



Aviva Response to the Competition Commission Investigation into Private Motor Insurance “Statement Of Issues”

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Executive Summary

- (1) Aviva provides peace of mind for more than 43 million people across the world, providing insurance, savings and investment products. More than 14 million customers rely on us in the UK. We insure 1 in 10 private cars and have more than 2.4 million personal motor customers. We are committed to serving our customers well in order to build a stronger, sustainable business, which makes a positive contribution to society, and for which our people are proud to work. In 2011 Aviva dealt with approximately 316,000 claims on behalf of our personal motor customers.
- (2) This submission sets out Aviva's response to the Statement of Issues published by the Competition Commission (**Commission**) on 14 December 2012 in relation to its Private Motor Insurance (**PMI**) Market Investigation (**Investigation**). Aviva sets out below its views on the five theories of harm identified by the Commission and, where possible provides evidence to support its views.
- (3) Whilst this Investigation relates to PMI, similar adverse effects on competition are apparent for commercial vehicles as well. Aviva appreciates that commercial motor insurance does not form part of the frame of reference for this Investigation. However, the Commission should be mindful that its analysis of PMI will have wider relevance.
- (4) Aviva has consistently expressed the view to the Office of Fair Trading (**OFT**), UK Government, Transport Select Committee and others that the present market for the supply of PMI has become dysfunctional as a result of the growth and expansion of claims farming and uninsured loss recovery claims for credit hire, credit repair and personal injury (**PI**). Along with many other insurers, Aviva has lobbied extensively for change and, therefore, welcomes the Commission's Investigation as a real opportunity to remedy the flaws with the current system.
- (5) In Aviva's view, the Commission's Investigation should concentrate its efforts on theory of harm 1 (**ToH1**), namely the harm caused by the separation of cost liability and cost control in the supply of services to non-fault parties. This issue was the focus of the OFT's investigation and lies at the core of the problems with the current system.
- (6) The primary concern must be that the present system does not provide any real incentives for a non-fault party or a third party acting on their behalf, such as a claims management company (**CMC**) to keep down or mitigate the costs faced by the fault insurer. The current position is that many procurers of services and accident management companies (**AMCs**) derive significant income from claims farming and have no incentive to control or mitigate the costs incurred by a non-fault party. As a consequence, the ultimate cost is likely to be passed on to consumers in higher premiums.



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- (7) In our view, the Commission has correctly recognised the "prisoner's dilemma" in which the industry has found itself, where costs have been pushed up even though this is not in the interests of insurers or consumers. In practice, any gains an insurer makes from a non-fault party through referral fees it might obtain or differential repair costs are simply ploughed back to keep insurance premiums competitive. Some of the ultimate beneficiaries are those outside the supply chain who do not provide products and services to PMI customers but simply take a windfall benefit.
- (8) Furthermore, consumers are put in a position where they take on a liability for debt under a loan agreement to a CMC which could be called upon if the CMC cannot fully recover its claim from the fault insurer. Whilst in practice this may be waived, it is a further example of the unnecessary consumer detriment that arises from the current separation of cost liability and cost control.
- (9) However, contrary to the Commission's proposed approach, Aviva considers that leaving PI as a matter to be considered by the Ministry of Justice (**MoJ**) to be a lost opportunity and may prevent the Commission from properly assessing the functioning of the PMI market. Insurers do not design and sell separate products for PI and non-PI claims and the costs of PI claims are a significant driver of premiums. Ignoring an important cost driver in any industry will inevitably confuse many aspects of any economic analysis of competition in the market. In our view, PI claims entail the same issue of separation of cost liability and cost control as credit hire and credit repair. The PMI sector requires fundamental change in the way that all potential heads of claim and damage that arise from motor accidents are administered and this Investigation represents the only real opportunity to achieve this. Aviva would be reluctant for this Investigation to interfere with the outcome of the MoJ's work, but considers this unlikely given that the Commission's work should be entirely complementary to the focus of the MoJ to date.
- (10) With regard to theory of harm 2 (**ToH2**), although Aviva considers that there is to some extent a mismatch in incentives between beneficiaries and procurers of services and that a lack of transparency for consumers as to their choices and the implications of those choices at the time of an accident may, on a few occasions, lead to poorer outcomes than would otherwise be the case, Aviva considers these effects are entirely secondary and of more limited impact than the harm caused by the separation between cost liability and cost control identified in ToH1.
- (11) As the OFT and the Commission have both appreciated, the PMI market is fundamentally one where there is extensive competition and all participants in the supply chain, from consumers upwards, exercise their choices. There are numerous insurers who provide a wide variety of products and there are many alternative routes to market for PMI providers that meet different consumers' preferences in accessing PMI products. Customers are aware of this choice and actively research the alternatives before purchasing their PMI policy. Indeed, up to one third of customers switch their insurance provider on renewal and the experience of Aviva Direct is that the typical lifetime of a customer is [REDACTED]. This represents a much more intense competitive dynamic than is the case for most other financial services products.



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- (12) There are significant issues in the sector, but those arise at the point of claim for the reasons set out in ToH1 and to a much lesser extent, ToH2.
- (13) The Statement of Issues contains a number of further theories of harm which were not considered or only considered by the OFT to a limited extent during its market study and were quickly discounted as not raising a significant competition concern.
- (14) Aviva also notes that in respect of some issues, there is potential for significant overlap with the activities of the Financial Services Authority (**FSA**) and its successor body, the Financial Conduct Authority (**FCA**). This is most notably the case for "add-on" insurance products, which are the subject of a study launched by the FSA on 19 December 2012, but are also a significant element of the Commission's theory of harm 4 (**ToH4**). Unlike, the MoJ's work referred to in paragraph [9] above, there is a real risk of direct overlap and duplication between the FSA's work and that of the Commission. As a matter of policy, it is not desirable for two bodies to be considering the same issues at the same time. We would welcome clarification and assurance that the Commission will co-operate with the FCA to ensure consistency and avoid duplication.
- (15) Theories of harm 3 to 5 are both wide ranging and potentially complex as Aviva discovered in the context of preparing its response to the Statement of Issues. The Commission has already signalled that it is not minded to consider many aspects of these theories of harm further, or will consider them only at a high level to assess whether further review is merited. Aviva considers that the work required both by the Commission and private parties to engage fully with all the potential theories of harm is likely to be disproportionate, if not grossly disproportionate, to any benefit that might be achieved. Aviva also considers some of the potential sources of harm identified to be largely if not wholly irrelevant to the current problems faced by the PMI sector and not plausible in the context of a market that is essentially competitive.
- (16) Aviva considers that it is not correct to focus on the specific segments proposed by the Commission under theory of harm 3 (**ToH3**) (i.e. (i) drivers in Northern Ireland; (ii) young and inexperienced drivers; and (possibly) (iii) elderly drivers). These are highly competitive, both in themselves and as part of the PMI market.
- (17) Aviva also considers that the various provider strategies highlighted by the Commission under ToH4 to be symptoms of a competitive market rather than potential causes of harm. Certainly, Aviva's product design and pricing decisions are driven by its assessment of consumer needs. It is important that there is sufficient transparency and clarity for consumers to exercise their choices effectively, but on the whole, we have no reason to believe there is any such lack of transparency and clarity.



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- (18) Aviva has serious doubts regarding whether many of the potential areas of harm identified under theory of harm 5 (**ToH5**) are realistic. For example, Aviva does not consider that there are a sufficient number of areas where both repair is concentrated and repairers have vertical relationships with insurers so as to generate material harm.
- (19) Looking ahead, Aviva does have concerns about how the price comparison website (**PCW**) segment will evolve and would welcome a closer look now by the Commission at competition between PCWs, insurer-owned PCWs and the effects of most favoured nation (**MFN**) clauses, which we believe are prevalent.
- (20) In summary, the key dysfunction in the PMI sector arises from the separation of cost liability and cost control which the Commission set out in ToH1. In our view, it does raise the costs of providing services considerably and unnecessarily, even more so if PI claims are taken into account. These increased costs ultimately flow through into the premiums that consumers pay. We recognise that quantification of these effects is not straightforward, but they are real, and we look forward to assisting the Commission in its work to understand these better.
- (21) Aviva considers that if the Commission is serious about addressing the heart of the current problems with the PMI sector it should take an early decision to focus its attention primarily on ToH1. Otherwise, Aviva considers that there is a significant risk that both the Commission and private party respondents will be put to considerable cost and effort in considering extraneous matters and that this will detract from the identification of appropriate and effective remedies for the very real concerns in this market.
- (22) If at any stage Aviva can assist the Commission further, please feel free to contact either:
- Dominic Clayden, Claims Director, Aviva Insurance,
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 - Nick Emberson, Snr. Project Manager, Aviva Insurance
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- (23) We would be more than happy to meet with you to discuss any aspects of our submission or issues associated with PMI.

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Theory of Harm 1

Theory of Harm 1

The separation of cost liability and cost control

Introduction

- (1.0) Aviva agrees with the Commission that it is appropriate to investigate whether the separation of cost liability and cost control in the supply of services to non-fault parties involved in motor accidents increases the costs of services supplied. In our view, this is the case. Aviva, therefore, supports the Commission's intention to investigate ToH1 and considers that in the context of all the issues before the Commission, it is right that the Investigation concentrates its efforts on these issues in particular.
- (1.1) In essence, Aviva believes the present separation of cost liability and cost control in the supply of services to non-fault parties results in the costs of the services being higher than necessary. The non-fault party, who receives the services, exercises very limited (if any) control or price restraint and any procurer of services advising the non-fault party is acting so as to maximise its own profit and income from the claim. There is no market incentive to mitigate the cost in the same way as for a fault claim, as the fault party is left to pay the bill at a later time.
- (1.2) Aviva considers that there is an adverse effect on competition in PMI as a result of the separation of cost liability and cost control which will require remedy by the Commission. Aviva also believes that in order to remedy the position, it will be necessary to address the underlying incentives of the players in the PMI market to ensure that all parties have an equal requirement and incentive to focus on providing a high quality and cost effective service to both fault and non-fault consumers. The right moment has been reached to reform the PMI market in this area so that significant and meaningful change is made to address the separation of incentives identified. It will not be sufficient merely to address individual behaviours; any solution has to apply to the whole market, and the underlying incentives that drive it.
- (1.3) Whilst this Investigation relates to PMI, the same separation of cost liability and cost control exists and has similar adverse effects on competition in the commercial motor market. Aviva appreciates that commercial motor insurance does not form part of the frame of reference for this Investigation. However, the Commission should be mindful that its analysis of PMI will have wider relevance.

Theory of Harm 1

Overview of the Key Legal Considerations In The PMI Sector

- (1.4) This section of our submission responds to paragraphs 19 to 22 of the Commission's Statement of Issues.

The legal requirement to insure vehicles

- (1.5) The Road Traffic Act 1988 (as amended) (**the Act**) requires all motorists in the UK to insure their vehicle(s). No-one can use a motor vehicle on a road or other public place in the UK, unless there is a PMI policy (or security) in place which complies with the Act. The beneficiary of the policy may be someone other than the driver, for example, a passenger.
- (1.6) Although there are various types of PMI cover available to purchase, the Act requires that, as a minimum, PMI policies must provide cover for third party claims. However, few customers have third-party-only cover, with the vast majority choosing to purchase a comprehensive policy which also covers loss or damage to their own vehicle. The cost of purchasing PMI is largely driven by the cost of providing cover for liabilities incurred to other third parties where the driver is at fault. Consumers purchasing comprehensive cover has become the norm, with 90-95% of consumers choosing to purchase such cover.
- (1.7) Comprehensive insurance products can be supplemented with various "add on" elements of cover. For example, although some policies will include legal expenses insurance (**LEI**) as standard, it is more usual either to add LEI or buy separate standalone cover. Other "add on" products include breakdown cover, courtesy cars and foreign use.
- (1.8) It is often the owner or keeper of the vehicle who takes out the insurance. That individual may or may not be the driver at the time of any accident. For example, the driver may be a spouse or child of the family. Some policies are written with named and additional drivers covered, and sometimes "any driver" cover is available where additional drivers are not named at the outset.

An insurer's right of subrogation

- (1.9) In insurance law, it is the contractual right of an insurer who has paid a loss under a contract of indemnity (i.e. an insurance policy) to be able to subrogate (recover) the amount paid as an indemnity in the name of the insured.
- (1.10) These actions are based on the law of tort and apply to the extent that there is a fault party who was negligent and is obliged to provide compensation for the damage caused by their breach of duty of care. The amount that is claimed should be reasonable and put the non-fault party back into the same position that they were in before the accident.

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- (1.11) It is important to note that where the claim is non-fault the ultimate cost of the claim does not affect the loss ratios¹ of the non-fault insurer, but rather the loss ratio of the fault insurer. Where the non-fault insurer addresses the claim under its policy, that claim is subrogated by the non-fault insurer who carried out the repair and is paid by the fault insurer. In many other cases, these claims are captured by various third parties such as CMCs and referred into their own claims processes and repair networks without the non-fault insurer becoming aware that an accident has occurred.

Distinction between insured and uninsured losses

- (1.12) There is also an important distinction to be made between insured and uninsured losses. It is this distinction which has led to many of the present problems in the PMI sector, and the rapid growth of claims farming.
- (1.13) An example of an insured loss would be the cost of the repairs to a vehicle. All standard personal lines comprehensive policies provide an indemnity (or cover) for the cost of repair. If an accident is due to the negligence of a third party, the insurer of that third party who settles the claim, will then subrogate the cost incurred in the name of the non-fault party from the fault party/their insurer.
- (1.14) In addition to the insured losses in most claims there will be a number of uninsured losses which are not covered by a personal lines motor policy. Uninsured losses could include the policy excess, loss of earnings, credit hire and a claim for any personal injuries sustained. Put simply, the existing policy terms of UK PMI policies do not necessarily cover all the losses a motorist may suffer following an accident.
- (1.15) In the UK, a non-fault party can make a claim directly for all of their insured and uninsured losses against the fault party and their insurer because the Act provides for compulsory cover against all third party claims and the non-fault party has a right in tort to be put in the position he was in before the accident, which is more extensive than a simple contractual right to cover for insured losses under an insurance policy. In simple terms, the fault party's insurer is potentially liable to provide full cover for all the non-fault party's losses.
- (1.16) Like insured losses, uninsured losses must be reasonable and any final dispute as to the value and extent of the losses is determined by the Court. Uninsured losses will only affect the loss ratio of the fault insurer, as they are not insured losses which the non-fault insurer is contractually required to bear under the terms of its insurance policy.

¹ Loss ratio is defined as the total cost of claims, including claims-handling expenses, expressed as a percentage of the premium paid by the customer. This typically represents a significant proportion of the premium and hence is a key metric for a PMI underwriter.

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Overview of market practices in the PMI sector

(1.17) Although it is compulsory for motorists in the UK to insure their vehicles, it is not compulsory for motorists to claim on their own policy in the event that they suffer loss or damage. For example, an insured party may:

- decide to live with the damage to his vehicle or undertake a repair personally. The insured party may decide to do this if, for example the cost is likely to be within his excess (the amount of any claim he is personally responsible for) or if he wishes to protect his no claims bonus (**NCB**) (a discount off the insurance premium that insurers offer to reduce the number of small claims reported, or the cost of all claims);
- report damage to his own insurers who may have a different approach to the claims process and cost outcome depending on whether they will ultimately be responsible for the cost of that claim or whether they will be able to recover that cost from an insurer of a fault party; or
- where the insured party is not at fault, present the claim directly to the fault party or his insurer. This can be done personally but it is more likely that any such claim will be facilitated by others (for example, an AMC).

(1.18) In practice, an insured party may not be aware of all the options available to them after an accident and, therefore, may not be able to make an informed choice about which of the various options might be preferable for them. The insured party is likely to receive a range of advice and pressure from various parties in the market which might include:

- the manufacturer of his vehicle (many now include an electronic notification of an incident to a First Notification of Loss facility);
- the vehicle recovery operator;
- the Police or Accident & Emergency Unit in a NHS hospital;
- the garage where his vehicle is taken for repair;
- his broker;
- his own insurer; or
- a third party insurer.

(1.19) The advice the insured party receives will differ depending on whether they have had a fault or a non-fault claim as the needs and requirements of these customers are different. However, the advice and assistance they receive will often reflect the commercial interests and incentives of the parties referred to above. The separation of cost liability and cost control has led to all the players in the PMI market wanting to be the first to capture as many non-fault claims as possible because they represent an opportunity for those players to maximise their own profits in the knowledge that the costs of the claim will be borne by the fault insurer.

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(1.20) In Aviva's view, the way that those who provide advice and services to non-fault parties needs to be addressed so that consumers can make informed choices and decisions. In particular, a non-fault party may be uncertain about whether to present his claim to his own insurer (i.e. a contractual claim under his own insurance policy), to the insurer of the fault party (i.e. a claim in tort) or to use a third party to facilitate a tort claim against the insurer of the fault party. The various options available to a non-fault party following an accident involve different routes to redress and different product offerings and outcomes. In particular, the cost of the services they receive depends on who provides the advice and services to the non-fault party, with each of the following options resulting in potentially different cost outcomes:

- self-insure/repair;
- use own insurer (no fault differentiation²);
- use fault insurer direct;
- use own insurer (with fault differentiation²); or
- use fault insurer via a Credit Hire Company (**CHC**).

(1.21) The primary reason for disparity in the cost outcomes in these different scenarios relates to the different incentives of those involved. The various scenarios are considered further below:

- *Customer arranges own repair:* A customer arranging his own repair has the strongest incentive to exercise cost control on the repair and will naturally look to obtain the best price that they can as a direct customer or mitigate the cost by carrying out repairs themselves or sourcing second-hand parts. However, their ability to buy services effectively and cost efficiently is limited. In Aviva's opinion the cost of a customer using a local garage is almost certainly higher than the cost an insurer could obtain from its managed network of repairers.

² Some insurers choose to treat fault and non-fault claims in the same way, using the same repairers and/or replacement vehicle providers and charging for those services in the same way, where the customer is at fault or not. Other insurers differentiate in their treatment of fault and non-fault claims.

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- *Non-fault customer presents claim to his own insurer:* If an insured customer presents his claim to his own insurer he is then protected by the insurer's repair guarantee and will receive the service and advice that he has paid for when purchasing the policy. The customer will also benefit from the insurer's knowledge and service chain. However, as non-fault insurers know that they are likely to recover/subrogate the repair or total loss costs from a fault insurer, they have both an incentive and the ability to adopt a different approach to the claim than they would if it were a fault claim. For example, there may be less cost control and/or different contractual arrangements so as to drive revenue or subsidise the cost of fault claims. More labour hours may be incurred in the repair than necessary, the labour hours might be charged at a different rate or parts discounts which are otherwise available to the insurer may not be shared with the fault insurer. The customer's own insurer will, however, have every incentive to provide a good quality service, as the beneficiary is its own customer, who may choose to switch if he is dissatisfied.
 - *Non-fault customer presents claim to fault insurer directly:* If the customer gives the fault insurer the opportunity to manage the outcome for him directly without using a CMC, then the costs involved in meeting the claim may be slightly higher than if the customer had used his own insurer but not markedly so. The difference in cost will be due to the provision of a like for like or near equivalent vehicle by the fault insurer (as opposed to the courtesy car usually provided by non-fault insurers) at a pre-agreed direct hire contractual cost (often referred to as an "intervention cost"). Like the non-fault insurer, the fault insurer will have incentives to provide a good quality service as the non-fault party is a potential customer.
 - *Non-fault customer presents claim to a CMC:* If the customer's claim is presented to the fault insurer via a CMC, this is likely to generate the highest costs. This is because:
 - it is likely that the CMC will provide a credit repair solution (increasing repair costs by about 10%); and
 - the CMC will have provided a replacement vehicle on credit hire as opposed to intervention cost terms (increasing hire costs by approximately 40%).
- (1.22) A fault insurer has no contractual limitations on its financial exposure or liability in respect of claims presented by or on behalf of non-fault drivers because the claim is made in tort rather than contract. The only protection that a fault insurer has to limit its exposure is the limited protection derived from the non-fault party's obligation to mitigate its loss and the requirement that any compensation sought by the non-fault party must be "reasonable." However, both the concepts of mitigation and reasonableness are imprecise and therefore offer only limited protection.



