed the claim

	%			
	<i>All</i>	<i>At-fault</i>	<i>Non-fault</i>	<i>CMC</i>
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	472	135

Source: Non-fault Survey, question C11.

\*Difference is statistically significant.

Note: Base for all respondents does not sum to the total for the other columns because it includes cases where the at-fault insurer was the same as the non-fault insurer, where there was a bilateral agreement between the two insurers, where an organisation other than insurer or CMC handled the claim and where the respondent did not know the main organisation that handled the claim – see [annex](#).

6. Table 2 shows that the most commonly-stated reason for respondents saying that not all of the damage was repaired was that they did not think the repairs were carried out properly. Other cited reasons, in order of frequency, were: the insurer refused to make the repair; minor/cosmetic damage only; and respondents not wanting to pay further costs. The sample sizes for these responses were very small (which is why Table 2 shows the numbers of respondents rather than percentages).

TABLE 2 Reason(s)\* why not all damage was repaired, analysed by who managed the claim

	<i>All</i>	<i>At-fault</i>	<i>Non-fault</i>	<i>CMC</i>
Minor/cosmetic damage only	13	2	7	0
Respondent did not want to pay further costs	9	2	6	0
Repairs not carried out properly	30	12	11	2
Insurer refused to make repairs	14	5	3	2
Other/not stated	16	4	10	0
Base (weighted)	82	23	37	4

Source: Non-fault Survey, question C12.

\*Each respondent may give more than one reason.

7. Table 3 shows respondents' perception of how much damage was repaired according to who made the final decision as to who would carry out the repairs. The table shows that most respondents perceived that only part of the damage was repaired among those who chose a repairer they knew of. However, it is possible that some of the differences may be accounted for by respondents being more involved in the repair process when choosing their own repairer. These respondents may have a greater tendency to say that not all damage was repaired if they were not entirely satisfied by the services they received. The number of respondents falling into the 'other' category was small. For this reason, we do not show the result for this category in the table.

TABLE 3 **How much damage was repaired split by who made the final decision as to who would carry out the repair and how that decision was taken**

<i>How much damage was repaired</i>	<i>All</i>	%		
		<i>Choice made by you: repairer you knew of</i>	<i>Choice made by you: options provided by insurers/CMC</i>	<i>Choice made by insurer/CMC</i>
All	93	81*	94	95*
Most	5	14*	5	4*
Some	2	5*	1	1*
Base (weighted)	1,159	148	121	797

Source: Non-fault Survey, question C11.

\*Difference is statistically significant.

8. Table 4 shows respondents' assessment of the condition of their vehicle after it had been repaired compared with prior to the accident. Most respondents (88%) said that the condition was the same or better. Among captured claims, 13% of respondents said that their vehicle was in a worse condition after the repairs compared with before the accident, while the equivalent figure was 8% for claims handled by the non-fault insurer and 10% for claims handled by CMCs.

TABLE 4 **Condition of the vehicle after the repairs were made, analysed by who managed the claim**

<i>Compared to before the accident</i>	%			
	<i>All</i>	<i>At-fault</i>	<i>Non-fault</i>	<i>CMC</i>
In a lot better condition	5	4	5	5
In somewhat better condition	8	10	8	8
Same	75	73*	79*	77
Slightly worse	10	12*	7*	7
Much worse	1	1	1	3
Don't know	1	0	1	0
Base (weighted)	1,163	364	475	135

Source: Non-fault Survey, question C22.

\*Difference is statistically significant.

9. The main reason for the vehicle being perceived to be in a worse condition was because not all the repairs were carried out (see Table 5). The second most cited reason was that the paintwork was not of the same colour or quality.

TABLE 5 **Reason(s)\* why the condition of the vehicle was worse, analysed by who managed the claim**

<i>Reasons cited</i>	<i>All</i>	<i>At-fault</i>	<i>Non-fault</i>	<i>CMC</i>
Paintwork not the same quality/colour	27	10	7	3
Not all damage repaired	98	34	31	9
Vehicle does not drive as well	7	4	2	0
Base (weighted)	1,156	364	470	135

Source: Non-fault Survey, question C23.

\*Each respondent may give more than one reason.

10. Table 6 shows that the main reasons for respondents perceiving their vehicle to be at least in the same condition as before the accident were because the vehicle returned to the original state and that the vehicle looked the same as before the accident.

TABLE 6 Reason(s)\* why repaired vehicle was at least in the same condition, analysed by who managed the claim

	<i>All</i>	<i>At-fault</i>	<i>Non-fault</i>	<i>CMC</i>
Vehicle looks better than before the accident	31	12	14	5
Vehicle looks the same as before the accident	279	87	108	36
Vehicle returned to original state	310	86	147	34
Damage repaired	198	65	77	25
Damaged part(s) replaced	75	22	37	7
Vehicle drives as well as before the accident	40	6	17	9
Newer/better parts used in the repairs	58	15	29	6
Vehicle cleaned/polished	20	8	7	2
Vehicle resprayed/repainted	73	22	28	11
Scratches removed	18	6	11	0
Other	76	23	29	6
Don't know	8	2	3	0
Base (weighted)	1,156	364	470	135

Source: Non-fault Survey, question C23.

\*Each respondent may give more than one reason.

11. Table 7 shows respondents' perceptions of their ability to assess the repairs to their vehicle. Overall, respondents perceived themselves to be fairly or very confident of their ability to assess the condition of their vehicle following the repairs (85%), but a higher proportion of those who said that their vehicle was in a better condition post-repair considered themselves able to assess this than those who said that their vehicle was in a worse condition (92% and 60% respectively).

TABLE 7 How confident are respondents to be able to assess the repairs analysed by condition post-repair

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

Source: Non-fault Survey, question C25.

\*Difference is statistically significant.

12. Table 8 shows that about a fifth of respondents' vehicles had been inspected for the quality of repair by a family member or friend and about one in ten by an independent inspector. The condition of the vehicle was more likely to have been assessed as worse if an inspection took place. However, these figures need to be interpreted carefully as an inspection might only have been conducted because of concerns or a dispute about the repair work.

TABLE 8 Condition of the vehicle by whether the repairs were assessed

	%		
	<i>All claims</i>	<i>Inspected by:</i> <i>Family/ friends</i> <i>Inde- pendent</i>	
<i>Compared to before the accident</i>			
A lot better	5	4	5
Somewhat better	8	11	5
Same	75	71	70
Slightly worse	10	13	14
Much worse	1	1*	7*
Don't know	1	1	0
Base (weighted)	1,163	257	101

Source: Non-fault Survey, question C21.

\*Difference is statistically significant.

13. Table 9 shows the length of time taken to complete the repair work. To avoid misleading results driven by the mix of different types of damage across categories, rather than differences in the handling of the claim, we considered the average length of time taken to repair damage to the back of the vehicle as this was the damage most commonly reported by non-fault claimants in our survey. We conducted this analysis for high, medium and low levels of damage. In our view, this comparison of the average length of time to complete the repair work between captured and non-fault claims did not suggest a distinct pattern.

TABLE 9 Average length of time (days) taken to repair a vehicle split by severity of damage

	<i>number of days</i>		
	<i>At fault</i>	<i>Non-fault</i>	<i>CMC</i>
Low damage	7	8	11
Medium damage	22	11	13
High damage	15	23	25
All types of damage*	14	11	13

Source: Non-fault Survey, question C3.

\*The average has been weighted by the number of claims for each type of damage.

14. Our non-fault survey asked respondents who made the final decision as to which repairer would carry out repairs to their vehicle. Table 10 shows the vehicle post-repair condition analysed by responses to this question. The table shows that a greater proportion of those who chose the repairer considered the car in slightly worse condition compared with the situation in which the non-fault insurer chose the repairer.

TABLE 10 Condition of the vehicle after repair by who decided who would carry out the repairs

	%				
	All	You	Non-fault	At-fault	Other*
<i>Compared with before the accident</i>					
A lot better	5	5	4	5	9
Somewhat better	8	11	8	9	3
Same	75	71†	78†	75	76
Slightly worse	10	13†	8†	10	8
Much worse	1	1	2	1	2
Don't know	1	0	1	1	3
Base (weighted)	1,163	299	439	306	119

Source: Non-fault Survey, question C22.

\*Includes claims where the final decision as to who would carry out the repair was taken by legal firms, repairers, dealerships and CMCs.

†Difference is statistically significant.

15. Our non-fault survey went on to ask those respondents who had chosen the repairer themselves to say how they chose who would carry out the repairs. Among these respondents, over half said that they had chosen from repairers they knew. Among this latter group of respondents, 16% said that the condition of their vehicle was worse after repair, compared with 11% who gave this answer across all respondents (see Table 11). We note that the caveat to the analysis of Table 3 in paragraph 7 applies equally to the analysis shown in Table 11.

TABLE 11 Post-repair conditions split by who made the final decision as to who would carry out the repair and how that decision was taken

	%			
	All	Choice made by you: repairer you knew of	Choice made by you: options provided by insurers/CMC	Choice made by insurer/CMC
<i>Post-repair conditions</i>				
Better condition	5	5	6	5
Somewhat better	8	10	13	8
Same condition	75	69*	72	77*
Slightly worse	10	15*	8	9*
Much worse	1	1	1	2
Don't know	1	0	0	1
Base (weighted)	1,163	148	121	799

Source: Non-fault Survey, question C22.

\*Difference is statistically significant.

16. Table 12 shows respondents' perceptions of the value of their vehicle post-repair compared with prior to their accident. The table shows that 14% of respondents said that they thought their vehicle was worth less. Whilst this appeared higher among claims that had been captured, this difference was not statistically significant.

TABLE 12 Value of the vehicle after the repairs were made, analysed by who managed the claim

	%			
	<i>All</i>	<i>At-fault</i>	<i>Non-fault</i>	<i>CMC</i>
<i>Compared with before the accident</i>				
Vehicle was worth more	1	0	0	0
Vehicle was worth the same	80	81	81	83
Vehicle was worth less	14	15	12	13
Don't know	5	4	6	3
Base (weighted)	1,163	364	475	135

Source: Non-fault Survey, question C24.

17. Table 13 shows the respondents' degree of satisfaction split by who managed the claim. Non-fault claimants appear to have a higher degree of satisfaction in comparison with captured claims. For both types of claims, respondents appear to be fairly or very satisfied with the repair service provided, 93% for non-fault claims versus 86% for captured claims.

TABLE 13 Satisfaction with the repair service analysed by who managed the claim

	%			
	<i>All</i>	<i>At-fault (a)</i>	<i>Non-fault (b)</i>	<i>CMC (c)</i>
Very satisfied	61	56 <sub>b</sub>	66 <sub>a</sub>	63
Fairly satisfied	28	30	27	24
Neither satisfied nor dissatisfied	4	6 <sub>b,c</sub>	2 <sub>a</sub>	1 <sub>a</sub>
Fairly dissatisfied	3	4	2 <sub>c</sub>	6 <sub>b</sub>
Very dissatisfied	4	3 <sub>c</sub>	2 <sub>c</sub>	6 <sub>a,b</sub>
Base (weighted)	1,159	364	472	135

Source: Non-fault Survey, questions C26.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

### *Nature of the accident*

18. We considered whether the severity of the accident had any impact on the provision of services. Table 14 presents two outcome measures for repair services, as indicators of the difference in service quality, and analyses them by three characteristics of the accident: the severity of damage to the vehicle; whether the main damage to the vehicle was to the back of the vehicle; and whether the driver of the vehicle sustained an injury.



TABLE 14 Stated quality of the repair services by nature of the accident

	All claims	Severity of the accident			Damage mostly to back	Personal injury
		Low (a)	Medium (b)	High (c)		
<i>Repair</i>						
Better condition	13	14	13	14	11	11
Worse condition	11	9 <sub>c</sub>	12	15 <sub>a</sub>	11	16*
Worth more	0	0	0	1	1	1
Worth less	14	11 <sub>b,c</sub>	18 <sub>a</sub>	18 <sub>a</sub>	14	21*
Average base (weighted)	1,123	498	472	148	537	271

Source: Non-fault Survey, questions B1, C2, C3.

\*Statistically different from claims where there was no injury.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

19. The table shows that there appears to be more evidence of perceived poor quality in relation to repairs the more severe the damage to the vehicle (medium and high compared with low damage), although whether or not the main damage was to the back of the vehicle appears to make little difference. Among cases where the driver was injured in the accident, a particularly high proportion of respondents stated that they thought the vehicle was in a worse condition after repair.

### Legal entitlement

20. There may be potential for differences in quality of goods and services when a claimant is unaware of their legal rights. Table 15 presents the same two outcome measures analysed by the extent to which the claimant said they had been made aware of their legal rights. The table shows that outcomes tended to be better among those who said that they had been informed of their legal rights in relation to their claim. However, we noted that it was possible that some of the differences could be accounted for by respondents having a greater tendency to say that they had been made aware of their legal rights if they were generally happy with the services they had received.

TABLE 15 Awareness of legal rights by stated quality of repair services

	Were you made aware of your legal rights?				
	Yes, all	Yes, some	No	Don't know	Total
<i>Repair</i>					
Better condition	13	16	14	10	13
Worse condition	8*	8	14*	8	11
Worth more	1	0	1	0	1
Worth less	13	18	17	8	15
Average base (weighted)	1,127	269	86	626	146

Source: Non-fault Survey, question D30.

\*Differences are statistically significant.

## ***Evidence from insurers***

21. In this subsection we consider evidence from insurers and repairers on the repair services provided in different situations. As discussed in Appendix 5.3, we found that insurers did not differentiate significantly in how they managed repairs between at-fault and non-fault repairs.
22. We found that, to a limited extent, credit repairs were less likely to use non-OEM parts than insurer-managed repairs; and credit repairs had a higher proportion of replacement to repair than insurer-managed repairs. However, we were not able to quantify the impact on average repair costs of these differences. Also, we found no evidence to indicate that this additional level of service from credit repair was unreasonable. We noted that the at-fault insurer could challenge inappropriate repair methods (eg the excessive use of replacement parts) through the scrutiny of its engineers.
23. We observed a few differences between non-fault insurer-managed repair services, captured repair services and credit repair services, as follows:
  - (a) When repairs are handled by non-fault insurers, claimants are sometimes required to pay their insurance excess, in particular if liability is initially unclear or if claimants wish to use their own repairer. The claimant must then claim the excess back from the at-fault insurer, sometimes with little assistance from the non-fault insurer. In contrast, for both credit repairs and captured non-fault repairs, no excesses are payable.
  - (b) Another consequence when repairs are managed by non-fault insurers is that claimants might lose their NCB. This should only be a temporary loss until liability is fully established or until the claim is settled but, again, this does not happen in credit repairs or captured non-fault repairs.
  - (c) In principle, credit repair customers may be exposed to the risk of being liable for the repair bill should the credit repairer not fully recover the costs from the at-fault insurer.<sup>2</sup> In practice, this risk appears small as some credit repairers offer insurance cover for this eventuality, and others told us that, although a customer might be legally liable, they would never expect a customer to pay.
  - (d) Captured non-fault claimants and CMC customers do not have access to the Financial Ombudsman Service in case of a dispute with the at-fault insurer (though CMCs are regulated by the Claims Management

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<sup>2</sup> Claimants with comprehensive cover would be able to make a claim on their own insurance, but would still be at risk of having to pay for the repair before the claim under their own insurance had been dealt with. Claimants without comprehensive cover would be at risk of bearing the costs themselves.

Regulator and customers can seek advice from the Claims Management Regulation Unit (part of the Ministry of Justice)).

24. We also noted that, alongside a credit repair service, a CMC may provide non-fault claimants with other services, which might not be provided to a captured non-fault claimant by an at-fault insurer, as follows:
- (a) In addition to claiming for the reasonable costs of repair, some CMCs will also claim for a diminution in value of the vehicle as a result of the accident (when the reasonable cost of repair is not sufficient to compensate for the difference in the value of the vehicle post-accident).<sup>3</sup> None of the insurers which responded to our questionnaire offered their non-fault customers help with diminution claims. We found that, when such payments were made, they were typically for between 5 and 15% of the pre-accident value of the vehicle, but that diminution payments were rare (ie they occur in less than 2% of claims).
  - (b) Some CMCs also assist their non-fault customers in recovering uninsured losses, such as travel expenses, loss of earnings, recovery of insurance excesses and vehicle recovery costs. CMCs provided us with a wide range for the cost of providing these services, from £[redacted] to £[redacted] per repair. We found that some insurers provided these services to their non-fault claimants only if they had an MLEI policy (for a more detailed analysis, see paragraphs 90 to 97).
25. When comparing the services (other than the repair itself) provided to credit repair customers and the services provided to own-insurer non-fault customers, it appeared to us that credit repair services (and captured non-fault repair services) were slightly better. In particular, this was because credit repair providers do not require the payment of an excess and the claim does not affect the NCB of the claimant, albeit that these comparative benefits might be temporary as non-fault insurer claimants might be restored to their pre-accident condition in respect of these things subsequently.
26. With regard to the additional services provided by some CMCs, these would appear to be services provided to assist some claimants in pursuing their entitlements under tort law.

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<sup>3</sup> The non-fault claimant is entitled to be compensated for the diminution in value of their vehicle as a result of the accident. Courts usually assess this amount as the 'reasonable cost' of repair but, if this is insufficient to compensate for the diminution in value, may make an additional award (because an award of damages by a court is final with no means of claiming again when that diminution in value is realised, most commonly when the vehicle is sold).

## Replacement cars

27. In this section, we discuss evidence relevant to assessing whether the level of replacement car services is different according to the claim handler.

### *Evidence from consumers*

#### *Perceived quality of replacement cars*

28. The following tables set out the key outcome measures which provide an indication of respondents' perceived quality in relation to replacement cars, each analysed by the main claim handler.
29. About 80% of the respondents to our non-fault survey were given access to a replacement car as part of their accident claim. Of the remainder, most were either offered a replacement vehicle and did not take up the offer or did not need a replacement vehicle. In only 1% of all non-fault claims (22 unweighted cases) did the respondent ask for a replacement vehicle and was not given one.
30. Table 16 shows respondents' views on how well the replacement car they received met their needs. 85% of respondents who received a replacement car said that it either met or exceeded their needs. The proportion of respondents who felt that the replacement vehicle fell short of their needs was slightly higher among captured claims than claims handled by the non-fault insurer and CMC.

TABLE 16 How well the replacement vehicle met needs, analysed by who managed the claim

	%			
	<i>All</i>	<i>At-fault (a)</i>	<i>Non-fault (b)</i>	<i>CMC (c)</i>
Far exceeded needs	11	11	10	11
Somewhat exceeded needs	6	4	7	7
Met needs	68	66	69	72
Fell slightly short of needs	9	14 <sub>b,c</sub>	8 <sub>a</sub>	4 <sub>a</sub>
Fell well short of needs	5	5	5	7
Base (weighted)	1,186	345	439	171

Source: Non-fault Survey, question D19.

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Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

31. Table 17 shows the most stated reasons for the replacement car exceeding respondents' needs while Table 18 shows the most stated reasons for the replacement car falling short of their needs. The most stated reason for the replacement car exceeding needs was that it was newer than the respondents' own vehicle while the most stated reason for the replacement car

falling short of their needs was that it was less spacious or smaller than their own vehicle.

TABLE 17 Reason(s)\* why the replacement vehicle exceeded needs, analysed by who managed the claim

	<i>All</i>	<i>At fault</i>	<i>Non-fault</i>	<i>CMC</i>
It was newer	80	27	23	11
It was more powerful / had a bigger engine	25	3	10	5
It was more spacious/bigger	61	12	21	15
It was less bulky/smaller	3	0	2	0
More economical	7	5	0	0
Higher specification	11	3	6	0
Low expectations/requirements	12	0	5	4
Was a good car (various)	4	2	2	0
Similar to my car/suitable to my needs	9	3	5	0
More expensive to run	4	0	0	2
Had vehicle for longer than was needed	3	0	0	0
Other	3	0	2	0
Don't know	1	0	0	0
Base (weighted)	205	51	75	30

Source: Non-fault Survey, question D20.

\*Each respondent may give more than one reason.

TABLE 18 Reason(s)\* why the replacement vehicle did not meet needs, analysed by who managed the claim

	<i>All</i>	<i>At fault</i>	<i>Non-fault</i>	<i>CMC</i>
Worse make/model	34	17	11	2
Method of pick-up/delivery	2	0	0	2
Older than own vehicle	2	2	0	0
Smaller engine than own vehicle	24	6	9	5
More bulky/bigger than own vehicle	10	5	3	0
Less spacious/smaller than own vehicle	96	35	34	12
Manual/automatic/diesel/petrol wanted	13	3	7	2
It was not clean	4	2	2	0
It was faulty	8	3	2	0
Fuel consumption too high	6	4	0	0
Unable to transport dog	4	2	2	0
Difficult/uncomfortable to drive	5	3	2	0
Not suitable for disabled people	5	3	2	0
Other	22	12	4	3
Don't know	2	0	2	0
Base (weighted)	171	67	59	19

Source: Non-fault Survey, question D21.

\*Each respondent may give more than one reason.

32. Table 19 shows respondents' views on whether they had their replacement car for the right length of time. Nine in ten customers said that they had the replacement car for at least as long as they needed it, while 9% of respondents said that they had the replacement car for a shorter time than needed.

TABLE 19 Length of time had access to replacement car, analysed by who managed the claim

	%			
	<i>All</i>	<i>At fault</i> <i>(a)</i>	<i>Non-fault</i> <i>(b)</i>	<i>CMC</i> <i>(c)</i>
A longer time than needed	3	3 <sub>c</sub>	2 <sub>c</sub>	7 <sub>a,b</sub>
As long as needed	88	88	88	86
A shorter time than needed	9	9	9	8
Base (weighted)	1,178	341	435	171

Source: Non-fault Survey, question D23.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

33. Table 20 shows the main reasons given for having had access to the replacement car for longer than needed, while Table 21 shows the reasons for needing the replacement car longer. The main reason given by the small proportion of respondents who had their replacement car for longer than required was that they retained the vehicle for some time after the repair to their own vehicle was completed. Conversely, the reasons for needing the replacement car for longer were that they had no access to another suitable vehicle for part of the time, or they needed time to find or to finance the purchase of another vehicle.

TABLE 20 Reason(s)\* why access was longer than needed, analysed by who managed the claim

	<i>All</i>	<i>At fault</i>	<i>Non-fault</i>	<i>CMC</i>
Had it for some time after the repairs had been completed	16	4	2	5
Did not use vehicle at beginning or end of period for which replacement vehicle was provided	5	2	2	2
Had access to another vehicle	5	2	1	0
Delays with the repair work	6	2	1	3
Told to keep hold of it longer	5	2	2	0
Did not use the vehicle	5	0	2	3
Other	1	1	0	0
Don't know/can't remember	2	0	2	0
Base (weighted)	41	12	9	12

Source: Non-fault Survey, question D24.

\*Each respondent may give more than one answer.

TABLE 21 Reason(s)\* why didn't have replacement vehicle long enough, analysed by who managed the claim

	%			
	<i>All</i>	<i>At-fault</i>	<i>Non-fault</i>	<i>CMC</i>
Couldn't collect the replacement car straight away	17	3	5	3
Didn't have access to another vehicle for part of the time	40	7	23	4
Didn't have access to a suitable vehicle for part of the time	25	9	4	4
Car written off which caused delays	5	2	1	0
Needed time to find another car to purchase	28	8	13	3
Car had to go back for repairs	5	2	2	0
Needed time to finance purchase of another car	9	5	0	4
Needed car for commuting	4	2	0	0
Other	3	2	2	0
Base (weighted)	105	30	41	13

Source: Non-fault Survey, question D25.

\*Each respondent may give more than one answer.

34. Our non-fault survey asked respondents who had decided on the provider of the replacement car. Tables 22 and 23 show the proportion of replacement cars that met the respondents' needs and the proportion of time replacement cars were provided analysed by the responses to this question.

TABLE 22 How well replacement car met needs by who chose provider

	%				
	<i>All</i>	<i>You (a)</i>	<i>Non-fault (b)</i>	<i>At-fault (c)</i>	<i>CMC (d)</i>
Far exceeded needs	11	12	10	12	12
Somewhat exceeded needs	6	4	8	5	9
Met needs	68	61	71	67	66
Fell slightly short of needs	9	16 <sub>d</sub>	8	11	6 <sub>a</sub>
Fell well short of needs	5	8 <sub>b</sub>	3 <sub>a</sub>	6	6
Don't know	0	0	0	0	1
Base (weighted)	1,191	44	464	375	161

Source: Non-fault Survey, question D14.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

TABLE 23 Length of time had access to replacement car by who chose provider

	%				
	<i>All</i>	<i>You</i>	<i>Non-fault</i>	<i>At-fault</i>	<i>CMC</i>
A longer time than needed	3	4	3	4	6
As long as needed	88	77	87	86	88
A shorter time than needed	9	18*	10	10	6*
Base (weighted)	1,178	44	459	372	161

Source: Non-fault Survey, question D14.

\*Difference is statistically significant.

## Awareness of replacement car costs

35. In our non-fault survey, we asked respondents whether they were made aware of the total hire cost of their replacement car and whether, given such cost, they would have been content with a lower-quality vehicle or having the vehicle for less time. 25% of those that received a replacement car were aware of the total cost. Of these, 41% said that they would have been content with a less good-quality replacement car and 21% said that they would have been content with having the replacement car for less time. We noted that only 21% of these respondents had said that the replacement car provided exceeded their needs and only 5% had said that they had it for longer than needed. In our working paper,<sup>4</sup> we suggested that knowledge of the actual replacement car cost might increase claimants' willingness to accept a lower-quality service. In its response to this working paper, the CHO said that the only cost that the consumer might have been aware of would have been the hire rate appearing on the face of the rental agreement with the credit hire operator and that the majority of hire claims were settled under the GTA (or bilateral agreements) at lower rates. We accepted that this made it more difficult to interpret responses to this question.

## Nature of the accident

36. There may be potential for differences in quality of replacement car services according to the severity of the accident. Table 24 presents two outcome measures for replacement cars, as indicators of difference in service quality, and analyses them by three characteristics of the accident: the severity of damage to the vehicle; whether the main damage to the vehicle was to the back of the vehicle; and whether the driver of the vehicle sustained an injury.

TABLE 24 Stated quality of the replacement cars by nature of accident

		%				
	All claims	Severity of the accident			Damage mostly to back	Personal injury
		Low (a)	Medium (b)	High (c)		
<i>Replacement car</i>						
Exceeded needs	17	16	18	18	18	17
Fell short needs	15	18 <sub>c</sub>	14	10 <sub>a</sub>	14	12
Longer time than needed	3	5 <sub>b</sub>	2 <sub>a</sub>	3	3	3
Shorter time than needed	9	3 <sub>b,c</sub>	10 <sub>a</sub>	17 <sub>a</sub>	7	18*
Average base (weighted)	1,177	417	502	254	544	356

Source: Non-fault Survey, questions B1, C2, C3.

\*Statistically different from claims where there was no injury incurred.

Note: Each subscript letter denotes a column against which the difference between findings is statistically significant.

<sup>4</sup> ToH 1: Analysis of non-fault survey in relation to overprovision.



37. The table shows that, when damage to the vehicle was low, a greater proportion of respondents (compared with the base overall) said that the replacement car provided did not meet their needs but that they had it for long enough. When damage was more severe the opposite occurred, ie more said that the vehicle met their needs but they needed it for longer than it was supplied. Where the driver had sustained an injury during the accident, a significant minority (18%) said that they did not have the replacement car for long enough.

### *Legal entitlement*

38. Table 25 shows whether the awareness of legal rights has an impact on the quality of replacement car services. The table presents the same two outcome measures analysed by the extent to which the claimant said they had been made aware of their legal rights. The results tended to be better among those who said that they had been informed of their legal rights in relation to their claim. We note that the caveat to the analysis of Table 15 in paragraph 20 applies equally to the analysis shown in Table 25.

TABLE 25 Awareness of legal rights by stated quality of replacement cars

<i>Replacement car</i>	<i>Were you made aware of your legal rights?</i>				<i>Total</i>
	<i>Yes, all</i>	<i>Yes, some</i>	<i>No</i>	<i>Don't know</i>	
	%				
Exceeded needs	23*	22	14*	17	17
Fell short needs	9*	11	19*	8	14
Longer time than needed	4	1	4	4	3
Shorter time than needed	6*	13	10*	7	9
Average base (weighted)	1,188	286	103	640	159

Source: Non-fault Survey, question D30.

\*Differences are statistically significant.

### **Other evidence**

39. We considered evidence from insurers and CMCs/CHCs in order to assess whether there were differences in the quality of replacement car services provided to non-fault drivers. We also considered the additional services provided alongside credit hire.

40. We present results for a sample of motor insurers (Admiral, Ageas, Aviva, AXA, CISGIL, DLG, esure, LV, RSA and Zurich) and CMCs (Accident Exchange, ACM, Ai Claims Solutions, ClaimFast, Crash Services, Enterprise, Helphire, Kindertons and WNS Assistance).

### *Additional services*

41. We assessed the additional services provided to non-fault drivers under credit hire, which were beyond the level of services provided to non-fault drivers under direct hire. We considered:
- (a) the impact of credit hire on replacement car provision to non-fault drivers;
  - (b) the provision of replacement cars to non-fault drivers where liability is uncertain or disputed by the at-fault insurer;
  - (c) the speed of replacement car provision by CMCs/CHCs;
  - (d) the quality of the replacement car provided by CMCs/CHCs;
  - (e) the extent of the non-fault driver's liability in relation to any damage to the replacement car; and
  - (f) additional post-accident services provided by CMCs/CHCs under credit hire, such as after-the-event insurance and uninsured loss recovery.

### *Impact of credit hire on replacement car provision to non-fault drivers*

42. The emergence of credit hire in the 1980s was in response to the limitations of the mobility provided by motor insurers to non-fault drivers following an accident.<sup>5</sup> Prior to the advent of credit hire, non-fault drivers would in principle have had the following options in respect of the provision of a replacement car:
- (a) claim under their PMI policy (provided that they had comprehensive insurance and courtesy car cover included under their basic PMI policy or they had purchased suitable cover as an add-on);
  - (b) source a replacement car themselves and claim the hire costs from the at-fault insurer as an uninsured loss;
  - (c) secure alternative mobility (ie use public transport or rely on friends and family for transportation); or
  - (d) submit a claim for loss of use to the at-fault insurer.
43. Third party capture or intervention, the process whereby the at-fault insurer captures and manages the non-fault driver's claim, did not take place prior to the introduction of credit hire. Instead, the motor insurers in our sample told us

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<sup>5</sup> See Appendix 2.2.

that third party capture was in direct response to the increased non-fault mobility costs incurred by them (as the at-fault insurer) following the introduction of credit hire. By controlling the claim, the motor insurer is able to minimise hire costs by placing the non-fault driver in a direct hire replacement vehicle (secured at significantly lower rates than under a credit hire agreement).

44. The CHCs in our sample told us that motor insurers minimised costs by providing a lower quality of replacement car under direct hire than they provided under credit hire. However, in response, esure told us that if an at-fault insurer underprovided replacement car services to a captured non-fault driver, there was a risk that the driver would accept the services of a CHC, thus increasing the hire costs incurred by the driver and payable by the at-fault insurer.

*Replacement car provision where liability is uncertain or disputed by the at-fault insurer*

45. CHCs do not require upfront payment of their hire charges, which are recovered from the at-fault insurer, thus effectively providing non-fault drivers with risk-free mobility.<sup>6</sup> This may be of particular importance where liability is uncertain or disputed by the at-fault insurer, because under this scenario, it is unlikely that the at-fault insurer will capture the non-fault driver and meet their mobility until liability has been formally settled.<sup>7</sup>

*Determination of liability*

46. Liability is only formally settled following an admission of liability from the at-fault insurer, which can take considerable time to achieve. For example:
  - (a) Ai Claims Solutions told us that on average liability was admitted by the at-fault insurer within seven days of the accident in 50 to 60% of its claims and within 60 days of the accident in 80 to 90% of its claims. 5% of claims took up to a year to admit admission and 5% of claims usually remained disputed.
  - (b) ClaimFast told us that a straightforward claim (ie where there was no dispute between the at-fault insurer and the CMC/CHC over the liability for the accident) could settle with an efficient insurer on average within two to four months of FNOL. Where liability is disputed and it is likely that

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<sup>6</sup> Under the terms of a credit hire agreement, the driver is ultimately liable for the costs of the provision of replacement car services should the CHC be unable to recover the costs from the at-fault insurer. However, the CHCs in our sample told us that they rarely sought to recover costs from drivers.

<sup>7</sup> We found that, at FNOL, car 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 car insurers in our sample suggested that the categorisation of a driver as non-fault changed following FNOL in between 2 and 12% of cases.

litigation will be inevitable, this can extend timescales by three to twelve months (depending on the capacity of the courts and the complexity of the claim). This is illustrated by the information provided by Kindertons, where a greater proportion of straightforward cases were settled within 48 hours and seven days of FNOL (see Table 26 below).

TABLE 26 Kindertons liability settlement, 2012

Type of case	%	
	<i>Cases where liability was settled within 48 hours of FNOL</i>	<i>Cases where liability was settled within 7 days of FNOL</i>
Grade A (straightforward)	13.49	33.68
Grade B (uncertain)	11.12	29.06
All cases	12.47	31.71

Source: Kindertons.

(c) Table 27 shows that Helphire managed to settle liability within 90 days of FNOL [X].

TABLE 27 Helphire liability settlement, 2012

<i>Period between FNOL and case closure</i>	<i>Proportion of cases closed %</i>	<i>Average duration of settlement (days)</i>
[X]	[X]	[X]

Source: Helphire.

47. The CHCs in our sample told us that the presence of credit hire caused liability to be resolved more often and more quickly. Given that CHCs provide replacement car services on deferred payment terms, a prompt and accurate assessment of liability is essential to reducing the risk of non-recovery or only partial recovery of the cost incurred in the provision of these services from the at-fault insurer.<sup>8</sup> For example, Accident Exchange told us that it sought to confirm liability within one working day of being contacted by a non-fault driver.
48. The motor insurers in our sample told us that the presence of credit hire had no impact upon the settlement of liability, because:
- (a) The speed of the assessment of liability was very much dependent upon the nature of the accident rather than the presence of CMCs/CHCs. Admiral told us that liability could be assessed promptly where the

<sup>8</sup> Under the terms of a credit hire agreement, the non-fault driver is ultimately liable for the costs incurred by the CHC should the CHC be unable to recover the costs from the at-fault insurer. However, the CHCs in our sample told us that they rarely sought to recover costs from non-fault drivers.

accident circumstances were straightforward or where it was able to verify events with all parties concerned and any independent witnesses.

(b) CHCs typically provided mobility to non-fault drivers where liability was not disputed, in order to ensure that they had reasonable prospects of the recovery of the cost incurred in providing a temporary replacement vehicle under credit hire from the at-fault insurer. Admiral told us that although CHCs were increasingly taking on more disputed claims, the majority of the claims they accepted were clear non-fault cases or those that had reasonable prospects of recovery.

49. The motor insurers also told us that they were incentivised to settle liability promptly, in order to progress a non-fault claim to settlement and minimise the credit hire costs incurred. For example, CISGIL told us that motor insurers might admit liability (even where liability was uncertain or split), in order to mitigate or end the indefinite accrual of costs by CMCs/CHCs, which they were otherwise unable to control. Further, the application of GTA late payment penalties was punitive, which encouraged early resolution of claims.<sup>9</sup>
50. The CMCs/CHCs in our sample also told us that the presence of a bilateral agreement covering replacement car provision between the at-fault insurer and non-fault insurer negatively impacted upon the determination of liability. However, the motor insurers in our sample who had such bilateral agreements in place ([REDACTED], [REDACTED], [REDACTED], [REDACTED] and [REDACTED]) told us that the agreements applied only when liability had been settled and one party was deemed to be at fault and therefore liable for the costs of hire.
51. Testing the contrasting views of CHCs and insurers was not straightforward. Most insurers do not record the time needed for the resolution of liability; and CHCs only hold data for the claims in which they were involved. Moreover, it would not be informative to compare the claims in which CHCs provided a replacement vehicle with those in which they were not involved. Since CHCs have to minimise the risk of non-recovery, they tend to accept relatively more clear-cut cases, in which the determination of liability is less problematic. Therefore, we would expect the cases where a CHC is involved to show a lower proportion of split liability settlements and a quicker resolution of liability. The difference in such cases, though, cannot be attributed to the presence of the CHC.

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<sup>9</sup> The GTA's guidelines specify that payment in settlement of a credit hire or credit repair claim should be made within 30 days of the dispatch of the claim to the at-fault insurer. If payment is late, the outstanding amount incurs a late payment penalty at both 30 and 60 days. Under the terms of the GTA, a CHC is entitled to progress settlement outside of the GTA (eg through litigation) if a claim has not been settled after 90 days from the dispatch of the claim to the at-fault insurer.

52. More interesting results can be obtained when comparing claims in which CHCs may decide to intervene with those for which this possibility is absent. The latter is the case when the insurers involved in a claim have signed a bilateral agreement for the provision of replacement vehicles. In this case, the non-fault insurer does not refer the claimant to a CHC, but directly provides the vehicle through direct hire. By comparing claims in which bilaterals are applicable with those in which they do not apply, we sought to observe the differences in the frequency and timing of the resolution of liability due to the presence of the CHC.
53. We asked each of the ten insurers in our sample to provide information on all their claims with more than one vehicle involved, divided into three categories:
- (a) claims in which all vehicles were insured by them;
  - (b) claims involving another insurer, but not where they had a bilateral agreement with the other insurer; and
  - (c) claims involving one of the insurers with which they had a bilateral agreement for the provision of replacement vehicles to non-fault claimants.
54. Insurers were asked their total number of claims for each category and their corresponding number of claims which resulted in split liability. The comparison between categories (b) and (c) would show the impact of the presence of CHCs on the frequency of resolution of liability.
55. The figures for the [REDACTED] insurers in our sample which have bilateral agreements are shown in Table 28. The percentage of cases with split liability is similar under categories (b) and (c) and even slightly lower in the case of bilateral agreements. In other words, the presence of CHCs does not seem to have any impact on the frequency of resolution of liability.

TABLE 28 Percentage of split liability in the 'same insurer, 'no bilateral' and 'bilateral' scenarios'

	%		
	<i>Same insurer</i>	<i>No bilateral</i>	<i>Bilateral</i>
[REDACTED] Weighted average	[REDACTED] 13.76	[REDACTED] 15.66	[REDACTED] 13.63

Source: Insurers.

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Note: Aviva's data is relative to liability assessment at FNOL.

56. One party observed that the comparison should be based on liability assessments at FNOL, not on final assessments, because only the former are relevant when it must be decided whether to provide a replacement vehicle to the claimant. We have not been able to collect this information for a sufficiently wide sample of insurers. However, we have also compared the frequency of

replacement vehicle provision (see paragraph 75) and we have not found evidence of widespread underprovision in the presence of bilateral agreements.

57. With regard to the speed of resolution of liability, only one insurer ([REDACTED]) was able to provide data on the timing of liability determination. [REDACTED] average length of liability determination was lower under bilateral agreements. While this observation needs to be treated with caution, we saw no evidence to suggest a higher speed of liability resolution where there is no bilateral agreement in place.

#### *Replacement car provision*

58. There is some variation among the CHCs in our sample in relation to replacement car provision where liability is uncertain or disputed by the at-fault insurer:

(a) Four of the nine CHCs in our sample ([REDACTED]) provide replacement cars to non-fault drivers when liability is uncertain or disputed by the at-fault insurer. For example:

- (i) [REDACTED] told us that in complicated accident circumstances, it performed further investigations following FNOL, including calling the at-fault driver, calling the at-fault insurer, calling any independent witnesses, speaking to local shops and councils in relation to the availability of any relevant closed-circuit television footage, and liaising with the police (if necessary). In some cases, it might also engage its in-house investigation team to obtain a report to verify the accident circumstances. In some cases where a customer's car was not drivable as a result of the accident, [REDACTED] might make an initial assessment of liability and provide hire on that basis, but then undertake investigations to verify that initial assessment. In the rare cases where it subsequently changed its initial assessment, it might terminate the hire, but did not pursue either the customer or the at-fault insurer for the costs of hire incurred up to that point.
- (ii) [REDACTED] told us that it attempted to seek an admission of liability from the at-fault insurer prior to providing a replacement car to a non-fault driver, although this was not always possible (eg due to an accident not being reported to the at-fault insurer or the at-fault insurer still investigating the accident circumstances). Where the driver's car was not roadworthy, it might provide hire without an admission of liability from the at-fault insurer. [REDACTED] on average commenced hire without

receiving an admission of liability from the at-fault insurer in around 25% of cases.

(iii) [REDACTED] told us that it routinely provided a replacement car where liability was unclear or disputed. If the non-fault driver's car was not road-worthy (and therefore they required immediate access to a replacement vehicle), [REDACTED] might provide a replacement car on credit for up to seven days at no charge while it tried to establish liability. If the driver was later deemed to be at fault, [REDACTED] did not seek to recover the costs of hire from the driver. [REDACTED] told us that in 2012 only 12% of its claims had liability admitted within 48 hours of FNOL and 32% of its claims within seven days of FNOL. For Grade B cases (ie where liability was uncertain), [REDACTED] provided a replacement car on average within two days of FNOL, despite not receiving an admission of liability from the at-fault insurer on average until 25 days from FNOL.

(b) The remaining five CHCs in our sample ([REDACTED]<sup>10</sup>) appeared less likely to provide replacement cars where liability was uncertain. Rather, for these firms, a replacement car is provided once liability has been established or the CHC is confident that the driver is not at fault for the accident. For example:

(i) [REDACTED] told us that it would not provide its services if, in its opinion, liability could not be assessed. Where liability could not be assessed at first contact due to incomplete information, it would carry out further investigations at its own expense. Customers were not placed into replacement cars whilst this additional investigation was performed.

(ii) [REDACTED] told us that [REDACTED].

### *Speed of replacement car provision*

59. The CHCs in our sample told us that they were usually able to provide non-fault drivers with a replacement car under credit hire within 1 to 4 hours of receipt of the mobility request (in line with their contractual stipulations).<sup>11</sup>

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<sup>10</sup> [REDACTED] told us that where the information captured during FNOL supported a decision to apportion primary liability with the third party insurer, it referred the customer to its outsourced service provider who would assess the customer's eligibility to receive a credit hire vehicle.

<sup>11</sup> This applies to non-fault claims where the non-fault driver's car is not roadworthy (where the non-fault driver's car is roadworthy, delivery of the replacement car takes place upon commencement of the repair of the driver's car) and where liability has been established or the CHC is confident that it will be able to recover its costs from the at-fault insurer upon completion of the hire period and submission of the invoice to the at-fault insurer.



60. However, as many CHCs provide replacement cars under both credit hire and direct hire terms and some motor insurers use the same CHC for both types of hire provision, an at-fault insurer (through its contracted direct hire provider) is also able to provide a replacement car to a captured non-fault driver promptly following the capture of the claim. For example, Admiral told us that its service levels with its direct hire providers were designed to ensure that the providers did not prioritise credit hire instructions over and above direct hire instructions and that they were given equal merit in terms of speed of provision. Where there was an immediate request and requirement for hire, Admiral expected its providers to meet the contractual obligation of provision within 4 hours of instruction.

#### *Replacement car quality*

61. The CHCs in our sample told us that they were more likely to provide non-fault drivers with a replacement car that met their legal entitlement (ie a broadly equivalent replacement car subject to the non-fault driver's duty to mitigate their loss with consideration to their need) than an at-fault insurer, who, as the payer of the replacement car services, is incentivised to minimise the cost of those services.

#### *Replacement car upgrades*

62. In practice, a non-fault driver is usually provided with a like-for-like replacement car for as long as is reasonably necessary, subject to their duty to mitigate their loss with consideration to their need.
63. Sometimes non-fault drivers receive a replacement car of a higher class than their own car (ie an upgrade) at no extra cost due to the unavailability of a like-for-like replacement car. In these cases, the CHC recovers from the at-fault insurer only the hire charges applicable to the class of the customer's own car. Table 29 shows the proportion of replacement car upgrades provided by the nine CHCs in our sample to their credit hire and direct hire customers in 2012.

TABLE 29 Provision of replacement car upgrades, 2012

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

Source: CMCs/CHCs.

\*The direct hire data may include fault claims.

†[REDACTED]

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

§[REDACTED]

64. Table 29 shows that between [REDACTED] and [REDACTED]% of credit hire customers were provided with upgrades (at an average of 17%) compared with between [REDACTED] and [REDACTED]% of direct hire customers (at an average of 10%). However, for two of the three CHCs in our sample where figures were provided for both credit hire and direct hire ([REDACTED] and [REDACTED]), there was a greater proportion of upgrades for direct hire customers than credit hire customers, suggesting that there are no clear conclusions from this evidence. Given that upgrades are the result of operational issues and do not increase the bill to the at-fault insurer, we have not analysed this practice further.

*Review of motor insurer and CHC electronic call records*

65. We reviewed a sample of electronic call records provided by the ten motor insurers and the nine CHCs in our sample, in order to assess whether there was any evidence of differences in:

- (a) the type of replacement car provided to the driver by a non-fault insurer or CHC and an at-fault insurer; and/or
- (b) the assessment of the driver’s need for that type of car,

and therefore, any indication that insurers or CHCs provide non-fault drivers with replacement car services that exceed the services to which they are legally entitled.

66. We were aware that these call records reflected only one interaction between the claimant and the provider and there may have been other interactions.<sup>12</sup>
- *Claims managed by non-fault insurer or CHC*
67. We reviewed 56 electronic call records where the non-fault claim was managed by the non-fault insurer or a CHC:
- (a) In 51 of the 56 records, the replacement car was provided under a credit hire agreement.
  - (b) In 4 of the 56 records, the replacement car was provided under a direct hire agreement, as the non-fault claim was subject to a bilateral agreement between the at-fault insurer and non-fault insurer.<sup>13</sup>
  - (c) In 1 of the 56 records, the driver received a courtesy car rather than a credit hire replacement car, as the non-fault insurer concerned does not refer its drivers who are not at fault to CHCs for the provision of replacement cars under a credit hire agreement.
68. In 19 of the 56 records, we were unable to compare the replacement car provided to the driver with the car requiring repair, in order to assess whether the replacement car was a like-for-like or a lower-class replacement, because the claims handler did not discuss the type of replacement car that was later provided to the driver (18 records) or the driver's car was not disclosed during the call (one record).
69. We were able to ascertain the type of replacement car provided to the driver in the remaining 37 records:
- (a) In 34 of the 37 records (92% of the sample), the driver was provided with a like-for-like replacement car. In 26 of the 34 records (76%), the claims handler did not appear to assess whether the driver required a like-for-like replacement car or whether a replacement car of a lower class would

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<sup>12</sup> The electronic call records provided by the ten motor insurers and the nine CHCs in our samples enabled us to assess the type of replacement car provided to the driver, but not the driver's need for a replacement car or the driver's need for a replacement car on credit. We note that an assessment of the driver's need for a replacement car might have been carried out at a later stage in the process. Also, by focusing only on records where a replacement car was provided, we have not captured those cases where there was an assessment of the driver's need, which resulted in a replacement car not being provided. Under the terms of a credit hire agreement, the driver is ultimately liable for the costs of the provision of replacement car services should the non-fault insurer or CHC be unable to recover the costs from the at-fault insurer. However, the CHCs told us that they rarely sought to recover costs from drivers who were not at fault. We do not consider credit further in this section.

<sup>13</sup> A low proportion of claims were subject to a bilateral agreement between the at-fault insurer and non-fault insurer. We note that the insurers concerned notified us that these claims were subject to a bilateral agreement (and therefore the replacement car was provided under a direct hire agreement) and this was not disclosed in the calls.

have met their needs. In the remaining eight records (24%), the driver demonstrated a genuine need for a like-for-like replacement car.

- (b) In 3 of the 37 records (8%), the driver was provided with a replacement car of a lower class than their own car. In these cases, the driver appeared to accept that a lower class of replacement car was sufficient for their needs.

- *Claims managed by at-fault insurer*

70. We reviewed 44 electronic call records where the driver who was not at fault was captured by the at-fault insurer, which subsequently provided a replacement car to the driver:
- (a) In 35 of the 44 records, the replacement car was provided under a direct hire agreement.
  - (b) In 9 of the 44 records, the driver received a courtesy car rather than a direct hire replacement car.<sup>14</sup>
71. In 11 of the 44 records, we were unable to compare the replacement car provided to the driver with the car requiring repair, in order to assess whether the replacement car was a like-for-like or a lower-class replacement, because the claims handler did not discuss the type of replacement car that was later provided to the driver (eight records) or the driver's car was not disclosed during the call (three records).
72. We were able to ascertain the type of replacement car provided to the driver in the remaining 33 records:
- (a) In 23 of the 33 records (70%), the driver was provided with a like-for-like replacement car or courtesy car. In 19 of these 23 records (83%), the claims handler did not appear to assess whether the driver required a like-for-like replacement car or whether a replacement car of a lower class would have met their needs. We note that, although an at-fault insurer has the incentive to minimise the cost of the replacement car provided to a captured driver who was not at fault, if it offers a poor quality of service, the driver may reject their services and accept the services of a CHC, which is likely to be more expensive for the at-fault insurer (due to higher daily rates and, possibly, a longer hire duration). In 3 of the 23 records

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<sup>14</sup> Only two insurers ([REDACTED]) in the sample of electronic call records reviewed engaged in the practice of providing a courtesy car through their approved repairer network rather than a direct hire replacement car to captured non-fault drivers.

(13%), the driver demonstrated a genuine need for a like-for-like replacement car. In 1 of the 23 records (4%), where the driver was provided with a courtesy car, the driver's own car was equivalent to the standard Class A courtesy car typically provided by an insurer's approved repairer network.

(b) In 10 of the 33 records (30%), the driver was provided with a replacement car or a courtesy car of a lower class than their own car. In these cases, the driver appeared to accept that a lower class of replacement car was sufficient for their needs.

*Bilateral agreements*

73. The CMCs/CHCs in our sample also told us that bilateral agreements covering replacement car provision between insurers might suppress consumer entitlement, as they sought to control costs by, among other things, attempting to influence the type of replacement car provided to the non-fault driver. However, the motor insurers in our sample which have such bilateral agreements in place ([redacted], [redacted], [redacted], [redacted] and [redacted]) told us that the agreements ensured that the replacement car was provided in line with the non-fault driver's legal entitlement. For example:

(a) [redacted] told us that that its bilateral agreements contained provisions in relation to the type of replacement car to be provided, such as 'it is agreed that non-fault drivers will be offered a vehicle, subject to need, up to a class which is equivalent to their own vehicle (blanket provision on a like-for-like basis is not anticipated as there is a duty to mitigate loss wherever possible)'. [redacted] told us that, in practice, the needs were established with the customer and the right size car was provided.

(b) [redacted]

(c) [redacted] told us that [redacted] its mobility bilateral agreements, [redacted] (see Table 30).  
[redacted]

TABLE 30 [redacted] replacement car provision in mobility bilateral agreements

<i>Driver vehicle class*</i>	<i>Minimum offer</i>	<i>Maximum offer</i>
[redacted]	[redacted]	[redacted]

Source: [redacted].

\*These are the vehicle groups specified by [redacted].

(d) [redacted] told us that its [redacted] bilateral agreements included obligations to ensure that any loss was mitigated and provided that a vehicle would be

offered ‘subject to need, up to a class which is equivalent to [the driver’s] own vehicle’. [REDACTED] agreements also included [REDACTED].

(e) [REDACTED].

74. We considered two ways in which the quality of service could be reduced through bilateral agreements (in addition to settling a larger proportion of claims with split liability, which we had already dismissed (see paragraphs 51 to 55)):

(a) providing replacement vehicles to a smaller proportion of non-fault claimants; and

(b) providing replacement vehicles of a lower category or with an inferior service.

75. Table 31 shows the proportion of non-fault claimants receiving a replacement vehicle (excluding courtesy cars) in the three categories of claims described in paragraph 53: ‘same insurer’, ‘no bilateral’, and ‘bilateral’.

TABLE 31 Provision of replacement vehicles in the ‘same insurer’, ‘no bilateral’ and ‘bilateral’ scenarios

	%		
	<i>Same insurer</i>	<i>No bilateral</i>	<i>Bilateral</i>
[REDACTED] Weighted average	[REDACTED] 51.85	[REDACTED] 49.65	[REDACTED] 55.04

Source: Insurers.

[REDACTED]

76. This evidence was difficult to interpret. It appeared to us that, for some insurers ([REDACTED]), the proportion of non-fault claimants provided with a replacement vehicle was significantly lower under bilateral agreements than for other claims. Other insurers, however, showed different patterns, with a small difference for [REDACTED], and a higher provision rate under bilaterals for [REDACTED].<sup>15</sup>

77. It appeared to us that, individually, insurers do not have an incentive to underprovide in the service they give their non-fault claimants. In arranging a replacement vehicle, they are providing a service to their own customer, while recovering the cost to the at-fault insurer. On the other hand, if both parties to a bilateral reach an implicit understanding to reduce provision, they can both gain through lower costs.<sup>16</sup>

<sup>15</sup> One CHC rightly observed that we should also compare the timing of provision. However, we were not able to collect this data in a form which enabled a reliable analysis.

<sup>16</sup> Such an implicit understanding may be easier to reach between insurers of a similar size, which can get similar cost benefits from the other insurer’s underprovision. On the other hand, a large insurer might be more reluctant

78. [X] told us that its higher provision of replacement cars under its bilateral agreements was driven by the following factors: [X].
79. Overall, we found that much of the evidence in relation to quality was unclear regarding the provision of replacement vehicles under bilaterals compared with when no bilateral agreement was in place.
80. We did not find evidence that the vehicles provided under bilaterals were of a lower category than that to which non-fault claimants were legally entitled, nor that the service they received was generally worse than their entitlement.

*Non-fault driver liability for damage to the replacement car*

81. Non-fault drivers are provided with a comprehensively insured replacement car under both credit hire and direct hire. The excess typically matches the excess on the driver's motor insurance policy.<sup>17</sup> A CHC might provide claimants with an additional collision damage waiver, which reduces the excess payable to nil, or this may be offered to the customer for an additional charge (which is not then recovered from the at-fault insurer).
82. Table 32 outlines the excess applied by the nine CHCs in our sample to the replacement car under credit hire and direct hire:
  - (a) [X] provides all of its credit hire customers with a collision damage waiver, which reduces the amount payable as a result of theft or damage to the replacement car to nil. In contrast, its direct hire customers would be liable for the excess under similar circumstances.
  - (b) [X] provide their credit hire and direct hire customers with the same excess and collision damage waiver entitlement.
  - (c) The collision damage waiver entitlement provided by [X] to its direct hire customers depends on its agreement with the referring insurer. Whether the excess is higher or lower than a customer would receive from [X] under credit hire depends both on [X] contractual agreement with the insurer and on the level of excess in the customer's own insurance (since this determines the level of excess when [X] provides credit hire).
  - (d) [X] outsources the provision of direct hire vehicles, so a comparison of credit hire and direct hire excess and collision damage waiver entitlement

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to reach such an understanding with a much smaller competitor, as the smaller insurer has more to gain from the agreement.

<sup>17</sup> Under clause 5.3 of the GTA, the credit hire daily hire rate includes full liability, theft and damage insurance subject to a £50 excess, unless the customer has a third party, fire and theft policy or their PMI policy excess exceeds this figure, when a higher excess can apply but with no compulsory additional charge to the customer.

is not possible. However, the entitlement under credit hire is similar to what other companies provide under direct hire.

- (e) [X] do not provide replacement cars under direct hire, and therefore no comparison was possible. We noted, however, that the excess was lower than provided by other companies to direct hire customers.

TABLE 32 Replacement car excess

CMC/CHC	Credit hire		Direct hire	
	Excess	Additional collision damage waiver	Excess	Additional collision damage waiver
Accident Exchange	[X]	[X]	[X]	[X]
Ai Claims Solutions	[X]	[X]	[X]	[X]
ACM	[X]	[X]	[X]	[X]
ClaimFast	[X]	[X]	[X]	[X]
Crash Services	[X]	[X]	[X]	[X]
Enterprise	[X]	[X]	[X]	[X]
Helphire	[X]	[X]	[X]	[X]
Kindertons	[X]	[X]	[X]	[X]
WNS Assistance	[X]	[X]	[X]	[X]

Source: CHCs.

[X] outsources the provision of vehicles under direct hire. The excess figures represent the average excesses provided by the external provider. Although [X] does not directly offer collision damage waiver to direct hire claimants, the external vehicle provider might do so.

83. Overall, it appeared to us that, on average, claimants received a higher value product under credit hire than under direct hire. This was clearly the case for [X] customers, who are provided with zero excess. In 2012, these [X] companies accounted for around 13% of the credit hires among the CHCs our sample. However, once we exclude these [X] CHCs, our data suggests that, on average, credit hire customers are not provided with systematically lower excesses than direct hire customers. We compared the excesses provided by Enterprise to claimants captured by ten large insurers, with the excesses provided by the remaining CHCs in our sample. If we assume that, among all PMI policies, the average excess is higher than £155, which seems a reasonable assumption, then the average excess provided under direct hire is not higher than under credit hire.
84. We approximated the cost direct hire customers would incur in compensating for this quality difference by multiplying the average number of credit hire claims in which a zero excess is provided (13% of the 301,000 overall claims) by the average rate at which such a cover is sold by CHCs and direct hire providers (£40 per hire). The result is approximately £1.6 million (£5.25 per claim). We take this into account in our comparison of the cost of credit hire and direct hire and in our detriment calculations (see Appendix 6.6).



*Additional post-accident services provided under credit hire*

85. In addition to the provision of a replacement car, a number of the CMCs/CHCs in our sample provide additional post-accident services to non-fault drivers under credit hire at no extra cost to the driver, such as after-the-event insurance and uninsured loss recovery.<sup>18</sup>

*After-the-event insurance*

86. 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 are required to pursue the driver for the settlement of the claim.
87. Four of the nine CMCs/CHCs in our sample ([redacted]) told us that they provided their credit hire customers with after-the-event insurance:
- (a) [redacted] told us that its after-the-event insurance covered the costs of hire, repair and legal expenses. The premium cost to it was £[redacted] plus insurance premium tax per policy.
  - (b) [redacted] told us that the underlying cost of this service was around £[redacted] per hire.
  - (c) [redacted]
88. We understand that, irrespective of whether a non-fault driver takes out after-the-event insurance, it is very rare for a CHC to pursue a driver for settlement of the costs of credit hire where the CHC cannot recover the costs from the at-fault insurer.<sup>19</sup> However, the driver may be liable for the costs incurred by the providers of any other post-accident services that they require.
89. We note that 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 the non-fault driver.

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<sup>18</sup> The provision of these services may be part of a claimant's legal entitlement under tort law, depending on the circumstances of the claim.

<sup>19</sup> A CHC typically only pursues a driver for settlement of the costs of credit hire in relation to fraudulent claims and claims where there is a change in the initial assessment of liability (ie from non-fault to at-fault).

### *Uninsured loss recovery*

90. Under this service, the CMC/CHC pursues on behalf of the non-fault driver any uninsured losses which they might have suffered, such as:
- (a) payment of their PMI policy excess;
  - (b) loss of earnings (eg if the customer could not work as a result of the accident);
  - (c) loss of personal effects (if any items were damaged in the accident);
  - (d) vehicle recovery charges (if incurred);
  - (e) vehicle storage charges (if incurred); and/or
  - (f) loss of value to their vehicle (ie a diminution claim).
91. The effects of the provision of uninsured loss recovery (ULR) services by CMCs/CHCs depend on whether the client has purchased MLEI, which assists policyholders with pursuing their legal rights to recover uninsured losses:
- If the client has purchased MLEI, the provision of ULR services by CMCs/CHCs results in a benefit to the MLEI provider which otherwise would have to provide ULR services to the claimant. Given competition between CMCs/CHCs to obtain referrals from non-fault insurers, this would most likely be reflected in CMCs/CHCs paying a lower referral fee than they would pay if they did not provide ULR services.<sup>20</sup>
  - If the client does not have MLEI, the client receives a benefit which is the opportunity cost of the time spent recovering the loss from the at-fault insurer.<sup>21</sup>
92. In the first case (benefit to the MLEI provider), the quantum of the benefit would be the average cost to CMCs/CHCs of providing the ULR service to each client times the number of CMC/CHC clients who both receive ULR

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<sup>20</sup> If the MLEI provider is different from the non-fault insurer receiving the referral fee from the CMC/CHC, the MLEI provider would also pay a bigger fee to the non-fault insurer which would offset the lower referral fee received by the non-fault insurer from the CMC/CHC.

<sup>21</sup> Since our benchmark assumes that claimants receive their legal entitlement, and given that claimants are entitled to recover uninsured losses, the relevant benefit is the opportunity cost even if, in the absence of CMCs/CHCs, the claimant would not try to recover the losses.

services and have MLEI. This would also be the impact on our detriment calculation.<sup>22</sup>

93. In the second case (benefit to the client), the client receives a benefit equal to the opportunity cost of recovering the loss from the at-fault insurer. The quantum of the impact on our detriment would be the average opportunity cost of attempting to recover the loss times the number of CHC clients who receive ULR services but do not have MLEI.
94. Table 33 shows the data on ULR services we have received from six CHCs. Two of them (Crash Services and Enterprise) do not offer these services. Among the other four (Accident Exchange, ClaimFast, Helphire and Kindertons), the number of claims in which ULR services are provided varies significantly. Kindertons appears to be the only CMC/CHC providing ULR as a service to its referring insurers and brokers even in the absence of a credit hire claim (in 2012 there were [redacted] such claims).

TABLE 33 Number and cost of ULR claims in 2012

	Number of ULR claims	Average cost per claim £	Total number of hires
Accident Exchange	[redacted]*	[redacted]	[redacted]
ClaimFast	[redacted]	[redacted]	[redacted]
Crash Services	[redacted]		[redacted]
Enterprise	[redacted]		[redacted]
Helphire	[redacted]†	[redacted]‡	[redacted]
Kindertons	[redacted]§	¶	[redacted]
Total in our sample	Between 6,286 & 9,944		246,604
Total in the market			300,970

Source: CMCs/CHCs.

