

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Update to statement of issues

1. On 12 December 2012, we published our statement of issues, the purpose of which was to assist those submitting evidence to focus on the issues we envisaged being relevant to our investigation. We presented those issues in the form of theories of harm (ToHs).
2. In response, many parties provided useful evidence which has caused us to change our views on some of the theories of harm. Some issues which we were minded to investigate, we have now excluded; while other issues which we were minded not to investigate, we will now consider further.
3. The purpose of this document is to inform parties of the revised scope of our inquiry. The core issue of our investigation, represented in the statement of issues as ToH 1, remains unchanged and continues to represent our principal focus.

Theories of harm

4. We continue to group our theories of harm into the same five broad areas, as follows:
 - ToH 1: harm arising from the separation of cost liability and cost control (moral hazard).
 - ToH 2: harm arising from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services.
 - ToH 3: harm due to horizontal effects (market concentration).
 - ToH 4: harm arising from providers' strategies to soften competition.
 - ToH 5: harm arising from vertical relationships (vertical integration).

ToH 1: Harm arising from the separation of cost liability and cost control (moral hazard)

5. This issue remains the principal focus of our investigation. We intend to investigate whether the separation of cost liability and cost control in the supply of services (excluding personal injury (PI)) to non-fault parties involved in motor accidents increases the costs of the services supplied (due to a lack of price competition or an unwarranted increase in quality).
6. There is no change to this theory of harm.

ToH 2: Harm arising from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services

7. This issue is closely related to ToH 1. We intend to investigate the various ways in which consumers may be put at a disadvantage due to information asymmetries,

leading to a lack of alignment between their interests and those of the parties which procure post-accident services on their behalf.

8. There is no change to this theory of harm.

ToH 3: Harm due to horizontal effects (market concentration)

Insurers

9. In our statement of issues we said that we intended to assess the extent of any market segmentation by insurers and that we would consider whether the reduced number of rivals in some segments may allow those operating in that segment to charge a higher price (or reduce quality). We also said that we would consider why other insurers do not enter into these segments. Given that the barriers to moving from one market segment into another appeared to us to be quite low, we said that we would conduct our analysis at a high level initially to ascertain whether we should look at it in more detail.
10. In response to our statement of issues, we received no complaints relating to the horizontal concentration of insurers other than in relation to Northern Ireland. Many insurers provided us with evidence of their general competitiveness.
11. In light of the lack of submissions suggesting high concentration in relation to other market segments, we intend to focus our investigation of this theory of harm solely on Northern Ireland. We will investigate the profitability of insurers in Northern Ireland and consider which segments of the Northern Irish market each insurer serves, in order to ascertain whether for some portions of the community (eg rural drivers or young drivers) there might be a particularly limited choice.

Price comparison websites

12. The responses to the statement of issues provided a variety of views on whether the four large price comparison websites (PCWs) have market power and, if so, the extent to which any increase in the fee they charge providers of private motor insurance (PMI) leads to customer harm, and whether this harm is outweighed by any benefits for consumers from there being a limited number of PCWs. In light of these responses, we still intend to consider this issue at a high level initially to determine whether we should look at it in more detail. If we find that it warrants further investigation, this will involve considering the barriers faced by new PCWs to launching and becoming established.

Other sectors

13. The responses to the statement of issues did not change our view that the supply of other goods and services appear to be characterized by a large number of providers (ie brokers, credit hire companies, direct hire companies, repairers, claims management companies, parts and paint suppliers and solicitors). Therefore, we do not intend to consider these other goods and services in relation to horizontal effects.

Summary of changes to ToH 3

14. We will consider whether there is market concentration among PMI providers in Northern Ireland, or in segments of the market within Northern Ireland, and we will

not look at other possible areas of PMI market concentration. With regard to the possible concentration among PCWs, our intended analysis is unchanged.

ToH 4: Harm arising from providers' strategies to soften competition

Strategic product differentiation of PMI

15. We considered this issue further in light of the responses to the statement of issues and it appears to us that, while there is some differentiation between PMI providers in the products they offer, due to the choice of different excesses and add-ons, there is also a considerable degree of homogeneity in basic policies. Moreover, although there are consumer search costs in buying PMI, differentiation is likely to yield some customer benefits since it makes it more likely that one of the PMI policies on offer will exactly fit a consumer's needs (as discussed in the statement of issues).
16. Overall, it does not appear to us to be sufficiently likely that there is an adverse effect on competition arising from the interaction of product differentiation and search costs. Therefore, we do not intend to investigate this issue further.

Drip-in pricing (partitioned pricing)

17. We also considered this issue further in light of the responses to the statement of issues. We noted that drip-in pricing is not an issue specific to the supply of PMI and related goods and services but is a form of selling which occurs across many markets, where consumers may start by shopping for a central product and find that price increments are dripped in through the sales process as additional products and services are added to it, without necessarily considering whether those products are available cheaper elsewhere.
18. With regard to those add-ons commonly sold with PMI, it appears to us that their transparency and complexity (see below) are more likely to give rise to adverse effects on competition than the fact that they are often sold through drip-in pricing.
19. For these reasons, we do not intend to investigate drip-in pricing any further.