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- (1.23) A non-fault party assisted by a procurer of services in making a claim has very limited incentives to mitigate his costs and, in practice, the fault insurer, because of the current case law, will have difficulty proving that any actions the non-fault party took were unreasonable. The fault insurer must, therefore, accept the claim or incur disproportionate costs in attempting to shave percentages off the claim presented.
- (1.24) For example, it is not viable for the fault insurer to challenge a credit repair bill which is 10% too high if the bill is within a band or range of reasonableness and it will cost more than the amount in dispute as the usual value of the claim will fall within the small claims track. The fact that the fault insurer could have repaired the car (to the same or a better standard) for less, if given the first opportunity, is not taken into account. It is also quite difficult to challenge an invoice after the event once the car is repaired.
- (1.25) Similarly, it is difficult for a fault insurer to dispute the increased costs of credit hire as the claim is presented in tort which only subjects the claim to a broad reasonableness test and does not take into account the fact that if the non-fault party had approached the fault insurer directly, the intervention costs incurred by the fault insurer would have been contractually negotiated with the insurer's replacement vehicle provider and would be a fixed and managed cost and therefore less than the credit hire claim.
- (1.26) The fault insurer, who ultimately pays for the service is only able to choose the provider of services to the non-fault party if it "captures" the non-fault party with a view to saving the additional costs which would be incurred if the claim is presented to him by the non-fault party's insurer, or other procurer of services. It is sometimes the case that the non-fault party chooses to approach the fault insurer directly (without the intervention of his own insurer) either personally or with the assistance of others.
- (1.27) However, there is very little incentive and no requirement on the non-fault party, his insurer or any other player in the market to refer non-fault claims to the fault insurer. This is because many parties have the possibility to make a profit out of such claims and some have the opportunity to earn referral fees for capturing non-fault claims.
- (1.28) As a result, money can be made out of the confusion and disparity between claims in contract and tort. The result, in the current market structure, is that an unfortunate accident becomes a money making opportunity for too many of those who are involved in the PMI market.³

³ The same can also be said of the commercial fleet and motor market.

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Referral fees

- (1.29) In order to attract business, service providers (e.g. repairers, CMCs, CHCs, solicitors etc) often pay referral fees to those willing to put them in contact with parties involved in an accident (particularly non-fault parties).⁴ The referral fees paid are often considerable and are paid to a wide variety of parties who are incentivised to capture claims. For example, fees are paid to the Police, Hospitals, repairers, recovery operators and CMCs.
- (1.30) Aviva agrees with the Commission's comments at paragraph 32 of the Statement of Issues that referral fees represent a cost of acquiring business for many service providers and that as these costs need to be recovered, they result in costs to fault insurers (and, therefore, represent further costs on top of those required to remedy the non-fault party's loss, which may ultimately feed through to consumers in increased premiums).
- (1.31) It should not be assumed that because insurers sometimes receive referral fees the net effect on consumers is not harmful. We believe that the presence of referral fees is likely to lead to upward pressure on premiums. This is because: (i) the amount of referral fees actually received by insurers is small in terms of the PMI market as a whole; and (ii) in practice, any gains an insurer makes from a non-fault party through referral fees it might obtain are simply ploughed back to keep insurance premiums competitive. The ultimate beneficiaries are those outside the supply chain who do not provide products and services to PMI customers and simply take the windfall benefit.

Incentives Arising In Relation to Non-Fault Claims

- (1.32) This section of our submission responds to paragraphs 27 to 32 of the Commission's Statement of Issues.
- (1.33) The Statement of Issues correctly identifies at paragraph 27 that the present situation may give rise to incentives which cause distortions and Aviva strongly supports the Commission's intention to investigate the impact of these incentives.

Customer incentives

- (1.34) Aviva considers that there is a fundamental mismatch in the incentives of insurance customers that operates to discourage cost control in non-fault claims.

⁴ As the Commission notes at paragraph 21 of the Statement of Issues, as a result of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (**LASPO**), the payment and receipt of referral fees by regulated professions for claims with a PI element will be banned from April 2012 (applying to solicitors, insurers, brokers and CMCs). However, referral fees will still be able to be paid to and received by all businesses for claims where there is no PI element and by non-regulated businesses such as CHCs and repairers, regardless of the nature of the claim.

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- (1.35) This is because if there is a non-fault claim, the customer receiving the post accident services (the non-fault driver) does not pay for them. The recipient's incentive is to secure the best possible service, irrespective of the cost. He, therefore, does not exercise the price restraint which might otherwise be expected and the normal trade offs that consumers make between cost, quality and value do not operate. The consumer is only interested in quality, irrespective of cost or value, and will gladly take incremental improvements in quality at great cost (that they would not necessarily value and pay for if they were buying the service themselves).
- (1.36) Furthermore, unlike a fault claim, the recipient of services has not even paid for the post accident services through the purchase of his insurance policy (where a customer is required to choose the extent of the protection they wish to secure as against the price they are prepared to pay). Therefore, for the recipient of the services, there is no obvious and immediate correlation between the quality and cost of the services he accepts and the cost of his premium. At no point is the consumer in a position where they have to consider the cost consequences of the choices they make because they are not responsible for payment. However, if a sufficient number of consumers make high cost decisions, this would inevitably lead to higher premiums overall for all consumers.

The incentives of procurers of non-fault services

- (1.37) The situation is further exacerbated by procurers of services on behalf of non-fault parties. Their incentives are to provide the highest priced services allowable, to as many customers as possible, regardless of the cost of acquiring such customers, for example, through the payment of referral fees. This ensures they can maximise their profits.
- (1.38) The present system does not provide any real incentives for a non-fault party or a third party acting on their behalf, such as a CHC to keep down or mitigate the costs faced by the fault insurer. The CHC is always looking to maximise the daily rate, hire periods and acquire as many customers as possible, at considerable expense. They face no price pressure from their customers who do not pay and there is no other meaningful control or incentive to reduce the ultimate costs, which are passed on to insurers.
- (1.39) The current position is that many brokers, procurers of services and AMCs derive significant income from claims farming and have the ability to generate profits which are to a significant degree unchecked. As a direct consequence of the increased costs Aviva and other insurers face and our inability to reduce the impact of claims farming the ultimate cost is likely to be passed on to consumers in higher premiums.

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Insurer incentives

- (1.40) Although an insurer has an incentive to mitigate costs on its own fault claims (the benefits of which are passed on to consumers in the form of lower prices), no such incentive exists in respect of its non-fault claims, as those costs will be recovered from the fault insurer. There may even be a commercial advantage to the non-fault insurer in increasing a fault insurer's costs, especially where that insurer is known to be referring its own non-fault customers to CHCs.
- (1.41) Furthermore, as the OFT recognised⁵, where the procurer is an insurer, raising costs for a non-fault claim has a further consequence as it raises the costs of a rival fault insurer and so improves their own competitiveness in the provision of PMI.
- (1.42) Aviva does not agree with the Commission's suggestion at paragraph 30 of the Statement of Issues that because each insurer is likely to be in the fault position for some claims and in the non-fault position for others, this will affect all insurers. Aviva considers that the impact may vary between insurers as they do not have homogenous portfolios and risk profiles. For example, insurers with a greater risk appetite who insure a greater proportion of young or inexperienced drivers for example, are likely to receive a higher proportion of fault claims than those with a more varied portfolio.
- (1.43) Nevertheless, Aviva notes that the potential for non-fault insurers to raise fault insurers' costs will be tempered by the fault insurer's ability to refuse to pay any element of cost they consider to be excessive or not caused by the negligence of the fault party. However, Aviva does not believe that this mechanism is sufficiently effective in mitigating the costs of the fault insurer. As explained further below, the ultimate limit of recoverability is the Court's judgment on what charges are reasonable (although this can be an expensive option for the fault insurer)

Differentiation between fault and non-fault claims

- (1.44) As noted above, some insurers and CHCs adopt different approaches to the treatment of fault and non-fault claims owing to the fact that they are responsible for the costs of fault claims themselves but will be able to recover the cost of non-fault claims from the fault insurer. The current system therefore creates the incentive to treat these two types of claim differently.

⁵ Paragraph 1.7 of *Private Motor Insurance - OFT's Report on the Market Study and proposed decision to make a Market Investigation Reference* (May 2012).

Theory of Harm 1

- (1.45) However, there is no principled justification for doing so in terms of the nature or quality of the service the customer requires. Different outcomes are only possible because non-fault insurers or CHCs do not have the incentive to control the cost of services which they know will be reimbursed by another insurer. The extra cost is also unnecessarily generated because the non-fault party is not obliged to use their own insurance and brokers and some insurers wrongly refer their customer into a credit arrangement even when the customer can claim on their own insurance policy.
- (1.46) The non-fault claim is, however, an opportunity for the fault insurer to service the non-fault party's needs as he is a potential future customers and the service delivered could be seen as both a liability cost the insurer has to incur and also a marketing opportunity.
- (1.47) Aviva considers there is no good reason arising from a difference in underlying cost or customer need why the repair of a vehicle and the price charged for that repair should be different if the repair costs are paid under an insurance contract (for a fault claim) or under tort (for a non-fault claim). The need to repair the vehicle is the same and the different legal frameworks ought not to produce a different financial result. In both fault and non-fault situations customers' interests are best served by the quickest and most cost-effective repair. Similarly, the need for a replacement vehicle does not change depending on who is at fault.
- (1.48) It is also important to appreciate that the current situation means that cost differences arise from the provision of identical services for fault and non-fault customers. CHCs may suggest that there are features of non-fault claims that make them inherently more expensive (such as the right to a like-for-like replacement vehicle rather than a courtesy car). However, there are also factors which typically relate to non-fault claims that usually reduce costs. For example, fault repairs are normally to the front of the vehicle which are considerably more expensive to fix than non-fault repairs to the side or rear. In any event, it is critical to recall that the same services (whatever they are) will be considerably more expensive to procure via a CHC than for a fault customer through his insurer. The end cost for the same redress is in essence more expensive if provided by a non-fault provider as opposed to the fault insurer.
- (1.49) [REDACTED]

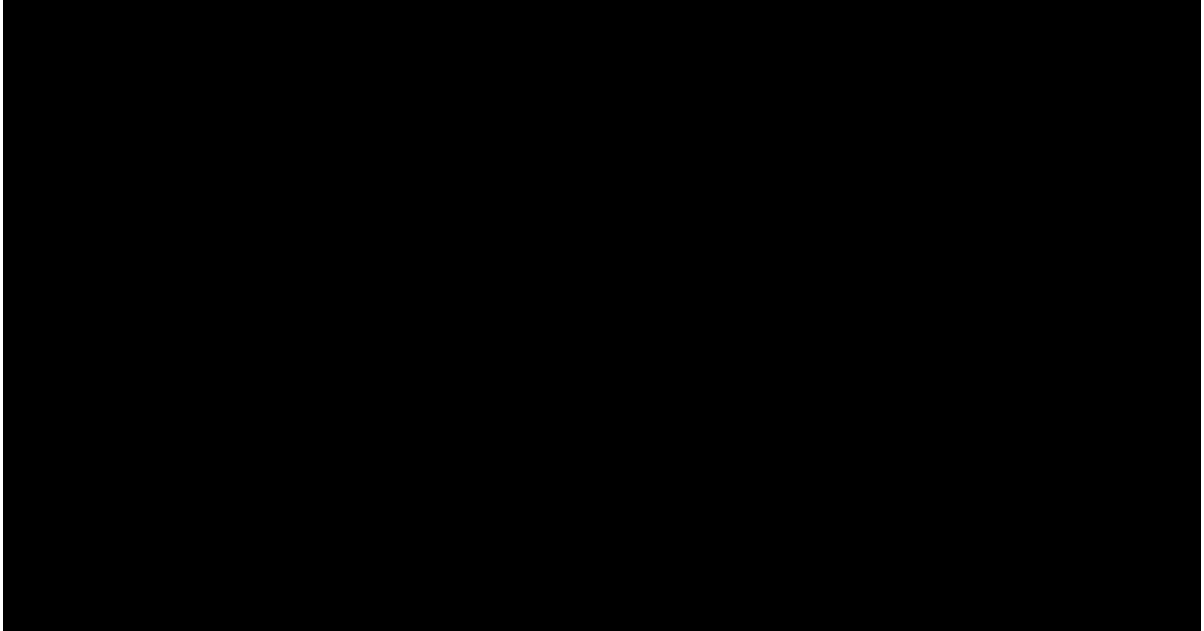


Theory of Harm 1

- (1.50) Aviva agrees with the Commission's suggestion in the Statement of Issues (paragraph 27(a)) that the present system results in the cost of services being more expensive than they need to be. There is no need in a non-fault claim (other than where the non-fault party is TPFT and impecunious) for them to use a credit repair service. Aviva does not accept that a car repaired on a credit repair basis is repaired to a better standard than if a claim is made on their policy. In fact, Aviva considers that it manages and monitors repair costs, times and service far better via our staff motor engineers, Aviva owned repairers and our managed repair network than the CHC market.
- (1.51) Indeed, Aviva was instrumental in raising standards by introducing PAS145 to our repair network and has long supported the Motor Insurers Repair and Research Centre at Thatcham which seeks, amongst other things, to improve the reparability, security and safety of vehicles.
- (1.52) Aviva runs a highly efficient and cost effective repair network and works hard to maintain this in a highly competitive and fine margin industry. For example, in our network of body shops we have recently [REDACTED]
- [REDACTED]
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
- (1.53) Aviva provided the OFT with a graph illustrating the difference in cost for replacement vehicles where we control the cost and this is reproduced below for ease of reference.

Theory of Harm 1

Figure 1



- (1.54) In many situations the non-fault party can claim directly from the fault insurer for both repair and a replacement vehicle which is consistent with his rights and meets his needs without the need to enter into any credit agreements. It is the current legal framework which allows the different approaches to exist.
- (1.55) Providing the contractual customer with an indemnity and returning the non-fault party to his pre-accident position in tort ought to involve much the same considerations. Both parties need a cost effective repair and a replacement vehicle while their own undergoes repair.

Limitations of checks on the cost of non-fault claims payable by fault insurers

- (1.56) In principle, the legal system creates checks on market player incentives to raise fault insurer costs for non-fault claims. However, these legal checks operate only to a very limited extent. In addition, the control that you might expect the fault insurer who pays for the service to exercise, in practice cannot be exerted.

Limited ability of Fault Insurer to constrain costs

- (1.57) The final cost of the non-fault claim will ultimately be presented to the fault insurer but only after all of the cost and associated expenses are already incurred and in an aggregated form that does not allow an assessment of the reasonableness of those costs. The fault insurer has no ability prior to this to control the cost.

Theory of Harm 1

"Reasonable" recovery

- (1.58) It is a fundamental legal principle that the insured or non-fault party should receive only an indemnity and their insurer should recover no more than the amount of that indemnity. In other words, whether the claim is made in contract or tort, neither the insured nor the non-fault party should profit from the loss or damage sustained. It is also a well established principle that fair compensation in tort means neither over nor under-compensation so the fault party should not under or over compensate the non-fault party.
- (1.59) In principle, this is a form of cost control which should limit the extent of fault insurers' cost liability for non-fault claims. This is because non-fault parties should not be over compensated and if there is any excess amount it is not recoverable. The indemnity provided and the amount of any recovery must be reasonable.
- (1.60) However, the concept of what is "reasonable" is a fluid one and can itself lead to litigation (at further cost). Furthermore, the Courts have so far been reluctant to use the concept of "reasonableness" to act as a brake on the extent of fault insurers' cost liability for non-fault claims. The concept of "reasonable" recovery, therefore, has not acted as an effective check on market player incentives to raise fault insurers' costs for non-fault claims.
- (1.61) The concept of a "reasonable" amount was raised most recently in the High Court case of *Coles v Hetherton*.⁶ In that case, the judge considered that the measure of damage to be recovered is the diminution in market value of the vehicle as a result of the accident. He also observed that where damage is repairable and the cost does not exceed the vehicle's pre accident value, then the claimant's recoverable loss (in this case his insurer's loss under subrogation) will be the cost of repairs.
- (1.62) However, the judge went on to say that this value is recoverable as general damages and irrespective of whether repairs are carried out, or whether the claimant pays for them or is liable to pay them. It follows that a claimant may recover the reasonable cost of repairs without reference to the actual cost incurred or to whether they were carried out at all or gratuitously or whether the claimant has any residual liability for the cost. It was also confirmed in a previous case, *Bee v Jenson*⁷ that a claimant's insurance arrangements are irrelevant both to the question of recoverability and the measure of the loss.

⁶ *Coles v Hetherton* [2012] EWHC 1599 (Comm).

⁷ *Bee v Jenson* [2006] EWHC 3359 (Comm) (21 December 2006).

Theory of Harm 1

- (1.63) Against this backdrop, the ability of a claimant to recover a reasonable cost of repair without reference to the actual cost incurred permits the recovery of excess or surplus amounts unconnected with returning the vehicle to its pre-accident condition. It also encourages others to profit from the accident. These others can "gold plate" the service provided and add to costs in circumstances where the fault insurer cannot exercise any real constraint on their activities. The end result is costs rising faster than inflation would justify (faster than RPI) due to the higher cost of the service provided to the non-fault customer. Although the non-fault customer receiving the services will be content to receive a "high quality" service, eventually the spiral of increasing costs impacts all consumers, as insurers must price for actual and anticipated future costs.
- (1.64) It does not seem reasonable to Aviva that the fault insurer should have little or no real control over the eventual bill to be paid (as illustrated in Fig. 1 in the Statement of Issues), and the elastic concepts of "fair compensation" and "reasonableness" leave the paying party with very little, if any, influence over the end cost.
- (1.65) In addition, it is the excess in the level of the amount(s) that are allowed and recoverable before the courts that has created the margin which, in turn, has allowed the proliferation of referral fees offered by the procurers of non-fault services which are, ultimately, likely to cause harm to consumers through increased premiums, without discernible improvements in service.

The duty to mitigate loss

- (1.66) We operate within a legal system where the non-fault party has a duty to mitigate its losses. In principle, that duty should constrain the ability of others to increase the extent of fault insurers' cost liability for non-fault claims for their own benefit. However, the impact of the duty to mitigate has in most situations, been limited.
- (1.67) For example, where a non-fault customer and/or those providing services on their behalf chooses not to make a claim on his own policy and claims direct from the fault party's insurer instead (often via a procurer of post-accident services), this will not necessarily constitute a failure to mitigate. The present system and policy cover create a range of insured losses and uninsured losses and a non-fault party can decide how they make a claim against the fault party and how the losses they have suffered are to be redressed.
- (1.68) This raises a number of questions regarding the extent and operation of the duty to mitigate following a road traffic accident (RTA). Aviva and many other insurers have sought to rely on the duty to mitigate in various different circumstances, but the courts will seldom find that a non-fault party has failed to mitigate. In the context of credit hire, the obligation of a non-fault party to mitigate was raised in various ways during the credit hire test litigation, but it is now accepted law that a non fault party does not have to mitigate his loss by using a replacement vehicle provided by his insurer. Instead, the non-fault party can claim for the cost of a like for like vehicle on a credit hire basis.