\*[redacted]

†In the case of Helphire, we have excluded all the claims in which the customer was covered by a before-the-event policy arranged through Albany Assistance, as they do not constitute a service to the insurers or brokers referring for credit hire.

‡The cost is an average for all claims, including those in which the customer is covered by a before-the-event policy. The service provided to these customers is better and, presumably, more costly. The average cost for the other claims is likely to be lower.

§Kindertons does not record separately the recovery of repair costs and pre-accident value for the cases in which credit repair is provided and for the cases in which the customer arranges the repair independently and asks Kindertons to recover the costs. Only the second category of claims is relevant for our calculation. [redacted]

¶[redacted]

95. The uncertainties on the number of relevant claims and on the incremental cost of ULR services make it difficult to compute an accurate estimate of their total cost. We have adopted a conservative approach, taking the higher number of claims (9,944) and assuming an average cost of £40 per claim.

<sup>22</sup> The provision of ULR by CMCs/CHCs results in referral fees being understated compared with what they would be if referral fees and ULR services were charged separately. The understatement of referral fees leads to the net detriment being overstated; hence the required adjustment to remove the overstatement of the net detriment is equal to the understatement of referral fees.

The estimated total number of ULR claims for the entire credit hire market is therefore 12,136,<sup>23</sup> implying a total cost of approximately £485,000.

96. We do not have information on the opportunity cost to claimants without MLEI of claiming uninsured losses themselves, but it seems to us the average opportunity cost is unlikely to exceed £40 per ULR claim.<sup>24</sup>
97. On this basis, the impact of CMCs/CHCs' ULR recovery is to reduce the detriment from the separation by no more than £485,000. Dividing this amount by the total number of credit hires, we get an average cost per hire of £1.61.<sup>25</sup>

#### *Other aspects of quality relating to replacement car services*

98. The ten motor insurers in our sample told us that they monitored the quality of the replacement car services provided to their customers by their credit hire and direct hire providers by:
  - (a) monitoring customer complaints;
  - (b) reviewing performance against contracts or service level agreements;
  - (c) performing audits of the customer experience; and/or
  - (d) meeting regularly with providers to review performance.
99. For example, DLG told us that its direct hire and credit hire provider, [X], must meet clear service standards, including in relation to quality and safety requirements and detailed performance measures and targets. DLG said that it monitored [X] performance against these service levels and against customer metrics (eg satisfaction and complaint rates). They also had regular service reviews.
100. Table 34 presents customer complaint data for the ten motor insurers and nine CHCs in our samples, relating to direct hire and credit hire. The table shows that there is no significant variation in the level of customer complaints received by the ten motor insurers and nine CHCs in our samples in relation to credit hire and direct hire services, which suggests that there is no significant difference in customers' perceptions of these services. However, we noted that this evidence was limited, as the majority of the parties do not

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<sup>23</sup> 9,944\*(total number of hires in the market)/(total number of hires in the sample).

<sup>24</sup> We took into account that the opportunity cost involved would essentially be that of contacting the at-fault insurer and requesting return of the excess (ie CHCs do not pay for legal assistance for claimants without MLEI to recover their excess). Those most daunted by this process, and hence likely to have the highest opportunity cost, would be those for whom MLEI was most attractive. In this context, we considered it relevant that take-up of MLEI was high (about 76% in 2012 – see Table 7.2).

<sup>25</sup> Since coverage of MLEI is high (see previous footnote), we do this by increasing the referral fee.

record complaints relating to credit hire and direct hire separately and instead capture complaints data for all replacement cars provided, including courtesy cars.

TABLE 34 Credit hire and direct hire customer complaints, 2012

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

Source: Motor insurers and CMCs/CHCs.

\*The direct hire data may include fault claims.

†[REDACTED]

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

§Crash Services does not provide direct hire services.

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

## Presentation of the survey results

1. In this annex we present some of the principal survey results split by the organisation mostly responsible for managing the respondent's claim. For both repair and replacement cars we considered the following situations:
  - (a) non-fault insurer and at-fault insurer the same;
  - (b) captured claims;
  - (c) bilateral agreement between the non-fault and at-fault insurer;
  - (d) non-fault insurer handled the claim;
  - (e) CMC appointed by the non-fault insurer, the respondent or someone else (eg the garage the vehicle first went to, the other driver, a legal/solicitors firm);
  - (f) other organisation handled the claim; and
  - (g) don't know.
2. For claims dealt with under bilateral agreements, we considered separately the provision of repairs and the provision of replacement cars due to the different types of bilateral agreements in place between insurers.
3. In the tables in this annex, we use the following shorthand to refer to these seven groups (respectively): at-fault = non-fault, at-fault, bilateral, non-fault, CMC, other and don't know.<sup>1</sup>
4. Table 1 shows the proportion of claims by who handled the claim. Around 40% of all claims were handled by the driver's own insurer and in 30% of cases the claim was captured by the at-fault insurer. In 13% of claims a CMC was appointed by the respondent, the non-fault insurer or another organisation (different from the at-fault insurer) to manage the claim. In 6% of claims the non-fault driver and at-fault driver were insured by the same company. 5% of claims were handled under a bilateral agreement for repairs and 10% were handled under a bilateral agreement for replacement cars.

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<sup>1</sup> If a respondent's claim was mostly handled by their own insurer (non-fault) but that insurer had a bilateral agreement with the other driver's insurer, the claim would be coded to the bilateral category.

TABLE 1 Analysis variables for main organisation handling the claim

	%	
	<i>Repairs</i>	<i>Replacement cars</i>
Non-fault insurer handled the claim*	41	37
Claim captured by at-fault insurer†	30	30
CMC handled the claim‡	13	13
Non-fault and at-fault insurer the same	6	6
Bilateral agreement in place	5	10
Other	4	3
Don't know	1	1
Base (weighted)	1,500	1,500

Source: Non-fault Survey, questions A16, A17 and additional information on bilateral agreements.

\*Includes claims managed by the non-fault insurer and claims managed by other organisations (eg legal solicitors) where these were appointed by the non-fault insurer. It excludes claims managed by CMCs and claims where bilateral agreements were in place or claims where the non-fault and at-fault insurer were the same.

†Includes claims managed by the at-fault insurer and claims managed by CMCs, repairers, dealerships and other companies where these were appointed by the at-fault insurer. It excludes claims where the non-fault and at-fault insurer were the same.

‡Includes claims managed by CMCs where these were appointed by the non-fault insurer, the respondents or someone else (eg the garage the vehicle first went to, the other driver, a legal/solicitor firm).

5. Table 2 shows that the organisation which first has contact with the claimant is most likely to handle the claim. Most drivers (68%) made first contact with their own insurer and, in these cases, the non-fault insurer went on to manage the claim in half of the cases. Of the 11% of cases where first contact was with the at-fault insurer, this insurer went on to handle 80% of cases.

TABLE 2 First contact analysed by who managed the claim

	%		
	<i>First contact</i>		
<i>Main claim handler</i>	<i>Non-fault insurer</i>	<i>At-fault insurer</i>	<i>Other*</i>
Non-fault and at-fault insurer the same	8	4	3
At-fault insurer	22	79	28
Non-fault, bilateral agreement†	6	1	5
Non-fault insurer	49	10	32
CMC	12	5	19
Other	2	1	12
Don't know	1	0	1
Base (weighted)	1,022	170	308

Source: Non-fault Survey, questions A10, A10a.

\*Includes claims managed by legal firms, repairers, dealerships and CMCs appointed by the claimant.

†Includes bilateral agreements for repairs only.

6. The number of respondents falling into the 'at-fault = non-fault', 'bilateral' and 'other' categories was small. For this reason, in the main body of this appendix we only show comparisons between captured claims, claims handled by the non-fault insurer and claims handled by CMCs. We benchmark figures against all claimants.

7. Figures in this appendix have been weighted to correct for oversampling in Wales, Scotland and Northern Ireland.
8. The response rate for our survey of non-fault claimants was 18%.
9. Survey responses are subject to error and some of the key questions asked in this survey depended on the subjective responses of respondents, for example the question asking respondents the condition of their vehicle after the repair compared with before the accident. We recognised that responses would not be based on an objective assessment of post-accident services and there could be other factors influencing responses too.



## The effects of the separation of cost liability and cost control on PMI providers' costs and revenue

### Introduction

1. This appendix describes how we estimated the effects on insurers' and brokers' costs of the separation of cost liability and cost control.
2. Our approach made use of data on claims numbers, average revenues and costs from the ten largest motor insurers operating in the UK (Admiral, Ageas, Aviva, AXA, CISGIL, DLG, esure, LV, RSA, and Zurich) and from several brokers (Acromas, BGL, Endsleigh, Hastings, and Swinton). There was a significant level of uncertainty around some of the numbers. Moreover, our calculations were based on a number of assumptions which introduced further uncertainty. For this reason, we have checked the sensitivity of our estimates to changes in the data or to the assumptions we have made. Our estimations must be seen as indicative of the scale of the detriment, not as an exact quantification of it.

### Summary

#### *Our approach*

3. We estimated the net detriment as the difference between the higher costs incurred by at-fault insurers and the revenue obtained by non-fault insurers and brokers ('residual approach').<sup>1</sup> This is the extent to which at-fault insurers pay more for replacement vehicles, repairs and write-offs than they would have paid if they managed the claims themselves (assuming non-fault claimants are provided with their legal entitlements). As a consequence, our estimated net detriment may include some costs which are unavoidably associated with the separation of cost liability and cost control, as well as potentially avoidable transactional and frictional costs resulting from inefficiencies in the supply of post-accident services. We took this point into account in our consideration of remedies.
4. We recognised that there were uncertainties associated with the residual approach. Therefore, to measure the likely magnitude of possible errors we performed sensitivity checks (see paragraphs 63 to 81). Despite there being

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<sup>1</sup> We have also controlled for differences in the quality of service provided to consumers and benefits (other than revenue) obtained by non-fault insurers.

some uncertainties associated with our approach, we believed that it was the best available and that its use was warranted.

5. We computed the detriment separately for credit hires, credit repairs, credit write-offs, insurer-managed repairs and insurer-managed write-offs.

### ***Assumptions***

6. In order to estimate the net detriment, we had to make assumptions about the allocation of insurers' claim handling costs and about the pass-through of costs and revenues to premiums.
7. We obtained information from insurers on their incremental claim handling costs, according to whether they were driven by the provision of repairs/write-offs, the provision of replacement vehicles or by other factors. We allocated costs driven by other factors to repairs/write-offs. We did this because all claims involve a repair or write-off but not all claims necessarily involve the provision of a replacement vehicle (see paragraph 28). This assumption affected our separate estimates of the net detriment (ie for credit hire, credit repair etc) but it had a very limited impact on our estimate of the total net detriment.
8. In relation to the pass-through of costs and revenue to premiums, we assumed that both the higher costs incurred by at-fault insurers and the revenues earned by non-fault insurers and brokers were fully passed through to policy premiums (see paragraphs 6.70, 6.71 and 6.81).

### ***Credit hire***

9. To estimate the cost incurred by at-fault insurers as a result of the market features we had identified, we started from the average difference between credit hire and direct hire bills (see Appendix 6.1, paragraphs 30 to 69). In doing this calculation:
  - We adjust the average direct hire bill to reflect the same distribution of vehicles<sup>2</sup> and the same hire duration as under credit hire.
  - We consider only the actual revenues received by CHCs, not the amounts claimed.<sup>3</sup>

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<sup>2</sup> Including provision of estate and automatic cars – see Appendix 6.1, paragraph 65.

<sup>3</sup> Therefore the average credit hire revenue is computed including also those claims for which no revenue was obtained.

- We adjust the average credit hire bill to reflect the benefit at-fault insurers get from the longer delay in payments<sup>4</sup> and the benefit of better collision damage waivers.<sup>5</sup>

We obtain an average difference of £555 per hire claim. To this amount, we add the frictional and transactional costs incurred by an at-fault insurer when dealing with a CHC, which we estimate at £78 per claim (see paragraph 21). We then subtract the management cost that the at-fault insurer would have incurred if it had directly managed the provision of a replacement vehicle, which we estimate to be £27 per claim (see paragraph 21). The cost increase for an at-fault insurer is therefore £607. Multiplying this figure by the number of credit hire claims per year, we obtain an overall cost increase of £183 million per year.

10. Non-fault insurers and brokers receive revenue when referring a customer for credit hire in the form of referral fees, and additional services may be provided by CHCs to the insurers' customers, eg ULR services (see Appendix 6.5, paragraphs 90 to 97). We estimate these two components, taken together, to have an average value of £328 per claim, amounting to a total revenue to non-fault insurers and brokers of £99 million per year.
11. Using these figures, we estimate that the net detriment for credit hire is about £84 million per year.

### ***Credit repair and write-off***

12. We estimate that the average difference between the cost to insurers of a directly managed repair and a credit repair, taking into account the benefit that at-fault insurers get from the delayed payment of credit repair bills,<sup>6</sup> is about £290 per claim. We estimate this difference to be about £125 for CMC-managed write-offs per claim. To these figures we add the frictional and transactional costs incurred by an at-fault insurer in the case of a credit repair/write-off, estimated at £45 per claim, and subtract the management costs it would have incurred by directly managing the repair/write-off, which we estimate to be £111 per claim (see paragraph 30). Multiplying this figure by the number of credit repair/write off claims, we obtain an overall cost of £20 million per year.

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<sup>4</sup> See Appendix 6.1, paragraphs 56–61.

<sup>5</sup> See Appendix 6.5, paragraphs 81–84.

<sup>6</sup> See Appendix 6.2, paragraph 26.

13. When referring a customer for credit repair/write-off, non-fault insurers and brokers receive an average referral fee of £53. Their total yearly revenues from this amount to £6 million.
14. Using these figures, we estimate that the net detriment for credit repairs and write-offs is about £15 million per year.<sup>7</sup>

### ***Insurer-managed repairs and write-offs***

15. Our starting point for the estimation of the higher costs incurred by at-fault insurers for insurer-managed repairs is the average difference between a subrogated repair claim and what insurers pay for a directly managed repair. We estimate that this averages to £95 per claim across all insurers, although there are differences between insurers. We then add the estimated frictional and transactional costs of an at-fault insurer, subtract the estimated management costs the at-fault insurer saves by not managing the repair directly and multiply by the number of insurer-managed repairs, giving a total cost of £4 million per year.
16. Though there are differences between insurers, on average non-fault insurers achieve a mark-up of £95 when recovering the cost of a repair. On the other hand, we estimate that they incur an average management cost of £113 per claim. As a result, across all non-fault insurers, receipts from at-fault insurers fall short of management costs by £17 per claim, which corresponds to a total of £5 million per year.
17. The net detriment for insurer-managed repairs is the sum of the higher costs for at-fault insurers and the losses incurred by non-fault insurers, which we therefore estimate to be about £9 million per year.
18. Using the same approach for insurer-managed write-offs results in a net detriment of £2 million per year.

### ***Sensitivity analysis***

19. Given the uncertainties around the data, we have tested the impact of using data from alternative sources and of varying key assumptions.<sup>8</sup> This analysis suggests:

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<sup>7</sup> The net detriment for credit repairs/write-offs is not equal to the difference between the additional costs to at-fault insurers and the revenue to non-fault insurers and brokers due to rounding errors.

<sup>8</sup> See paragraphs 63–81.

- an estimated credit hire net detriment of £67 million to £181 million per year
- an estimated total net detriment (from the AEC we have found under ToH 1) of £101 million to £214 million per year

20. Our main estimates (£84 million per year for credit hire and £110 million per year for the total net detriment) are towards the lower end of these ranges.

## Insurers' management and frictional costs

### Our estimates

21. To be able to separately estimate the detriment for credit hire, credit repair, credit write-off, insurer-managed repair and insurer-managed write-off, we estimated the costs incurred by insurers in managing hires and repairs/write-offs and in dealing with the third party insurer and/or CMC/CHC, and with their own customers. Table 1 show the estimates relevant for our calculation of the detriment.

TABLE 1 Insurers' management and frictional costs

		£
Credit hires	Frictional costs incurred by the at-fault insurer	78
	Management costs saved by the at-fault insurer	27
Credit repairs and write-offs	Frictional costs incurred by the at-fault insurer	45
	Management costs saved by the at-fault insurer	111
Insurer-managed repairs and write-offs	Management and frictional costs incurred by the non-fault insurer	115
	Frictional costs incurred by the at-fault insurer	32
	Management costs saved by the at-fault insurer	111

Source: CMA.

22. Although there is some uncertainty around these figures, it was clear to us that:

- the frictional costs incurred by the at-fault insurer were highest in the case of credit hire
- credit repairs and write-offs involved lower frictional costs, but they were still higher than for insurer-managed repairs and write-offs
- the costs at-fault insurers incurred in managing a repair (or write-off) for a captured claim were higher than those of managing a hire<sup>9</sup>

<sup>9</sup> The difference is affected by the allocation of 'other' claim handling costs not driven by the number of repairs/write-offs or replacement vehicles (see paragraph 28).

23. According to our estimates, the costs incurred by a non-fault insurer when managing a repair were similar to the costs an at-fault insurer incurs when managing a captured claim. These two types of claim involve different costs. In the case of at-fault insurers, capturing the claim is costly, but there is no need for a claims recovery process. In contrast, non-fault insurers can gain control of a claim at a much lower cost but incur costs in pursuing the claim against the at-fault insurer.

**Estimation methodology**

24. In order to derive these figures, we asked insurers to estimate their claim handling costs for different categories of claims. We requested the average incremental cost that would be determined by a significant number (1,000) of extra claims, including both the internal claim handling costs and any external costs due to litigation.

25. Table 2 shows the information we obtained for at-fault insurers' costs. We asked for the costs involved in the management of a captured claim and for the costs of managing and, potentially, litigating non-captured claims. The values in the table are weighted averages, with weights given by the GWP of each insurer in 2012.<sup>10</sup>

TABLE 2 Information on at-fault insurers' costs

	£		
	Captured claims	Non-captured claims Claims managed by non-fault insurers with the hire component referred for credit hire	Claims managed by CMCs
Repair/write-off	53	32	45
Replacement vehicle	27	78	78
Other	57		

Source: Insurers.

Note: The 'other' category includes the costs of capturing a claim that cannot be easily allocated to either the repair or the replacement vehicle components. Different insurers adopted different approaches with respect to these costs. Some allocated all or most of them, others reported high figures under this category.

26. Some parties told us that the low cost associated with captured claims might reflect the fact that, in those cases, liability had already been agreed upfront. However, Aviva told us that costs could be high on captured claims because they included a high proportion of repairs carried out outside its repair network

<sup>10</sup> Since 'captured claims' are the basis for our benchmark, it was not appropriate to weight insurers based on their current capture rates, but on their potential for capturing claims. Ideally, we would have liked to have weighted insurers according to the number of their at-fault claims. The same would be the preferred weights for the cost of subrogated claims. However, we could not obtain reliable data on the numbers of at-fault claims. Using GWP, we took into account both the size of the insurers and the average risk level of their policyholders (and so their likelihood of being the at-fault party in an accident).

and because it cost more to deal with a non-fault driver which was not its own customer, for example because of the need to explain why Aviva wanted to handle the claim and to build trust. We noted that the cost incurred by at-fault insurers on captured claims was not low by comparison with the cost incurred by non-fault insurers on other claims (£110 excluding incremental costs of replacement vehicles on captured claims (see Table 2) compared with £115 including some frictional costs for repair/write-off on other claims (see Table 1)).

27. Table 3 summarises the underlying calculations to compute the estimates for the frictional costs incurred by at-fault insurers and for the management costs they save by not directly managing a claim.

TABLE 3 Estimation of relevant at-fault insurers' costs

<i>Component of the claim</i>	<i>Type of costs</i>	<i>Calculation method</i>
Credit hires	Frictional costs incurred by the at-fault insurer	Average of the costs incurred on replacement vehicles for non-fault insurer-managed and CMC-managed claims. The weights used are the estimated numbers of insurer-managed repairs and credit repairs respectively.
	Management costs saved by the at-fault insurer	Costs incurred on replacement vehicles for captured claims.
Credit repairs and write-offs	Frictional costs incurred by the at-fault insurer	Costs incurred on repairs/write-offs for CMC-managed claims.
	Management costs saved by the at-fault insurer	Costs incurred on repairs/write-offs for captured claims, plus 'other' costs.
Insurer-managed repairs and write-offs	Frictional costs incurred by the at-fault insurer	Cost incurred on repairs/write-offs for non-fault insurer-managed claims.
	Management costs saved by the at-fault insurer	Costs incurred on repairs/write-offs for captured claims, plus 'other' costs.

Source: CMA.

28. Computing the saved management costs requires the allocation of the 'other' costs incurred in capturing a claim. These costs are driven by the number of claims rather than the number of repairs/write-offs or replacement vehicles provided. In our main estimates of the detriment, we have attributed these costs to repairs/write-offs since all claims involve a repair or write-off but not all claims involve the provision of a replacement vehicle (because the circumstances of some claimants are such that they do not need a replacement vehicle for the period their own vehicle is unavailable).
29. Table 4 shows the resulting estimated management costs saved by the at-fault insurer for replacement vehicles and repairs/write-offs, together with an alternative estimate assuming an equal split of 'other' costs between the two activities.

TABLE 4 Estimates of management costs saved by the at-fault insurer

	£	
	<i>Allocation of 'other' costs</i>	
	<i>All to repair/ write-off</i>	<i>Equal split</i>
Saved management cost of replacement vehicles	27	55
Saved management costs of repair/write-off	111	82

Source: CMA.

30. We also obtained information on the management and frictional costs incurred by a non-fault insurer when managing a repair. These include the costs of dealing with the customer, arranging the repair, pursuing recovery of the claim and, if necessary, defending it. The value in Table 1 is an average of the costs provided by the insurers in our sample, weighted by the respective number of non-fault repairs in 2012. Similarly to the at-fault insurer's costs, we attributed the non-fault insurer's other costs to repairs/write-offs.

### Net detriment for credit hire

#### *Higher costs to at-fault insurers*

31. As shown in Appendix 6.1 (paragraphs 31 to 69), we estimated that the average difference between a credit hire and a direct hire bill after adjusting for quality differences is £555. Compared with the case of a captured claim, with separation an at-fault insurer incurs additional frictional costs when dealing with a CHC. We have estimated this cost to be £78 (see Table 1, row 1). On the other hand, the insurer saves the costs it would have incurred in directly managing the hire. We have estimated this cost to be approximately £27 (see Table 1, row 2).
32. Table 5 multiplies the average cost increase faced by an at-fault insurer by our estimated number of credit hires in 2012. This was estimated by grossing up figures from the non-fault insurers and brokers in our sample for those providers' shares of supply – see Annex A. We noted that the resulting estimated total number of credit hires might be an underestimate because it did not take into account credit hire referrals by firms other than insurers and brokers, for example breakdown companies and repairers might also refer for credit hire.<sup>11</sup> The total cost increase amounted to £183 million per year.

<sup>11</sup> To obtain more comprehensive data, we sought information from at-fault insurers on the number of claims received from CMCs/CHCs and from other insurers. Unfortunately, a number of insurers were unable to provide the requested information and therefore this approach did not provide us with useful data on the total number of credit hires and credit repairs.



TABLE 5 The extra cost of credit hire

	Our sample		Estimated total number of credit hires '000	Average difference between credit and direct hire bills £	Average frictional costs £	Average saved management costs £	Average total costs per claim £	Estimated total cost £m
	Number of credit hires '000	Share of supply %						
Referred by insurers	151	82	184					
Referred by brokers	76	65	117					
Total			301	555	78	(27)	607	183

Source: CMA.

33. Some claims are managed by non-fault insurers which themselves provide a direct hire replacement vehicle (rather than referring for credit hire). It did not appear to us that such claims were likely to lead to material extra costs compared with claims where there was no separation of cost liability and cost control. This was for two reasons: first, there were few such claims because in most cases non-fault insurers referred for credit hire; second, we saw no evidence that direct hire costs were higher when the claim was managed by the non-fault insurer than when managed by the at-fault insurer.<sup>12</sup>

### **Net revenue stream to non-fault insurers and brokers**

34. Non-fault insurers and brokers get a referral fee when referring a claimant for credit hire. We estimated the average referral fees for credit hire and credit repair using data provided by the insurers and brokers in our sample, as reported in [Annex B](#), Table 1.
35. Where claims are referred for credit hire, insurers and brokers are unlikely to incur specific management costs, so we assumed that their net revenue was equal to the total amount of referral fees, as shown in Table 6.

TABLE 6 Referral fees for credit hire

	Estimated total number of credit hires '000	Average referral fees £	Estimated total referral fees £m
Referred by insurers	184	339	62
Referred by brokers	117	308	36
Average Total	301	327	98

Source: CMA.

36. To this amount, we added the cost incurred by CHCs in the provision of ULR services, which we estimated to be £1.61 per claim (see Appendix 6.5,

<sup>12</sup> Typically a non-fault insurer would itself provide a direct hire replacement vehicle only when it had a bilateral agreement with the at-fault insurer or when the non-fault and at-fault insurers were the same.

paragraph 97). The estimated revenue from credit hire earned by non-fault insurers and brokers was then £98.8 million per year.

### **Net detriment**

37. Our resulting estimate for the credit hire net detriment was therefore £84 million per year, as shown in Table 7.

TABLE 7 **Detriment for credit hire**

	<i>Profits to non-fault insurers and brokers</i>	<i>Higher costs to at-fault insurers</i>				<i>Net detriment (costs less profits)</i>
	<i>Referral fees</i>	<i>Difference between credit and direct hire bills</i>	<i>Frictional costs</i>	<i>Saved management costs</i>	<i>Total costs</i>	
Average values (£)	328	555	78	(27)	607	278
Total values (£m)	<b>98.8</b>	167	23.5	(8)	<b>182.5</b>	<b>83.7</b>

Source: CMA.

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### **Net detriment for credit repair**

#### **Higher costs to at-fault insurers**

38. We estimated the average cost increase due to credit repair compared with a situation without the separation of cost liability and cost control by summing two components:

- (a) the estimated mark-up for repairs managed by non-fault insurers (£95 – see paragraph 48); and
- (b) the average difference between credit repair bills and bills for non-fault repairs handled by non-fault insurers, adjusted for the benefit at-fault insurers receive from delayed payments (£195 – see Appendix 6.2, paragraph 26).<sup>13</sup>

We therefore estimated that the total difference was approximately £290.

39. In addition to this cost, an at-fault insurer also incurs frictional costs when dealing with a CMC, at an average amount of £45 (see Table 1, row 3). On the other hand, it saves the cost of directly managing the repair, which we estimated to be £111 (see Table 1, row 4).

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<sup>13</sup> This estimate does not control for differences in the mix of claims between credit repairs and repairs handled by non-fault insurers. However, we believed that these differences were small, because the choice between credit and directly managed repair depends mostly on the identity of the non-fault party, ie whether it is an insurer or a broker.

40. We estimated the number of credit repairs from converted referrals to CMCs by the insurers and brokers in our sample.<sup>14</sup> As the decision on whether to repair a car or to write it off is taken only after the referral, we used data from our consumer survey and estimated that a repair would take place in 80% of cases.<sup>15</sup>
41. Using these estimates, we calculated the total cost increase to be £19.1 million per year, as shown in Table 8.

TABLE 8 The extra cost of credit repair

	<i>Our sample</i>		<i>Estimated total number of credit repairs '000</i>	<i>Average difference between credit repair bills and at-fault insurer's costs £</i>	<i>Average frictional costs £</i>	<i>Average saved management costs £</i>	<i>Average total costs per claim £</i>	<i>Estimated total cost £m</i>
	<i>Number of credit repairs '000</i>	<i>Share of supply %</i>						
Referred by insurers	33	82	40					
Referred by brokers	30	65	46					
Total			85	290	45	(111)	224	19.1

Source: CMA.

### **Net revenue stream to non-fault insurers and brokers**

42. Non-fault insurers and brokers incur negligible costs when referring a claimant for credit repair, while receiving a referral fee in return. We estimated the average referral fee to be £53 for both insurers and brokers (see [Annex B](#), Table 1). Multiplying this by the total number of credit repairs (85,000), we get a total amount of approximately £4.6 million per year.

### **Net detriment**

43. Our resulting estimate for the credit repair net detriment was therefore £14.6 million per year, as shown in Table 9.

<sup>14</sup> Consequently, the estimated number of credit repairs does not include referrals from firms other than insurers and brokers and may be an underestimate (see paragraph 32).

<sup>15</sup> We assumed that the ratio of repairs to write-offs was the same for both insurers and CMCs.

TABLE 9 Detriment for credit repair

	Profits to non-fault insurers and brokers	Higher costs to at-fault insurers				Net detriment (costs less profits)
		Difference between credit repair bills and at-fault insurer's costs	Frictional costs	Saved management costs	Total costs	
	Referral fees					
Average values (£)	53	290	45	(111)	224	170
Total values (£m)	4.6	24.8	3.8	(9.5)	19.1	14.6

Source: CMA.

## Net detriment for credit write-offs

### Higher costs to at-fault insurers

44. We estimated the average mark-up on write-offs for CMCs to be £125.<sup>16</sup> Both the additional frictional costs incurred by at-fault insurers and the management costs they save are the same as in relation to repairs. Table 10 shows the total extra costs due to credit write-offs using these estimated numbers in 2012.

TABLE 10 The extra cost of credit write-off

	Our sample		Estimated total number of credit write-offs '000	Average over-costing of CMC-managed write-offs £	Average frictional costs £	Average saved management costs £	Average total costs per claim £	Estimated total cost £m
	Number of credit repairs '000	Share of supply %						
Referred by insurers	8	82	10					
Referred by brokers	7	65	11					
Total			21	125	45	(111)	59	1.3

Source: CMA.

### Net revenue stream to non-fault insurers and brokers

45. The average referral fee that non-fault insurers and brokers receive in credit write-offs is similar to that for credit repairs (£53 on average – see paragraph 42). Given a total of 21,400 credit write-offs in 2012 (see paragraph 40), we calculated the total revenues to be approximately £1.1 million per year.

### Net detriment

46. Our resulting estimate for the credit write-off net detriment was therefore £0.1 million per year, as shown in Table 11.

<sup>16</sup> The average cost increase for write-offs managed by CMCs was obtained as an unweighted average of the revenues for three large CMCs ([§]).

TABLE 11 **Detriment for credit write-offs**

	<i>Profits to non-fault insurers and brokers</i>	<i>Higher costs to at-fault insurers</i>				<i>Net detriment (costs less profits)</i>
	<i>Referral fees</i>	<i>Over-costing of CMC-managed write-offs</i>	<i>Frictional costs</i>	<i>Saved management costs</i>	<i>Total costs</i>	
Average values (£)	53	125	45	(111)	59	6
Total values (£m)	1.1	2.7	1	(2.4)	1.3	0.1

Source: CMA.

47. The difference in costs claimed is smaller for credit repair/write-off than for credit hire, and other net costs to the at-fault insurer are also lower (though referral fees are also lower). These factors, together with the fact that there is less credit repair/ write-off, mean that the net detriment is considerably lower for credit repair/write-off than for credit hire (£15 million per year compared with £84 million per year).

## **Net detriment for insurer-managed repairs**

### ***Higher costs to at-fault insurers***

48. We obtained from the non-fault insurers in our sample an estimate of the average rebate they received from approved repairers and/or of the profits they made when they owned a repairer network (see the first two columns of [Annex B](#), Table 1). We then computed the average mark-up for these ten insurers. We used this value (£95) as an estimate of the average repair cost increase to at-fault insurers. We noted that there was considerable variation in mark-up between insurers. Some insurers told us that they obtained large revenues for repairs; others that they did not retain any mark-up. However, we noted that the situation appeared to be fluid, with at least one insurer ([X]) recently starting to retain a large mark-up, and another ([X]) discontinuing that practice.
49. When the non-fault insurer manages the repair, the at-fault insurer saves the costs of doing it itself (£111) (see Table 1, row 7), but incurs frictional costs (£32) (see Table 1, row 6) and is charged the mark-up that the non-fault insurer generates (£95 – see paragraph 48).
50. We received from most of the insurers and brokers in our sample only the combined number of repairs and write-offs in 2012 and we estimated the proportion of claims in which a repair took place using the split observed in our consumer survey. Moreover, we excluded, when possible, those claims in which the same insurer was in both the at-fault and non-fault position, or in which a bilateral agreement on repairs existed between the two insurers. In

these two cases we did not expect a mark-up to be retained.<sup>17</sup> Not all the insurers in our sample were able to identify the categories of claims to be excluded. However, we found that the number of bilateral agreements involving repairs was small,<sup>18</sup> so we expected the extent of any overestimation to be very limited.

51. Our approach was based on the implicit assumption that all non-fault repairs are made by repairers within the insurers' approved networks. In reality, some repairs are performed by repairers directly chosen by the claimant and, in these cases, the non-fault insurer does not receive any rebates. These repairs should therefore be excluded when computing the higher cost due to the separation of cost liability and cost control. However, since we included them both here and when estimating non-fault insurers' revenues, the assumption had little impact on the net detriment, because both costs and revenues were similarly overestimated.<sup>19</sup>

52. The results of our estimate are shown in Table 12.

TABLE 12 The extra cost of insurer-managed repairs

<i>Our sample</i>		<i>Estimated total number of repairs '000</i>	<i>Average over-costing of insurer-managed repairs £</i>	<i>Average frictional costs £</i>	<i>Average saved management costs £</i>	<i>Average total costs per claim £</i>	<i>Estimated total cost £m</i>
<i>Number of repairs '000</i>	<i>Share of supply %</i>						
198	82	240	95	32	111	17	4.1

Source: CMA.

### **Net revenue stream to non-fault insurers and brokers**

53. Non-fault insurers generate an average mark-up on repairs of £95 (see paragraph 48). On the other hand, they bear the cost of dealing with the customer, managing the repair and pursuing recovery of the claim. We estimate these costs to be about £115 (see Table 1, row 5). The aggregate net revenue of non-fault insurers is shown in Table 13.

<sup>17</sup> There may still be a small mark-up in the case of bilateral agreements, especially if the two insurers differ in size or in efficiency. In this case, an agreement may be reached in which the larger or more efficient insurer retains a mark-up.

<sup>18</sup> See Appendix 6.5, Annex, paragraph 4.

<sup>19</sup> The cost and revenue effects will offset each other unless the proportion of repairs in repairers chosen by the claimant is affected by the separation of cost liability and cost control or pass-through rates for costs and revenues differ (see Appendix 6.4).

TABLE 13 **Non-fault insurers' revenue from directly managed repairs**

<i>Our sample</i>		<i>Estimated total number of repairs '000</i>	<i>Average mark-up £</i>	<i>Average management and frictional costs £</i>	<i>Average total profits per claim £</i>	<i>Estimated total profit £m</i>
<i>Number of repairs '000</i>	<i>Share of supply %</i>					
198	82	240	95	(115)	(20)	(4.8)

Source: CMA.

## **Net detriment**

54. Our resulting estimate for the net detriment for insurer-managed repairs was therefore £8.9 million per year, as shown in Table 14.

TABLE 14 **Detriment for insurer-managed repairs**

	<i>Profits to non-fault insurers</i>			<i>Higher costs to at-fault insurers</i>				<i>Net detriment (costs less profits)</i>
	<i>Mark-up</i>	<i>Management and frictional costs</i>	<i>Total profits</i>	<i>Over-costing of insurer-managed repairs</i>	<i>Frictional costs</i>	<i>Saved management costs</i>	<i>Total costs</i>	
Average values (£)	95	(115)	-20	95	32	(111)	17	34
Total values (£m)	23	(27.8)	<b>-4.8</b>	23	7.8	(26.6)	<b>4.1</b>	<b>8.9</b>

Source: CMA.

## **Net detriment for insurer-managed write-offs**

### **Higher costs to at-fault insurers**

55. The analysis of the cost increase attributable to insurer-managed write-offs is the same as for repairs. The only difference is that the average mark-up is lower: our estimate was £53 (see [Annex B](#), Table 2). As in the case of repairs, there is considerable variation in mark-up between insurers. Table 15 presents our estimate of the overall extra cost.

TABLE 15 **Extra cost of insurer-managed write-off**

<i>Our sample</i>		<i>Estimated total number of write-offs '000</i>	<i>Average over-costing of insurer-managed write-offs £</i>	<i>Average frictional costs £</i>	<i>Average saved management costs £</i>	<i>Average total costs per claim £</i>	<i>Estimated total cost £m</i>
<i>Number of write-offs '000</i>	<i>Share of supply %</i>						
52	82	64	53	32	(111)	(25)	(1.6)

Source: CMA.

## **Net revenue stream to non-fault insurers and brokers**

56. The analysis of non-fault insurers' revenues is also the same as for repairs, except for the lower average mark-up (£53). This is an average figure, with

some insurers charging significantly more and others not generating any mark-up. Table 16 shows the aggregate net revenue.

TABLE 16 Non-fault insurers' revenue from directly managed write-offs

Our sample		Estimated total number of write-offs '000	Average mark-up £	Average management and frictional costs £	Average total profits per claim £	Estimated total profit £m
Number of write-offs '000	Share of supply %					
52	82	64	53	(115)	(62)	(3.9)

Source: CMA.

## Net detriment

57. Our resulting estimate for the net detriment for insurer-managed write-offs was therefore £2.4 million per year, as shown in Table 17.

TABLE 17 Detriment for insurer-managed write-offs

	Profits to non-fault insurers			Higher costs to at-fault insurers				Net detriment (costs less profits)
	Mark-up	Management and frictional costs	Total profits	Over-costing of insurer-managed write-offs	Frictional costs	Saved management costs	Total costs	
Average values (£)	53	(115)	-62	53	32	(111)	-25	34
Total values (£m)	3.4	(7.3)	-3.9	3.4	2.1	(7.1)	-1.6	2.4

Source: CMA.

58. Our estimates of the net detriment for insurer-managed repairs/write-offs were smaller than for credit repairs/write-offs (£11 million per year compared with £15 million per year) despite there being almost three times as many insurer-managed repairs/write-offs as credit repairs/write-offs. This reflects the fact that, on average, transactional/frictional costs are lower for insurer-managed repairs/write-offs than for credit repair/write-offs. Reduction in Paper Exchange (RIPE) agreements, to which many insurers subscribe,<sup>20</sup> reduce transactional/frictional costs. For example, one insurer [X] told us that [X]. Nevertheless, even when two insurers have a RIPE agreement with each other, they incur some costs associated with the claims recovery process which they would not incur in the absence of separation.

## Overall net detriment

59. The overall detriment is given by the sum of the components. The overall profit to non-fault insurers and brokers is £96 million, while the increase in the

<sup>20</sup> See paragraph 6.17.



costs incurred by at-fault insurers is £205 million. The net detriment is therefore approximately equal to £110 million.

60. There is some evidence that separation is associated with better quality of service on replacement vehicles (see Appendix 6.5). We believed our calculations controlled for the most obvious sources of quality difference (see paragraph 9).

### **Distributional effects**

61. We recognised that the impact of the market features we identified was likely to differ for different categories of drivers. As high-risk drivers are more likely to be at-fault in accidents, the higher costs to at-fault insurers will have a larger impact on their PMI premiums compared with lower-risk drivers. On the other hand, the revenues insurers get when managing non-fault claims are likely to be passed through more evenly to their customer base. As a consequence, while PMI premiums for high-risk drivers are likely to be higher, those for low-risk drivers are likely to be lower than in the absence of the features.
62. Our analysis allows for a separate assessment of the distributional effects due to credit hire, credit repairs and write-offs, and insurer-managed repairs and write-offs. We found that there were no clear distributional effects in relation to repairs and write-offs as, although there is a cost to at-fault insurers, the net profit to non-fault insurers from credit repairs and write-offs is broadly offset by the loss they suffer on insurer-managed repairs and write-offs.<sup>21</sup> However, we found that there were clear distributional effects in relation to credit hire, since there is both a cost to at-fault insurers and a profit to non-fault insurers (from the receipt of referral fees).

### **Sensitivity analysis**

63. In our main calculation we have used the best data we could obtain from the parties and we have made the most plausible assumptions, given our knowledge of the market. However, because of the uncertainties involved in some of the data we have used, we have checked the sensitivity of our estimates to changes in the data or to the assumptions we have made. In this subsection we analyse the impact of uncertainty about:

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<sup>21</sup> Tables 7, 9 and 11 show that, when credit hire or repair is involved, non-fault insurers and brokers make profits. This is not the case, on average, for insurer-managed repairs and write-offs, in which non-fault insurers make a small loss, as shown in Tables 14 and 17. The reason is that, while some insurers charge a mark-up higher than the management costs they incur, others do not and instead make losses when managing a non-fault repair.

- insurers' estimates of management and frictional costs
- our assumptions regarding the existing level of provision and costs
- our assumptions regarding the benchmark level of provision and costs
- our assumptions regarding the extent of pass-through of insurers' revenues on non-fault claims

### ***Insurers' estimates of management and frictional costs***

64. We asked insurers to estimate their costs of handling claims and used the average of the available estimates in our calculation of the net detriment (see paragraphs 24 to 30). There was substantial variation between insurers in their ability to estimate these costs and, for those insurers which were able to provide an estimate, there was also substantial variation in the numbers they provided. We noted that the variation in responses could reflect genuine cost differences between insurers, but could also reflect different approaches to cost estimation. In order to understand the effect of the uncertainty associated with the latter, we estimated the total net detriment and the net detriment from credit hire using cost data from the insurers which generated, respectively, the highest and lowest detriment figures, as shown in Table 18.

TABLE 18 **Detriment estimates using management and frictional costs from individual insurers (and change compared with main estimate of net detriment)**

	<i>£ million</i>	
	<i>Total net detriment</i>	<i>Net detriment from credit hire</i>
Highest figure	177 (+67.4)	115.9 (+32.3)
Lowest figure	85.2 (-24.4)	63.7 (-20)

Source: CMA.

65. One insurer gave us very low estimates of the frictional costs it incurs when at fault and relatively high estimates of the cost of managing captured claims. These figures resulted in a low net detriment, both on credit hire and overall. On the other hand, another insurer provided very high figures for frictional costs and low estimates of management costs. These figures resulted in a very high detriment.

66. Our main estimate of the net detriment assumed that all the management costs related to captured claims which could not be directly attributed to the provision of replacement vehicles should be allocated to repairs/write-offs (see paragraph 28). Table 19 shows the changes in the net detriment

estimate if instead these costs are allocated equally between repairs/write-offs and replacement vehicles.

TABLE 19 Net detriment under equal split of common costs between repair/write-offs and replacement vehicles (and change compared with main estimate of net detriment)

	£ million	
	Credit hire	Total
Cost data from all insurers in the sample	75.1 (-8.6)	112.8 (+3.2)
Cost data from one insurer (highest figures)	62.7 (-21)	85.6 (+24.1)
Cost data from one insurer (lowest figures)	112 (+28.3)	178.5 (+68.9)

Source: CMA.

Note: We tested the impact of a different allocation of per-claim management costs which are common to repairs/write-offs and to the provision of replacement vehicles. Since the overall number of claims involving repairs/write-offs is larger than the number of claims in which a replacement vehicle is provided, the different assumption has an impact on the size of the total net detriment.

### Existing level of provision and costs

67. We considered the following areas of uncertainty in relation to the existing level and cost of post-accident non-fault service provision:

- average credit hire bill
- number of credit hires and credit repair/write-offs
- VAT may not be charged on some credit hire bills
- credit hire claimants receive a benefit from the GTA classification of cars being narrower than the standard car hire classification

68. Using data on revenue from our sample of CHCs, we estimated that the adjusted average cost of a credit hire in 2012 was £1,100. Other data suggested the average cost was higher than this. Data from insurers suggested an average cost of about £1,400<sup>22</sup> and our survey of CHCs suggested an average bill close to £1,235.<sup>23</sup> We found that the figures from insurers might not be comparable with those used in our main estimate and so we used the average bill from our survey of CHCs as an alternative basis for our net detriment calculation.<sup>24</sup> Table 20 shows estimates of the detriment for credit hire adopting this higher value in two ways:

<sup>22</sup> See Appendix 6.1, Annex A, Table 1.

<sup>23</sup> See Appendix 2.2, Annex. Taking into account the benefit insurers get from delayed payments, this amount reduces to £1,209.

<sup>24</sup> We did not calculate an additional sensitivity for credit repair as the average credit repair bill used in our main estimate ( £1,576) was very similar to the average credit repair bill suggested by our survey of CHCs (£1,601, or £1,572 after taking into account delayed payments).

- Using the same ratio of credit and direct hire bills as in the baseline calculation (appropriate if the actual average credit hire bill is higher due to longer hire lengths or more expensive car classes which would also affect our estimated average direct hire bill).
- Using the same average direct hire bill as estimated in the baseline calculation (appropriate if the actual average credit hire bill is higher for other reasons, which would not affect our estimated average direct hire bill).

TABLE 20 Net detriment for credit hire under alternative average bill

	Average credit hire bill £	Credit hire £m
Fixed credit/direct rate ratio	1,209	99.3 (+15.7)
Fixed average direct rates	1,209	115 (+31.3)

Source: CMA.

69. As explained in [Annex A](#), the number of credit hires and credit repair/write-offs used in our main estimate of the net detriment was based on grossing up estimates for a sample of insurers and brokers. We noted the estimated number of private credit hires from our survey of CHCs was slightly lower, at 289,000,<sup>25</sup> than the 301,000 used in our main estimate.<sup>26</sup> While the figures from the CHC survey also involved estimation, in particular for the proportion of credit hires by privately insured claimants, we noted they would reduce the credit hire net detriment to £80.4 million and the total net detriment to £106.3 million (£3.3 million lower than our main estimate).
70. As discussed in Appendix 6.1, paragraphs 48 to 51, the credit hire rates we considered were inclusive of VAT. This was because, as insurers are VAT-exempt, they cannot reclaim from HMRC the VAT paid on hire services. The only exception is when the claimant is VAT-registered, in which case VAT is paid by the claimant. However, this happens rarely for privately-insured claimants. One insurer told us this happened in less than 5% of claims. If we exclude VAT in 5% of credit hire claims, the credit hire net detriment is reduced by £3.3 million to £80.4 million and the total net detriment to £106.3 million.
71. Credit hire claimants may receive a benefit from the GTA classification of cars being narrower than the standard car hire classification (see Appendix 6.1,

<sup>25</sup> See Appendix 2.2, Annex, Table 1.

<sup>26</sup> We did not calculate an additional sensitivity for credit repair as our main estimates assumed 85,000 credit repairs and 21,000 credit write-offs (a total of 106,000), whereas the CHC survey showed 98,000 private credit repairs, though this may or may not have included credit write-offs. It therefore was not clear whether our main estimate of credit repairs and write-offs was higher or lower than implied by the CHC survey.

paragraphs 52 to 55). This is not captured in our model, because we adopt the standard classification for both credit and direct hire. Therefore we attempted to correct for this possible quality difference by looking at the loss of consumer surplus.<sup>27</sup>

72. Estimating the benefit claimants get from the adoption of the GTA classification is not easy, as we do not know how many claimants are affected and what additional value they assign to the slightly better car potentially received under credit hire. Results from our survey showed that about 6% more respondents whose claims were managed by at-fault insurers felt the car fell slightly short of their needs.<sup>28</sup> If we assume that the less good quality of service to these respondents is worth £100, the average benefit from separation would be £6 per hire (6% of £100). While it seems implausible that this benefit is entirely due to the broader classification of vehicles under direct hire,<sup>29</sup> if we do assume this to be the case, the effect is to reduce the credit hire detriment by £1.8 million to £81.9 million (the total net detriment would be £107.8 million).
73. Accident Exchange said that our approach was incorrect as we had recognised that there was a quality shortfall under direct hire but, instead of assessing the cost of remedying this quality shortfall, had instead estimated the value to consumers of the higher quality. In Accident Exchange's view, this effectively meant that we had approached the assessment on the basis that consumers' legal entitlements were not being met and had valued those entitlements to consumers. Accident Exchange said that the correct analysis would have been to calculate the cost to the consumer of remedying the quality shortfall under direct hire. However, we did not agree with this view for the following reasons:
- We did not find clear evidence of direct hire falling short of claimants' legal entitlements (or of credit hire exceeding non-fault claimants' legal entitlements) (see paragraph 6.29).<sup>30</sup>

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<sup>27</sup> We adopt the same adjustment when we consider a scenario in which the quality of the vehicles provided by CHCs is higher than that to which claimants are entitled (see paragraphs 77–79).

<sup>28</sup> See Appendix 6.5, Table 16.

<sup>29</sup> The part of this benefit due to other factors (eg getting a replacement vehicle in a lower standard hire category) should not be taken into account, because the adjustments to direct hire rates adopted in our calculation already account for those factors.

<sup>30</sup> Accident Exchange provided us with an example where an insurance company had offered a car in GTA class P6 (or P7) which it said was within GTA class SP7 to a claimant whose car was in GTA class SP7, and the claimant had declined the offer. (Accident Exchange also told us that the hire company had conceded, on behalf of the insurer, that it could not offer vehicles from the SP7 group but subsequently did agree that it could source a SP7 vehicle from another company at a rate which was 70% higher than the rate shown in the insurer tariff). We noted that GTA class SP7 was in the same wider group as GTA class P6 (and P7) and hence this could be an example of how direct hire claimants with premium cars were offered replacement vehicles that were not strictly like-for-like. However, we noted that cars were only included in our data if claimants accepted the car (which had

- In these circumstances, we adjusted as far as possible for quality differences by calculating the cost of direct hire at the credit hire level of provision.
- There was one respect in which, because of data limitations, we were unable to make this adjustment, which was in relation to the cost of direct hire on the basis of the more granular GTA classes of vehicle. However, we did not see reason to believe this had led to downward bias in our estimates: the difference between the cost of credit and direct hire was smaller, not larger, for those car classes where the GTA classes were more granular.<sup>31</sup>
- Nevertheless, as there was still a possibility that credit hire claimants benefitted from the more granular GTA classification, we calculated a sensitivity with an upper estimate of this benefit.

### ***Benchmark level of provision***

74. For our main calculation we assumed that, in the benchmark, claimants received the same kinds of vehicles as currently provided under credit hire, and for the same number of days. This was appropriate if credit hire claimants currently received their legal entitlement and no more. However, we considered alternative approaches as sensitivities:

- The type of vehicle provided under the benchmark is similar to those currently received by credit hire claimants but the benchmark length of hire is reduced to the current direct hire average.
- The benchmark type of vehicle is assumed to be similar to the current direct hire average but hire lengths remain in line with current credit hire averages.
- Both the type of vehicle and the hire length are in line with direct hire average.

We discuss each of these in turn.

75. As regards hire length, our main estimate of the net detriment assumed that, in the benchmark, direct hires would have the same length as credit hires do currently. The data we received from car hire providers showed, however, that direct hires are on average shorter. Although we did not find clear evidence

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not been the case in the example quoted by Accident Exchange), and it was not obvious that in any such case the claimant had not received their legal entitlement.

<sup>31</sup> See Appendix 6.1, paragraph 55.

that this difference was due to unreasonably long credit hires, we noted that this explanation was a possibility.<sup>32</sup> Furthermore, existing credit hire lengths could be affected by difficulties coordinating the hire and repair process when two different companies are involved (insurer managing repair/write-off and CHC managing the replacement vehicle provision), which would not occur in our benchmark situation (where claimants receive their legal entitlement but there is no separation). It is therefore possible that in our benchmark hire lengths would be similar to the current direct hire average rather than the current credit hire average.

76. If we multiply the average direct hire rates for each class of vehicles by the corresponding ratio between the average durations of credit hires and direct hires, we obtain an average £636 difference between credit hire and direct hire bills. Using this value, the net detriment for credit hire increases to £108.1 million (£24.4 million higher than our baseline estimate).
77. With regard to the type of vehicle, our main estimate of the net detriment assumed that, in the benchmark, car hire classes are similar to current credit hire car classes, ie that currently credit hire claimants receive their legal entitlement and no more (see the first bullet in paragraph 9). On average, direct hire currently involves less expensive car classes than credit hire and this may be associated with a higher level of mitigation under direct hire.<sup>33</sup> Therefore we considered an alternative assumption, under which hire classes in our benchmark situation (where claimants receive their legal entitlement but there is no separation) were similar to existing direct hire averages. We recognised that an implication of this assumption was that credit hire claimants on average would receive a higher quality replacement car than their legal entitlement (ie the benchmark assumption) and we took this into account.
78. The data from direct hire providers implies an average bill of £479 based on existing direct hire classes and credit hire lengths.<sup>34</sup> Subtracting it from the average £1,105 credit hire bill, we get an average difference of £626. To this we must subtract an estimate of the average benefit claimants get from the better cars provided under credit hire. On the assumptions set out above (see

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<sup>32</sup> See paragraph 6.27.

<sup>33</sup> Credit hire providers have an incentive to provide a class of car that is more expensive than needed because their profit is likely to increase with the class of car (the ratio of credit hire cost to direct hire cost is broadly constant across car classes (see Appendix 6.1, Table 7), but additional credit hire costs, including referral fees, are broadly constant per claim). Our review of a small number of call records indicated there was less mitigation under credit hire than under direct hire (see Appendix 6.5, paragraphs 65–72).

<sup>34</sup> We weighted the direct hire rates for each vehicle category by the number of direct hire claims in 2012 and multiplied the average by the average length of credit hires. The fact that we could not identify the number of direct hires involving vehicles in the GTA classes F9, P11–P13, and SP11–SP13 (see Appendix 6.1, Table 7) created minimal distortions.

paragraph 74), the average benefit is £6 per hire reducing the average difference to £620. As a consequence, the net detriment for credit hire becomes £103.3 million (an increase of £19.6 million over our main estimate).

79. If we assume that, in the benchmark, both direct hire lengths and car classes are in line with current direct hire averages, rather than current credit hire averages, the net detriment for credit hire becomes £127 million (an increase of £43.3 million).

### ***Pass-through of non-fault insurers' revenues***

80. We assumed that both the additional costs incurred by at-fault insurers and the additional revenues made by non-fault insurers (and brokers) are passed through in PMI premiums pro rata. However, there is greater uncertainty on the level of pass-through of non-fault insurers' additional revenues (see paragraph 6.81). We expect this pass-through to be high but Table 21 shows the impact of assuming a pass-through of 90% or 80% rather than 100% as in our main estimate.

TABLE 21 Net detriment under alternative pass-through of non-fault insurers' revenues

<i>Pass-through</i>	<i>£ million</i>					
	<i>Credit hire</i>	<i>Credit repair</i>	<i>Credit write-off</i>	<i>Insurer-managed repair</i>	<i>Insurer-managed write-off</i>	<i>Total</i>
90%	93.6 (+9.9)	15 (+0.5)	0.2 (+0.1)	11.2 (+2.3)	2.7 (+0.3)	122.7 (+13.1)
80%	103.5 (+19.8)	15.5 (+0.9)	0.4 (+0.2)	13.5 (+4.6)	3 (+0.7)	135.8 (+26.2)

Source: CMA.

### ***Net detriment ranges***

81. We calculated the range of possible values of the net detriment combining the effects analysed above (except for those using the claim handling costs of individual insurers).<sup>35</sup> Table 22 shows the assumptions used to generate the upper and lower values of the ranges. The values are then shown in Table 23.

<sup>35</sup> We have not used the claim handling costs of individual insurers as they may be outliers.



TABLE 22 Assumptions used to determine the ranges of possible net detriment estimates

	Credit hire		Repairs and write-offs (either credit or insurer-managed)		Total	
	High level	Low level	High level	Low level	High level	Low level
Allocation of common costs	All to repair	Equal split	Equal split	All to repair	Equal split	All to repair
Average credit hire bill	£1,209 (fixed average direct rates)	£1,105			£1,209 (fixed average direct rates)	£1,105
Number of hire claims	301,000	289,000			301,000	289,000
VAT on credit hire	Always included	Excluded in 5% of claims			Always included	Excluded in 5% of claims
Adjustment for different classifications	No	Yes			No	Yes
Adjustments for vehicle models and duration	No	Yes			No	Yes
Pass-through of revenues	80%	100%	80%	100%	80%	100%

Source: CMA.

TABLE 23 Ranges of possible net detriment values

	£ million	
	High estimate	Low estimate
Credit hire	178.4	67.2
Credit repair	17.9	14.6
Credit write-off	1	0.1
Insurer-managed repair	20.4	8.9
Insurer-managed write-off	<u>4.9</u>	<u>2.4</u>
Total	213.9	101.4

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.

## Data sources and weighting

1. We obtained data from the ten largest insurers in the market and from some of the largest brokers. However, we needed an estimate of the detriment for the entire market. In order to calculate this estimate, we weighted the data based on the number of policies in force for each provider in our sample. The total number of PMI policies in the UK is approximately 25 million,<sup>1</sup> of which around 35% (or 8,750,000) have been sold through brokers.<sup>2</sup> We made the simplifying assumption that, if a policy is sold through a broker, FNOL would be to the broker. Given the average number of policies in force in 2012 for each of the brokers in our sample, we estimated the percentage of the brokers' market that our sample covers (see Table 1 below). We obtained estimates for the entire brokers' market by dividing the total number of claims handled or the total revenues received by the brokers in our sample by this percentage.

TABLE 1 **Weights for brokers' data**

	<i>Number of policies in force (average in 2012) ('000)</i>	<i>Percentage of total brokers' policies (%)</i>
Acromas	[X]	[X]
BGL	[X]	[X]
Endsleigh	[X]	[X]
Hastings	[X]	[X]
Swinton	[X]	[X]
Total	5,650	65
Total for all brokers	8,750	

Source: Brokers.

2. We followed a similar approach for insurers. We collected the average numbers of policies in force in 2012 for each of them and we estimated the number of those policies which were sold through brokers. We used the number of policies not sold through brokers as the basis for our calculations, estimating the percentage of the non-broker market covered by the insurers in our sample (see Table 2). Dividing the total number of claims, total cost increase or total revenues for these ten insurers by this percentage, we reached estimates for the entire non-broker market.

<sup>1</sup> Source: Datamonitor report on UK Private Motor Insurance 2010.

<sup>2</sup> *ibid.*

TABLE 2 **Weights for insurers' data**

	<i>Number of policies in force (average in 2012) ('000)</i>	<i>Policies in force not sold through brokers ('000)</i>	<i>Percentage of total policies (excluding brokers) (%)</i>
Admiral	[X]	[X]	[X]
Ageas	[X]	[X]	[X]
Aviva	[X]	[X]	[X]
AXA	[X]	[X]	[X]
CISGIL	[X]	[X]	[X]
DLG	[X]	[X]	[X]
esure	[X]	[X]	[X]
LV	[X]	[X]	[X]
RSA	[X]	[X]	[X]
Zurich	[X]	[X]	[X]
Total	18,791	13,361	82
Total for all insurers	25,000	16,250	

Source: Insurers.

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3. We weighted the data based on the number of policies in force and not on the GWP because we used data from the non-fault insurers. Weighting the insurers by their GWP would mean linking the number of non-fault claims they receive to the riskiness of their customers, because premiums reflect the risk of a driver being at fault in an accident. However, the probability that a customer will be the not-at-fault party in an accident is only weakly correlated with their risk of being at fault. This implies that, once we control for the number of policies in force, the number of non-fault claims received by a non-fault insurer is only weakly correlated with its GWP. Therefore, the number of policies in force is likely to be a better weight.

## Information obtained on revenues to non-fault insurers and brokers

1. We obtained estimates on the average referral fees received by the insurers and brokers in our sample, as reported in Table 1.

TABLE 1 Referral fees for credit hire and credit repair

	£	
	Credit hire	Credit repair
<i>Insurers</i>		
Admiral	[REDACTED]	[REDACTED]
Ageas	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]
AXA	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]
LV	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]
Average	339	53
<i>Brokers</i>		
Acromas	[REDACTED]	[REDACTED]
BGL	[REDACTED]	[REDACTED]
Endsleigh	[REDACTED]	[REDACTED]
Hastings	[REDACTED]	[REDACTED]
Swinton	[REDACTED]	[REDACTED]
Average	308	53

Source: Insurers and brokers.

*Notes:*

1. Most values are obtained by dividing the total amount of referral fees received by insurers and brokers in 2012 by the number of claims in the same year. There may be timing differences, as some claims referred in 2012 may not have been settled in the same year and vice versa. However, we believed any resulting error was likely to be small.
2. [REDACTED]
3. [REDACTED]
4. [REDACTED]

2. On revenues from insurer-managed repairs and write-offs, we obtained the information shown in Table 2 from non-fault insurers.

TABLE 2 Revenues for insurer-managed repairs and write-offs

£

	<i>Rebates from repairers or profits of integrated repairers</i>	<i>Referral fees for paints or parts</i>	<i>Rebates or similar payments from salvage companies</i>
Admiral	[REDACTED]	[REDACTED]	[REDACTED]
Ageas	[REDACTED]	[REDACTED]	[REDACTED]
Aviva	[REDACTED]	[REDACTED]	[REDACTED]
AXA	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL	[REDACTED]	[REDACTED]	[REDACTED]
DLG	[REDACTED]	[REDACTED]	[REDACTED]
esure	[REDACTED]	[REDACTED]	[REDACTED]
LV	[REDACTED]	[REDACTED]	[REDACTED]
RSA	[REDACTED]	[REDACTED]	[REDACTED]
Zurich	[REDACTED]	[REDACTED]	[REDACTED]
Average	82	14	53

Source: Insurers.

Notes:

1. When an insurer adopts multiple business models, rebates from repairers or profits of integrated repairers are computed as a weighted average of the revenues gained under the different models.
2. [REDACTED]
3. [REDACTED]
4. Most insurers found it very challenging to estimate the average cost of managing a non-fault claim. Moreover, they may not have interpreted the term 'management costs' in the same way. Some included overheads (which we would ideally exclude, being interested in changes in marginal costs); others may have adopted a very narrow definition. DLG did not provide an estimate at all. We therefore used a weighted average of all the other values.

