

Speaking notes for talk at Post Claims Club Event

9 October, 2013

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Introduction

1. [Welcome]
2. The Competition Commission investigation of the private motor insurance market began with a reference from the Office of Fair Trading on 28 September 2012 following its own initial review of the market.
3. I chair the Group of Members which is reviewing the evidence of this investigation and I'm joined by Robin Aaronson, who is a competition economist; Roger Finbow, a competition lawyer; Stephen Oram, former Director of the Newspaper Publishers Association; and Anthony Stern, whose career has been in corporate finance.
4. In December last year we published our issues statement that identified our five theories of harm that would form the framework for our investigation to date:
 - a. Harm arising from the separation of cost liability and cost control (moral hazard).
 - b. Harm arising from the beneficiary of post-accident services being different from and possibly less well informed than the procurer of those services.
 - c. Harm due to horizontal effects
 - d. Harm arising from providers' strategies to soften competition.
 - e. Harm arising from vertical relationships

5. We are now a year into our investigation and we have received evidence from more than 100 parties; we've conducted ten formal hearings with representatives from the ten largest insurance providers, brokers, repairers and the four market-leading price comparison websites.
6. In the summer we published our working papers that have shared with the industry and interested parties our analysis to date. Responses are available on the CC's website and are currently being examined by our staff. The Group is yet to come to its provisional decisions, and obviously I am not able to give you any kind of sneak preview or even hints about decisions that have not been made. I'm going to talk about some of the analysis set out in our annotated issues statement and working papers, focussing on three areas of our investigation:
 - a. Subrogation
 - b. Credit hire of replacement vehicles
 - c. Price comparison websites and most-favoured nation clauses

Subrogation

7. As you all know, under tort law, a non-fault party is entitled to be put back into as good a position as he/she was in before the accident occurred, and the fault party (ie the fault insurer) is liable to cover the "reasonable cost of repair". In practice the non-fault driver will require assistance either from the fault insurer or from another provider, such as their own insurer or a claims management company.
8. When an insurer (other than the fault insurer) or a claims management company provide post-accident services to the non-fault party, the non-fault party's rights are "subrogated" and the provider of the post-accident services has the right to recover "reasonable costs" from the fault insurer . This is the situation identified under our Theory of Harm 1, where the person controlling the cost is separate from the person liable for it.

9. Leaving aside write-off cases, as a general rule, such reasonable costs are the costs to repair the vehicle and to put back the non-fault party into his pre-accident position. Within this context, current authorities suggest that
- a. such costs are not necessarily the costs actually incurred;
 - b. the reasonableness of the invoice is to be assessed from the position of the individual claimant (ie without taking account of efficiencies that insurers or claims management companies are able to achieve compared to an individual) .
10. Our analysis suggests that the separation of cost liability and cost control may enable non-fault insurers and claims management companies to increase the average cost of post-accident services to fault insurers compared with a scenario in which fault insurers manage these services.
11. We are currently trying to understand the factors which may give rise to these higher overall costs. We note that at least some of these factors could represent inefficiencies.
12. In our working papers we discuss how insurers and claims management companies manage non-fault repairs. We have received evidence of practices leading to an inflation of charges passed on to fault insurers above the net costs incurred. Such practices include receiving referral fees or rebates that are not passed on to the fault insurer, charging an administration fee or making an upward adjustment to the invoiced costs.
13. We are currently investigating the effects on consumers of such uplift in costs to fault insurers. We are aware of course that there is a flow of income to non-fault insurers. We are also aware that some insurers have a greater proportion of fault claimants or non-fault claimants than other insurers, so transfers of value from fault insurers to non-fault

insurers might be beneficial for some insurers and disadvantageous for others, but it is the ultimate impact on consumers which is the focus of our attention.

14. Like you, we are following with interest the developments in *Coles v Hetherton*, for which hearings are scheduled on the 16th of October.

15. The quality and level of post-accident services is another important consideration for our investigation. We are investigating whether the level of service provided to customers is affected by the separation of cost liability and cost control, or the asymmetry of information between service providers and consumers (over or under provision).

Credit hire of replacement vehicles

16. Our analysis has shown that the cost of temporary replacement vehicles for a non-fault driver may be significantly higher when provided under a credit hire agreement than when provided under a direct hire agreement. On average, insurers pay around twice as much for a credit hire vehicle than for a direct hire vehicle. The cause of this higher cost appears to be as a result of two factors:

- a. A higher daily rate
- b. A longer hire duration

17. We have looked at both factors to find further evidence as to why this might be the case. It seems to be the case that it is the daily rate which is the main contributor to the higher cost of credit hire.

18. Higher credit hire rates (set by the GTA) reflect in part the additional costs incurred by credit hire providers in the provision of credit hire services and the additional services provided under a credit hire agreement.