Theory of Harm 1

- (1.69) In addition, a non-fault party is not presently required either to claim on his own policy or suffer any financial risk if he does not mitigate his costs. The non fault party does not have to approach the fault insurer to see if the at fault insurer is prepared to offer redress before incurring any costs or involving a lawyer. It is this absence of a clear legal obligation to mitigate which has led to a growth in non fault service providers who service the non fault party's needs in exactly the same way as an fault insurer could. However, their service is provided at a cost which is far in excess of the managed cost for which the fault insurer could provide the service and incorporates a substantial profit-margin.
- (1.70) Furthermore, in almost all cases where the post-accident services are procured by a CHC, any shortfall in the recovery made from the fault insurer is the responsibility of the customer under the terms of its loan agreement with the CHC. Therefore, the failure of the CHC to keep costs under control not only has the potential to increase the fault insurer's costs but also to cause a customer to incur a legal liability for the shortfall where none would have existed had he triggered his own insurance cover (assuming he is, as is typical in the UK, comprehensively insured).
- (1.71) Although the customer's liability to the CHC under the loan agreement may be waived by the CHC or itself subject to insurance cover, it is another example of the harmful effects of the separation of costs liability and cost control which requires investigation and remedy.
- (1.72) CHCs may argue that they need to recover a higher cost in individual cases because a number of their claims will not succeed and they will not always be sure of recovering the loan they have made to the customer. However, Aviva considers that each case should be regarded as an individual claim by a non-fault party against a fault party and it is not the fault party's responsibility to meet this increased cost which is unconnected with its own personal fault and liability. In other words, fault insurers should not be responsible for the profitability of CHCs.

Measures Adopted By Insurers

- (1.73) This section of our submission responds to paragraphs 33 to 34 of the Commission's Statement of Issues.
- (1.74) Insurers have attempted to institute various measures to mitigate the harm arising from the separation of cost liability and cost control. Aviva has itself engaged in some of these efforts and these include:
- The Association of British Insurers (**ABI**) General Terms of Agreement (**GTA**);
 - Bilateral agreements; and
 - Attempts to "capture" the non-fault party.



Theory of Harm 1

- (1.75) The various efforts represent insurers' best endeavours to mitigate cost for the benefit of consumers. However, Aviva's view is that such efforts have had a limited effect in checking the costs of non-fault claims. This is because bilateral agreements are not universal and, therefore, have had limited impact. Similarly, the GTA does not cover all claims as some claims fall outside its parameters and not all CHC/insurers support it. As regards attempts to "capture" the non-fault party, this has created a race to contact the relevant individual and has contributed to some undesirable behaviour on the part of the broader market (for example sending text messages asking consumers whether they have been involved in accidents).

The GTA

- (1.76) The GTA on credit hire and credit repair sets out the arrangements for the provision of replacement vehicles to third party motorists involved in accidents that were not their fault and, where appropriate, the undertaking of repairs. Some insurers (including Aviva) and various CHCs subscribe to the GTA.
- (1.77) The GTA has provided a workable solution to the credit hire litigation experienced in the early 2000s. Its main benefit has been that insurers receive early notification of the loss and forthcoming claim plus "payment packs" (i.e. claims presented in an agreed format). The GTA also pre agrees the daily rate to be charged for the hire, so at least one point of dispute is removed; however, there remains some friction around the need to hire, the duration of the hire and liability. In any event, the rates charged represent a daily rate which might be charged to an individual for a replacement vehicle and not what an insurer's buying power is able to deliver on interventions. Also, there is no discount for lengthy hires; typically 18 days, and little incentive for CHCs to manage hire periods or drive down costs down significantly as they have to cover customer acquisition costs before moving into profit.
- (1.78) The GTA (November 2001 version), following notification by the ABI, was subjected to regulatory scrutiny by the OFT culminating in a decision in 2004. The OFT's decision was successfully challenged by the ABI before the Competition Appeal Tribunal (**CAT**). Subsequently, the OFT's position was reported to be that whilst the GTA contained certain restrictions, it was likely to meet the criteria for exemption and that there were no grounds for further action. In the event, the GTA was revised by the ABI (which consulted the OFT) in about 2005. In 2007, the OFT closed its file. Aviva has no reason to believe that the current version of the GTA does not comply with competition law.
- (1.79) Under the current framework, as an insurer, Aviva believes that being a member of the GTA is better than nothing, but, as indicated elsewhere in this response, Aviva would much prefer to see the system overhauled, than preserve some variant of the GTA.

Theory of Harm 1

Bilateral agreements

(1.80) In an attempt to control costs, Aviva has sought to enter into bilateral agreements with the largest of insurers to control the costs of claims. Aviva looked to negotiate bilateral agreements (in conjunction with competition lawyers). These concern how we treat temporary replacement vehicles charges (mobility), how we transact standard recovery claims and how charges are levied for repair costs. The purpose of these is to agree to offer similar levels of redress at reasonable cost to each other's customers. All of our agreements have been individually negotiated with the purpose of improving customer service, reducing cost and removing inefficiency to the benefit of our customers.

(1.81) The mobility agreements work by placing non fault customers into direct hire (bilateral rates) rather than credit hire. To deliver financial benefit for both parties, the bilateral rate is calculated as cost of credit hire less direct hire, less loss of referral fee, with the net benefit being shared between Aviva and the third party insurer in proportion to the volume of claims submitted by each insurer.

(1.82) Aviva has also negotiated recovery bilateral agreements to try and avoid unnecessary litigation, help with liability decisions and generally speed up the settlement of the customers claim. The mechanism to achieve this is via electronic data exchange.

(1.83) Aviva has, and continues to participate in conversations with many UK Insurers, sometimes successfully and sometimes not. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

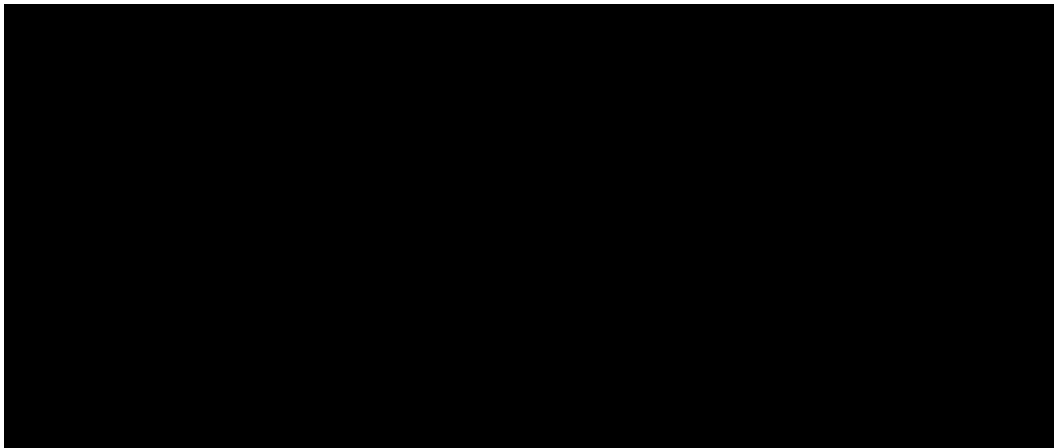
[REDACTED]

[REDACTED]

(1.84) [REDACTED]

(1.85) [REDACTED]

Theory of Harm 1



- (1.86) The basis of the 'RIPE' agreement is to achieve a reduction in the need to exchange evidence/disputes costs leading to potential litigation. The relationship works on trust, but each of the insurers has the right to audit cases across the year to ensure the costs being paid are correctly applied. The benefit working with other insurers in this manner is that it reduces the administration burden, reduces the risk of litigation, and speeds up settlement of the claim. Where issues are discovered in any audit this is raised with the other Insurer and can result in the termination of the RIPE agreement principles.
- (1.87) Aviva's experience has been that whilst in principle such arrangements can be helpful, in practice, they have had limited effects. This is for a number of reasons including the fact that these claims only represent a very small percentage of the claims made against Aviva by third parties or their service providers. In addition, the insurer can only make commitments in respect of the claims that are directly notified to them and which they manage. In cases where the management of the claim is controlled by a broker or an AMC, the ability to mutually reduce the cost and deliver a quick and cost effective settlement is removed due to these claims being farmed, often before the insurer is even aware of the accident.
- (1.88) In addition, negotiating and operating a bilateral agreement requires an appetite on both sides to reduce cost versus maximising revenue and can be time consuming and costly to administer for both parties.
- (1.89) In this context, it is also important to note that although it is possible that some insurers might have an equal proportion of fault claims, most likely each insurer will adopt a different approach to risk and focus on different types of PMI customer. For example, there is a big difference between insurers writing standard covers for Mondeo drivers (sometimes referred to as "Mondeo Man"), those targeting younger drivers or drivers with a poor accident or conviction history, and perhaps insurers writing heavy fleet business.

Theory of Harm 1

- (1.90) Consequently, there may in practice be considerable asymmetry between the proportion of fault and non-fault claims that different insurers receive as some will have a book of business that results in a considerably greater proportion of fault claims than others. Motor insurance is not a perfectly homogeneous product, with insurers taking a mixture of approaches and focussing on different types of customers. Real competitive advantage can be gained by underwriting skill.
- (1.91) Where it is possible to achieve an effective bilateral agreement this is positive for consumers. We do not agree with the suggestion that they result in lower quality services to non-fault parties, as the Commission suggests might be the case at paragraph 34 of the Statement of Issues. Consumers are not adversely affected as any uninsured losses are not in any way prejudiced. Bilateral agreements only apply to the limited extent agreed (e.g. replacement vehicles) and do not apply to any other losses a non fault customer may have suffered.
- (1.92) Bilateral agreements are not detrimental to competition and are beneficial to consumers. They provide the same or better levels of service as they remove the need to enter into a credit hire agreement and the customers often receive a replacement vehicle above the size of the courtesy car provided by the policy. The net effect is the reduced cost which is subrogated has a positive effect on customer premiums and the service is identical to that provided by a CHC.

Capture of non-fault customers by fault insurers

- (1.93) Currently, there is a "race" to contact the non fault party after an accident. On day one or within seconds of an accident, not only are the claims farmers looking to capture the non fault party, but the fault insurer is also looking to capture them and offer redress at its own direct hire rates and repair the vehicle. The potential difference in cost to an insurer when they are able to capture the non fault motorist is considerable, especially where they are also able to avoid the involvement of a solicitor, CHC or any associated legal costs.
- (1.94) [REDACTED]
- (1.95) The services provided to non-fault capture customers are likely to be as good if not better than those enjoyed by the fault insurer's own customers. This is because insurers are anxious to avoid criticism of this process which is actually beneficial to the captured customer who will have a one stop shop for all his needs and does not have to fund any excess on his own policy or put his NCB at risk.
- (1.96) However, the need to take steps to capture third party claimants itself adds to the overall administrative costs of the current system as insurers have to actively contact and offer their services before a non-fault provider does so.



Theory of Harm 1

PI Claims

(1.97) This section of our submission responds to paragraphs 23 to 26 and paragraphs 35 to 37 of the Commission's Statement of Issues.

Background

- (1.98) Aviva is aware of the review of legal expenses insurance by the FSA and is engaged in on-going dialogue as to how this product can be better understood by consumers. Aviva considers that legal expenses insurance is a valuable product to consumers and with the introduction of the Jackson reforms and the Legal Aid & Sentencing Act 2012 (LASPO), will be of even more value to customers who wish to protect their damages awards from being reduced by up to 25% by their lawyers. This is because as a result of those reforms from 1st April 2013, lawyers will only be able to claim a success fee from their client and not the fault insurer.
- (1.99) In addition to the summary of the proposed statutory and regulatory changes referred to by the Commission at paragraphs 35 and 36 of the Statement of Issues, Aviva notes that the MoJ is also consulting on "*Reducing the number and costs of whiplash claims*" which involves a review of the diagnosis of whiplash injuries and the level at which the damages threshold should be set arising from RTAs for either PI or whiplash under the Small Claims Track.
- (1.100) Aviva's experience indicates that c.90% of all PI claims brought against it arising from road traffic accidents (**RTAs**) are brought on a conditional fee agreement (**CFA**) basis. Aviva has supported Lord Justice Jackson's opinion that these agreements currently mean the claimant has no "skin in the game" and no incentive to control the cost of his litigation. The changes which will come about in April 2013 as a result of the LASPO Act are positive in that they will mean that success fees will return to being purely a matter between the claimant and his solicitor. This means that claimants will be incentivised to "shop around" for the solicitor who offers him the best deal.
- (1.101) It also means that a claimant solicitor must risk assess his own client's case appropriately rather than simply receiving an additional 12.5% success fee on top of his costs from the defendant for a claim where no possible risk existed. Indeed, there is little evidence that the 12.5% success fee encouraged claimant lawyers to take on riskier cases as was intended, but rather that they treated the extra costs received as a windfall.
- (1.102) Aviva's experience indicates that c.75% of all PI claims brought against it arising from RTAs are brought with an after the event insurance (**ATE**) policy behind them. The recoverable premium is typically between £175 and £500 for a standard whiplash claim. Lord Justice Jackson noted that because this fee has been recoverable against a defendant (who has no say in what product or cost is chosen by the claimant) and the Courts have been very reluctant to determine a premium "unreasonable", no competitive market has developed. Aviva welcomes the LASPO Act which will prevent recovery of ATE premiums from the defendant and encourage claimants who wish to insure their risk of losing their claim or an adverse cost award against them to shop around for the best (and cheapest) product which suits their needs.

Theory of Harm 1

- (1.103) In any event, with the introduction of Qualified One Way Cost Shifting (**QOCS**) in April 2013,⁸ Aviva anticipates that claimants' need for ATE will be much reduced. Under the provisions of QOCS (as Aviva understands them) an unsuccessful claimant will not be liable for a successful defendant's legal costs unless "adverse" features are present (for example, fraud or the claimant fails at trial to beat the settlement offer resulting in the damages they recover being off-set against any post offer costs liability).
- (1.104) LASPO applies in England and Wales only. In Scotland and Northern Ireland success fees and ATE premiums have never been recoverable from the fault defendant. In these jurisdictions a "post LASPO" position has always existed where these issues are matters between solicitor and client, not claimant and defendant. Aviva operates in both jurisdictions and is aware both have healthy PI sectors where claimants receive access to justice without impediment.

Comments on Commission's proposed approach to PI claims

- (1.105) Aviva notes the Commission is minded – contrary to the scope of the market reference by the OFT – to neglect the issue of PI and to leave this area to be considered by the MoJ as part of the reforms it is considering with the aim of reducing the cost of PI claims (paragraph 37 of the Statement of Issues). Aviva considers that leaving PI solely to the MoJ to consider is not only a lost opportunity, but may also prevent the Commission from properly assessing the functioning of the PMI market.
- (1.106) Aviva notes that the main cost driver in PMI is that of indemnifying the insured party for the liability he may have incurred to another for damages and legal costs. PMI providers must take PI claims' costs into account when setting their premiums. In our view, PI claims entail the same issue of separation of cost liability and cost control as credit hire and credit repair,⁹ which the Commission will have to look into. These losses are commonly brought together (and their costs are jointly reflected in the PMI providers' premiums). Separating PI claims' costs out from the Commission's Investigation will, Aviva believes, prevent the Commission from carrying out a correct assessment of how the PMI market is functioning. Ignoring an important cost driver in any industry will inevitably confuse many aspects of any economic analysis of competition in the market.
- (1.107) Furthermore, ignoring PI will likely prevent the Commission from properly considering remedies that are effective at addressing any adverse effect on competition identified and will raise concerns as to the accuracy of any analysis of proportionality of remedies.

⁸ Please note that the QOCS rules have not yet been published and accordingly it is not known whether the proposed April start date will be affected.

⁹ It is also a concern to Aviva that non-fault providers are already looking at other ways of making additional heads of claim or increasing the cost of claims in order to derive revenue (Aviva is aware of proposals to recommend credit physiotherapy and credit rehabilitation).

Theory of Harm 1

- (1.108) However, in Aviva's view, the PMI sector requires fundamental change in the way that all potential heads of claim and damage that arise from motor accidents are administered. This Investigation represents the only real opportunity to achieve this and to consider the particular effect that PI claims and all the other market features that have contributed to raise motor premiums. An outcome to this inquiry which addresses all legitimate non-fault customer claims jointly is more likely to deliver an effective and lasting solution for the sector, and the Commission should embrace the opportunity.

Substantive comments on PI claims

- (1.109) While Aviva accepts that PI claims often have a more subjective element than other types of claim, it notes that the vast majority of injury claims are currently for soft tissue/whiplash. It is, therefore, of the view that provided there is consistency of diagnosis and valuation, legal advice ought not to be required to provide compensation.
- (1.110) Aviva is also of the view that there are currently far too many whiplash claims presented to insurers especially given that the frequency of accidents has reduced and safety features in cars have increased. Aviva is also keen to ensure that only genuine claims are received and the non genuine/fraudulent claims dis-incentivised by a more rigorous diagnosis and prognosis mechanism and by making most genuine whiplash claims non cost bearing. This would go some way towards helping insurers tackle concerns regarding rising premiums. Please see "Appendix of Documents Supporting Theory of Harm 1" document "*ToH1-Project Polo- Aviva Press Releases - Quotations 2012.docx*"
- (1.111) The MoJ has recently issued a consultation on increasing the small claims track for small PI claims to £5,000 which Aviva also supports. This consultation recognises that the effect of the ever growing number of whiplash claims has to be corrected to help stem the rising costs of PMI premiums.
- (1.112) Provided an agreed method of medical reporting was introduced, Aviva considers that damages for the most common types of injury (namely whiplash) could be readily agreed through a common valuation tool and without the need for any lawyers fees on either side. Aviva also provides private medical insurance and believes such a solution is feasible.
- (1.113) However, Aviva accepts that where the injuries are severe and/or prognosis is poor or there is a dispute on liability, or delay, legal advice is quite rightly required and can be provided on a "No Win No Fee" basis.

Summary View

- (1.114) In Aviva's view, the Commission's Investigation should concentrate its efforts on ToH1. The separation between cost liability and cost control lies at the heart of the problems with the current system and should, as was the case before the OFT, be the focus of the Commission's Investigation.