## Effects on consumer surplus of the separation of cost liability and cost control

1. Any change in car insurance premiums, for example associated with costs or revenue arising from the separation of cost liability and cost control, may affect demand for car insurance and consequently have effects on consumer surplus.
2. This is illustrated in Figure 1:<sup>1</sup>
  - (a) The top chart illustrates that separation of cost liability and cost control leads to higher costs for at-fault insurers (rectangle *X*) and this increases premiums from  $m^*$  to  $m$ . Associated with such higher premiums, separation of cost liability and cost control reduces demand for PMI, implying additional loss in consumer surplus for 'priced-off' drivers (triangle *A*).
  - (b) The lower chart illustrates the effect of the offsetting revenue stream for non-fault insurers (rectangle *Y*), which is associated with an offsetting reduction in premiums from  $n^*$  to  $n$ . Associated with such lower premiums, there is an offsetting increase in demand and further gain in consumer surplus (triangle *B*).
3. The consumer surplus effects in Figure 1 arise because changes in PMI premiums are assumed to affect demand for PMI, ie the demand curve is not vertical (demand is not completely price inelastic).

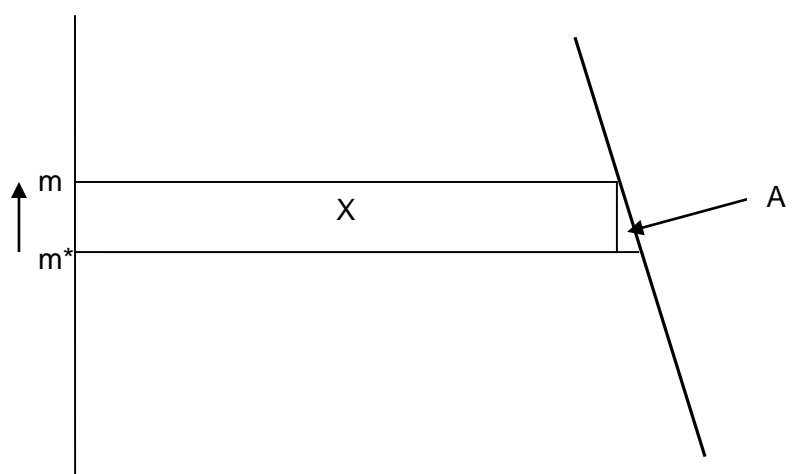
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<sup>1</sup> The figure is intended to illustrate that the effect on premiums may be different for different drivers according to how likely they are to be at fault and not at fault in accidents. It is a simplification of reality in two important respects. First, the cost and offsetting revenue effects are shown as separate. However, in reality, they are interdependent, since all drivers have some probability both of being at fault and not at fault in accidents, albeit these probabilities differ between drivers; the result is that cost effects are likely to affect mostly the premiums of drivers with a high probability of being at fault in accidents, while revenue effects are likely to affect mostly the premiums of drivers with a high probability of being not at fault in accidents. Second, a change in the number of drivers of different types may change the number of accidents and hence the costs and revenue associated with separation of cost liability and cost control.

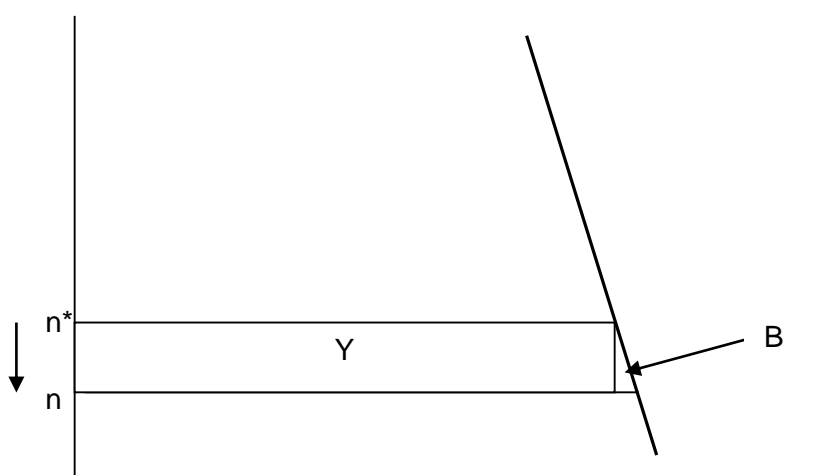
FIGURE 1

**Effects on car insurance premiums of separation of cost liability and cost control**

***At-fault insurers***



***Non-fault insurers***



Source: CMA analysis.

4. As drawn, Figure 1 assumes that the impact of the separation of cost liability and cost control on cost and on revenue is similar, and also that the slope of the demand curve is similar in both charts. Under these assumptions, the loss in consumer surplus in the top chart is offset by the gain in consumer surplus in the lower chart.
5. As set out in Section 6, however:
  - (a) Our assessment is that the effect of the separation of cost liability and cost control on costs (£206 million) exceeds the revenue stream (£96 million), implying area  $X$  exceeds area  $Y$ .

(b) It is plausible that demand from drivers most likely to be at fault in accidents is less price inelastic than the demand from other drivers (see Appendix 6.4).<sup>2</sup> Hence the slope of the demand curve in the top chart would be less steep than the slope of the demand curve in the lower chart.

Both these points would suggest that the loss in consumer surplus in the top chart (area A) would exceed the gain in consumer surplus in the lower chart (area B).

6. Nevertheless, as also noted in Appendix 6.4, demand even from drivers most likely to be at fault in accidents is likely to be price inelastic (even if not as price inelastic as demand from other drivers). Hence any consumer surplus effect is likely to be very small relative to the other effects of separation of cost liability and cost control. For example, assuming a straight line demand curve with an arc elasticity of  $-0.2$  and total car insurance premiums of £10,000 million, the loss of consumer surplus would be no more than  $\text{£}\{0.00001 \cdot (209)^2\}$  million, that is £0.4 million.<sup>3</sup>

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<sup>2</sup> Reasons for this include that the cost of car insurance for such drivers would be higher relative to the total cost of motoring and that such drivers may tend to be younger drivers with lower-than-average incomes for whom insuring their own car could become unaffordable.

<sup>3</sup> The estimated loss in consumer surplus ignores any gain associated with revenue from the separation of cost liability and cost control (Y) and hence is an upper estimate of the net loss in consumer surplus.



## **The benchmark for assessing the separation of cost liability and cost control**

1. This appendix discusses in more detail some conceptual issues raised in responses to our provisional findings on ToH 1 relating to the 'benchmark' against which we assess whether there is an AEC. We first set out our guidelines, then the approach taken in our provisional findings, the main responses received and our assessment of them.

### **CMA guidelines**

2. The CC guidelines (adopted by the CMA) state the following regarding concluding the AEC test:

319. Having considered evidence of all kinds, the CC comes to a rounded judgement on what may be causing any adverse effects on competition. This judgement entails the CC reaching a finding on whether there is a feature, or combination of features, of a relevant market that prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or part of the UK. If so, it will find that there is an AEC. In forming its judgement the CC will apply a 'balance of probabilities' threshold to its analysis, ie it addresses the question: is it more likely than not that features or a combination of features lead to an AEC?

320. In identifying some features or combination of features of the market that may give rise to an AEC, the CC has to find a benchmark against which to determine how the market may be judged to be performing. In the absence of a statutory benchmark, the CC defines such a benchmark as 'a well-functioning market' (see paragraph 30)—ie one that displays the beneficial aspects of competition as set out in paragraphs 10 to 12 but not an idealized perfectly competitive market. The benchmark will generally be the market envisioned without the features. But there may sometimes be reasons to depart from that general concept, for example, if features are intrinsic to the market but nevertheless have anticompetitive effects (as in the case of a natural monopoly) or if the nature of competition in the

market is defined by arrangements put in place by Government, eg as in rolling stock leasing.<sup>1</sup>

3. We consider that the benchmark/counterfactual is a tool for our analysis – it is not the whole basis for deciding on an AEC. Our duty is to consider the whole picture in our findings (and remedies). In this context, we note three main points:
  - the benchmark is generally the market envisioned without the features;
  - the benchmark is not an idealised perfectly competitive market; and
  - there may sometimes be reasons to depart from that general concept.
4. It is important to recognise that, while the benchmark is generally not a perfectly competitive market, it may not always be possible to identify a feasible well-functioning market outcome.<sup>2</sup> In these cases, the benchmark is used to inform our analysis, but does not represent the desired market outcome that we seek to achieve through our remedies. The Enterprise Act 2002 clearly envisages two separate stages of a market investigation: first, the CMA decides whether there is an AEC; second, if there is an AEC, the CMA decides on the remedies. Alternative feasible market outcomes are considered not as part of the AEC, but as part of the remedies process.
5. AECs in the CMA's market investigations may therefore involve either of the following circumstances:
  - The situation absent the feature(s) is a feasible alternative market outcome. This will tend to be the case only when the problem is particular contractual terms (for example, wide MFN clauses)<sup>3</sup> or tacit collusion. In such cases, the remedy is likely to involve trying to get to that alternative outcome, though in the case of tacit collusion this may not be easy.
  - The situation absent the feature(s) is not a feasible alternative market outcome. The remedies involved will then tend to be more complex, involving the consideration of alternative market outcomes that are not purely the world without the features; for instance, it may involve an outcome where the AEC is mitigated rather than prevented or an alternative

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<sup>1</sup> *Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3)* (adopted by the CMA), Part 3: Section 4 – Concluding the AEC test.

<sup>2</sup> For example, in the case of a natural monopoly (such as water distribution) the benchmark is not the market outcome when there are two or more suppliers (which would involve high costs due to scale diseconomies) but a hypothetical situation where there is no natural monopoly.

<sup>3</sup> It is not, however, normal for a market investigation to focus on contractual terms since these are covered by Chapter 1 of the Competition Act 1998 and/or Article 101 of TFEU.

outcome where the features(s) remain but the detrimental effect on customers is removed or mitigated. For example, in the case of a natural monopoly, the remedy may involve mitigating the detrimental effect on customers through price control.

### **Approach taken in our provisional findings**

6. Our issues statement set out, as one of the theories to be tested, that there was harm arising from the separation of cost liability and cost control (separation).
7. Initially, we sought to assess the effect of separation compared with a benchmark where there was no separation. This raised a number of issues, of which perhaps the most important were associated with quality differences, as follows:
  - Some parties argued that the quality of service was much better with separation. However, our survey of non-fault claimants suggested that the difference was fairly small, with respondents whose claims were captured by the at-fault insurer experiencing only slightly worse service. Comparing captured claims (no separation) with others (separation), the survey results suggested that no more respondents felt the replacement car fell well short of their needs; that only 6% more felt it fell slightly short of their needs; and that no more felt they had access to a replacement car for a shorter time than needed (see Section 6 Table 6.2).<sup>4</sup>
  - Parties argued that the quality of service currently offered by at-fault insurers to captured claimants was better as a result of the existence of CMCs/CHCs but that in the absence of separation, CMCs/CHCs would not exist. In particular, it was argued that, in the absence of separation, at-fault insurers would offer lower-quality replacement cars or would not offer them at all. In relation to this point, we noted that it meant both that there were benefits to non-fault claimants (better quality of replacement vehicles) and costs to all drivers (higher costs of providing replacement vehicles which would be passed through to higher premiums); that neither was taken into account in our estimate of detriment (which was based on like-for-like replacement vehicles); and that there was no clear evidence on whether the benefits did exceed the costs.
  - There appeared to be some quality benefits associated with captured claims and hence with non-separation, in particular non-fault claimants

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<sup>4</sup> There was even less evidence of quality difference for repairs (see Section 6, Table 6.3).

getting their car repaired by the fault insurer without having to pay the excess themselves (as sometimes appeared to happen when the non-fault insurer managed the claim, though not when a CMC managed it).

8. Ultimately, we provisionally found two features that in combination gave rise to an AEC: (a) separation and (b) various practices and conduct of the parties managing non-fault drivers' claims, which together gave rise to an inefficient supply chain. This was reflected in the benchmark, which assumed that consumers received their legal entitlements.

9. The following paragraph was therefore included in the provisional findings:

6.3 In assessing the effect on competition, we considered a benchmark 'well-functioning market' to be a market which delivered consumers' legal entitlements in an efficient way. We therefore looked at two dimensions: (a) how separation affects insurers' costs and revenue streams and ultimately its effect on the price paid by consumers; and (b) differences in the quality of service received by claimants that were associated with separation to understand any impact of separation on the quality of service received by consumers. We took both into account in reaching our provisional view on the effect on competition.

## Responses to the provisional findings

10. The main response to our provisional findings on this issue came from Accident Exchange, which summarised its views as follows:<sup>5</sup>

- The CMA's benchmark for conducting the AEC analysis is extreme. It is an idealised world of no frictional costs and is neither shown to be a market outcome in general nor is it the specific market outcome that would arise if the features allegedly leading to the AEC were not present (since in that case at-fault insurers would have at best limited incentives to provide direct hire). The CMA's adoption of this benchmark does not explain why at-fault insurers would provide direct hire absent separation or why consumers would not have to incur frictional costs themselves to receive their legal entitlement.
- The CMA should have included in its estimates of the net impact the frictional costs incurred by consumers to realise

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<sup>5</sup> Some of Accident Exchange's points were also raised by other respondents.

their legal entitlement in the absence of separation.

Alternatively, the CMA should recognise that adopting such an extreme benchmark for the AEC assessment creates a bias towards finding an AEC and the imposition of remedies, which must be taken into account in any remedy assessment.

- The CMA has not correctly applied its conceptual benchmark (one of legal rights being maintained) in practice as the CMA recognises that absent separation there will be a shortfall in quality and service provision but the CMA does not adjust its quantification to account for this. In particular, when assessing the effects on competition of separation against its benchmark, the CMA has failed to consider the costs to consumers of making up the quality and service shortfall of direct hire compared with credit hire so that consumers do in fact realise their legal entitlement as postulated in the benchmark.
- Since the CMA's benchmark assumes that consumers' legal entitlements are maintained, the CMA's analysis of the AEC cannot form an adequate basis to assess any remedies that do change consumers' legal entitlements or the degree to which consumers would realise their legal entitlements.
- The AEC identified by the CMA has distributional implications for consumers, ie there would be winners and losers in the status quo compared with the CMA's benchmark, given quality and service differentials. In particular non-fault drivers might be worse off since they would suffer the quality and service differentials. The CMA has failed to address this because it has only considered consumers in aggregate (ie it has conceptually averaged benefits across all consumers rather than only those who receive them). It is highly unusual for a competition authority to reach an AEC finding that creates winners and losers among different groups of consumers based on changing their legal entitlements since such a finding includes implicit value judgments (more usually AEC findings are based on features of the market that make at least some consumers worse off and no consumers better off).

### **Assessment of responses**

11. The key issue in Accident Exchange's response was related to the type of AEC we had found. Where the problem in the market is weak rivalry, the

benchmark can be the market with stronger rivalry (though depending on the features, this may or may not be a feasible market outcome – see paragraph 5). However, when, as in this case, market rivalry is strong and the problem is elsewhere, the benchmark needs to be the hypothetical situation where the problem does not exist.

12. The CMA's guidelines state that the benchmark is 'not an idealised perfectly competitive market', reflecting that the CMA would not find a problem just because there is imperfect rather than perfect competition in a market. Nevertheless, the guidelines do not say that the benchmark cannot be idealised in any sense, ie that it has to be a feasible market equilibrium.
13. It is worth noting that Accident Exchange's points about ToH 1 would apply at least as strongly to the AEC we have found under ToH 4. In relation to ToH 1, Accident Exchange argued that our benchmark assumed that non-fault claimants received their legal entitlements but we did not take into account the costs non-fault claimants would incur in obtaining their legal entitlement from at-fault insurers. However, a similar argument can be applied to ToH 4. Under ToH 4, we have found a problem associated principally with information asymmetries but we did not attempt to compare the current situation against a benchmark taking into account the costs that consumers would incur in acquiring sufficient information to overcome the information asymmetries.
14. We recognised that Accident Exchange raised some important points regarding the benefits consumers obtained from separation, and we took account of quality benefits in our analysis of the net detriment arising from the AEC. We assumed that, in the benchmark scenario, consumers received their legal entitlements (see paragraphs 8 and 9). We took account of the potential role of CHCs in ensuring that consumers received their legal entitlements in our assessment of the proportionality of remedies.
15. On Accident Exchange's specific points (see paragraph 10), we noted:
  - The benchmark is just a tool for our analysis and is the situation without the features. It does not have to be a feasible market outcome. Furthermore, the AEC we have found is the result of two features, not just separation.
  - We agreed that our remedies analysis needed to take into account all relevant costs, including any indirect costs, such as non-fault claimants obtaining lower-quality replacement vehicles but which still met their legal entitlement (this could occur, for example, if some non-fault claimants currently receive a quality of replacement vehicle that is in excess of their legal entitlement).

- We agreed that, in the absence of separation (which is one of the two features that in combination cause the AEC), non-fault claimants might not obtain, and/or might incur additional costs in realising, their legal entitlement to a like-for-like replacement vehicle (subject to need). However, as a matter of logic, the existence of this problem (in the hypothetical situation where there is no separation) does not imply that there is no existing problem associated with rent-seeking by third parties and an inefficient supply chain. That is why our benchmark assumes that claimants receive their legal entitlement.
- We agreed that our provisional findings provided no basis for including in the net detriment any lower premiums resulting from non-fault claimants receiving a level of replacement vehicle lower than their legal entitlement.<sup>6</sup> This was a corollary of our benchmark assuming that claimants received their legal entitlement.
- We agreed that our AEC involved distributional implications, ie some consumers might be better off as a result of the features while others would be worse off, and the net effect was negative. Indeed, we stated this in our provisional findings.<sup>7</sup>

## Conclusion

16. In our provisional findings we stated that we believed the benchmark 'well-functioning market' to be a market which delivered consumers' legal entitlements in an efficient way.
17. We recognised 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. We recognised also that any remedy which addressed the AEC arising from separation would need to make provision to ensure that there was not underprovision of service, and this would have a cost, so that the detriment estimated as arising from the AEC could be only partially removed. We took account of these issues within our consideration of remedies rather than in our calculation of the detriment arising from the AEC (see Section 10).

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<sup>6</sup> Such benefits could arise if the extra cost of direct hire of a vehicle meeting non-fault claimants' legal entitlement was greater than the benefit obtained by non-fault claimants (compared with some alternative level of entitlement, eg that under their own policy, usually a courtesy car).

<sup>7</sup> This finding is not unusual. A merger could involve price reductions for some customers (due to cost savings) but price increases for others (due to enhanced market power in some but not all market segments). A practice such as payment protection insurance (PPI) may have adverse effects for many consumers but would tend to benefit consumers purchasing the primary product (eg loans) but not PPI due to the 'waterbed' effect. The Financial Conduct Authority referred to this in relation to insurance add-ons in its recent market study.

## Analysis of add-ons

### Introduction

1. In this appendix, we consider:
  - (a) descriptions of add-ons provided by motor insurers to consumers at the point of sale;
  - (b) the possible point-of sale advantages for motor insurers when selling add-ons;
  - (c) the profitability of some add-ons; and
  - (d) our consumer survey results in relation to add-ons.

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

2. In this section, we consider the descriptions of add-ons (sold separately from the basic PMI policy) provided by motor insurers to consumers at the point of sale.
3. The descriptions provided by the ten motor insurers in our sample for a selection of add-ons are presented in [Annex A](#).

### *Personal injury cover*

4. Personal injury cover typically provides cover in the event that the policyholder and/or their partner suffer injury or death as a result of an accident. The cover provides compensation and/or money towards the cost of medical treatment.
5. Five of the ten motor insurers in our sample (Admiral, Aviva, esure, LV and Zurich) offered personal injury cover as an add-on. Four motor insurers in our sample (Ageas, AXA,<sup>1</sup> DLG and RSA) provided this cover as part of their basic PMI policy. One motor insurer in our sample (CISGIL) did not offer

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<sup>1</sup> 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 its basic comprehensive PMI policy. In addition, AXA provided the option of Personal Accident Plus as an add-on. This applied to both Swiftcover and AXA Direct brands.



personal injury cover as an add-on and did not include it in its basic PMI policy.

6. We expected a description of personal injury cover to detail the parties included under the cover, the key features of the cover and the relevant compensation limits. The descriptions provided by the six motor insurers which offered personal injury cover as an add-on avoided the use of unnecessary complex language or terminology. However, there was considerable variation in the level of detail provided to consumers. For example, the descriptions provided by Admiral, Aviva and esure summarised the key features of the add-on. In contrast, the descriptions provided by LV and Zurich provided a high-level overview of the add-on without reference to its key features.

### ***NCB protection***

7. NCB protection ensures that a customer's NCB years remain intact (subject to certain conditions) in the event of an accident where the customer is required to claim under their PMI policy. It does not protect a customer's PMI premium.
8. Six of the ten motor insurers in our sample (Admiral, Aviva, AXA, LV, RSA and Zurich) offered NCB protection as an add-on. Three motor insurers (Ageas, CISGIL and esure) 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). For example, [X]. One motor insurer (DLG) did not treat NCB protection as a standard add-on, but as a variation to the pricing on a basic PMI policy.
9. We noted that there was considerable variation in the level of detail provided to consumers in relation to NCB protection. For example, the description provided by Admiral explained clearly and concisely the conditions required to be considered eligible for NCB protection and the difference between protecting and guaranteeing a NCB. In contrast, the descriptions provided by AXA and Zurich were short and provided the consumer with little information about the product. In our view, the level of detail provided by the other motor insurers (Aviva, LV and RSA) was superior to that provided by AXA and Zurich, but inferior to that provided by Admiral.
10. Further, none of the descriptions presented comprehensively the complexities of the cover, notably that a driver's NCB was affected if they submitted too many claims in a specified period of time (typically more than one claim in a year or more than two claims over three years). It was also not made explicit by any of the motor insurers that the add-on protected the driver's NCB years but was not a protection of their current premium (which could be affected by claims independently of a driver's NCB). In our view, these were significant

deficiencies in the descriptions of NCB protection provided by the motor insurers in our sample.

### ***Extended foreign use cover***

11. Extended foreign use cover extends a customer's comprehensive PMI policy to any member country of the EU for up to 90 days per trip.
12. We noted that the basic comprehensive PMI policies provided by all ten motor insurers in our sample provided the minimum cover required by law.<sup>2</sup> In addition, four of the ten motor insurers in our sample (Aviva, CISGIL,<sup>3</sup> LV and RSA) offered extended foreign use cover as an add-on. Five of the ten motor insurers in our sample (Admiral, Ageas,<sup>4</sup> AXA, esure and Zurich) did not explicitly offer extended foreign use cover as an add-on, but may have provided cover (at a cost) if requested. One motor insurer (DLG) did not offer extended foreign use cover as an add-on.
13. The descriptions provided by Aviva, CISGIL and LV were concise and comprehensibly summarised the key features of the extended foreign use add-on.<sup>5</sup> However, in our view it would have been useful if the differences between the cover provided by the add-on and the cover provided by the basic comprehensive PMI policy were made explicit in the description, in order for a consumer to assess accurately the suitability of the add-on for their needs.

### ***Key loss cover***

14. Key loss cover provides cover for replacement locks and keys in the event that the customer's car keys are lost or stolen.
15. Four of the ten motor insurers in our sample (Admiral, AXA, esure and Zurich) offered key loss cover as an add-on. Five of the ten motor insurers (Ageas, Aviva, CISGIL, LV and RSA) provided this cover as part of their basic PMI policy. The remaining motor insurer (DLG) did not provide this cover as an add-on and did not provide it in its basic PMI policy.

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<sup>2</sup> The minimum legal cover (usually the equivalent of UK third-party-only cover) allows the customer to use the car in any member country of the EU and any other country that has agreed to follow Article 7(2) of the EU Directive on Insurance of Civil Liabilities arising from the use of motor vehicles (number 72/166/EEC) for up to 90 days in a year.

<sup>3</sup> CISGIL's extended foreign use was available as an add-on for the Co-operative Car Insurance product only.

<sup>4</sup> Ageas provided free EU cover for 90 days in its basic PMI policy. An extension to the 90 days or a request for cover outside the EU may or may not have been granted, but would attract an additional charge if granted.

<sup>5</sup> RSA's Foreign Use Extension add-on could only be purchased on the telephone and therefore there was no description of the add-on on the RSA website.

16. The descriptions provided by Admiral, AXA and Zurich provided a high-level overview of the key features of the add-on in a comprehensible manner. However, the description provided by esure was far more substantial, providing a detailed summary of the scenarios under which the add-on could be utilised, and thus better allowing a consumer to assess the suitability of the add-on for their needs.

### ***Courtesy car cover***

17. Courtesy car cover typically provides the customer with a standard, Class A courtesy car in the event that their car is immobile following an accident, stolen and not recovered, or declared a total loss.
18. Four of the ten motor insurers in our sample (Aviva, DLG,<sup>6</sup> LV and RSA<sup>7</sup>) offered courtesy car cover as an add-on. The remaining six motor insurers (Admiral, Ageas, AXA,<sup>8</sup> CISGIL,<sup>9</sup> esure and Zurich) provided this cover as part of their basic PMI policy.
19. We expected a description of courtesy car cover to include the key features of the cover, such as the conditions under which the car would be provided, the type of car provided, the hire duration and any limitations of the cover. However, only Aviva's description presented all of these key features, thus allowing the consumer to make an accurate assessment of whether the add-on was suitable for their needs. The descriptions provided by the other three motor insurers, although comprehensible, did not detail the type of car provided under the cover.
20. We noted that all four motor insurers did not explain to consumers that, in circumstances where they were not at fault for an accident, they were likely to be entitled to a like-for-like replacement car paid for by the at-fault insurer (subject to a duty to mitigate their loss with consideration to their need), which could reduce the perceived benefit of this add-on.

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<sup>6</sup> DLG offered (since 8 September 2013) 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. DLG offered Guaranteed Hire Car (GHC) and Guaranteed Hire Car Plus (GHC+) as optional add-ons, which enabled customers to purchase hire car provision. DLG considered the GHC and GHC+ add-ons to be 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 to 14 consecutive days for GHC and 21 consecutive days for GHC+. Customers with GHC or GHC+ were not entitled to a courtesy car benefit. There were a very small number of DLG legacy policies which provided a courtesy car under the basic PMI policy.

<sup>7</sup> RSA included windscreen cover and courtesy car cover in the basic More Than PMI policy, but they were sold separately (and required to be purchased as add-ons) from the basic eChoice PMI policy.

<sup>8</sup> AXA provided courtesy car cover as standard under its basic PMI policy for its AXA Direct brand. Under its Swiftcover brand, courtesy car cover was offered as an add-on.

<sup>9</sup> This add-on was only applicable where the customer's car was repaired by a CISGIL-approved repairer.

### ***Enhanced courtesy car cover***

21. Enhanced courtesy car cover provides the customer with a like-for-like replacement car or a replacement car of a superior quality to the standard Class A courtesy car typically provided under courtesy car cover in the event that their car is being repaired, stolen and not recovered, or declared a total loss.
22. Seven of the ten motor insurers in our sample (Admiral, Ageas, AXA,<sup>10</sup> esure, LV, RSA and Zurich)<sup>11</sup> told us that they did not offer enhanced courtesy car cover. Of the remaining three motor insurers:
  - (a) Aviva told us that it offered its Aviva customers an enhanced courtesy car add-on, which entitled them to a replacement car of a superior quality to a standard courtesy car (but not a like-for-like replacement car).
  - (b) CISGIL told us that it offered its Co-operative Motor Insurance customers an enhanced courtesy car add-on, which entitled them to a replacement car of a similar engine specification (up to a maximum engine size of 1800cc) and size to their vehicle for up to 14 days.
  - (c) DLG told us that it offered its customers a Guaranteed Hire Class Plus add-on, which entitled them to a replacement car of a similar physical size to their own car (although this was not guaranteed) for up to 21 consecutive days.
23. Table 1 shows the proportion of Aviva, CISGIL and DLG customers which typically purchased the enhanced courtesy car add-on.

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<sup>10</sup> AXA did not offer its customers an enhanced courtesy car add-on which provided 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 would be provided.

<sup>11</sup> Zurich told us that its basic PMI policies included courtesy car provision as standard, and typically this would be a group A car (eg a small hatchback), usually with a manual gearbox, and this would only be available in the UK. On its high-net-worth product, if the courtesy car provided did not meet the customer's requirements, it would provide a hire car of a similar specification to the vehicle which was the subject of the claim.

TABLE 1 **Enhanced courtesy car cover take-up**

Motor insurer	Proportion of customers who purchased add-on (%)		
	2010	2011	2012
Aviva	[REDACTED]	[REDACTED]	[REDACTED]
CISGIL*	[REDACTED]	[REDACTED]	[REDACTED]
DLG†	[REDACTED]	[REDACTED]	[REDACTED]

Source: Aviva, CISGIL and DLG.

\*We noted that CISGIL provided courtesy car cover as standard under its basic PMI policy (where any repair was undertaken by a CISGIL-approved repairer).

†These figures were in relation to the GHC+ add-on offered by DLG, which was its closest equivalent to offering policyholders 'a replacement vehicle similar to their own'.

24. We noted again that these three motor insurers did not explain to consumers that, in circumstances where they were not at fault for an accident, they were likely to be entitled to a like-for-like replacement car paid for by the at-fault insurer (subject to a duty to mitigate their loss with consideration to their need), which could reduce the perceived benefit of this add-on (see paragraph 20).

### Information at point of purchase

25. All ten motor insurers in our sample told us that consumers were provided with the same information in relation to add-ons regardless of whether they accessed the motor insurer's website directly or clicked through to the motor insurer's website from a PCW. The ten motor insurers in our sample re-offered add-ons to consumers upon click-through from the PCW to their website, because:

- (a) PCWs did not offer the entire suite of add-ons provided by motor insurers; and
- (b) the pricing of and the level of cover provided by add-ons could be variable, depending on the age of the vehicle and cover level selected (eg breakdown cover) or on the excess amount insured (eg excess protection) and PCWs were unable to match this functionality on their websites.

### MFN clauses for add-ons

26. [REDACTED]<sup>12</sup>

27. [REDACTED]

28. [REDACTED]

<sup>12</sup> [REDACTED]

## **Profitability of add-ons**

29. We looked at the claims ratios of some add-ons as a basic measure of their profitability. We could not review expense ratios as motor insurers did not allocate expenses between their add-on products.<sup>13</sup>
30. The claims ratio, which is presented as a percentage, measures the proportion of premiums paid out in claims. It is calculated as claims costs divided by net earned premium (NEP). Claims costs are the total of claims paid, net of any recoveries from motor insurers, and any changes in provisions for claims, net of reinsurance; NEP is gross written premium (GWP), net of Insurance Premium Tax (IPT) and premiums ceded to motor insurers and any changes in provisions for unearned premiums. All things being equal, a low claims ratio indicates higher profitability for a motor insurer than a high claims ratio.

## ***Data requested from the parties***

31. We asked motor insurers to complete a template spreadsheet containing a split of NEP and claims costs by type of risk covered. The template spreadsheet covered the five years 2008 to 2012. The types of risks covered were:
  - (a) basic cover;
  - (b) MLEI;
  - (c) NCB protection;
  - (d) windscreen;
  - (e) breakdown;
  - (f) personal injury;
  - (g) courtesy car; and
  - (h) other (including key loss and extended foreign use cover).

## ***Data received***

32. Of the ten large motor insurers, only seven were able to provide data splitting NEP and claims costs for some add-on products. No motor insurer was able

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<sup>13</sup> The expense ratio is expenses expressed as a percentage of premiums.

to provide data on all the add-on products in our list (see paragraph 31). Motor insurers provided data on the following add-ons:

- (a) Aviva: [REDACTED];
- (b) AXA: [REDACTED];
- (c) CISGIL: [REDACTED];
- (d) DLG: [REDACTED];
- (e) esure: [REDACTED];
- (f) LV: [REDACTED]; and
- (g) RSA: [REDACTED].

33. Three motor insurers ([REDACTED]) did not provide a split of NEP and claims costs by add-on product, for the following reasons:

- (a) [REDACTED] add-ons were all launched in the second half of 2012, so it had limited data.
- (b) [REDACTED] had a limited range of add-on products, which were provided mainly by third parties.
- (c) [REDACTED] add-on products were either included in its basic cover or provided by third parties.

### **Analysis of the data**

34. Table 2 shows which motor insurers provided data on which add-ons in order for us to be able to calculate claims ratios.

TABLE 2 **Data available for add-on products**

<i>Add-on product</i>	<i>Motor insurers providing suitable data</i>	<i>Number of parties with data compared with number offering add-on</i>
Breakdown	[REDACTED]	3 out of 3
MLEI	[REDACTED]	6 out of 8
NCB protection	None	0 out of 10
Windscreen	[REDACTED]	2 out of 3
Personal injury	[REDACTED]	1 out of 6
Courtesy car	[REDACTED]	4 out of 5
Other:		
Key loss	[REDACTED]	1 out of 4
Extended foreign use	[REDACTED]	2 out of 6

Source: CMA based on responses from the parties.

NEP

35. Table 3 shows the aggregate NEP for basic cover and each add-on product for the five-year period for the seven motor insurers listed in paragraph 32.

TABLE 3 Analysis of NEP by type of risk

	2008	2009	2010	2011	2012	2012 share to total NEP %
Basic cover	5,302.7	5,285.6	5,558.9	5,699.5	5,176.7	91.5
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.

36. Table 3 shows that basic cover accounted for 91.5% of total NEP in 2012. Breakdown cover and NCB protection accounted for 2.8 and 2.7% respectively, and no other add-on accounted for more than 2%.

Claims ratios

37. Table 4 shows the claims ratios for basic cover and each add-on product for the five-year period. The averages were weighted according to the size of the motor insurer (based on NEP).

TABLE 4 Claims ratios by type of risk covered, 2008 to 2012

	2008	2009	2010	2011	2012	Average	Parties providing data
Basic cover	84	96	108	85	82	91	All 7
Breakdown	[§]	[§]	[§]	[§]	[§]	[§]	3: [§]
MLEI	[§]	[§]	[§]	[§]	[§]	[§]	6: [§]
Windscreen	[§]	[§]	[§]	[§]	[§]	[§]	2: [§]
Personal injury	[§]	[§]	[§]	[§]	[§]	[§]	1: [§]
Courtesy car	[§]	[§]	[§]	[§]	[§]	[§]	4: [§]
Key loss	[§]	[§]	[§]	[§]	[§]	[§]	1: [§]
Extended foreign use	[§]	[§]	[§]	[§]	[§]	[§]	2: [§]
<b>Overall</b>	<b>80</b>	<b>90</b>	<b>102</b>	<b>80</b>	<b>77</b>	<b>86</b>	

Source: CMA calculations based on responses from the parties.

Basic cover

38. The weighted average claims ratio for basic cover was 91% over the five-year period, with consistency across the years except for 2010. [§]



### *MLEI*

39. The weighted average claims ratio for MLEI was extremely low at 5 to 10% over the five-year period:
- (a) [REDACTED] showed [REDACTED]. It told us that [REDACTED].
  - (b) [REDACTED] had [REDACTED] claims ratio for MLEI, at an average of [REDACTED]% over the five-year period.
  - (c) [REDACTED] did not provide its claims ratio, but told us that the claims cost for MLEI was very low as it usually sought to recover the costs incurred from the at-fault insurer. [REDACTED] told us that this cover provided customers with valuable benefits, enabling them to recover uninsured losses or to pursue a personal injury claim following a non-fault accident.

### *Windscreen*

40. Two motor insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 70 to 100% over the five-year period, typically being only a little lower than the basic cover claims ratio.

### *Breakdown*

41. Three motor insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 30 to 45% over the five-year period. We noted that:
- (a) [REDACTED] claims ratio for each year was [REDACTED] (between [REDACTED] and [REDACTED] %); and
  - (b) [REDACTED] ratio fluctuated (probably due to a build-up and subsequent release of reserves), but averaged [REDACTED] %.

### *Personal injury*

42. Only [REDACTED] was able to provide data on this add-on.

### *Courtesy car*

43. Four motor insurers provided data on this add-on. The weighted average claims ratio ranged from 25 to 60% over the five-year period. [REDACTED] and [REDACTED] showed [REDACTED] claims ratios, of between [REDACTED] and [REDACTED] %, whereas RSA showed [REDACTED] ratios in 2009 and 2010 of [REDACTED] and [REDACTED] % respectively.

*Other: key loss*

44. Only [redacted] provided data on this add-on. Its average claims ratio for the five-year period was [redacted]%.  
[redacted]

*Other: extended foreign use*

45. Two motor insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 20 to 40% over the five-year period. [redacted] average claims ratio for the five-year period was [redacted]%, and [redacted] was [redacted]%.<sup>14</sup>

*NCB protection*

46. Although NCB protection insures a customer against a specific risk (ie losing the NCB as a result of a claim) and a premium is charged for it, there is no claims cost clearly associated with it as it relates to the amount of premium payable by a customer in the future. Consequently, none of the motor insurers provided us with a claims ratio. However, they told us how they priced the product (including whether it had a standard price or whether the price was dependent on the risk of the policyholder), the costs associated with the product, and how those costs were accounted for. We set out this evidence below.

*Pricing of NCB protection*

47. It appeared to us that all ten motor insurers took a risk-based approach to setting the price at which they offered NCB protection to policyholders:
- (a) [redacted], [redacted] and [redacted] noted that their pricing took account of customer profitability, which reflected claims performance. [redacted] told us that, where protected NCB was available, the price was calculated as a percentage addition to the premium for basic cover and, therefore, it reflected the overall risk of the individual policyholder. [redacted] told us that the price was 14% of the basic premium. [redacted] told us that the price was up to 15% of the basic premium.
  - (b) [redacted] and [redacted] told us that the selection of NCB protection was treated as a variable in the overall premium calculation, ie the total premium was adjusted if the customer selected NCB protection rather than there being a separate figure calculated to represent the cost of NCB protection. [redacted] explained that this was because the benefit of NCB protection related to

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<sup>14</sup> [redacted] noted that its 'other' category of claims was mainly against foreign use cover, but could include a small number of claims made against other covers.

the cost of the basic cover, whereas claiming under other add-ons did not affect the basic cover and its pricing. [X] told us that the price was dependent on the number of claim-free years and was 2.5% if the number of NCB years protected was five or more, and 10% if four years' NCB was protected (and NCB protection was not offered for less than four years' NCB).

- (c) [X] and [X] told us that NCB protection was priced in the same way as basic PMI cover and was therefore based on the risk of the individual policyholder.
- (d) [X] and [X] told us that NCB protection was priced as an additional percentage of the basic PMI premium and was therefore based on the risk of the individual policyholder. [X] said that the price was currently 10 or 15% of the basic premium for [X] told us that it charged an additional [X]% of the basic premium for NCB protection.
- (e) CISGIL told us that [X].

*The cost to motor insurers of NCB protection*

- 48. Nine of the ten motor insurers told us that the cost to them of NCB protection was the income forgone from not reducing the discount applied to the premium at renewal (which would otherwise happen if the customer had made a claim).
- 49. [X] estimated that the opportunity cost of not increasing the renewal premium was between 0.5 and 1% of the NEP for basic cover plus the NCB protection add-on. [X] noted that, for [X] renewals in the first quarter of 2013, for a customer who had nine years' NCB but had made at least one at-fault claim during the previous year, there was an average premium increase of over 60% for customers without NCB protection and a significantly lower increase of below 15% for customers with NCB protection.
- 50. [X], AXA, DLG and LV told us that an additional cost to the motor insurer was that customers with NCB protection were more likely to make small claims than customers without NCB protection (since the latter might decide not to make a claim in order to avoid an increase in premium due to losing their NCB). However, [X] noted that, whilst in theory customers with NCB protection could be expected to make more small claims than customers without it, its experience was that overall the claims cost of customers with NCB protection was lower than for customers without it. Similarly, [X] noted that its loss ratio was better (ie lower) on policies with protected NCBs. [X] noted that customers with NCB protection who had made a claim were more likely to

switch motor insurers at renewal than customers without NCB protection who had made a claim because they would be able to obtain more competitive renewal quotes.

51. One motor insurer ([redacted]) told us that the additional claims cost associated with policyholders who had NCB protection was the only cost directly considered when it calculated premiums.

*Accounting treatment*

52. It appeared to us that the extent to which renewal premiums were lower as a result of NCB protection was reflected in motor insurers' overall premium income. Similarly, the extent to which claims were higher than would have been the case was reflected in the overall claims cost. Two motor insurers, LV and Zurich, noted that the costs associated with NCB protection could not be separated from the overall claims cost, as it was not possible to know which claims the customers with NCB protection had made which they would not have made had they not purchased it.

*Add-on products supplied by third parties*

53. The motor insurers in our sample were generally unable to supply us with data on the profitability of add-on products supplied by third parties. However, we received some data on selected add-ons from two motor insurers: CISGIL and esure.
54. CISGIL's breakdown cover and enhanced courtesy car cover add-ons were provided by a third party (so not included in the calculations above). Table 5 shows the maximum retail price and margin to CISGIL for each of these products (ie the retail price less the IPT (currently 6%), the direct cost to CISGIL, allocated costs (such as marketing, sales staff, system expenses, etc), and a contribution towards indirect costs).

TABLE 5 CISGIL's breakdown and enhanced courtesy car cover add-on products

	<i>Breakdown</i>	<i>Courtesy car</i>
Maximum retail price (£)	60	17.50
Margin (£)	[redacted]	[redacted]
Margin (%)	[redacted]	[redacted]

Source: CISGIL; CMA calculations.

55. Since October 2010, CISGIL has also offered key loss cover from a third party supplier (Keycare).<sup>15</sup> CISGIL set the retail price (currently £15) to cover the

<sup>15</sup> CISGIL offered key loss cover as an add-on under its Ecoinsurance brand.

net rate payable to the claims administrators (currently £[redacted] for each new business policy and £[redacted] for each policy renewal (ie effectively the claims costs per policy)), direct and indirect CISGIL costs, IPT and its profit. The retail price net of IPT less the amounts payable to the claims administrators produced a margin of between £[redacted] and £[redacted] which covered CISGIL's costs of selling, allocated costs, indirect costs and profit.

56. esure's breakdown cover was provided by Green Flag. esure told us that [redacted].

## Our consumer survey results in relation to add-ons

### Take-up of add-ons

57. Table 6 shows respondents' stated take-up of add-ons.<sup>16</sup> Take-up was particularly high for windscreen cover at 85%, though we noted that this add-on was included in the basic PMI policy for seven of the ten motor insurers in our sample. The majority of respondents said that they had NCB protection, legal cover, courtesy car cover and personal injury cover included in their policies. The high stated take-up of NCB protection suggested that some respondents might not have been clear on the distinction between NCB and NCB protection, so we treated this result with some caution.

TABLE 6 Products included in policy

	%		
	Yes	No	Don't know
Windscreen cover	85	10	5
NCB protection	80	17	4
MLEI	76	18	6
Courtesy car cover	70	24	6
Personal injury cover	56	30	14
Breakdown cover	39	58	3
Extended foreign use cover	30	56	14
Key loss cover	24	54	22

Base (unweighted) = 1,501

Source: CMA PMI consumer survey, question B2.

58. The final column of Table 6 shows that some policyholders were unsure about the content of their policy. The percentages of respondents who did not know whether they were protected by particular add-ons were 22% for key loss cover, 14% for extended foreign use cover and 14% for personal injury cover.

59. Differences in the take-up rates between add-ons suggested: (a) differences in the number and type of add-ons offered to consumers; (b) differences in

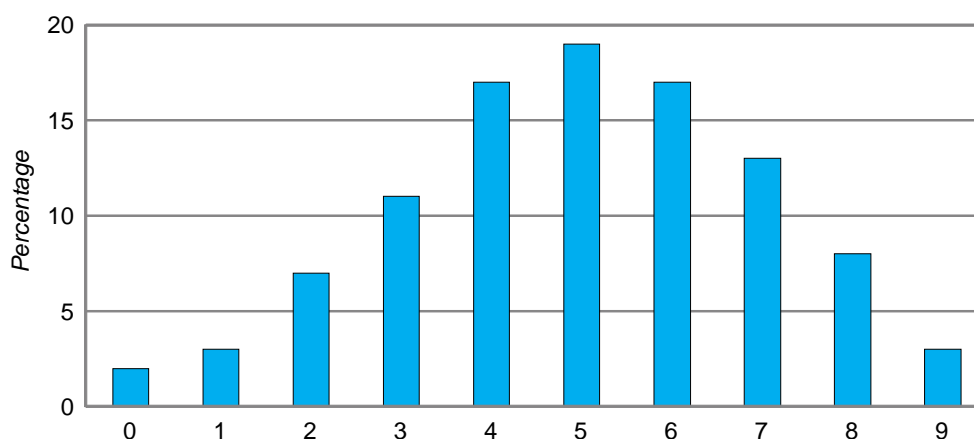
<sup>16</sup> Take-up meant the number of policyholders covered by a specific add-on, regardless of whether the add-on was bought separately (with an additional premium) or included within the basic PMI policy.

how they were typically offered to consumers; and/or (c) the exercise of choice among consumers about which add-ons to purchase. We noted that some motor insurers included certain add-ons (often windscreen cover and glass cover) in their basic PMI policy, such that a policyholder could not opt out from this protection (unless they switched PMI provider). We also noted that some add-ons were not offered by all PMI providers, such that if their policyholders wished to buy a specific protection, they had to do so from a different provider (or switch PMI provider).

60. Figure 1 shows the number of add-ons taken up by respondents. Only a very small proportion of respondents took up either all or none of the nine add-ons in our list, with the modal number being five.

FIGURE 1

**Number of add-ons included in policy**



Source: [CMA PMI consumer survey](#), question B2.

61. Our consumer 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 policy.
62. Table 7 shows that most people who considered an add-on at the time of purchase of their motor insurance policy went on to buy it (either within their basic policy or separately). This is particularly true of windscreen cover, the most frequently taken up add-on. In contrast, 23% of those who considered

breakdown cover did not take it up, which might have been due to there being many stand-alone options for breakdown cover (eg from the AA or RAC).<sup>17</sup>

TABLE 7 Products considered by the policyholder

	%		
	<i>Considered</i>	<i>Included</i>	<i>% who considered but did not include</i>
Windscreen cover	89	85	4
NCB protection	86	80	8
MLEI	83	76	9
Courtesy car cover	77	70	10
Personal injury cover	64	56	12
Breakdown cover	51	39	23
Extended foreign use cover	33	30	11
Key loss cover	29	24	18

Base (unweighted) = 1,501

Source: [CMA PMI consumer survey](#) questions B2, B3.

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\*Percentage of those who included this add-on in their policy.

63. Most respondents who had an add-on in their policy (either purchased separately or included in the basic policy) said that they compared that add-on across motor insurers the last time they compared PMI policies (see Table 8). Summing across the nine add-ons in our list, 52% of add-ons included in policies were compared in this way. However, we noted that different consumers might have meant different things in terms of the extent and nature of the comparison they made.
64. Most respondents who compared features of add-ons across motor insurers said that they found it easy to do so, in particular for windscreen cover and NCB protection (see Table 8). It appeared that consumer purchasing behaviour was similar for personal injury cover, extended foreign use cover and key loss cover, with relatively little comparison of these add-ons across motor insurers.

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<sup>17</sup> We noted that only 3% of respondents said that they did not know whether breakdown cover was included in their PMI policy, which suggested a high level of consumer awareness about this add-on (see Table 1).

TABLE 8 Percentage of policyholders covered by the product who compared the product across motor insurers

	<i>Included</i> %	<i>Of which: Compared motor insurers</i> %	<i>Of which: Comparison of feature was</i>		<i>Unweighted base</i>
			<i>Easy</i> %	<i>Difficult</i> %	
Windscreen cover	85	52	73	9	653
NCB protection	80	62	65	12	735
MLEI	76	52	55	17	569
Courtesy car cover	69	53	59	14	539
Personal injury cover	56	47	53	17	399
Breakdown cover	39	52	59	13	355
Extended foreign use cover	30	26	59	18	114
Key loss cover	24	32	52	15	127

Source: CMA PMI consumer survey questions B2, B7, B8.

\*Easy' combines responses to B9 of; 'quite easy' and 'very easy'; 'difficult' combines 'quite difficult' and 'very difficult'.

65. Table 9 shows respondents' perceptions of the value for money of those add-ons which they had purchased.

TABLE 9 Perceived value for money among those that have the feature

	<i>Included</i>	<i>Value for money*</i>		
		<i>Good</i>	<i>Poor</i>	<i>Don't know</i>
Windscreen cover	85	65	8	7
NCB protection	80	69	6	7
MLEI	76	53	6	14
Courtesy car cover	69	54	7	14
Personal injury cover	56	51	7	12
Breakdown cover	39	64	7	9
Extended foreign use cover	30	38	16	23
Key loss cover	24	35	8	10

Source: CMA PMI consumer survey questions B2, B9.

\*Question B9 of the consumer survey asks 'On a five point scale where 5 is very good value and 1 is very poor value, how would you rate the value for money of the feature available to you'. Responses of 4 or 5 are categorized as 'good' for the purpose of this table, and responses of 1 or 2 are categorized as 'poor'.

66. Most respondents thought that the add-ons they had taken up were good value for money.<sup>18</sup> This was particularly true of NCB protection (69%). For most add-ons, only a small percentage of respondents who had taken up an add-on regarded it as poor value for money (6 to 8% for most add-ons). The proportions were higher for extended foreign use cover, which is discussed below (see paragraph 77).

67. A relatively high proportion (23%) of those respondents who said that they had extended foreign use cover said that they did not know whether it was good value. This suggested to us that many consumers of this add-on were

<sup>18</sup> We noted that, where an add-on was purchased as part of a basic PMI policy, and without the payment of an additional premium, the 'cost' of the add-on might still have been assessed by comparison with the cost of the add-ons from another provider.



unclear of the cover provided and whether or not it was needed in order to drive abroad.

### **Personal injury cover**

68. The name of this add-on varied between motor insurers. Over half of the respondents to our consumer survey of PMI policyholders (56%) said that they had this add-on. We noted that there was also evidence of a seasonal effect with the add-on being taken up more often when policies were renewed in the first three months of the calendar year (60%), which possibly reflected greater awareness of the risk of injury at that time of year.
69. Table 10 shows the extent to which respondents believed they understood the personal injury cover add-on,<sup>19</sup> analysed by their rating of its value for money. Half of respondents rated the add-on as good or very good value for money and these respondents tended to be those who claimed to understand it. This pattern applied to all nine add-ons, ie the more respondents believed they understood the add-ons, the better value for money they perceived the add-on to be.

TABLE 10 Perceived understanding compared with perceived value for money – personal injury cover

	How well the respondent believed they understood the feature					All
	Not at all				Very well	
	1	2	3	4	5	
Poor or very poor value	21	28	10	6	3	9
Neither poor nor good value	28	30	41	29	19	30
Good or very good value	26	27	35	57	71	50
Don't know	26	16	14	8	8	11
Total	5	10	30	26	29	100
Base	43	90	279	244	266	922

Source: CMA PMI consumer survey questions B9, B10.

70. Table 11 shows the results of a suite of three questions designed to test actual understanding of personal injury benefits. The questions were asked of all those who had considered (most of whom also took up) personal injury cover. While most respondents said that they were covered by the add-on, only 17% answered correctly that passengers, other than themselves and

<sup>19</sup> Question B10 of the consumer survey asked the following: 'And still thinking about the last time you were considering which features to include in your Private Motor Insurance Policy, how well do you believe you understood what exactly the feature covered? Please answer on a scale of 1 to 5 where 5 is very well understood and 1 is not at all understood.' The results shown categorise respondents' perceived understanding into 'High' (a response of 4 or 5 to the question), 'Medium' (a response of 3) and 'Low' (a response of 1 or 2). The very small number of respondents who said they didn't know were excluded from the analysis.

their spouse, were not covered by it. Only 5% of respondents answered all three questions correctly.

TABLE 11 Actual understanding of personal injury benefits

	%		
	<i>Do you think the following are covered?</i>		
	<i>You</i>	<i>Your spouse</i>	<i>Any passengers</i>
Yes	84*	58*	56
No	6	22	17*
Don't know	9	20	27
<i>% 'yes' by claimed understanding</i>			
High	89*†	61*	59
Medium	83*	56*	53
Low	79*†	56*	50

Source: CMA PMI consumer survey questions B10, B10a.

\*Indicates the correct answer (although a few motor insurers might have provided cover with a slightly different scope, we believed the market shares of such providers was insufficient to materially affect our results).

†Statistically significant difference.

71. The second part of Table 11 shows the percentage of respondents who said 'yes' to each of the questions asked broken down by their perceived level of understanding of the add-on. The table shows that the percentage of respondents who said 'yes' increased with their perceived level of understanding, though in the last case 'yes' was the incorrect answer (ie 59% of those who thought that they understood the add-on well answered incorrectly).
72. Table 10 shows that the perception of understanding of an add-on tended to make a consumer value it more. Table 11 suggests that this was because such consumers thought that the add-on offered wider cover than other consumers, though sometimes they did so incorrectly. Subsequent tables in this section supported this finding.
73. Table 12 shows the results of a similar set of questions for medical expenses. In this case the correct answer to all three questions was 'yes', and 40% of those with the add-on answered all three questions correctly. Again, the perceived coverage of the add-on tended to increase with the perceived understanding (though in this case it was correct that coverage was wider).

TABLE 12 Actual understanding of medical expenses

	%		
	<i>Do you think the following are covered?</i>		
	<i>You</i>	<i>Your spouse</i>	<i>Any passengers</i>
Yes	84*	58*	50*
No	7	23	20
Don't know	10	19	30
<i>% 'yes' by claimed understanding</i>			
High	87*	62*	55*†
Medium	83*	54*	45*†
Low	80*	60*	45*

Source: CMA PMI consumer survey questions B10, B10b.

\*Indicated the correct answer.  
 †Statistically significant difference.

### NCB protection

74. Our consumer survey found a high stated take-up of NCB protection (80%). However, we believed this was likely to be an overstatement due to some consumers confusing NCB and NCB protection. Data from five of the ten largest motor insurers suggested that actual take-up rates of NCB protection were between [X] and [X]%, with an unweighted average of 49%. This suggested that a significant proportion of consumers who thought that they had the protection did not actually have it.
75. Nevertheless, a high proportion of respondents (77%) thought that they had a good understanding of this add-on. Table 13 shows that 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, and only 29% of respondents who said that they had the add-on answered this question correctly.<sup>20</sup> Respondents claiming a high level of understanding of NCB protection tended to be the most optimistic about the extent of its cover.

<sup>20</sup> A PMI premium could rise following an accident, notwithstanding NCB protection, as a motorist involved in an accident (whether fault or non-fault) may have been deemed by a motor insurer to be statistically more likely to have an accident in the future. NCB protection was also usually limited to a certain number of claims in a defined time period, such that if there were more accidents, the NCB would decrease.

TABLE 13 Actual understanding of NCB protection

	%		
	<i>Does the protection prevent your premium going up as a result of a claim?</i>		
	Yes	No	Don't know
All with feature	56	29*	14
<i>By claimed understanding</i>			
High (base 991)	59†	29*	12†‡
Medium (base 182)	46†	31*	23†
Low (base 108)	50	27*	23‡

Source: CMA PMI consumer survey questions B10, B10c.

\*Indicates the correct answer.  
 † and ‡ indicate statistically significant differences.

76. 37% of those who said that they had made a ‘claim’ against their NCB protection answered the question correctly. 47% of those who had made a ‘claim’ said that they understood the add-on very well; with 48% of respondents who had not made a ‘claim’ saying the same. This was different from all other add-ons (except extended foreign use travel where the number of claims was very low), where the experience of claiming against the add-on tended to increase both the stated and actual understanding.

**Extended foreign use cover**

77. Only 30% of respondents said that they had extended foreign use cover. Among these, 60% said that they had a good understanding of this add-on, but only 30% of these correctly answered the question testing their understanding of it (see Table 14).<sup>21</sup> A higher proportion (42%) of those who said they had a low understanding of the add-on gave the correct answer.

TABLE 14 Actual understanding of extended foreign use cover

	%		
	<i>Do you need the feature to be able to drive your vehicle at all in continental Europe?</i>		
	Yes	No	Don't know
All with feature	55	30*	16
<i>By claimed understanding</i>			
High (base 272)	61†	30*	9
Medium (base 108)	56	27*	17
Low (base 71)	42†	42*	15

Source: CMA PMI consumer survey questions B10, B10d.

\*Indicates the correct answer.  
 †Indicates statistically significant difference.

<sup>21</sup> Foreign use cover is not necessary in order for the policyholder to drive their car in Europe (as a basic PMI policy provides at least third party cover abroad).

## Key loss cover

78. Only 24% of respondents said that they had key loss cover. Take-up was higher among the C2DE socioeconomic group (29%) and much higher in Northern Ireland (38%). It was also higher among those who had foreign travel cover (32%).
79. Of respondents with key loss cover, 67% said that they had a good understanding of it. However, only 9% correctly answered both the consumer survey questions which tested their understanding (see Table 15).<sup>22</sup> Those who thought that they understood the add-on tended to be more optimistic about its coverage, though not always correctly.

TABLE 15 Actual understanding of key loss cover

	%		
	<i>Will this pay for replacement keys and locks to your car if you lose your keys?</i>		
	Yes	No	Don't know
All with feature	75*	6	18
<i>By claimed understanding</i>			
High (base 267)	86*†‡	3†‡	11†‡
Medium (base 86)	63*†	10†	27†
Low (base 47)	57*‡	15‡	28‡
	<i>Will someone appointed by the insurance company come out to you and fix the problem if you lose your keys?</i>		
	Yes	No	Don't know
All with feature	50	14*	37
<i>By claimed understanding</i>			
High (base 267)	55	12*	32
Medium (base 87)	43	17*	40
Low (base 48)	46	17*	38

Source: CMA PMI consumer survey questions B10, B10e, B10f.

\*Indicates the correct answer.

† and ‡ indicate statistically significant differences, eg in column 1, 86% is statistically higher than 63% and 57% but 63% is not statistically higher than 57%.

<sup>22</sup> Key loss cover insures for the replacement cost of locks and keys for the car if the policyholder loses the keys, but the insurance company will not send someone to sort out the problem. From the evidence we have seen, a very small proportion of key loss covers included the motor insurer sending someone out.

## Descriptions of add-ons provided by motor insurers on their websites

### Personal injury cover

#### ***Admiral***

Personal Injury Cover provides cash when hospitalised after an accident, and up to £50,000 cover for serious injury or accidental death in your car. It also includes all the following benefits:

All named drivers are covered (under the age of 80)

Cover is extended for the policyholder travelling in any other privately insured car in the UK

You're covered whether the accident is your fault or not, and if you're hit by an uninsured driver

Please click [here](#) for full terms and conditions

#### ***Aviva***

Regardless of who's to blame for an accident involving the insured vehicle, if the main driver is seriously injured, this cover helps to provide financial peace of mind.

£40,000 payment following death or permanent loss of a limb, sight or hearing within 3 months of an accident in the UK.

Or if you prefer choose joint cover for the main driver and their partner (£20,000 each).

#### ***esure***

With our Personal Injury Benefit you get peace of mind in the knowledge from knowing that you'll get up to £30,000 worth of compensation if you, your partner and any named drivers or passengers suffer an injury in an accident – regardless of who's to blame. Simply add Personal Injury Benefit to your car insurance policy and you also get the following:

All named drivers and passengers covered

Policyholder covered whilst travelling in any other private car in the UK

The cover applies regardless of whether the accident is your fault or not

Up to £30,000 worth of compensation

Plus these Cash Benefits if medical treatment is required:

£200 per night spent in hospital (10 days maximum)

£1,000 if you need an operation or surgical procedure

£500 if you need cosmetic dental work

£250 if you need physiotherapy

## ***LV***

With our standard comprehensive insurance, we'll pay you £10,000 if you or your husband, wife or civil partner is accidentally injured while travelling in, or getting into or out of, any car. For a small additional fee you can increase this cover to £100,000. This is only available with comprehensive cover.

## ***Zurich***

This cover provides up to £30,000 for you or your passengers in the event of death, loss of limbs, sight or hearing following an accident in your car or while getting into or out of it. Our Personal Accident Cover is provided by Ultimate Insurance Company Limited.

## **NCB protection**

### ***Admiral***

Please select the level of protection you would like for your No Claims Bonus from the available list

If you have 3 or fewer years No Claims Bonus you cannot choose to protect it. Please select the 'None' option

If you have 4 or more years No Claims Bonus, you can choose to protect it (subject to conditions). This means that you can have up to 2 claims in the next 3 years without losing your No Claims Bonus.

If you have 5 or more years No Claims Bonus, you can choose to guarantee it (subject to conditions). This means that you cannot lose

your No Claims Bonus, regardless of the number and type of claims you may have.

### **Aviva**

Protected no claim discount (NCD) protects you from up to 2 'at-fault' claims in a 3 year period. If any of your named drivers has had one 'at-fault' claim in the last 2 years you can still protect your NCD, but it will only be protected against 1 at-fault claim in a 3 year period.

### **AXA**

If you have five or more years no claims discount, why not protect it? This will allow you to have one claim in a year or two claims in a three year period without it affecting your no claims discount.

### **LV**

If you protect your no claim discount it won't be reduced, regardless of the number of claims you make. If you don't protect your no claim discount, it could be reduced if you make a claim. We can only protect your no claim discount if you have four or more years.

### **RSA**

With this protection if you make a claim on your policy we'll allow you to keep your No Claim Discount (providing no more than two claims occur within five consecutive years of insurance). If you need to make more than two claims, we'll only reduce your No Claim Discount in line with the scale described in your policy booklet.

### **Zurich**

For a little extra, you can also:

Protect your no claims discount

Make 2 claims in 5 years without it affecting your overall bonus.



