

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Theory of harm 4: Analysis of add-ons

Introduction

1. Insurers offer their customers a range of additional products known as add-ons. Add-ons provide cover for various risks over and above the core risks covered by a basic private motor insurance (PMI) policy, eg motor legal expenses insurance (MLEI), windscreen cover, breakdown cover, medical expenses/personal injury cover, personal belongings cover, courtesy car cover, key loss cover, foreign use cover and no-claims bonus (NCB) protection. Add-ons are often sold separately from the basic PMI policy for an additional premium; however, some basic PMI policies include some of these protections, with no additional premium being paid.
2. Harm may arise where add-on products are complex and where it is difficult for consumers to know what is included or excluded in the cover, in particular if the information available to consumers at the point of sale does not enable consumers to understand the product, estimate its value or make comparisons between different potential providers.
3. The purpose of this paper is to consider the transparency and complexity of add-on products. The evidence we discuss includes the results of our survey¹ and a high-level assessment of the profitability of different add-on products.
4. In our analysis we have focused on those add-ons which appear complex and difficult for consumers to understand and evaluate. We reviewed the report of a qualitative survey in relation to MLEI commissioned by the Financial Services Authority

¹ The CC commissioned the market research agency IFF to conduct a survey of PMI policyholders (see the working paper 'Survey report').

(FSA)² and we conducted some online research of our own. On the basis of these reviews, we chose four add-ons on which to focus our analysis: personal accident cover/medical cover, NCB protection, foreign travel cover and key cover (we refer to these together as our 'assessment group'). We did not focus on MLEI because the Financial Conduct Authority (FCA)³ had undertaken its own investigation into the supply of this product.

Summary

5. Most PMI policyholders are covered by one or more add-on. Of the nine add-ons considered in our survey (which did not include MLEI), windscreen cover was the most popular, which appears to be at least in part because many basic PMI policies include it. Our survey found that the majority of PMI policyholders preferred to have the choice of selecting add-ons separately, rather than having covers included in their basic PMI policy.
6. Add-on premiums account for a small proportion of total premiums. For the insurers in our sample, the basic PMI policy premium accounted for 92 per cent of total premiums in 2012, while add-on premiums accounted for the remaining 8 per cent.
7. Our survey of PMI policyholders found that most policyholders who said they had compared add-ons offered by different insurers believed that add-ons were easy to compare across insurers, although it also showed that the majority of consumers who purchased personal belongings cover, foreign use cover and key loss cover did not make any comparisons.

² See www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research. This study assessed customers' views on their understanding of MLEI, personal accident cover/medical cover, windscreen cover, break-down cover, courtesy car cover and NCB protection. We sought to complement the FCA's study with our own research to avoid excluding other less well-understood add-ons.

³ The FSA was abolished and the FCA was formed in April 2013.

8. Table 1 shows a summary of the results of our survey and our analysis of the profitability of certain add-ons. Although we focused our assessment on four add-ons (see paragraph 4), we gathered evidence on other add-ons for comparative purposes.

TABLE 1 **Selected results from our analysis of add-ons**

				<i>per cent</i>
	<i>Take-up¹</i>	<i>Percentage who compared insurers²</i>	<i>Good value for money³</i>	<i>Unweighted average claims ratio 2012⁴</i>
Basic cover				82
MLEI	76	52	53	7
Windscreen	85	52	69	84
Breakdown	39	52	64	38
Personal accident/injury/medical expenses*	56	47	51	5
Courtesy car/temporary replacement vehicle	70	53	54	51
Key loss*	24	32	35	25
Foreign use*	30	26	38	29
NCB protection*	80 ⁴	62	69	Not available ⁵

Sources:

1,2, 3: CC analysis of data from our survey of PMI policyholders. We note that some respondents might have purchased certain add-ons as part of their basic cover and not on a separate basis for an additional premium (see paragraph 1).

4: CC calculations based on responses from insurers in our sample.

* Product in the assessment group.

9. We found that the majority of policyholders perceived most add-ons to be good value for money. However, with the exception of windscreen cover, the unweighted average claims ratios⁶ were below that for basic cover, some considerably below.^{7,8} This would appear to suggest that, on average, customers are not able to assess the value of these add-ons. Respondents to our survey perceived key loss cover and foreign use cover to be less good value than other add-ons and these products had the lowest take-up rates.

⁴ 80 per cent of survey respondents said that they had NCB protection; however, evidence from insurers shows that the actual take-up of NCB protection is much lower. This suggests some misunderstanding of the difference between NCB and NCB protection. Moreover, our survey found that only around 30 per cent of those who claimed to have NCB protection correctly answered the question designed to test consumers' understanding of this product.

⁵ It has not been possible to assess the profitability of NCB protection because there is no clear cost of a 'claim' against this add-on.

⁶ In our analysis of the claims ratios of add-ons, we have only taken into consideration data provided by insurers relating to add-ons sold separately from the basic PMI policy, ie for an additional premium (see paragraph 1).

⁷ The claims ratio reflects the proportion of premiums paid out in claims. Therefore, all other things equal, a low claims ratio indicates higher profitability than a high claims ratio (see paragraph 46).

⁸ None of the insurers who provided data to us could provide claims ratios for all the add-ons (see paragraphs 50 and 51).