Theory of Harm 1

- (1.115) The primary concern must be that the present system does not provide any real incentives for a non-fault party or a third party acting on their behalf, such as a CMC to keep down or mitigate the costs faced by the fault insurer. Consequently, many brokers and other service procurers derive significant income from claims farming and have no incentive to control or mitigate the costs incurred by a non-fault party. As a consequence, the ultimate cost is likely to be passed on to consumers in higher premiums.
- (1.116) Aviva would like to see reforms that deliver a fair and cost effective system where the costs of dealing with comparable elements of a claim by a non fault party are broadly similar to the costs of dealing with a fault driver's claim and the non fault party is provided with the right level of redress. The benefit to all consumers if the right legal and regulatory changes can be made would be a reduction in claims costs and expenses with no reduction in the level of service, which is likely to deliver better value PMI products than the current system has done.
- (1.117) In particular, Aviva believes that the Commission should consider how to re-orientate market player incentives to achieve a more efficient, cost effective provision of services to non-fault claimants. For example, Aviva strongly believes that a non-fault party should in the first instance give the fault insurer the chance to offer and provide redress. This has to be because the fault insurer has a clear obligation to provide this redress and the fault insurer has an incentive to manage costs so, for example, the credit hire claim is reduced to a direct hire rate.
- (1.118) Alternatively, in Aviva's view if a customer has their own insurance cover they should be encouraged to use it before being referred into a process that benefits the broker/insurer. It has long been our view that this creates a conflict of interest.
- (1.119) Aviva has also considers that the Commission should carefully consider the impact of referral fees on market players' incentives. Aviva has consistently argued that there should be a ban on referral fees that applies to all market players followed by a reduction in hourly rates and fixed legal costs by the MoJ. The MoJ has announced a ban on the payment of referral fees for PI cases with effect from 1st April 2013.
- (1.120) Aviva believes that a similar step in respect of referral fees paid in credit hire and credit repair claims with a commensurate reduction in the cost of these claims would be one initial means of removing the incentive for a non-fault claim to be farmed and sold to the person prepared to pay the highest fee rather than provide the best service.
- (1.121) However, this raises larger policy questions regarding whether the premiums of the many should pay for the losses of the few and how the finite premium cake should be distributed to fault and non fault motorists and the victims of accidents. For example, half the money Aviva spends on claimants' legal fees in bodily injury cases is on whiplash claims, even though whiplash claims comprise only 30% of all payouts for bodily injury. That cannot be right.

Theory of Harm 2

Theory of Harm 2

Information available to the beneficiary of post-accident services as compared with the procurer of those services

Introduction

(2.1) In this theory of harm, the Commission has set out the hypothesis that consumer detriment may arise as a consequence of:

- the procurer of post accident services being a different party to the consumer who benefits from those services;
- there being a mismatch between the incentives and interests of the beneficiary of the services and those who procure the services;
- there being an asymmetry of information and inadequacy of information available to the consumer, both at the point at which a policy is sold to them and at the point at which post accident services are provided;
- this state of affairs operating to the detriment of consumers, as providers of services concentrate on meeting the needs of procurers of services rather than those of consumers, with the result that the quality of service delivered to beneficiaries of post accident services suffers.

(2.2) On the whole, Aviva believes that beneficiaries of post-accident services receive the services they require and are entitled to and has seen no evidence of them suffering in terms of quality of service. However, Aviva considers that non-fault claims are provided in an inefficient manner and at much greater cost than is necessary. In the main, Aviva does not consider that there is harm to the non-fault party. Rather, the greatest harm is caused to the market and ultimately to consumers as a whole, due to the cost of the service being maximised. Consequently, a beneficiary of post-accident services is likely to reach a satisfactory outcome whichever route to redress they follow, but as they do not directly bear the cost of those services, they are unlikely to have strong incentives to exercise their choices to achieve a more efficient outcome i.e. a high quality service provided at the lowest cost.

(2.3) We have set out below our understanding of the decision points that customers face when they require post accident services and how those decisions are made, the incentives of those who procure post accident services on behalf customers and how those incentives are reflected in the provision of services and the ultimate cost. Finally, we have looked specifically at the consequences of the lack of transparency for beneficiaries of post accident services.

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- (2.4) These are observations based on our own experience. However, we anticipate that the Commission will conduct its own research to understand consumer behaviour, which could provide further valuable insight. In our view, survey evidence alone will not be sufficient and the Commission may find that it will need to obtain evidence from focus groups to develop a fuller understanding of how consumers make their decisions and what matters to them.
- (2.5) The FSA requires that at each stage, the insurer properly advises the consumer and enables them to make an informed choice. Aviva considers that whilst consumers understand their rights in broad terms following an accident, some procurers of services for non-fault customers do not provide information about customer choices and the implications of those choices. At the margins, this leads to poorer outcomes than would otherwise be the case.
- (2.6) However, Aviva considers these effects of ToH2 are entirely secondary and of more limited impact than the mismatch in cost liability and cost control discussed in the context of ToH 1.

Customer rights and options post-accident

- (2.7) Aviva agrees with the Commission that the process outlined in paragraph 39 and Figure 1 of the Statement of Issues are the most common routes that the majority of RTA claims follow post-accident.
- (2.8) However, it is important to note that some types of claim may follow a different route. For example, the non-fault party may have been outside the car at the time of the accident (e.g. a pedestrian or cyclist) and so will not have his own insurance policy. Alternatively, there may have been a single vehicle accident where only the passengers have claims against the fault party/driver or indeed the passenger may be the fault party where for example, he opens the passenger door into the path of an oncoming cyclist.
- (2.9) There are also a variety of ways in which claims may be resolved. For example, some customers may take their vehicle to their own garage to obtain quotations and then provide these for approval by their insurer. In addition, in a number of minor accidents the fault and the non-fault party may agree the cost of repairs between themselves, with the fault party paying for the repairs themselves, to avoid making a claim on their policy and affecting their NCB.

Typical Available Choices Post-Accident

- (2.10) The first option following an accident for either party is to decide whether to make a claim on their policy at all and whether to notify the insurers involved.

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- (2.11) In our view, almost all customers know that regardless of the circumstances, they can or should notify their insurer if they are involved in an accident. The decision to take that step does and must rest with the parties involved in the accident. That said, it is not uncommon for insured drivers not to notify their insurer of an accident. By way of example, Aviva is often contacted by the non-fault party to an accident or a party acting on his behalf, before our own insured customer/driver has notified us of the accident. It may be that there is some reticence on the part of the fault driver to notify his insurer given the potential for this to affect his NCB and increase his future premiums.
- (2.12) As noted above in the context of ToH 1, for a non-fault party, there are a number of further options available in addition to self-repair (with or without the agreement of the at fault party) or relying on their own insurer. These include:
- engaging directly with the fault insurer; or
 - using the services of a CHC or other procurer of services to obtain redress from the at fault party's insurer.

The importance of how those choices are exercised the considerations that apply

- (2.13) In many of the common scenarios, the consumer's primary concern is to have his losses and damages addressed as quickly, efficiently and conveniently as possible. The process is not driven by the consumer knowingly exercising a choice or being aware of the effect his decision will have on him or the party ultimately responsible for the costs of the claim.
- (2.14) The consumer has a duty to mitigate his loss but he does not have to choose the lowest cost option. As a result, costs can be higher than they might have been, even for an identical product or service. In principle, the consumer is only entitled to recover a reasonable cost from the fault party. The difficulty is that in many respects there is little clarity regarding what is or is not reasonable. In practice "reasonableness" is a nebulous concept whose final meaning can only be definitively determined by the courts in any individual case.

Choices exercised by the fault party when the policy is purchased and at the point of claim

- (2.15) In the majority of cases, a party who is at fault may not want to exercise any choice as to how post accident services are provided. That party has bought insurance that covers him for the cost of the repairs to his vehicle, in the expectation that the insurer will collect, repair and deliver the car back to the customer once the repairs are completed. The customer has effectively exercised his choice at the point of buying the policy.

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- (2.16) We sell customers a product that promises to repair their vehicle to the highest industry standards. If a customer uses their own garage instead of an insurer approved one this does not mean that they will get any better service and, in our view, in many cases the contrary is true. In any event, a key element of the appeal of our offer is the assurance that we will, as their insurer take responsibility for organising repairs, guarantee the provision of a quality service and fulfil the contractual promise made when the policy was sold.

The exercise of choice for a non-fault party at the point of claim

- (2.17) A non-fault party does not have to use his insurance cover. The non-fault party can choose to repair the car himself and claim back the cost from the other party, claim on the fault party's insurance, or choose to use a provider of non-fault services.
- (2.18) It seems unlikely to us that these choices are exercised in a systematic or informed way at the point of claim. Decisions may be prompted by an unsolicited contact and, as a result, often the choice is made for the non-fault party that serves that procurer of services' commercial interests.

The effect of that choice

- (2.19) Aviva encourages all of our policyholders whether they are fault or non-fault to notify any accidents as soon as possible and this is standard in most PMI policies, as a general condition of cover. In other words insurers have entered into a contract with the customer on the condition that any accidents are notified promptly.
- (2.20) This is to ensure that Aviva can provide the customer with advice about making a claim in accordance with our contractual and regulatory obligations to them. It is also because a third party can bring a direct claim against Aviva as the RTA insurer and so Aviva wants to ensure it is aware of potential claims so that we can actively investigate and try to settle any third party claim arising from our customer's negligence on the best terms and mitigate the cost.
- (2.21) As insurers are regulated, customers not only have a contractual right to a service under their insurance policy, but also a right to complain to the Financial Ombudsman Service if they are not satisfied with the standard of the service. No similar customer complaints service exists if the customer chooses to use a non-fault service provider.
- (2.22) The policy wording presently used by Aviva encourages customers, whether fault or non-fault, to notify an accident and use the cover they have purchased. An example Policy wording has been included in the "Appendix of Documents Supporting Theory of Harm 2" as document "*ToH2- Project Polo- Extracts from Aviva UK Direct Policy.docx*"
- (2.23) The policy terms will of course also set out the cover that applies for damage to a third party vehicle and also the cover that applies to the damage caused to the customer's own vehicle.



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- (2.24) A non-fault party in an accident will have suffered losses that are insured and covered by the terms of their own policy (known as insured losses) and potentially other losses that are not covered (for example, personal injuries) which are known as uninsured losses.
- (2.25) This is an area that Aviva considers many customers simply do not understand and many believe that their policy covers them for all of their losses when in fact the cover and benefits provided in most comprehensive PMI policies do not cover all of the actual or potential losses. As an example, the policy may provide them with a small courtesy car and will not provide them with a "like for like" sized car. The law allows the non-fault party to use credit hire, or go directly to the fault insurer and claim the cost of obtaining a larger car than their policy cover provided.
- (2.26) This difference in cover versus the losses only matters to a consumer where they want to obtain services or recover losses that are over and above their policy cover and they were the non fault driver.
- (2.27) The effect of this is that the non-fault party will not be advised to claim these losses or extra losses via the most simple and cost effective route but the route that suits the provider of those services. There are numerous options that could be chosen e.g. going direct to the fault insurer but these choices are unlikely to be recommended unless the non-fault party is at risk of being at fault and the procurer of post accident services may not be able to recover the cost of the services they arrange.
- (2.28) Aviva went to some length to explain the difference between insured and uninsured losses to the OFT and it is of crucial importance to the way that the PMI market operates. We have set out a summary at paragraphs 1.12 to 1.16 above.
- (2.29) The Commission should be aware that much of the farming of claims and referral is driven by the potential gap in redress a non-fault party may experience if it relied wholly on his own insurer. For example, there is presently no requirement for the non-fault party to notify the at fault party before entering into a credit hire or credit repair agreement. However, if a non-fault party approached the fault insurer there would be no such gap and the fault party's insurer could provide full redress without that party taking the financial risk of credit hire or credit repair. In our view, the non-fault party should be encouraged to start with their own or the fault insurer. In that way, the cost of the service would be reduced whilst ensuring that the customer's rights are preserved.
- (2.30) In terms of repairs, Aviva considers that claiming on a customer's own policy would normally be in that customer's best interests and is a preferable option to entering into a credit repair. If advised properly of the full range of options, many would not choose credit repair.



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- (2.31) Currently, unless there is an insurer to insurer bilateral agreement in place, a non-fault party is unlikely to receive a like for like replacement vehicle under the terms of their own policy. As case law in credit hire has allowed the recovery of the cost of a "like for like" vehicle, in most cases a non-fault service provider can easily inform the non-fault party that their policy cover will be for a lesser vehicle and that they are not limited to using that cover. As a result many customers take a vehicle on credit terms, with the CHC paying a referral fee.
- (2.32) Currently, a procurer of post accident services can use the non-fault party's legal position of not having to claim on their policy to convert all of their insured losses into uninsured losses by stepping into the shoes of the non-fault party and assisting that party in exercising their rights. In effect they are, without their knowledge or with limited consent and understanding exercising that right for the non-fault party, but doing so by funding the repairs and hire on credit/commercial terms. The credit repair or credit hire agreement which underpins the provision of services by these providers creates a contractual debt and liability for the non-fault party, which may be called upon if the procurer of services is ultimately unsuccessful in claiming the cost of those services from the fault insurer.
- (2.33) Aviva believes that those who procure post-accident services should inform the non-fault party if and when they have adequate policy cover and if they do not need to use their services. Aviva explains below how certain FSA principles and example ICOBS provisions already support the proposition that almost all of the parties who procure or provide services should be ensuring that their customers know and understand their rights, policy cover and options before the services are provided.
- (2.34) Those who procure post accident services for non-fault parties only do so where the risk of not making a recovery is low, and this is also the case in "No Win No Fee" litigation where substantial cherry-picking of claims occurs. If those who are acting on behalf of the non-fault party, having captured the claim, decide they are no longer prepared to take the risk of not making a recovery, those services will quickly come to an end, and those customers are faced with having to make a claim to their own insurer.

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- (2.35) We can provide a good recent example of where a service which was being provided to non-fault parties who were not fully informed. The CHC Drive Assist has very recently entered into administration and provided a credit hire and credit repair service to brokers and some insurers.¹⁰ Aviva was contacted by customers who had been referred by their broker into a credit repair even though they had comprehensive cover with Aviva. Their vehicles were already with repairers who were now uncertain of being paid and had stopped working on the cars. Aviva took immediate steps to intervene in any cases where our customers were involved and take over the responsibility of those repairs to ensure that customers were not affected. Aviva has then negotiated a reduced rate with those garages to reflect that they are no longer credit repair cases and the benefit of that reduction will be passed on to the fault insurer (and ultimately, to their customers).
- (2.36) In summary, whilst for a straightforward non-fault case, a recipient of post accident services may find they achieve a similar outcome in terms of obtaining an acceptable replacement vehicle and a repair regardless of the route of redress they choose, there are some potentially significant ramifications, which are not fully understood by most customers when exercising that choice:
- reliance on the non-fault party's own insurer (where possible) means that services are provided by a body regulated by the FSA and that there is access to the Financial Ombudsman Scheme if the service is not satisfactory;
 - whilst procurers of accident services may assist in bridging a gap where there are uninsured losses that the non-fault party's own insurance will not cover, in many cases, there are no such gaps;
 - the use of a third party procurer on credit hire or credit repair terms creates an unnecessary contractual debt and liability for the non-fault party;
 - the use of procurers can create uncertainty as to whether the service will be delivered, who is delivering that service and the quality of that service. For example, this could be the case if the procurer of services changes its assessment of the risk of the claim, or, as in the CHC Drive Assist case, on insolvency.
- (2.37) More widely, the year on year rise and prevalence of credit hire and total cost to the PMI market has now reached the point where if all insurers provided larger replacement vehicles as standard cover and subrogated those costs when not at fault, all customers including fault customers could benefit from enhanced cover and insurers would still reduce our claims costs and be able to reduce premiums. In addition, a significant amount of the wasted administrative costs that result in non-fault claims would potentially be eliminated.

¹⁰ Aviva understands that the main reason for this event was that Drive Assist lost a major contract.

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The Differing Duties and Incentives of Procurers and Providers

- (2.38) Aviva agrees that there is a misalignment of incentives between the beneficiaries of post accident services and the procurers of those services as set out in paragraph 40 of the Statement of Issues. There is certainly huge competition in the PMI market from all sides to capture the non-fault claims.
- (2.39) The reasons procurers of non-fault services seek to capture such claims is a consequence of the dysfunctional system that has built up around the way in which PMI claims are made and compensation is provided following a RTA.
- (2.40) The law in the UK in the private motor market allows a non-fault insurer, driver, broker and vehicle hire providers to claim for goods and services at the rates and levels allowed by the courts as uninsured losses. There is no clear statement as to the exact and expected duty to mitigate in a non-fault RTA claim and the levels of recovery which are considered reasonable and proportionate. This is one of the factors that leads to rising costs. The high margins that exist can be recovered by a non-fault provider helps fund the referral fees.
- (2.41) The duty of a non-fault party and anyone who is acting on their behalf such as a CHC, broker, insurer, or an AMC should be to fully mitigate their losses and to reduce the period of loss and the amount to the levels that an fault insurer could at the same standard. However, the problem is that due to the lack of any influence and control over that cost by the fault party and the uncertainty as to when that duty is being breached, we now have a non-fault PMI market that is continually striving to maximise the amount of the claim. It is, in effect, taking matters to a level where the non-fault party is being over compensated and obtaining a service at a cost that is well in excess of that which his own insurer would have paid or the amount that he would have reasonably chosen to pay if he had to pay himself.
- (2.42) For the procurers and providers of post-accident services, as discussed in the context of ToH1, a non-fault claim amounts to a money making opportunity, which is certainly not consistent with the interests of PMI customers overall.
- (2.43) Whether the particular examples of potential harm highlighted in paragraph 43 of the Statement of Issues arise in practice from a mismatch of incentives is difficult to assess. They seem in our view to be more theoretical than actual.
- (2.44) The drivers for quality and levels of service in connection with repairs are discussed further below.

Quality of repair and service

- (2.45) A customer faced with an accident needs to be confident that cover will be available, that service will be smooth and that repairs will be carried out efficiently and to a high quality standard. A customer that has a poor experience will go elsewhere.



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- (2.51) Aviva believes that the focus of insurers has to be to deliver the highest standards in accordance with the contractual promise given when the policy is sold, whether that customer is at fault or not when they claim. As a practical matter, in competing for PMI customers, an insurer will want to ensure that both fault and non-fault customers receive a good service, that leads them to buy insurance from that provider and recommend that insurer to others. However, as mentioned in our response to ToH1, simply because Aviva is the underwriting insurer of the non-fault party it does not mean that Aviva will ever have a claim made or notified to it by the customer or any party acting on their behalf and so may not be in a position where it resolves the claim for the customer.
- (2.52) The same incentives do not apply to credit repair, where the relationship between customer and CHC is typically a one-off. Aviva is not aware of any evidence that suggests that the extent and quality of the repairs carried out where the vehicle is subject to a credit repair is materially better to when that repair is carried out by an insurer. Aviva can say that such repairs are done at a higher cost.
- (2.53) Different insurers and repairers do take different approaches to the pricing of repairs in the PMI market. This is because many of the discounts that apply are linked to volume, the mix of the average value of the cars being repaired and the extent to which the supply chain is managed and controlled by different insurers. Such differences are a consequence of competition in the market rather than a difference in treatment between different types of claims. However, some insurers and repairers do treat the pricing of services in respect of non-fault claims differently from those of fault claims but we have not seen any direct evidence.
- (2.54) In any claims that are notified to Aviva and where we arrange and control the repairs we do not differentiate between customers' vehicles when it comes to the method or standard of repair. All vehicle repairs are based on and underpinned by the same Aviva standards, guidelines and processes which are summarised below and which are issued to our internal engineers and external repairer partners. Copies of the Aviva standards and guidelines are in the Appendix of Documents Supporting Theory of Harm 2.
- **PAS125** – Industry Publicly Available Standard with independent audits undertaken by British Standards Institute. PAS125 sets out standards covering accreditation for man machine and methods setting out the requirements to ensure compliance.
 - **Technical standards** – sets out the Aviva requirements for insurance contract interpretation, repair and total loss procedures and settlement to ensure indemnity for all customers.
 - **Repairer technical standards** - sets out the Aviva requirements for insurance repair and total loss procedures and settlement to ensure indemnity for all customers.

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- **Technical audits** – independently audits repairers and engineers against our technical standards to ensure a consistent application is being applied. [REDACTED]

[REDACTED] A copy of the National Audit Data Nov above is included in the Appendix of Documents Supporting Theory of Harm 2.