## **Extended foreign use cover**

### **Aviva**

Extended foreign use matches your UK cover and extends it whilst driving abroad in the countries listed below. Cover is valid for up to 90 days for one trip and up to 6 months during the year.

Andorra, Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France (inc Monaco), Germany, Gibraltar, Greece, Hungary, Iceland, Republic of Ireland, Italy, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, San Marino, Slovakia, Slovenia, Spain, Sweden, Switzerland, Vatican City.

If the country you want to travel in is not in the list above, we may still be able to offer cover. Please contact us to complete your quote.

Extended foreign use cover can also be extended to include European breakdown recovery, provided by the RAC.

### **CISGIL**

Are you a frequent visitor to Europe, or do you like to escape to the Mediterranean to avoid the British winter?

With our motor policy you are covered to drive your vehicle abroad for up to 8 days in any policy year. However if you require an extension to this, then you should consider our Extended foreign use cover.

Our Extended foreign use would provide you with:

A similar level of car insurance cover as you have in the UK for 365 days a year, with a single trip limit of 90 days.

Cover whilst driving abroad in any country which is a member of the European Union.

Freedom to go on holiday without having to let us know.

Peace of mind that you have the backing of The Co-operative Insurance and its partners if you are involved in an accident abroad.

Please be aware:

A limit of 90 days per trip applies to this cover.

The £15 charge for this cover is a flat fee. This is irrespective as to when the cover is added to the policy or the number of trips taken.

## **LV**

All of our policies meet the minimum compulsory insurance requirements in the European Union. However, this wouldn't cover damage to your car. For a small additional fee, you can choose to extend this minimum cover to get the full benefits of this insurance when you're travelling in EU countries up to 180 days in a policy year, including when your car is being transported. If your vehicle can't be driven or has been stolen and not recovered in one of the countries covered by the extended foreign use, one of the options available to you is you could hire a vehicle. We will reimburse you on your return to the UK, up to a total of £1,000.

## **Key loss cover**

### ***Admiral***

Keycare cover provides the protection of up to £1,500 for the costs of replacement locks and keys, if yours have been lost for 3 days or have been stolen.

Some of the other benefits include:

Cover for any of your keys, not just your car and your home, as long as they are attached to the Keycare fob (and the claim is reported to Keycare within 30 days)

Emergency helpline open 24 hours a day, 365 days a year

Access to a nationwide network of locksmiths

No excess to pay

You can also extend the policy to another set of keys belonging to someone else in your household, so their keys benefit from the same level of cover as well.

Please [click here](#) for full terms and conditions.

## **AXA**

Up to £300 if your car key is lost or stolen, or £1,500 to replace the locks of your car.

## **esure**

With our new 'Key Cover' we'll provide protection in the event of loss, damage to or theft of your car key. We will arrange to pay for:

- The cost of retrieving your car key if it is accidentally locked in your car; or
- Transport costs for you to collect a spare key from your home address if you do not have a spare car key with you at the time of the loss or damage or theft, if we consider the cost to be reasonable; or
- The cost of replacing the car key and for resetting or reprogramming your car's immobiliser and alarm system, up to a maximum of £300;
- The cost of replacing a lock if your car key breaks in the lock and cannot be removed; and
- Transporting you, your car and up to 8 passengers to the nearest suitable garage within the Green Flag network to obtain a replacement key or replace the locks.
- If your car key cannot be replaced, or we are satisfied that the identity or location of your car is known to any person who may have your car key, we will pay up to £1,500 for replacing the locks on your car and for resetting or reprogramming your car's immobiliser and alarm system or replacing the directly associated electronic control units.

## **Zurich**

This cover provides up to £2,500 for replacing locks and keys for your car, home and office, including locksmith charges. You'll also receive three days of emergency car hire or the option to reclaim the cost of onward transport if your car keys are lost or stolen.

## **Courtesy car cover**

### ***Aviva***

Relax with peace of mind that we'll keep you on the road if your car is written off or stolen. The package includes the following features:

Guaranteed replacement car\* for the duration of repair if you use an approved repairer.

Guaranteed replacement car following a total loss, theft or fire claim for 14 days or on settlement of the claim (whichever is earliest), if you use an approved repairer.

If your vehicle is immobile or is not roadworthy the repairer can collect your vehicle and leave you with a courtesy vehicle.

\* standard courtesy car – entitles you to a small three door hatchback vehicle with an engine size of 1 litre.

enhanced courtesy car – five door vehicle with an engine size of 1.6 litres, with room to seat five people.

### ***DLG***

For a small extra premium, we'll supply a hire car for up to 14 days if your car is unusable or in for repair following a claim (excluding windscreen damage), this applies even if your car is stolen and not recovered or written off as a total loss. Guaranteed Hire Car can only be added to your policy if you have Comprehensive cover.

### ***LV***

For a small additional fee you can be covered for a courtesy car. We'll pay for the courtesy car while your car is being repaired by our selected repairer service, or for up to 14 days if your car is damaged beyond economical repair, can't be driven or has been stolen and not recovered. We'll insure the courtesy car; you'll just have to pay for the fuel.

### ***RSA***

We'll supply you with a courtesy car for up to 14 days whilst yours is either:– being repaired at a repairer not recommended by ourselves –

has been stolen or – has been declared a total loss. Following an incident which is not covered under your policy. Click for more info.

## **Enhanced courtesy car cover**

### **Aviva**

Relax with peace of mind that we'll keep you on the road if your car is written off or stolen. The package includes the following features:

Guaranteed replacement car\* for the duration of repair if you use an approved repairer.

Guaranteed replacement car following a total loss, theft or fire claim for 14 days or on settlement of the claim (whichever is earliest), if you use an approved repairer.

If your vehicle is immobile or is not roadworthy the repairer can collect your vehicle and leave you with a courtesy vehicle.

\* standard courtesy car – entitles you to a small three door hatchback vehicle with an engine size of 1 litre.

enhanced courtesy car – five door vehicle with an engine size of 1.6 litre, with room to seat five people.

### **CISGIL**

Could you manage without your car if it was written off or stolen?

Our motor policy will provide you with a standard courtesy car but only whilst yours is being repaired by one of our appointed repairers. However if your car has been written off or stolen and not recovered then you could be left without a car.

Would our standard courtesy car meet your needs?

Our standard courtesy car is generally a small Class A vehicle, for example a Nissan Micra or Ford Ka and only provided whilst your vehicle is being repaired by one of our appointed repairers.

If your answer is 'No' to one or both of the questions above, then our Enhanced Courtesy Car Cover may be for you.

Enhanced Courtesy Car cover ... would provide you with:

A saloon or hatchback vehicle of similar engine size to your own up to a maximum of 1,800cc (Van drivers can get a van up to a maximum of 3.5tonne GVW).

For 14 consecutive days cover in the event that your vehicle is stolen and not recovered, unfit to drive as a result of a road traffic accident or written off.

You and up to 2 named drivers on your policy can drive the vehicle, provided you all hold full licences.

A vehicle that is fully insured, subject to a policy excess.

Possibility to extend the period beyond the 14 days. Whilst you will be responsible for paying the hire charges for the period in excess of 14 days, preferential rates are available to The Co-operative Insurance customers. (Minimum extension period is 7 days)

Please be aware:

The Enhanced Courtesy Car will be delivered to you with at least £15 worth of fuel, which will be payable by yourself upon return of the vehicle.

If your vehicle is a 4x4, MPV, Electric or a motor caravan, the Enhanced Courtesy Car provided will be a saloon or hatchback motor car of similar engine size to your own vehicle up to a maximum of 1,800cc.

The Enhanced Courtesy Car will not be provided in the event of your vehicle still being roadworthy following a road traffic accident.

If your vehicle has been adapted to accommodate a disabled driver or passenger, we cannot guarantee being able to provide a suitable replacement.

#### Buying Enhanced Courtesy Car Cover

You can add our Enhanced Courtesy Car optional extra (which is managed on our behalf by Albany Assistance Limited) when taking out your Co-operative car insurance online for £17.50 extra per year. When you have received your online car insurance quote simply select 'Add' next to Enhanced Courtesy Car, then click on the recalculate button to view the updated price.

**DLG**

For a small extra premium, we'll supply a hire car for up to 21 days if your car is unusable or in for repair following a claim (excluding windscreen damage). This applies even if your car is stolen and not recovered or written off as a total loss. Guaranteed Hire Car Plus can only be added to your policy if you have Comprehensive cover.

## Impact of MFN clauses on competition in the PMI market

### Introduction

1. This appendix provides the supporting material to the findings in Section 8. It covers the following areas:
  - our definition of MFN clauses for the purposes of this investigation
  - our analysis of the impact of narrow MFN clauses on competition
  - MFN clauses as a coordination mechanism between PCWs
  - advertising competition as a result of wide MFN clauses
  - circumvention tactics
  - evidence of the impact of wide MFN clauses
  - pro-competitive effects of PCWs and MFN clauses

### Definition of MFN clauses<sup>1</sup>

2. For the purpose of our assessment, we initially defined three MFN clauses on the basis of their different scopes. These definitions broadly described the main features of the majority of MFN clauses currently in force in relation to PMI:
  - (a) A PMI provider may not offer a particular policy on its own website at a lower price than it is advertised on the PCW ('own-website MFN').
  - (b) A PMI provider may not offer a particular policy on any online sales channel at a lower price than it is advertised on the PCW ('online-sales MFN').
  - (c) A PMI provider may not offer a particular policy on any sales channel at a lower price than it is advertised on the PCW ('all-sales MFN').

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<sup>1</sup> The term 'most-favoured nation' comes from multilateral trade negotiations, where one of the principles has been that a trading deal offered to one country (the most-favoured nation) must also be offered to all other nations. Its use has been expanded to cover commercial arrangements in which the terms negotiated with one party (the most favoured) automatically become a part of the deal with other parties.



3. In our analysis, we mainly discuss ‘narrow’ MFN clauses, referring to own-website MFN clauses and ‘wide’ MFN clauses, referring to online-sales and all-sales MFN clauses.

### **Impact of narrow MFN clauses on competition**

4. Some insurers have argued that narrow MFN clauses reduce competition in the PMI market. We discuss the effects of narrow MFN clauses on premiums and on innovation. We then discuss whether there is a network effect from narrow MFN clauses.

### **Premiums**

5. Saga argued that each direct channel provided a competitive constraint on PCW pricing, and that narrow MFN clauses undermined that source of pressure. Saga asked us to imagine a consumer who could be competitively provided by ten insurers. Without any MFN clauses, that consumer could be supplied through all the competing PCWs through which the insurers made their products available and directly on the ten competing own-channels. Each narrow MFN that is entered into would eliminate one potentially competing channel, and if all insurers had a narrow MFN clause, competition in the market would be entirely reduced to competition between the PCWs.
6. We accepted Saga’s analysis, but not the conclusion drawn by it. Given that most consumers search for PMI on PCWs, PMI policies are most in competition with each other when listed on PCWs (ie interbrand competition is higher on PCWs). Therefore, as long as competition between PCWs is operating effectively, competition between policies is enhanced by being conducted through PCWs rather than through direct channels. Searching many direct channels is hard and costly for consumers, which is why the service performed by PCWs is beneficial.
7. One of the implications of narrow MFNs is that a PMI providers’ direct customer<sup>2</sup> who does not use PCWs is nevertheless charged at least as much as they would be charged on a PCW. Acromas, owner of the AA and Saga brands, told us that consumers who did not use PCW services should not have to be constrained by PCW pricing.<sup>3</sup>

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<sup>2</sup> A PMI provider’s direct customers are those who use the providers own sales channels, such as the website or telephone, rather than intermediaries such as a PCW or brokers (in the case of insurers only.) The direct channel and direct sales channels, similarly, refer to the telephone sales and own website sales.

<sup>3</sup> We noted that many of AA’s direct customers come through the telephone, which is a sales channel which is not typically covered by narrow MFNs.

8. Acromas estimated that 3.6 million consumers who did not use PCWs could face lower prices without narrow MFNs.<sup>4</sup> Acromas calculated that, if all of the consumers who did not use PCWs were offered policies at a discount equal to the PCW commission rate, the possible saving from prohibiting all MFNs would be £30 million. Acromas added that this benefit could still be achieved in the presence of alternative contractual arrangements like anti-quote-poaching clauses.
- (a) In our view, Acromas's calculation of the number of customers affected by narrow MFNs was too high for three reasons. First, the sales figures appear to include telephone sales as well as sales through PMI providers' websites. However, narrow MFNs do not cover telephone sales and therefore these should be excluded.
- (b) Second, some brands are not on PCWs so their sales should not be included in the calculation. In addition, some brands sell a different product on their own website (eg multi-car products) which are not available on PCWs.
- (c) For several brands (see [Annex L](#)), PCWs have lowered the cost which would otherwise be incurred in acquiring customers and have so enabled these brands to enter the market. For such brands it would not be in their interests in the long term to price lower on their own websites, as they would have to spend more on advertising which would be likely to increase their overall costs (although it may be in their short-term interests to do so).
9. Taking account of points (a) and (b) above, we estimated that there were up to 1.2 million consumers who did not use PCWs and who could face lower prices without narrow MFNs. However, we believed this was still an overestimate because of the reasons in point (c).
10. More importantly, though, both the Acromas' calculation and our adjusted calculation were based on the number of consumers who *could* receive lower prices, not the number who *would be likely* to receive lower prices. Our survey of consumers indicated that those who shopped around were the ones likely to be offered discounts at renewal, and those who shopped around on PCWs made the greatest savings (see [Annex B](#)). Consumers who did not shop around were likely to face higher prices, especially at renewal.

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<sup>4</sup> Acromas told us that 'from the provisional findings report, there are 25.7m vehicles ... and 55–65% of new business sales are sourced through PCWs and 60% of customers renew with their existing insurer. It follows that 40% x 25.7m = 10.28m consumers buy (as opposed to renew) motor insurance each year. Assuming 65% of those consumers use a PCW (the higher estimate), then at least 35% x 10.28m = 3.6m consumers do not use a PCW.'

Comparethemarket also told us that PMI providers were increasingly basing their pricing decisions on detailed willingness-to-pay considerations rather than on broad cost-based methodologies. Evidence from PMI providers suggested that the price elasticity of demand for consumers who did not visit PCWs was much lower than for those who did (see Table 8.1). Therefore, it was likely that those consumers who did not use PCWs to buy their policies, not even as a research tool, would be offered higher prices rather than lower prices.<sup>5</sup> Moreover, we found that only two PMI providers, [redacted], had direct customer acquisition costs which were unambiguously lower than PCW customer acquisition costs.<sup>6</sup> Therefore, for all providers except [redacted], in the long-run, we expected that there would be higher prices in relation to any purchases not made on PCWs than those made on PCWs, even if the direct channel were permitted to offer lower prices.<sup>7</sup>

11. For these reasons, we did not accept Acromas's implicit assumption that all consumers who *could* be offered lower prices *would* in fact be offered lower prices.<sup>8</sup> For the same reasons, we believed that the competitive constraint offered by direct sales channels was weak relative to the competition offered by sales on PCWs.

### **Innovation**

12. Many insurance providers told us that narrow MFN clauses restricted their ability to innovate. Several told us, for example, that they would like to make more investment in fraud prevention but, with a narrow MFN, there was insufficient incentive to do so. If the provider implemented such measures on its own website, it could not then attract consumers through being able to offer lower premiums to those consumers who presented a lower fraud risk as its prices would be limited by the MFN.
13. In this way, if the PMI provider's website is an important sales channel, narrow MFN clauses could undermine the provider's incentives to innovate. However, if the PMI provider's website is not an important sales channel, then

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<sup>5</sup> Oxera queried whether there was evidence of lower pricing on PCWs than off PCWs. The AA told us 'that if prices were likely to be higher for direct online channel customers than for PCW customers, there would be evidence demonstrating that. [redacted.]' Evidence from our consumer survey demonstrated the cost savings made by consumers when using PCWs (see Annex B). Whilst not directly showing that prices were lower off PCWs than on PCWs for the same brand, the results of the consumer survey were consistent with our price elasticity of demand data as we would in general expect PMI providers to price in a way which reflected consumers' sensitivity to prices, although not all PMI providers may do this.

<sup>6</sup> See Annex L. [redacted]

<sup>7</sup> As highlighted in the discussion of credibility and free-riding in Section 8, there may be other reasons for PMI providers to price lower on their own website than on PCWs, which are not related to the competitiveness or cost efficiency of the PCW channel.

<sup>8</sup> Although in some cases this might be true.

it would be unlikely that there would be any loss of innovation from the presence of narrow MFN clauses. In either case, PMI providers would still have incentives to innovate to lower the cost of their premiums relative to other PMI providers.<sup>9</sup>

14. Saga told us that consumers shopping directly (ie not using PCWs) had better risk profiles than those shopping through PCWs. DLG said that consumers acquired directly (as opposed to through PCWs) could generate lower loss ratios as well as higher repeat business. Ageas UK said that the PCW channel was inherently more risky for insurers precisely because customers who used PCWs had a higher tendency to provide misleading information through the PCW channel compared with other channels.
15. These views would suggest that PMI providers should be offering their best prices through their own websites. However, overall we saw no reason why a competitive PCW market would not seek to offer all the plausible innovations and fraud detection capabilities of direct sales channels, especially when these would lead to lower prices.<sup>10</sup> Our discussion of whether a PMI provider's own website would always have the lowest risk is in [Annex C](#).
16. Acromas and Aviva also told us that, if we did not prohibit narrow MFNs, we would distort innovation by insurers on their direct channels, eg in how they might use social media to filter for risk and to acquire customers. They said, for example, that an insurer could sell through social networks and pay individuals for referrals leading to sales, which might be a cheaper customer acquisition strategy than the present system based largely on television advertising, much of it by PCWs.
17. Whilst we recognised that new ways of selling might emerge which could offer lower customer acquisition costs, and we accepted that such innovation might, in the absence of narrow MFNs, be pioneered by a direct seller, it appeared to us intrinsic to the nature of innovation that where an innovation originates is fundamentally unpredictable. For the purposes of assessing the extent of any distortion, the relevant question appeared to us to be whether it was likely that any such innovation *by its nature* could not be originated by PCWs. PCWs offer an element in the sales process, ie ranking, which consumers value and which strongly promotes competition and we saw little reason why any innovation which improves customer acquisition would be essentially incompatible with this service (see [Annex C](#)). Therefore, we would expect a competitive PCW sector to adopt efficient sales innovations. We

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<sup>9</sup> If PCWs have incentives to innovate, which narrow MFN clauses should not preclude, this innovation will lead to lower prices for all consumers on the PCW rather than just the PMI provider's customers.

<sup>10</sup> [ ]

believed that, without wide MFNs, there would be greater pressure within the PCW sector to compete on prices, and therefore incentives to adopt sales innovations which offered risk selection and cost advantages. Overall, we did not believe that the risk of discouraging innovation in the direct channel by allowing narrow MFN clauses to continue was likely to be significant.<sup>11</sup>

### ***Is there a network effect from narrow MFN clauses?***

#### *Incentives analysis*

18. Our analysis of incentives suggested that wide MFN clauses, in the context of commission-based pricing, would eliminate price competition between PCWs (see paragraphs 8.32 to 8.43). We found that this would lead to competition being lessened through:
  - (a) commission rate increases and therefore premium increases, limited only by the PMI providers' 'outside option' of delisting; and
  - (b) reduced entry and innovation into the PCW market based on strategies for acquiring market shares through offering low premiums.
19. DLG told us that a network of narrow MFN clauses would have the same damaging effects as a wide MFN because PMI providers had the incentive to keep their direct channels competitive.
20. DLG relies on the premise that any increases in premiums in a PCW channel due to commission increases would lead to DLG being forced to increase its price in its direct channel. Consequently, it would be unable to price its direct channel competitively. If this were true, narrow MFN clauses would relieve the competitive constraint on PCWs' commission rates, as shown by the following:
  - (a) A narrow MFN requires prices on the direct channel to be no lower than those found on the PCW.
  - (b) The requirement to keep the direct channel competitive forces up the price of channels that were previously lower priced.

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<sup>11</sup> AA/Saga told us that 'PCW fees are flat for each scale of insurance, and weigh disproportionately on smaller premiums. The direct online channels could offer better value to consumers than PCWs through the use of appropriate pricing structures. In the absence of competition from the direct online channel, PCWs will have no interest in innovating as regards their pricing models, with a consequent adverse impact on large numbers of customers.' Whilst we recognised that flat fees weigh disproportionately on lower premiums, we expected that a competitive PCW market would change charging structures to reflect this point. In our view, it was the wide MFN clauses which were more likely to be preventing such a change rather than narrow MFN clauses.

- (c) This relieves the PCW with the narrow MFN of the competitive constraint of loss of market share.
- (d) Therefore the PCW with the narrow MFN has an incentive to increase commission rates, leading to higher premiums (effectively in the same way as with wide MFNs).
21. However, we did not accept the second step in this argument. In our view, there is not always a requirement to maintain the direct channel as the most competitive if a narrow MFN has been signed as that depends on the size and attractiveness of the direct channel compared with the available PCW channels.
22. We considered that one way to think of narrow MFN clauses was that they tie sales channels together, so that the direct channel and the MFN channel enter the PMI provider's profitability calculations as a single, 'average' channel. Reducing the price on the direct channel means reducing the price on the MFN channel, and the impact on profits will depend on the market shares and profitability of the average of the two channels.
23. In our view, rather than always maintaining the direct channel as the most competitive, the profit-maximising PMI provider will rebalance prices across all its sales channels, and this will quite possibly involve lowering premiums on low-cost channels and raising premiums on its own channel. For example, imagine a low-commission-rate entrant PCW and a high-commission incumbent PCW which has a narrow MFN. The profit-maximising PMI provider may offer lower premiums to the entrant because these attract a high margin rather than maintain the competitiveness of its own channel, since this will require a higher market share going to the low-profitability incumbent PCW with which it has an MFN.
24. [Annex D](#) provides a series of detailed numerical examples in which premiums are set optimally to show that narrow MFN clauses do not necessarily create the incentives to price equally across PCWs with a set of narrow MFN clauses. In Scenario 3, we show a case where narrow MFN clauses lead to the insurer pricing the same across all PCWs. This requires that customers of the direct channel have a large, exogenous fixed preference and therefore that this channel generates a large proportion of sales even without being price competitive with the PCW channels. This will happen in the case where loyal customers 'single-home' with an insurer. In such a situation, the insurer does not try to attract sales to the high-margin non-MFN PCWs (as in Scenario 2) because that would come at too great a cost in terms of lost sales on its own highly profitable own channel. In this special case, a narrow MFN has the same impact as a wide MFN. However, this is also the scenario in

which an insurer is likely to find it most attractive either not to list on a PCW at all or to negotiate not to be bound by a narrow MFN, even if it is at the cost of higher commission rates, to avoid the constraints of narrow MFN clauses.

25. In [Annex D](#) we discussed a critique of our modelling from Oxera. We found that the results of Scenario 3 (and an Oxera scenario) were not related to network effects but rather to optimal pricing behaviour absent narrow MFNs. In other words, the incentive to set the same prices across all PCWs would exist even if there were no narrow MFNs. Overall, we were not able to find a scenario where a PMI provider would set different prices on low-cost PCWs, but not do so in the presence of narrow MFNs. This indicated that cases where narrow MFNs have a network effect were unlikely to arise in the PMI market.
26. In most cases, we found that a collection of narrow MFNs or a single narrow MFN would not have the same impact as a wide MFN. This was particularly clear in considering the entry-detering detriment of wide MFN clauses, as we found that someone wishing to enter the PCW market with a low premium offering may still be able to do so even in the presence of a collection of narrow MFNs. As long as commission fees from the new entrant were low enough and the preference for the direct channel not too great, the insurer would wish to encourage low premium sales through the new channel to some degree, even if its direct channel suffered. The narrow MFNs might even enhance the attractiveness of the low-price entrant because they would force the direct channel to offer higher premiums than would be optimal without the narrow MFNs. Thus, the low-cost entry strategy would be preserved, and possibly even enhanced.

### *Summary of incentives*

27. We have found that a collection of narrow MFN clauses would, in general, not impose the same constraints on a PMI provider (and thus incentives on PCWs) as a wide MFN. We found there might be some cases where narrow MFNs provide a similar constraint to wide MFNs.<sup>12</sup> This was when the following conditions hold:<sup>13</sup>
  - (a) the price-independent attractiveness of a brand is strong, ie the stronger the brand, the greater the likelihood that narrow MFN clauses will be a constraint on PMI providers' behaviour; and

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<sup>12</sup> Although, as noted in paragraph 25, this result appeared to be independent of the presence on narrow MFNs.

<sup>13</sup> Clearly, the PMI provider's brand will also have to be listed on a PCW to be affected by the MFN clause.



(b) the margins which might be available for a PMI provider on low commission rate PCWs are low, ie the more attractive low-commission PCWs are, the greater the incentive to offer premiums on these PCWs at lower prices than those offered on a direct channel constrained by a narrow MFN.

28. However, as noted in paragraph 25, the result of PMI providers having an incentive to price in a similar way to wide MFNs appeared to be independent of the presence of narrow MFNs. Moreover, we have found that a collection of narrow MFN clauses would not usually have the same entry-deterrence or innovation-suppressing impact on PCWs as a wide MFN, as profitable third party channels can usually be encouraged and rewarded with low premiums.

#### *Extent of network effects*

29. In this subsection, we assess which brands are likely to be affected by the network effect of narrow MFNs and the significance of these brands. For a brand to be affected by narrow MFN clauses in the same way as wide MFN clauses, both of the conditions in paragraph 27 need to hold as a PMI provider may, for example, advertise heavily to drive higher sales through PCWs.<sup>14</sup> Alternatively, the PMI provider may have a significant sales through their own website but not be featured on PCWs.

30. We considered which PMI brands were strong by looking first at advertising expenditure and then at providers' sales channel data. Figure 1 shows the advertising expenditure for a number of PMI brands in the year to October 2012.

FIGURE 1

#### **PMI providers' advertising spend by brand, November 2011 to October 2012**

[✂]

*Source:* Ebenchmarkers.

*Note:* Red triangles represent brands which are not listed on PCWs; blue squares represent brands which are listed on PCWs.

31. We found that [✂].

32. We looked next at whether the PMI provider's website accounted for a large proportion of its online sales. Figure 2 shows the proportion of online sales

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<sup>14</sup> Oxera argued against the condition that the direct channel needs particularly strong price-independent attractiveness in order for narrow MFNs to have similar effects to wide MFNs. We discuss their arguments in [Annex E](#).



made by brands which spent significantly on advertising and which appeared on PCWs.

FIGURE 2

**PMI providers' expenditure on advertising and the proportion of sales on their website, November 2011 to October 2012**

[REDACTED]

Source: Ebenchmarkers.

Note: Brands listed on PCWs are in blue; the brand not listed is in red.

33. Of the brands which sell through PCWs and which spent most significantly on advertising, we found that [REDACTED], [REDACTED],<sup>15</sup> [REDACTED] and [REDACTED] all sold a significant proportion of their online sales on their own websites.<sup>16</sup> We found that the data in Figure 2 was consistent with the submissions from DLG and Saga about narrow MFN clauses and their effects on pricing.<sup>17</sup>
34. We found that a small number of brands [REDACTED] appeared to have characteristics which meant they could be affected by narrow MFN clauses. A PMI provider which operated on PCWs and also had a large direct sales channel might be affected by narrow MFN clauses by:
  - (a) lowering the incentives for the PMI provider to innovate on its own sales channel;
  - (b) removing a significant constraint on PCWs; and
  - (c) creating an inability for the PMI provider to price-differentiate across PCWs, leading to higher commission fees and premiums.
35. Data from the PCWs suggested that these [REDACTED] brands accounted for a small proportion ([REDACTED]%) of all policies sold on the largest four PCWs.
36. We noted that, in the case of Churchill (one of the [REDACTED] brands), whilst DLG may find that it cannot innovate on Churchill's own website, it also operates the Direct Line brand which does not operate on PCWs, and would therefore still be able to innovate on this own website. Moreover, the Direct Line brand will still compete with PCWs to offer policies to consumers. We also noted that, whilst the Churchill brand may be affected by narrow MFN clauses, Privilege, another DLG brand, mainly operates on PCWs and should have the incentive to quote different prices on the various PCWs if commission fees

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<sup>15</sup> [REDACTED]

<sup>16</sup> Although [REDACTED] also makes a significant proportion of its online sales on its own website, [REDACTED].

<sup>17</sup> A fuller assessment of all the PMI providers and their advertising strategies is in [Annex E](#).

changed. Overall we found that there should be no reduction in competition from DLG as a whole as a result of narrow MFN clauses, although narrow MFN clauses may affect the behaviour of one of its brands.

37. We found that the case of Saga (another of the [X] brands) was slightly different as it sold significantly through its own sales channels as well as through PCWs. We noted that Saga did not operate a multi-brand strategy and thus, in the presence of narrow MFNs, might face reduced incentives to innovate on its own website. However, the extent to which Saga's direct channel competed with PCWs was limited, given that Saga's total online sales<sup>18</sup> were a very small percentage (about [X]%) of the four largest PCWs' total sales. With respect to the impact on commission fees, we noted that if Saga's own website currently provided its most profitable business, under its current business strategy a series of narrow MFN clauses could have similar effects on Saga as a wide MFN as Saga might want to keep the price on its own website as low as on any of the PCWs.<sup>19</sup>
38. We noted, however, that DLG had created a multi-brand strategy to distribute its insurance products, with a PCW-focused brand, a direct-only brand sold only through its own sales channels and a mixed brand. DLG's direct-only brand, which was not available on PCWs, gave it pricing freedom. We noted that [X] had opted for a similar multi-brand strategy, which enabled it to have some pricing freedom on its direct channels and also to have a PCW-focused brand.<sup>20</sup> It was not clear to us why this strategy would not also be available to other providers with significant brands.<sup>21</sup>
39. DLG told us that we had likely underestimated the number of policies affected by the network effect of narrow MFNs. It provided an alternative estimate of 30% of total online PMI sales.<sup>22</sup> However, we rejected DLG's calculation for two reasons. First, Oxera, on behalf of DLG, used as its threshold for including significant brands those for which direct sales accounted for at least 25% of the brand's total online sales using our illustrative channel price model. However, the illustrative channel price model was uncalibrated, and the

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<sup>18</sup> That is PCW and own-website sales.

<sup>19</sup> The arguments here would also apply to [X].

<sup>20</sup> CISGIL [X].

<sup>21</sup> CISGIL told us that narrow MFNs were inefficient as they had led in some circumstances to insurers launching different brands for different channels to obtain some pricing 'freedom' from MFN clauses, therefore leading to higher costs for consumers. However, the scenario of having different brands for different channels appeared to us to be limited to just a few providers and therefore the costs of that strategy were likely to fall more on the relevant providers than on consumers.

<sup>22</sup> Oxera used in its calculations all online sales rather than just PCW sales. As we were focusing on the impact that narrow MFNs had on competition between PCWs (network effect), it appeared to us that the proportion of PCW sales was a more appropriate measure (In paragraphs 7–17 we discuss the impact narrow MFNs have on competition between PCWs and the PMI providers' websites). In addition, the key is the number of brands affected and the relative significance of those brands in the context of the overall market.

suggested threshold, therefore, in our view, had no evidential basis.<sup>23,24</sup> Second, DLG used data from our consumer survey to assess which brands had direct website sales of more than 25%. However, in our view the eBenchmarkers data which we used was more comprehensive than our consumer survey for this purpose (see [Annex E](#)).

40. Nevertheless, we did assess how many brands could be affected by narrow MFNs (and the proportion of PCW sales those brands accounted for) if we used the 25% of own-website sales as a cut-off.<sup>25</sup> This brought [redacted] more brands ([redacted]) into the calculation and resulted in an estimate of [redacted]% of policies sold through PCWs being affected by narrow MFNs.<sup>26</sup> However, [redacted] told us that it used its advertising to drive brand recognition and this caused higher sales on PCWs. Therefore, it appeared to us that [redacted] brand investment was for the purposes of raising its profile in order to increase purchasing on all its sales channels, including PCWs, and it was for this reason that we had excluded it.
41. Overall, it seemed to us that the proportion of cases in which narrow MFNs might have a similar impact to wide MFNs was limited: we estimated a range of between three and six brands accounting for between [redacted]%<sup>27</sup> and [redacted]%<sup>28</sup> of the policies sold on PCWs<sup>29</sup> (see [Annex E](#)). We believed it was likely to be on the lower end of this range. However, our analysis of the channel price model (see [Annex D](#)) suggested that it was not the presence of narrow MFNs that drove this result. Therefore, even these brands did not appear to be affected by narrow MFNs in the same way as wide MFNs.

#### *Effects of not banning narrow MFNs*

42. Acromas also told us that, by permitting narrow MFNs, we would distort future negotiations with PCWs such that narrow MFNs would become impossible for PMI providers to resist. Acromas said that it had resisted such clauses to date

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<sup>23</sup> Oxera told us that the aim of its analysis was not to demonstrate that 25% direct website sales, out of total online sales, was the appropriate threshold for network effects but simply to demonstrate that network effects could occur with a much lower proportion of direct online sales than in some of the examples we had provided.

<sup>24</sup> Our further analysis showed that the effect Oxera found was due to optimal pricing behaviour absent MFNs, not because of narrow MFNs (see [Annex D](#)).

<sup>25</sup> [redacted]

<sup>26</sup> [redacted]

<sup>27</sup> [redacted]

<sup>28</sup> [redacted]

<sup>29</sup> To calculate the proportion of sales affected by narrow MFNs, we used data on the sales by PMI providers on PCWs provided by PCWs. The data Oxera used in its response to our provisional decision on remedies was Ebenchmarkers data. If we had used Ebenchmarkers data for this calculation too, we would have calculated proportions between [redacted] and [redacted]%. However, the PCW data is more comprehensive so we have used PCW data as the basis for our calculations of overall shares of sales in this section, but used Ebenchmarkers data as the source for assessing which brands have significant direct sales and advertising expenditure.

because of the possibility that they would be considered unlawful under competition law and, by not prohibiting them, we were undermining the basis of its resistance. [REDACTED]

43. Acromas provided us with several examples of its correspondence with PCWs which it said supported its views. However, we found that it was difficult to conclude on the basis of this evidence that any narrow MFNs had been resisted up to now on the grounds of legal uncertainty in relation to them.<sup>30</sup> Moreover, PCWs told us that there had been no instances in which they had decided not to enter into a narrow MFN because they had had concerns that it might not be enforceable as a matter of law.
44. In contrast, we saw several examples of communication between PCWs and PMI providers which suggested that such concerns had affected behaviour in relation to wide MFNs. For example, Confused told us that its change in policy to remove all wide MFN clauses from its contracts with PMI providers was due to their legal uncertainty.

#### *Summary of analysis on network effect*

45. In our view, the solution to the business problem faced by a PMI provider which wants a strong direct channel is not to sign narrow MFN agreements with PCWs.<sup>31</sup> If PMI providers do sign narrow MFN agreements, we would expect both their direct channels to become less competitive and competition between PCWs to be strengthened. If PCWs insist on narrow MFN clauses, then non-listing, as practised by some brands (eg some DLG and [REDACTED] brands), may be the way of preserving sales through a high-margin direct channel.
46. The number of brands with a substantial direct sales channel is small. There are many brands which only sell through PCWs, or which have an almost non-existent direct channel, and for these brands narrow MFN clauses are not a significant pricing constraint. There are also other brands with very large direct channels (the main Direct Line brand, the [REDACTED] brand, and [REDACTED] product) which are unaffected by MFN clauses because they are not listed on PCWs. We found that it is only for the brands in an intermediate position for which narrow MFNs might come to have a similar impact to wide MFNs.<sup>32</sup> We

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<sup>30</sup> AA told us that the correspondence it had provided demonstrated that narrow MFNs had been resisted on the basis of legal uncertainty. However, both the examples it cited were in relation to correspondence between AA and [REDACTED] and, given that [REDACTED], we found it difficult to conclude that AA had resisted a narrow MFN clause because of legal uncertainty.

<sup>31</sup> [REDACTED] It said that this showed the anticompetitive effect of narrow MFNs. However, this was the only example of negative lifetime value from all the providers we contacted and it led us to question why [REDACTED] continued to list on PCWs if it was making a loss on these customers.

<sup>32</sup> [REDACTED]

estimated that the few brands in this position represented a small proportion (between [X] and [X]%) of the value of all policies sold on PCWs. We concluded that the vast majority of the market would not be affected by a series of narrow MFN clauses in the same way as wide MFN clauses. In our view, in such a scenario there would continue to be strong interbrand competition from the substantial portion of the market unaffected by the narrow MFNs, which would be likely to lead to either restricted brands needing to absorb CPA increases or to a change in sales strategy by these brands.

47. In addition, as noted in paragraph 25, the result of PMI providers having an incentive to price in a similar way to wide MFNs appeared to be independent of the presence of narrow MFNs. Therefore, we consider harm from the network effects of narrow MFNs to be unlikely to occur.

### **Coordination between PCWs<sup>33</sup>**

48. Three conditions are necessary for coordination to be sustainable:<sup>34</sup>
- (a) the ability to reach and monitor terms of coordination;
  - (b) internal sustainability, with it being in each firm's interest to adhere to the coordinated outcome; and
  - (c) external sustainability, ie coordination is unlikely to be undermined by competition from outside the coordinating group.
49. We considered the hypothesis that MFN clauses could enable coordination between PCWs by setting a floor price for PMI policies.<sup>35</sup> We discuss each condition for such coordination in turn:
- (a) If a policy is covered by a wide MFN, then the floor price of the policy is determined by its price on the PCW which has the wide MFN clause. Monitoring is effectively carried out through the monitoring of MFN clauses by the PCWs which have them.

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<sup>33</sup> We also considered the possibility that MFN clauses might reduce competition between PMI providers by providing them with an opportunity to make it more costly to reduce premiums. However, we did not pursue this line of investigation and did not conclude on whether or not MFN clauses might be used in this way. The opposition to MFN clauses which we found among PMI providers suggested that they did not see this value.

<sup>34</sup> See [CC3](#), paragraph 250.

<sup>35</sup> It is possible that PCWs could try to coordinate over commission fee fees rather than over final PMI prices. It is also possible that MFN clauses would help this. However, we focus on coordination on PMI prices because this is the most direct way that MFN clauses might affect coordination. Our hypotheses on the effects of MFN clauses (commission fee upward price pressure, PMI upward premium price pressure, and restrictions on entry) all suggest that they could lead to an increase in PMI premiums.

- (b) Internal sustainability requires that deviations from the coordinated outcome be punished. To the extent that deviation breaks the MFN clause, it is punishable in law and thus the MFN provides a very strong mechanism for internal sustainability.
- (c) External sustainability requires that entry be constrained or that fringe competitors who are not covered by the MFN be unable to disrupt coordination. The MFN helps to do this by softening the competitive constraint from other sales channels/PCWs and by excluding a common entry strategy based on offering lower prices. Indeed, in the absence of price competition, entry requires substantial investment in advertising, which is likely to create a barrier to entry.
50. Overall, it appeared to us that wide MFN clauses could be thought of as potentially reproducing conditions akin to coordination, but doing this in a fragmented market using bilateral contracts. We would usually think of coordination as involving the adjustment of the behaviour of each party in response to the history of behaviour of all other parties to the coordinated outcome. However, wide MFN clauses do not require that sort of adjustment; they simply require that bilateral contracts be honoured. It appeared to us that wide MFN clauses potentially replicate the outcomes of coordination, ie increased upward pressure on PMI premiums for all PCWs.

### **Advertising competition as a result of wide MFN clauses**

51. If PCWs were competing to offer PMI policies at the best prices for the final consumer, we might expect them to use any negotiating strength they might have to put pressure on PMI providers to offer policies at lower premiums. A successful negotiation of a lower premium for a specific PCW would mean higher market share and higher revenues from commission fees.
52. However, in the presence of a wide MFN this strategy cannot work. As long as a policy is covered by even just one wide MFN, PCWs will not be able to negotiate a price advantage. Therefore, there is reduced pressure from the sales channel for lower PMI premium prices.
53. It appears that wide MFN clauses soften price competition between PCWs (see paragraphs 8.40 to 8.43). Without wide MFN clauses, we would expect to see more price competition and lower commission fees and, as a result, we would expect lower commission fees to imply lower advertising expenditure. Hence, if we compare the outcomes with and without wide MFN clauses, we would expect a market with lower commission fees and lower advertising in the no or narrow MFN case, and higher fees and higher advertising in the wide MFN case.

54. If wide MFNs have the effect of channelling competitive pressures from price-based competition to non-price, advertising-based competition, they could be creating a wasteful level of advertising. This is not to say that the industry does not need advertising as there are clearly pro-competitive aspects to consumers being well informed about the availability of PCWs. However, in our view, wide MFN clauses might increase the level of advertising beyond this amount. If so, a combination of wide MFN clauses and increased advertising expenditure could have the effect of restricting competition through limiting entry.
55. Several PMI providers told us that the PCW sector had reached (or was near to reaching) saturation and that additional investment in advertising by PCWs was only taking share from other PCWs rather than increasing the number of customers using PCWs as a whole. Indeed, PMI providers told us that additional expenditure on advertising and marketing had been the reason given by some PCWs for increases in commission fees. Swinton told us that additional volume from a PCW as a result of advertising did not necessarily guarantee additional revenues for Swinton overall as, in many cases, it simply took business from another PCW. DLG said that the harmonising effect of MFN clauses on prices across PCWs mitigated the risk of PCWs losing business to their competitors, with the result that PCWs competed more on the basis of non-price benefits to customers (eg cuddly toys or Nectar points).
56. Evidence from Tesco Compare and Covea SGAM suggested that advertising represented a substantial barrier to successful entry. Covea SGAM told us that, in order to compete effectively with the four largest PCWs, a new entrant would need to invest at least as much in advertising and probably more in the early stages as it sought to build a consumer brand. Similarly Tesco Compare told us about some analysis it had commissioned which estimated that it could gain about 10% of the PMI PCW market if it invested around £20 million a year in advertising, which it chose not to do.
57. It is possible that the existence of wide MFN clauses increases the amount of advertising spending and therefore the size of the barrier to entry. By increasing commission rates, wide MFN clauses make advertising more profitable and therefore more is done.
58. Although this is a plausible mechanism, we noted that it was likely that the advertising barrier to entry would still exist without MFN clauses. Markets in which advertising is effective in adding to demand often maintain relatively high concentrations because it is profitable for incumbents to pay to grow their own demand through advertising rather than allowing new entrants to incur sunk costs to serve that demand. We expected that the PCW market would remain advertising-intensive and concentrated for that reason.

59. Figure 3 shows the evolution of aggregate advertising spend and total sales volumes for the four largest PCWs.

FIGURE 3

**Advertising expenditure and sales volume by the big four PCWs (2008–2012)**

[✂]

*Source:* PCWs.

*Note:* Sales volume data for Comparethemarket is based on the closest accounting year rather than the calendar year.

60. Both advertising and the overall market have grown at broadly similar rates. Consequently, PCWs have become an increasingly important sales channel for new PMI business over this period.
61. Figure 4 shows the market shares of PCWs between November 2008 and October 2012. Concentration in the PCW market did not change significantly between 2010 and 2012.

FIGURE 4

**PCW market shares**

[✂]

*Source:* Ebenchmarkers.

62. We considered whether this data suggested that PMI advertising by the four largest PCWs was used not just as a way of competing for new customers but also as a barrier to entry as, although the market was growing, the number of firms serving it was more or less constant. However, we did not find any evidence of the claim made by some PMI providers that PCW advertising spending was only reallocating market shares rather than growing the market. We recognised that it was possible that concentration had remained constant and the market had grown because the most efficient suppliers had advertised their services effectively. In other words, we did not exclude alternative explanations that advertising might have the effect of being a barrier to entry.

**Circumvention tactics**

63. We considered whether PMI providers (or PCWs) could circumvent wide MFN clauses and still offer consumers a cheaper policy. If MFN clauses could easily be circumvented then they would be unlikely, in the long run, to lead to harmful effects on competition.



64. Some parties told us that it was possible to circumvent MFN clauses. We discuss these potential circumvention strategies in [Annex F](#). However, overall, we found that many of these strategies were likely to be costly for most providers (eg a multi-brand strategy<sup>36</sup>) or in fact restricted by the MFN clause (eg time-limited price-based offers and cashback offers).
65. BGL, in its response to our provisional findings (and in previous submissions), explained the scope for insurers and other channels to circumvent MFNs effectively if they were genuinely prepared to invest in new technologies and systems and offer innovative pricing and incentive packages to consumers. BGL raised concerns that the CMA had not investigated the possible ways of circumventing MFNs in any detail. However, we noted that PCWs' support of the importance of MFNs and their desire to have them in contracts itself indicated that they were not easy to circumvent. If they were easy to circumvent then it is unlikely that PCWs would consider them important or that PMI providers would complain about their use.
66. We concluded that the harm we had identified arising from wide MFNs could not be easily avoided.

## **Evidence of incentives of wide MFN clauses**

### ***Commission fees***

67. In [Annex G](#), we present an analysis of the relationship between MFN clauses and commission fees. We consider a group of large insurers and a group of small insurers on the basis that the providers within each group should have approximately equal bargaining power with the PCWs.
68. In the case of the large insurers, we found little difference between commission fees on policies which are covered by wide or narrow MFN clauses. We found that the large insurers tended to enjoy lower commission rates and also tended to enjoy a larger number of narrow MFNs (rather than wide MFNs) than the smaller insurers. BGL told us that there were a number of factors, including differences in insurer size and sales volumes, which explained differences in commission fees, rather than it being due to differences in MFNs. The data from the largest insurers is consistent with BGLs view.<sup>37</sup> However, in the case of the smaller insurers, commission fees tended to be

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<sup>36</sup> Although this strategy is more viable for a smaller number of providers.

<sup>37</sup> However, we noted that the mechanism described above, whereby narrow MFNs have in practice the same impact on behaviour as wide MFNs for insurers with large direct business, might account for some part of this absence of a result. If wide and narrow MFN clauses have effectively the same impact on incentives, there ought to be no difference in the commission fees observed.

lower for those which enjoyed narrow MFNs (rather than wide MFNs). In our view, this evidence was consistent with the incentive-based logic which suggested that there would be higher commission fees in the presence of wide MFNs.<sup>38</sup>

69. GoCompare, in its response to our provisional findings, told us that CPA fees had not risen above inflation despite the presence of wide MFNs. It said that this showed that there was no evidence of harm from wide MFNs. However, GoCompare did not discuss what the level CPAs would be absent wide MFNs, nor whether the increase in CPAs over time would have been less. Whilst it was true that CPAs, overall, had not increased beyond inflation, we did not believe that this was an appropriate counterfactual and it did not indicate a lack of harm from wide MFNs. In particular, PMI providers might have been better able to resist CPA increases if wide MFNs were absent.

### ***Entry and innovation***

70. We discussed above how a common route to entering a market is to offer a low-cost alternative to the incumbents, and how wide MFNs preclude this entry strategy.
71. We received evidence which indicated that entry had been deterred for this reason in the past. Covea SGAM, which considered launching a new PCW in the UK, told us that it believed existing wide MFNs would prevent a new entrant from differentiating itself in the market through the offer of cheaper insurance premiums. It said that it ought to be possible to achieve this consumer offering through offering discounted commission fees to insurance providers, but the existence of MFN clauses prevented this.
72. We also found evidence that the entry/expansion of some cashback websites might have been deterred by the operation of wide MFNs. An internal document from [redacted] identified the threat posed from cashback sites such as Quidco, which, it noted, if they continued to grow, could erode [redacted] profits. The document mentioned using a 'best price guarantee' (among other things) to achieve a competitive advantage over cashback websites, and we noted that the contracts that [redacted] with a number of PMI providers specifically mentioned cashback websites being within the scope of the MFN clause. The inclusion of cashback websites [redacted].
73. However, in contrast to these examples, Tesco Compare and Google, both small PCWs, told us that MFN clauses could help an entrant PCW by

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<sup>38</sup> We noted that the static analysis of CPA fees will tend to underestimate the effect of wide MFNs because the CPA rate with one PCW may be affected by wide MFN clauses elsewhere.

providing credibility to customers that the policies they offered were genuinely good value. In our view, though, it seemed possible for a new entrant to offer a price-matching guarantee to retail consumers without requiring a formal MFN. John Lewis, for example, does this as a retailer despite its offer to consumers not necessarily being reflected in its supplier agreements.

74. The PCW market is young and technologically dependent, and it appeared to us that, in such a market, there is often potential for much innovation. We noted that cashback websites were one example of a sales channel innovation which, to date, had not taken off for the sale of PMI and had been covered by a wide MFN with one PCW.<sup>39</sup> Other emerging innovations included retailing through social media platforms. In our view, the potential for new entrants to gain a foothold in the PCW market appeared to be made harder by their inability to differentiate on price due to the presence of wide MFNs.

### **Pro-competitive effects of PCWs and MFN clauses**

75. In this final section of this appendix we outline some of the evidence on the pro-competitive effects of PCWs and MFN clauses. We first discuss whether PCWs make the PMI market more competitive before we assess alternative mechanisms to narrow MFN clauses to counteract free-riding by consumers and PMI providers.

#### ***Do PCWs make the PMI market more competitive?***

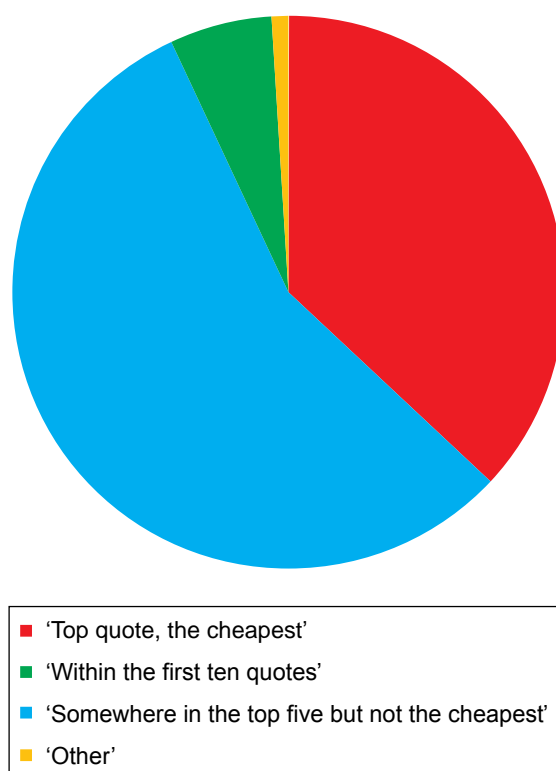
76. We found that there was strong evidence that PCWs had made the PMI market more competitive. This view was also broadly undisputed among all parties.
77. Figure 5 shows how consumers choose their quotes on PCWs. It shows that 93% of selections are from within the top five quotes. Therefore, for PMI providers to make a sale, they will need to be price competitive. In addition, Table 8.1 in Section 8 shows that the price elasticity of demand for PMI is higher on PCWs than on any other sales channels. This evidence indicated that PCWs were helping to drive competition between PMI providers.

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<sup>39</sup> We note that there may be other reasons why cashback websites had not taken off (see [Annex F](#)).

FIGURE 5

**Consumer quote selection on PCWs**



Source: Datamonitor's General Insurance Consumer Survey 2012 (response to question: 'When you purchased your policy, where was your chosen provider in the quotation list?').

78. [Annex B](#) presents evidence from our consumer survey which shows that consumers who use PCWs shop around more and achieve cheaper premiums than those who do not. Some observers have commented that competition has increased so much due to PCWs that many consumers may now be buying too much on the basis of price and ignoring other important attributes of the product they purchase. On the other hand, Figure 5 shows that many consumers typically do not pick the cheapest policy they are offered but choose instead from among the top price-ranked policies.

**Free-riding**

79. Narrow MFNs prevent PMI providers from free-riding on the exposure provided by PCWs. Currently, every time a quote is produced on a PCW it is accompanied by the logo of the PMI provider offering the quote. Moreover, brands and reputation are important in this market, with consumers often choosing from among the cheapest offerings rather than the absolute cheapest. Thus, the logo of the PMI provider is an important piece of information in the consumer's search. If it were widely known that to get the best price you should visit the PMI provider's website directly after finding the

ranking on a PCW, then PCWs would offer a service but, under their current business models, would not be rewarded for it.<sup>40,41</sup> In such a scenario, PCWs might go out of business and good search solutions might not be offered to consumers.

80. Free-riding can be an issue in many markets but will not necessarily lead to the failure of the market, as the market may evolve other solutions or alternatively those disadvantaged may be able to rely on loyal customers. We considered some alternative mechanisms for PCWs to use in relation to the sale of PMI in order to avoid the free-riding problem:
- (a) PCWs could rely on single-homing customers to pay for the investment in the PCW.
  - (b) PCWs could provide anonymous quotes, which allowed consumers to compare products and features without the PMI provider's brand being provided.
  - (c) PCWs could move to an alternative revenue-generating model.
  - (d) PCWs could implement quote-poaching clauses.

### *Single-homing*

81. Saga told us that PCWs did not even need narrow MFN clauses to sustain their current business models as they could rely on single-homing customers to provide revenues to cover their fixed costs. PMI providers told us that they estimated that they had single-homing rates on the four largest PCWs of between 50 and 80%.
82. [X] Such high rates of single homing would imply that PCWs have an ability to earn substantial revenues from their 'captured' retail customers even if a better deal is available for a consumer elsewhere on the Internet, and even if

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<sup>40</sup> Oxera, on behalf of DLG, told us that 'insurers that might in theory have financial incentives to undercut PCW prices are likely to be those that are heavily dependent on the PCW model'. However, in our view, whilst this might be true relatively (ie an insurer with 100% of sales on PCWs can gain more than an insurer with 50% sales on PCWs), this does not mean that an insurer may not still have significant incentives to free-ride, nor that it may not still have the ability to free-ride. We noted that a less PCW-dependent insurer is likely to be in a better position to free-ride on the additional exposure the PCW has given it than one which is more dependent on PCWs.

<sup>41</sup> Oxera also stated that 'if CPA levels were lower the incentives to free-ride would be lower'. In our view, whilst this was true, free-riding was not the only reason that PCWs wanted to retain narrow MFNs, as shown by the discussion on credibility (see paragraphs 8.89–8.98). In addition, data received from PMI providers showed that margins on PCWs were lower than on direct sales channels, which was consistent with the evidence on price elasticity of demand (see Section 8, Table 8.1). If PMI providers could make PCWs less attractive and acquire more customers directly, in the long term this would be likely to lead to higher profitability.

that better offer were from the PMI provider which is supplying the product through the PCW.<sup>42</sup>

83. Our consumer survey estimated that 33.5% of consumers who use PCWs use only one PCW. This provided another measure of the possible number of 'captured' or 'single-homing' consumers whom PCWs might be able to rely on to provide revenues, even if cheaper policies were only a few clicks away.<sup>43</sup> This percentage amounts to [X] customers for the smallest of the big four PCWs, or PMI revenues of around £[X] million.
84. Submissions from PCWs suggested that their annual fixed costs of operation were between £[X] million and £[X] million excluding advertising. Therefore we calculated that, under current single-homing rates, PCWs could conceivably recover their fixed costs of operation through single-homing customers, although it may mean a reduction in advertising expenditure.
85. However, in our view, the data on single-homing retail customers needed to be treated with some caution, given that the reward to retail customers for visiting multiple PCWs was limited due to the prevalence of wide MFNs. If there were no wide MFNs, we might expect more retail customers to shop around and the number of single-homers to fall considerably. Therefore, in the absence of wide MFNs, cost recovery for PCWs through a reliance on single-homers may not be a credible alternative to narrow MFNs.

#### *Anonymous quotes*

86. Another alternative mechanism for PCWs to narrow MFNs is to offer consumers anonymised search results in which the identity of the PMI provider is only revealed by clicking through to the destination site. Some other online services, eg for ordering taxis, operate on this model, returning quotes without the identity of the cab company.
87. However, in the case of PMI, we noted that retail consumers often did not pick the cheapest quote, and that non-price considerations entered their choices. If the insurance brand was essential to the consumer choice because, for example, the PMI provider's reputation of dealing with claims was important to the consumer, any system which restricted the visibility of that brand in the search result would imply a worse product for consumers. In addition, if the

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<sup>42</sup> The case study is not a perfect analogy to being without a narrow MFN: by being delisted, the [X] policies were no longer 'a click away' on the motor insurer's site, but would have to be found elsewhere on the Internet, which would represent a greater challenge.

<sup>43</sup> If the PCW business were sustained in this kind of way, it would imply that one set of retail consumers (the single-homing ones) would effectively be subsidising those who optimised and used the PCW for reference purposes only.

identity of the provider would eventually be disclosed, the consumer could still at this point search again directly on the provider's website. Therefore, this option did not appear to us to be a credible alternative to the use of narrow MFNs.

### *Charging model*

88. PCWs could change their current charging model from the commission fee model<sup>44</sup> to a pay-per-click model or a listing fee model.

89. BGL told us:

There are ways other than commission fees supported by MFN clauses to cover ... costs; however, in [our] view, these alternatives are not practicable or, indeed, are likely to give rise to more adverse outcomes. For example, upfront fees or annual subscriptions would create greater barriers to entry for newer or smaller PMI providers and a cost per click model would take away the direct correlation between policy sales and acquisition costs which contributes so significantly to the efficiency of the PCW model.

90. BGL did not develop its submission that non-commission-based business models would increase barriers to entry, nor that there is some special efficiency in the commission model.

91. We noted that listing fees, conversion floors<sup>45</sup> or cookie-based affiliate marketing fees could be used to reward PCWs irrespective of their sales-conversion rates. As PCWs provide a service to PMI providers irrespective of the sales they generate (ie by informing consumers that a given policy is reasonably good value), PMI providers could pay for this service directly. Moreover, we noted that some PCWs (including [redacted]) had introduced conversion floors for some PMI providers, which suggested that they were already moving away from the pure commission-based model.<sup>46</sup>

92. Whilst there may be benefits to the commission model, it appeared to us that the survival of PCWs did not rely on maintaining this model and PCWs could (and did) raise revenue through other charging models. Therefore, alternative

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<sup>44</sup> The commission fee model means that PMI providers only pay the PCW if a sale is completed.

<sup>45</sup> A conversion floor of 20% would mean that a PMI provider pays the PCW as if 20% of the clicks through to the PMI provider's website were converted into a sale. If the conversion rate is above 20%, the PMI provider just pays the usual commission fee.

<sup>46</sup> [redacted]

charging models did appear to represent a credible alternative to narrow MFNs.

### *Quote-poaching clauses*

93. PCWs told us that PMI providers could avoid paying commission fees by encouraging customers to come to them directly after having searched on a PCW.
94. However, several parties told us of other mechanisms currently in place in some contracts between PMI providers and PCWs which did not require physical click-throughs and sales completion. For example, data audits could keep track of where a retail consumer had found information about a policy and could reward sites accordingly. Some car insurers already operated 'click-poaching' agreements with PCWs in this way.
95. On the technical feasibility of basing referral payments on mechanisms other than completion, [redacted], for example, told us: 'There is no practical obstacle to be able to marry those things up [ie a customer visit on a price comparison site and an eventual sale of a policy]. It is data.' [redacted] told us: 'If [the customer] effectively transacts a policy with us very soon [after seeing our policy on a PCW] then we will have sensible conversations about the attribution of that cost. That [solution] is available now and part of the audit process.'
96. It appeared to us that quote-poaching clauses represented another credible alternative to the use of narrow MFNs by which PCWs could overcome the problem of potential free-riding.<sup>47</sup>

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<sup>47</sup> Saga (and the AA) told us that quote-poaching clauses could solve the PCW problem of credibility. In particular, they said 'PCWs use insurers' or brokers' own websites to obtain a quote when a customer enters their details. Accordingly, that customer information is then stored by the insurance provider. If the same customer went to that provider's own website and re-tendered for a quote, the provider would recognise that customer from their details. Accordingly it could ensure that the customer was presented with the same price-quote as they were given on the PCW. Conversely, if the customer visited the insurance provider's own website directly before using a PCW, if that customer then re-tendered on the PCW, the insurance provider could ensure that the price it offered on its own website, if lower, was presented to the customer through the PCW as well. Therefore, PCWs would not be undermined by a perception that direct-channel prices are cheaper.' However, it was not clear to us whether this would in reality lead to prices being any different than under narrow MFNs as PMI providers in this case would need to consider the probability of the consumer visiting a PCW and then add on the expected costs of providing a quote through a PCW. The outcome, therefore, might not be any different to outcomes under narrow MFNs and the direct website would still be constrained, albeit indirectly.



- Annex A: Prevalence and characteristics of MFN clauses in contracts between PCWs and PMI providers
- Annex B: Evidence from our consumer survey on PCWs' impact on the PMI market
- Annex C: Rewarding channels with lower risk
- Annex D: An illustrative channel pricing model
- Annex E: Analysis of PMI providers' advertising strategies
- Annex F: Effectiveness of circumvention strategies
- Annex G: Analysis of effects of MFN clauses on commission fees
- Annex H: Profitability of the four large PCWs
- Annex I: Evidence of the exercise of market power without MFNs
- Annex J: Effect of PCW ownership structure on competition between PMI providers
- Annex K: Single-homing and the threat of delisting
- Annex L: Effectiveness of advertising expenditure on PCWs

## Prevalence and characteristics of MFN clauses in contracts between PCWs and PMI providers

### Introduction

1. This annex discusses the prevalence of the different types of MFN clauses in contracts between PMI providers and PCWs.

### Background

2. The vast majority of contracts signed by PMI providers and PCWs have an MFN clause which prevents the PMI provider offering the same policy at a cheaper price via some other channel(s).
3. PCWs present consumers with quotes provided by PMI providers. PCWs ask consumers questions and the answers are passed on to PMI providers, which they map on to variables to enable them to assess risk. The MFN applies to prices that are quoted for identical inputs to the PMI provider risk model, with each different set of variables effectively being a different product.
4. The four large PCWs (Confused, Comparethemarket, GoCompare and Moneysupermarket) all use MFN clauses in at least some of their contracts and some of the smaller PCWs [redacted] do as well.