10. One explanation for policyholders' perceiving most add-ons to be good value for money while claims ratios are so low is that policyholders do not understand fully the cover which is provided by an add-on and overestimate its value to them. Our survey asked questions to test consumers' understanding of some add-ons. We found that in relation to some add-ons the proportion of correct answers was low, and in relation to other add-ons there was a relatively high or medium proportion of correct answers in relation to some aspects of the cover but a low proportion in relation to other aspects. A significant proportion of customers who claimed that they understood an add-on did not, or did not fully understand it.
11. However, we recognize that there are other possible explanations. In particular:
- (a) Because the cost of an add-on is low (relative to the cost of a basic PMI policy), some consumers might be willing to pay the price of the add-on to have 'peace of mind', in particular where the potential loss being covered could be very large.
 - (b) Because the cost of an add-on is low (relative to the cost of a basic PMI policy), some consumers might not consider it worthwhile searching in order to achieve, at most, a small saving and so they might be willing to pay a slightly higher price for the add-on.
 - (c) Because the cost of an add-on is much lower than the cost of a basic PMI policy, the expense ratio of an add-on (eg the costs of selling the policy and administering claims, expressed as a proportion of the premium) is likely to be higher than for a basic PMI policy, meaning that the profitability of an add-on overall (taking into account both the cost of claims and the cost of expenses) might not be dissimilar to the profitability of a basic PMI policy.
12. In this paper, we first consider the FCA's report on MLEI before setting out our analysis of:
- (a) our survey results in relation to add-ons; and

(b) the profitability of some add-ons.

The FCA's review of MLEI

13. The FCA published its report into MLEI in June 2013.⁹ The main conclusions of this report were:
 - (a) MLEI is a product which can be useful in enabling policyholders to pursue legal rights to recover uninsured losses;
 - (b) consumers have little understanding of what the product does and the benefits it provides;
 - (c) the opt-out¹⁰ selling of MLEI is not consistent with good consumer protection (despite MLEI being the add-on most commonly sold with PMI on an opt-out basis).
14. The report recommended that firms should:
 - (a) provide consumers with better explanations of MLEI; and
 - (b) review the basis on which MLEI is provided, especially where this is on an opt-out basis.
15. The report said that the FCA would look again at the supply of MLEI after one year and firms which had not amended their business practices in line with best practice by that time were likely to face regulatory action.

Analysis of our survey results in relation to add-ons

16. Our survey of PMI policyholders sought first to ascertain the take-up of different add-ons and then to assess policyholders' understanding of each of the four add-ons in our assessment group. The approach for this assessment was first to ask consumers

⁹ www.fca.org.uk/static/documents/thematic-reviews/tr13-01.pdf.

¹⁰ Opt-out selling means the product is pre-selected rather than actively selected by the customer.

about their perceived level of understanding and then to ask one or more factual questions about the add-on to test their understanding.¹¹

17. The response rate to our survey was 5 per cent, giving rise to some concern about the potential for response bias in the results.¹² We have no particular evidence of response bias, but we note that there was a slightly higher response rate among older policyholders.

Take up of add-ons

18. Table 2 shows respondents' stated take-up of add-ons.¹³ Take-up is particularly high for windscreen cover at 85 per cent, though we note that this add-on is included in the basic PMI policy for seven of the ten largest PMI insurers (see Table 12). The majority of respondents said that they had NCB protection, legal cover, courtesy car cover and personal accident/personal injury/medical cover included in their policies. The high stated take-up of NCB protection suggests that some respondents may not be clear on the distinction between NCB and NCB protection, so we treat this result with some caution.

TABLE 2 **Products included in policy**

	<i>per cent</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
Windscreen cover	85	10	5
NCB protection	80	17	4
Legal expenses/legal protection	76	18	6
Courtesy car/TRV	70	24	6
Personal accident/personal injury/medical expenses	56	30	14
Personal belongings cover	44	40	16
Breakdown cover	39	58	3
Foreign use cover	30	56	14
Key loss cover	24	54	22

Base (unweighted) = 1,501

Source: CC PMI Customer Survey, question B2.

¹¹ The figures in this section have all been weighted to correct for oversampling in Wales, Scotland and Northern Ireland.

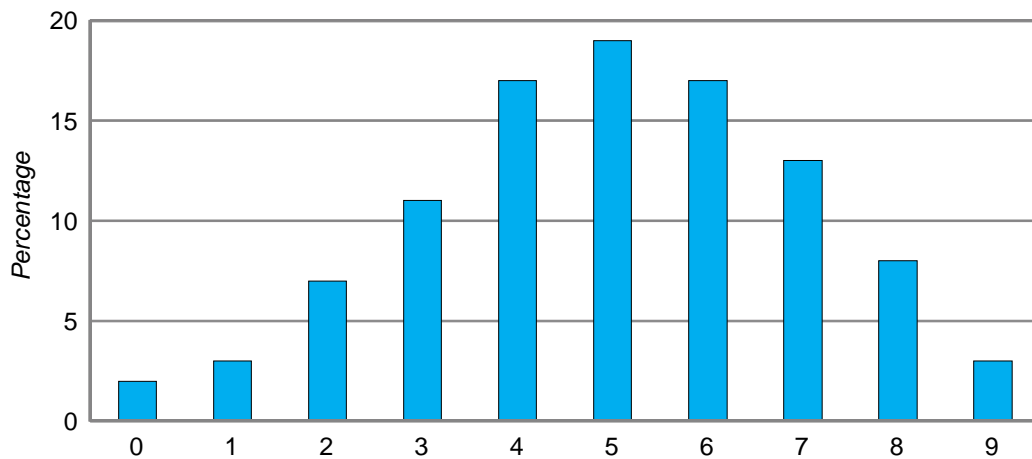
¹² As only 5 per cent of the policyholders contacted were both available and willing to respond to the telephone interview, they are therefore unusual in this respect, which causes us to question the extent to which their survey answers can be considered to be representative of all PMI policyholders.