- (2.55) There are, nevertheless, some situations where the lack of alignment between the interests of the procurer of services and the non-fault party may result in a poor outcome for the non-fault party. One example relates to the assessment of "total loss" and a vehicle is considered beyond repair. In these cases, the customer may well secure a more favourable outcome from its own or the fault party's insurer than from another procurer of services. For example, Aviva will, where the level of vehicle damage is [REDACTED] value of the vehicle, look to declare that vehicle a total loss and will always consider any requests from customers to declare the vehicle a total loss where it is marginal and they do not want the car repaired. This ensures that only the right cars are repaired and protects the customer's best interests. Aviva does not consider that this same level of protection and service exists where a non-fault provider is looking to maximise the period of hire and obtain revenue from the non-fault repair.

Conflicts of Interest and Regulation

- (2.56) As the Commission has observed, there is the potential for conflicts of interest to arise between the procurer or provider of post accident services and the beneficiary of those services. There is, however, some regulatory constraint on the management of those conflicts of interest as insurers and brokers and some CMCs are regulated by the FSA and are, therefore, subject to the FSA principles and ICOBS.
- (2.57) In our view, the following principles and their application are relevant to those who are regulated and provide or procure post accident services namely:
- FSA Principle 6 which states that "a firm must pay due regard to the interests of its customers and treat them fairly".
 - FSA Principle 8 which states that "a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client."
 - FSA Principle 9 which states that "a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment."
- (2.58) In addition the guidance provided with regard to Principle 8 in ICOBS **2.3.1(G)** states:

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- *"(1) Principle 8 requires a firm to manage conflicts of interest fairly, both between itself and its customers and between a customer and another client. This principle extends to soliciting or accepting inducements where this would conflict with a firm's duties to its customers. A firm that offers such inducements should consider whether doing so conflicts with its obligations under Principles 1 and 6 to act with integrity and treat customers fairly.*
- (2.59) All regulated firms must comply with ICOBS. As a consequence of FSA Principle 6, they must also treat customers fairly and this obligation is equally applicable to brokers or any other firms that procure services and are regulated. The consequence of a breach of the FSA principles is that the FSA could take enforcement action to prevent a continuance of that breach. The Financial Ombudsman Service also provides additional oversight and requires firms to adopt good insurance practice. In many other ways, the threat of adverse publicity also modifies potential detrimental behaviour.
- (2.60) Aviva agrees that many customers are unaware of their rights and the options available to them and, in particular, there is often a failure to advise that they have cover for the repair and/or a courtesy car. In our view, a failure to provide this information so that the customer can make an informed choice, where it operates against the customer's interests, may amount to a breach of the FSA Principles set out above and the relevant ICOBS guidance.
- (2.61) One particular example of this issue arises in the context of how some insurers choose to handle non-fault claims by their own customers. Aviva does not refer any of its non-fault customers into a credit repair. Aviva is aware that other insurers do so even where the customer has a comprehensive policy. This is an area where there should be consistency of approach so that all insurers and regulated firms are clear on whether a referral to credit repair without a full explanation to the customer of what they are entitled to claim for under their policy amounts to a potential breach of the FSA regulations.
- (2.62) Our own view is that this could amount to be a breach of ICOBS 8.1.1 (R) which states:
- *"An insurer must: (1) handle claims promptly and fairly; (2) provide reasonable guidance to help a policyholder make a claim and appropriate information on its progress;"*

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- (2.63) This is because where a customer has bought cover for their car to be repaired the advice which is often in the customer's best interests is that he claim on his policy or contact the fault insurer. To do otherwise puts the customer in the position of taking on a potential debt/liability, which is in fact unnecessary when they have comprehensive cover. In our view, some regulated firms justify their position of referring comprehensively covered customers into a credit repair by claiming that the service the customer receives is better than their policy cover. Aviva does not consider that this is a valid reason given that the customer also has direct recourse to the fault insurer who has an obligation to provide full redress to the customer. If a referral to a credit repairer is not a breach of ICOBS or the FSA principles Aviva would welcome guidance from the FCA to all insurers so that a consistent application of this rule in the context of the PMI market can be published.
- (2.64) In dealings with non-fault parties who are not our customers, Aviva subscribes to the ABI Third Party Capture Code. This code demonstrates that insurers are aiming to inform the non-fault party of their rights and shows how a third party coming direct to the fault insurer will be protected and have their rights and options explained. A full copy of the ABI Third Party Capture Code is annexed in the Appendix of Documents Supporting Theory of Harm 2 as document "ToH2-Project Polo-ABI Code of Practice Third Party Assistance.docx." Insurers who subscribe to the Code aim to treat the non-fault third party as our own customer and the extract highlights the approach taken to ensure that they are made aware of their rights and the losses that can be claimed. The code also sets out how a PI claim will be treated and that in some situations independent advice is required.

Extract from ABI Code of Practice – Third Party Assistance

The unrepresented claimant should be treated fairly and managed with due regard to their interests. The FSA's Principles for Business and, where relevant, the claim handling rules in Chapter 8 of the FSA's Insurance: Conduct of Business Sourcebook (ICOBS) should form the basis of all interactions with the unrepresented claimant. Insurers should also ensure that they are acting in accordance with the expectations set out in the FSA factsheet on third party assistance.^[1]

In particular, insurers should ensure that they have appropriately audited their processes and procedures, as well as recording settlement amounts, in order to satisfy FSA that they have acted in accordance with the FSA guidelines and the related regulation.

Written confirmation of the agreement to provide services should be provided to the unrepresented claimant. This should include:

- *Details of the agreed services, estimated timescales and of the frequency in which updates will be provided – these should match or beat the timescales under the pre-action protocols (or equivalent) in the relevant jurisdiction where appropriate.*
- *Advise who to contact if the unrepresented claimant wishes to make a complaint.*

^[1] http://www.fsa.gov.uk/pubs/other/third_party_capture.pdf

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- *Clearly state the right of the unrepresented claimant to seek independent legal advice at any time.*
- *Clearly state the alternatives to dealing directly with the insurer*
- *Attach either the ABI consumer guide or own-brand consumer guide which summarises the rights of the unrepresented claimant.*
- *Where liability enquiries are ongoing, keep the claimant informed and adhere to pre-action protocols (or equivalent) time scales.*

The incentive effect of referral fees

- (2.65) Aviva has argued for some time that referral fees in PI claims should be banned as they have created extremely large incentives in non-fault cases for “claims farming”, with parties receiving substantial referral fees of up to £1000 for providing little or no service at all. In respect of credit hire and credit repair it is in many respects exactly the same issue, with referral fees of up to £400 regularly being paid to acquire a non-fault claim. Once the details of the non-fault party are obtained there is no requirement for that provider to explain or highlight the available options to the non-fault party. The provider merely offer services and the non-fault party will not be aware of the alternatives that were available and at the end of the claim will have little or no knowledge of the ultimate cost borne by the fault insurer.
- (2.66) Both credit hire and credit repair involve the non-fault party entering into a credit arrangement which creates a liability to repay those charges in the event of non-recovery by the provider. In many cases, in the event of non-recovery the costs are waived but this is purely a commercial decision made by the provider of the services. The services are offered in such a way that it results in limited or no actual consideration by the non-fault party as to the end cost, whether they are complying with their duty to mitigate and their potential liability if the claim is successfully challenged by the fault insurer.
- (2.67) There is no risk or barrier to a provider of services referring non-fault parties into their chosen process or any requirement to provide all the choices and options to the customer, including the ability to use their own cover. As a result of this and the non-fault party not having to use their own policy cover, they have no “skin in the game” and do not have to make any real choices other than to take and accept the services that are put before them.
- (2.68) Lord Justice Jackson in his review of civil litigation and PI cases recognised that in respect of PI claims the system was operating in such a way that an injured party had no risk or “skin in the game” and as a result this was having a detrimental effect on the way these cases were conducted.
- (2.69) This report led to a recommendation that the recoverability of the success fee and ATE insurance premium should no longer be recoverable and that these should be paid for by the claimant from their damages. The similarity in the competition for injury claims and those for credit hire and repair is obvious and requires consistency of approach if intervention and action is contemplated.



Theory of Harm 2

- (2.70) The MoJ has, as part of LASPO¹¹, banned the payment of referral fees between regulated parties for information leading to the offering of legal services for a PI claim. In addition, the MoJ has recognised that there has to be a significant reduction in the legal costs that are recovered in these claims, which helps provide the "fat in the system" to fund the levels of referral fees paid.
- (2.71) In our view, exactly the same issues exist for credit hire and credit repair and a wider ban of referral fees in these areas is essential and will reduce much of the negative impact of the focus on competition for claims that exists.

Post Accident Services

- (2.72) It seems to Aviva that it is almost impossible to determine what route a customer might have chosen but for the advice or actions of others who intervene to provide a non-fault service.
- (2.73) When an accident takes place, the customer's primary concern is that they remain mobile in a similar car to the one that is damaged and their own vehicle is repaired and returned with little or no inconvenience to them as soon as possible. As long as the process works as smoothly as possible and this is achieved, the customer's needs will be met.
- (2.74) Most customers, when they have had an accident, quite rightly require and are happy to accept direction as to the options and next steps and how to make a claim from any party who is prepared to help. In view of the level of commission and referral fees that are available from non-fault service providers for non-fault claims there is no shortage of parties who are prepared to provide a replacement hire car and repair on credit terms. The wide and complex networks of contracts and referral arrangements that exist have resulted in an ever growing number of non-fault claims never being notified to the non-fault insurer due to the actions of brokers or other procurers of non-fault services. In fact, Aviva believes that there is a growing propensity for fault claims to be referred by brokers into their repair networks so that they receive a referral fee. This gives insurers even less ability to control the cost and provide the service that was purchased by the customer.
- (2.75) We agree that the way non-fault services are provided removes any real engagement of the actual non-fault party in the claims process and they do not always make an informed choice. Many when questioned would probably not be concerned as long as they stay on the road and secure repairs to their vehicles with minimal inconvenience.

¹¹ *Legal Aid, Sentencing and Punishment of Offenders Act 2012 (c. 10), Part 2 — Litigation funding and costs, Section 56.*



Theory of Harm 2

- (2.76) It is not the case that they do not know their rights in broad terms (i.e. to be returned to the position they were in before the accident). Rather, they are typically unaware that their own insurer and/or the fault insurer could have provided an identical service at a fraction of the cost without the potential risks inherent in a credit hire or credit repair relationship, or the ultimate increase in premiums to all insured motorists that otherwise results.
- (2.77) It is very difficult to see how the best advice that any party who procures services on behalf of a non-fault party should give can be anything other than to initially contact the fault insurer, or in fact to claim on their own policy, as opposed to entering into a credit repair or credit hire agreement which creates a contractual debt and liability for the non-fault party. As set out at paragraphs 2.1 to 2.6 above, our view is that lack of transparency as to the available options not only impedes consumers from making informed choices, but may also amount to a breach of the FSA principles and associated ICOBS guidance.
- (2.78) By way of example, if a broker/insurer refers a customer into a credit repair, the standards of repair are not known. The accountability for the repair quality will depend upon who is actually paying for the cost of the repair and in any credit repair claims it is not clear who is providing the guarantee for the repair. By contrast, the customer loses the repair guarantee his own insurer would have provided.
- (2.79) A credit repair agreement is a personal debt on credit terms and the broker receives a referral fee for referring that customer. It has to be questionable for the broker or any insurer to refer a customer into a credit repair when that customer has bought a policy from the broker with the broker acting as agent for the customer and where the customer rightly expects the broker to act in his best interests. It is not at all clear that a customer would make the same choice if it was disclosed to him that in making the recommendation to use its repairer the broker would be receiving a referral fee of £400, as opposed to the customer making a claim on his own policy and having his car repaired to the managed high standards of the repairers selected by his own insurer.
- (2.80) A comprehensive motor policy gives all customers a full indemnity with no personal risk or liability for the cost of the repairs and in most cases a courtesy vehicle. In our view, if a broker or any other regulated party does not advise them of their policy cover and contractual rights and the full range of options then this falls short of the FSA principles and ICOBS. The customer has bought a product and that product and its cover has to be explained so they can make an informed choice and understand their post-accident options. In addition, any party procuring services/providing services should do so, with full disclosure of their own incentives as this will otherwise be seen as a failure to treat that customer fairly.

Theory of Harm 2

- (2.81) However, as we have already observed, whilst there can be real differences to consumers from choosing different options, these issues will typically surface in a minority of cases and are not likely to influence many consumers whose primary concern, understandably, is to receive the post accident services they need with minimal inconvenience. An improvement to transparency, though welcome, would not on its own create a step change that leads to meaningful change in the operation of the market. As we indicated in response to ToH1, a more fundamental recalibration of the underlying incentives of the various participants in the provision of PMI services is necessary for the existing dysfunctional nature of PMI to be resolved.

Summary View

- (2.82) In our view, the Commission has correctly identified the fact that beneficiaries of post accident services do in fact have a number of choices as to how those services are delivered to them, but in practice, do not have those choices presented to them at the time that services are required and do not make informed choices about which route to choose.
- (2.83) A further issue in this context is that many of those who procure post-accident services are regulated, but others are not. Further, the FSA principles and ICOBS which apply to regulated firms are not interpreted and complied with in a consistent manner by those to whom they do apply and are exploited by those who provide services but are not regulated. As a result, consumers receive advice of varying quality regarding their rights and options. For example, if a non-fault party has adequate cover then he should be advised that in the first instance he does not need to use a procurer of services.
- (2.84) Consumers are uncertain about their legal rights and options following an accident and it would be of some value to raise customer awareness of their rights and the choices they have so they can make an informed choice. However, in practice, consumers' basic needs for replacement vehicles and repair are being broadly met. The extent to which more information will lead consumers to look beyond these and consider wider risks and benefits is likely to be modest.
- (2.85) The Commission has already recognised that the way the law applies to the exercise of PMI policies is complex and that there may be, and we believe are, a number of differing interests and conflicts that exist in relation to these.
- (2.86) The real solution is to address the underlying incentives of those operating in the provision of PMI and related services and raise industry standards so that those who sell products, provide services and have the greater knowledge to apply that knowledge to the benefit of the customer, as outlined in our response to ToH1. The lack of any "real duty to mitigate" in a non-fault claim is the source of many of the adverse effects on competition that have been observed, because the check which the law provides on the mismatch of incentives between those who pay for a service and those who benefit from it does not operate effectively. In our view, there are a number of ways this could be achieved and which the Commission should in due course explore.

Theory of Harm 3

Theory of Harm 3

Horizontal Effects

Introduction

- (3.1) The Commission rightly recognises at paragraph 47 of the Statement of Issues that *"given the relatively large number of insurers providing PMI, there appears to be little scope for harm from horizontal market concentration"*. Consumers have a wide choice of insurers to select from who compete with one another primarily, but not exclusively, on the basis of price.
- (3.2) Although there may be some segments of the market where the number of competing insurance providers may be lower than others, Aviva considers all segments across the PMI market to be competitive and has no reason to believe that premiums in these segments are uncompetitive or that product quality is reduced.
- (3.3) Aviva supports the Commission's intention to investigate whether the four large PCWs have market power and whether there is scope for these PCWs to use any market power identified to charge a higher cost-per-acquisition (**CPA**) fee to PMI providers than if competitive conditions prevailed.

Competition between insurers

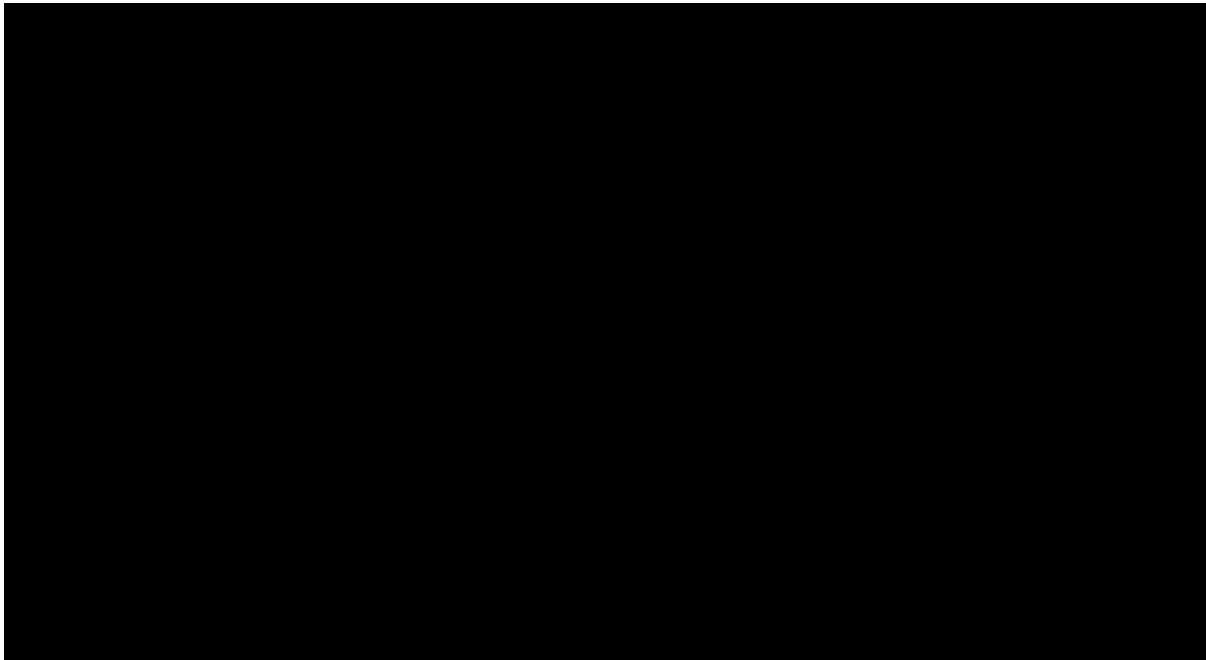
- (3.4) This section of Aviva's submission relates to paragraphs 47 and 48 of the Commission's Statement of Issues.

The UK PMI Market is Highly Competitive

- (3.5) At the outset, it is important to recognise exactly how competitive the market for PMI really is. With numerous underwriters writing business under multiple brands, the provision of motor insurance in the UK is extremely competitive. A customer will typically have over 100¹¹ options for a typical quote for motor insurance. Market shares have also changed considerably for some of the larger providers of underwriting capacity over the last 7 years. This can be seen in the graph (Figure 2.) below.

Theory of Harm 3

Figure 2.