### Prevalence of MFN clauses

5. All the insurers and brokers from which we gathered evidence had MFN clauses in almost all of their PCW contracts.<sup>1</sup>
6. Table 1 summarises the type of MFN clause for each PMI provider in each of its contracts with a PCW in 2012. We classified MFN clauses according to three categories: 'own website', 'online' and 'all sales',<sup>2</sup> though we noted that this classification was unlikely to be fully reflective of pricing constraints as some MFN clauses were informal agreements (eg [redacted]).

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<sup>1</sup> Ageas Insurance was an exception because it does not sell policies directly through PCWs. Ageas Insurance's PMI policies are available through brokers (including Ageas Retail (its wholly-owned broking business)), many of which sell through PCWs, and through 'affinity' brands.

<sup>2</sup> Narrow MFN clauses are the same as 'own website' MFN clauses. Wide MFN clauses include both 'online' and 'all sales' MFN clauses.

TABLE 1 Type of MFN clause with the four largest PCWs for each PMI provider in 2012

	<i>Comparethemarket</i>	<i>Confused</i>	<i>GoCompare</i>	<i>Moneysupermarket</i>
	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: CMA.

[REDACTED]

7. Table 2 shows the number of policies sold under narrow, wide or no MFN through the four biggest PCWs in 2012. We found that the least restrictive type of MFN, the narrow MFN, was the most frequently used MFN, with almost half ([REDACTED]%) of PMI policies sold through PCWs being covered by a narrow MFN clause. The most restrictive, the wide MFN, was only slightly less frequent, with still close to half ([REDACTED]%) of PMI policies sold through PCWs being covered by a wide MFN clause. A significant minority ([REDACTED]%) of policies were not covered by any MFN clause.<sup>3</sup>

TABLE 2 Policies volume under MFN type for the four biggest PCWs, 2012

<i>MFN</i>	<i>Comparethemarket</i>	<i>Confused</i>	<i>GoCompare</i>	<i>Moneysupermarket</i>	<i>Total</i>
Wide	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Narrow	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
None	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: PCWs.

8. However, an insurer having in place at least one wide MFN with one PCW constrains the rest of the PCWs even if they are under a narrow MFN or do not have any MFN clause in place. Table 3 shows that the number of policies either under a wide MFN or constrained by at least one wide MFN with a PCW represented a large majority ([REDACTED]%) of the total number of policies sold through the four large PCWs in 2012. The number of policies covered by no MFN or only narrow MFNs across the four PCWs represented a minority ([REDACTED]%). The number of policies not constrained by any MFN clause across the four PCWs represented a very small proportion ([REDACTED]%) of the total sales volume.

<sup>3</sup> This does not necessarily imply that PMI providers undercut PCWs. We found that in some relationships, the PMI provider accepted the principle of a narrow MFN clause even if it was not contractual.

TABLE 3 Volume of policies taking into account the MFN clauses across the four biggest PCWs, 2012

<i>Insurers' policies under</i>	<i>Total number of policies</i>	<i>%</i>
At least one wide MFN	[X]	[X]
One wide MFN	[X]	[X]
Two wide MFN clauses	[X]	[X]
Three wide MFN clauses	[X]	[X]
At least one narrow MFN clause (with no wide MFN clauses)	[X]	[X]
Only narrow MFN clauses	[X]	[X]
Mix of narrow and no MFN clauses	[X]	[X]
No MFN (only)	[X]	[X]
Total	[X]	[X]

Source: PCWs.

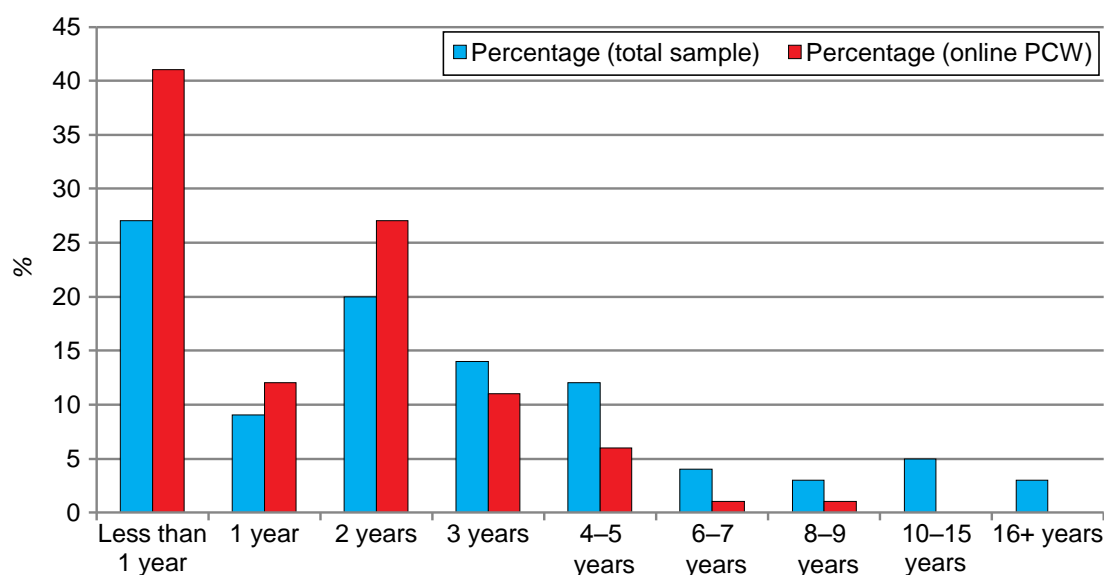
- 
9. We noted that PCWs did offer policies from some PMI providers without an MFN clause in place. However, PMI providers told us that they did not believe they had sufficient bargaining power against the PCWs to resist an MFN clause where a PCW insisted on it. PMI providers said that they felt obliged to accept MFN clauses if they wanted to sell their products on PCWs.
  
  10. Although this annex has presented the data available to us (from 2012), we noted that the use of MFN clauses had been a point of recent and ongoing discussion between some PCWs and PMI providers. We found that a recent request by some PCWs to extend the scope of their MFN clauses had been strongly resisted by PMI providers. We also found that some PCWs had relaxed their MFN clauses, possibly due to increased interest by competition authorities in such clauses.

## Evidence from our consumer survey on PCWs' impact on the PMI market

1. In this annex we consider evidence from our consumer survey on the extent to which PCWs make the market for PMI more competitive.
2. Consumers who purchase through PCWs are significantly less likely to stay with the same insurer for many years. Figure 1 shows that 79% of consumers who purchased through PCWs have renewed their PMI policy with the same insurer for two years or less compared with 56% of the total sample.

FIGURE 1

### Length of time consumers have stayed with their current insurer

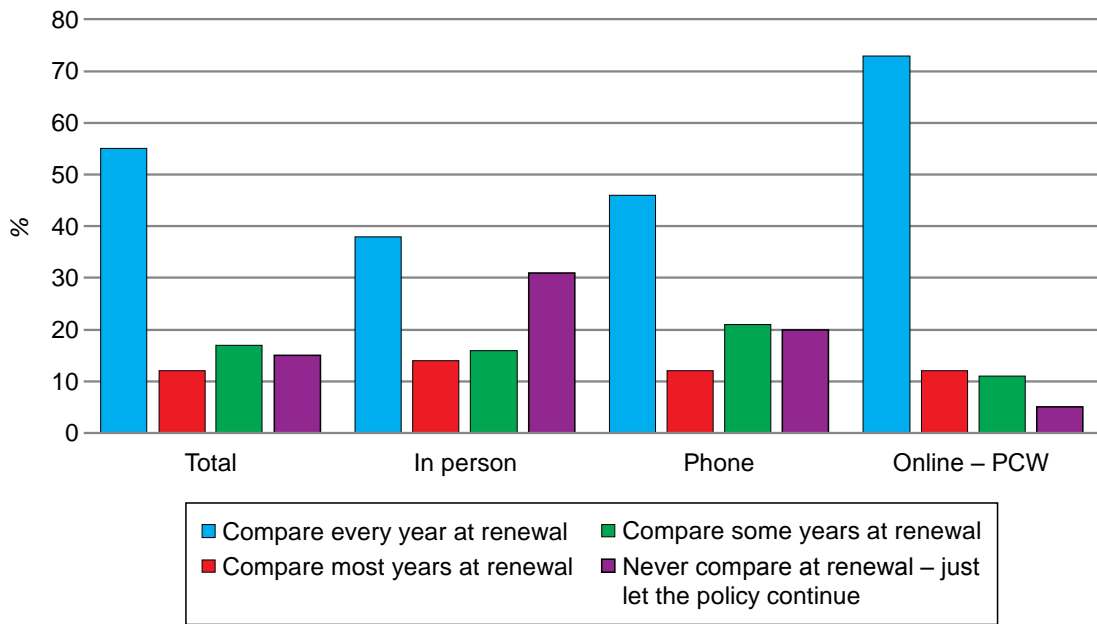


Source: CMA consumer survey.

3. PCW users are also more likely to compare their insurance policies each year at renewal compared with those who compare policies in person or by using the phone (see Figure 2).

FIGURE 2

Percentage of consumers who compare insurance policies each year

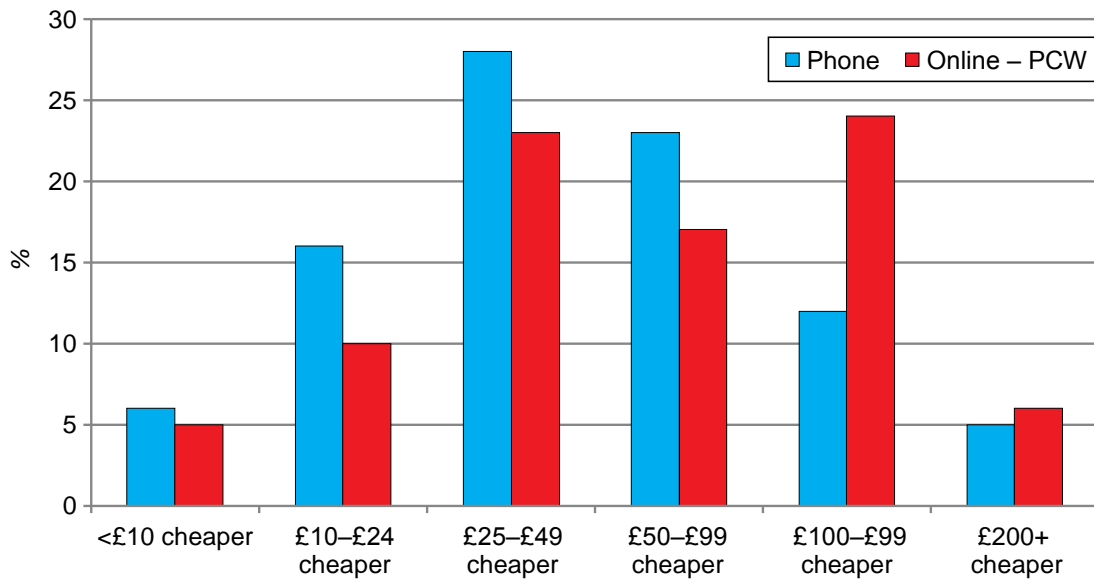


Source: CMA consumer survey.

- For those who paid a cheaper price compared with their renewal quote, Figure 3 shows that the price paid through PCWs was considerably cheaper than by phone.

FIGURE 3

How much cheaper was consumer’s insurance policy compared with the renewal price



Source: CMA consumer survey.

5. The general picture which emerges from the results of our consumer survey is that PCW users are less loyal and more likely to switch, and that they achieve cheaper premiums. This suggests that PCWs have a pro-competitive effect in the PMI market.

## Rewarding channels with lower risk

1. Saga and DLG told us that the risk profiles of consumers were different for different channels. An efficient channel pricing model would imply an ability to reward those channels which attracted lower-risk consumers with lower premiums. For example, insurers usually cited their own direct channel as being superior to PCW channels because of the relatively higher fraud levels for consumers gained through PCWs (eg consumers submitting repeatedly different answers in an attempt to lower quotes).
2. BGL said that insurers did not pass on cost savings of cheap channels. In particular, the cheapest channel was a renewal, and yet renewals lead to the highest premiums. BGL said that it had offered insurers various fraud-detection innovations but found very little interest.
3. In this annex, we consider whether we would expect competing PCWs to have an incentive to offer fraud detection and other risk-lowering innovations.
4. The channel choice model presented in [Annex D](#) shows that, in general, lower-cost channels should be rewarded with lower premiums and higher market shares. A normal competitive process ought to make genuine improvements in channel technology spread throughout the PCW market. Therefore, if wide MFN clauses are preventing interchannel competition, this might include limiting the spread of cost-reducing technology across the sector.
5. The only case in which a direct channel would have an absolute advantage over a PCW in risk filtering would be if the very fact of using a PCW constituted an indicator of high risk. However, it seemed to us implausible, especially as a high and growing percentage of the market uses PCWs. If PCWs implemented the fraud detection regimes which insurers claimed were available on their own websites (eg limiting questionnaire resubmissions), then we would not expect their effects to be different on one website rather than the other.<sup>1</sup>

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<sup>1</sup> [redacted] However, the evidence [redacted] produced in support of this point was also consistent with PCWs increasing competition between insurers. In addition, we would expect that excessive risk transfer would reduce as competition between PCWs increases in the absence of wide MFNs.



### An illustrative channel pricing model

1. It has been argued that narrow MFN clauses force PMI providers to post the same price on all PCWs.
2. Consider, for example, an insurer with a brand, Brand A, which has 50% sales on PCWs, 50% direct sales, and is covered by at least one narrow MFN (but no wide MFN clauses). A narrow MFN prevents the price on the direct sales channel being lower than on the PCW, although the insurer is permitted to set a higher price on the direct sales channel than on the PCW:
  - (a) The insurer wants to maintain the competitiveness of Brand A through its direct sales channels because these are the most profitable sales (it has no commission to pay and arguably might be better at fraud prevention on its own website). It also advertises significantly to consumers to encourage them to come directly to Brand A's website.
  - (b) It therefore does not want any PCW to offer Brand A's policies cheaper than on its own website.
  - (c) A single narrow MFN in this context imposes a floor price for Brand A's policies on any PCW which is *equal* to the own-website price, just as a wide MFN would.
  - (d) Imagine a low-commission-rate entrant PCW wishing to list Brand A's policies at a lower premium than other PCWs: the insurer would not want to reward the entrant PCW with lower premiums than on the other PCWs because its MFN clauses with the other PCWs would then require it to maintain its direct sales price above the price on the entrant PCW, which would take sales away from its own direct channel. Low-commission-rate entry would have been discouraged just as it is by wide MFNs.
  - (e) Imagine also a commission rate increase on the part of the PCW with the narrow MFN. The insurer would want to increase premiums on that channel. However, as a result it would have to increase premiums on its own channel and on any other PCWs that would otherwise be lower cost than the direct channel. Thus, the absence of constraint on commission rates is identical to the case described for wide MFN clauses.
3. In the absence of the narrow MFN clause, the direct channel could be the cheapest and the prices of policies on PCWs would be in relation to their costs (a combination of commission rates and the risk profiles of the business they introduced to the PMI provider).

4. In this annex, we describe a few simple numerical examples of channel choice. The purpose is not to produce an accurate forecast of the premiums that an insurer will charge under different MFN regimes, but rather to isolate and illustrate the incentives that the insurers face and the impact of these incentives on premium pricing. The structure of the channel choice problem has been captured in the model, but not the magnitudes of any parameters.
5. Our simplified model has the following structure:
  - (a) An insurer chooses the premium at which a policy will be offered through its own channel, through each of four PCWs and, in some examples, through an entrant channel.
  - (b) Each channel has a cost associated with it, which we can think of as being the average cost of sales through that channel, ie commission fees in the case of PCWs and consumer acquisition costs (mainly advertising) in the case of the direct channel.
  - (c) There is a maximum price that the insurer cannot exceed, which we can think of as the price at which the policy becomes uncompetitive and ceases to sell. Below that price, we assume that total demand for the policy through all channels is fixed. This is clearly a simplification of the usual price sensitivity of demand, but it helps to isolate between-channel effects.
  - (d) We model MFN clauses as constraints on the premiums at which the insurer can offer policies.
  - (e) We model consumers as switching channels in response to the price differences between the channels. We use a Dixit-Stiglitz Constant Elasticity of Demand specification for the consumer choice. We assume that consumers have some fixed channel-specific preference over and above price differences – a strong fixed preference makes it harder for any price difference to shift consumers. In all scenarios, we assume that consumers are very price sensitive, although fixed preferences eventually limit that price sensitivity. Our assumption of great price sensitivity up to some point is intended to capture the behaviour that we see in the market whereby many consumers check many channels before making a purchase, but some consumers are ‘single-homers’ who do not search actively through many channels. The exact specification of the demand model is not considered to be critical in this exercise: we are not so concerned with the magnitude of different effects as with illustrating the existence and direction of different effects.

- (f) The decision that the insurer makes is to maximise profits (premium minus channel cost) subject to the premium not exceeding the allowed maximum and subject to any constraints imposed by MFN clauses. We use Excel's non-linear constrained optimisation routines to simulate the insurer's profit-maximising decision.
  - (g) The scenario variables which we consider with this model are:
    - (i) degree and scope of MFN coverage (none/narrow/wide, and the number of such clauses);
    - (ii) profitability of the direct channel (profitable versus unprofitable) – we take this to characterise the difference between those PMI providers which have substantial branding goodwill invested in their policies and which can therefore attract attention to their direct sales channel at a relatively low average cost versus those who do not have strong brands and for whom attracting attention to their website is expensive relative to doing so through PCW listings; and
    - (iii) the price-independent preference for the direct channel, ie its degree of 'single-homing'.
6. The rest of this annex describes specific illustrative examples of channel choice. We present three scenarios which gradually build up to establishing the parameters needed to establish where narrow MFN clauses act like wide MFN clauses so that the insurer tries to maintain its own-channel competitiveness, so raising all premiums to the level of the premium covered by an MFN clause.
7. The progression in the scenarios we explore is the following:
- (a) We start with a profitable direct channel with no special price-independent attractiveness to consumers and no MFN clauses. We consider this to be a 'benchmark' case for insurers with attractive direct channels.
  - (b) We add a narrow MFN clause to the above and show a set of parameters under which the narrow MFN clauses are not like wide MFN clauses, ie the impact of the MFN clause is to increase the premium offered on the direct channel but to keep the premiums available on high-margin channels low.
  - (c) We increase the price-independent attractiveness of the direct channel to show that this has the effect of making narrow MFN clauses like wide MFN clauses. The insurer has the incentive to minimise sales on all channels except its own, and it does so by raising prices on all channels.

The model does not allow a ‘delisting’ choice, but a useful interpretation of the result that PCW channels’ market shares are minimised is that this would, in practice, mean a delisting.

## Scenario descriptions

8. In all cases, we assume that consumers switch readily between channels in response to premium differences, although we vary the premium-independent preference level for channels in the last scenario. In all the numerical examples, the maximum price before demand disappears completely is 10 and, below that price, 100 policies are spread between the channels. In the scenarios where premium-independent channel preferences are equal (1 and 2), the lower-premium channels receive higher market shares.

### **Scenario 1: Channel choice with no MFN clauses and a profitable direct channel**

9. Table 1 summarises the numerical example for Scenario 1.

TABLE 1 Channel choice with no MFN clauses and a profitable direct channel

Channel	Channel preference	Average channel cost	Premium	Sales	Market share (%)	Total cost	Total revenue	Profit
Own	0.18	3.5	<b>8.34</b>	5.17	46	18.08	3.11	25.02
PCW1	0.18	7	<b>10.00</b>	0.84	8	5.91	8.45	2.53
PCW2	0.18	6.5	<b>10.00</b>	0.84	8	5.49	8.45	2.96
PCW3	0.18	4.6	<b>10.00</b>	0.84	8	3.89	8.45	4.56
PCW4	0.18	4	<b>9.54</b>	1.36	12	5.44	12.96	7.52
Entrant	0.10	3.6	<b>8.58</b>	2.17	19	7.80	18.59	10.79
	Total profit	53.39	Weighted av price	9.19				

Source: CMA analysis.

10. The important features of the scenario construction are the following:
- (a) Channels vary in their average costs and therefore their profitability for the insurer. There is an entrant channel offering a low-cost option for the insurer. This entrant has a low channel preference parameter, reflecting the difficulty any entrant faces in gathering attention, regardless of premiums offered.
  - (b) We have made the ‘own channel’ the most profitable of all the channels on offer, just slightly more profitable than the entrant’s offering. This reflects the fact that there are no commissions payable on the own channel.
11. The important features of the optimal channel pricing solution (highlighted in bold in Table 1) are the following:

- (a) The insurer's interest is to divert a great deal of sales to its own website, which is the most profitable for it, and to do this it reduces prices there to the lowest of all channels.
- (b) The insurer has some interest in selling more than the minimum through the next two highest margin channels because encouraging further sales through the 'own channel' would reduce prices too far and hence reduce margins on own sales.
- (c) The more expensive PCW channels are unattractive and the insurer offers premiums at the maximum price through them to minimise their market share.

*Discussion of the scenario*

- 12. With no MFN clauses in place, the direct sales channel is treated as any other, ie it is the lowest cost of all the channels and therefore the insurer seeks to maximise sales through it. It has equal 'visibility' (premium independent preference) as the incumbent PCW channels, so sales maximisation implies giving the own channel a price advantage.

**Scenario 2: Channel choice with one narrow MFN clause and a profitable direct channel**

- 13. Table 2 summarises the numerical example for Scenario 2.

TABLE 2 Channel choice with one narrow MFN clause and a profitable direct channel

Channel	Channel preference	Average channel cost	Premium	Sales	Market share (%)	Total cost	Total revenue	Profit
Own	0.18	3.5	<b>10.00</b>	1.12	10	3.92	11.20	7.28
PCW1	0.18	7	<b>10.00</b>	1.12	10	7.84	11.20	3.36
PCW2	0.18	6.5	<b>10.00</b>	1.12	10	7.28	11.20	3.92
PCW3	0.18	4.6	<b>10.00</b>	1.12	10	5.15	11.20	6.05
PCW4	0.18	4	<b>9.25</b>	2.45	23	9.82	22.69	12.87
Entrant	0.10	3.6	<b>8.32</b>	3.91	36	14.07	32.53	8.46
	Total profit	51.93	Weighted av price	9.49				

Source: CMA analysis.

- 14. The scenario is identical to Scenario 1 except that PCW1 is assumed to have a narrow MFN with the insurer, ie the insurer's price cannot be cheaper than PCW1's.
- 15. The important features of the optimal channel pricing solution are the following:

- (a) The insurer prices in order to shift demand to the two lowest-cost, highest-margin channels.
- (b) The own-channel price rises to its maximum level to match the maximum that PCW1 was already being priced at, to satisfy the narrow MFN constraint.

*Discussion of the scenario*

- 16. Although the own channel is the most profitable, the imposition of a narrow MFN clause leads to sales being diverted to the next best alternatives. The insurer does not, in this case, find it profitable to maintain the share of its own channel when that means increasing the share of the least profitable of all channels, PCW1. Thus this is an example of a parameter set that goes against narrow MFN clauses acting like wide MFN clauses.
- 17. The DLG view (see paragraph 19) relies on the assumption that an insurer will want to maintain the profitability of its direct channel. This scenario shows that even when the direct channel is the most profitable, there are cases where the insurer sacrifices that channel and does not maintain its competitiveness. The imperative to maintain competitiveness is not so strong as to eliminate the incentive to increase sales through the next most competitive channels.
- 18. The implication of the DLG view would be that in order to maintain the competitiveness of its brands on the direct sales channels, the price of other cheaper PCWs must also be increased. This is not profit-maximising behaviour under these parameters. There is a general point which is not linked to the specifics of the channel choice model here, which is that it does not make sense in general for an insurer always to maintain the profitability of its own channel when doing so would imply losing market share through attractive channels.
- 19. DLG told us that: [✂].
- 20. In the scenario below, we demonstrate what is needed to make this not just a possible strategy, but a profit-maximising strategy.

***Scenario 3: Channel choice with one narrow MFN clause and a strong direct channel preference***

- 21. Table 3 summarises the numerical example for Scenario 3.

TABLE 3 Channel choice with one narrow MFN clause and a strong direct channel preference

Channel	Channel preference	Average channel cost	Premium	Sales	Market share (%)	Total cost	Total revenue	Profit
Own	0.70	3.5	<b>10.00</b>	7.00	70	24.50	70.00	45.50
PCW1	0.06	7	<b>10.00</b>	0.60	6	4.20	6.00	1.80
PCW2	0.06	6.5	<b>10.00</b>	0.60	6	3.90	6.00	2.10
PCW3	0.06	4.6	<b>10.00</b>	0.60	6	2.76	6.00	3.24
PCW4	0.06	4	<b>10.00</b>	0.60	6	2.40	6.00	3.60
Entrant	0.06	3.6	<b>10.00</b>	0.60	6	2.16	6.00	3.84
	Total profit	60.08	Weighted av price	10.00				

Source: CMA analysis.

22. The important features of this scenario construction are:

- (a) The scenario is as for 2, with PCW1 having a narrow MFN clause.
- (b) The direct channel is given a very strong exogenous preference. The way to read this is to say that without making any effort on prices, the direct channel attracts most sales. This represents the case of a brand with a great deal of past advertising investment and high visibility.

*Discussion of the scenario*

- 23. The MFN forces the price offered on the own channel up to the maximum level, as it does in Scenario 2.
- 24. The premiums on PCW4 and the entrant channel are also raised to the maximum level. This happens because any price reduction on those channels which aims to take sales away from less profitable channels ends up taking more sales away from the direct channel.
- 25. This scenario occurs where an important direct channel and a single narrow MFN lead to price equalisation across all channels. DLG [X], and this is consistent with its description of its incentives, as in this scenario.
- 26. In response to our provisional findings, DLG criticised the scenarios in the model presented in this annex. In particular, Oxera, on behalf of DLG, said:

The results of any model of this kind depend on the assumptions used, and the CC acknowledges that the model is illustrative. Critically, however, the CC model assumes PCWs that charge a low commission (as reflected in the ‘average channel cost’) are able to enjoy large market shares. For example, the ‘entrant’ PCW captures 36% of all sales in Scenario 2; which does not fit with reality. Indeed, capturing 36% of the market is not consistent

with the CC's conclusion that 'Entry and expansion appear to be limited threats' in the PCW market.

27. Oxera produced a version of the model where, for a lower own-channel preference, it found network effects.<sup>1</sup> However, after examining Oxera's version of the model and Scenario 3 further, we found that, in both cases, the effects were due to the optimal pricing behaviour of the insurer absent narrow MFN clauses, not because of narrow MFN clauses. In other words, if we used the same assumptions in Scenario 1 with no MFNs, then the optimal behaviour would be to price the same on all PCWs (although lower on the insurer's own website.)
28. We sought to find an average channel cost and channel preference matrix which replicated the results of Scenario 3 (and Oxera's scenario), whilst keeping the comparable properties of Scenario 1 (ie the incentives to price differently on different PCWs without MFN clauses), but we were not able to do so. In part, this might be due to the limitations of the model. Nevertheless, whilst the result of the model did not allow us to conclude that there were no scenarios where network effects might take place, it did highlight that the results in Scenario 3 were not common and in the case of Scenario 3 were, in fact, due to optimal behaviour in the absence of narrow MFN clauses.

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<sup>1</sup> When we sought to replicate Oxera's results, we found that the insurer would still choose to price lower on the low-cost entrant PCW than on the other PCWs. We accepted in principle that PCWs with higher channel preference may demand higher CPA fees, although the average channel cost matrix used in Scenarios 1 to 3 combined with Oxera's channel preference results would have allowed for this.



## Analysis of PMI providers' advertising strategies

1. In this annex, we assess PMI providers' advertising strategies, especially in the context of PCWs. This supports the analysis of which PMI brands are likely to be affected by narrow MFN clauses in a similar way to how they are affected by wide MFN clauses. We also discuss submissions we received from Oxera on behalf of DLG concerning whether significant own-brand advertising is necessary for the finding of network effects.

### PMI providers' advertising

2. Figure 1 shows PMI providers' own website sales as a proportion of all online sales. We found that the vast majority of PMI providers were selling substantially more through PCWs than through their own website. [REDACTED] but the direct channel represented only 26% of sales on average.

FIGURE 1

#### Proportion of PMI providers' direct online sales volumes in 2012

[REDACTED]

Source: PMI providers.

3. Figure 2 shows advertising expenditure by brand. The chart shows that, in the relevant period, advertising expenditure varied by brand, for some PMI providers reflecting their multi-brand segmentation strategy.

FIGURE 2

#### PMI providers' marketing spend by brand, November 2011 to October 2012

[REDACTED]

Source: Ebenchmarkers.

Note: Red triangles represent brands that are not available on PCWs. Blue squares are available on PCWs and through direct channels.

4. We considered each PMI provider's advertising expenditure with its comments on its brand strategy:
  - (a) Acromas [REDACTED]. The sales for each brand were positively related with the marketing spend: [REDACTED], this was in line with PCW sales requiring less advertising.

- (b) Admiral (Admiral, Diamond, Elephant and Bell Direct): Admiral's expenditure on advertising was focused [REDACTED].
- (c) Ageas (UKAIS, Kwik Fit Insurance Services, Express Insurance Services and The Green Insurance Company): These brands relied either entirely or mostly on PCWs and advertising expenditure was very low or nil.
- (d) Aviva:<sup>1</sup> Aviva Direct represented most of Aviva's advertising expenditure. [REDACTED] advertising expenditure was related to its sales volume through its direct online channel.
- (e) BGL had low advertising expenditure for its PMI brands, which was in line with its strategy of focusing on PCWs and reducing advertising expenditure.
- (f) CISGIL also had [REDACTED], 'ecoinsurance'. [REDACTED].<sup>2</sup>
- (g) DLG (Churchill, Direct Line and Privilege):<sup>3</sup> This was probably the best example of brand segmentation. Direct Line is not sold through PCWs and [REDACTED].
- (h) esure: esure told us that [REDACTED].<sup>4</sup>
- (i) LV (LV= and [REDACTED]): LV told us that it still promoted itself directly despite the fact that PCWs generated around [REDACTED]% of its direct new business sales.
- (j) RSA (MoreThan): RSA said that it had [REDACTED]. eChoice (not shown in Figure 2) is its online brand selling predominantly through PCWs.
- (k) Swinton (Swinton, The Insurance Line, Bullseye, Diva, Its4me and MIW): The Swinton brand was heavily promoted, to support its offline operations, while the rest of its brands were focused on PCWs and promotional spend was more limited.
- (l) Zurich: [REDACTED].

5. We found that the data in Figure 1 on the proportion of direct online sales was broadly consistent with the PMI providers' responses and strategies concerning how much weight they gave to their own channel. There had been a reduction in advertising expenditure which PMI providers told us was because they did not see a clear causal link between direct advertising and increases

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<sup>1</sup> Advertising expenditure in Figure 2 does not include the [REDACTED] brand that is advertised principally through PCWs.

<sup>2</sup> [REDACTED]

<sup>3</sup> Sainsbury's is a partner brand of DLG.

<sup>4</sup> esure noted that it believed that the introduction of PCWs had resulted in the shift of advertising spending from PMI providers to PCWs, which now generally did the advertising themselves.

in sales. This was because of the predominance of PCWs in generating new sales. However, most PMI providers had maintained a certain amount of direct advertising spend, possibly attracting those customers who could be reached at low cost but also enhancing click-through rates from PCWs.

6. Figure 3 shows PMI providers' advertising expenditure in the period between May 2009 and April 2013. Advertising expenditure is split in two parts: online and offline (mainly television) expenditure. [REDACTED] Both online and offline trends were consistent with insurers' comments about reducing offline advertising and relying more on PCWs while keeping online advertising to maintain existing customers. The amount of money which PMI providers spend on advertising remained very high, although some providers said that they had reduced significantly their advertising spend. We noted that [REDACTED] DLG, had large brands which they did not list on PCWs.

FIGURE 3

**PMI providers' advertising expenditure, May 2009 to April 2013**

[REDACTED]

Source: Ebenchmarkers.

7. Figure 4 is a scatter plot showing PMI providers' advertising spend on the x-axis and the percentage of providers' own online sales on the y-axis. Many PMI providers told us that one of the reasons for reducing their advertising spend was because advertising was inefficient in increasing sales through their direct channel. Nevertheless, it appeared from the larger PMI advertisers that sufficient spending is capable of maintaining a large direct channel.

FIGURE 4

**PMI providers' website sales and marketing spend,  
November 2011 to October 2012**

[REDACTED]

Source: Ebenchmarkers.

8. It appeared to us that the PMI providers which told us that direct advertising investment was not, or was no longer, an efficient way of attracting new customers were effectively saying that, for incremental sales, the direct channel was a low-margin (or even loss-making) channel. For these providers, wide and narrow MFN clauses had very different incentive effects. Some providers, such as Saga and [REDACTED], were in a midway position. Saga, for example, appeared to have a relatively small, loyal direct channel, though it still listed on PCWs [REDACTED]. It therefore had been able to combine flexible optimal

pricing on its own channel with MFN-constrained pricing on PCWs. Whether a move to include narrow MFN clauses across the market would lead to greater platform competition would depend on the incremental cost of direct sales and the sensitivity of direct sales volumes to price differences with PCWs.

9. [X] DLG had chosen not to list its 'Direct Line' brand on PCWs but did sell 'Churchill' and 'Privilege' brands on PCWs. We found that [X]. It appeared to us that this approach would be consistent with short-term profit maximisation if the fixed preference for the non-PCW brand was high enough to replicate the results of Scenario 3 (see [Annex D](#)), while the other brands fell below the threshold required. One way of interpreting Scenario 3 was that the insurer had an interest in minimising the sales through the PCWs with which it had MFN clauses. Our model did not allow delisting as an option. Not listing on PCWs was effectively the choice taken by DLG on its non-PCW brand.
10. We found that the only other insurer with a similarly important direct channel was [X]. [X] did not list its [X] brand on any PCW and so did not have any MFN agreements for that brand. In our view, the decision to avoid listing on PCWs and avoid any MFN made sense if that allowed the company freedom to set the price on its large direct channel consistent with profit maximisation.
11. [X] told us that it objected to narrow MFN clauses on the grounds that it 'believes these could suppress the growth in market sales for lower cost distribution channels such as digital and social media and could restrict competition'. As we saw in Scenario 2 (see [Annex D](#)), this would not generally be the case, but it might be true for [X]. [X] did not describe its own incentives in the same way as DLG and did not argue that narrow MFN clauses would have the same effects as wide ones.
12. Our channel pricing model (see [Annex D](#)) suggested a different but closely related point, ie if an insurer does have a strategic goal of maintaining a strong direct sales channel, then it may not be a good idea to enter into agreements containing narrow MFN clauses. The reason for this was precisely that, in such a case, profit maximisation tended to increase the price and reduce the market share of the direct channel relative to attractive untied channels. Thus, it was true that narrow MFN clauses tended to undermine direct channels; but it was not true, as claimed by DLG, that narrow MFN clauses necessarily undermined competition between PCWs, as happens with wide MFN clauses.
13. We found that the solution to the business problem faced by the PMI provider who wants a healthy direct channel was not to sign narrow MFN agreements at all with PCWs (see [Annex D](#)). If providers did sign narrow MFN agreements, we would expect both their direct channels to become less competitive

*and* competition between PCWs to be strengthened. If PCWs insisted on narrow MFN clauses, then non-listing, as practised by some PMI providers, might be the way of preserving sales through a high-margin direct channel.

14. When insurers do not consider their direct channel to be important, channel optimisation is simpler. This might arise if there is little goodwill invested in the insurers' brands through past advertising. In this case, getting sales from the direct channel would require a high incremental cost (for the purchase of attention) compared with sales through PCWs. The insurer will optimise premiums to the various PCWs in relation to the attractiveness of sales through each of them, ie PCWs with lower commission rates will be offered lower premiums. The narrow MFN constraint will not have any impact on the pricing of the direct channel because sales through this unattractive channel are already minimised. Therefore, it is not a burden on the insurer to maintain own-channel premiums at or above the maximum of all the PCW premiums.

**Does the direct channel need strong price-independent attractiveness for network effects to apply?**

15. Oxera, on behalf of DLG, said that we had found that it was not sufficient for a firm to have a significant proportion of direct online sales to be affected by 'network effects' and that two additional conditions were necessary: first, an insurer needed to have significant advertising expenditure, and second this expenditure should not be designed to strengthen the insurer's brand simultaneously on direct channels and PCWs.
16. Oxera submitted that there were several reasons why those conditions did not appear to be necessary for the 'network effects' of narrow MFNs to arise, as follows:
  - The direct channel attractiveness did not have to be built through advertising, eg it could be strengthened because of convenience or trust.
  - To the extent that channel attractiveness was built through advertising, this did not have to be current advertising. Brands which had been built through historic advertising spend might have an attractiveness for consumers that was independent of price, even if current levels of advertising were relatively low.
  - Even if advertising was used to boost sales on PCWs as well as direct sales, this did not mean that the *relative* attractiveness of the PCW channel would increase compared with the direct channel (ie a company could be interested in raising its profile on PCWs and generating new

PCW sales, while at the same time keeping the direct website channel competitive).

17. Oxera said that its analysis, based on our model, indicated that the channel attractiveness of the direct channel need not be particularly strong for network effects to occur (eg the relative price-independent attractiveness of the direct channel was seven times lower in Oxera's model than in our version).
18. However, in our view:
  - The claim that direct channel attractiveness does not have to be built through advertising did not appear consistent with PCWs and insurers needing to advertise so that customers come to their respective websites. We believed that convenience was likely to apply mainly to renewal customers and, whilst trust might help an insurer to increase its direct channel attractiveness, this was unlikely to be at the expense of significant brand and advertising investment.
  - The claim that direct channel attractiveness can be built through historical advertising was at odds with PCWs' assessment of their need to continue to invest in advertising to keep customers coming to their websites. We noted that a report commissioned by Tesco showed that, as its advertising fell, Tesco's share of customers also fell significantly. We believed it would be surprising if this effect did not also apply to PMI providers, especially as they were competing with PCWs to bring customers to their websites.
  - The claim that the relative attractiveness of the PCW channel would not increase did not deal with the fundamental business strategy of a brand which was seeking to profit maximise, rather than ensuring that its own channel was the cheapest. If a brand was investing in advertising to enhance its sales on PCWs, it was clearly not following a strategy where it always sought to make its own website the cheapest channel.
19. In [Annex D](#) we discuss our model and the implications of changing certain assumptions in it. We found that scenarios where insurers priced the same on all PCWs were due to the optimal pricing behaviour of the insurers absent narrow MFNs, not because of the narrow MFNs.

## Effectiveness of circumvention strategies

1. The potential harm to competition arising from MFN clauses described in Section 5 may be negated if PMI providers and PCWs can pursue strategies which circumvent the pricing restrictions. In this annex we outline some of the potential circumvention strategies which PMI providers and/or PCWs could adopt, as well as evidence on their effectiveness.
2. The potential strategies a PMI provider might use are to:
  - offer customers who purchase from its website a cashback guarantee at the end of the policy period if the pricing restriction only applies to the initial premium paid
  - differentiate its policies slightly between different channels (eg by including ancillary items of cover as part of the product sold, like free MLEI)
  - sell very similar policies through different brands (assuming the MFN only applies to one brand)
3. Similarly, PCWs could engage in strategies to help circumvent the effects of MFN clauses in providers' agreements with other PCWs by engaging in various strategies, including:
  - offering customers who purchase from its website a cashback guarantee at the end of the policy period if the pricing restriction only applies to the initial premium paid
  - offering other non-cash incentives to purchase through the PCW
  - offering insurers short-term reductions in commission fee in return for lower premiums ('exclusive offers')
  - using a different set of questions for different PCWs
4. These strategies, if successful, could limit the incentive of a PCW with an MFN to raise its commission fees.

### PMI circumvention strategies

#### ***Cashback***

5. Several PMI providers have sought to use cashback websites to reach customers and/or have offered cashback on their own websites in order to

attract customers. In particular, [X] has [X] and it told us that this was one way in which it circumvented the effects of MFN clauses.

6. We found that the use of cashback sites by consumers in relation to PMI has been very limited, with the volumes involved generally being very low compared with the volumes achieved through PCWs. DLG told us that [X]. It said that, as a mechanism for enabling insurers to price appropriately across channels, the use of cashback or other incentives was inefficient and ineffective, as well as being unnecessarily elaborate.
7. Confused told us that it had (until it revised its contracts in light of the competition concerns with MFN clauses (see paragraph 44)) included the use of cashback sites within the scope of a number of its MFN clauses. Moneysupermarket also said that its standard MFN clause would, in principle, prevent a PMI provider with which Moneysupermarket had a signed contract offering cashback or a free gift in relation to a policy available through its website.
8. Considering both the limited use of cashback by PMI providers, the convoluted nature of the offer and the inclusion of cashback websites in the scope of Confused's previous MFN clauses, the use of cashback did not appear to us to be a likely effective strategy by which a PMI provider could circumvent MFNs.

### ***Differentiated policies***

9. Another possible way of circumventing MFN clauses is by including ancillary covers (such as MLEI) as a way of improving the products available, either through the provider's own website or through particular PCWs or sales channels.
10. Comparethemarket told us of a number of special offers which insurers had run:
  - esure/Sheilas' Wheels free spa day
  - Octagon's insurance premium prize draw or rewards scheme
  - Kwik Fit's free MOT
  - Hastings Essential's half-price MOT
11. Both Comparethemarket and Confused mentioned PMI providers introducing free MLEI for a period of time. [X] DLG told us that it also considered such strategies acceptable as these offers did not represent part of the premium.



12. However, it appeared to us that, similarly to the use of cashback, these strategies did not adjust the price at which PMI policies were available. It seemed that the reasons for using these strategies might be more related to competition between PMI providers on a particular PCW rather than PMI providers seeking ways to circumvent MFNs. Therefore it seemed unlikely that this would be an effective or efficient PMI provider circumvention strategy to MFN clauses.

### ***Multi-brand strategy***

13. Another way a PMI provider might circumvent MFNs (and certainly wide MFN clauses) would be to use different brands for different sales channels. We found that DLG, [REDACTED] and [REDACTED] were to some extent doing this: DLG had kept the Direct Line brand off PCWs but had included Churchill and Privilege brands on them; [REDACTED]; and [REDACTED] launched the [REDACTED] brand specifically for PCWs, [REDACTED].
14. A50 also said that it had launched a PCW-specific product. It said that, due to the highly price-sensitive nature of the PCW channel, the pricing of this product was managed in a highly dynamic way in order to attract the planned volume of customers.
15. Whilst a multi-brand strategy might be one way of avoiding the effects of MFN clauses, we found that it had not been utilised by many PMI providers. Moreover, we found that the [REDACTED] which had clearly operated this strategy had invested [REDACTED] in their non-PCW brand, which suggests that this might not be a strategy which all insurers could necessarily follow. We concluded that it seemed unlikely that this would be an effective circumvention strategy to wide MFN clauses for all PMI providers.

### **PCW circumvention strategies**

16. Similarly to PMI providers, rival PCWs might also engage in strategies to circumvent the effects of MFNs, both online sales MFNs and all-sales channel MFNs as both have the potential directly to affect competition between PCWs.

### ***Cashback***

17. As discussed above, whilst cashback could be a way of circumventing the effects of MFN clauses, we found that this strategy had not been widely used by PMI providers or by PCWs. We found that Confused included cashback as part of the restriction enforced by the MFN clause and thus PMI providers with this MFN would not be able to use cashback as a way of circumventing it.

### ***Non-cash incentives***

18. Another way of circumventing an MFN clause is to offer consumers non-cash incentives. For example, Comparethemarket has offered free meerkat toys when a policy is sold through its PCW, and Confused has offered free Nectar points.
19. We found that the Comparethemarket offer had had a material effect on the market with [redacted]. Confused board minutes stated that:

The Comparethemarket promotion to give away a free meerkat with every sale made via Comparethemarket continued to be successful and had led to Comparethemarket increasing market share by 6/7% despite making a net loss given the cost of the campaign.

GoCompare mentioned in its internal documents that 'comparison sites broadly competed on 3 things: (1) TV creative; (2) online management and (3) incentive offerings'. However, Moneysupermarket's board minutes noted that the meerkat offer appeared to be focused on the retention of customers. DLG also told us that it believed PCWs made extensive use of such promotions (eg meerkats and Nectar points) to support their own sales.

20. Whilst the free toy offer from Comparethemarket has clearly had an effect on the market, we found that it was unclear whether this was as a circumvention measure by Comparethemarket of MFNs or a form of additional advertising investment aimed at improving consumer retention. We found that this strategy did not affect the pressure on commission fees and therefore premiums due to the effect of MFNs.

### ***Exclusive offers***

21. PCWs could seek to encourage PMI providers to provide exclusive offers to the PCW in return for a reduction in the commission fee charged. We found that several PMI providers and PCWs had sought to engage in exclusive offers by way of such a reduction.
22. We collected evidence from several PMI providers who had been offered exclusive deals by PCWs. About a quarter of these providers had not considered the deals because of wide MFN clauses in their contracts with other PCWs, whilst another provider was worried about damaging its relationships with other PCWs if they did accept the offer. The remaining providers in our sample (around three-quarters) had accepted the deals but over half of them told us that they were later put under pressure from at least

one other PCW for providing a lower price on the first PCW. Some providers had been threatened with suspension or delisting. For example, [REDACTED] told us that it had taken part in price-based offers with both [REDACTED] and [REDACTED] at different times in the past. However, as these offers affected the prices quoted on these sites, [REDACTED] said that it had received complaints asserting that they were in breach of certain MFN clauses and both offers were eventually removed. [REDACTED] Another provider said that wide MFN clauses inevitably reduced its incentives to engage in commission sacrifice offers and price promotions.

23. We noted that, [REDACTED]. Other PMI providers told us that they had also been challenged by PCWs when their prices on other PCWs were lower, even when this was not due to a commission sacrifice offer. It appeared to us that this evidence indicated the importance to PCWs of offering the lowest available prices from providers and therefore that PCWs might seek to achieve similar outcomes to wide MFNs if they were removed.
24. We found that, on the basis of historic practice, where there is an MFN in place, PCWs are likely to enforce them against whatever exclusive offer another PCW and PMI provider might try to devise, making it unlikely that they represent an effective circumvention strategy.

#### ***Different question sets***

25. PCWs told us that their MFN clauses applied to consumers with identical risk profiles. Therefore, PCWs could set different question sets on their websites to circumvent MFN clauses. However, we found that PCWs sought to minimise the price differences with other PCWs so it seemed unlikely that this approach would generate significant differences in prices. We therefore concluded that it was unlikely to represent an effective circumvention strategy.

## Analysis of effects of MFN clauses on commission fees

1. In this annex we set out our analysis of the effects of MFN clauses on commission fees by using cross-sectional averages.<sup>1</sup>
2. In order to explore the link between the scope of MFN clauses and the commission fees paid to comparison websites, we divided PMI providers into two groups: 'the largest 50%' and 'the smallest 50%' (on the basis of sales). We considered that it was likely that negotiating strength played a role in determining both the scope of the MFN and the level of commission paid, and we expected negotiating strength to be related to a provider's size.
3. In the data below, we used only information from PMI providers which had brands on all four large PCWs in 2012.<sup>2</sup> Whilst there was a danger of missing some information, Figure 1 shows that we captured over 90% of sales.<sup>3</sup>

FIGURE 1

### Proportion of sales that largest and smallest PMI providers account for on each PCW

[✂]

Source: CMA analysis of PCWs' data.

4. Figure 1 shows that the largest PMI providers account for over 80% of sales through the four large PCWs (on average). Some PMI providers operate a multi-brand strategy so the sales of an individual brand might not be as high.
5. Figure 2 shows the commission fees which the largest and smallest 50% of PMI providers paid to each PCW.

FIGURE 2

### Commission fees for largest and smallest PMI providers

[✂]

Source: CMA analysis of PCWs' data.

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<sup>1</sup> [✂]

<sup>2</sup> If a PMI brand appeared on three out of four large PCWs and the PMI provider had another brand featuring on the other PCW, it was included in our calculations.

<sup>3</sup> [✂]

6. Figure 2 shows that the largest PMI providers were able to negotiate much better rates than the smallest providers, with the difference being about £4.
7. Figure 3 shows the proportion of sales that take place under wide MFN clauses for each PCW.

### FIGURE 3

#### **Proportion of sales under wide MFN clauses**



*Source:* CMA analysis of PCWs' data.

8. Figure 3 shows that Moneysupermarket had no wide MFN clauses in place with PMI providers. It shows that the smallest 50% of PMI providers [✂]. Larger PMI providers often had wide MFN clauses in their contracts with PCWs but much less often than the smaller PMI providers.
9. Figure 4 shows the difference in commission fees for PMI providers with wide MFN clauses, narrow MFN clauses and none at all.<sup>4</sup>

### FIGURE 4

#### **Commission fees for large and small PMI providers by type of MFN**



*Source:* CMA analysis of PCWs' data.

10. Figure 4 shows that commission fees were higher when there was a wide MFN in place. However, the difference in commission fees between narrow MFN clauses and none was not clear as there were some examples where the commission fee was higher with a narrow MFN clause and some examples where the commission fee is lower.
11. Because of the ambiguous nature of differences in commission fees between narrow and no MFN clauses, Figure 5 compares the average commission fee for wide MFN clauses against a combined 'narrow' and 'none' category.

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<sup>4</sup> Where there is a missing column, this is due to the PCW not having that type of MFN clause with this category of PMI provider.

FIGURE 5

**Commission fees for large and small PMI providers by type of MFN  
(narrow and no MFN types combined)**



Source: CMA analysis of PCWs' data.

12. Figure 5 confirms that commission fees were higher when a wide MFN clause was in place. It also shows that the commission fee was higher for smaller insurers than for large insurers.
13. Whilst the above analysis showed that commission fees were higher when wide MFN clauses were in place, it did not establish causality. In particular, we noted that both parts of this result could reflect the negotiating strength of the PMI provider and the PCW, ie a PMI provider which was unable to resist a wide MFN from a PCW was more likely also to be unable to resist a higher commission fee. Therefore, we considered further the 11 largest PMI providers on PCWs. These providers, whilst still varying in size, were likely to have more similar bargaining strengths than in the analysis above. Figure 6 shows that these providers accounted for 61% of all PMI sales on the four largest PCWs.<sup>5</sup>

FIGURE 6

**Proportion of sales accounted for by the top 11 PMI providers**



Source: CMA analysis of PCWs' data.

14. Figure 7 shows the proportion of sales made under wide MFN clauses for these providers. The figure shows that this proportion was lower for the top 11 PMI providers on PCWs than for the group of large insurers (see Figure 3).

FIGURE 7

**Proportion of sales under wide MFN clauses for the top 11 PMI providers**



Source: CMA analysis of PCWs' data.

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<sup>5</sup> In all the charts which follow, data from PMI providers which own a PCW has been excluded from the data of that PCW.

15. Figure 8 shows the difference for these 11 providers in commission fees between policies sold under a wide MFN and those sold under a narrow or no MFN clause.

FIGURE 8

**Top 11 PMI providers' commission fee by MFN type**

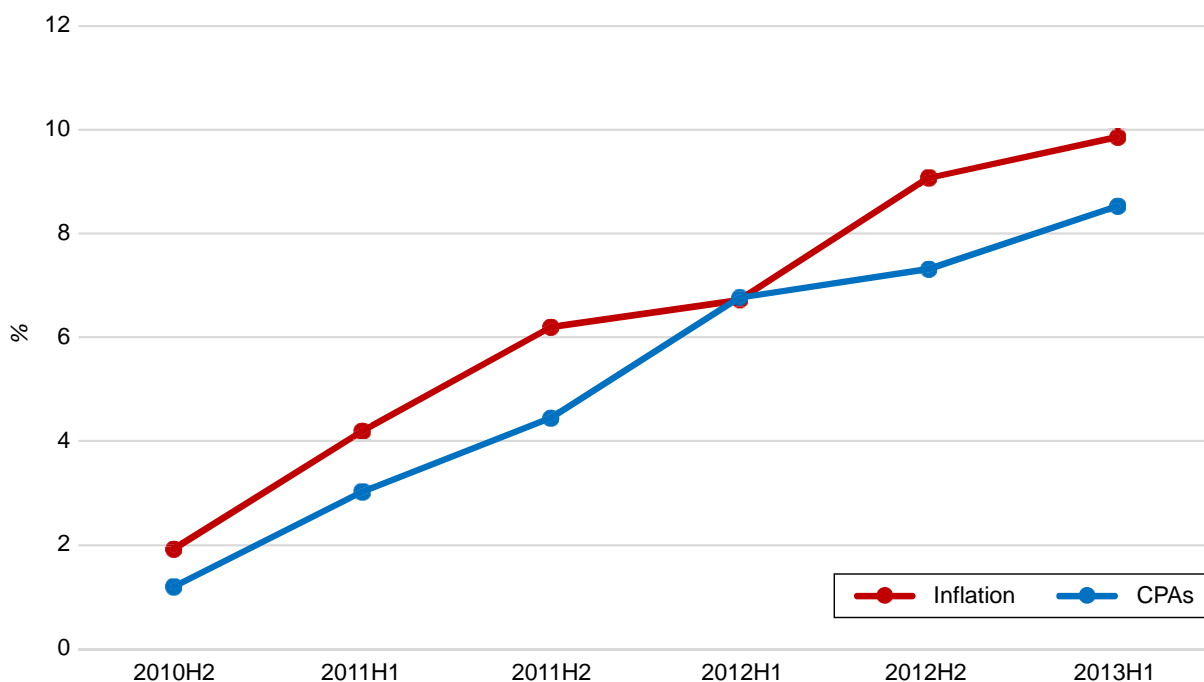


Source: CMA analysis of PCWs' data.

16. Although there was still a difference between the commission fees charged depending on the type of MFN, this was relatively small (£0.78 on average) and was even less on two of the PCWs. This suggested that, once bargaining power is accounted for, the difference in commission fees between insurers with wide and narrow MFN clauses is small.
17. We also looked at how commission fees had changed over time (see Figure 9). Some insurers told us that these fees had increased significantly beyond inflation; however, whilst this might have been true for some individual providers, the figure shows that overall they have gone up in line with, or sometimes slightly below, inflation. We noted that one PCW's commission fees had increased by more than inflation, although this PCW's fees were on average lower than for the other PCWs.

FIGURE 9

**Increases in CPA and inflation, 2010 to 2013**



Source: ONS and PCWs.

## Profitability of [REDACTED] PCWs

1. This annex examines the profitability of [REDACTED] PCWs.

### Why we look at profitability in market investigations

2. The CMA's market guidelines state that outcomes of the competitive process in their different forms in a market, eg prices and profitability, can provide evidence about its functioning.<sup>1</sup>
3. The guidelines<sup>2</sup> state that, in practice, a competitive market would be expected to generate significant variations in profit levels both between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. The profitability of some firms may exceed what might be termed the 'normal' level, for example as a result of past innovation or superior efficiency, but a situation where the profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process. Examples of these limitations could be the presence of entry barriers, or the existence of significant market power.
4. The guidelines<sup>3</sup> mention four possible types of analysis of prices and profitability: pricing patterns; price cost margins; price comparisons; and profitability. Annex A of the guidelines (Market characteristics and outcomes) states<sup>4</sup> that where capital employed cannot be reliably valued, the CMA may consider alternative measures, such as the return on sales or other relevant financial ratios.

### Analysis

5. The [REDACTED] PCWs were not able to provide figures from their management accounts for PMI-only profit because they did not allocate costs to PMI sales. Therefore, we asked the [REDACTED] PCWs to provide us with an analysis which would identify the operating profit for the PMI part of their business for the last five years. We did not look at other measures of profitability such as return on assets or return on capital as we believed that it would be very difficult for the

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<sup>1</sup> CC3, paragraph 103.

<sup>2</sup> CC3, paragraphs 117 & 118.

<sup>3</sup> CC3, paragraph 107.

<sup>4</sup> CC3, paragraph 15.



PCWs to calculate an appropriate asset base and cost of capital for the PMI part of their businesses only. We asked the PCWs to set out clearly their approach for allocating both their direct and indirect costs to the PMI part of their businesses, if necessary differentiating between divisional, group and holding company overheads. We said that we expected to see at least the following headings in their analysis: turnover/income, cost of sales, gross profit, expenses, contribution, allocation of shared costs, operating profit, interest, and profit before tax.

6. The [redacted] PCWs [redacted] provided us with a profitability analysis.
7. Table 1 shows the combined turnover, operating profit and operating margin for [redacted] PCWs for the three years 2010 to 2012 for the PMI part of their businesses.

TABLE 1 Summary of total PMI profitability, 2010 to 2012

	2010	2011	2012
Turnover (£m)	[redacted]	[redacted]	[redacted]
Operating profit (£m)	[redacted]	[redacted]	[redacted]
Operating profit margin (%)	[redacted]	[redacted]	[redacted]

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

8. Turnover [redacted] by [redacted] over the three-year period; operating profit [redacted] by [redacted]; and the operating profit margin [redacted].
9. Overall, we noted that, in aggregate, [redacted] PCWs had achieved an operating profit margin of around [redacted]% over the last three years. We did not conduct a more detailed analysis of their profitability but, in our view, this finding was consistent with [redacted] PCWs having had some bargaining power against PMI providers.
10. In the rest of this annex [redacted].

[redacted]

11. [redacted]

12. [redacted]

[redacted]

## Evidence of the exercise of market power without wide MFNs

1. This annex describes in more detail two pieces of suggestive but inconclusive evidence of the exercise of market power by a PCW without wide MFNs. These are:
  - (a) [REDACTED]; and
  - (b) [A PMI provider's] account of its conversations with [one PCW] about MFN clauses.
2. [REDACTED] using selective delisting, although these are not analysed further:
  - (a) [REDACTED]; and
  - (b) [REDACTED] told us that it had reached a compromise position with [REDACTED] such that if [REDACTED] reduced its prices on a rival PCW [REDACTED] was allowed temporarily to delist [REDACTED] from its service.

[REDACTED]

3. Figure 1 shows [REDACTED].

FIGURE 1

[REDACTED]

Source: [REDACTED].

4. [REDACTED]
5. We considered two explanations for this pattern of sales, the first based on 'diversion', the second on 'tit-for-tat':
  - (a) Diversion: it could be that consumers search on both [REDACTED] and, when they find [REDACTED] policies cheaper on [REDACTED], they switch their custom from [REDACTED] to [REDACTED]. Hence, [REDACTED] sales of [REDACTED] fall and [REDACTED] sales of [REDACTED] rise.
  - (b) 'Tit-for-tat': when [REDACTED] discovers lower [REDACTED] prices [REDACTED], it actively degrades [REDACTED] search results on [REDACTED] to reduce sales there, rendering the price reduction achieved by [REDACTED] on [REDACTED] unattractive.
6. We were not able to identify which explanation applied. [REDACTED], although it had no specific evidence for this. In favour of 'diversion' was the fact that we were not aware of any mechanism for search degradation which could be used. In

favour of 'tit-for-tat' was the fact that we would have expected 'diversion' to apply to all PCWs, and yet [X] seemed to have been largely immune to any diversionary effect.

7. The ambiguity of the data meant that we were unable to conclude on the explanation. However, it alerted us to the possibility that strategies like 'tit-for-tat' might be used to replicate the effects of wide MFNs.

[X]

8. [A PMI provider] told us about a commission sacrifice offer made to it by [a PCW]. [X]
9. [X] described the commission sacrifice offer from [X] as being, in the ordinary course of business, incredibly desirable. However, it felt that, due to certain MFN clauses, it would be unable to explore it further. [X] Therefore, when the commission sacrifice offer came in, it found itself 'regrettably declining' to pursue it.
10. [X] expected that, if the deal had gone through, which would have involved a price reduction on [X] of between £5 and £10, most of the increment in sales would have come from other PMI brands on [X] and very little would have come from 'diversion' from other PCWs.
11. [X]
12. It appeared to us that most of the account of [X] interaction with [X] described the operation of a wide MFN and its impact in curtailing the ability of a PMI provider to reduce its prices on a rival PCW. We noted that it also indicated that a 'tit-for-tat' strategy could be pursued even without MFNs. However, this evidence was again inconclusive.

## Effect of PCW ownership structure on competition between PMI providers

### Introduction

1. In this annex we discuss whether a PMI provider integrated with a PCW might use the information obtained through the services offered by its PCW (a) to undercut rival PMI providers' quotes or (b) to manipulate their quotes (eg by including features (such as a lower excess) not requested by the customer).

### PCW/PMI providers

2. PCWs are a major sales channel for PMI. Many insurers and brokers told us that it was important, or even essential, to sell on a range of PCWs in order to compete effectively in the PMI sector. In fact, the majority of customers search on multiple PCWs. We found that, on average, customers used 2.2 PCWs the last time they shopped around for PMI (see the results of our [consumer survey](#)).
3. Among the four large PCWs, there are three which are fully or partly owned by a provider of PMI (insurer or broker), as follows:<sup>1</sup>
  - (a) Comparethemarket, [X], is an independent division of BISL Limited, which is part of the privately-owned BGL Group (BGL) (a large broker);
  - (b) Confused is a wholly-owned subsidiary of Admiral (an insurer); and
  - (c) GoCompare is 50% owned by esure (an insurer).

### Price undercutting

4. We considered whether an integrated PCW/PMI provider could operate the PCW such that rivals' quotes were gathered before it quoted, so that it could ensure that its price for a policy was slightly cheaper. We noted that this could be done in real time just before the quotes were made available to the consumer.
5. However, price undercutting would be harmful for consumers only if the price quoted by the PCW/PMI provider would have been lower absent the information on its rivals' prices. If, on the other hand, the price would have

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<sup>1</sup> We provide more information on insurers, brokers and PCWs in Section 2.

been higher, customers would benefit from the provider's price-undercutting behaviour, at least in the short term (for an assessment of long-term effects, see paragraph 14).