Transparency and complexity of add-on products and services

20. We continue to believe that some of the additional products and services which can be bought alongside PMI are complex and the information which might be available to consumers at the point of sale might not enable them to understand these products fully or estimate their value. However, it appears to us that this is unlikely to be the case with respect to all add-on products/services, some of which consumers appear to understand very well (eg breakdown cover).
21. Therefore, we intend to consider whether harm arises in relation to the sale of some add-on products, but we will focus only on those products which appear complex and difficult for consumers to understand and evaluate.
22. Following our discussions with the FSA, we do not intend to conduct our own analysis of Motor Legal Expenses Insurance on the basis that the FSA is in the process of concluding its own investigation into the sale of this product, but we will consider the work undertaken by the FSA.
23. We are also aware that the FSA has recently launched an investigation into the sale of add-ons across all general insurance but we understand that the scope of this

investigation is likely to be much wider than the specific issues in relation to PMI add-ons, on which we intend to focus. However, we will continue to liaise with the FSA.

Increasing the obstacles to customers switching PMI provider

24. Our intention remains to consider whether there are factors which might make it hard for consumers to switch their PMI provider, enabling providers to increase their prices (or reduce the quality of their policies) offered to customers on renewal. In particular the prevalence and effect of no-claims bonus protection may affect consumer switching. We are aware that the FSA has considered the effect of cancellation fees on consumer switching and will review this work before deciding whether to investigate the effect of cancellation fees further.

Summary of changes to ToH 4

25. We do not intend to consider further the following issues:
- the interrelation between search costs when shopping for PMI policies and product differentiation; and
 - the prevalence of drip-in pricing at the point of sale of PMI.
26. We intend to consider whether harm arises in relation to the sale of some add-on products, but will focus only on those products which appear complex and difficult for consumers to understand and evaluate. With regard to Motor Legal Expenses Insurance, we will consider the work undertaken by the FSA rather than carry out our own analysis.
27. We will consider whether there are factors which might make it hard for consumers to switch their PMI provider, but are likely to focus in particular on no-claims bonus protection.

ToH 5: Harm arising from vertical relationships (vertical integration)

Ownership of PCWs by insurers/brokers

28. Although the views we received on this issue were varied, it still appears to us that, of the strategies we set out in the statement of issues, which arise as a result of this vertical integration, only the undercutting of prices or direct manipulation of quotes may plausibly give rise to harm. Therefore, we will investigate this issue. However, as indicated in our statement of issues, in light of PCWs' incentives, we intend to investigate it at a high level initially in order to determine whether to look at it in more detail. We do not intend to consider the possibility of PCW-integrated insurers/brokers attempting to understand better their rivals' risk and pricing models or engaging in some kind of foreclosure.

PCWs requiring insurers and brokers to accept most-favoured-nation clauses

29. In our statement of issues we said that we did not intend to consider this issue further. We recognized that most-favoured-nation (MFN) clauses could have detrimental effects on competition and that they had been considered by competition authorities in many contexts.

30. However, in response to our statement of issues, many parties said that MFN clauses were likely to give rise to an adverse effect on competition, in particular competition between PCWs but also competition between PMI providers.
31. Contracts between PCWs and PMI providers may include different types of MFN clause:
- provider website MFN: the PMI provider cannot quote a lower price for the same PMI policy on its own website;
 - online MFN: the PMI provider cannot quote a lower price for the same PMI policy through any other online sales channel; or
 - all sales channels MFN: the PMI provider cannot quote a lower price for the same PMI policy on any other sales channel (both online and offline).
32. In light of the responses we received, we now intend to consider whether the restrictions which arise due to MFN clauses in the contracts between PCWs and the providers of PMI are harmful to competition.

Insurers—broker relationships (through equity or contract)

33. In our statement of issues we said that, in the absence of market power among either insurers or brokers, it did not appear to us that vertical relationships between insurers and brokers were likely to give rise to competition issues. We continue to hold this view and therefore we will not consider this issue further.

Repairer—insurer relationships (through equity or contract)

34. In our statement of issues we said that it appeared doubtful that the number of areas where there was both a high market concentration in car repair and the presence of an insurer-affiliated repairer was very large. However, since we did not have much information on this topic we did not wish to exclude the issue at that time.
35. Having considered this issue further in light of the responses to our statement of issues and responses to an initial request for information, we now feel sufficiently confident that it is unlikely that there are many areas where both repair is concentrated and some repairers have vertical relationships with insurers. Therefore, we do not intend to consider this issue further.

Insurer—parts/paint manufacturer/distributor relationships (through contract)

36. In our statement of issues we said that we had limited and incomplete information about the contracts between insurers and parts (including glass) and paint manufacturers or distributors and we were not able to judge whether harm from such relationships was likely. This continues to be the case. Moreover, having considered the issue further in light of the responses to the statement of issues, the same is true of vertical relationships between providers of PMI and cost estimation software providers.
37. Therefore, we intend to investigate this issue, and will include within its scope relationships between PMI providers and cost estimation software providers. As indicated in our statement of issues, we will investigate this issue at a high level initially before deciding whether to consider it in more detail.

Summary of changes to ToH 5

38. We will consider whether the restrictions which arise due to MFN clauses in the contracts between PCWs and the providers of PMI are harmful to competition.
39. We do not intend to consider further, as a separate vertical theory of harm, the relationships between insurers and repairers (ie concerns about insurers owning or having contracts with repairers). Clearly these relationships are relevant to other theories of harm, in particular both ToH 1 and ToH 2, and will be considered in these contexts.
40. We will consider whether harm may arise from vertical relationships between insurers and providers of cost estimation software.
41. The other areas of our analysis under this theory of harm are unchanged.