¹³ Take-up means the number of policyholders covered by a specific add-on, regardless of whether the add-on was bought separately (with an additional premium) or included within the basic PMI policy.

19. The final column of Table 2 shows that some policyholders were unsure about the content of their policy. The percentages of respondents who did not know whether they were protected by particular add-ons were 22 per cent for key loss cover, 16 per cent for personal belongings cover, 14 per cent for foreign use cover and 14 per cent for personal injury/personal expenses/medical expenses cover.
20. Differences in the take-up rates between add-ons suggest (a) differences in the number and type of add-ons offered to consumers; (b) differences in how they are typically offered to consumers; and/or (c) the exercise of choice among consumers about which add-ons to purchase. We note that some insurers include certain add-ons (often windscreen cover and glass cover) in their basic PMI policy, such that a policyholder could not opt-out from this protection (unless switching PMI provider). We also note that some add-ons are not offered by all PMI providers, such that if their policyholders wish to buy a specific protection they must do so from a different provider (or switch PMI provider).
21. Figure 1 shows the number of add-ons taken up by respondents. Only a very small proportion of respondents took up either all or none of the nine add-ons in our list, with the modal number being five.

FIGURE 1

Number of add-ons included in policy



Source: CC PMI Customer Survey, question B2.

22. Our survey asked respondents whether they preferred to have add-ons offered to them separately, so that they could be added, or whether they preferred to have them already included in the basic PMI policy. Most respondents, 53 per cent, said that they had either a slight or strong preference for add-ons to be offered separately, while 32 per cent said that they preferred them to be included in the basic policy.
23. Table 3 shows that most people who considered an add-on at the time of purchase of their PMI policy went on to buy it (either within their basic PMI policy or separately). This is particularly true of windscreen cover, the most frequently taken-up add-on. In contrast, 23 per cent of those who considered breakdown cover did not take it up, which might be due to there being many stand-alone options for breakdown cover (eg from the AA or RAC).¹⁴

¹⁴ We note that only 3 per cent of respondents said that they did not know whether breakdown cover was included in their motor insurance policy, suggesting a high level of customer awareness about this add-on (see Table 2).

TABLE 3 **Products considered by the policyholder**

			<i>per cent</i>
	<i>Considered</i>	<i>Included</i>	<i>% who considered but did not include</i>
Windscreen cover	89	85	4
No claims bonus protection	86	80	8
Legal expenses/legal protection	83	76	9
Courtesy car/temporary replacement vehicle	77	70	10
Personal accident/personal injury/medical expenses	64	56	12
Personal belongings cover	49	44	10
Breakdown cover	51	39	23
Foreign use cover	33	30	11
Key loss cover	29	24	18

Base (unweighted) = 1,501

Source: CC PMI Customer Survey questions B2, B3.

*Percentage of those who included this add-on in their policy.

24. Most respondents who had an add-on in their policy (either purchased separately or included in the basic cover) said that they compared that add-on across insurers the last time they compared PMI policies (see Table 4). Summing across the nine add-ons in our list, 52 per cent of add-ons included in policies were compared in this way. However, we note that different consumers might have meant different things in terms of the comparisons they made.
25. Most respondents who compared features of add-ons across insurers said that they found it easy to do so, in particular for windscreen cover and NCB protection (see Table 4). It appears that consumer purchasing behaviour is similar for personal belongings cover, personal accident/personal injury/medical expenses, foreign use cover and key loss cover, with relatively little comparison of these add-ons across insurers.

TABLE 4 **Percentage of policyholders covered by the product who compared the product across insurers**

	<i>Included</i>	<i>of which:</i>	<i>of which:</i>		<i>Unweighted</i>
		<i>Compared</i>	<i>Comparison of</i>		<i>base</i>
	<i>%</i>	<i>Insurers</i>	<i>Easy</i>	<i>Difficult</i>	
	<i>%</i>	<i>%</i>	<i>%</i>	<i>%</i>	
Windscreen cover	85	52	73	9	653
No claims bonus protection	80	62	65	12	735
Legal expenses/legal protection	76	52	55	17	569
Courtesy car/temporary replacement vehicle	69	53	59	14	539
Personal accident/personal injury/medical expenses	56	47	53	17	399
Personal belongings cover	44	32	52	18	210
Breakdown cover	39	52	59	13	355
Foreign use cover	30	26	59	18	114
Key loss cover	24	32	52	15	127

Source: CC PMI Customer Survey questions B2, B7, B8.

*'Easy' combines responses to B9 of 'quite easy' and 'very easy'; 'difficult' combines 'quite difficult' and 'very difficult'.

26. Table 5 shows respondents' perceptions of the value for money of add-ons which they have taken up.

TABLE 5 **Perceived value for money among those that have the feature**

		<i>per cent</i>		
		<i>Value for money*</i>		
	<i>Included</i>	<i>Good</i>	<i>Poor</i>	<i>Don't know</i>
Windscreen cover	85	65	8	7
No claims bonus protection	80	69	6	7
Legal expenses/legal protection	76	53	6	14
Courtesy car/temporary replacement vehicle	69	54	7	14
Personal accident/personal injury/medical expenses	56	51	7	12
Personal belongings cover	44	37	18	10
Breakdown cover	39	64	7	9
Foreign use cover	30	38	16	23
Key loss cover	24	35	8	10

Source: CC PMI Customer Survey questions B2, B9.

*Question B9 of the survey asks 'On a five point scale where 5 is very good value and 1 is very poor value, how would you rate the value for money of the feature available to you'. Responses of 4 or 5 are categorized as 'good' for the purpose of this table, and responses of 1 or 2 are categorized as 'poor'.