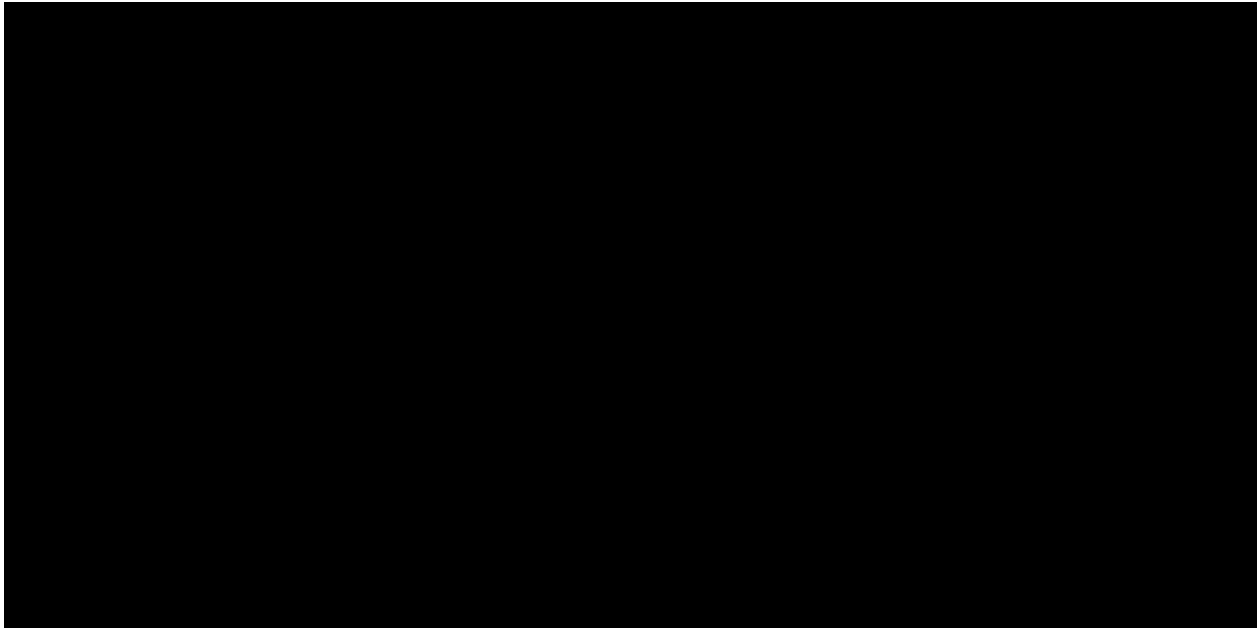


- (3.6) Indeed, the OFT has described the PMI market in the following terms:
*"From the evidence gathered we concluded that the private motor insurance market does not appear to be particularly concentrated, there appears to be a high degree of competitive rivalry between insurers and consumers are generally shopping around effectively for private motor insurance cover."*¹²
- (3.7) In addition, the fact that there is a legal requirement to purchase PMI has meant that it is often regarded as a "compulsory purchase" in the sense that the customer sees no or little value in it for himself. (It is essentially a legal requirement which is primarily intended to protect third party interests rather than the customer's own). This means that price is one of the primary factors which consumers use to determine which insurer to purchase from. Therefore, small changes in the prices charged by insurers can have a significant impact on the volume of business sold. This further serves to heighten the competitive nature of the market.
- (3.8) The data below (Figure 3.) also shows that there are a large number of insurers competing across the PMI market and across a broad spectrum of risks and customer types. The graph which is produced by Consumer Intelligence shows insurers' levels of "quotability" for November 2012 based on a limited sample of quotes from potential customers. It provides a good indication of the extent of the PMI market that each insurer is willing to cover. The data below shows that a large number of insurers will quote for over 80% of the sample of potential customers.

¹² Paragraph 2.14 of Private Motor Insurance - OFT's Report on the Market Study and proposed decision to make a Market Investigation Reference (May 2012).

Theory of Harm 3

Figure 3.



- (3.9) Finally, Aviva notes that insurers have made an underwriting loss for 16 consecutive years and recorded a loss of £480 million in 2011. It is clear that motor insurers are not making excessive profits.

Insurers can provide a wide range of PMI insurance products

- (3.10) In general, it is possible for PMI insurers to write all kinds of PMI business. Therefore, it is not difficult for PMI insurers to expand their operations to provide insurance to new types of customer (e.g. customers with different risk profiles because of their age or the type of vehicle they drive) or to new geographic locations (e.g. rural areas) or to switch between customer or geographic segments depending on how attractive the business is and the insurer's strategy and risk appetite.
- (3.11) However, like any business, insurers make decisions about the segments of the market that they choose to operate in and focus on. The sort of considerations that might affect an insurer's willingness to write certain kinds of business include:
- The insurer's risk appetite.
 - The insurer's underwriting expertise in a particular segment.
 - The scalability of the insurer's IT system.
 - The data sources and data items the insurer holds which affect the insurer's ability to create a suitable product.

Theory of Harm 3

The segments identified by the Commission are competitive

(3.12) At paragraph 47 of its Statement of Issues the Commission identifies three segments of the PMI market where parties commenting to the OFT raised the concern that the number of insurers quoting for policies is much lower than for the PMI market overall. These segments were:

- drivers in Northern Ireland;
- young and inexperienced drivers; and
- (possibly) elderly drivers.

(3.13) Aviva considers the degree of competition in each of these potential segments below.

Northern Ireland

(3.14) The PMI business in Northern Ireland is mainly transacted through brokers [REDACTED] through this distribution channel which we estimate represents a share of [REDACTED] business in Northern Ireland.

(3.15) Aviva considers that the provision of PMI in Northern Ireland is extremely competitive with brokers and insurers fighting for share.

(3.16) In Aviva's view, the reasons why fewer insurers choose to quote for drivers in Northern Ireland is that writing business there is inherently more risky than elsewhere in the UK. To the extent that premiums are higher, they reflect that greater risk. An important reason for this is that the Northern Ireland population is relatively smaller and some of the key data sets¹³ which feed into insurers' pricing models are not available. Risk assessments rely much more on underwriting judgments and pricing decisions are therefore considerably less robust than they are in Great Britain.

Young and inexperienced drivers

(3.17) Aviva considers there to be a high degree of competition for young and inexperienced drivers. There are a large number of insurers which compete strongly in this segment. Indeed, the Consumer Intelligence data below shows that there are a large number of providers willing to quote for substantial amounts of this business and Aviva quotes for the vast majority of young (Figure 4) and inexperienced driver (Figure 5) risks.

¹³ For example, Experian's consumer classification data, or Stats19 data concerning the location of road traffic accidents attended by police are not available for Northern Ireland.

Theory of Harm 3

Figure 4-Drivers Under 20

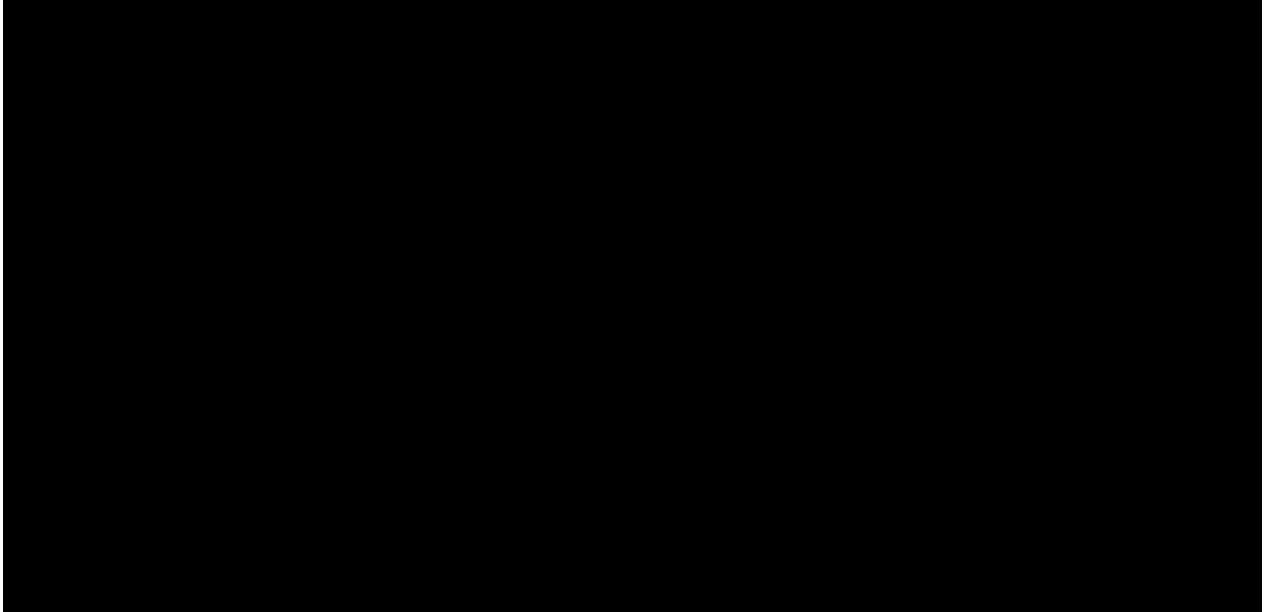
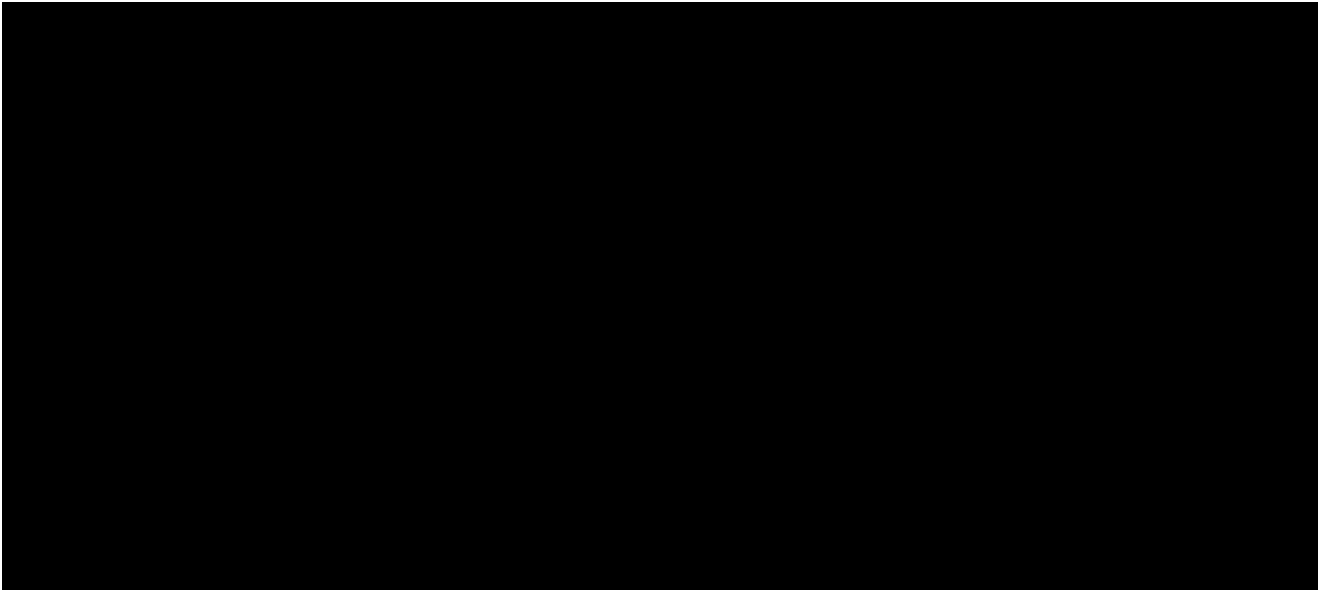


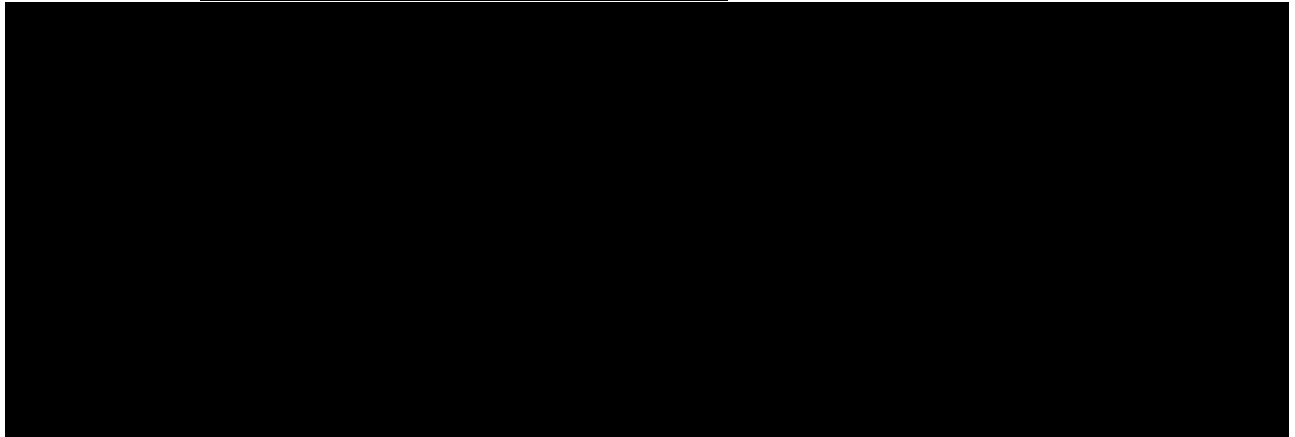
Figure 5. Inexperienced Drivers



- (3.18) Aviva regards premiums for young and inexperienced drivers to be competitive. Although premiums for these customers are typically higher than for other kinds of business, this is simply a reflection of the higher levels of risk inherent in insuring these drivers.
- (3.19) This higher level of risk is largely due to the higher proportion of bodily injury claims made by these customers. The following graph (Figure 6), illustrates this by showing the relative likelihood of bodily injury claims by driver age (and gender) and clearly show that such claims are more likely for young drivers.

Theory of Harm 3

Figure 6: [REDACTED]

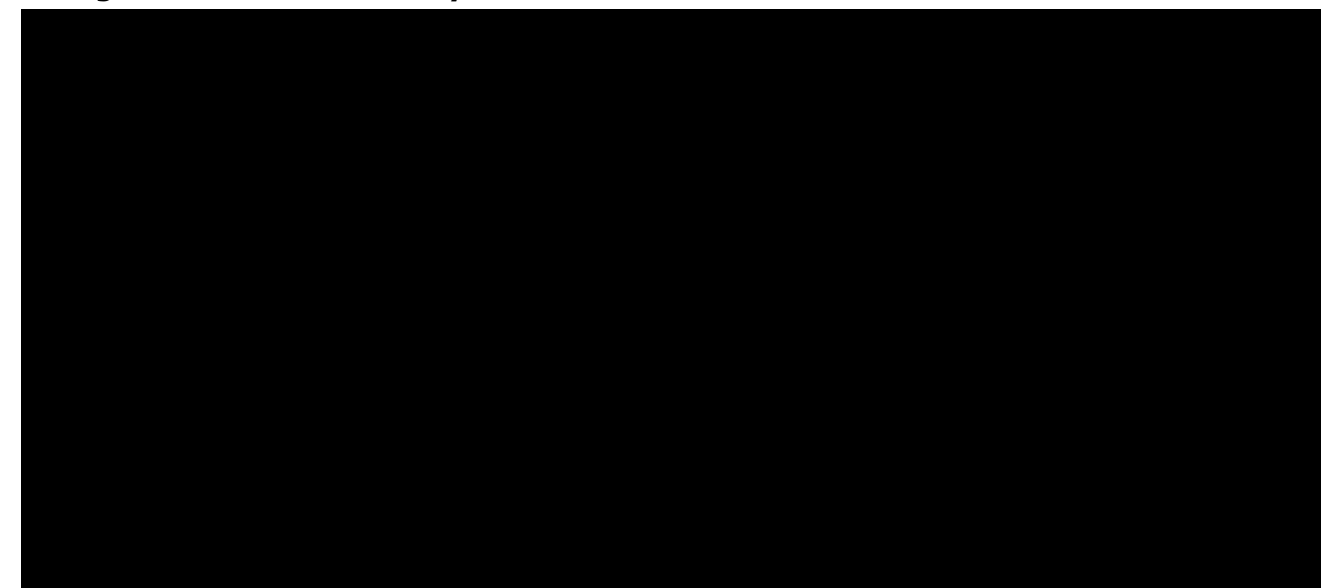


- (3.20) Indeed, approximately [REDACTED] of claims cost for drivers [REDACTED] relate to PI and Aviva's internal data shows that the cost of injury claims for a [REDACTED] [REDACTED] [REDACTED]. In addition, an injury claim costing more [REDACTED] is [REDACTED]s more likely to have been caused by a [REDACTED] [REDACTED]

Elderly drivers

- (3.21) Similarly, Aviva considers that there is a high degree of competition for elderly providers. There are a large number of insurance providers which compete strongly for this business. Indeed, the Consumer Intelligence data below (Figure 7) suggests there is an even greater range of options for consumers over the age of 65 to choose from than is the case for young or inexperienced drivers.

Figure 7: Drivers Over 65yrs



Theory of Harm 3

- (3.22) These providers compete fiercely and Aviva regards the premiums for this segment to be competitive although, as with young drivers, premiums will typically be higher as there is a higher incidence and size of claims for elderly drivers, particularly for bodily injury. Indeed, the cost of injury claims for an [REDACTED] driver [REDACTED] than that of a [REDACTED] old.
- (3.23) The fact that insurers face greater uncertainty and risk owing to the higher proportion of bodily injury claims made by young, inexperienced and elderly drivers means that not all insurers will have the same risk appetite for insuring this business and some may have stricter underwriting criteria. This explains why fewer insurers may choose to insure these drivers. However, as explained above the competition for these customers remains strong owing to the large number of competitors active in these segments.

Barriers to entry and expansion

- (3.24) If insurers in each of the proposed segments for: (i) Northern Ireland; (ii) young and inexperienced drivers; and (iii) elderly drivers sought to raise prices, it would be straightforward for insurers to change their policies and enter or expand their business into these segments as barriers to entry and expansion are low.

Northern Ireland

- (3.25) Insurers, including Aviva, operate in Northern Ireland using their base and infrastructure in Great Britain. Whilst some features of the local landscape in Northern Ireland are different to Great Britain, it is possible to access local knowledge, through brokers or otherwise and so enter or expand in that segment.

Young, inexperienced and elderly drivers

- (3.26) Even if insurers are not active in the segments for young, inexperienced and elderly drivers or are only active to a limited extent, it is easy for them to enter or expand into these segments because the barriers to entry and expansion are not high.
- (3.27) Lack of data is not a barrier to entry given that many data sources can be bought relatively inexpensively. In addition, expertise can be acquired from actuarial consultancy firms¹⁴ and reinsurance firms who can also help to reduce claims volatility in the initial years of start-up.
- (3.28) Similarly, Aviva does not consider that where certain insurers have scale in particular segments (e.g. young drivers) this is a barrier to other entrants even though these insurers might have a larger number of customers in that specific segment from which to base prices.

¹⁴ For example, "dummy" rating algorithms exist and can easily be obtained from actuarial consultancies. The cost of doing so is relatively small compared to the cost of capital solvency should a new entrant be considering entering the market.



Theory of Harm 3

- (3.29) This is because most insurers use general linear models (**GLMs**) in measuring risk and there are no accepted minimum volumes for GLM analysis of PMI business. Experience suggests that around 400,000 vehicle years (e.g. 100,000 policies over four years) is enough to produce a reasonable (if basic) cost model across all segments. Crude models could be produced from less data, although clearly a higher volume of data will enable more detailed analysis.
- (3.30) Therefore, insurers do not require much data on young drivers in order to price this business. In a multi-variate model only age (all other things being equal) is the key factor for this segment. Therefore, the greater analytical granularity offered by increased volumes of data does not really relate to driver age. The overwhelming effect of age is though a simple factor. Even modest volumes of data are sufficient to produce an age differential so that it is still possible to produce a crude analysis with less than 100,000 records.
- (3.31) Furthermore, with regard to some types of customer (e.g. inexperienced drivers) rating may be driven by underwriter judgment rather than large volume data analysis. The ABI also publishes age scales that new entrants to the market could use. Underwriting judgment and increased documentation vigilance is also available to new market entrants.
- (3.32) Were prices for any of these groups of customers to rise above competitive levels, there is no shortage of insurers or brokers who could expand their business to cover them.