19. The two principal additional costs which arise in the provision of credit hire services are:

- a. frictional costs, which represent the additional administrative and legal costs incurred by both the credit hire provider and the fault insurer; and
- b. referral fees, which constitute a cost of acquiring business for a credit hire provider but, as non-fault insurers and brokers 'control' the non-fault claimant, also appears to represent a method of extracting the profits generated by credit hire providers in the provision of credit hire.

Quality of service

20. An important consideration in our analysis is the quality of service provided to consumers. In relation to the additional services provided under credit hire, the credit hire providers tell us that they provide drivers with prompt access to a replacement vehicle and are more likely than insurers to provide a vehicle that is suitable for the driver's needs.

Price comparison websites and most-favoured nation clauses

21. We have included all price comparison websites in our investigation. We have focused on the four market leaders

- a. Go Compare
- b. Money Supermarket
- c. Confused
- d. Compare the Market

22. Many of you will be familiar with most-favoured nation clauses which guarantee a price across sales channels. For the provision of car insurance we identified two types of such clauses in use by price comparison websites:

- a. Narrow: requiring a common price between a car insurer's site and the comparison site.
- b. Wide: requiring a common price between all comparison sites; or a common price across all sales channels, not just on-line channels.

23. We sought evidence on the nature and impact of such clauses. We found that the vast majority of car insurance policies sold through comparison sites are covered by an MFN clause.

24. In order to assess whether these clauses cause an adverse effect on competition and give rise to consumer detriment, we are considering the trade-off between the beneficial and harmful effects that they may have on competition.

25. There seem to be four potentially anti-competitive effects of the wide MFN clauses to consider; and two potential pro-competitive effects of MFN clauses in general.

The potential for anti-competitive effects:

Is there upward price pressure on acquisition fees as a result of MFN clauses.

26. We are concerned that that MFN clauses may remove the incentive to lower acquisition fees and reduce the bargaining power of insurers or brokers facing increased acquisition fees.

Is there upward price pressure on insurance premiums as a result of MFN clauses?

27. We would expect PCW commissions to be passed through into insurance premiums, and therefore if MFN clauses may increase commission rates they may increase premiums.

Do MFN clauses inhibit new-entrants?

28. We have seen evidence that price is the key-factor in determining the purchasing of insurance for most people: Datamonitor note that almost three quarters cite price as the key factor and evidence from comparison sites showed that 60 per cent of customers opted for the cheapest premium available. This would suggest that a new entrant seeking to build a market presence might try to do so by reducing commission rates and seeking lower prices on its platform.

29. We heard evidence that MFN clauses in fact offer credibility to new entrants because they offer a guarantee of lowest pricing. Nevertheless, we saw evidence that entry on the basis of price competition has been dissuaded by the presence of MFN clauses.

Do MFN clauses lead to an excess level of advertising expenditure?

30. Without MFN clauses we would expect to see price competition and lower acquisition fees. Clearly businesses need to advertise but we are considering whether the presence of MFN clauses leads to excessive levels of advertising as PCW's seek to compete on brand rather than price.

31. The level of advertising expenditure by comparison sites, and the link with MFN clauses, is currently subject to further analysis and will be addressed in our provisional findings.

The pro-competitive effects of MFN clauses

Do comparison sites improve the ability of consumers to make searches between policies and providers?

32. In considering this question we looked at the clear evidence that comparison sites have increased the quality of searches for consumers and we know that a large number of consumers choose to purchase car insurance via comparison websites.

33. The Italian competition authority has found that comparison websites have not been successful in gaining consumer traction, because amongst other reasons, prices on the comparison sites are not usually the cheapest prices available, and often not the same as the prices observed on the insurers' own websites.

Do MFN clauses protect the investment made by comparison sites in establishing themselves?

34. Comparison sites worry that in the absence of MFN clauses, retail consumers might use their sites for search but then find the policy through another cheaper channel. However, one interesting observation is that consumers do not seem today to fully trust comparison sites to deliver the lowest price, with 63 per cent of customers using more than one comparison site.

35. To some degree, MFN clauses seem to safeguard the investment of comparison sites; however, it would appear that there may be other viable alternatives such as anti-“quote poaching” clauses or even ‘doing nothing’ in the knowledge that a sufficient number of customers will not switch or that a large number of those that do will switch back. We are examining those alternative mechanisms in more detail.

36. The balance that the group will be considering is whether the positive aspects of MFN clauses outweigh the negative effects.

Next steps

37. The Group is currently reviewing material in order to form its provisional decision on whether there are any areas that are likely to lead to an adverse effect on competition and we expect to publish these provisional findings at the end of November.

38. This will be a public document and we will be seeking views and comments from all interested parties in the run up to the Christmas break.
39. In any areas where the Group may provisionally find an adverse effect on competition we will also identify what actions should be taken to remedy these effects and if this is the case we will be looking to conduct hearings on this matter in the new year.
40. The statutory deadline is 27 September next year and we no doubt have some further work to complete. The industry has been incredibly co-operative during our investigation and I thank all of those involved and who are here today for your assistance with our work.

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