27. Most respondents thought that the add-ons they had taken up were good value for money.¹⁵ This was particularly true of NCB protection (69 per cent). For most add-ons, only a small percentage of respondents who had taken up an add-on regarded it as poor value for money (6 to 8 per cent for most add-ons). The proportions were

¹⁵ We note that, where an add-on was purchased as part of a basic PMI policy and without the payment of an additional premium, the 'cost' of the add-on might still have been assessed by comparison with the cost of the add-ons from another provider.

higher for foreign use cover and personal belongings cover, which are discussed below.

28. A relatively high proportion (23 per cent) of those respondents who said that they had foreign use cover said that they did not know whether it was good value. This suggests to us that many consumers of this add-on are unclear of the cover provided and whether or not it is needed in order to drive abroad.
29. 18 per cent of those respondents who said that they had personal belongings cover said that they thought it was poor value for money. We considered whether people who took up this add-on were likely to be particularly risk averse, but the evidence from the survey suggested this was not the case (13 per cent of those who said that it was very important to cover all eventualities in the risk-aversion question¹⁶ said that this add-on was poor value for money compared with 14 per cent among the rest of those who had the add-on).

Personal accident/personal injury/medical expenses

30. The name of this add-on varies between insurers. Over half of the respondents to our survey of PMI policyholders (56 per cent) said that they had this add-on. Stated take-up was particularly high among those who also had personal belongings cover (71 per cent). We noted that there was also evidence of a seasonal effect with the add-on being taken up more often when policies were renewed in the first three months of the calendar year (60 per cent), possibly reflecting greater awareness of the risk of injury at that time of year.

¹⁶ Question B12 asks 'How important is it to you that you have a very comprehensive private motor insurance policy that covers all possible eventualities?' The choice of responses is 'Very important', 'Fairly important', 'Neither important nor unimportant', 'Not very important', or 'Not at all important'.

31. Table 6 shows the extent to which respondents believed they understood the personal accident/personal injury/medical expenses add-on,¹⁷ analysed by their rating of its value for money. Half of respondents rated the add-on as good or very good value for money and these respondents tended to be those who claimed to understand it. This pattern applies to all nine add-ons, ie the more respondents believed they understood the add-ons, the better value for money they perceived the add-on to be.

TABLE 6 Perceived understanding compared to perceived value for money

Personal accident/personal injury/medical expenses

	<i>How well the respondent believed they understood the feature</i>					<i>All</i> %
	<i>Not at all</i>				<i>Very well</i>	
	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: CC PMI Customer Survey questions B9, B10.

32. Table 7 shows the results of a suite of three questions designed to test actual understanding of personal injury benefits. The questions were asked of all those who had considered (most of whom also took up) personal injury/personal accident/medical expenses cover. While most respondents said that they were covered by the add-on, only 17 per cent answered correctly that passengers, other than themselves and their spouse, were not covered by it. Only 5 per cent of respondents answered all three questions correctly.

¹⁷ Question B10 of the Customer Survey asked the following:

'And still thinking about the last time you were considering which features to include in your Private Motor Insurance Policy, how well do you believe you understood what exactly the feature covered? Please answer on a scale of 1 to 5 where 5 is very well understood and 1 is not at all understood.'

The results shown in this paper categorise respondents' perceived understanding into 'High' (a response of 4 or 5 to the question), 'Medium' (a response of 3) and 'Low' (a response of 1 or 2). The very small number of respondents who said they didn't know have been excluded from the analyses.

TABLE 7 Actual understanding of personal injury benefits

	<i>per cent</i>		
	<i>Do you think the following are covered?</i>		
	<i>You</i>	<i>Your spouse</i>	<i>Any passengers</i>
Yes	84*	58*	56
No	6	22	17*
Don't know	9	20	27
<i>% 'yes' by claimed understanding</i>			
High	89*†	61*	59
Medium	83*	56*	53
Low	79*†	56*	50

Source: CC PMI Customer Survey questions B10, B10a.

*Indicates the correct answer (although a few insurers might provide cover with a slightly different scope, we believe the market shares of such providers is insufficient to materially affect our results).

†Statistically significant difference.

33. The second part of Table 7 shows the percentage of respondents who said 'yes' to each of the questions asked broken down by their perceived level of understanding of the add-on. The table shows that the percentage of respondents who said 'yes' increases with their perceived level of understanding, though in the last case 'yes' is the incorrect answer (59 per cent of those who thought that they understood the add-on well answered incorrectly).
34. Table 6 shows that the perception of understanding of an add-on tends to make a customer value it more. Table 7 suggests that this is because such customers think that the add-on offers wider cover than other customers, though sometimes they do so incorrectly. Subsequent tables in this paper support this finding (see Tables 8 to 11).
35. Table 8 shows the results of a similar set of questions for medical expenses. In this case the correct answer to all three questions was 'yes', and 40 per cent of those with the add-on answered all three questions correctly. Again, the perceived coverage of the add-on tended to increase with the perceived understanding (though in this case it was correct that coverage was wider).

TABLE 8 Actual understanding of medical expenses

	<i>per cent</i>		
	<i>Do you think the following are covered?</i>		
	<i>You</i>	<i>Your spouse</i>	<i>Any passengers</i>
Yes	84*	58*	50*
No	7	23	20
Don't know	10	19	30
<i>% 'yes' by claimed understanding</i>			
High	87*	62*	55*†
Medium	83*	54*	45*†
Low	80*	60*	45*

Source: CC PMI Customer Survey questions B10, B10b.

*Indicates the correct answer.

†Statistically significant difference.