Price comparison websites

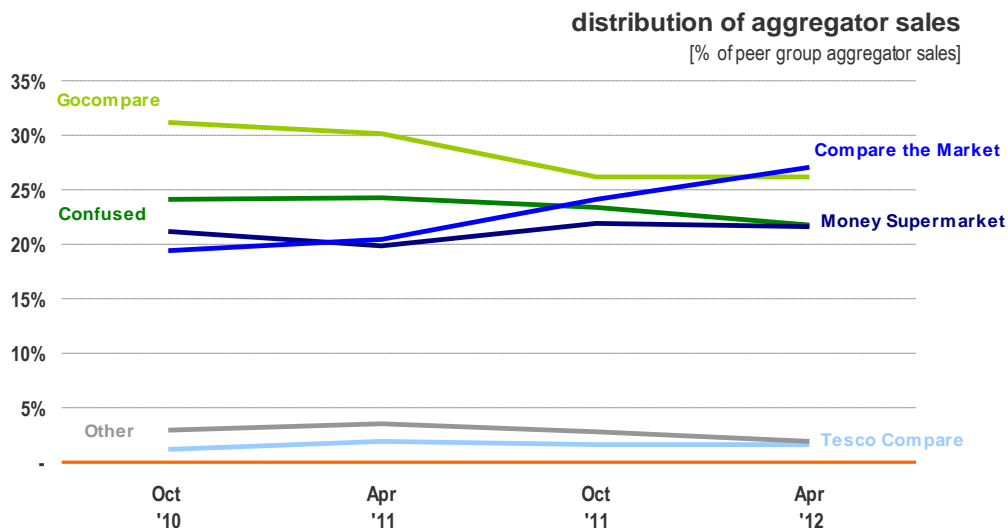
- (3.33) This section addresses paragraphs 49 to 52 of the Statement of Issues.
- (3.34) There are currently only four large PCWs which offer quotes for PMI (Gocompare, Confused, Money Supermarket and Compare the Market). Together these players control approximately 96% of business acquired through aggregator websites (Figure 8) and have a combined market share of approximately 57% of new UK PMI business.¹⁵

¹⁵ See the "ToH3-eBenchmarks Spring 2012 online insurance report -Car Aviva.ppt" In Appendix of Documents Supporting ToH 3.



Theory of Harm 3

Figure 8



(3.35) Aviva, therefore, supports the Commission's intention to investigate whether the four large PCWs have market power and whether there is scope for these PCWs to use any market power identified to charge a higher CPA fee to PMI providers than if competitive conditions prevailed. This is an increasingly important sales channel for PMI. For the market to remain a competitive one it is crucial that PCWs remain competitive.

Other sectors

(3.36) We agree with the Commission's view in paragraph 53 of the Statement of Issues that with regard to the supply of other goods and services there are a large number of providers at both a regional and local level and that there is not currently scope for harm from horizontal effects in the supply of these other goods and services. Therefore, Aviva does not object to the Commission's intention not to consider the supply of these other goods and services further under ToH3.

Theory of Harm 4

Theory of Harm 4

Competition between providers

Introduction

- (4.1) Under Theory of Harm 4, the Commission presents hypotheses that competition between insurers may be softened because:
- the products offered are complex and not standardised, so that consumers find it difficult to shop around (paragraphs 55 to 58 of the Statement of Issues);
 - "drip in pricing" for add-on insurance products, which may not be transparent, leads consumers to buy more and/or pay more for insurance than would otherwise be the case (paragraphs 59 to 66 of the Statement of Issues); and / or
 - a variety of factors make it more difficult for consumers to switch provider (paragraphs 69 to 76 of the Statement of Issues).
- (4.2) Any hypothesis that competition between insurers is softened needs to be assessed against the basic characteristics of the PMI market, which is fiercely competitive.
- (4.3) There are numerous insurers who provide a wide variety of products to customers and an ability for providers of PMI to enter or expand their offer with innovative products. Consumers are aware of this choice and actively research the alternatives when buying PMI.
- (4.4) The OFT's survey of consumers, presented in its Call for Evidence found that 73 per cent of customers in Great Britain and 54 per cent of customers in Northern Ireland shopped around at their last renewal. A 2008 survey by the OFT in the context of its market study into personal current accounts found that 61 per cent of respondents had switched motor insurance provider in the last five years, the highest switching rate amongst the products surveyed by the OFT. The average lifetime of an Aviva Direct customer is [REDACTED]. This represents a much more intense competitive dynamic than is the case for most other financial services products and in that context it is not credible that there is a significant adverse effect on competition arising from insurer strategies to soften competition.
- (4.5) So far as each of the Commission's hypotheses are concerned:
- Aviva recognises the product differentiation identified in the Statement of Issues, but certainly in Aviva's case, product design choices are driven by an assessment of the preferences of consumers and benefit consumers. The willingness of PMI customers to search for alternatives and switch does not suggest that high search costs limit consumers' ability to switch.



Theory of Harm 4

- The use of add-ons and the separate pricing of these insurance products is an example of product differentiation that is designed to give customers a degree of choice that they expect, and reflects their differing needs. These add-on options need to be presented in a clear way that is understood by consumers. We believe Aviva achieves this. We note that the FSA has announced that it intends to investigate whether there are features of add-on covers which weaken competition and drive poor consumer outcomes. There is considerable potential overlap between the proposed FSA study and the Commission's consideration of these issues and we would urge both bodies to work together to ensure consistency of approach and avoid duplication.
- The evidence shows that factors such as automatic renewal, the charging of cancellation fees and the use of protected NCBs do not deter customers from switching. In each case, there are good reasons for the feature identified by the Commission. So far as protected NCBs are concerned, there is scope to improve and simplify the process of verification and transfer of NCBs between insurers, for the benefit of consumers. However, there is already work underway to do this, and in the absence of an adverse effect on competition, this is not an issue which the Commission should address.

Differentiation of PMI

- (4.6) This section of Aviva's submission addresses the differentiation of PMI products and relates to paragraphs 55 to 58 of the Statement of Issues.
- (4.7) Aviva recognises the product differentiation described in the Statement of Issues, and that this does, to some extent, give rise to a cost (i.e. search cost) to the customer when they shop around for a PMI policy.
- (4.8) However, we do not believe that there is, as a result, an adverse effect on competition. We consider that product design decisions are typically driven by an assessment of consumer preferences and actually benefit consumers.
- (4.9) Customers expect a degree of choice in the covers they buy, and a 'one size fits all' approach would result in many receiving cover they do not need or want, or receiving duplicate cover for eventualities they may have already bought elsewhere. This is reflected in the design of add-on products, which are discussed further below.
- (4.10) Aviva designs its products with regard to its target customer segments and aims to provide the key requirements for those customers' needs. In all cases, we use customer and competitor insight to inform our product design decisions.
- (4.11) The evidence does not suggest that any search costs that result create a barrier to effective consumer switching. Indeed, customers appear to understand the products that are available to them and exercise their choices to switch.

Theory of Harm 4

Structure and pricing of add-on products

- (4.12) This section addresses the issues raised in relation to add-on products and services at paragraphs 59 to 68 of the Statement of Issues.
- (4.13) On 19 December the FSA, in anticipation of the competition duties of the FCA, announced a study of general insurance products sold as add-ons. In particular, the FSA has said that "*the study will look at whether there are common features of the add-on markets that weaken competition and drive poor consumer outcomes*". It seems to us that there is a great degree of potential duplication and overlap between the Commission's consideration of the issues in the context of PMI and the FSA's own study. We would urge both bodies to work together to ensure consistency of approach and avoid duplication.

The purpose and structure of add-on covers

- (4.14) Add-on covers are elements of cover that are not automatically included in the core insurance policy and which a customer can elect to buy. Additional covers allow customers to tailor the PMI product to their personal needs, giving them control over what they buy.
- (4.15) Typical options for add-on covers include:
- Personal accident cover
 - Legal expenses
 - Breakdown cover
 - Healthcare (physiotherapy cover)
 - Courtesy car
 - Foreign use
 - Breakdown cover
- (4.16) The key reason to offer a policy feature as an "add on" rather than as part of the core policy is that it is a feature that is not universally needed by customers either because it would duplicate cover that the customer has elsewhere, or because it is a feature that the customer does not need. Customers need and fully expect a degree of control which allows them to select and pay for only the cover that they need. A 'one size fits all' approach would not serve customers well, as otherwise many would find themselves paying for cover they do not need, or not accessing specialist cover that they would value.
- (4.17) For example:
- All new cars are supplied with breakdown cover of between 1 to 5 years. A customer with that existing cover will not want or need it incorporated in his PMI policy.
 - Some covers may be included in other insurance policies that a customer holds, for example, physiotherapy cover under a health insurance policy, or legal expenses under a home contents policy.

Theory of Harm 4

- In respect of courtesy cars, 42% of households own more than one vehicle. As a result many customers will not want or need courtesy car cover.
- Only 2% of cars are taken out of the UK. As such, the vast majority of customers will not need foreign use cover.

The presentation and sale of add on products

- (4.18) Aviva believes that it is crucial that customers fully understand each of the add-ons they are offered, and what cover they will be entitled to if they purchase and subsequently claim against them.
- (4.19) Our own approach to ensuring that customers have the appropriate understanding includes the following elements:
- Add-ons are presented on our web pages clearly as additional covers that customers can add to their core PMI product. No add-ons are pre selected, and therefore must be added by the customer. The price of each add-on is clearly shown before the customer is committed to the purchase.
 - Each add on has a clear explanation of the cover it will provide via a help button. Additional details of these covers are also found in our policy wordings which are available to view before purchase.
 - The additional costs of each add-on are also clearly explained.
 - In our call centres, our advisors are trained to explain core coverages to our customers, and to offer the additional add-ons, with a clear explanation of what the cover will provide, and how much it will cost them.
 - Once the customer has purchased PMI, our policy schedule shows any additional add-ons which have been purchased, and the price that has been charged. Where a customer has not selected a courtesy car as an add-on, a clause wording will confirm the omission for the avoidance of doubt.
- (4.20) Legal expenses cover, by its nature, can be less clear for consumers to understand and we have recently initiated work to both review the product and the cover it offers to our customers, and to re-write the policy wording in much clearer terms.

Consumer purchasing behaviour

- (4.21) Aviva believes that on the whole, consumers understand the products and choices that are presented to them and that there are good reasons for having those choices. All the evidence shows that consumers do compare the offers of different providers and switch between them. Insurers have to keep their product offers competitive.
- (4.22) As a result, Aviva does not believe that there is an adverse effect on competition arising from drip-in pricing or a lack of transparency or complexity in the presentation of add-on products and services.

Theory of Harm 4

Customers switching PMI provider

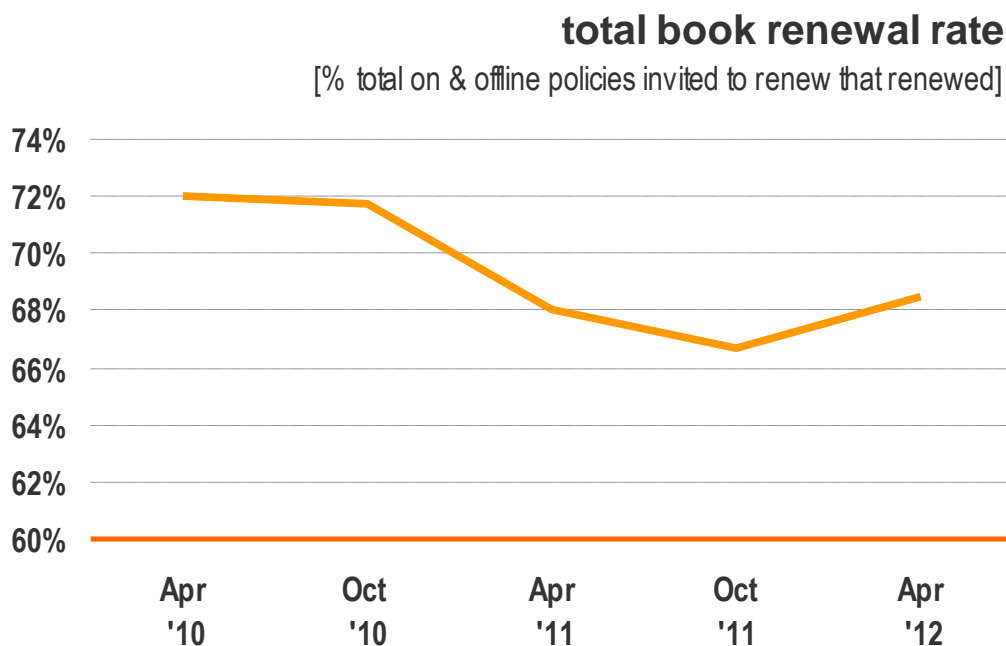
(4.23) This section addresses the various factors that the Commission identified at paragraphs 69 to 76 of the Statement of Issues which it considered may make it harder for consumers to switch their PMI provider. In short, Aviva does not believe that there are significant barriers to switching in PMI and there are good reasons for the existence of the features the Commission identified.

Automatic renewal

(4.24) Aviva does not believe automatic renewal to be a barrier to customers switching their policy. This is a market in which a large numbers of people switch provider at renewal.

(4.25) An estimated 18m people shop on PCWs each year for PMI. Data from E-Benchmarkers shows that switch rates at renewal can be as high as one third (please see Figure 9 below).

Figure 9



(4.26) The average lifetime of an Aviva direct policy is [REDACTED] which further demonstrates that customers are switching on a frequent basis.

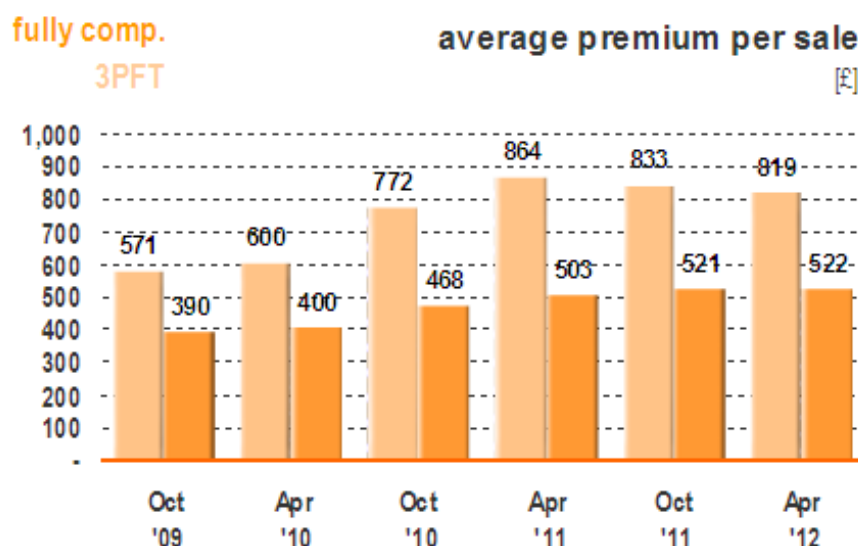
(4.27) Automatic renewal protects customers from the risk of inadvertently becoming uninsured, which is especially important in light of the introduction of Continuous Insurance Enforcement in 2011 and the possible fines associated with owning or being registered as a vehicle keeper of a vehicle that is not insured.

Theory of Harm 4

Charging a cancellation fee

- (4.28) Most providers charge cancellation fees ranging from £0 to approximately £75. Included in the "Appendix of Documents Supporting Theory of Harm 4" a table of cancellation charges used by different providers which was compiled by Defacto in 2011 has been provided. The document reference is "*ToH4-Table of Cancellation Fees.docx*"
- (4.29) The average comprehensive insurance premium in April 2012 was £522 (see Figure 10, E-benchmarkers graph below), making a typical cancellation charge of £40 equivalent to 7.7% of the premium. Initial annual prices charged reflect the expectation that the customer maintains a policy in force for 12 months. There are costs involved in acquiring, administering and servicing a policy which are incurred whether or not the customer maintains the policy for a full year. In our view it is fairer that customers choosing to leave mid-term pay an appropriate fee rather than for those costs to be spread across the premiums of all customers.

Figure 10: Comprehensive v TPFT



- (4.30) A typical PCW CPA is around £45, which we would be obliged to pay whether the customer remained with Aviva for the full term of the policy or cancelled it at the outset. In that context, a cancellation charge of approximately £50 is proportionate to the costs Aviva has incurred in issuing the policy and will not fully recover through the premium, particularly when there are other administrative costs to consider.
- (4.31) In addition, most providers do not charge a fee in the cooling off period of a policy and cancellation charges form an effective means of fraud prevention by making a reduced refund less attractive when a policy has been purchased with criminal based funds. As such, it is in a provider's interest to highlight this charge to the customer at the point of sale.

Theory of Harm 4

- (4.32) Therefore, we do not believe that cancellation charges are a barrier to switching but believe it is important that providers make sure that the consumer is aware of any administration charges prior to purchase.

Protected no-claims bonuses

- (4.33) NCB is a useful tool to reward safer customers who do not claim. Aviva and other insurers give the customer the opportunity to protect their NCB and to mitigate against large premium increases.

- (4.34) The NCB processes do differ between providers in various ways, including how many years NCB a customer can accrue and the level of discount applied. For example, [REDACTED]

For example, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

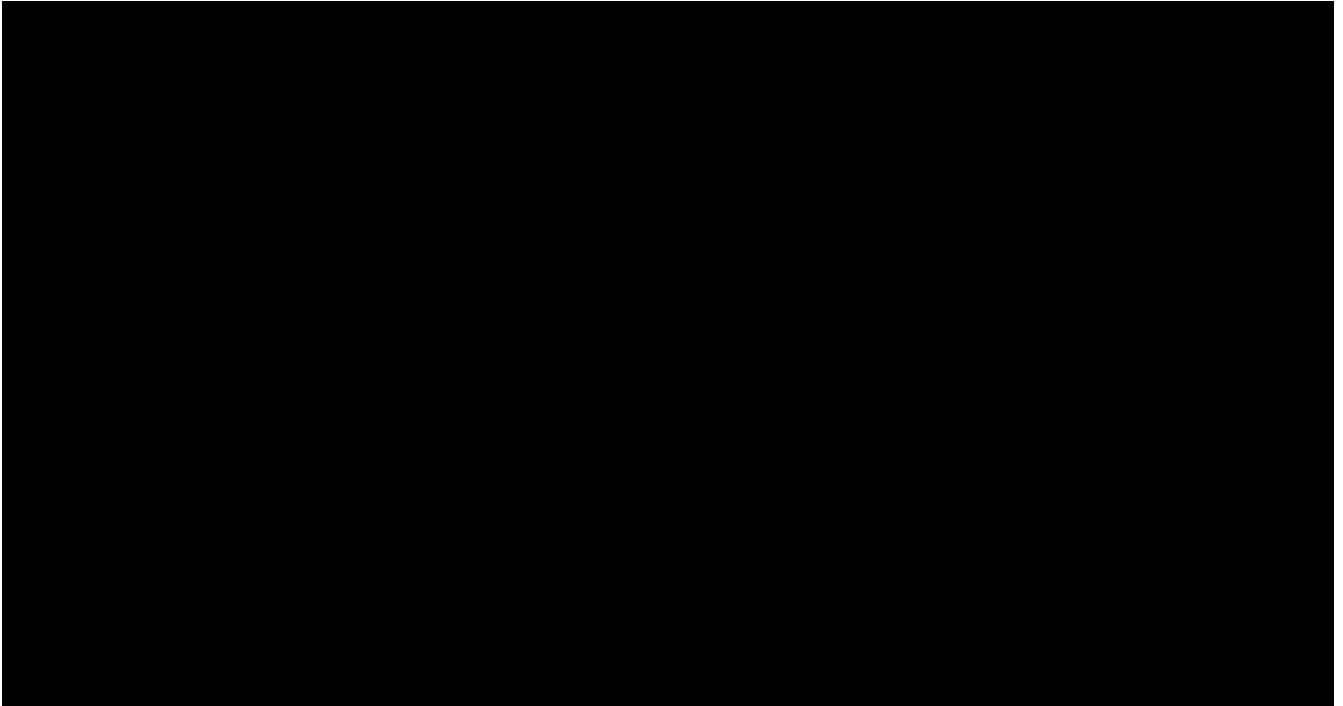
- (4.35) [REDACTED]
[REDACTED]
[REDACTED]. For this reason, we do not believe that protected NCD acts as a barrier to switching.