6. The process of undercutting would rely on having a continuous flow of quoting information within the structure of the integrated PCW/PMI provider. However, this appeared to be possible as both Admiral and BGL told us that their integrated PCW could provide them with aggregated statistical data. Admiral explained that it had access to similar statistics/KPIs from other PCWs with which it worked and that it also made occasional ad hoc data requests to other PCWs.
7. Admiral told us that it had a contract with Confused (its integrated PCW) under which Admiral might ask Confused to provide daily/monthly KPI statistics and, from time to time, it might also submit ad hoc data requests. Admiral said, however, that it also had access to similar statistics/KPIs from other PCWs with which it worked and it made occasional ad hoc data requests to them. Confused told us that its contract with Admiral was based on a standard template and the same information would be available to its other PMI providers. It said that all its PMI providers would be treated equally. It told us that the results displayed on its website would be based on premiums and would not be influenced by relationships or agreements with any PMI provider.
8. Admiral told us that it was unaware of any computer software (or other mechanism) which would allow a PMI provider to access a rival's price. Although it would probably be possible for a PMI provider and a PCW operating together to build the necessary software, Admiral said that it had never been party to such an agreement and it was not aware of any PCW/PMI provider with such an agreement. We noted that Admiral had told the OFT that having Confused granting Admiral access to the real-time data of its PMI rivals would be 'commercial suicide' for Confused as it needed to offer the broadest range of coverage in terms of PMI providers and such behaviour would make rival PMI providers run away.
9. BGL told us that its PMI intermediary business and Comparethemarket operated within one legal entity but as distinct business units, with processes and procedures in place to prevent the sharing of customer data and quote data between them. BGL told us that Comparethemarket provided BGL's intermediary business simple data that the intermediary business then analysed in order to identify trends, but this was aggregated statistical data, not customer or quote data, and it was data which was also made available to other PMI providers using Comparethemarket. BGL noted that other PCWs offered access to similar information.

10. esure told us that its participation as a panel member of GoCompare was on a strictly arm's length commercial basis. esure said that GoCompare was independent and operationally separate from esure, and esure received no information different from that provided to it by other PCWs in which it had no equity stake. Moreover, esure said that it was not aware of any software or other method which would allow a PMI provider to analyse rivals' prices through any PCW in order to provide a lower quote.
11. Although both Admiral and esure told us that they were unaware of any software or other method which would enable the undercutting of rivals' prices, we reviewed some of the internal documents of a number of parties and found that [REDACTED]. These internal documents suggested to us that suitable software might be available or, at least, feasible.

### **Direct manipulation of quotes**

12. GoCompare told us that PMI quotes were generally displayed first to consumers ranked by price, with the cheapest premium at the top. Customers could then re-sort the order according to other criteria or preferences. Customers could also select add-ons, which were usually added prior to the search. However, where the customer left questions relating to add-ons unanswered, it was up to the PMI provider to determine whether to include add-ons in the policy search or not. This choice could clearly affect the resulting ranking.
13. Integrated PCW/PMI providers could have the incentive to manipulate rivals' quotes to ensure that their PMI policies appeared at the top of the ranking. This could be achieved, for example, by including in rivals' PMI products some add-on services (eg windscreen cover, breakdown cover, etc) which then made them appear more expensive.

### **Possible consequences for competition in PMI provision**

14. In the long term, an integrated PCW/PMI provider might benefit from the additional sales achieved through either the undercutting of rivals' quotes or the direct manipulation of search results to increase its market share to the detriment of its competitors. However, we noted that the ability of the integrated PCW/PMI provider to use its improved market position to increase its prices would still be constrained by the presence of other PMI providers in the market. Moreover, the integrated PCW/PMI provider would be constrained by other PMI providers delisting from its PCW if the benefit of being quoted on the PCW became lower than the detriment incurred.

## Sales volumes of large PMI providers on the top four PCWs

15. We asked some of the largest insurers and brokers to tell us the proportion of their PMI sales through PCWs by each of the large PCWs. Table 1 shows the results.

TABLE 1 Proportion of policies sold through PCWs by each PCW for each PMI provider in 2012

[REDACTED]

Source: CMA.

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[REDACTED]

16. Table 1 suggests that in 2012 [REDACTED].
17. We also collected data from PCWs on the number of sales made by each PMI provider. In Table 2, we show the proportion of sales that each PMI provider accounted for on each PCW.

TABLE 2 Proportion of PCWs sales accounted for by the largest selling PMI providers on PCWs (2012)

				%
	<i>Comparethemarket</i>	<i>Confused</i>	<i>GoCompare</i>	<i>Moneysupermarket</i>
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: PCWs' data.

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18. In 2012 [REDACTED].
19. However, we noted that, [REDACTED].
20. Overall, we concluded that the information provided by the large PMI providers gave no indication that the integration of some PCWs with PMI providers gave rise either to the undercutting of quotes or the manipulation of quotes.

## Consumer awareness of vertically integrated PCW/PMI providers

21. The OFT has considered the importance of disclosing to consumers clear information about the identity of the business operating a PCW, and information regarding the commercial relationships it has with providers of the products it offers. To inform its analysis, the OFT conducted an online consumer survey.<sup>2</sup> The survey covered a wide range of products and services offered by PCWs, one of which was PMI.

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<sup>2</sup> [www.of.gov.uk/OFTwork/markets-work/advertising-prices/#named4](http://www.of.gov.uk/OFTwork/markets-work/advertising-prices/#named4).

22. The survey showed that, of all consumers who used PCWs in all markets surveyed, a substantial majority (81%) did not always purchase through a PCW. When asked why, 17% gave the reason that they were not independent, and 13% said it was because some PCWs were owned by the suppliers of the products being compared. Among consumers that used PCWs in 2010,<sup>3</sup> a substantial majority, 76% (75% for car insurance only), considered them to have at least some drawbacks, and 'not being independent or impartial' was a drawback reported by 39%. Of these consumers who did not consider PCWs to be independent or impartial, 41% (44% for car insurance only) said that this was because 'some of the PCWs are run by the suppliers listed on the site'. Only a small minority (11%)<sup>4</sup> of those consumers who said that they were aware of the vertical integration between some PCWs and some PMI providers said that they would use the PCW both to compare and to purchase, as opposed to the majority who said that they would use the PCW to compare products or services but would not always purchase on the PCW.
23. Unfortunately, we did not have data on the purchase behaviour of informed consumers specific for PMI. However, shoppers for PMI through a PCW constituted around half of the respondents to the OFT's survey (49%) and we knew from our customer survey that, among those who compared policies online, the vast majority used one or more PCW (87%). Moreover, we saw no reason why consumers' general behaviour (ie whether they would purchase through a PCW in the knowledge of vertical integration) would vary depending on the product for which they were using the PCW.
24. In our view, the OFT's survey provided a useful insight into consumer awareness of PCWs' vertical integration. However, it did not allow us to assess whether choices by informed consumers could limit or exclude any undercutting or quote manipulation by PCWs. In particular, we did not know the proportion of informed consumers which would not buy a PMI policy from a vertically-integrated PCW.<sup>5</sup>

### **Third parties' views regarding such behaviour**

25. Non-integrated PMI providers told us that they were aware of the conflict of interest faced by PCWs which were owned by rival PMI providers and, for this reason, we expected that they would monitor closely their sales performance

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<sup>3</sup> This period represented the last 12 months at the time of the study.

<sup>4</sup> The number of responses for this question was very small so this result should be interpreted with some caution.

<sup>5</sup> The share of consumers, in the OFT's survey results, who did not purchase through a PCW because they had concerns about integration was derived from too small a base to infer general results.



on each PCW in order to identify any unexpected changes (eg a decrease in sales volumes).

### ***Price undercutting***

26. [REDACTED]

### ***Direct manipulation of quotes***

27. [REDACTED]

28. [REDACTED] told us that its ability to identify any manipulation of the quotes it offered was limited. It said that, more generally, non-integrated insurers/brokers had no evidence that their products were not being quoted fairly on PCWs, though they were acutely aware that integrated PCW/PMI providers had both the incentive and the ability to do so.

29. Most non-integrated PMI providers told us that they would consider delisting from a PCW if they believed that they were not being quoted fairly on it. However, it appeared to us that this option was typically considered as a last resort and the PMI provider would prefer to rely on good relationship management to resolve any issues, or would consider other options to protect its business and to mitigate any negative impact. As an example, [REDACTED]. We recognised that the decision to delist from a PCW might result in a significant loss of sales for a PMI provider, though we noted that many customers visited more than one PCW before making a purchase. We also noted that price was not the sole consideration for consumers when selecting policies on PCWs. We found that, to date, none of the PMI providers which provided us with information had ever delisted from a PCW due to a fear of quote manipulation.

30. RSA told us that it [REDACTED].

## Single-homing and the threat of delisting

### Introduction

1. In this annex, we assess how the rate of single-homing can affect PMI providers' incentives when threatened with delisting by a PCW because of the provider's failure to price lowest on that PCW.
2. In this analysis we used three different approaches:
  - (a) In the first analysis, we asked the question 'How big would a commission sacrifice offer have to be for a PMI provider to accept it in the face of a possible delisting from another PCW?' We used 2012 customer numbers, the single-homing rate and the price elasticity to estimate the commission (CPA) reduction required to make an insurer indifferent between accepting the commission reduction deal and being delisted. It provided a critical CPA value, below which commission sacrifice deals would be rejected if faced with the threat of delisting.
  - (b) In the second analysis, we asked the question 'How low do single-homing rates need to be for a typical commission sacrifice deal to be accepted?' We used assumed levels of CPA reductions<sup>1</sup> and premium levels<sup>2</sup> to estimate the level of single-homing that would make a PMI provider indifferent between accepting the commission reduction deal and being delisted. It provided a critical single-homing rate, above which commission sacrifice deals would be rejected if faced with the threat of delisting.
  - (c) In the third analysis, we asked the question 'Would an insurer ever choose to delist itself if a PCW increased its CPA rates?' We assumed that one PCW increased its CPA rate and compared the profits from delisting from that PCW against the profits from accepting the CPA increase. By accepting the CPA increase, the PMI provider would either increase prices across the board or accept a margin decrease on sales for the PCW that increased its CPA rate, given that the PCW was expecting price parity. The results showed how much more profitable it would be to accept a CPA increase against delisting.
3. The first two analyses use the following base formula:

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<sup>1</sup> The results in this annex model £10 CPA reduction.

<sup>2</sup> The results in this annex model an average premium of £500.

$$(1) \text{ Profits lost from delisting} = sh_i \cdot n_i \cdot m_i$$

$$(2) \text{ Profits gained from delisting} = \Delta p_j \cdot \mu_j \cdot n_j \cdot m_j$$

Where:

$sh_i$  is the single-homing rate of PCW  $i$

$n_i$  is the number of customers of PCW  $i$

$m_i$  is the profit margin earned on each customer on PCW  $i$

$\Delta p_j$  is the percentage price change on PCW  $j$

$\mu_j$  is the price elasticity of demand on PCW  $j$

$$(3) \text{ Profits lost from delisting} \leq \text{Profits gained from delisting}$$

$$(4) sh_i \cdot n_i \cdot m_i \leq \Delta p_j \cdot \mu_j \cdot n_j \cdot m_j$$

4. We can rearrange (4) to create the formulae for approaches 1 and 2:

$$(5) \Delta p_j \geq \frac{m_i}{m_j} \cdot \frac{n_i}{n_j} \cdot \frac{sh_i}{\mu_j}$$

$$(6) sh_i \leq \Delta p_j \cdot \mu_j \cdot \frac{n_j}{n_i} \cdot \frac{m_j}{m_i}$$

5. We can simplify this further by assuming  $m_i = m_j$  so that  $\frac{m_i}{m_j} = \frac{m_j}{m_i} = 1$ . This simplifying assumption normalises profits and allows us to look at the effects on prices without having to worry about how a firm may react to price decreases, and whether it may choose to increase its margin:

$$(7) \Delta p_j \geq \frac{n_i}{n_j} \times \frac{sh_i}{\mu_j}$$

$$(8) sh_i \leq \Delta p_j \cdot \mu_j \cdot \frac{n_j}{n_i}$$

6. Equation (7) gives the condition for our first analysis. This says that the price decrease (in percentage terms) needs to be greater than the ratio of consumers on PCW $_i$  and PCW $_j$  and the ratio of single-homing customers on PCW $_i$  to the price elasticity of demand on PCW $_j$ .

7. We can then convert the price decrease (in % terms) into a monetary CPA decrease if we make an assumption about the (average) premium level.

8. Equation (8) gives us the condition for our second analysis. It says that the single-homing rate for PCW $_i$  must be below the (normalised) profits gained from delisting divided by the number of customers on PCW $_i$ . If the actual single-homing rate is higher, then being delisted is more costly than accepting a commission sacrifice deal from another PCW.

9. In analysis 3, we take a scenario where one PCW increases its CPA fee and the insurer is left with the choice of whether to delist from that PCW (and lose the single-homing customers), to accept the higher CPA and a margin reduction on that PCW or to accept the higher CPA and increase prices across all PCWs (with a consequent increased margin).
10. The results are summarised below.

### **Analysis 1: Critical rates of CPA**

11. In this analysis, we sought to find out when an insurer is threatened with delisting from another PCW how big a commission sacrifice offer from one PCW would need to be to make the commission sacrifice offer more attractive than being delisted.
12. The commission sacrifice offers we observed were typically been between £5 and £10. Given that CPAs were around £50, it seemed to us unlikely that CPA reductions above £10 would be offered in the near future. Table 1 shows the critical CPA rate reduction required, above which commission sacrifice deals would be accepted, even with the threat of delisting.

TABLE 1 **Critical CPA rate reductions**

	<i>CPA reduction required (£)</i>		
	<i>Minimum*</i>	<i>Average†</i>	<i>Maximum*</i>
Insurer A	15.97	30.59	53.92
Insurer B	42.85	75.29	139.35
Insurer C	12.94	19.65	30.75
Insurer D	15.14	28.14	45.90
Insurer E	16.53	47.10	107.80
Insurer F	22.98	38.88	68.52
Insurer G	66.48	89.84	122.18
Insurer H	14.09	38.10	81.15
Insurer I	5.13	26.74	70.16
Insurer J	17.80	34.42	56.00

Source: CMA analysis.

\*From the CMA's model, minimum (maximum) refers to the lowest (highest) offer found that could induce an acceptance of a commission sacrifice offer given a threat of delisting.

†From the CMA's model, average refers to the average offers that need to be made to induce acceptance of a commission sacrifice offer given a threat of delisting.

13. For an average premium of £500, there was only one PMI provider who would be likely to accept a commission sacrifice offer in the face of delisting from one particular PCW. However, this might not be a particularly representative PMI provider due to its significantly greater sales on one particular PCW and its low number of sales overall. Given that it was the high-sales PCW which was most likely to delist a PMI provider, there appeared little possibility of a PMI provider accepting a commission sacrifice deal from one PCW if it were threatened with delisting by a high-sales PCW. Thus it appeared that the threat of delisting would be a real and credible threat to a PMI provider.

## Analysis 2: Critical rate of single-homing

14. In the second analysis, we sought to find out how low the rate of single-homing would have to be for a PMI provider to accept a commission sacrifice offer of £10. Table 2 shows the critical level of single-homing, below which commission sacrifice deals would be accepted, even with the threat of delisting. We also provide the actual single-homing rates experienced by PMI providers across the PCWs on which they operate.

TABLE 2 Critical level of single-homing

	%			
	Critical single-homing rate*		Actual single-homing rate†	
	Minimum	Maximum	Minimum	Maximum
Insurer N	9	45	[REDACTED]	[REDACTED]
Insurer O	10	40	[REDACTED]	[REDACTED]
Insurer P	5	15	[REDACTED]	[REDACTED]
Insurer Q	6	11	[REDACTED]	[REDACTED]
Insurer R	10	31	[REDACTED]	[REDACTED]
Insurer S	5	34	[REDACTED]†	[REDACTED]‡
Insurer T	11	32	[REDACTED]	[REDACTED]
Insurer U	7	111	[REDACTED]	[REDACTED]
Insurer V	17	40	[REDACTED]	[REDACTED]
Insurer W	13	38	[REDACTED]	[REDACTED]

Source: CMA analysis.

\*Our models produced a range of results but this shows the lowest and highest rates found.

†Refers to single-homing rates on largest four PCWs.

‡[REDACTED]

15. PMI providers' estimates of single-homing rates varied by provider and by PCW on which they operate but they were all in the range of 50 to 80%. However, the critical value for single-homing was almost always lower for any individual commission sacrifice offer.<sup>3</sup> As the critical value was not met, being delisted by a PCW would typically be unprofitable for a PMI provider.<sup>4</sup> Even with a CPA reduction of £40, in very few cases would the largest-selling PCW be discouraged from delisting.
16. The critical level of single-homing was low in most cases and thus, even with lower actual single-homing rates than those shown in Table 2, it appeared that the threat of delisting would still be a real and credible threat to a PMI provider.

## Analysis 3: Delisting in the face of CPA increase

17. In the third analysis, we assessed whether a PMI provider would choose to delist in the face of a £10 CPA increase from one of the PCWs, which also

<sup>3</sup> [REDACTED]

<sup>4</sup> Assuming average premiums of £500 and CPA reductions of £10.

insisted on price parity, even in the absence of a wide MFN contractual clause. The analysis here was in essence very similar to the analysis of effects of wide MFNs, and PMI providers' ability to resist wide MFNs if the alternative option was not to be listed.

18. We assessed the difference between the profits earned by a PMI provider in the scenario where the CPA increase was accepted and the profits earned in the scenario where the provider was delisted. As acceptance of the CPA increase could lead to a margin cut or a price increase, we used a maximum function to display a single result, as shown in Table 3.

TABLE 3 Additional profit from accepting CPA increase (against delisting)

[X]

Source: CMA analysis.

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19. For a CPA increase of £10, with average premiums of £500, the acceptance profits were always greater than the delisting profits. In fact, even if the CPA was increased by £30, half of the PMI providers would still not choose to delist. However, if CPAs were to increase by this much, the option of using the PMI provider's own sales channels might become more attractive.
20. This third analysis again showed that the threat of delisting would be a real and credible threat to a PMI provider.
21. Overall, we found that it was not surprising that very few PMI providers had voluntarily delisted from a PCW. We also did not see much evidence of PCWs delisting PMI providers, although we did hear some anecdotal evidence suggesting that it had occasionally been threatened. Nevertheless, given the results of our analysis in this annex, and the extent of single-homing currently on PCWs (see Table 2), it appeared to us that, in the absence of wide MFNs, we would expect actual delisting, and the threat of delisting, to increase.

## Effectiveness of advertising expenditure on PCWs

1. This annex outlines the cost of PMI customer acquisition off PCWs and on PCWs.
2. We collected data from eBenchmarkers on sales volumes by channel and advertising expenditure by brand. We combined this with data provided by PCWs on the level of CPA fees.
3. By combining this data we sought to assess the efficacy of advertising expenditure off PCWs and on PCWs. We estimated the cost of advertising expenditure on PCW sales as the relevant CPA rate for that brand. For non-PCW sales (telephone and online), we divided the total advertising expenditure by the number of sales.
4. Whilst there was a danger that some PCW sales might have been due to non-PCW advertising, it was also true that some non-PCW sales might have been due to PCW leads.<sup>1</sup> Overall, we believed that our methodology provided a good picture of the relative acquisition costs for PMI providers through different channels. Table 1 presents the results.

TABLE 1 Sales and advertising expenditure by brand for brands that spent more than £1 million on advertising in 2012\*

	Sales data ('000)		Advertising expenditure (£m)	Cost per customer	
	PCW	Non-PCW		Average CPA fee	Non-PCW
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: CMA analysis, eBenchmarkers data and PCWs' data.

\*Data from eBenchmarkers in columns 2, 3, 4 and 6 covers the period November 2011 to October 2012.

5. We found that the two [REDACTED] offline PMI advertisers did not appear on PCWs, and that the per-customer acquisition costs for these providers were [REDACTED]. For all of the major brand investors (those which spend more than £1 million on

<sup>1</sup> Oxera, on behalf of DLG, submitted that:

almost all the largest providers of PMI have a wide offer of other products such as home insurance, life insurance, pet insurance, investment products etc. Therefore any general advertising expenditure could have been used to drive sales in those categories also (eg by promoting the brand name). Calculating the advertising expenditure on a PMI-sales basis risks inflating the customer acquisition costs. Even if only advertising which specifically aims to drive PMI sales were included in the calculations, the acquisition costs would still be biased as customers might be purchasing other products such as home insurance along with their car insurance.

However, in our view, this bias can go both ways as advertising for other products can enhance the sales of PMI by the insurer. Therefore, we did not consider this bias to be significant.

non-PCW advertising), only three providers [X] had lower significantly acquisition costs for non-PCW customers than for PCW customers.<sup>2</sup>

6. We could not draw strong conclusions from low-advertising PMI providers as their customer acquisition strategy off PCWs might not be sustainable if they were seeking to attract significant numbers of customers to their own sales channels.
7. This data appeared to show that PCWs were an efficiency-enhancing advertising platform for PMI providers, although there were some PMI providers which appeared able to attract customers more cheaply directly than through PCWs.<sup>3</sup>

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<sup>2</sup> [X] also had lower non-PCW costs although they were only marginally different.

<sup>3</sup> Oxera, on behalf of DLG, also told us that 'according to the CMA's own evidence, some insurers are using advertising to drive both PCW sales and non-PCW sales', and that 'PCWs have told the CMA that 40% to 50% of customers do not choose the cheapest quote on a PCW, [indicating] that factors such as trust and/or branding, which are built through advertising, are important factors driving PCW sales as well as direct sales'. However, we found that the [X]. As this was the clearest comparison of the respective acquisition costs of customers on PCWs and other channels, this supported our view that PCWs had, on average, lowered the costs of acquiring customers for PMI providers.



## Summary of views on remedies relating to theory of harm 1

### Introduction

1. In this appendix, we set out a summary of the views of parties on remedies relating to ToH 1. We have published the responses we received to our provisional findings, our Remedies Notice and our provisional decision on remedies on our website.<sup>1</sup>

### Remedy A

#### ***What information should be provided to consumers?***

##### *Brokers*

2. BGL told us that the information should cover the issues set out in paragraph 18 of the Remedies Notice and that supplemental information might be supplied, depending on the customer's circumstances and the status of the FNOL provider, and that the wording should be standardised and prescribed by law.

##### *CMCs/CHCs*

3. Accident Exchange told us that the information provided at the point of sale and FNOL should not be the same and that consumers should be made aware that there were many different sources of provision of repair and replacement vehicle services.
4. Accident Exchange told us that the information which could be provided about a consumer's legal entitlement would differ depending on when it was given and by whom. Accident Exchange also told us that consumers should be made aware that there were many different sources for the provision of repair and replacement vehicle services.
5. Quindell told us that, in addition to the information set out in paragraph 18 of the Remedies Notice, information on the following should be provided to consumers:
  - (a) consumers' entitlement to choose between using their own insurance policy or not;

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<sup>1</sup> See the CMA's [PMI case page](#).

- (b) whether OEM or non-OEM parts will be used in the repair of the consumer's vehicle;
- (c) whether a repair or replacement strategy will be used by the insurer;
- (d) rights to rehabilitation (for the driver and passengers), rights to other medical treatment and compensation for losses, pain, suffering and loss of amenity; and
- (e) any commission payable in relation to the services provided.

In addition, providers should be required to disclose complaints ratios so as to enable consumers to make an informed decision as to whether they can trust the provider.

### *Insurers*

6. Most insurers agreed that the information to be provided to consumers should be standardised and adopted by all market participants.
7. Aviva told us that as a minimum, and in addition to the information set out in paragraph 18 of the Remedies Notice, all consumers needed to be provided the following:
  - (a) an explanation that their policy is a legally binding contract of indemnity and that they have separate rights in tort;
  - (b) a brief explanation of any additional cover purchased; and
  - (c) a brief synopsis of what is not covered by the policy and how they can be helped in these instances (either through MLEI, or through advice or services from other providers).
8. CISGIL suggested that it might be necessary for different statements to be provided in England and Wales, Scotland and Northern Ireland, given the differences in the legal systems in these regions of the UK.
9. DLG told us that the Road Traffic Act was defined as any Acts, laws or regulations, which governed the driving or use of any motor vehicle in Great Britain, Northern Ireland, the Isle of Man and the Channel Islands.
10. esure told us that a policyholder's entitlements under the Scottish law of delict was the same under tort law in England and Wales (ie to put a claimant in the same position as they would have been in had they not sustained the wrong),

although further analysis would be required to confirm the extent of any differences once the level of detail to be included in any further documentation was known.

11. RSA told us that the FCA regulated all financial services undertaken and provided in the UK such that there were no differences in customer-facing regulations in the different nations of the UK.
12. esure told us that consumers should be made aware that when they entered into a credit agreement with a credit repairer or CHC, they might be liable for the costs incurred by that provider, in the event that the provider was unable to recover its costs from the at-fault insurer.

#### *Law firms*

13. Keoghs told us that the information should include a description of the benefits to the consumer of using the insurer's approved network (eg use of OEM parts (where applicable); warranty on repairs; and repairs carried out to PAS 125 standard (where applicable)).
14. Winn Solicitors told us that the consumer should be provided with a risk/benefit analysis of proceeding with a claim on their insurance or alternatively proceeding with a tort action against the at-fault insurer.

#### *Trade associations*

15. The Lloyds Market Association (LMA) told us that consumers must be informed that they had responsibilities as well as rights, most notably a legal duty to mitigate any losses, and that failure to mitigate losses could lead to the consumer being liable for part or all of the costs they incur.
16. The Liverpool Law Society (LLS) told us that the information should include:
  - (a) a description of consumers' contractual rights under their insurance, and their rights under tort law (as far as being put back into the position in which they would have been but for the accident);
  - (b) the need for the consumer to report an accident, provide their details and ensure that they do not prejudice their insurer's position;
  - (c) guidance for both at-fault and non-fault drivers;
  - (d) an explanation of the consumer's entitlement to a replacement vehicle;

- (e) an explanation of the process of vehicle recovery, engineer inspection, repair authorisation and the repair work itself with advice relating to choice of repairer, quality of repair and storage during repairs;
- (f) an explanation of the consumers' responsibility to mitigate their losses;
- (g) an explanation of the impact of a claim on the consumer's insurance policy; and
- (h) advice about the type of bodies which would or could be involved in the claim.

***When is this information<sup>2</sup> best provided to consumers – with their annual insurance policies, at the FNOL, or at some other point? Should this information be available on insurers' websites?***

*Brokers*

- 17. Acromas told us that providing information with annual insurance policy documentation would risk overloading the consumer with information at a time when they were unlikely to be focused on the issue.
- 18. Swinton recommended the provision of information both with the annual insurance policy documentation and at FNOL.

*CMCs/CHCs*

- 19. There were varying views as to whether the information would be most effective if provided with the annual insurance policy documentation or at FNOL or at both points.
- 20. WNS told us that a consumer would not necessarily be receptive to much information about their legal entitlements at FNOL.

*Insurers*

- 21. There was no consensus among insurers as to the most suitable point at which to provide information to consumers about their legal entitlements following an accident. For example:
  - (a) Admiral told us that such information should be provided in the policy documentation (ie at policy inception), as this information could potentially

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<sup>2</sup> This information concerns consumers' rights and obligations following an accident.

be both lengthy and detailed, and could also be provided in the Frequently Asked Questions (FAQs) section of an insurer's website.

- (b) AXA told us that the provision of additional information to policyholders with their policy documentation would not be effective, because consumers were already informed of their rights and entitlements in their policy documentation and it was not clear whether policyholders read this documentation in its entirety.

#### *Law firms*

22. DAC Beachcroft told us that information should be provided at policy inception and then reiterated (in greater detail) at FNOL, as this would ensure (as far as is possible) that the information had been reiterated to the consumer at the time it was most needed (ie following an accident).

***Would it be more effective for consumers to be provided with a general statement of consumers' rights which was prepared and periodically updated by a body such as the ABI or are there any examples of existing best practice in relation to information given to consumers by insurers?***

#### *Brokers*

23. Swinton told us that the key principles of the information to be provided to consumers should be agreed by the ABI and the British Insurance Brokers' Association (BIBA).
24. Acromas told us that the GTA Technical Committee would be better placed to prepare this information, because it included representatives from both CMCs, CHCs and insurers.

#### *CMCs/CHCs*

25. A number of CMCs/CHCs, including Accident Exchange, Kindertons and Quindell, told us that the ABI was not the suitable body for preparing information to be provided to consumers (as it represented insurers) and that an independent body, such as The Law Society, was better placed to assume this role.

#### *Insurers*

26. There was a general consensus among insurers that the ABI was a suitable body to prepare the information to be provided to consumers. However, CISGIL told us that the CMA or another regulatory body, such as the FCA,

would be better placed to take on responsibility for this remedy. DLG also told us that the FCA was a suitable body to perform this role.

#### *Law firms*

27. DAC Beachcroft told us that a general statement of consumer rights would ensure uniformity in the information being provided to consumers.

#### *Trade associations*

28. The ABI told us that it could lead the preparation of the information to be provided to consumers in consultation with other industry stakeholders.
29. The LLS said that it would be inappropriate for any organisation involved with the provision of accident-related services to be responsible for the drafting of the information.

#### ***Would this remedy give rise to distortions or have any other unintended consequences?***

#### *Brokers*

30. Acromas expressed concern that the provision of too much information at FNOL might confuse consumers.
31. BGL told us that the remedy would not give rise to distortions or have any other unintended consequences if the information provided to consumers was prescribed by law and applied consistently across the PMI market.

#### *CMCs/CHCs*

32. A number of CMCs/CHCs told us that the implementation of this remedy would result in an increase in the cost of claims and, consequently, an increase in premiums. For example:
  - (a) Quindell told us that increasing awareness among consumers about their rights to have their vehicle repaired at a repairer of their choice and not accept the fitting of non-OEM or repaired parts to their vehicle would increase repair costs, which would likely lead to an increase in premiums.
  - (b) WNS told us that the provision of further information at FNOL would increase the cost of handling the claim.

### *Insurers*

33. RSA told us that care would be required to ensure that the provision of the recommended information did not adversely affect the customer journey at the point of claim and throughout the claims process.

### *Law firms*

34. Winn Solicitors told us that there might be an increase in tort claims, as it would generally be better for non-fault claimants to proceed via a tort claim if liability was clear.

### *Trade associations*

35. The LMA told us that an increased awareness of legal rights could lead to an increase in claims, which would cause premiums to increase. However, this could be mitigated by increasing consumers' understanding of their responsibilities (as well as their rights), thereby only encouraging legitimate claims.

### ***What circumvention risks would this remedy pose and how could these be addressed?***

### *Brokers*

36. There was agreement among brokers that the provision of standardised information would mitigate the risk of circumvention of the remedy.

### *CMCs/CHCs*

37. Quindell told us that, where insurers were responsible for providing information, there was a risk that they could use it as an opportunity to increase the chance of capture of non-fault drivers and then underprovide services to them.

### *Insurers*

38. Most of the insurers echoed the views of the brokers in suggesting that the provision of standardised information would reduce the risk of circumvention.

***How would this remedy best be monitored, particularly in relation to a statement of rights at the FNOL?***

*Brokers*

39. Acromas told us that the FCA would be best placed to monitor implementation of the remedy, as it supervises insurers, brokers and PCWs.
40. BGL told us that, as the proposed remedy would be a legal and regulatory obligation of each service provider, there would be no requirement for additional monitoring, as all existing legal obligations were already adequately monitored by the relevant regulator.

*CMCs/CHCs*

41. Kindertons suggested that effective implementation of the remedy could be monitored through audits.
42. Quindell told us that the remedy could be monitored by the FCA or The Law Society.

*Insurers*

43. Insurers suggested various methods by which to monitor the remedy, including an effective scripting and call-monitoring programme, which would be for the FCA to monitor as an external regulatory body (Admiral); regular audits/inspections by the FCA (Allianz); and post-claim surveys (Aviva).
44. RSA told us that the monitoring of compliance with the terms of any enforcement order would fall most naturally to the FCA as regards insurers, but it was important to ensure that appropriate enforcement and monitoring mechanisms could be applied to non-regulated industry players (eg CMCs/CHCs).

*Trade associations*

45. The ABI told us that compliance could be encouraged by ensuring that the agreed wording was displayed on the websites of all relevant parties (ie insurers, brokers, solicitors, replacement vehicle providers, repairers and CMCs).



### ***How much would it cost to implement this remedy?***

#### *Brokers*

46. Acromas told us that the provision of information (orally) at FNOL would not be costly.
47. BGL estimated that an additional minute on all FNOL calls would cost approximately £40,000 a year.

#### *Insurers*

48. Insurers told us that the costs which would be incurred in the implementation of this remedy would include:
  - (a) costs incurred in the preparation of the information to be given to consumers. NFU Mutual told us that it would be unlikely that this could be achieved without legal consultation;
  - (b) administrative costs in changing policy documentation, call centre scripting and websites; and
  - (c) ongoing operational costs due to an increase in the length of FNOL calls and additional training of claims handlers.

#### *Law firms*

49. DAC Beachcroft told us that implementation costs should not be high on the basis that the relevant information was already supplied to policyholders and it simply required improving this information and making it uniform.

### ***Is there any reason why this remedy should not be implemented through an enforcement order?***

#### *CMCs/CHCs*

50. Accident Exchange told us that an enforcement order would not be required, as undertakings would be sufficient and more appropriate and would allow industry participants to negotiate on the information to be provided to consumers by each category of market participant.

### *Insurers*

51. Allianz, Aviva and CISGIL supported the implementation of the remedy through an enforcement order, as it would ensure a consistent and standard approach across the industry.

***Is this remedy more likely to be effective in combination with other remedies than alone and, if so, which combinations of remedy options would be likely to be effective?***

### *Brokers*

52. Acromas told us that this remedy could be effective on a stand-alone basis, but would also be effective in conjunction with Remedy 2A: compulsory audits of the quality of vehicle repairs.

### *CMCs/CHCs*

53. Accident Exchange told us that as a stand-alone measure, this remedy would not address the AEC identified under ToH 1.

### *Insurers*

54. Allianz told us that this remedy could be effective on its own. Admiral told us that this remedy was sufficient in conjunction with effective monitoring. Other insurers (Aviva, NFU Mutual and Zurich) told us that this remedy would only be effective in combination with other remedy measures.

***Would the recommendation that a few questions on the legal entitlements of at-fault and non-fault claimants in relation to insurance claims following an accident be included in the driving theory test be likely to be effective in enhancing consumers' understanding of their legal entitlements?***

55. Some parties told us that informing and educating consumers about motor insurance at any and at all opportunities could only be beneficial to consumers, and providing this information to consumers before they had been introduced to the motor insurance industry would enable them to have the facts at the earliest chance.
56. However, other parties told us that:
- (a) the driving theory test was designed to test a driver's understanding of road traffic law, predominantly from a road safety perspective and, therefore, the provision of questions in relation to insurance was not relevant; and

- (b) there was a significant risk that drivers would forget this information in the period between taking their theory test and being involved in an accident.
57. The DfT requested additional detail on the proposal and told us that its preliminary view, based on the information available, was that questions on how a driver should behave in the event of an accident, such as taking any emergency action and performing first aid, were in line with EU law and were already part of the test. However, testing a driver's knowledge of their legal rights when making an insurance claim was likely to be outside the scope of EU Directives on driving tests.

## **Remedy 1A**

### ***The ABI***

58. The ABI told us that while the remedy proposal had the potential to assist the insurance industry to manage the cost of credit hire effectively, there were a number of issues with the remedy which would impact significantly on the ability of the remedy to be introduced and for it to be effective. The main points highlighted by the ABI were as follows:
- (a) the introduction of the remedy would require primary legislation which would take several years;
  - (b) in the absence of subrogation, the non-fault insurer would bear the cost of its policyholders' non-fault accidents so low-risk drivers would subsidise high-risk drivers; and
  - (c) the proposed remedy would create a new add-on enabling the policyholder to choose the level of replacement vehicle cover. 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.

### ***Insurers***

59. Six of the ten largest motor insurers (Ageas UK, Aviva, CISGIL, LV, RSA and Zurich) told us that they supported the remedy in principle and/or that it would lead to lower replacement vehicle costs and/or that it had the potential to address the concerns around the cost of replacement vehicles. However, all these motor insurers raised a number of caveats, as set out in paragraphs 61 and 62.
60. Three of the ten largest insurers (Admiral, DLG and esure) told us that they did not support this remedy.

61. AXA told us that it strongly believed that the remedy would remove the excessive costs which were created through the separation of cost liability and cost control. AXA said that, in order to be effective, claimants must not have the ability to recover costs of a replacement vehicle from the at-fault insurer.
62. The main concerns raised by insurers with the remedy proposal were as follows:
- (a) If the remedy applied only to PMI, there would be different arrangements for commercial vehicles and motorcycles (this concern was raised by six of the ten largest insurers).
  - (b) A consequence of non-fault insurers bearing the cost of providing replacement vehicles to non-fault claimants would be that premiums for safer drivers would rise relative to premiums for high-risk drivers (this concern was raised by six of the ten largest insurers). One insurer pointed out that this effect would create a moral hazard by reducing the incentive to drive safely.
  - (c) Policyholders who did not purchase replacement vehicle cover could be left without mobility following an accident (this concern was raised by six of the ten largest insurers). This could apply to policyholders who were most concerned to minimise their premium, as well as to those who believed that they would not need a replacement vehicle in those circumstances. To address this concern, four insurers proposed that some level of replacement vehicle cover should be mandatory under PMI policies, although views varied as to whether that should be a like-for-like vehicle or a basic courtesy car.
  - (d) If replacement vehicle cover were sold as an add-on, consumers would be faced with a more complicated choice than at present when purchasing a PMI policy (this concern was raised by two insurers).
  - (e) The remedy would not be timely. As legislation would be required to implement the remedy, there would be no certainty about when it would come into effect (this concern was raised by five insurers).
  - (f) If a third party were to control the repairs, that party would have no incentive to control the repair duration, which could give rise to additional costs for the non-fault insurer which had provided the replacement vehicle and would create the potential for disputes (this concern was raised by three insurers). There would be duplicated claims management costs.

- (g) If insurers responded to the remedy by selling replacement vehicle cover which applied equally when the driver was not at fault or at fault, there would be a greater level of like-for-like replacement vehicle cover for at-fault drivers than at present (consumers do not typically take out like-for-like cover for when they are at-fault) and this could lead to higher costs overall (this concern was raised by two insurers). Two insurers also noted that, if at-fault drivers with non-comprehensive policies were able to take out replacement vehicle cover, they would be provided with a vehicle following an accident but have no cover for the repair costs.
- (h) Taking away non-fault claimants' tort law entitlements to be put back into the same position they were in before the accident would either raise premiums for safer drivers who are risk-averse and choose to purchase replacement vehicle cover, or would result in a lower-quality outcome for drivers who are either unable or unwilling to bear the extra cost of replacement vehicle cover when they are not at fault in an accident (this concern was raised by one insurer).

### **CMCs/CHCs**

- 63. The CMCs/CHCs told us that they did not accept that there was an AEC, and they objected strongly to this remedy.
- 64. The CMCs/CHCs main concerns with Remedy 1A were as follows:
  - (a) The remedy would change the long-established principle of tort law that entitles the non-fault party to look to the at-fault party to be put back into the position they would have been before the accident. The remedy was not a proportionate response to the AEC (even assuming that the CHCs/CMCs accepted that there was an AEC, which they did not) because of the consequences of the remedy.
  - (b) Consumers would have to pay a premium for insurance cover which would provide for a replacement vehicle, in the event that they were not at fault in an accident. This would put consumers in a worse position than at present because they are currently entitled to a replacement vehicle (subject to need) under existing tort law.
  - (c) Some consumers may choose not to pay an additional premium for replacement vehicle cover in order to minimise their total premiums. These consumers would be left without mobility in the event of a non-fault accident, ie they would be worse off than at present. Some consumers might choose not to pay an additional premium for replacement vehicle cover because they expected not to need a replacement vehicle in the

event of an accident. If these consumers found themselves in need of a vehicle following an accident, they would be worse off than at present.

- (d) The cost of providing replacement vehicles to non-fault claimants would be transferred from at-fault insurers to non-fault insurers, which would lead to an increase in the premiums for low-risk drivers relative to high-risk drivers.
- (e) As set out in the Remedies Notice, consumers would be able to choose whether or not to take out replacement vehicle cover as an add-on to a basic PMI policy. This would complicate consumers' decisions when purchasing a policy and may give rise to the concerns identified under ToH 4 (insurers may not provide sufficiently clear explanations of add-ons).
- (f) The remedy would lead to the disappearance of CMCs and the services provided to non-fault claimants would deteriorate because non-fault insurers would seek to minimise the cost of claims. The main point made by CMCs was that they can provide a replacement vehicle to a non-fault claimant within a few hours of being notified of a claim, whereas non-fault insurers do not have the resources to determine liability so quickly. CMCs also noted that they assisted non-fault claimants in other ways (for example, to recover any excess that has been paid and any other losses (such as loss of earnings), to ensure that an NCB is reinstated, to monitor the progress of the repair and to negotiate the pre-accident value of vehicles in write-off cases). They said that, if CMCs did not exist, claimants would have to deal directly with their insurer on these matters.

### *Enterprise*

65. Enterprise told us that it believed that if Remedy 1A were implemented with some key amendments, it could be a highly effective basis for the industry to enhance the services offered to consumers while improving costs.

### ***Other parties***

66. The responses to the Remedies Notice we received from other parties raised many of the same points as those from the insurers and CMCs/CHCs. Additional concerns raised were that the remedy would:
- (a) favour large insurers who could access large discounts from providers of rental vehicles;
  - (b) reduce non-fault claimants' choice of which party handles their claim; and

- (c) lead to an immediate increase in premiums for replacement vehicle cover, while any reduction in claims costs as a result of the remedy would be reflected in reduced premiums only after a period of time once insurers had been able to assess the impact.

### ***Variations to Remedy 1A***

#### *Aviva*

- 67. Aviva told us that it supported Remedy 1A but that it was concerned that a change in law would take time to effect. Aviva proposed a variant of Remedy 1A which it believed would avoid the need for a change in law:
  - (a) Mandatory first-party insurance to be provided by the insurer which would provide the policyholder (regardless of fault) with an equivalent or similar-sized replacement vehicle, subject to a cap on the class of vehicle (eg executive premium vehicle or 2,000-cc engine).
  - (b) A policyholder would still be able to use credit hire if the cover provided under their policy did not materially meet their needs (eg if they drive a larger vehicle) as subrogation rights would still apply in this case.
  - (c) Alternatively subrogation rights could be retained generally, provided that the cost of hire was controlled as proposed in Remedy 1C or by way of bilateral agreements with the fault insurer.
- 68. Aviva told us that it expected that, if this proposal were adopted, insurers would offer the same level of replacement vehicle to non-fault and at-fault claimants. Aviva expected the impact on the overall level of premiums to be neutral or to reduce.
- 69. AXA told us that it thought a change in law would be required to alter claimants' rights so that they could not obtain a replacement vehicle from a CMC/CHC if the vehicle offered by their insurer were adequate.

#### *CISGIL*

- 70. CISGIL told us that Remedy 1A could create potentially significant consumer detriment, as it would remove a non-fault claimant's legal entitlement to mobility, where reasonable need can be established. Therefore, it proposed a variant to Remedy 1A whereby:
  - (a) A minimum level of replacement vehicle cover (eg a Class A replacement vehicle) is made mandatory in all insurance policies regardless of fault, which would ensure that consumers' legal entitlements under tort law

would be met. 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.

- (b) The cost of provision would be spread among the entire policyholder base, resulting in a lower unit cost to be incorporated into product pricing.
- (c) No excess would be payable and the submission of a claim would have no impact on the claimant's NCB.
- (d) For non-fault claims, no excess would be payable and the submission of a claim would not affect the motorist's claims record or adversely influence any no claims discount.

### *Enterprise*

71. Enterprise proposed a similar variation to Aviva:
- (a) Insurers should be required to provide a like-for-like replacement vehicle for all non-fault policyholders.
  - (b) Insurers should be able to subrogate the replacement vehicle costs against the at-fault insurer.
  - (c) There should be controls on the amount of the subrogated claims.
72. Enterprise told us that this variant would not require a change in law because non-fault claimants would be provided with the same level of replacement vehicle to which they would be entitled under tort law, and the right to sue could remain. By retaining subrogation, the cost of providing replacement vehicles to non-fault claimants would remain with at-fault insurers.
73. RSA told us that Remedy 1A with mandatory like-for-like replacement vehicle cover and with subrogation:
- (a) would not require any change to the existing and long-standing principle of subrogation; but
  - (b) although it might initially be implemented without a change in law, would ultimately require a change in law to mandate insurers to offer like-for-like replacement vehicle cover as a core policy benefit.



## **Remedy 1B**

74. 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 about the practical aspects of the variants of the remedy, which could lead to unintended consequences. CMCs/CHCs and some third parties also said that Remedy 1B might be ineffective.

### ***Removal of claimants' rights to choose their service provider***

75. Remedy 1B would remove or reduce a consumer's right to choose their service provider for post-accident services. Insurers and brokers noted that consumers' decision to purchase a particular insurance product was not purely based on price but was also influenced by other factors such as trust and service differentiation, which were reflected in their premium. Under Remedy 1B, post-accident services would not be provided by their chosen insurer but by a third party insurer. Several parties argued that such a change in consumers' legal rights required a change in law which would be disproportionate to the financial benefits of the remedy.

### ***Unintended consequences***

76. There was a shared concern by many different parties that this remedy would introduce additional steps and unnecessary complexity into the claims process. This would cause delays in the provision of post-accident services, and possibly uncertainty and confusion for customers.
77. Insurers and brokers also identified practical difficulties for insurers and claimants in cases where liability was uncertain or split. At-fault insurers would be required to make a quick and uninformed decision on whether to accept the claim without the benefit of any detailed evidence. This could cause further difficulties for insurers in identifying fraudulent claims. LV said that non-fault insurers, brokers and CMCs/CHCs would generate ways to game the system to make it more difficult for at-fault insurers to intervene. Most insurers also said that there was a risk that Remedy 1B might lead to an increase in frictional costs, in particular when repairs and replacement vehicles were provided by different parties.
78. Brokers, CMCs/CHCs and some insurers also suggested that Remedy 1B would inevitably result in a reduction of service provision because at-fault insurers had fewer incentives to meet claimants' legal entitlements. This would affect in particular vulnerable consumers (eg who have suffered a personal injury). However, other insurers argued that their incentives would be

to provide a high-quality service as a captured claim was an opportunity to acquire a new customer. CISGIL said that the third variant of this remedy could lead to overprovision as parties would engage in a bidding war in order to capture the claimant, whilst the second variant could conceivably lead to underprovision. Brokers, CMCs/CHCs and some third parties said that, because the scope of this remedy was limited to replacement vehicles and, possibly, repairs, other service requirements of customers would not be met. In particular, this remedy would lead to at-fault insurers dealing with other aspects of a claim (eg in relation to personal injury), and as their incentive was to minimise costs, the concern was that this would lead to an overall decrease in the quality of these services.

79. CMCs/CHCs were also concerned that, because the proposed remedy would give at-fault insurers the option to take claims from them, they would face a drop in volume and would not be rewarded for situations where work would be started but then aborted. The remedy, and in particular the second variant which removed claimants' choice, would therefore lead to the disappearance of CMCs and the services provided to non-fault claimants would deteriorate because non-fault insurers would seek to minimise the cost of claims. A few law firms and law societies raised similar concerns.

### **Effectiveness**

80. CMCs/CHCs were concerned that Remedy 1B would not be effective, as it would not have any impact on many non-fault claims. Helphire suggested that up to 40% of non-fault accidents would not be affected by this remedy.
81. Some parties were concerned that if a claimant's right to choose their post-accident replacement vehicle provider were maintained, the remedy might be ineffective. LLS noted that insurers had generally been unsuccessful in making offers compliant with *Copley vs Lawn* to claimants, which raised the question as to whether insurers were able or motivated to intervene early in the form of providing an appropriate replacement vehicle.
82. DAC Beachcroft endorsed this remedy. However, it stated that the remedy would be ineffective if a claimant's right to choose their own insurer or another provider were maintained. This remedy would reverse the GTA 'first to the customer principle' and should remove the uncertainty and unpredictability of so-called 'Copley' strategies. Another advantage of the remedy would be that consumers would not need to enter into credit hire contracts. As regards the inconvenience caused to a claimant by a delay in provision, DAC Beachcroft stated that this would vary on a case-by-case basis. For instance, a delay of more than 24 hours might inconvenience many claimants whose vehicle was not deemed roadworthy after the accident, but a seven-day delay might not

inconvenience a claimant whose vehicle was still roadworthy after the accident.

## **Remedy 1C**

### ***What would be the most effective way of implementing this type of remedy?***

#### *Brokers*

83. Acromas told us that the remedy could be implemented by way of an enforcement order.
84. BGL told us that the GTA could be developed to perform an independent regulatory function, which was either replaced or managed by a regulatory body (such as the FCA). The GTA could also undertake a more prescriptive role in the determination of prices to reduce disputes (ie setting specific rates for credit hire replacement vehicles as opposed to price caps or indicative rates).

#### *CMCs/CHCs*

85. Kindertons told us that an independent body would be required to oversee the implementation of the remedy.
86. Quindell told us that the remedy would require the GTA to be replaced or to be made mandatory.

#### *Insurers*

87. There was no common consensus in the responses from insurers:
  - (a) Allianz and Zurich told us that an enforcement order was the most appropriate method of implementation.
  - (b) Aviva, LV and NFU Mutual told us that an undertaking to replace the GTA with a new mandatory, independent body was more appropriate.
  - (c) Aviva, esure, NFU Mutual and RSA stressed the importance of judicial guidance in ensuring that the principles of a new system were enforceable by courts and adhered to in contentious cases. esure told us that the guidance could take a similar form to the Guidelines for the Assessment of General Damages in Personal Injury issued by the Judicial College.

### *Trade associations*

88. The ABI told us that an enforcement order would be the only effective way of implementing the proposed remedy, as it would make the measures and rates legally binding on all parties, whereas an undertaking to replace the GTA would mean that the replacement mechanism would be voluntary, allowing participants to withdraw from the protocol if and when they wished to do so. The ABI also commented that, if the solution imposed did not apply to the whole market, competition would be distorted as some CHCs would be operating under controlled rates and others would not.

### ***Which parties should be covered by this remedy?***

89. There was a general consensus among respondents that this remedy should cover all parties engaged in the provision of credit hire activities (both the parties which procure the services, eg insurers, CMCs and brokers, and the parties which provide the services, eg CHCs and other vehicle hire providers).

### ***What is the appropriate time period in which repairs should commence once a replacement vehicle has been provided? How should the hire period be monitored and by whom?***

#### *Brokers*

90. Both Acromas and BGL referenced the current GTA framework, which provides guidance on hire duration and sets out the responsibility of the CHC in monitoring the repair process (as the repair duration is typically a proxy for hire duration).
91. Acromas also noted that the implementation of a rigid formula in respect of hire/repair duration would be ineffective, given that customers' needs differ on a case-by-case basis.

#### *CMCs/CHCs*

92. A number of CMCs/CHCs told us that the GTA had an appropriate framework in place in relation to hire duration.
93. Accident Exchange told us that the existing test of reasonableness under tort law was appropriate when assessing hire duration, because it was impossible to specify for all circumstances when repairs must be commenced, as the circumstances of an accident and repair were unique.
94. Accident Exchange also noted that we had not identified an AEC in relation to hire duration and, therefore, to the extent that this remedy impacted hire

duration, it would extend beyond the AEC identified in our provisional findings and was not necessary.

#### *Insurers*

95. A number of insurers, such as Allianz, CISGIL and Zurich, repeated the views expressed by brokers and CMCs/CHCs that there was no standard repair/hire duration, as the length of each repair could depend on a number of variables, such as the type of vehicle that needed to be repaired, the availability of parts, the capacity of the repairer, etc.
96. esure told us that the maximum hire duration could be linked to the labour hours necessary to repair the vehicle plus an allowance for administration of the repair and the sourcing of parts. In the event that a vehicle hire and associated repair continued for longer than the maximum duration, the non-fault insurer (or other subrogating party) would have an obligation to explain to the at-fault insurer the reason for the delay, at which point the at-fault insurer would then have the opportunity to challenge. At-fault insurers could monitor the duration of hire for replacement vehicles and ensure that they were not provided for longer than necessary.
97. LV told us that the framework for, and costs allowable in relation to, hire duration could be designed to ensure that a CHC achieved greater profitability through shorter hire periods.

#### *Law firms*

98. Law firms stressed the difficulty in standardising hire duration.
99. Keoghs told us that the current GTA framework had no punitive measure for non-compliance with the hire duration guidelines.
100. The LLS said that the provision of guidance in relation to hire periods appeared to go beyond the scope of the AEC identified.

#### *Trade associations*

101. Most parties underlined the inherent difficulty in prescribing definitive rules in respect of hire duration. However, the LMA suggested that a fixed hire period based on agreed scenarios could reduce the scope for abuse.

***What is the most appropriate mechanism for setting hire rates for replacement vehicles? Who should determine the hire rates?***

*Brokers*

102. Acromas told us that an independent body (eg an accountancy firm or economics consultancy) should determine the framework for the calculation of a cap on daily hire rates and that the mechanism for setting hire rates would need to:
- (a) ensure that the basket of hire rates was genuinely representative of the market rate and would not enable the major vehicle rental providers to manipulate or otherwise distort the data set in order to gain a competitive advantage; and
  - (b) consider how extraneous factors (such as geographical differences in hire rates and seasonal fluctuations in demand) were built into the methodology used to calculate the average retail hire rate.

*CMCs/CHCs*

103. The majority of CMCs/CHCs told us that the GTA was successful in setting appropriate hire rates for insurers and CMCs/CHCs.
104. Helphire told us that daily rates were affected by supply and demand, local trading conditions and macroeconomic factors. Therefore rate changes could be very significant and very fast.

*Insurers*

105. There was a general consensus among insurers that the rate should be set by an independent body (suggestions included the ABI, CMA, FCA, Financial Ombudsman, and Ministry of Justice (MoJ)) and that credit hire rates were not the appropriate benchmark for determining the new hire rates.
106. A number of insurers (Aviva, DLG, LV, NFU Mutual and Zurich) told us that the appropriate benchmark for determining hire rates was the direct hire rates agreed between insurers and their respective replacement vehicle providers. Both Aviva and NFU Mutual suggested that only a fixed or small percentage should be added to cover credit charges. Aviva told us that if the at-fault insurer admitted liability within 24 hours of FNOL, there should be no allowance for credit charges, as recovery of the cost of the claim (including replacement vehicle provision) was guaranteed.

107. esure told us that a cap should be set with reference to a blended average of the high street rates of the top five providers of direct hire vehicles (by vehicle class) less a reasonable discount to reflect the stronger negotiating position of market participants (eg insurers). esure told us that there could be a separate cap for costs of credit set with reference to recognisable financial market benchmarks.

#### *Law firms*

108. DAC Beachcroft told us that the rate would need to be reviewed annually and there was a need to consider whether discounts for prompt payment should still apply.
109. The LLS told us that the capping of recoverable rates effectively amounted to price fixing, which would seem to be anticompetitive.

#### *Trade associations*

110. The ABI told us that in the event of a claim coming before a court, the court should apply the rates that had been determined under this remedy and not the rates a claimant could reasonably achieve in person (ie the basic or retail hire rate).
111. In contrast, the CHO told us that the appropriate basic hire rates were those established in law as falling within the range of rates available to the consumer.

### ***What administrative costs should be allowed? At what level should administrative costs be capped?***

#### *Brokers*

112. Acromas told us that the allowance for administrative costs should be set at a level which enabled CHCs to earn a reasonable rate of return while continuing to provide non-fault claimants with replacement vehicles which met their needs.

#### *CMCs/CHCs*

113. Quindell told us that the GTA allowed for an administration charge of £37 per hire, but this was insufficient to cover all the costs associated with providing credit hire services.
114. Accident Exchange told us that it would not be possible or proportionate to set a level of administrative charges at a fixed level on the basis that to do so

would give an advantage to operators with scale and disadvantage small operators, potentially creating a barrier to entry into the CHC market.

#### *Insurers*

115. The majority of insurers told us that there should be no separate allowance for administrative costs and that such costs should be incorporated into the daily hire rates.

#### *Law firms*

116. Winn Solicitors suggested that competition between replacement vehicle providers would determine an appropriate level of administrative costs.

#### *Trade associations*

117. The Motor Accident Solicitors Society (MASS) told us that, although recommended rates were contained within the GTA, it was ultimately for the court to consider on a case-by-case basis the reasonableness of any administrative costs.

#### ***Is it practicable for the relevant documentation to be exchanged through a web portal rather than in paper form?***

118. There was a general consensus in favour of the use of a portal to improve the efficiency of managing and resolving replacement vehicle claims. A number of parties noted that a portal was already being developed by the GTA Technical Committee and that a portal was currently administered by the MoJ for personal injury claims.
119. Allianz questioned the need for a separate portal for replacement vehicle claims (given that the implementation of a separate portal would incur further costs).
120. Both Aviva and NFU Mutual told us that the introduction of a portal for the management of replacement vehicle claims would reduce administrative costs.
121. NFU Mutual told us that any portal should cover all elements of a claim and not just mobility.

#### ***What costs would the measures in this remedy entail?***

122. Parties noted that costs would be incurred in the following areas:



- (a) An independent body would need to be appointed in order to set hire rates, and to calculate and review those rates. Zurich told us that these costs should not be significant as the GTA had been administered at relatively low cost over a significant period of time.
- (b) Monitoring of compliance with the new rates.
- (c) Establishment of a portal. Parties suggested that these costs should not be significant given that work has already commenced. DAC Beachcroft suggested that the costs incurred in the development of the MoJ portal for personal injury would be an appropriate benchmark.

***Would this remedy give rise to distortions or have any other unintended consequences?***

*Brokers*

123. BGL told us that if the daily hire rates were set at levels which were commercially unsustainable for some vehicle hire providers, they might be forced to exit the market.

*CMCs/CHCs*

124. A number of CMCs/CHCs told us that a reduction in credit hire rates might result in:
- (a) the reduction or elimination of referral fees, as the CHCs would have no profit margin from which to pay such fees. They noted that we had found in our provisional findings that referral fees were currently passed on to consumers (to a significant extent);
  - (b) the exit from the credit hire market of some CHCs, thus reducing competition and allowing the remaining CHCs to retain referral fees rather than pass them on to insurers and ultimately consumers; and
  - (c) the elimination of the credit hire industry, thus removing the incentive of at-fault insurers to provide mobility to non-fault claimants through direct hire.
125. Coral Insurance Services told us that CHCs might seek to make up the shortfall caused by a reduction in hire rates through further inflation of costs in the repair or total loss process.

### *Insurers*

126. Both Ageas and esure told us that there was a risk that the reduction in daily hire rates could be recovered through an extension of the hire duration.
127. DLG told us that there was a risk of collusion or attempted market manipulation among market participants when submitting information on rates (ie submitting rates which did not accurately reflect true market conditions in order for the cap to be set at a level which reflects their interests).

### *Law firms*

128. Keoghs and Winn Solicitors told us that if the ability to recover losses was capped (through a cap on rates within the GTA), claimants may still be liable for unrecovered charges exceeding the cap, as was currently the case.

### *Trade associations*

129. The LLS said that the remedy might result in the exit of CHCs from the credit hire market, thus reducing both the choice of replacement vehicle providers and the incentive of insurers to provide a quality replacement vehicle service to non-fault claimants.

***To what extent is there a risk that this remedy could be circumvented by the evolution of new business models that are not subject to it? How could this risk be avoided?***

### *CMCs/CHCs*

130. Quindell told us that the remedy could be circumvented unless a consumer's tort law entitlement to pursue a claim for loss or to take receipt of a mobility solution was removed. Quindell told us that a consumer had a right in law to pursue damages for losses caused in a road traffic accident.

### ***Parties' responses to the provisional decision on remedies on Remedy 1C***

131. In this subsection, we summarise the parties' responses to the provisional decision on remedies in respect of Remedy 1C. We have grouped the responses under the following headings:
  - (a) questions over the use of our powers;
  - (b) the likely consequences of the remedy;
  - (c) the impact of the remedy on frictional costs;

- (d) the design of the remedy; and
- (e) other alternative proposals made by the parties.

### *Questions over the use of our powers*

#### *Our provisional decision on how to apply Remedy 1C*

132. In paragraphs 2.56 to 2.59 of the provisional decision on remedies, we set out ‘to whom and to what should Remedy 1C apply?’. We stated that the remedy would ‘need to cover all replacement vehicle provision to non-fault PMI claimants’; and we went on to say that ‘we propose to require that the remedy is mandatory for all those involved in the provision of replacement vehicles to claimants (insurers, brokers, credit hire companies (CHCs)/claims management companies (CMCs), repairers and vehicle recovery providers)’. We also said that ‘the remedy would apply at the point a claim is submitted by the replacement vehicle provider to the at-fault insurer’.
133. Elsewhere, when summarising the proposed remedy, we used ‘subrogation’ as a shorthand for both claims pursued by CMCs and CHCs on behalf of non-fault claimants and claims made by the non-fault insurer against the at-fault insurer after an indemnity payment has been made to the non-fault policyholder.