NCB protection

36. Our survey found a high stated take-up of NCB protection (80 per cent). However, as noted in paragraph 18, it appears to us that this is likely to be an overstatement due to some customers confusing NCB and NCB protection. Data from five of the ten largest PMI insurers suggests that actual take-up rates of NCB protection are between [20] and [30] per cent, with an unweighted average of 49 per cent. This suggests that a significant proportion of consumers who think that they have the protection do not have it.

37. Nevertheless, a high proportion of respondents (77 per cent) thought that they had a good understanding of this add-on. Table 9 shows that 59 per cent of those who claimed to understand it well wrongly thought that NCB protection would prevent their PMI premium going up as a result of a claim, and only 29 per cent of respondents who said that they had the add-on answered this question correctly.¹⁸ Respondents claiming a high level of understanding of NCB protection tended to be the most optimistic about the extent of its cover (see paragraph 34).

¹⁸ A PMI premium may rise following an accident, notwithstanding NCB protection, as a motorist involved in an accident (whether fault or non-fault) may be deemed by an insurer to be statistically more likely to have an accident in the future. NCB protection is also usually limited to a certain number of claims in a defined time period, such that if there are more accidents, the NCB will decrease.

TABLE 9 Actual understanding of NCB protection

	<i>per cent</i>		
	<i>Does the protection prevent your premium going up as a result of a claim?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
All with feature	56	29*	14
<i>By claimed understanding</i>			
High (base 991)	59†	29*	12†‡
Medium (base 182)	46†	31*	23†
Low (base 108)	50	27*	23‡

Source: CC PMI Customer Survey questions B10, B10c.

*Indicates the correct answer.

† and ‡ indicate statistically significant differences.

38. 37 per cent of those who said that they had made a 'claim' against their NCB protection answered the question correctly. 47 per cent of those who had made a 'claim' said that they understood the add-on very well; with 48 per cent of respondents who had not made a 'claim' saying the same. This is different from all other add-ons (except foreign use travel where the number of claims is very low), where the experience of claiming against the add-on tends to increase both the stated and actual understanding.

Foreign use cover

39. Only 30 per cent of respondents said that they had foreign use cover. Among these, 60 per cent said that they had a good understanding of this add-on, but only 30 per cent of these correctly answered the question testing their understanding of it (see Table 10).¹⁹ A higher proportion (42 per cent) of those who said they had a low understanding of the add-on gave the correct answer.

¹⁹ Foreign use cover is not necessary in order for the policyholder to drive their car in Europe (as a basic PMI policy provides at least third party cover abroad).

TABLE 10 Actual understanding of foreign use cover

	<i>per cent</i>		
	<i>Do you need the feature to be able to drive your vehicle at all in continental Europe?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
All with feature	55	30*	16
<i>By claimed understanding</i>			
High (base 272)	61†	30*	9
Medium (base 108)	56	27*	17
Low (base 71)	42†	42*	15

Source: CC PMI Customer Survey questions B10, B10d.

*Indicates the correct answer.

†Indicates statistically significant difference.

Key loss cover

40. Only 24 per cent of respondents said that they had key loss cover. Take-up was higher among the C2DE socioeconomic group (29 per cent) and much higher in Northern Ireland (38 per cent). It was also higher among those who had personal belongings cover (35 per cent), and those who had foreign travel cover (32 per cent).
41. Of respondents with key loss cover, 67 per cent said that they had a good understanding of it. However, only 9 per cent correctly answered both the survey questions which tested their understanding (see Table 11).²⁰ Those who thought that they understood the add-on tended to be more optimistic about its coverage, though not always correctly (see paragraph 34).

²⁰ Key loss cover insures for the replacement cost of locks and keys for the car if the policyholder loses the keys, but the insurance company will not send someone to sort out the problem. From the evidence we have seen, a very small proportion of key loss covers will include the insurer sending someone out.

TABLE 11 Actual understanding of key loss cover

	<i>per cent</i>		
	<i>Will this pay for replacement keys and locks to your car if you lose your keys?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
all with feature	75*	6	18
<i>By claimed understanding</i>			
High (base 267)	86*†‡	3†‡	11†‡
Medium (base 86)	63*†	10†	27†
Low (base 47)	57*‡	15‡	28‡
	<i>Will someone appointed by the insurance company come out to you and fix the problem if you lose your keys?</i>		
	<i>Yes</i>	<i>No</i>	<i>Don't know</i>
All with feature	50	14*	37
<i>By claimed understanding</i>			
High (base 267)	55	12*	32
Medium (base 87)	43	17*	40
Low (base 48)	46	17*	38

Source: CC PMI Customer Survey questions B10, B10e, B10f.

*Indicates the correct answer.

† and ‡ indicate statistically significant differences, eg in column 1, 86 per cent is statistically higher than 63 and 57 per cent but 63 per cent is not statistically higher than 57 per cent.

Summary of analysis of our survey results in relation to add-ons

42. Most PMI policyholders are covered by one or more add-ons. Of the nine add-ons considered in our survey (which did not include MLEI), windscreen cover was the most popular, which appears to be at least in part because many basic PMI policies include it. Our survey found that the majority of PMI policyholders preferred to have the choice of selecting add-ons separately, rather than having covers included in their basic PMI policy. A minority of respondents were unsure about which add-ons they had.
43. Most respondents to our survey who said that they had compared the add-ons offered by different insurers believed that add-ons were easy to compare across insurers but, for some add-ons, particularly personal belongings cover, foreign use cover and key loss cover, most of those who said they were covered by the add-on did not make any comparisons.

44. Respondents' understanding of the cover provided by add-ons was generally poor. Even among those who claimed they understood an add-on, many answered questions about it incorrectly. In particular, we note that 80 per cent of survey respondents said that they had NCB protection, though we know from evidence from insurers that actual take-up is much lower, suggesting some confusion between NCB and NCB protection. Of those who claim to have NCB protection, only three in ten correctly answered the question about it.

Analysis of the profitability of some add-ons

45. We looked at the claims ratio of some add-ons as a basic measure of their profitability. We could not review expense ratios as insurers do not allocate expenses between their add-on products.²¹
46. The claims ratio, which is presented as a percentage, measures the proportion of premiums paid out in claims. It is calculated as claims costs divided by net earned premiums (NEP). Claims costs are the total of claims paid, net of any recoveries from reinsurers, and any changes in provisions for claims, net of reinsurance; NEP is gross written premiums (GWP), net of Insurance Premium Tax (IPT) and premiums ceded to reinsurers and any changes in provisions for unearned premiums. All things being equal, a low claims ratio indicates higher profitability for an insurer than a high claims ratio.

Data requested from the parties

47. We asked insurers to complete a template spreadsheet containing a split of NEP and claims costs by type of risk covered. The template spreadsheet covered the five years 2008 to 2012. The types of risks covered were:
- (a) basic cover;

²¹ The expense ratio is expenses expressed as a percentage of premiums.

- (b) MLEI;
- (c) NCB protection;
- (d) windscreen;
- (e) breakdown;
- (f) personal injury;
- (g) courtesy car; and
- (h) other (including key loss and foreign use cover).

How insurers provide add-on products

48. We note that insurers provide add-on products in two different ways depending on which party bears the risk:

- (a) Some add-ons are designed, underwritten, supplied and managed by the insurer, eg NCB protection and foreign use cover. In these cases, the risk is borne by the insurer.
- (b) Some add-ons are designed, underwritten and managed by a third party provider but supplied by the insurer, either under its name or under the name of the supplier. In these cases, the risk is borne by the third party supplier and the insurer acts as a distributor. The retail price consists of the unit cost (controlled by the third party), the margin (controlled by the insurer) and IPT (payable on the retail cost). As this is risk-free income for the insurer, it is usually recognized as fee income. The third party supplier is responsible for all claims handling in relation to these products.

Some add-ons (eg breakdown cover, windscreen cover and MLEI) are offered by some insurers under the in-house model and offered by other insurers under the outsourced model. For example, esure offers breakdown cover which is supplied by Green Flag, whereas LV offers breakdown cover underwritten in-house (Britannia

Rescue). Where add-on products were supplied by an outsourced provider, most insurers were unable to provide us with claims data.²²

49. Three insurers told us that the pricing and profitability of add-ons could not be assessed by looking at add-ons individually:
- (a) One insurer ([REDACTED]) told us that, due to the complexity of rating and cross-cover rating dynamics in the price calculation, it was not simple to split out the add-on premium. For example, if the overall premium had been overridden by the sales representative to achieve the sale, this could impact the premium of any one of the covers included.
 - (b) [REDACTED] provided an analysis of claims costs by the take-up of certain add-ons (NCB protection, courtesy car cover and foreign use cover). It showed, for example, that customers buying guaranteed NCB protection were more likely to make more frequent and smaller claims than other customers. [REDACTED] told us that its pricing approach was to compare the overall profitability of a customer who selected the add-on, against eligible customers who did not select it.
 - (c) [REDACTED] told us that any additional margin from add-on products, such as breakdown cover, fed into the overall underwriting result and ultimately into customers' basic PMI premium prices.

Data received

50. Of the ten large insurers, only seven were able to provide data splitting NEP and claims costs for some add-on products. No insurer was able to provide data on all the add-on products in our list (see paragraph 47). Insurers provided data on the following add-ons:
- (a) Aviva: [REDACTED];
 - (b) AXA: [REDACTED];

²² With the exception of data on breakdown, courtesy car and key loss covers provided by CISGIL (see paragraph 72 onwards).

(c) CISGIL: [REDACTED];

(d) DLG: [REDACTED];

(e) esure: [REDACTED];

(f) LV: [REDACTED]; and

(g) RSA: [REDACTED].

51. Three insurers ([REDACTED]) did not provide a split of NEP and claims costs by add-on product, for the following reasons:

(a) [REDACTED] add-ons were all launched in the second half of 2012, so it had limited data.

(b) [REDACTED] has a limited range of add-on products, which are mainly provided by third parties.

(c) [REDACTED] add-on products are either included in its basic cover, or provided by third parties.

52. Table 12 summarizes which of the ten large insurers offers which add-ons and whether they are provided by a third party supplier, underwritten by the insurer or included by the insurer in the basic cover.

TABLE 12 Summary of add-on products offered by each insurer

<i>Insurer</i>	<i>MLEI</i>	<i>NCB protection</i>	<i>Windscreen</i>	<i>Breakdown</i>	<i>Personal injury</i>	<i>Courtesy car</i>	<i>Other</i>
Admiral	Included in basic	Yes	Included in basic	Yes via 3P	Yes	Included in basic	
Ageas Insurance	Yes via 3P	Yes	No	Yes via 3P	No	No	Key loss cover (only 2010-2011 via an MGA relationship)
Aviva	Yes	Yes	Included in basic	No	No	Yes	Foreign use, PhysioFast
AXA	Yes	Yes	Yes	Yes via 3P	Yes	Yes	Key loss
CISGIL	Yes	Yes for purchase by qualifying customers only	Included in basic	Yes via 3P	Some elements of personal accident cover are included in basic	Yes via 3P	Extended foreign use; key loss (via 3P)
DLG	Yes	Yes*	Included in basic	Yes	Included in basic	Yes†	
esure	Yes	Yes‡	Included in basic	Yes via 3P	Yes	Included in basic	Foreign use ; Key loss (from Oct 2012); Misfuelling
LV	Yes	Yes	Included in basic	Yes	Yes§	Yes	Foreign use
RSA	Yes	Yes	Yes¶	Yes	Yes	Yes#	Foreign use
Zurich	Yes via 3P	Yes	Included in basic	Yes via 3P	Yes	Included in basic	Key loss (via 3P)

Source: CC based on responses from the parties.