#### *Concerns expressed by respondents*

134. The shorthand of ‘subrogation’ led to some respondents raising questions about the applicability of our proposed Remedy 1C. We were told that:
- (a) CHCs/CMCs are not subrogated to claims; rather they issue a statement of charges and a demand to pay to a non-fault claimant and then usually seek to recover the claim on behalf of the non-fault claimant (although some CMCs/CHCs leave the claimant to recover the claim themselves).
  - (b) CHCs/CMCs do not ‘charge’ at-fault insurers. Although CHCs/CMCs operate different types of business models, in general, the arrangement when a vehicle is provided on credit hire is as follows:
    - (i) the claimant remains liable to pay the hire charges but the claimant’s liability to pay the replacement vehicle provider is deferred;
    - (ii) the claimant authorises the replacement vehicle provider (or an appointed representative) to pursue their claim in their name;

- (iii) the claimant authorises the replacement vehicle provider to retain any settlement money offered in full or in part settlement of the claim and/or to pay to the replacement vehicle provider any payment received by the claimant in respect of the claim; and
    - (iv) an insurance policy is sometimes provided for the benefit of the claimant which covers the hire charges (and any repair charges) which cannot be recovered from the at-fault driver/insurer, and legal costs incurred in pursuing the claim against the at-fault driver/insurer.
  - (c) It was not clear whether our proposed approach would capture solicitors acting on behalf of claimants.
135. In particular, we were told that the CMA does 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 as:
- (a) claims brought by CHCs/CMCs on claimants' behalf cannot be capped directly as this would be attempting to regulate a claim in tort against an at-fault party; and
  - (b) 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), so this would also be attempting to regulate a claim in tort against an at-fault party.
136. One of the insurers, DLG, made an alternative proposal to address the concern about whether we would have the 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 charges its customers for the vehicle hire. 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.
137. This alternative implementation approach would not apply to non-fault insurers as, in such cases, there is no charge for the temporary replacement vehicle provided.

138. On 28 July 2014, we engaged in further consultation with parties on this alternative proposal. Parties' responses to this further consultation are summarised in paragraphs 173 to 193.

*Likely consequences of the remedy*

139. All of the insurers which responded to our consultation broadly supported the remedy, although several made suggestions on the design of the remedy (see paragraphs 155 to 172).
140. Many of the insurers raised concerns over possible circumvention strategies which could be adopted by CHCs/CMCs, as well as likely unintended consequences of the remedy and the potential for it to have distortive effects.
141. For example, LV told us that, since we were no longer intending to control subrogated repair and total loss claims, there was a risk that some market participants which had business models predicated on 'claims income' would shift their attention from hire, which was being curtailed, to repair, which was not. Some other insurers were concerned that vehicle providers which also controlled the repair process would shift their attention to maximising income from repairs or would 'spin out' the repair duration and so increase hire costs.
142. Allianz told us that adopting a dual rate cap (or, at least, a dual rate with a differential between the low and high rate as large as 100%) would risk creating unintended behaviours and increase disputes. Many other insurers also said that CHCs/CMCs would be incentivised to cause delay to insurers in deciding whether or not to accept liability for hire charges (for example, by providing incomplete information with the notification of a claim) in order to prevent insurers from reaching a decision within the prescribed time frame, such that the higher rate would then become payable. Some insurers said that at-fault insurers would come under pressure to accept liability early to avoid paying the higher rate without informing or involving their policyholder adequately in the decision. If insurers were more likely to admit liability, this would lower the risk for the CHCs and result in an increase in credit hire, and potentially an increase in cases of credit hire fraud.
143. Allianz and the ABI both said that obliging an insurer to inform a claimant at FNOL whether or not it considered them to be not at fault would have unintended consequences, in that this might induce the driver to hire a replacement vehicle on credit terms, only to find later that he was personally liable for the charges, if it was subsequently determined that he was, in fact, at fault for the accident.

144. The ABI told us that, hitherto, split liability claims were often not an attractive proposition for CHCs. However, with the introduction of a higher capped rate together with potentially longer hire periods, the number of such claims might increase under the model proposed in the provisional decision on remedies, increasing credit hire frequency and costs.
145. Zurich said that the exclusion of commercially insured vehicles (howsoever defined) would give rise to distortions. For example, it said that a private motor insurer would not get the benefit of a capped hire rate if the at-fault vehicle was commercially insured, while the insurer of a commercial vehicle would benefit from the capped rate if the at-fault driver was privately insured.
146. Many of the credit hire companies said that Remedy 1C would be likely to lead to the elimination of the credit hire market. Five of them said that the provision of vehicles at the lower capped rate (assuming that this would be based on direct hire rates) would not be profitable. Kindertons also said that the remedy would ultimately eliminate referral fees, which would prevent CHCs/CMCs generating a sufficient volume of business to operate at an efficient scale and potentially undermine the business viability of CHCs/CMCs.
147. The CHCs also told us that the elimination of credit hire would be detrimental to consumers:
- (a) Three of them said that, in the absence of the availability of credit hire, many consumers would not obtain their legal entitlements as established under the common law of tort. For example, they said that many drivers would not be provided with a like-for-like replacement vehicle; some younger drivers (such as those with poor driving records) would not obtain a replacement vehicle at all following an accident; and hire periods would generally be shorter.
  - (b) Two of them said that consumers would not receive the assistance they currently get from CHCs/CMCs within the claims process, for example determining liability, correct provision of a like-for-like temporary replacement vehicle and in recovering uninsured losses. Kindertons said that CMCs insulated claimants from the risk of non-recovery from the at-fault driver.
  - (c) Kindertons also said that there would be an increase in the number of consumers self-hiring at retail rates and recovering costs directly from the at-fault insurer. Kindertons and DAML said that claimants who could not finance the cost of car hire in this way would be likely to be unable to get a replacement vehicle at all in the absence of CHCs.

(d) 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 the non-fault claimant to the outside world where, in the absence of credit hire, consumers' ability to realise their legal entitlements might well have been eradicated. DAML noted that, currently, insurers rarely sent Copley letters and preferred to let credit hire proceed rather than capture claims.

148. Accident Exchange said that, post-implementation of the remedy, insurers would face weak unilateral incentives to provide consumers' legal entitlements and strong incentives, explicitly or tacitly, to agree not to provide consumers' legal entitlements, given that this would allow them to avoid collectively the cost of replacement vehicle provision.

#### *Impact of the remedy on frictional costs*

149. Insurers told us that the main areas of friction were the type of replacement vehicle provided (eg need), the rate charged for the vehicle, and the duration of the hire. While Remedy 1C as proposed might reduce frictional costs in respect of the hire rates charged, there remained scope for friction over the acceptance of liability, mitigation and duration. Some insurers said that we had underestimated the risks with respect to hire duration when credit repairs were involved.

150. While some insurers accepted that the proposed arrangement fee (£37, in line with the current GTA rate) was acceptable, others said that it was too high or should be abolished altogether. A few insurers said that what was included within the cap by way of extras (eg estate car, automatic transmission, roof racks, child seats, costs of insurance, excess waivers, collection and delivery etc) needed to be clearly defined or otherwise controlled, as this represented a significant source of frictional costs.

151. The ABI told us that the remedy as currently proposed would have the unintended consequence of insurers taking a more rigid approach on the acceptance of liability, which could lead to an increase in the number of disputes, more litigation and therefore higher costs.

152. Accident Exchange said that capping hire rates was highly unusual as it only indirectly attempted to remedy frictional costs. It said that it was not clear whether frictional costs would be reduced at all by capping prices given that insurers would still dispute duration, need and liability. It said that even if the CMA considered that there was friction over the level of rates, it would not need to set the rate cap at a level lower than current credit hire rates in order

to remove friction: it would just need to set a regulated rate in order to remove the possibility for disputes over rate.

153. Accident Exchange and Kindertons said that frictional costs were not high under the GTA, and most friction arose from claims which fell outside the GTA. Three CHCs said that the remedy would not reduce friction as insurers would still dispute need and duration. Quindell said that, in its view, there was no AEC. Separation was good for consumers and some friction was inevitable.
154. Kindertons said that the remedy, as currently designed, could increase friction in respect of late payment. At present, if a claim was outstanding after 90 days it fell outside of the GTA and the CHC could then seek a higher rate. It said that this gave the insurer some incentive to settle. There was no equivalent provision in Remedy 1C, which envisaged that the high rate cap would continue to apply. Auto Logistics told us that many insurers paid late and ignored the late payment penalty charges contained within the GTA.

### *Design of the remedy*

#### *How to set the rate cap*

155. The ABI, and almost all of the ten largest insurers, told us that the low rate cap should be based on direct hire rates. Allianz said that the rate cap should be at the current level agreed by insurers and credit hire organisations and that the dual rate should be scrapped, or at least the differential should be reduced from 100% to about 25%. NFU Mutual disagreed with the concept of a dual rate cap and thought that there should only be a low rate. Aviva thought that the starting point should be that the GTA rate was appropriate for the higher rate cap and that this rate should be discounted to a rate close to the direct hire rate for early admission of liability.
156. RSA told us that clarity was needed on whether the daily rate cap included the costs of insurance, excess waivers, automatic vehicles, delivery and collection etc. There was general concern from several insurers that if such extras were not included in the daily rate cap, then CHCs would exploit this as a loophole to levy additional charges. Such extras were a significant source of frictional costs.
157. While some insurers thought that the proposed administration fee of £37 plus VAT was acceptable, others told us that it was too high and should either be dropped from the proposed remedy, or at least reduced once a credit hire portal was up and running.



158. There was general agreement among insurers that the retail price index (RPI) was not the appropriate measure for annual indexation of the rate cap. Some insurers thought that CPI would be more appropriate while LV said that neither RPI nor CPI were appropriate and that we should seek an index which was more reflective of the cost inflation affecting the car rental market. NFU Mutual also said that the method of indexation merited further research.
159. All the large CHCs told us that direct hire rates were not the appropriate benchmark for the low rate cap, as they did not make any allowance for business acquisition costs, inevitable frictional costs or the costs of assessing whether or not a potential hirer had been at fault for the accident. Direct hire rates also did not include the costs of delivery and collection, collision damage waivers or excess waivers. Some CHCs said that, if the lower rate cap were based on direct hire rates, they would not be able to recover their costs.
160. Three CHCs said that the proposed administration fee was inadequate. Quindell estimated the fixed costs per hire at around £110, made up of delivery and collection (£50), vehicle preparation (£20) and the cost of liability assessment (£40).
161. Accident Exchange told us that neither RPI nor CPI were appropriate for the annual indexation of the rate cap. It said that the costs of running a car fleet were not reflected in these indices.
162. Kindertons and Redde said that the rate cap, as proposed, did not contain any incentive for insurers to pay claims quickly.

*Time period for acceptance of liability to benefit from low rate cap*

163. Admiral told us that the three-day time period for acceptance of liability was realistic and necessary, and that decisions on whether to accept liability for the payment of hire charges could be made rapidly (provided that the admission extended only so far as the hire claim element was concerned and did not prejudice their position in relation to other heads of claim which might result from the same accident, such that it would necessitate a more detailed investigation of the issue of liability). All the other insurers, and the ABI, told us that three days was too short and that at least five working days were necessary as it could take time to obtain information from the policyholder. The ABI said that a three-day period did not strike the appropriate balance between the rights of the various parties or align with the FCA principles of 'treating customers fairly' as policyholders must be involved in material decisions including admissions of liability. It also said that a time frame as short as three days would make it harder for insurers to detect and combat fraud. Ageas said that the time period should only start once the at-fault

insurer had been provided with sufficient information to enable it to determine liability, ie information equivalent to that set out in the GTA new claim advice form.

164. All the insurers said that a credit hire portal would assist with the exchange of information and most said that such a portal should be mandatory. The ABI said that, if a portal were not mandated, then at the very least notification should be made to a central email address for each insurer to avoid possible circumvention by CHCs, for example by sending notifications by second class post to the wrong office of the at-fault insurer. It said that the current proposal could have the unintended consequence of insurers taking a more rigid approach to liability, leading to an increase in the number of disputes and more litigation.
165. All the insurers said that a distinction should be made between acceptance of liability to pay the hire charge and acceptance of liability for any other consequences of the accident (eg personal injury).
166. Quindell said that three days should be more than sufficient for an insurer to assess liability, and that CHCs had the capacity to undertake such investigations and make a decision on liability usually within 24 hours. It said that many non-fault drivers had an immediate need for a replacement vehicle (eg if their vehicle was undriveable) and that a longer period for the admission of liability by the at-fault insurer could result in the CHC having to wait before deciding whether to hire or not. Kindertons also said that the provision of a hire vehicle could be delayed, as CHCs would have less incentive to investigate liability quickly.
167. Kindertons told us that a three-day period to accept liability may lead to insurers putting pressure on their policyholders to agree to an admission of liability, and that there might be practical difficulties if the insured could not immediately be contacted. The LLS said that three days might be too short in the case of accidents involving multiple vehicles.
168. Quindell was concerned about permitting at-fault insurers subsequently to change their liability decision from acceptance to dispute. It thought this could give rise to tactical temporary admissions of liability to reduce hire rates temporarily, or to potentially dissuade a CHC from providing a hire vehicle if it could not operate a business model based on the lower rate cap.
169. Kindertons and the LLS told us that a withdrawal of an admission of liability by an insurer could create problems for claimants who had already authorised repairs on the basis of liability having been admitted. Kindertons also said that it could be used by insurers as a tactic to secure the lower rate cap.

170. Accident Exchange said that the dual rate structure of the proposed cap would incentivise insurers to withdraw admissions of liability and then seek to negotiate a settlement with the CHC. It also said that the lower rate would not provide insurers with sufficient incentive to admit liability early. It said that claimants would therefore be more likely to be forced to make a claim under their own insurance policy, meaning that they would be unlikely to obtain a like-for-like replacement vehicle.

*Impact of the remedy on credit hire agreements*

171. Accident Exchange told us that our remedy, as proposed, had implications for credit hire agreements. It said that, with a dual rate, CHCs would not be able to give the consumer a clear price for vehicle hire, which would breach the Consumer Protection from Unfair Trading Regulations 2008 and the Consumer Contracts (Information, Cancellation and Additional Charges) Regulation 2013. It said that it would be impossible to document in the rental agreement a charge that was capped by reference to a dual rate cap under which a different rate, with penalties, may or may not apply depending on the acts of a third party.
172. Redde told us that, if the amounts charged to consumers contained additional charges, credit hire agreements would not be exempt from the Consumer Credit Act. Vehicle providers would therefore have to issue regulated agreements which were subject to more stringent requirements, and apply for a licence under the Consumer Credit Act and be subject to more regulation.

***Parties' responses to the further consultation on Remedy 1C***

173. In this subsection, we summarise the parties' responses to our further consultation on Remedy 1C, which set out an alternative way in which to implement the remedy. In this consultation, we asked parties the following questions:
- (a) Would this approach be an effective way in which to implement Remedy 1C?
  - (b) Would the remedy create distortions between the provision of temporary replacement vehicles to non-fault claimants and the provision of hire vehicles to retail customers?
  - (c) Would the definition of who the remedy applies to capture effectively the provision of credit hire vehicles to non-fault claimants or are there any further circumvention risks from this proposed wording?

- (d) Would the remedy create distortions between CHC/CMC provision and non-fault insurer provision of temporary replacement vehicles?
- (e) Would the courts be likely to limit the sums recoverable in subrogated claims to the rate cap set by the CMA on the basis that this indicates the reasonable cost or, if not, would the cap for CHC/CMC provision have to be set at a level which aligned with that currently allowed by the courts for subrogated claims for temporary replacement vehicles; and would a dual rate cap create greater ambiguity for the courts in these circumstances?
- (f) Would the remedy be expected to lead to greater provision of temporary replacement vehicles by non-fault insurers under the terms of consumers' insurance policies, and what are the benefits and costs of this greater provision, if it occurred?
- (g) Would this alternative approach create any other unintended consequences, costs or benefits from those already expressed?

174. We first summarise some of the general comments made by parties, and then summarise their responses to each of the questions (a) to (g) above.

#### *General comments*

- 175. All the insurers, and Enterprise, supported the proposed variant of Remedy 1C. All the CHCs, Winn and the LLS opposed it. NFU Mutual, while it supported the proposal, said that the remedy might be vulnerable to challenge as ultra vires and an attempt to regulate tort rights by a backdoor route.
- 176. Enterprise said that it would prefer a single rate cap, at a level significantly below GTA rates, rather than a dual rate cap. It was concerned about how a dual rate cap, based on a liability decision by a third party, would be applicable to a contractual liability between a temporary replacement vehicle provider and its customer. BGL also said that it was concerned about the proportionality of and the potential adverse effects associated with a dual rate cap which could in practice feasibly result in consumers receiving a service that fell short of their entitlement.
- 177. Many of the insurers told us that the low rate cap should be close to the direct hire rate, although RSA thought it should be at the basic retail hire rate to align with amounts recoverable via subrogation or tort rights.
- 178. The CHCs, along with Winn and the LLS, told us that we should abandon the remedy. Some of them told us that there were doubts as to whether it would be within the powers of the CMA to enforce it, for example because it would amount to an attempt to use competition law to amend the law of tort.

179. Some CHCs questioned the existence of an AEC at all. Quindell said that transactional and frictional costs were a symptom of the law of tort, and that separation helped to protect consumer rights.
180. Many CHCs told us that the remedy would destroy the CHC sector, which would be to the detriment of non-fault claimants and, in particular, impecunious non-fault claimants. BGL said that the remedy risked harm if consumers were left to the mercy of insurers. Accident Exchange told us that the remedy would create a closed system in which only insurers would operate, bringing with it a serious risk of collusion.

*Is the remedy effective?*

181. All the insurers told us that the remedy would be effective, though some said it would only be effective provided the low rate cap was set at a level close to direct hire rates. Some insurers told us that, to minimise distortion, the remedy should apply not only to CHCs but also to insurers and any other party involved in the supply chain for temporary replacement vehicles.
182. All the CHCs told us that it would not be effective, for example because it would be easy to circumvent, or it would create distortions because it only applied to one part of the market, or because claimants would be denied their rights under the law of tort and it would help insurers avoid their responsibilities.

*Will there be distortions between retail hire and the supply of temporary replacement vehicles to non-fault claimants?*

183. All the insurers said that they did not anticipate any such distortions.
184. All the CHCs said that there would be distortions. Four CHCs told us that retail customers could approach CHCs and claim to be non-fault victims of an accident and so benefit from hiring a vehicle priced at the low rate cap. Enterprise told us that a price cap would inevitably create a difference between the rate for a temporary replacement vehicle to non-fault claimants and the rate for a retail hire. However, this was no different from today's credit hire market. The LLS told us that artificially lowering the price for one type of company immediately gave rise to market distortion.

*Does the definition of who is caught by the remedy work?*

185. Many insurers told us that the definition should be broader in order to prevent circumvention. For example, they thought it should include claimants partially at fault, cars provided through 'after-the-event' insurance or under MLEI, cars

provided under payment on demand agreements,<sup>3</sup> and all other providers of temporary replacement vehicles except where the claimant arranged a retail hire.

186. The CHCs told us that our proposed definition did not work. AX told us that it might be broad enough to capture retail car rental, while others said that it allowed multiple routes for circumvention.

*Will there be distortions between the provision of temporary replacement vehicles by non-fault insurers and CHCs?*

187. Most of the insurers said that there would not be any such distortions, or at least there would not be provided that the remedy applied to all forms of non-fault temporary replacement vehicle provision except retail hire. NFU Mutual told us that there was clear potential for distortion unless the remedy applied equally to insurers. Zurich made a similar argument.
188. The CHCs all told us that distortions were likely. Three CHCs told us that non-fault insurers could make subrogated claims for temporary replacement vehicle costs at a higher rate than CHCs would be permitted to charge and CHCs would therefore not be able to compete. Quindell said that the non-fault insurers' pricing advantage over CHCs would enable them to offer referral fees, or even direct hire, to consumers who were not their insurance customers to provide replacement vehicle services. It said that CHCs would cease to exist and vertically integrated insurer subrogation would occur.

*Would the courts have regard to the CMA capped rate in subrogated claims?*

189. There was a reasonable degree of consensus on this question between all the parties. The parties all told us that the courts would probably not be influenced by the capped rate, or at least there was an inherent risk that the courts would ignore the capped rate. Enterprise also told us that a dual rate cap would cause greater ambiguity for the courts, and Kindertons said that judges would query why a replacement vehicle had two prices.

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<sup>3</sup> In contrast to credit hire agreements, where the agreement provides that payment is due on a future date, typically in 11 months' time, payment on demand agreements provide that payment is due on demand by the hire company. In practice, the hire company would forbear from demanding payment from the hirer, as it would attempt to recover the hire charges from the at-fault insurer.

*Will non-fault insurers provide more temporary replacement vehicles under customers' insurance policies?*

190. There was a variety of different views among insurers on this question, with some telling us that there would be increased insurer provision of temporary replacement vehicles and others taking the opposite view. Allianz told us that most claimants did not need or want a like-for-like replacement vehicle. LV said that insurers should not discourage non-fault claimants who believed a courtesy car was sufficient for their needs or if they did not need a vehicle at all. Some insurers said that insurers might seek to sell add-ons for temporary replacement vehicle cover. BGL told us that, if the CHC model were undermined as a consequence of the remedy, insurers would not fill the gap unless it was profitable for them to do so, which would mean significantly higher add-on costs for policyholders than the current AEC detriment per policy. It said that whether or not consumers would have access to a temporary replacement vehicle would be likely to depend on whether their insurer wanted to operate in that market or not.
191. CHCs were reasonably consistent in their responses that non-fault insurers would not provide more temporary replacement vehicles. For example, Redde told us that the availability of temporary replacement vehicles would suffer and like-for-like provision would dramatically reduce. It said that small courtesy cars would increasingly be used, and that insurers had proven again and again that they had no interest in providing third party mobility.

*Would there be any unintended consequences?*

192. Most of the insurers told us that they did not foresee any unintended consequences of implementing the remedy, or at least there would not be provided the remedy was implemented with the widest possible scope. However, NFU Mutual said that if the rate cap was materially less than the open market day rate, and that a secondary industry was likely to be established to assist non-fault drivers to reclaim the gap, with the potential for years of litigation. It said that this would negate the basis of the remedy.
193. CHCs told us that there was a risk that CHCs would cease to exist if the remedy was implemented, or that they would attempt to circumvent the remedy. Some also said that claimants would receive a worse service and would not be able to realise their legal entitlement. The LLS said that this variant of Remedy 1C would have more serious unintended consequences than the original variant. Quindell told us that the likely outcome would be the collapse of the GTA.

## Remedy 1D

### ***What would be the most effective way of implementing this remedy?***

#### *Insurers*

194. A number of insurers, such as Allianz, NFU Mutual and Zurich, told us that this remedy would be most effectively implemented by an enforcement order.
195. Aviva told us that any such cost control was most effectively implemented through the use of a mandated industry portal, which should include an estimating system that was used to determine the cost of repair in an auditable fashion and could adjust the cost using the agreed capped rates.
196. CISGIL told us that neither the proposed Remedy 1D(a) nor the proposed Remedy 1D(b) would be effective. Therefore, CISGIL proposed an alternative remedy, whereby there would be a mandatory prohibition of discrimination or differentiation between the repair rates charged for at-fault and non-fault repairs.

#### *Law firms*

197. DAC Beachcroft told us that it would be necessary for this remedy to be part of a package of measures that prohibited referral fees and also any other form of arrangement which achieved the same ends.

#### *Trade associations*

198. The ABI told us that this remedy would be most effectively implemented by an enforcement order.
199. MASS told us that the non-fault insurer should be required to provide to the at-fault insurer a repair invoice with a statement of any discounts or allowances applicable to the invoice together with confirmation that no commission or other payment was due from the repairer to the non-fault insurer.
200. The NAB told us that this remedy could be effectively implemented through the establishment of an Independent Lead Body, a pan-industry adjudicator/watchdog to oversee any outcomes of our investigation and to prevent future insurance market dysfunction.



***Would either variant of this remedy give rise to distortions or have any other unintended consequences?***

*Insurers*

201. RSA told us that the subrogation of repair costs at wholesale rates would reduce incentives for insurers to lower costs through buying efficiencies by requiring them to pass on the benefit of their efficiency gains to their competitors, which would place upward pressure on repair costs across the industry, leading to higher PMI premiums. RSA told us that subrogation at standardised rates addressed this undesirable efficiency effect by allowing insurers to earn a margin to the extent they could undertake repairs at a cost lower than those standard rates, thereby creating an incentive for the industry to pursue efficiency in repairs.
202. esure told us that the standardisation of repair costs would increase insurers' incentives to reduce the quality of a repair where the actual cost of a repair was below the generated standardised cost. esure also told us that the costs of establishing and maintaining the accurate assessment of repair costs would outweigh any potential benefits of Remedy 1D(b), leading to higher PMI premiums.
203. Allianz and NFU Mutual told us that the standardisation of repair costs would allow larger insurers to build in a profit against the standardised costs, as they would be able to agree commercial rates below the standard costs and this would penalise the smaller insurers in the market.

*Brokers*

204. BGL told us that the standardisation of the price of repairs could drive repairers to look to repair vehicles for less than the standardised price, in order to increase profit, which could be detrimental to consumers.

*CMCs/CHCs*

205. Quindell told us that if the rates were set too low, it might make some smaller insurers' models unviable due to them not being able to bargain with their supply chain at the level which would be necessary in order to recover their costs.

*Repairers*

206. Halo told us that a move to standardised costs would lead to demands from insurers, CMCs and others that repairers adopt these standardised costs in

their contracts, which would severely distort fair competition between repairers who were able to offer lower-priced repairs due to their superior operational efficiencies.

### *Trade associations*

207. The ABI told us that a standardised tariff might introduce frictional costs which were not present in the current system:
- (a) a standardised cost would need to be agreed/arbitrated between multiple stakeholders; and
  - (b) keeping a standardised cost fair and equitable to all parties would require those costs to be regularly reviewed and updated, potentially leading to incremental costs.

### **Remedy 1D(a)**

*How could repairers be prevented from inflating the wholesale prices they charge to non-fault insurers and passing excess profit to non-fault insurers through referral fees, discounts or other payments?*

#### *Insurers*

208. Allianz told us that the enforcement order should stipulate that entitlement to recovery was limited to the actual cost of the actual repairs net of all commercial discounts, referral fees, rebates, profit share agreements and any other financial benefit secured by the non-fault insurer. Further, it should mandate that the at-fault insurer must not differentiate between at-fault and non-fault accidents.
209. Aviva told us that the only way to make this remedy work was for a clear and enforceable order, or method by which a definition of reasonable rates for non-fault repairs which were subrogated or given to the market, to be reached (eg via an independent, technically capable authority).
210. Zurich told us that the remedy should specify that:
- (a) all discounts, fees or other payments were deducted from the repair bill and that it was only the net cost to the non-fault insurer which was recovered from the at-fault insurer; and
  - (b) the costs charged by the repairer should also be the same, irrespective of whether it was a fault or non-fault repair.

### *Brokers*

211. BGL told us that all invoices presented by the repairer would need to be transparent and list line by line all of the elements of the invoice.

### *Other*

212. Audatex told us that it was difficult to see how repairers could be prevented from inflating wholesale prices in the context of Remedy 1D(a), but that its cost estimation system would provide tools and solutions for an insurer to review and audit the submitted estimate prior to authorisation.

### *Could this remedy be circumvented by insurers vertically integrating with repairers?*

213. A number of parties, such as the ABI, Acromas, Aviva and Zurich, told us that this remedy could potentially be circumvented by insurers vertically integrating with repairers. For example, the ABI told us that the possibility of circumvention by insurers vertically integrating with repairers would need to be considered in any remedy design. The ABI told us that Alternative Business Structures were being adopted between insurers and legal service providers and it was possible that this model could be extended to repairers.
214. In contrast, BGL told us that this was unlikely due to the lack of availability of repairers in the marketplace which would be willing to vertically integrate with insurers.

### **Remedy 1D(b)**

*Is it practicable to set standardised costs for all aspects of repairs in subrogated claims? If not, what are the potential problems?*

### *Insurers*

215. A number of insurers (Admiral, Allianz, CISGIL, esure, LV and Zurich) told us that it would not be workable or practicable, or would be difficult, to set standardised costs for a number of reasons. For example, CISGIL told us that Thatcham's escribe platform had 400 vehicle repair ranges and 1.5 million separate repair options.
216. However, Aviva told us that, for the majority of repair costs, it would be possible to set standardised costs. For labour rates, parts and paint discounts, this would be relatively simple as there was an abundance of data available to set the standard rates. In respect of other costs, this may be a bit more complex. However, through, for example, Audatex, a menu pricing for the

majority of additional costs could be constructed and there was enough information available in the market to enable the setting of standardised costs.

#### *Brokers*

217. Acromas told us that, although not straightforward, it should be possible in principle to set standardised costs for all aspects of repairs in subrogated claims, using cost estimation systems to provide the necessary inputs. Acromas told us that it doubted that it would be possible to implement this remedy by way of an enforcement order.
218. BGL told us that the setting of standardised repair costs would not be practical, because:
- (a) the system could not account for repairing (rather than replacing) the damaged part – replacing the part was usually more expensive;
  - (b) it would not reflect any additional damage to the vehicle, which only became evident once the vehicle was stripped down; and
  - (c) the use of Audatex or Glassmatix systems would give these providers a high level of influence over repairers and insurers.

#### *CMCs/CHCs*

219. Helphire told us that the standardisation of labour rates was impractical, as they varied by geography, marque (labour rates for prestige vehicles were generally higher) and certain specialist areas (eg aluminium and low-temperature welding).

#### *Trade associations*

220. The ABI told us that a standardised tariff had the potential to be detrimental to the accurate assessment and safe repair of policyholders' vehicles, because it:
- (a) would remove the clear transparency of the cost of repair that the current sophisticated assessment systems provide;
  - (b) might encourage some insurers to adopt an approach where they refused to offer insurance cover for those vehicles which were more expensive to repair; and
  - (c) could lead to repairers and CMCs sacrificing safety and quality in order to provide the repair so as not to exceed the tariff price.

221. The NAB told us that it was practicable to set standardised costs but that the terms and operational standards would need to be set by an independent body and reviewed regularly to take account of changing market conditions.

*Other*

222. Audatex told us that its vehicle database covered 97% of the UK vehicle market with vehicle manufacturers' published data. It said that its estimation system processed 2 million estimates a year covering all sorts of vehicles and repairs.

*What are the appropriate benchmarks for inputs into the price control? To what extent are cost estimation systems helpful? What other indices would need to be used?*

223. The respondents to the Remedies Notice put forward a number of appropriate benchmarks for inputs into the price control, including cost estimation systems (eg Audatex and Glassmatix) and Thatcham.
224. Zurich told us that cost estimation systems provided a level of standardisation and accuracy in relation to vehicle repair estimates. Zurich told us that other benefits included efficiency savings achieved through the electronic processing of repair estimates between the insurer and repairer, and that repairers further benefited from being able to determine quickly the correct repair method when preparing the estimate (which helps to ensure that the vehicle is repaired in line with the manufacturer's specifications).

*Trade associations*

225. The ABI told us that Thatcham maintained a representative database of estimates from all three UK estimating systems used by insurers and CMCs and that this could be used to determine the average labour cost, which would be used to finalise a representative standardised price. This calculation could be refreshed on a six-monthly basis.

*What would be the costs of implementing this arrangement?*

226. Implementation costs would include:
- (a) the setting of standardised costs;
  - (b) the annual review of standardised costs; and
  - (c) the recalibration of existing cost estimation systems to accommodate the level of detail required to accurately present standardised costs.

227. Admiral told us that implementation costs would not be prohibitive.
228. The ABI told us that the costs of implementing the remedy were not likely to be substantial as the systems, processes and database required for the solution were already in place and funded.

*How would the monitoring of this remedy work?*

*Insurers*

229. Admiral told us that an independent body with a mix of stakeholders representing all parties within the market could complete periodic audits and that insurers could also be required to submit periodic data.
230. Aviva told us that an independent, technically capable organisation could be appointed to review the standardised rates in a transparent manner or, alternatively, the industry could accept that the standardised rates increased annually by whatever the RPI dictated.
231. NFU Mutual told us that this remedy would be self-policing, as it would not change the cost control arrangements between the insurer and the repairer.

*Brokers*

232. Acromas told us that the auditing of repairs would be onerous and expensive.

*Trade associations*

233. The ABI told us that its members and CMCs could be requested to report on a regular basis at an aggregate level the differences between the standardised and actual cost of their repairs, and these results would be reviewed against predefined tolerance levels. It said that revisions to any elements of the standardised costs could be submitted via the ABI Motor Committee for approval prior to adoption.

*Other*

234. Audatex told us that if the business rules and underlying mechanisms to produce the standardised costs were agreed, maintained and updated with openness and transparency, then the remedy should be self-monitoring.

*What would be the most appropriate organisation to review the inputs into the price control on a regular basis?*

235. The respondents to the Remedies Notice suggested a number of organisations which could be tasked with reviewing the price control, including the FCA, NAB or Thatcham.
236. Aviva told us that an independent, technically-capable review organisation could be formed from a number of existing trade associations (eg Thatcham, ABI, CHO, BIBA, etc) or alternatively, the price control could be reviewed by an independent auditor (eg an accountancy firm).

*What measures would be required to ensure that the price control arrangements would not have adverse consequences for the quality of repairs?*

237. A number of parties, including Admiral and BGL, told us that audits would ensure that the quality of repairs were maintained to the required standard.
238. The ABI told us that it would be essential to ensure that any base data that was used to construct the standardised cost would be defensible, transparent and fit for purpose.

## **Remedy 1E**

***Would either variant of this remedy give rise to distortions or have any other unintended consequences?***

*Insurers*

239. Aviva told us that:
- (a) under Remedy 1E(a), if the at-fault insurer did not take up the option of handling the salvage of non-fault write-offs, this could lead to insurers simply accepting each other's imperfect salvage models; and
  - (b) Remedy 1E(b) might lead to reduced salvage monies being paid by salvage companies to insurers in exchange for referral fees or simply to build sums into at-fault insurers' costs.
240. Aviva proposed an alternative to Remedy 1E, whereby a standardised percentage salvage return was adopted for each salvage category and, if an insurer obtained a higher return than the percentage for that category, it would keep the difference, but if it sold the salvage for a figure below the set percentage, it would absorb the difference.

241. CISGIL told us that Remedy 1E (a) was unlikely to be effective, as it would introduce extra costs and liabilities for the at-fault insurer, thereby increasing overall claims costs. For example:
- (a) Where a total loss claim decision took an extended period of time to resolve or where there was outstanding finance on a vehicle (in which case ownership of the vehicle salvage was with the finance company and the vehicle must remain in storage until the issue of finance was resolved), the fault insurer would incur significant salvage storage costs (often in excess of £20 per day).
  - (b) There would also be additional costs arising from (and delays to the claim due to) the physical transfer of the vehicle and the legal transfer of vehicle ownership.
  - (c) It was likely that there would also be issues for claimants as a result of the transfer, including recovery of personal effects from written-off vehicles.
  - (d) Additional costs would also be incurred where a written-off vehicle must be scrapped (ie Category A or B salvage categories), as such vehicles would be considered to be hazardous waste and would require licences to be transported and handled.
242. CISGIL told us that Remedy 1E (a) would also result in regulatory and compliance difficulties, including:
- (a) Under the Road Vehicles (Registration and Licensing) Regulations 2002, the insurer handling the salvage is required to notify the DVLA and ensure that the registration certificate for the vehicle (Form V5C) is surrendered or destroyed. The notification is carried out via the Motor Insurers Anti-Fraud and Theft Register (MIAFTR) and this process would be delayed until the at-fault insurer agreed to take over the disposal of the salvage.
  - (b) Continuous registration requirements, given that this remedy could lead to several changes of ownership before a vehicle was scrapped and deregistered.
243. NFU Mutual told us that the remedy options did not rule out the possibility of the different handling of at-fault and non-fault claims, which would need to be addressed to prevent insurers from applying a matrix approach to at-fault claims and an individual elements approach to non-fault claims.



### *CMCs/CHCs*

244. Helphire told us that under Remedy 1E(a), if at-fault insurers were given the option to handle the salvage, they would be incentivised to set a low pre-accident value, thus reducing the total loss payment received by the non-fault claimant.
245. Kindertons told us that this remedy would increase the length of the claim through disputes over who handled the salvage and further arguments over the pre-accident value of the vehicle, which would increase both administrative and temporary replacement vehicle hire costs.
246. Quindell told us that Remedy 1E(a) would expose the consumer to the at-fault insurer with which they did not have a contractual or any other relationship and which would be under no duty of care to assist the consumer or provide them with adequate service.

### *Salvage companies*

247. HBC Vehicle Services told us that the at-fault insurer had no insurable interest in the vehicle, nor any interest in the policyholder, and therefore that these vehicles would be left in storage for excessive periods of time.
248. Copart told us that under Remedy 1E(b), the additional information provided to insurers in relation to the actual salvage value would increase the duration of the claim and reduce the overall salvage proceeds recovered once additional administration costs were taken into account, thus increasing the overall cost of claims.

### *Trade associations*

249. The ABI told us that Remedy 1E(a) could result in an unnecessarily lengthy claims process, which would cause increased costs. For example:
  - (a) The at-fault insurer may inherit outstanding finance on the vehicle and, as a result, the vehicle would have to remain in storage until this was resolved (given that ownership of the vehicle salvage rests with the finance company), which may increase costs as insurers negotiated with each other over who was responsible for inherited storage charges.
  - (b) Under the Road Vehicles (Registration and Licensing) Regulations 2002, the insurer handling the salvage is required to notify the DVLA and ensure that the registration certificate (V5C) is surrendered or destroyed. Notification is carried out via the MIAFTR database. MIAFTR requires that the insurer handling the salvage enters the vehicle's details when the

vehicle is declared a total loss and not when the claim has been paid. To transfer responsibility for the legal registration of a write-off until after the claim is settled would result in significant delays at the DVLA.

### **Remedy 1E(a)**

*Would at-fault insurers be likely to take up the option of handling the salvage?*

#### *Insurers*

250. Aviva told us that take-up would be low, because:
- (a) there was a claims-handling cost in processing salvage and the at-fault insurer would be absorbing this cost into its expenses;
  - (b) it was not financially beneficial for the at-fault insurer to handle non-fault write-offs for Category A, B and C salvages; and
  - (c) cherished plate, outstanding finance and gap insurance cases would be unlikely to be handled by the at-fault insurer, because there would be an increased operational expense in handling these claims.
251. NFU Mutual told us that it would be unlikely that there would be any desire on the part of the at-fault insurer to deal with non-fault salvage, as it could involve handling the vehicle remains, and the transfer of recovery, towing and storage costs, all of which would add unnecessary cost.

#### *Brokers*

252. Acromas told us that it would be unlikely that at-fault insurers would take up the option of handling the salvage, because it would entail additional administration costs and might therefore increase claims costs.
253. BGL told us that it would be unlikely that at-fault insurers would take up the option of handling the salvage unless they had an interest in a salvage company, because they would have to arrange for the collection of the vehicle and deliver it to a salvage yard and, depending on the speed of the collection, there could be storage charges which they might incur or dispute.

#### *Salvage companies*

254. Copart told us that it would be advantageous to the at-fault insurer to have the option of controlling salvage, as it would allow it to maximise the value of salvage at disposal and to use that value to reduce its claims costs.

### *Trade associations*

255. The ABI told us that at-fault insurers could take up the option of handling the salvage, but this would cause areas of additional frictional cost (and thus detriment to consumers), because of the delays associated with the transfer of ownership, keys, personalised number plates and salvage storage fees from one owner to another.
256. The British Vehicle Salvage Federation (BVSF) told us that the smaller insurers would be unlikely to entertain the option of handling third party salvage, but the larger, leading insurers may well consider this a benefit.
257. MASS told us that at-fault insurers might be reluctant to absorb the additional administration costs associated with collecting and disposing of the non-fault vehicle and realising the salvage proceeds.

*At what point in the claims process should at-fault insurers be given this option?*

### *Insurers*

258. Allianz told us that, if Remedy 1E(a) were implemented, at-fault insurers should be given this option as soon as the vehicle was assessed as a write-off.
259. Aviva told us that the at-fault insurer should be engaged the moment the non-fault insurer believed its customer's vehicle might be a write-off, because:
- (a) it would remove the fear of the non-fault insurer stalling settlement to build up storage and replacement vehicle costs for the at-fault insurer;
  - (b) the at-fault insurer could consider other cost mitigation measures early on in the claims process (eg moving the salvage to a salvage partner which charged reduced storage fees compared with those where the vehicle was currently situated); and
  - (c) the at-fault insurer could consider and offer constructive total loss settlements if the damage to the non-fault vehicle was a borderline repair in order to reduce its overall claims cost.

### *Brokers*

260. BGL told us that this option could only be given once the vehicle had been assessed and confirmed as a total loss.

### *Salvage companies*

261. HBC Vehicle Services told us that it was strongly against this proposal but, if accepted, it had to be at the point that settlement had been agreed, because if the at-fault insurer intercepted the claim prior to settlement then it would become unclear to the insured who was actually in control of their claim.

### *Trade associations*

262. The ABI told us that at-fault insurers would need to be given this option as early in the claim process as possible.
263. The BVSF told us that this option could only be given to the at-fault insurer upon settlement of the claim, in order to avoid the accumulation of vehicle storage costs.
264. The LMA told us that the at-fault insurer should receive very early notification and be given the opportunity to handle the salvage or agree a price with the non-fault insurer. The LMA told us that, under this option, customers could potentially receive a more protracted service, albeit with fairer underlying economic practices and behaviours.
265. MASS told us that the at-fault insurer should not be given the option to dispose of salvage until the non-fault claimant had both agreed that their vehicle was a write-off and its pre-accident value.

### **Remedy 1E(b)**

*What impact would this remedy have on salvage companies? To what extent would this proposal reduce the incentives for insurers to get the best salvage value from salvage companies?*

#### *Insurers*

266. Allianz told us that this remedy would have no impact on salvage companies, as they would always pay the actual salvage value to the insurer.
267. Aviva told us that it would not reduce the number of salvage companies, affect their core operation or adversely affect their profit margins.
268. NFU Mutual told us that the remedy was unlikely to impact salvage companies, as the current salvage market was dominated by a small number of dealers who operated a variety of models.
269. Zurich told us that it should be mandated that insurers receive the same salvage whether the vehicle was involved in an at-fault or non-fault accident.

### *Brokers*

270. BGL told us that the incentive of salvage companies to seek higher salvage prices might reduce if they were passing any value that was in excess of the estimated salvage value back to the at-fault insurer.

### *Salvage companies*

271. Copart told us that the extra cost of accounting for the actual salvage proceeds would be imposed by insurers on salvage companies.

### *Trade associations*

272. The ABI told us that Remedy 1E(b) largely reflected the present position of most insurers and therefore it was likely to have a limited impact on salvage companies, as they normally paid the actual salvage value to the insurer. The ABI told us that a standardised salvage process might help counteract the possibility of the non-fault insurer selling salvage at an artificially low amount.
273. The BVSF told us that the larger salvage companies would benefit enormously from the at-fault insurer taking ownership of the salvage, but it would place many of the smaller salvage companies at considerable risk.

*What administrative costs would the adjustment mechanism have? What evidence would need to be provided to verify the salvage proceeds (and any referral fee)?*

### *Insurers*

274. Allianz told us that administrative costs were an operating expense which was incorporated into the premium received and were not currently recoverable by insurers.
275. Aviva told us that the following administrative changes would arise:
- (a) Salvage companies would have to produce a salvage sale receipt, which would need to be provided if the salvage value was challenged by the at-fault insurer.
  - (b) There would be an operational cost for both at-fault and non-fault insurers in the interim settlement model based on an estimated salvage return, as both insurers would wait for the actual cost and then reconcile the actual return against the estimated sum and either seek a further sum or draw a cheque as an adjustment.

276. Zurich told us that an adjustment mechanism would be too complex to operate between insurers, and would lead to operational inefficiencies and potentially further frictional costs. Zurich told us that subrogation should be sought from the at-fault insurer only once the salvage proceeds had been confirmed.

#### *Trade associations*

277. The ABI told us that some insurers suggested that the subrogated salvage claims should take account of the actual cost of handling and selling the salvage by the non-fault insurer, including commissions, clawbacks and volume discounts, but other insurers suggested that claims handling costs needed to be removed from the process (in line with some of the other proposed remedies).

### **Remedy 1F**

#### ***Could this remedy operate on a stand-alone basis? Which other remedies would benefit from this remedy as a supporting measure?***

278. Most parties told us that although this remedy could operate independently of the other remedies proposed under ToH 1, it did not directly address the consumer detriment caused by the separation of cost liability and cost control and therefore it would be more effective as a supporting remedy to those remedies which directly addressed the cost of replacement vehicle provision (eg Remedy 1C).

#### ***What questions should the non-fault insurer or CMC/CHC ask the non-fault claimant, in order to assess their need for a replacement vehicle, the appropriate type of replacement vehicle and to demonstrate that the provision of a replacement vehicle has been appropriately mitigated?***

#### *Brokers*

279. The questions suggested by brokers included:
- (a) What are your main uses for your vehicle?
  - (b) What is your weekly mileage?
  - (c) Do you have access to another vehicle that fulfils the same requirements?  
If so:
    - (i) Is this alternative vehicle available when you require it?
    - (ii) Will it inconvenience other users of the vehicle?

(iii) Do you feel safe driving the alternative vehicle?

(d) Do you want a replacement vehicle?

#### *CMCs/CHCs*

280. Both Kindertons and Quindell told us that the current version of the mitigation questionnaire under the GTA was an appropriate benchmark to assess a non-fault claimant's need and to ensure that they demonstrated that the provision of a replacement vehicle had been appropriately mitigated.

#### *Insurers*

281. The questions suggested by insurers included:

(a) Do you have access to another vehicle? If so would the other vehicle be suitable?

(b) Do you need a replacement vehicle?

(c) How often will you use the vehicle on a weekly basis?

(d) Is a courtesy car available? If so, would that be suitable?

(e) What is your average daily mileage?

(f) What is the vehicle used for?

(g) Do you have any particular family needs?

(h) Do you need a vehicle of the same size or could you manage with something smaller?

#### *Law firms*

282. The questions suggested by law firms included:

(a) Is there a certified need (ie no access to other vehicles)?

(b) Do you have provision for a replacement vehicle through your own insurer? If so, why have you not accepted it?

(c) Did you check your policy to see whether you had provision for a replacement vehicle?

(d) Did the at-fault insurer offer you a replacement vehicle? Did you enquire with them as to whether they would provide one? If not, why not? Why was any offer not accepted?

(e) What use was your original vehicle put to and how often was it used?

***Should the cover provided by the claimant's own insurance policy be considered in assessing the claimant's need?***

*Brokers*

283. BGL told us that the policy entitlement to provide a replacement vehicle in the event of an at-fault accident should not be considered in assessing the need for a replacement vehicle in the event of a non-fault claim, because some PMI policies provided courtesy cars as a standard benefit for the consumer, so the presence of this feature was not indicative of need.

*CMCs/CHCs*

284. Accident Exchange told us that a non-fault claimant had a right to a replacement vehicle under tort law regardless of the replacement vehicle entitlement under their policy.

*Insurers*

285. Aviva told us that if a non-fault claimant's policy provided cover for a replacement vehicle, there should be a (rebuttable) presumption that the claimant failed to mitigate their loss if they did not take advantage of this option or if they did not even look to check and establish the vehicle which would have been provided.

286. NFU Mutual told us that the non-fault claimant's replacement vehicle provision under their own policy should not be taken as evidence of their need for, or limit their entitlement to, a temporary replacement vehicle.

287. Zurich told us that the non-fault claimant's replacement vehicle provision under their own policy should not be taken as evidence of their need for a replacement vehicle. Zurich told us that the inclusion of such provisions in a policyholder's policy proved preference and not need.

*Law firms*

288. Winn Solicitors told us that the provision of cover in a claimant's own insurance policy should not be considered in assessing the claimant's needs, as it



was long-established case law that an insurance policy was purely for the claimant and not something which should be taken into account in mitigation.

#### *Trade associations*

289. The ABI told us that if a claimant's own policy provided cover for a replacement vehicle that was adequate for their actual need at the relevant time, there should be a (rebuttable) presumption that the claimant had failed to mitigate their loss if they took out a credit hire replacement vehicle.
290. MASS told us that *Daniels v Farish* stated that it was not for the at-fault insurer to dictate that the claimant should pursue their right in contract when they had a claim in tort, and therefore assessing the claimant's need with reference to the cover provided by their own insurance policy would require a change in law.

***Would the right of the at-fault insurer to see the mitigation declaration and have access to the call record be sufficient for this remedy to be self-enforcing without additional monitoring? Would giving the at-fault insurer access to the non-fault insurer's or CMC's/CHC's call records give rise to any data protection issues?***

#### *Brokers*

291. Acromas told us that the right of the at-fault insurer to see the revised mitigation declaration would be sufficient for this remedy to be self-enforcing without additional monitoring and that it would not be necessary or proportionate to provide call records to the at-fault insurer.
292. BGL told us that the cost of producing and sending the call recordings could be prohibitive and might cause issues with data protection (the customer would have to give their consent to the call being shared).

#### *CMCs/CHCs*

293. Accident Exchange told us that the right of the at-fault insurer to see the mitigation declaration would be sufficient for this remedy to be self-enforcing without additional monitoring and that providing call records might have data protection issues.
294. Quindell told us that the at-fault insurer, which had no contractual or other relationship with the non-fault claimant, should not be entitled to the call records, which could contain information which could prejudice other elements of the claim (eg personal injury).

### *Insurers*

295. Allianz told us that a standard set of questions produced to evidence need would result in the development of a set of standard responses engineered over a period of time to be accepted as proving appropriate mitigation. Therefore, seeing the mitigation statement and/or call record would not result in the remedy being self-policing.
296. NFU Mutual and RSA told us that providing the at-fault insurer with call records would be likely to raise data protection issues. NFU Mutual told us that this would require the permission of the non-fault claimant and the claims handler and, without explicit permission, there would have to be formal application for non-party disclosure. NFU Mutual also commented that accessing call records where they existed (as call records were not universal across the PMI industry) would be time-consuming and costly. However, Aviva told us that these issues could be resolved if the provision of call records was a part of the standard industry claim process and the non-fault party was informed of the sharing of these records at the outset of the claim.
297. DLG told us that there would be practical difficulties under the Data Protection Act in sharing call records.

### *Law firms*

298. DAC Beachcroft told us that there should be no data protection issues with the provision of call records to the at-fault insurer, if the non-fault claimant was advised that the call might be used.
299. Keoghs told us that it would be very easy to circumvent the remedy by leading the consumer with additional questions or phraseology to persuade them of a particular view.
300. Winn Solicitors told us that the disclosure of the call records might lead to data protection issues, albeit that non-fault insurers and CMCs could address this through an initial script to the customer. Winn Solicitors added that there would be data protection issues where solicitors undertook the initial call, as these would be subject to legal privilege.

### *Trade associations*

301. Both the ABI and MASS told us that recording and releasing the call to the at-fault insurer would require the consent of the non-fault claimant.

## ***How much would it cost to implement this remedy?***

### *Brokers*

302. BGL told us that costs would include:
- (a) improved phone technology (some market participants might not currently record calls);
  - (b) downloading, producing and sending call recordings;
  - (c) insurer technology upgrades to allow access to call recordings;
  - (d) development of new mitigation statements; and
  - (e) staff training for a new process.

### *CMCs/CHCs*

303. Kindertons told us that there would be minimal cost involved in the implementation of this remedy, as it formed part of its normal process in assessing need.

### *Insurers*

304. Admiral, Allianz, Aviva and Zurich told us that implementation costs would be minimal.<sup>4</sup> However, NFU Mutual told us that significant costs would be incurred in the installation of call recording systems and in the managing of requests for call records.

### *Law firms*

305. DAC Beachcroft and Winn Solicitors told us that implementation costs would be minimal.
306. Keoghs told us that the cost of standard wording should be minimal but there would be an expectation in the market of more calls and questions from policyholders, in addition to the cost of monitoring adherence.

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<sup>4</sup> Admiral noted that, on their own, these proposals would be unlikely to lead to any savings and arguably add to the total costs by adding a further area of dispute.

### *Trade associations*

307. The ABI told us that the provision of call records to the at-fault insurer would be likely to lead to costs which were disproportionate to the AEC found under ToH 1.

### ***Would this remedy give rise to distortions or have any other unintended consequences?***

### *Brokers*

308. BGL told us that the remedy would be likely to reposition frictional costs to disputes around the validity of the mitigation statement.

### *CMCs/CHCs*

309. Accident Exchange told us that at-fault insurers might seek to impose overly demanding mitigation questions with a view to deterring victims from taking up credit hire, and thereby reducing their incentives to provide direct hire.
310. Quindell told us that the implementation of this remedy would increase frictional costs, because at present there were very few disputes in relation to the type of replacement vehicle provided to non-fault claimants, as they generally had the right to a similar vehicle to their own. Therefore, this remedy would encourage the interrogation of a consumer's vehicle use and need.
311. WNS told us that additional questions and the provision of a mitigation declaration to the at-fault insurer would result in cost increases in the handling of the claim and that any such cost increases would need to be offset by reductions in replacement vehicle costs to avoid a negative impact on insurance premiums.

### *Insurers*

312. Aviva told us that the remedy might reduce the value or size of the credit hire market, if need was not self-proving and/or if it could be proved that a non-fault claimant's need could have been satisfied by a lesser replacement vehicle.
313. CISGIL told us that increasing the number of questions and allowing the at-fault insurer access to, and review of, call records in the event of a dispute (where available) might increase disputes and frictional costs.
314. NFU Mutual told us that the cost of challenging a mitigation statement in all but the highest value claims would be prohibitive.

### *Law firms*

315. Keoghs told us that there was a risk that some at-fault insurers would request access to call records too readily, resulting in an increase in administration and frictional costs.

### **Remedy 1G**

#### ***Could this remedy operate on a stand-alone basis?***

316. Most parties which supported this remedy agreed that it could not operate in isolation (as it would not directly address the AEC or consumer detriment identified under ToH 1) and said that it would be more effective as a supporting measure to the other remedies proposed under ToH 1, which could be undermined or circumvented if the payment and receipt of referral fees remained allowable.

#### ***Would remedies 1A to 1F benefit from a prohibition of referral fees as a supportive measure? Or would Remedies 1A to 1F have the effect of reducing referral fees in any event?***

### *CMCs/CHCs*

317. Coral Insurance Services told us that if credit hire rates were sufficiently capped (as proposed under Remedy 1C) and the level of administration fees also made sufficiently low, then the levels of referral fees available would reduce naturally.

### *Insurers*

318. Aviva told us that the combination of Remedy 1G with a reduction in the claims cost either by lower credit hire charges (as proposed under Remedy 1C) or subrogated repair costs (as proposed under Remedy 1D) and an increase in the salvage value (as proposed under Remedy 1E) would result in the reduction in the ability to pay a referral fee.
319. DLG told us that the reduction of credit hire rates and hire durations (as proposed under Remedy 1C) would reduce and may even eliminate referral fees.

### *Trade associations*

320. The ABI told us that Remedies 1A to 1F would likely reduce the amount of money available to pay referral fees but, in the absence of banning referral

fees explicitly, they would be likely to continue to exist, adding unnecessary costs.

321. ACIS Limited told us that measures to prevent claims from being marked up (as set out in Remedy 1D) might have the effect of reducing referral fees without the requirement for a separate remedy.

***What would be the impact on premiums if referral fees were prohibited?***

322. There were a range of views on the 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 were (to a significant extent) passed from insurers to consumers in the form of reduced premiums. However, other parties, including insurers, told us that the remedy would reduce the overall cost of non-fault claims, thus resulting in a reduction in premiums.
323. Keoghs told us that the impact of the remedy on premiums may depend on whether revenue generated from referral fees was greater than the cost saving envisaged by the other proposed remedies. Keoghs added that it could be an unintended consequence that in the short term premiums could rise, though over time savings should offset this loss.

***Would this remedy give rise to distortions or have any other unintended consequences? In particular, would a prohibition on referral fees create a greater incentive for insurers to vertically integrate?***

*Brokers*

324. BGL told us that a prohibition of referral fees would be likely to result in:
- (a) the reduction of FNOL services, exposing the consumer more frequently to direct interaction with the at-fault insurer, resulting in poorer consumer outcomes; and
  - (b) a major move to vertical integration across the industry, because there were a limited number of large-scale hire providers in the marketplace. However, as the cost of acquisition would deter insurers and the integration of repairers would be unlikely to provide nationwide coverage for the consumer, there would still be need for a second-tier network.

*CMCs/CHCs*

325. Accident Exchange told us that the prohibition of referral fees would be likely to result in a dramatic reduction in the ability of CHCs to promote themselves

and to capture the needs of non-fault drivers, thereby removing the competitive pressure on insurers in the servicing of non-fault claims and thereby reducing their incentive to provide replacement vehicles under direct hire.

326. Helphire told us that insurers (and others) might form entirely legal joint ventures to extract value from claims (in the absence of referral fee income).

#### *Insurers*

327. Aviva, NFU Mutual and Zurich told us that the remedy could result in vertical integration.

328. AXA told us that the remedy could result in vertical integration if referral fees were removed without controlling the cost of hire, as it could lead to an increase in profits, which might induce vertical integration.

329. Admiral told us that insurers would adapt to gain the transfer of value via alternative methods, as any commercial operation had a duty to its stakeholders to consider amendments to its current models.

330. esure told us that if the remedy extended to repairer networks, the costs subrogated to at-fault insurers by vertically-integrated insurers would increase, because the vertically-integrated insurer would be in a position to increase the level of profits in its upstream business, rather than in its insurance unit. esure also told us that the removal of payments such as volume discounts would increase the costs of repairs, as insurers would not be incentivised to use their economies of scale to generate greater efficiency in the repair process.

#### *Trade associations*

331. The ABI told us that the remedy could give rise to firms seeking to substitute their lost referral fee income with other sources of income (eg increased commission rates or increased repair bills).

332. The LMA told us that vertical integration was a possibility as, following the ban of referral fees in relation to personal injury claims, some insurers had merged with law firms in order to sidestep it. Similarly, MASS told us that the referral fee ban for personal injury claims had coincided with the introduction of Alternative Business Structures, which had enabled fees to be shared or charged in alternative ways.

***What circumvention risks would this remedy pose and how could these be mitigated? In particular, how could other monetary transfers (eg discounts) that have the same effect as referral fees be prevented?***

*Brokers*

333. Acromas told us that the risk of circumvention could be addressed by including within the scope of the remedy behaviours which had the equivalent effect of paying a referral fee.

*Insurers*

334. Allianz told us that this remedy would pose no circumvention risks if the scope of the remedy were extended to rebates, profit share agreements and other financial mechanisms.
335. NFU Mutual told us that circumvention risks could be mitigated by enforced disclosure of all financial transactions, rigorous audit by regulatory bodies, such as the FCA, or by a strictly controlled mandatory portal arrangement across the entire industry.

*Trade associations*

336. The LMA told us that the risk of circumvention could be mitigated by applying broadly drafted regulations preventing any method of using a non-fault claim to generate revenue for the non-fault insurer (or other intermediary).
337. MASS told us that there was a need for clear and precise rules surrounding the definition of a referral fee and guidance as to what constituted a referral fee.

***How could this remedy best be monitored and what costs would be incurred in doing so?***

*Brokers*

338. BGL told us that the remedy would need to be accompanied by a wide-ranging regulatory structure to ensure that referral fees were not paid and/or received by any market participants and the cost of setting up and administering such a structure would be wholly disproportionate to the value derived for consumers.



### *Insurers*

339. Zurich told us that monitoring could be undertaken by the FCA together with the Solicitors Regulation Authority and Claims Management Regulator.
340. CISGIL told us that the CMA was best placed to monitor the remedy, as monitoring by the FCA could only extend to companies regulated by it (ie insurers and brokers) and not to other parties involved in a claim (ie CMCs/ CHCs, repairers and salvage companies).
341. NFU Mutual told us that the costs of a stand-alone monitoring regime would be prohibitive and resource intensive unless provided by some form of electronic portal with built-in automated monitoring and control measures.

### *Trade associations*

342. The ABI told us that the monitoring of compliance with, and enforcement of, a ban on referral fees could be undertaken by existing regulators as part of their regulatory functions and it was unlikely that there would be significant additional costs in them doing so. The ABI also told us that it would be important for the CMA to consider how non-regulated entities, including replacement vehicle providers, would be monitored.
343. The Vehicle Builders and Repairers Association told us that the prohibition of referral fees should be publicised throughout the industry and compliance should be monitored by tracking complaints.

## Information for consumers

### **PART A: Statement of consumer rights following a road traffic accident<sup>1</sup>**

1. This statement is to help you understand:
  - (a) your rights following a road traffic accident (paragraphs 3 to 10); and
  - (b) the different ways in which a claim can be handled (paragraphs 11 to 14).
2. It is not a definitive statement of law. It focuses on your rights in relation to repairs and a temporary replacement vehicle. For further information on these rights or your rights in relation to any other losses you have incurred, or if you or your passenger(s) have been injured, you should seek further advice.

#### **Your rights following a road traffic accident**

3. You can choose to make a claim on your insurance policy or you may choose to use the services of a claims management company or solicitor to pursue a claim against another party (see paragraphs 11 to 14). You are entitled to be involved in any discussions relating to any admission of liability.

#### ***Claiming on your insurance policy***

4. The contractual rights you have to claim on your insurance policy are the same whoever is at fault for an accident or whether there is any dispute over who is at fault.
  - (a) If you have comprehensive motor insurance cover, your insurance policy will in most circumstances provide cover for repair of your vehicle or payment for its value before the accident if it is a write-off. It may also cover you for a temporary replacement vehicle.
  - (b) If you have third party or third party fire and theft cover, your insurance policy will not provide cover for repair to your vehicle, payment for its value before the accident if it is a write-off or a temporary replacement vehicle.

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<sup>1</sup> This information has been prepared based on the legal framework in England and Wales. If you have an accident in Scotland or Northern Ireland, you should be aware that there are some differences in the legal frameworks compared with England and Wales.

- (c) If you have motor legal expenses cover, purchased either as part of your motor insurance policy or separately before or after the accident, your insurance policy will provide cover for the legal costs of pursuing your claim.
5. If you do not understand exactly what cover is provided, you should check with your insurance provider.
  6. Any claim you make on your own insurance policy might require you to pay an excess and may affect your insurance premium and no-claims bonus. Some insurers may waive any excess if you are not at fault for an accident and you might be protected against any loss of no-claims bonus if you have taken out no-claims bonus protection. However, if liability of the other party is established you are entitled to recover from the other party any excess you have paid and any loss of no-claims discount.