*DLG does not treat NCB protection as an add-on, but as a variation to its pricing of the basic PMI policy.

†DLG offers guaranteed hire car (GHC) and guaranteed car hire+ (GHC+) as add-ons which enable customers to purchase hire car provision. DLG does not consider this to be the provision of a courtesy car. There are a very small number of DLG legacy policies which do provide a courtesy car.

‡esure offers NCB protection as an extension to the basic policy (for an increase in the premium).

§LV noted that personal injury/accident cover is included in basic comprehensive cover.

¶,#RSA noted that windscreen and courtesy car cover are optional extras only for policies sold through eChoice. For MoreThan customers, windscreen and courtesy car cover are included in the basic PMI policy.

Notes:

Yes = sold as a separate add-on.

Yes via 3P = sold as a separate add-on provided by a third party.

Analysis of the data

53. Table 13 shows which insurers provided data on which add-ons in order for us to be able to calculate claims ratios.

TABLE 13 Data available for add-on products

Add-on product	Insurers providing suitable data	Number of parties with data compared to number offering add-on
Breakdown	[X]	3 out of 3
MLEI	[X]	6 out of 8
NCB protection	[X]	0 out of 10
Windscreen	[X]	2 out of 3
Personal injury	[X]	1 out of 6
Courtesy car	[X]	3 out of 5
Other: key loss	[X]	1 out of 4
Other: foreign use	[X]	2 out of 6

Source: CC based on responses from the parties.

NEP

54. Table 14 shows the aggregate NEP for basic cover and each add-on product for the five-year period for the seven insurers listed in paragraph 50.

TABLE 14 Analysis of NEP by type of risk

	2008	2009	2010	2011	2012	2012 share to total NEP %
Basic cover	5,302.7	5,285.6	5,558.9	5,699.5	5,176.7	91.9
Breakdown	172.3	188.0	186.0	175.4	161.1	2.9
NCB protection	129.0	117.7	122.6	154.2	152.0	2.7
MLEI	70.6	84.6	87.5	104.2	109.4	1.9
Windscreen	20.7	20.3	25.0	28.3	21.9	0.4
Personal injury	-	0.0	0.2	0.3	0.2	0.0
Courtesy car	15.4	13.7	11.4	13.5	12.5	0.2
Other	2.5	2.6	2.7	2.6	2.0	0.0
Total	5,713.0	5,712.5	5,994.3	6,178.1	5,635.8	100.0

Source: CC analysis.

55. Table 14 shows that basic cover accounted for 92 per cent of total NEP in 2012. Breakdown cover and NCB protection accounted for 2.9 and 2.7 per cent respectively, and no other add-on accounted for more than 2 per cent.

Claims ratios

56. Table 15 shows the claims ratios for basic cover and each add-on product for the five year period. The averages are weighted according to the size of the insurer (based on NEP).

TABLE 15 Claims ratios by type of risk covered, 2008 to 2012

	2008	2009	2010	2011	2012	per cent Average	Parties providing data
Basic cover	84	96	108	85	82	91	All 7
Breakdown	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	3: [REDACTED]
MLEI	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	6: [REDACTED]
Windscreen	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	2: [REDACTED]
Personal injury	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	1: [REDACTED]
Courtesy car	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	3: [REDACTED]
Key loss	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	1: [REDACTED]
Foreign use	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	2: [REDACTED]
Overall	80	90	102	80	77	86	

Source: CC calculations based on responses from the parties.

Basic cover

57. The weighted average claims ratio for basic cover was 91 per cent over the five-year period, with consistency across the years except for 2010. [REDACTED].

MLEI

58. The weighted average claims ratio for MLEI was extremely low at 5 to 10 per cent over the five-year period:

(a) [REDACTED] showed [REDACTED]. It told us that [REDACTED].

(b) [REDACTED] told us that the claims cost for MLEI was very low as it usually sought to recover the costs incurred from the fault insurer. [REDACTED] told us that this cover provided customers with valuable benefits, enabling them to recover uninsured losses or to pursue a personal injury claim following a non-fault accident.

(c) [REDACTED] had [REDACTED] claims ratio for MLEI, at an average of [REDACTED] per cent over the five-year period.

Windscreen

59. Two insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 70 to 100 per cent over the five-year period, typically being only a little lower than the basic cover claims ratio.

Breakdown

60. Three insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 30 to 45 per cent over the five-year period. None of the insurers provided an explanation as to why its claims ratios were so low. We note that:

- (a) [X] claims ratio for each year was [X] (between [X] and [X] per cent);
- (b) [X] ratio fluctuated (being [X] per cent in 2008 and [X] per cent in 2009, probably due to a build-up and subsequent release of reserves), but averaged [X] per cent.

Personal injury

61. Only [X] was able to provide data on this add-on.

Courtesy car

62. Three insurers provided data on this add-on. The weighted average claims ratio ranged from 25 to 75 per cent over the five-year period. [X] and [X] showed [X] claims ratios, of between [X] and [X] per cent, whereas RSA showed [X] ratios in 2009 and 2010 of [X] and [X] per cent respectively.