### ***Your rights if an accident is your fault***

7. If an accident is your fault, you do not have to claim on your insurance policy, but if you do your contractual rights are set out in your policy documentation. For further information about your insurance policy, please contact your insurance provider or refer to the Frequently Asked Questions on your insurance provider's website. In law, you are responsible for losses you have caused others and your insurance will cover these if you are within the terms of your insurance policy.

### ***Your rights if an accident is another party's fault***

8. After an accident caused by someone else, you are entitled under law to be put back into the position you would have been in had the accident not occurred. The reasonable costs of doing so are recoverable from the at-fault party. If you are unsure what is reasonable in your circumstances, you should discuss this with the party handling your claim or seek further advice.
9. Your rights against the at-fault party include compensation for:
  - (a) **The damage to your vehicle:**
    - (i) You can choose to have your vehicle repaired by a repairer of your choice or by a repairer recommended by your insurance provider or the company handling your claim. If you choose not to use a repairer recommended by your insurer, you should check whether that has an impact on the cover you have or any excess you have to pay. The repairer should return your vehicle to its condition before the accident.

If you do not have comprehensive motor insurance or you agree to the repair being undertaken on credit and do not use your insurance cover, you will be responsible for the costs of the repair if they cannot be recovered from the at-fault driver. You may be offered a separate insurance policy by the company handling your claim which protects you against these costs.

- (ii) If your vehicle has been assessed as being uneconomic to repair and is a write-off, you are entitled to the market value of an equivalent vehicle of a similar age and condition before the accident. This is usually based on publicly available information.

**(b) A temporary replacement vehicle:**

- (i) If you need a temporary replacement vehicle for the period you are without your vehicle, you are usually entitled to one that is equivalent to your vehicle (for example, similar in size, model, number of doors and engine capacity) with zero excess and on the same insurance terms as those on which you were permitted to drive your own vehicle.
- (ii) You may be provided with a temporary replacement vehicle by your insurer as part of your motor insurance policy. If this is not suitable for your needs, you may be referred to a replacement vehicle provider who will provide you with a vehicle equivalent to your own, possibly on credit terms.
- (iii) You may also be offered a temporary replacement vehicle by the at-fault party's insurance provider. If this is not equivalent to your vehicle, you are entitled to ask for one which is. You should also ask what financial liabilities you might face.
- (iv) Unless the temporary replacement vehicle is covered by your insurance policy or by an insurance policy provided by the replacement vehicle provider, you will be liable for the hire cost should the cost not be recovered from the at-fault party or if you are ultimately considered to be at fault for the accident. You should check the hire terms of any temporary replacement vehicle you are provided with to ensure you understand what financial liabilities you may face.
- (v) Unless the temporary replacement vehicle is provided under the terms of your motor insurance policy or by the other driver's insurer, you will be asked questions about your need for the vehicle and you will be asked to sign a Mitigation Declaration Statement on receipt of the temporary replacement vehicle.

- (c) **Other losses** – You can also make a claim if you have been injured in the accident or have suffered other losses (eg legal costs, costs of any excess you have paid under your motor insurance policy and loss of earnings). Whether your insurer will assist you with recovering these losses is likely to depend on the terms of your motor insurance policy (for example, whether you have motor legal expenses cover).

***Your rights if an accident is both your and the other party's fault, or fault is not agreed***

10. If there is a dispute about who is at fault in an accident, it might have to be decided in court. If both of you have some fault, you will only be able to recover from the other party some of what you have lost, though if you have a comprehensive motor insurance policy you will still be entitled to your full rights set out in that policy.

**Different ways in which a claim can be handled**

11. Any claim you make against your insurance policy will usually be handled by your insurance provider.
12. If the accident is the fault of another party, you can pursue the claim yourself but claims are typically handled in one of the following ways:
- (a) **By your own insurance provider:** your insurance provider will handle the claim under your insurance policy and seek to recover the costs of the claim from the insurer of the other party. Your insurance provider might choose to refer you to another supplier for the provision of some services.
  - (b) **By the insurer of the other party:** the insurer of the other party might contact you following an accident and offer to handle your claim.
  - (c) **By a claims management company:** you, your insurance provider or the insurance provider of the other party might choose for a claim to be handled by a claims management company.
  - (d) **By a solicitor or a legal expenses provider:** you or your insurance provider might choose to have your claim handled by a solicitor or legal expenses provider.
13. Your legal entitlements are the same under all of these options.
14. If disputes arise with the party handling your claim, you should seek independent legal advice, or contact the Financial Ombudsman Service or Legal Ombudsman.

**PART B: Frequently Asked Questions – motor insurance policy claims (to be populated by insurers/brokers for basic motor insurance policies)**

1. What are my contractual responsibilities in the event of an accident? Do I need to notify you when I have an accident?
2. What happens if I believe I am not at fault for the accident but the other driver says that I am?
3. What happens if the other driver in an accident is not insured?
4. What should I do if the other driver does not have insurance or is insured in another country?
5. If I am in an accident in which I am at fault, how will this affect my annual motor insurance premium and/or my no-claims bonus? If so, how?
6. If I am in an accident in which I am not at fault, will this affect my annual motor insurance premium and/or my no-claims bonus? If so, how?
7. Under what circumstances will I be required to pay an excess towards the cost of the repair of my vehicle?
8. If I am required to pay an excess and am ultimately found to be not at fault for the accident, will you refund the excess or recover the excess on my behalf from the other driver's insurer?
9. Can I choose who repairs my vehicle? If so, will I incur additional costs over and above my motor insurance policy excess?
10. If my vehicle requires replacement parts, will the repairer use replacement parts made by the manufacturer of the original part?
11. Does my insurance policy entitle me to a temporary replacement vehicle during the period in which my vehicle is undergoing repair? What type of vehicle am I entitled to? Does my motor insurance policy cover use of such a hire vehicle?
12. What happens if my vehicle is a write-off?
13. What happens to my existing policy in the event of a write-off?
14. What are my rights in relation to the recovery of my losses other than those relating to the repair or write off of my vehicle and the provision of a temporary replacement vehicle following an accident?

## **PART C: First Notification of Loss (FNOL) statements**

**Statement 1 and questions (a) and (b) to be read out (either by a call handler or by an automated system) in FNOL situations by the party receiving the FNOL from the claimant, and when a claimant's insurer receives notification of a claim from a claimant, even if FNOL has been performed by another party (eg a broker).**

### **Exceptions:**

- **If FNOL or notification to the insurer is provided online, these statements should be displayed when completing any FNOL notification.**
- **If FNOL or notification to the insurer is made by someone other than the policyholder, the policyholder should be sent or directed to the Statement of Rights (see Part A).**

### **Statement 1**

1. You were sent a Statement of Rights with your motor insurance policy documentation.
  - (a) Would you like to hear a brief summary of your rights?
    - (i) If yes, paragraphs 2 to 4 should be read out by the FNOL provider;
    - (ii) If no, question (b) should be asked by the FNOL provider.
  - (b) Would you like to be sent a copy of the Statement of Rights?
    - (i) If yes, the FNOL provider should send a copy of the Statement of Rights using the preferred form of delivery of the claimant (email, post, etc).

### **Statements 2 to 4 to be asked if the answer to question (a) is 'yes':**

2. The rights you have to claim on your insurance policy are the same whoever is at fault for an accident or whether there is any dispute over who is at fault. Your contractual rights are set out in your motor insurance policy documentation. Any claim you make on your insurance policy may require you to pay an excess and may affect your no-claims bonus and insurance premium.
3. If the accident is another party's fault, it is the responsibility of the other party under law to put you back into the position you would have been in had the

accident not occurred. This will include repair of your vehicle or compensation for its value before the accident if it is a write-off. Also, if you need a temporary replacement vehicle for the period you are without your vehicle, you are entitled to one that is equivalent to your vehicle. You also have rights to recover other losses you may have incurred as a result of the accident. The reasonable costs of putting you back into the position you would have been in had the accident not occurred are recoverable from the at-fault party.

4. If there is a dispute about who is at fault in an accident, it may have to be decided in court.



### Mitigation declaration statement

#### Section A to be completed and signed by the replacement vehicle provider<sup>1</sup> and Section B to be countersigned by the claimant

#### Section A: to be completed by the replacement vehicle provider when deciding whether to provide a temporary replacement vehicle

1. Prior to the provision of a temporary replacement vehicle,<sup>2</sup> the claimant was reminded of the Statement of Rights and advised that:

- (a) they have a legal entitlement to be compensated for the loss of use of their vehicle and, if their need for it is established, they are entitled to a temporary replacement vehicle which is equivalent to the specification of their own vehicle (for example, in size, type, number of doors and engine capacity);
- (b) they are entitled to the temporary replacement vehicle from the time their own vehicle was undriveable or, if their vehicle was driveable, from the date repairs on their vehicle started until, at the latest, 24 hours<sup>3</sup> after the repair to their own vehicle is completed, or in the case of a write-off, seven days after receipt of cleared funds of a total loss payment;
- (c) any cost that they could reasonably avoid may not be recoverable from the other driver;
- (d) unless covered by their motor insurance policy or by an insurance policy provided with the temporary replacement vehicle, they will be held liable for the cost of the hire of the temporary replacement vehicle if they are ultimately considered to be at fault for the accident or if the replacement vehicle provider fails to recover the full cost from the at-fault driver.

2. The claimant's vehicle that was involved in the accident was a:

Make .....

<sup>1</sup> 'Replacement vehicle provider' is the credit hire company providing the temporary replacement vehicle. The statement would not need to be completed where an at-fault insurer is providing a temporary replacement vehicle to a non-fault claimant or where a temporary replacement vehicle is being provided to a claimant under the terms of their insurance policy.

<sup>2</sup> The mitigation declaration statement does not apply to temporary replacement vehicles provided under the terms of a claimant's insurance policy (for example, provided under courtesy car cover).

<sup>3</sup> Unless circumstances render this impossible, in which case the temporary replacement vehicle must be returned as soon as practicable.

Model (including engine size and number of doors) .....

Vehicle registration .....

Age of vehicle .....

3. The claimant was asked the following questions and provided the following responses to substantiate the need for a temporary replacement vehicle:

(a) Do you require a temporary replacement vehicle for the period whilst your vehicle is being repaired or is otherwise unavailable? If yes, why?

**Claimant's response:** .....

(b) Do you believe or have you been advised that your vehicle is not roadworthy and/or unusable? If yes, why?

**Claimant's response:** .....

(c) Have you received an offer of a temporary replacement vehicle from the other driver's insurer? Why was this offer not accepted?

**Claimant's response:** .....

(d) For the period while your vehicle is unavailable, do you have access to another vehicle? If yes, is there a reason why this is not suitable or you could not use this vehicle?

**Claimant's response:**.....

(e) Do you require a temporary replacement vehicle that is equivalent in size, type, number of doors and engine capacity to your own vehicle? If yes, why?

**Claimant's response:**.....

(f) For insurance purposes:

(i) are you under 25 or over 70 years old?

(ii) what is your profession?

(iii) have you held a full UK driving licence for less than 12 months?

(iv) have you convictions in the last four years, or court cases pending, which have or could result in an unspent ban or seven or more outstanding points?

**Claimant's response:** .....

4. Based on the responses above, the claimant will receive the following temporary replacement vehicle or equivalent (state category or class of vehicle):

.....

Signed .....

Name of agent at replacement vehicle provider .....

Date .....

Name of replacement vehicle provider .....

Address .....

Telephone .....

Email .....

**Section B: to be completed by the claimant upon receipt of the temporary replacement vehicle**

I have read and understood paragraph 1 above and I confirm that this was explained to me by the replacement vehicle provider prior to the arrangement of a temporary replacement vehicle. I confirm that I was asked each of questions (a) to (f) (see paragraph 3). I confirm that the answers are an accurate reflection of the responses I previously provided and are true to the best of my knowledge.

Signed .....

Name of claimant .....

Date .....

Address .....

## Summary of views on remedies relating to theory of harm 4

### Introduction

1. In this appendix, we set out a summary of the views of parties on remedies relating to ToH 4.

### Remedy 4A: Provision of all add-on pricing information from insurers to PCWs

#### *General comments*

2. The majority of respondents supported the provision of add-on pricing information on PCWs.
3. However, Zurich told us that it was not persuaded that the additional information proposed by the CMA 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 a meaningful comparison.
4. Swinton told us that, although it accepted the aims of this remedy, it believed that it was unworkable in practice. Swinton also said that it was concerned that the mandatory listing of add-ons would provide a basis for PCWs to levy CPA charges on add-ons or for PCWs to launch their own add-ons.
5. Similarly, RSA told us that it had some concerns as to whether such a remedy was capable of practical implementation, though it did not explain these concerns in any detail.

#### *Information provided to PCWs*

6. Table 1 sets out the add-ons for which PCWs told us they currently received pricing information from insurers. It shows that all the PCWs receive pricing information on the five most common add-ons: breakdown cover, courtesy car cover, MLEI, personal accident cover and windscreen cover.

TABLE 1 **Add-on pricing information received by PCWs**

<i>Confused</i>	<i>Comparethemarket</i>	<i>GoCompare</i>	<i>Moneysupermarket</i>
Breakdown	Breakdown	Breakdown	Breakdown
Courtesy car	Courtesy car	Courtesy car	Courtesy car
MLEI	MLEI	MLEI	MLEI
Personal accident	Personal accident	Personal accident	Personal accident
Windscreen	Windscreen	Windscreen	Windscreen
Green card	Driving abroad		
	Key loss		
	Personal effects		
	Sound equipment		

Source: Confused, Comparethemarket, GoCompare, Moneysupermarket.

### **Add-on pricing information displayed by PCWs**

7. GoCompare told us that the add-on pricing information it received varied by insurer. It said that it displayed pricing for the most commonly-purchased add-ons (shown in Table 1).
8. Moneysupermarket told us that it displayed pricing information for add-ons as follows:
  - When an add-on is included in the policy at no additional cost, the quote screen shows a tick.
  - If the add-on can be purchased separately and the cost is fixed, the quote screen shows the price provided to Moneysupermarket by the insurer.
  - If the cost is not fixed and is determined by the type of cover selected (eg breakdown cover), the quote screen shows the price ‘from’ the base price.
  - If an insurer does not offer a particular add-on, the quote screen shows a cross.
9. Comparethemarket told us that it displayed pricing for add-ons as follows:
  - If the product feature is included as standard, the price forms part of the core premium.
  - When the product feature is available for an additional price, a separate price will be provided (or a price ‘from’ will be displayed if the insurer offers a tiered product (in which case the lowest price tier is displayed) or if the add-on pricing varies according to the customer or quote information).
  - If the product feature is not available from an insurer, no reference is made to that feature.

10. All the PCWs told us that they did not receive prices separately for NCB protection.

### ***Incentives for PCWs to provide add-on pricing information***

11. We received mixed evidence on whether PCWs are sufficiently incentivised to provide add-on pricing information to consumers. Several parties told us that PCWs currently had no incentive to sell add-on products as their income was generated from selling the primary PMI policy. Some of these parties said that PCWs should be required to enable consumers to compare policies including add-ons.
12. CISGIL told us that, if PCWs could choose whether or not to display the information, it was likely that they would not do so, in order to avoid extensive implementation costs.
13. However, AXA told us that it was not necessary to require PCWs to publish add-on pricing information because the PCWs' business model meant that they were already sufficiently incentivised to do so.
14. PCWs told us that they would be incentivised to include add-on pricing information in order to improve consumer transparency and satisfaction. However, PCWs also said that displaying more add-on pricing information might create difficulties, in particular when displaying information on mobile devices.

### ***Scope of remedy***

15. We asked parties whether this remedy should also apply to brokers. The majority of respondents agreed and several parties told us that this remedy should apply to all distribution channels.
16. Some insurers told us that there would be difficulties in applying this remedy to brokers. LV told us that differing practices (eg independent sourcing of add-ons [☒]) may apply within the broker channel which may add complexity when applying this remedy to brokers.
17. Zurich told us that, given the differences in sales mechanisms, it was difficult to see how a remedy could effectively place this obligation on brokers and that there was added complexity as a broker may place the main cover with one insurer and the add-on(s) with other(s).
18. However, brokers did not raise any specific concerns about this remedy applying to them.

19. We received mixed evidence on whether the remedy should apply to all add-ons. Several parties told us that it should. MASS noted that applying the remedy to all add-ons would address the circumvention risk that insurers would create new add-on products which would not be covered by the remedy.
20. Other parties told us that the remedy should only apply to the most common add-on products, although CISGIL noted that this would require agreement as to which were the main add-on products.
21. GoCompare told us that it was not always clear to consumers what was covered by their core PMI policy and what was covered by an add-on, as policies varied between PMI providers.

***Time and cost implications***

22. We received mixed evidence on the time and cost implications of this remedy. Some insurers told us that it should be relatively straightforward to provide add-on pricing information to PCWs. The ABI told us that it did not anticipate that the cost to insurers of providing pricing information on add-ons to PCWs would be prohibitive. However, other insurers said that the costs would be significant. Brokers told us that they did not expect to encounter insurmountable barriers in providing this information to PCWs.
23. Insurers’ estimates of the time that it would take them to adapt their systems to provide pricing on all their add-ons to PCWs ranged considerably, from one week to 18 months, with costs from £300 to £4 million. Most insurers estimated a period of up to 12 months with costs of up to £500,000. Several insurers noted that it was very difficult to estimate accurately how long the changes would take or the likely costs. The responses from insurers are shown in Table 2.

TABLE 2 Insurers’ estimate of time and cost to provide pricing information on all add-ons to PCWs

<i>Insurer</i>	<i>Time</i>	<i>Cost</i>
Admiral	[X]	[X]
Aviva	[X]	[X]
Axa	[X]	[X]
CISGIL	[X]	[X]
DLG	[X]	[X]
esure	[X]	[X]
LV	[X]	[X]
RSA	[X]	[X]
Zurich	[X]	[X]

Source: Responses from parties.

24. We also asked PCWs to estimate the length of time and cost required for them to redesign their websites to allow consumers to preselect from a choice

of (a) all add-ons, or (b) the five most commonly sold add-ons, and then for the search results to be ranked by total price.

25. Confused told us that it would take 6 to 12 weeks to redesign its website to allow consumers to select from a choice of all add-ons, and three to six months to rank the search results by price, including a consumer's selection from the five most commonly selected add-ons. Confused said that these changes would not result in any additional costs over its normal development costs.
26. Comparethemarket told us that both options would require extensive planning and IT development. It told us that the design of its website reflected considerable research and development to date and that significant consultation and testing would be necessary to ensure that any changes were not detrimental to the consumer experience. Comparethemarket also told us that it would not be practical for an unlimited number of add-ons to be displayed on a PCW. Comparethemarket added that it would be necessary to consider how renewal quotes from insurers (which at present did not include add-ons) should be presented to ensure that consumers were not misled. Comparethemarket said that it would take several months to redesign its website to display and rank search results including add-ons.
27. Moneysupermarket told us that the length of time it would take to enable consumers to select from all add-ons would be mainly dependent on the time that it would take for it to be provided with the information consistently by all insurers, including the monthly premium. Moneysupermarket told us that allowing consumers to select from all potential add-ons would confuse consumers and ultimately lead to less switching and more automatic renewals. Moneysupermarket told us that ranking search results by price, including the five most commonly selected add-ons, would not be a significant development and the costs would not be prohibitive.

### ***Circumvention risks***

28. MASS told us that this remedy could increase the practice of insurers bundling in add-on products with basic insurance, which would result in a rise in cost, and might leave consumers with products they did not want or need, or even know they had.
29. Aviva told us that, if the remedy did not apply to all add-ons, there was a risk that add-ons could be rebranded to avoid providing pricing information.
30. CISGIL told us that, rather than selling add-ons at the point of sale, insurers might move to a model where they actively sold add-ons once the policy term



had commenced (either shortly after the sale of the basic policy or at renewal).

### ***Unintended consequences***

31. Several parties told us that this remedy was likely to lead to a standardisation of add-on products, thereby reducing innovation and consumer choice. Allianz told us that this remedy might reduce the range of add-ons available on PCWs (even if insurers offered a wider choice on their own sites). Similarly, Aviva told us that add-ons might not be offered to all customers and that add-on prices would potentially move away from flat pricing making them more expensive to certain customers.
32. [X] told us that there was a risk that insurers would seek to increase direct business, by offering higher pricing on add-ons purchased through PCWs compared with their direct offerings. However, [X] noted that insurers and PCWs could review their contractual arrangements to mitigate this.
33. Some parties told us that, without some form of standardisation of add-ons, insurers would be able to reduce the cover of add-ons in order to improve their price competitiveness and that this would increase the risk of consumers purchasing unsuitable products. Aviva told us that different levels of cover could be introduced with only the cheapest shown on the PCW in order to improve an insurer's ranking.
34. Several parties told us that implementing this remedy would increase complexity for consumers and lengthen the quote process. An unintended consequence of this could be that consumers were overwhelmed by information and exited the process without purchasing. Moneysupermarket told us that it used to rank insurers based on total price (ie including the price of five core add-ons) but had to revert to ranking based on core premium price as customer conversion reduced significantly. Moneysupermarket believed this was because, as a result of including add-ons, the prices they offered were higher than those on other PCWs.
35. CISGIL told us that the development, implementation and management costs incurred by PCWs in implementing this remedy were likely to be passed on to insurers through higher CPA fees, and that insurers would seek to recover these increased commission costs from customers through higher premiums.
36. Admiral told us that [X], GoCompare said that this remedy would involve a significant change to its business model, and was likely to represent a significant deterrent to new entrants to the PCW market.

37. Hastings Direct told us that there was a risk of ‘assumptive selling’ where a consumer would indicate a preference for an add-on product on a PCW on the basis of limited information and the insurers and brokers would then presume that the consumer had made that buying decision, making it difficult for the consumer to confirm that choice.

### ***Implementation***

38. The majority of parties told us that the FCA would be best placed to implement any remedy in this area. AXA told us that the FCA’s powers were sufficient to address our concerns and that to impose an enforcement order would contravene the regulatory principle of adopting the least intrusive approach.
39. However, CISGIL told us that it would expect this remedy to be implemented by way of an enforcement order and [REDACTED].
40. Many parties drew our attention to the FCA’s market study on general insurance add-ons and its thematic review of PCWs, and highlighted the need for consistency.

### **Remedy 4B: Better information concerning no-claims bonus and no claims bonus protection**

#### ***Making available to consumers details of the NCB scales both when consumers choose whether to take out NCB protection and when they receive their policy quote***

41. Several insurers told us that they did not believe NCB scales should be published:
- (a) Admiral told us that it understood why it may be desirable for consumers to understand the future impact of deciding whether or not to protect their NCB, but felt that attempting to achieve this by displaying NCB scales at the point of quotation would be problematic. Admiral also told us that it did not have a scale available to share in a readable format and that its discount rates varied by a large number of factors, meaning that the rate applied for each level of NCB was not fixed.
- (b) [REDACTED] told us that it did not publish the scales for NCB, as claim-free years were just one of many factors it considered when calculating premiums. It also told us that recent customer research indicated that customers were highly sceptical of advertised percentage discount scales, preferring instead to see how their driving history related to final premium.

- (c) AXA told us that it provided its NCB scales (in years only and not the discount provided to customers) and its step-back rules which applied, should claims occur during the period of insurance. AXA told us that the actual discounts provided were commercially sensitive and therefore not published.
  - (d) DLG told us that it did not believe that the publication of NCB scales was a desirable or appropriate means by which to help consumers make an informed buying decision.
  - (e) esure told us that it was not clear what benefit consumers would receive from the publication of NCB scales.
  - (f) LV told us that it did not believe it was necessary to publish NCB scales and was not convinced that consumers would refer to NCB scales at the point of sale. LV also noted that an added complexity was that varying NCB scales across the industry called into question whether consumers could make effective comparisons.
42. Insurers told us that NCB scales were complex. They said that the level of NCB discount was based on a number of rating factors and could vary significantly between insurers and over time. Insurers told us that, as a result, NCB rates could not be presented in a simple table and it would be impractical for insurers to provide the level of NCB discount for all combinations of NCB years. CISGIL told us that when a consumer purchased PMI on the telephone, it was not part of the standard sales script to describe the NCB scale, but, if the consumer asked for details, then these would be provided.
43. Some insurers told us that the publication of NCB scales could overload consumers with information, and be confusing and misleading as a higher percentage NCB discount did not necessarily imply a lower premium. The ABI told us that publishing NCB scales would not help consumers understand NCB policies better and in fact consumers would be left more confused about the value of their policy.
44. However, MASS told us that the publication of NCB scales was essential as it was apparent that many consumers did not know what they are buying when they took out NCB protection and that for them to make an informed decision they needed to be given the scales.

***Unintended consequences of the publication of NCB scales***

45. Aviva and Zurich told us that the requirement might be regarded by some insurers as so onerous that they might cease to offer NCB discounts altogether, and move to alternative rating discounts. DLG told us that we

should be mindful of imposing remedies which might result in insurers no longer offering NCB protection due to the risks of consumer misunderstanding. DLG said that this would cause significant consumer detriment. LV told us that it was possible that the requirement might result in NCBs being diluted or removed altogether in favour of discounts for other risk factors.

46. Allianz told us that there could be an incentive for insurers artificially to inflate the premium and then to show a high NCB discount being available, which might not, in practice, lead to a real saving for consumers. Similarly, Admiral told us that insurers who did not target low NCB consumers would potentially produce NCB scales displaying large NCB discounts, which could be interpreted by consumers as suggesting that there was a lot of value in protecting their NCB, but which might not be the case if the customer did not stay with the same insurer.
47. Admiral told us that there might be an increase in complaints as in some cases the NCB scale which was provided to the customer at the point of sale would no longer be valid at the point of renewal.
48. Aviva told us that some insurers might construct their scales to attract only those consumers with a high number of claim-free years and an unintended consequence of the proposed remedy could be a reduction in the number of insurers providing PMI to consumers with fewer claim-free years. Aviva also told us that broader published scales might make the market less efficient, leading to higher average prices.
49. Zurich told us that the publication of NCB scales would introduce extra ongoing costs which would ultimately be reflected in prices.

***What would be the practical difficulties and costs for insurers if they were required to quote the gross premium and NCB discount?***

50. Ageas told us that implementing this remedy option would require potentially significant changes to systems and documentation, create increased complexity and increase the length of telephone calls.
51. CISGIL also told us that implementing this proposal would require quotes to be prepared showing the premium with (a) nil NCB discount; (b) the relevant NCB discount applied; and (c) the relevant NCB discount applied and incorporating NCB protection. CISGIL said that extensive changes to its systems would be required. CISGIL noted that call times for its telephone sales would be extended to cater for the explanation of the different premium levels, its website would need to be updated to display the additional information with

appropriate explanations, and the PCWs would have to display multiple prices for each insurer.

52. DLG told us that implementing this proposal would take considerable effort and cost. It said that insurers would have to provide two quotes, one with and one without the NCB discount, and that these two premiums would need to be displayed to consumers in every case, whether on the insurer's own website or on PCWs, which would require significant systems development. DLG told us that, although it was not in a position to provide an accurate estimate, it expected that its costs would be in the region of £[redacted].
53. esure told us that there would be no significant practical difficulties with the proposal but said that significant time and resources would be required for insurers, brokers and PCWs to adapt their systems. It also said that increased telephone call times would result in higher call-handling costs.
54. LV told us that it provided customers with the level of discount generated by their NCB in their renewal documents but that to implement this measure for all online quotes would require significant work and a change in practices for its call centre business.
55. RSA told us that it would be costly to implement this proposal as extensive changes to systems would be required both for its online business to enable the gross premium and NCB discount to be displayed on screen, and also for its call centre staff to be provided with the same information.
56. One insurer told us that the need to produce three calculations to produce a quote would result in a delay in consumers receiving their quotations. It would also require widespread changes to the data exchange protocols between insurers, brokers and PCWs and changes to the quote screens of PCWs. It estimated that its own costs of implementing this measure would be £[redacted] to £[redacted].

***What would be the practical difficulties and costs for insurers if they were required to give examples of what would happen to the gross premium, NCB discount and NCB years if the customer were to make a claim (all other things being equal)?***

57. Admiral told us that providing this information could be misleading because it would not reflect the actual pricing that the consumer could potentially experience at the point of renewal.
58. Ageas told us that this proposal could potentially require significant changes to systems and documentation, cause increased complexity and lengthen call times. It suggested that the examples would either need to be very specific to

the consumer's risk profile or be more generic, and in any event they could only be indicative of the pricing that would apply at the time of renewal of the policy.

59. AXA told us that it would be impossible to provide details of exactly what would happen to a customer's gross premium, NCB discount and NCB years because the customer's premium at renewal would be influenced by many other factors. AXA suggested that an illustrative example could be provided which could be standardised across the industry, provided that it was stated clearly to be only indicative and not reflective of the customer's actual pricing at renewal.
60. CISGIL told us that this proposal could be misleading for consumers as the examples given would not reflect the consumers' pricing at renewal as numerous other factors could change. CISGIL also told us that major and costly systems changes would be needed to calculate and display the various examples, and that telephone sales scripts would need to be amended and call-handling times extended to allow sales staff to explain the examples to customers.
61. DLG told us that a requirement to quote both the gross premium and the NCB discount would result in substantial costs to amend its systems. DLG also said that this proposal would risk confusing consumers because of the number of other variables which could influence the renewal premium. DLG noted that it already provided its step-back rules (ie information on what happens to NCB years in the event of a fault claim) to its own-brand customers. DLG said that it could provide generic illustrated examples to convey the average value and limitations of the NCB product, eg by presenting the average premium at renewal for customers with at least one claim during the previous year, comparing the premium in the scenario with NCB protection with the scenario without it.
62. esure told us that it would be feasible to implement this proposal for online sales but it would increase the length of telephone sales and the time before a consumer could be provided with a quote.
63. LV told us that it would be feasible to implement this proposal for online sales provided that the examples were illustrative and could be incorporated in LV's documentation and website. LV told us that incorporating the examples in call-centre scripts would increase the length of the call and could result in potentially significant costs.
64. RSA told us that this proposal would be costly and complex to implement if it involved changing the functionality of its systems to display a range of prices

to consumers across all sales channels. RSA told us that a requirement to display hypothetical prices would be confusing to consumers and could be misleading as the actual premium at renewal would depend on a large number of various factors and would be likely to be different from that given in the example.

65. Zurich told us that it would be difficult to generalise the impact of a fault claim on premiums and NCB discounts because other factors were taken into account in assessing risk. Zurich said that introducing bespoke examples would be costly and complex.

***If insurers/brokers were required to explain to consumers what factors might alter a consumer's level of NCB up or down from one year to the next, distinguishing between situations where the consumer has and does not have NCB protection, what factors would you consider it appropriate to reveal to consumers in order to assist consumers in deciding whether to purchase NCB protection?***

66. Admiral told us that consumers could be told that their claims history and NCB protection might alter their level of NCB.

67. Ageas told us that consumers could be provided with the following information:

- the current scale of NCB years and percentage discounts
- the consumer's future position on the scale assuming no prejudicial claims
- the consumer's future position on the scale assuming one prejudicial claim, comparing protected NCB with unprotected NCB
- illustrative premiums based on the consumer's current premium

68. Aviva told us that factors to communicate to consumers would include:

- a clear comparison of the effects on NCB when an at-fault claim occurs between protected and unprotected policies
- confirmation that NCB protection may not protect a consumer from premium increases as the direct result of a claim
- the number of permitted claims in any given period that NCB protection will provide protection against

- where policies provide an ‘uninsured driver promise’, that the NCB will not be reduced when an accident is the fault of an uninsured driver even if the insurer cannot make a recovery
  - certain types of claim may not impact the NCB
69. AXA told us that it was not practicable to give an explanation to consumers of the range of factors which affected premiums and the level of NCB discount. AXA told us that it should be made clear to consumers that taking out NCB protection might not prevent the overall premium increasing at renewal (in the event of a claim).
70. CISGIL told us that, as the NCB calculation had developed, the level of discount applicable to each consumer had become linked to other risk factors and that, as the weighting of these risk factors in relation to each consumer’s number of claim-free years varied, it would be difficult to set out for each consumer which factor had the most influence on their own level of NCB. CISGIL said that it would be more appropriate to describe in broader terms the factors which interacted with claim-free years, which then determined the overall level of NCB discount.
71. DLG told us that the step-back rules which set out what would happen to consumers’ NCB years in the event that they made a fault claim were already provided to its own-brand customers (see paragraph 61). DLG said that it would not be helpful to explain in more detail the range of factors which determined the NCB discount as this would require setting out in detail a number of different variables (claims experience, margin pricing and brand strategy, marketing messages, etc) which all affected the overall pricing.
72. esure told us that there was nothing in principle about its calculation of NCB which could not be disclosed to consumers, but it was concerned that the amount of information provided to consumers should be proportionate, balancing (a) providing consumers with sufficient information to allow consumers to understand the operation of NCB and NCB protection and (b) not providing an excess of information which would carry the risk that consumers would not read or understand lengthy explanations.
73. LV told us that the step-back rules clarified the impact of claims on the number of years of NCB entitlement.
74. We received mixed evidence on whether the wording to explain NCB protection should be consistent across insurers. Allianz and the ABI told us that each insurer should be allowed the flexibility to adopt language which best fitted with their policy wording. DLG told us that it would not be appropriate for a generic description to be mandated across the industry. On the other hand,



Ageas told us that a consistent form of words across the industry explaining NCB to consumers could help and could be usefully formulated by a body such as the ABI.

***Including in the description of NCB protection a clear statement that a policyholder's premium may increase following an accident in which that policyholder was not at fault even when that policyholder had taken out NCB protection***

75. The majority of parties supported the principle of providing an explanation to consumers about the nature of NCB protection. However, some insurers were concerned that these statements did not make it clear that there were many factors which could affect a consumer's NCB discount, and these statements might cause consumers to undervalue NCB protection.

*'Your premium may increase following an accident in which you are not at fault even if you have No Claims Bonus Protection'*

76. Ageas and CISGIL told us that there was no reason why this statement could not be made to consumers. esure, RSA and Zurich also told us that they would have no objections to including this statement in their descriptions of NCB protection. esure suggested that an additional statement would add clarity: 'insurers use a large number of factors in calculating motor insurance premiums and any of these may result in an increase or decrease in your premium'.

*'Your premium may increase and your No Claims Bonus discount may decrease following an accident in which you are at fault even if you have No Claims Bonus Protection'*

77. Aviva told us that this statement could be misleading to consumers as NCB protection could prevent a consumer's NCB years reducing (ie so long as the claim was within the insurer's step-back rules). Similarly, DLG told us that this statement could be misleading as DLG customers were able to protect their NCB years subject to certain limitations on the number of claims made in specific periods. Ageas told us that this statement could be misleading as a consumer's premium might increase but their NCB protection would guarantee that their NCB entitlement would not be reduced as a result of a single prejudicial incident.

#### ***Remedy 4C: Clearer description of add-ons***

78. In general, parties were supportive of the principle of providing clearer descriptions of add-ons.
79. In our Remedies Notice we asked what should be included in the description of each add-on product.
80. Aviva told us that add-on descriptions should provide an overview of what cover was provided and confirmation of key exclusions or limitations of cover.
81. CISGIL told us that it was important to provide consumers with information that was not unnecessarily complex and that insurers should retain flexibility over the exact content and display of the information. Zurich told us that each insurer would have its own view on what key aspects needed to be communicated to its particular customers and that insurers should therefore retain flexibility over the exact content and display of this information.
82. Several parties suggested that further work was required to establish the key features of each add-on product which consumers needed to know before making their purchasing decision. For example, the ABI suggested undertaking a more thorough consumer research exercise to ensure that the information required to be provided would meet consumers' needs. Admiral told us that the quality of add-on descriptions could best be established by understanding the products and the needs of consumers in relation to the products, which could be done by monitoring insurers' data on claims repudiations, complaints and customer feedback, and through competitor research and analysis. CISGIL told us that further work should be undertaken with insurers, consumer groups and the FCA to assess what relevant information should be included and the format of any such information.
83. However, LV told us that insurers were already aware of consumers' information requirements. It said that significant research had already been undertaken to optimise the customer experience and to ensure that their demands were met. It said that it should, therefore, be relatively straightforward to identify those providers which did it well and to highlight examples against which to benchmark.
84. Most parties told us that descriptions should be provided across all distribution channels including in insurance policy documentation, on insurers' websites and on PCWs. Admiral told us that, in addition, descriptions should be included in sale scripts for purchases via a call centre.
85. Several parties highlighted the risk of overloading consumers with information, particularly on purchases through a PCW. DLG told us that too much detail,

included with the intention of increasing consumer understanding, could lead to worse consumer outcomes because the critical points would become lost or the information would simply not be read.

86. The ABI, CISGIL and Zurich suggested that the risk of information overload could be mitigated by including more detailed product information within the policy documentation and less technical information on websites and PCWs.
87. PCWs told us that it would not be time-consuming or costly to change the descriptions of add-ons on their websites. Confused told us that changes to standard wording were usually completed within six weeks and there would be minimal additional cost beyond its normal development costs. Comparethemarket told us that regular changes to the product descriptions on its website were made [X], usually within [X] of receipt from the insurer, but wide-scale changes might take longer and incur some cost. GoCompare told us that, although making changes to the descriptions of add-ons was not onerous, if the changes were instigated by GoCompare there might be some resource cost in obtaining the agreement of all the insurers whose policies were listed on its website, and that this might cause some delay. Moneysupermarket told us that any changes which it was required to make to the description of add-ons could be made with minimal effort.
88. The ABI told us that requiring standardised definitions of add-ons could stifle innovation and similarly Ageas told us that requiring standardised information about add-on products could stifle innovation, which would represent an unintended consequence of the remedy.
89. AXA told us that it did not support this remedy as the FCA already had sufficient powers to require insurers to provide more information and/or clearer statements at different stages of the process. Allianz told us that the FCA and consumer bodies should help regulate the quality of descriptions of add-ons and the Advertising Standards Authority should help regulate the accuracy of the descriptions of add-ons provided to consumers in advertising material. esure told us that it considered that the ABI and BIBA would be best placed to monitor insurers' descriptions of add-ons. Ageas told us that the CMA did not need to impose this remedy as it was unlikely to enable consumers to make informed (or better informed) decisions and would impose considerable implementation costs on the industry. It said that the FCA might be better placed to take forward the scoping and implementation of remedial action.
90. Most parties told us that, should the remedy be pursued, the FCA should monitor it.

## Interaction between our remedies and EU law

1. In this appendix we discuss a number of issues concerning the interaction between our remedies and the application of EU law.

### Issues raised by the parties

2. BGL made submissions concerning the relationship between the remedies that we proposed to implement in relation to ToH 5 and EU law, in particular on the duty imposed on Member States and their competition authorities by Article 3(2) of Council Regulation 1/2003<sup>1</sup> (Article 3(2)).
3. BGL told us that:
  - (a) the CMA is precluded from prohibiting wide MFN clauses<sup>2</sup> in this market, because they are agreements that are capable of affecting trade between Member States and are permissible under Article 101 of the Treaty on the Functioning of the European Union (Article 101), whether because of a lack of impact on competition or by reason of justification or exemption, including under the Vertical Agreements Block Exemption Regulation (VBER)<sup>3</sup>; and
  - (b) there is no reason why it would be necessary or appropriate for wide MFN clauses to be dealt with under the market investigation regime which is focused on market failures not (alleged) individual competition law breaches.

### Our assessment of these issues

4. Article 3(2) imposes a negative obligation that the application of national competition law may not lead to the prohibition of agreements which may affect trade between Member States but which do not restrict competition within the meaning of Article 101(1) or which fulfil the conditions of Article 101(3) or which are covered by a regulation for the application of Article 101(3). In contrast, Article 3(2) does not preclude national competition

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<sup>1</sup> 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 EU Treaty (now Articles 101 and 102 of the Treaty on the Functioning of the European Union).

<sup>2</sup> As defined in Section 8.

<sup>3</sup> Commission Regulation 330/2010 of 20 April 2010 on the [application of Article 101\(3\) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices](#), OJEU L 102, 23 April 2010, pp1–7.

authorities from applying stricter national laws to unilateral conduct engaged by undertakings.

5. The CMA's market investigation regime operates alongside other regulatory mechanisms such as merger control and the prohibitions under the TFEU and the Competition Act 1998 (CA98).<sup>4</sup> The scope and purpose of each of these regimes differ, though collectively they reflect the desire of parliament to establish a scheme of complementary measures to make markets work well.
6. Under Part 4 of the Act, the CMA is required to investigate and remedy the effects of any features of the referred markets, including agreements between undertakings, which it finds prevent, restrict or distort competition (an 'AEC'). A market investigation assesses whether competition in a market as a whole is working well as opposed to focusing on a single aspect of it or the conduct of particular firms within it. In this context, the CMA may consider, in relation to a particular market, the effects of agreements that may engage Article 101 as well as unilateral behaviour which causes adverse effects on competition in parallel with, as an alternative to, or in addition to these agreements.
7. Where an AEC is found, the CMA can impose a wide range of remedies to make a market more competitive. In particular, paragraph 2 of Schedule 8 of the Act permits an order adopted by virtue of Part 4 of the Act to prohibit the making or performance of an agreement and require any party to an agreement to terminate the agreement. The identification of anti-competitive features of a defined market (for instance, the structure of the market or unilateral conduct) in a market investigation or the imposition of remedies to address the adverse effects on competition arising from those features, does not mean that individual market participants have infringed existing competition law(s), in particular the prohibitions contained in Articles 101 and 102 of the TFEU and Chapters I and II of the CA98.<sup>5</sup> In the context of a market investigation, the role of the CMA is not to determine whether individual undertakings may have infringed these provisions.
8. On this basis, we concluded that it was appropriate for the nature and effects of wide MFN clauses in the PMI market (ie MFN clauses between PMI providers and PCWs) to be investigated as part of this market investigation, and, having found an AEC (see Section 8), that it was necessary for us to exercise our powers under Schedule 8 of the Act in order to remedy it (see Section 12).

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<sup>4</sup> Namely, Articles 101(1) and 102 of the TFEU and the Chapter I and Chapter II prohibitions under CA98. See further [CC3](#), paragraph 18.

<sup>5</sup> This is recognised in the CMA's guidance. See [CC3](#), paragraph 21.

## **Article 3(2)**

9. The CMA does not consider that the proposed application of paragraph 2 of Schedule 8 of the Act in this market raises issues under Article 3(2).
10. In any event, for completeness, we have conducted a limited assessment of the three limbs of the prohibition in Article 101 (jurisdictional scope, restriction of competition, exemption) against the information that we have collected in the course of our market investigation (the 'Article 101 Assessment'). By doing so, we have satisfied ourselves that, even if applicable, there would be no statutory bar imposed by Article 3(2) to the remedies that we are imposing to address the AEC identified in the market for the supply of PMI and related markets.
11. As already noted, we are not required under the market investigation regime to determine whether Article 101 (or Chapter I of the CA98) has been infringed (see paragraph 7) and we have not done so.

### ***(i) Jurisdictional scope of Article 101***

12. Article 101 applies to agreements or concerted practices between 'undertakings'. Our view for the purposes of the Article 101 Assessment is that this requirement is satisfied in the context of wide MFNs in the PMI market. PCWs and PMI providers are entities engaged in an economic activity which have entered into agreements relating to the supply of services by PCWs to PMI providers.
13. It has not been necessary for the purposes of our determination of a market investigation reference for us to determine whether these agreements might fall outside the scope of Article 101 altogether on the basis that they are 'genuine agency agreements' as defined by the jurisprudence of the EU courts. However, on the basis that PCWs provide services on a two-sided market, to both PMI providers and consumers, respectively, their contractual relationship with PMI providers does not appear to constitute a relationship between principal and agent. Our view for the purposes of the Article 101 Assessment is therefore that these agreements are not genuine agency agreements.<sup>6</sup>
14. So far as the other jurisdictional issue is concerned, namely, that the agreements have an appreciable effect on inter-state trade, our evidence and

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<sup>6</sup> We note that we have used the term 'agency model' when referring to PCWs' contractual arrangements with PMI providers (see paragraph 8.32 of the report). However, this is not to be confused with genuine agency agreements as defined by the ECJ and in the [EC Guidelines](#) on Vertical Restraints, *OJEU*, C 130/1.

analysis set out in Section 8 shows that MFN clauses, in general, affect the sale of PMI policies throughout Great Britain and/or Northern Ireland.

15. It was not necessary for us to make a comprehensive assessment of the effects of agreements containing wide MFN clauses on trade between Member States in order to find an AEC in the market for the supply of PMI and related markets. Whilst we have therefore not investigated this issue in detail for the purposes of this appendix, we cannot rule out that agreements containing wide MFNs have an effect on trade between Member States and have proceeded on this basis.
16. Overall, therefore, we have reached the conclusion, for the purposes of the Article 101 Assessment, that the first limb of Article 101 would be satisfied on the present facts. It has therefore also been necessary for us to consider the other two issues: restriction of competition and possible exemption.

***(ii) Appreciable prevention, restriction or distortion of competition by object and/or effect***

17. As already noted, the CMA's duty under the market investigation regime is to consider whether or not there is an AEC in the market(s) referred, not to consider whether the requirements of Article 101 are satisfied. Nonetheless, there is a potential overlap between a finding of an AEC and a finding of a restriction of competition within the meaning of Article 101 and we have therefore taken account of our findings in reaching a view, for the purposes of the Article 101 Assessment, as to whether this second limb of Article 101 is satisfied.
18. We have identified a PCW market, which is a two-sided market where PCWs provide (a) comparisons between PMI policies to consumers; and (b) sales opportunities to PMI providers (see Section 4). We have also noted that PCWs compete against PMI providers' own websites to provide quotations to customers.
19. We have found that, in general, agreements between PMI providers and PCWs containing a wide MFN clause prevent, restrict and distort competition in the UK (see Section 8).
20. For the purposes of answering the statutory questions in our market investigation we have not reached a view as to whether wide MFNs of the kind assessed in the report might be considered to restrict competition 'by object' contrary to Article 101. However, it appeared to us that such a view could not be ruled out (for example, if wide MFN clauses in the relevant market were

obviously to prevent, restrict and distort competition, they might, by their very nature, be injurious to the proper functioning of normal competition).<sup>7</sup>

21. Irrespective of whether or not wide MFNs in the PMI market might amount to a restriction of competition ‘by object’, we noted that our following findings applied in general to wide MFN clauses in this market:<sup>8</sup>
- (a) Their content includes an explicit restriction on PMI providers charging lower prices through other PCWs and in some cases other channels (paragraph 8.27).
  - (b) Their objective is to constrain the prices that an insurer charges through other PCWs and in some cases other channels (paragraphs 8.27 and 8.41).
  - (c) Having regard to their factual, legal and economic context, wide MFN clauses appreciably constrain the extent of competition between different PCWs. This is supported by the following:
    - (i) There is a greater prevalence of wide MFN clauses in agreements between PMI providers and those PCWs which account for a significant number of single-homing customers.
    - (ii) The structure of the PMI market and the nature of the legal relationship between PCWs and PMI providers is such that, in combination with the so-called ‘agency model’,<sup>9</sup> wide MFN clauses directly constrain the prices that consumers pay (paragraphs 8.32 et seq). Under the agency model,<sup>10</sup> intermediaries are not free to set different retail prices when competing for final consumers (paragraph 8.38), which means that the enforcement of a wide MFN clause by a PCW directly determines a minimum retail price charged by the PMI provider to consumers on any other PCW (or other distribution channel).
    - (iii) PCWs have become an increasingly important sales channel for PMI, accounting for [55–65]% of new business for PMI providers (paragraph 8.3). Some PMI providers have reduced their own advertising and become more focused on providing the best price through PCWs (paragraph 8.4). Only a limited number of PMI providers use their own website as a significant sales channel. Our analysis of

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<sup>7</sup> Case C-32/11 *Allianz Hungaria Biztosító v Gazdasági Versenyhivatal*, judgment of 14 March 2013, §36 and the case law cited. See also the opinion of Advocate General Mazák in Case C-439/09 *Pierre Fabre* [2011] ECR I-9419, §§25–26.

<sup>8</sup> This contrasts to our general assessment of narrow MFNs in this market.

<sup>9</sup> See footnote 6 above. The ‘agency’ pricing model which we observe with PCWs is where insurers set prices to final consumers while PCW-to-insurer negotiations set commission fees.

<sup>10</sup> 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.



consumers' behaviour also shows that the constraints from other channels selling PMI (including online and offline direct channels) on each PCW are weak (see paragraphs 8.65).

(iv) PMI consumers are price sensitive, and those consumers searching for PMI policies through PCWs can be expected to be particularly price sensitive.

22. Were the CMA to find that agreements containing wide MFN clauses constituted an infringement 'by object' in this market, it would be unnecessary for the purposes of applying Article 101(1) to demonstrate any actual or likely anti-competitive effects on the market.
23. However, in applying Part 4 of the Act to the market for the supply of PMI and related markets, we have reached conclusions as to the anti-competitive effects on competition of such wide MFNs in these markets. For instance, in addition to the aspects noted above, our analysis explains how wide MFN clauses in these markets reduce entry, reduce innovation and soften competition between PCWs, leading to higher commission fees and premiums (see paragraphs 8.32 to 8.43).
24. Overall, therefore, our view, for the purposes of the Article 101 Assessment, was that agreements between PMI providers and PCWs containing wide MFNs, on the assumption that they fall within the jurisdictional scope of Article 101 as agreements between undertakings with an actual or potential appreciable effect on inter-state trade, are also within the scope of Article 101(1) on the basis that they have a material adverse effect on competition (whether or not they might be found to constitute an infringement 'by object').

### ***(iii) Possible exemptions***

25. Given the above view, we also considered whether wide MFNs in the PMI market might benefit from individual or block exemption from Article 101(3). Again, we had no power or duty to reach a final view on this issue under Part 4 of the Act, but we addressed this issue on a limited basis purely for the purposes of the Article 101 Assessment.

#### *Individual exemption – efficiencies under Article 101(3)*

26. An agreement or concerted practice which restricts competition is exempt or legally excepted from, and does not therefore infringe, the prohibition under Article 101 where it is covered by a block exemption regulation, or where it satisfies all of the following cumulative conditions in Article 101(3) ('the exemption conditions'), namely where it:

- (a) contributes to improving production or distribution, or promoting technical or economic progress ('efficiencies');
- (b) allows consumers a fair share of the resulting benefit;
- (c) does not impose on the undertakings concerned restrictions which are not indispensable<sup>11</sup> to the attainment of those objectives; and
- (d) does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.
27. It is for a party claiming the benefit of a block exemption or the exemption conditions to adduce evidence that substantiates its claim.
28. As a general observation, hardcore restrictions are unlikely to satisfy the exemption conditions.<sup>12</sup> Were the CMA to conclude that agreements containing wide MFNs were an infringement by object, then that might equally undermine the likelihood of an individual exemption.
29. Nonetheless, we have considered whether, in general, wide MFN clauses in the PMI market might (a) satisfy all of the exemption conditions; or (b) be covered by way of a block exemption. In summary, we have again satisfied ourselves, for the purposes of the Article 101 Assessment, that neither (a) nor (b) is satisfied as regards wide MFN clauses in this market.
30. We considered three efficiency arguments raised by parties (see paragraphs 8.103 to 8.107):
- wide MFN clauses provide credibility to PCWs because consumers would not trust them unless they compared the best prices from PMI providers;
  - wide MFN clauses reduce consumers' search costs over and above narrow MFNs by providing them with a one-stop shop which provides the lowest prices; and
  - wide MFN clauses prevent insurers or other distribution channels from free-riding on the PCW's advertising investment.
31. We found that:
- (a) The benefits arising from wide MFN clauses in the PMI market in terms of credibility, search costs and the prevention of free-riding from other

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<sup>11</sup> Paragraph 73 of the Commission Guidelines on the application of Article 81(3) (now Article 101(3)), *OJEU C 101/97*, 27 April 2004, pp97–118 ('EC Guidelines on the application of Article 101(3)'), clarifies that the indispensability condition implies a twofold test: first, the restrictive agreement as such must be reasonably necessary in order to achieve the efficiencies, secondly, the individual restrictions of competition that flow from the agreement must also be reasonably necessary for the attainment of the efficiencies.

<sup>12</sup> Paragraph 47 of the EC Guidelines on the application of Article 101(3).

PCWs, over and above narrow MFN clauses, were unsubstantiated (see paragraph 8.116).

- (b) A wide MFN clause would help a PCW to return the cheapest available PMI price, but a PCW's inability to return the cheapest available price would be unlikely to undermine consumers' trust in the PCW. This was supported by the fact that, in recent years, PCWs had been able to increase their customer bases despite consumers apparently not typically believing that a single PCW was sure to return the best available quote (see paragraph 8.104). Moreover, not all PCWs believed that wide MFN clauses were necessary for their business model. Only a minority of PCWs operated with wide MFN clauses (see paragraph 8.105).
- (c) Wide MFN clauses could lead to PMI search cost savings for consumers, as they would have a one-stop shop providing the lowest prices. However, we noted that, for this to be true, a PCW would need a wide MFN clause with all the PMI providers on its panel, which no PCW had managed to achieve so far (see paragraph 8.110).<sup>13</sup>
- (d) There was little danger of free-riding from other PCWs in the absence of wide MFNs in the PMI market (see paragraphs 8.106 and 8.107). If competition were to make one PCW cheaper than another, PCWs would still be used to compare policies, but the purchase would be more likely to occur through the PCW with the lowest price.

- 32. Overall, we did not identify any significant efficiencies which were achieved by wide MFNs (over and above those attributable to narrow MFN clauses). Therefore, it seemed to us that any efficiencies which might arise from wide MFN clauses in the PMI market would not meet the exemption conditions.
- 33. So far as the other exemption conditions are concerned, it appeared to us that the third and fourth exemption conditions would not be satisfied on the basis that wide MFN clauses in the PMI market could not be deemed indispensable to the attainment of the efficiencies claimed to arise from MFN clauses in general, as there were other practicable and less restrictive means by which to achieve these benefits (eg implementing narrow MFN clauses) and, in particular, given the consequent elimination of intra-brand competition (see paragraphs 8.40 to 8.43). In other words, in assessing whether wide MFN clauses meet all of the exemption conditions, we believed that only the limited (if any) efficiencies arising from wide MFN clauses over and above those which arise from narrow MFN clauses should be considered.

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<sup>13</sup> Also our analysis suggests that any benefit arising from a one-stop shop would be relatively small.

34. For these reasons, it appeared to us that any efficiencies which might arise from wide MFNs and which could fall within the scope of Article 101(3) would not outweigh the restrictive effects of such clauses. Overall, therefore, we satisfied ourselves, for the purposes of the Article 101 Assessment, that the exemption conditions were not satisfied as regards wide MFN clauses in the PMI market.

#### *Block exemption regulation*

35. The final issue we considered was whether there was a realistic prospect that agreements containing wide MFN clauses might benefit from a statutory block exemption. On this issue, BGL told us that we had failed to assess whether wide MFN clauses would benefit from any block exemption regulation, with the effect that Article 3(2) would preclude a prohibition of such clauses as a remedy in our investigation.
36. In our view, the only conceivably relevant block exemption regulation would be the VBER. However, we were satisfied that agreements including wide MFN clauses in this market would not benefit from this particular block exemption for the reasons set out below.
37. Article 2(4) of the VBER contains a general exclusion from the block exemption for vertical agreements entered into between competing undertakings, subject to the proviso that the exemption still applies where competing undertakings enter into a non-reciprocal vertical agreement and, under Article 2(4)(b), ‘the supplier is a provider of services at several levels of trade, while the buyer provides its goods or services at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services’.
38. It appeared to us that Article 2(4) would preclude reliance on the VBER in the particular circumstances of the PMI market. The evidence in our analysis shows that wide MFN clauses in this market are included in vertical agreements between competing undertakings within the meaning of Article 2(4) of the VBER. Indeed, as discussed in Section 8, PMI providers and PCWs are competing undertakings to the extent that they both provide PMI quotations through their websites to customers and seek to capture customers through advertising.
39. As regards Article 2(4)(b) of the VBER, it appeared to us that (a) PMI providers were not ‘suppliers’ to PCWs, given that PCWs do not retail PMI, and in fact provide various services to insurers (as well as to end-users), and are remunerated as such by insurers; (b) PCWs in the PMI market were not suppliers operating at several levels of trade given that they do not retail PMI;

and (c) PMI providers compete with PCWs as regards the provision of PMI quotes to consumers.

40. For these reasons, and for the purposes of the Article 101 Assessment, we did not believe that the cumulative conditions set out in Article 2(4)(b) of the VBER were met, with the consequence that the application of the VBER was excluded. In addition, it appeared to us, for the purposes of the Article 101 Assessment, that wide MFN clauses in this market might well fall within the scope of Article 4(a) of the VBER, which provides that the block exemption does not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties (see also paragraph 20).<sup>14</sup>

## Conclusion

41. Overall, we are satisfied, for the purposes of the Article 101 Assessment, that our remedies would not lead to the prohibition of agreements which do not restrict competition within the meaning of Article 101(1), or which fulfil the conditions of Article 101(3) or which are covered by a Regulation for the application of Article 101(3).
42. For the avoidance of doubt, the CMA does not consider that the proposed application of paragraph 2 of Schedule 8 of the Act in this market raises issues under Article 3(2). We have undertaken this limited analysis for completeness, in response to an argument raised by BGL (see paragraph). By doing so, we have, satisfied ourselves that, based on the findings of this market investigation, even if Article 3(2) was applicable, there would be no statutory bar imposed by this provision to the remedies that we are imposing to address the AEC identified in the market for the supply of PMI and related markets. We are not at this time making any specific findings as to the compatibility or otherwise of wide or narrow MFN clauses in particular contracts between identified PMI providers and PCWs (or any other party) with domestic or EU competition law.<sup>15</sup>
43. Finally, and for completeness, we note that, in addition to undertaking the Article 101 Assessment, we have notified our findings in relation to wide

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<sup>14</sup> We also noted that the CMA has the ability to withdraw the benefit of a block exemption regulation.

<sup>15</sup> We are not in any way seeking to bind the CMA as to what, if any, action it might decide to take in relation to past, existing or future agreements, or conduct, which it might have a reasonable suspicion amounted to a breach of the prohibitions under Article 101 or Article 102 of the TFEU, or Chapter I or Chapter II of the CA98. There remains an obligation on all parties active in the supply of PMI and related services to ensure that the agreements they enter into are fully compliant with their legal obligations.

MFNs in the market for PMI and related markets to the CMA's Senior Directors of Antitrust and Research, Intelligence and Advocacy, who together are responsible for identifying and exploring new antitrust projects. We also asked them for a view on what impact our proposed remedy in relation to MFNs in the PMI market would have on a prioritisation assessment of enforcement action against wide MFNs in that market. Given our proposal to prohibit wide MFNs in the PMI market, the view of these CMA staff was that the likelihood of them proposing that the CMA should open an investigation into wide MFNs in the PMI market using powers under the CA98 would be significantly lowered.

## Glossary

<b>ABI</b>	The Association of British Insurers.
<b>The Act</b>	The Enterprise Act 2002.
<b>Add-ons</b>	Additional products which are typically offered on top of a basic insurance policy for an additional premium.
<b>AEC</b>	Adverse effect on competition.
<b>Approved repairer</b>	A repairer approved by an insurer or <b>CMC</b> for car repairs.
<b>CC</b>	Competition Commission.
<b>CHC</b>	Credit hire company.
<b>CHO</b>	Credit Hire Organisation, a trade association representing <b>CHCs</b> .
<b>CMA</b>	Competition and Markets Authority.
<b>CMC</b>	Claims management company.
<b>Commission fee</b>	See <b>CPA</b> .
<b>Comprehensive PMI</b>	Insurance cover for the policyholder's own vehicle as well as for <b>third party, fire and theft</b> .
<b>CPA</b>	Cost per acquisition fee, the charge levied by <b>PCWs</b> to PMI providers for a new customer.
<b>FCA</b>	Financial Conduct Authority.
<b>FNOL</b>	First notification of loss, the point at which a policyholder first notifies the fact of an accident.
<b>Frictional costs</b>	Costs of disputed claims.
<b>GTA</b>	ABI General terms of agreement between subscribing insurers and <b>CHCs</b> .
<b>GWP</b>	Gross written premiums, the total premiums paid for insurance policies written during an accounting period before deducting reinsurance costs.

<b>MFN</b>	Most-favoured nation, a clause within a contract which limits the price at which the supplier of a product can offer it through other sales channels.
<b>NAB</b>	The National Association of Bodyshops, a trade association representing the UK body repair sector.
<b>NCB</b>	No claims bonus (also known as 'no-claims discount').
<b>NEP</b>	Net Earned Premium, the GWP, net of Insurance Premium Tax and premiums ceded to reinsurers and any changes in provisions for unearned premiums.
<b>Non-fault claim</b>	A claim submitted by a driver who is deemed to be not responsible for the accident.
<b>OFT</b>	Office of Fair Trading.
<b>PCW</b>	Price comparison website.
<b>PMI</b>	Private motor insurance.
<b>Pre-accident value</b>	The value of the vehicle immediately before the accident.
<b>Replacement car</b>	See <b>temporary replacement vehicle</b> .
<b>RIPE</b>	Reduction in paper exchange, a voluntary agreement between participating insurers designed to reduce administrative costs in handling claims.
<b>Settlement</b>	The amount paid out by an insurer for a claim.
<b>Temporary replacement vehicle</b>	A vehicle issued to a claimant following an accident, while their vehicle is repaired (or <b>settlement</b> is made in case of a write off).
<b>Third party fire and theft</b>	Provides the same level of cover as third party cover, but also protects against damage from fire or theft, as long as the policyholder is not at fault.
<b>Third party insurance</b>	An insurance policy purchased for protection against the actions of another party.
<b>ToH</b>	Theory of harm.