Other: key loss

63. Only [X] provided data on this add-on. Its average claims ratio for the five-year period was [X] per cent.

Other: foreign use

64. Two insurers were able to provide data on this add-on. The weighted average claims ratio ranged from 20 to 40 per cent over the five-year period. [X] average claims ratio for the five-year period was [X] per cent, and [X] was [X] per cent.²³

NCB protection

65. Although NCB protection insures a customer against a specific risk (ie losing NCB as a result of a claim) and a premium is charged for it, there is no claims cost clearly associated with it as it relates to the amount of premium payable by a customer on renewal. Consequently none of the insurers provided us with a claims ratio. However, eight insurers told us how they priced the product (including whether it has a standard price or whether the price is dependent on the risk of the policyholder), the costs associated with the product, and how those costs were accounted for. We set out this evidence below.

Pricing of NCB protection

66. It appeared to us that all eight insurers took a risk-based approach to setting the price at which they offered NCB protection to policyholders:
- (a) [X],[X] and [X] noted that their pricing took account of customer profitability, which reflected claims performance. [X] told us that, where protected NCB was available, the price was calculated as a percentage addition to the premium for basic cover and therefore reflected the overall risk of the individual policyholder. [X] told us that the price was 14 per cent of the basic premium. [X] told us that the price was up to 15 per cent of the basic premium.
- (b) [X] and [X] told us that the selection of NCB protection was treated as a variable in the overall premium calculation, ie the total premium was adjusted if

²³ [X] noted that its 'other' category of claims was mainly against foreign use cover but could include a small number of claims made against other covers.

the customer selected NCB protection rather than there being a separate figure calculated to represent the cost of NCB protection. [X] explained that this was because the benefit of NCB protection related to the cost of the basic cover whereas claiming under other add-ons did not affect the basic cover and its pricing. [X] told us that the price was dependent on the number of claim-free years and was 2.5 per cent if the number of NCB years protected was five or more, and 10 per cent if four years NCB was protected (and NCB protection was not offered for less than four years' NCB).

(c) [X] and [X] told us that NCB protection was priced in the same way as the basic PMI cover and was therefore based on the risk of the individual policyholder.

(d) [X] told us that NCB protection was priced as an additional percentage of the basic PMI cover premium and was therefore based on the risk of the individual policyholder. [X] said that the price was currently 10 or 15 per cent of the basic premium for [X].

The cost to insurers of NCB protection

67. Seven of the eight insurers told us that the cost to them of NCB protection was the income forgone from not reducing the discount applied to the premium at renewal (which would otherwise happen if the customer had made a claim).

68. [X] estimated that the opportunity cost of not increasing the renewal premium was between 0.5 and 1 per cent of the NEP for basic cover plus the NCB protection add-on. [X] noted that, for [X] renewals in Q1 2013, for a customer who had nine years' NCB but had made at least one fault claim during the previous year, there was an average premium increase of over 60 per cent for customers without NCB protection and a significantly lower increase of below 15 per cent for customers with NCB protection.

69. [REDACTED], AXA, DLG and LV told us that an additional cost to the insurer was that customers with NCB protection were more likely to make small claims than customers without NCB protection (since the latter might decide not to make a claim in order to avoid an increase in premium due to losing their NCB). However, [REDACTED] noted that, whilst in theory customers with NCB protection could be expected to make more small claims than customers without it, its experience was that overall the claims cost of customers with NCB protection was lower than for customers without it. Similarly, [REDACTED] noted that its loss ratio was better (ie lower) on policies with protected NCBs. [REDACTED] noted that customers with NCB protection who had made a claim were more likely to switch insurers at renewal than customers without NCB protection who had made a claim because they would be able to obtain more competitive renewal quotes.

Accounting treatment

70. It appears to us that the extent to which renewal premiums are lower as a result of NCB protection than would have been the case otherwise is reflected in insurers' overall premium income. Similarly, the extent to which claims are higher than would have been the case is reflected in the overall claims cost. Two insurers, LV and Zurich, noted that the costs associated with NCB protection could not be separated from the overall claims cost as it was not possible to know which claims the customers with NCB protection had made which they would not have made had they not purchased it.

Add-on products supplied by third parties

71. The insurers in our sample were generally unable to supply us with data on the profitability of add-on products supplied by third parties. However, we received some data on selected add-ons from two insurers: CISGIL and esure.

72. CISGIL's breakdown and courtesy car cover add-ons are provided by a third party (so not included in the calculations above). Table 16 shows the maximum retail price and margin to CISGIL for each of these products (ie the retail price less the IPT (currently 6 per cent), the direct cost to CISGIL, allocated costs (such as marketing, sales staff, system expenses, etc), and a contribution towards indirect costs).

TABLE 16 CISGIL breakdown and courtesy car cover add-on products

	<i>Breakdown</i>	<i>Courtesy car</i>
Maximum retail price (£)	60	17.50
Margin (£)	[REDACTED]	[REDACTED]
Margin (%)	[REDACTED]	[REDACTED]

Source: CISGIL; CC calculations.

73. Since October 2010 CISGIL has also offered key loss cover from a third party supplier (Keycare). CISGIL sets the retail price (currently £15) to cover the net rate payable to the claims administrators (currently £[REDACTED] for each new business policy and £[REDACTED] for each policy renewal (ie effectively the claims costs per policy)), direct and indirect CISGIL costs, IPT and its profit. The retail price net of IPT less the amounts payable to the claims administrators produces a margin of between £[REDACTED] and £[REDACTED] which cover CISGIL's costs of selling, allocated costs, indirect costs and profit.
74. esure's breakdown cover is provided by Green Flag. esure told us that [REDACTED].