- [illegible]

Theory of Harm 4

(4.37) The following graph (Figure 11) shows the output [REDACTED], with the flat green line [REDACTED] after removing the influence from other factors) [REDACTED].

Figure 11

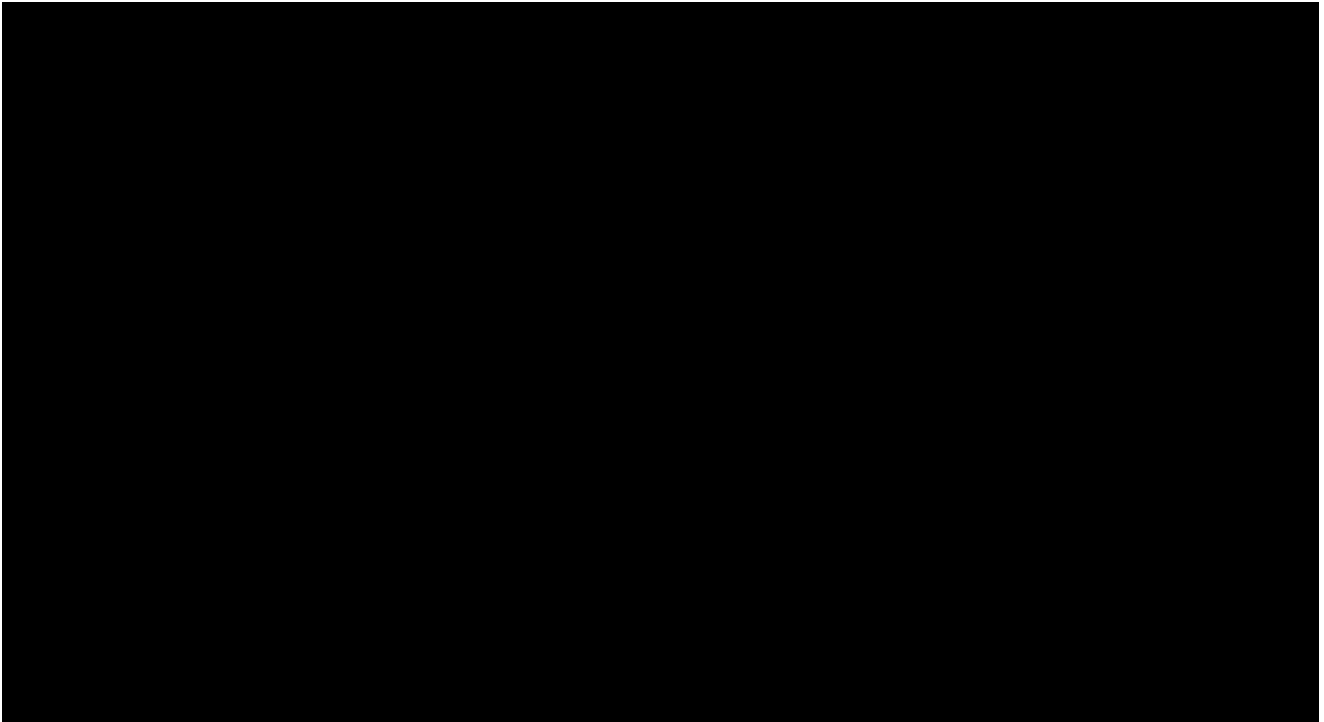




Theory of Harm 4

(4.38) Similarly, with the exception¹⁶ of customers who have made a claim in the past [REDACTED] have the same propensity to [REDACTED] [REDACTED] (all else being equal). This would suggest [REDACTED] [REDACTED]. This is demonstrated in the following graph (Figure 12)

Figure 12



(4.39) Aviva (like many other insurers) provides proof of NCB for customers who cancel their policy or let it lapse [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]. As such, a protected NCB does not create an obstacle to switching.

(4.40) Aviva does believe that there are ways in which the NCB system (including NCB Protection) can be simplified and made easier to operate. This would have a number of benefits including the potential for a system that is cheaper to administer and should, therefore, produce cost savings which could benefit consumers.

■ [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]



Theory of Harm 4

- (4.41) There is already work underway by the Motor Insurers' Bureau (**MIB**), which is considering better mechanisms to validate NCB, particularly through an 'NCB Hub'. Aviva believes that this would assist customers with their understanding of NCB (as well as insurers by providing accurate validation) and Aviva supports this initiative.
- (4.42) However, Aviva believes that any further work towards the clarifying the terms on which NCB is offered would sit more naturally within the FCA's remit.

Theory of Harm 5

Theory of Harm 5

Vertical relationships

Ownership of PCWs by insurers/brokers

- (5.1) This section of Aviva's submission relates to paragraphs 78 to 89 of the Commission's Issues Statement.
- (5.2) Aviva welcomes the Commission's proposal to investigate whether a PCW-integrated insurer might undercut its rivals' prices or manipulate the quotes through the PCW in a way which gives rise to harm.¹⁷ This is because Aviva has serious concerns regarding the potential for insurer-owned PCWs to misuse Aviva's data for the benefit of their own insurance operations.¹⁸
- (5.3) While Aviva does not have any evidence to suggest that insurer-owned PCWs are currently undercutting Aviva's prices, manipulating quotes or otherwise misusing Aviva's data to their own insurer's advantage, it nevertheless considers this to be a real risk given that insurer-owned PCWs have both the incentive and the opportunity to do so. More generally, PCWs are an increasingly important sales channel for PMI and it is crucial, if the PMI market is to remain competitive, that there is no scope for any player in the market to gain a competitive advantage by virtue of its vertical integration with a distributor of scale.
- (5.4) As the Commission notes in its Statement of Issues¹⁹ a PCW-integrated insurer will have the opportunity to misuse its rivals' data by:
- ensuring that its own price for a particular quote is always slightly cheaper than that of its rivals for comparable policies. The PCW-integrated insurer might do this by undercutting its rival in real time as quotes are provided to a consumer. This could occur if the PCW owner operates the PCW such that all other quotes are gathered first before it quotes, ensuring that its price is just lower than the lowest rival quote; or
 - manipulating the quotes obtained through its PCW to ensure that its PMI policies appear among the top quotes. For example, it could do this by including within the headline prices of the PMI products offered by its rivals any add-on services which are available to make them appear more expensive.²⁰

17 Paragraph 89 of the Statement of Issues.

18 In particular, Aviva welcomes the Commission's intention to investigate this area because it is difficult for a PMI provider to find out or indeed to prove that its data is being misused.

19 Paragraphs 81 and 84 of the Statement of Issues.

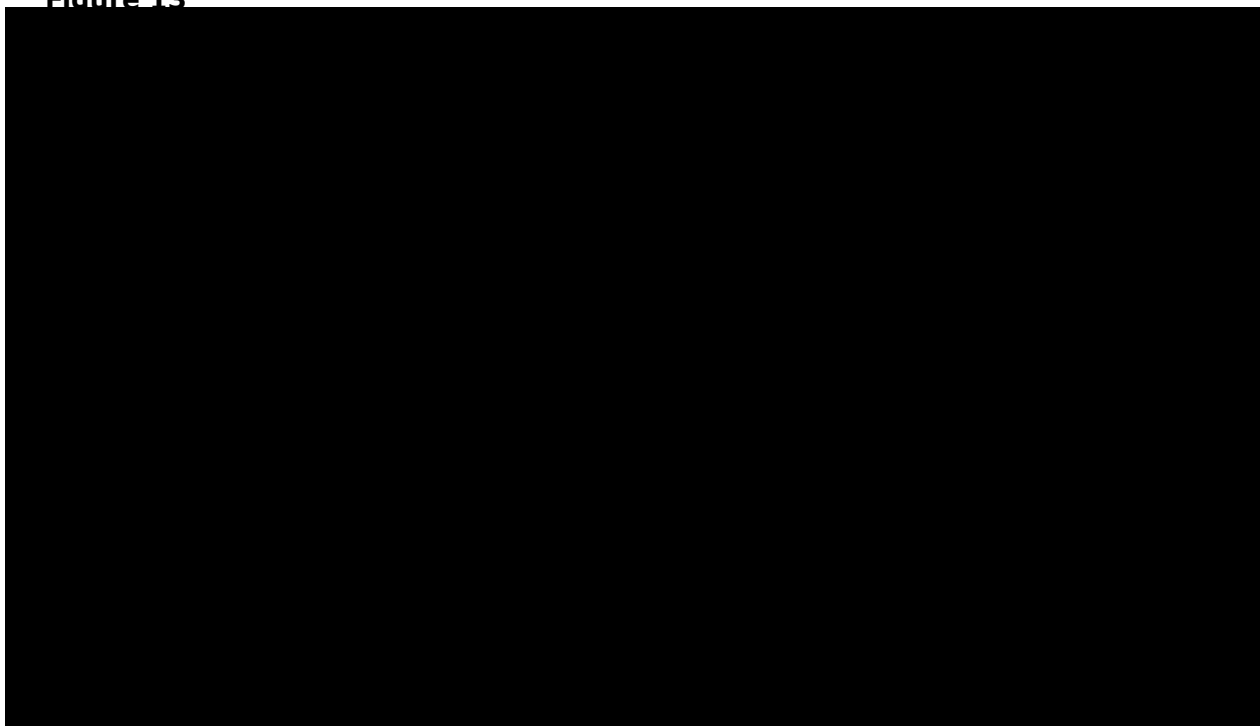
20 The Commission also notes that a PCW-integrated insurer might have the opportunity to misuse a competitor's quotation prices to understand the competitor's pricing models or limit access their PCW but Aviva notes that it does not consider these to be plausible theories of harm and is not proposing to consider them further.



Theory of Harm 5

- (5.5) Aviva also notes that in principle a PCW-integrated insurer also has the opportunity to misuse its rivals' data by not enabling its rivals' quotes to appear in respect of all the categories of business they have stated they wish to quote for.
- (5.6) PCW-integrated insurers also have the incentive to misuse rival insurers' data because they would obtain a significant commercial advantage by doing so.
- (5.7) Aviva notes that a good way for the Commission to validate if an insurer is gaining an undue commercial benefit from being the owner of a PCW (and causing market harm as a result) would be to look at the percentage of business that the insurer wrote through the PCW it owned relative to that PCW's market share
- (5.8) The ability of PMI providers to identify that their data is being misused is also limited. While a vigilant PMI provider might be able to identify that its quotes were being undercut or manipulated unfavourably, it is much less likely to be able to identify whether a PCW is providing to customers all the quotes that the provider has stipulated they would like to quote for.
- (5.9) Furthermore, if PMI provider data is being misused its effects are unlikely to be checked by competition between PCWs because most customers do not usually shop on more than one PCW. This fact is illustrated in the diagram below (Figure 13) which shows [REDACTED] in respect of [REDACTED] for Aviva's Quotemehappy.com brand in January 2012. Figure 13 shows that [REDACTED] that were provided quotes by Quotemehappy.com [REDACTED] [REDACTED] [REDACTED] [REDACTED].

Figure 13





Theory of Harm 5

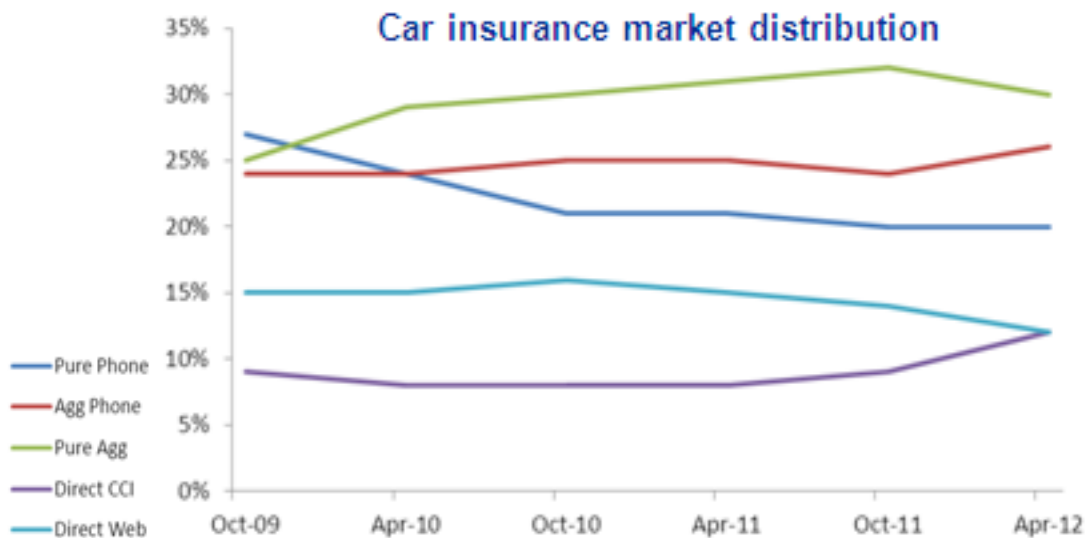
- (5.10) Aviva is sufficiently sensitive regarding the use of its data that it takes steps to protect it contractually by negotiating a right to audit PCWs' use of its data (where it is possible to negotiate such protection).
- (5.11) Nevertheless, Aviva believes there is the potential for insurer-owned PCWs to gain an advantage by misusing a competitor's data because:
- Not all PCWs will give contractual commitments as to the use they will make of insurer data;
 - Not all PCWs will give audit rights to the PMI provider for the purposes of ensuring that the provider's data is being used appropriately; and
 - It is difficult for a PMI provider to find evidence of misuse during an audit if the data has been misused for purposes other than generating a customer quote.
- (5.12) In light of the above, Aviva supports the Commission's decision to investigate the potential for harm caused by PCW-integrated insurers undercutting rivals' prices or manipulating quotes.

PCWs requiring insurers and brokers to accept MFN clauses

- (5.13) This section of Aviva's submission relates to paragraphs 90 to 95 of the Statement of Issues.
- (5.14) Paragraph 90 of the Statement of Issues is correct where it states that some PCWs do insist on MFN clauses which require insurers to quote the same price for a particular policy on the PCW as for sales through other online distribution channels.
- (5.15) Aviva has concerns regarding the use of these clauses, not least because (at least in Aviva's experience) three out of the four main PCWs insist on using some form of MFN clause.
- (5.16) Whilst many customers like to use PCWs to buy PMI, they are not the most cost effective way to distribute our products. The insistence on MFNs does not allow us to alter our prices to PCWs to reflect the costs of using their platforms and distorts distribution in favour of PCWs, as we cannot reflect the higher costs trading through their platforms. The prevalence of MFNs also softens competition between PCWs as one PCW cannot gain an advantage over another by attracting better priced products.
- (5.17) Any harmful effect of MFNs is likely to develop or increase as PCWs' total share of the PMI market grows (See Figure 14) or if one individual aggregator becomes very large and acquires market power. In that regard we note sales of PMI policies via PCWs are already the most popular means of acquiring PMI insurance and 50% of consumers who shop on PCWs complete their purchase online.
- (5.18) Aviva would therefore encourage the Commission to reconsider whether to investigate MFN clauses further.

Theory of Harm 5

Figure 14



Insurers—broker relationships

- (5.19) This part of Aviva's response relates to paragraphs 96 to 99 of the Commission's Statement of Issues.
- (5.20) Aviva notes that the Commission considers that vertical relationships between insurers and brokers are not likely to give rise to competition issues unless there is market power in either market and, therefore, does not intend to consider further the vertical relationships between insurers and brokers (unless it considers there is market power in the segments of PMI it considers under ToH3).
- (5.21) Aviva agrees with this approach and does not object to the Commission's proposal not to investigate this area further. As noted above, Aviva does not consider there is market power in the segments referred to by the Commission under ToH3 and so considers it unlikely that the Commission will need to consider this area further.
- (5.22) In any event, Aviva is not currently aware of any evidence suggesting that vertical relationships between insurers and brokers are liable to give rise to competition concerns.

Repairer—insurer relationships

- (5.23) This section of Aviva's response relates to paragraphs 100 to 102 of the Commission's Statement of Issues.
- (5.24) Aviva notes the Commission's intention to investigate at a high level whether there are any areas where both repair is concentrated and some repairers have vertical relationships with insurers to determine whether in these areas rival insurers may face higher repair costs.

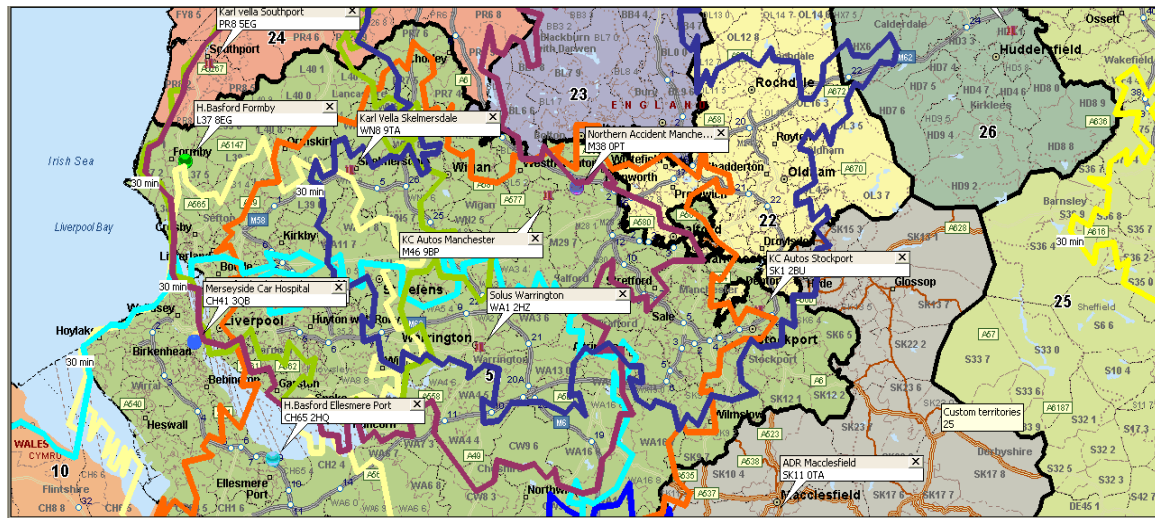
Theory of Harm 5

- (5.25) Aviva agrees with the Commission's view that the car repair market is highly fragmented. There are approximately 4,000 repairers in the UK (with 880 being PAS 125 accredited which many insurers look to use to ensure safety standards in repair quality).
- (5.26) Aviva also agrees with the Commission that repairer-insurer relationships are not exclusive and repairers can, therefore, work for other insurers. Indeed, repairers often work for many insurers, AMCs and retail customers as well as repairing cars unrelated to PMI claims.²¹
- (5.27) A number of insurers will have relationships with repairers, either by owning them or contracting with them. Insurers direct customers to use the networks they have established for three main reasons;
- Guarantee of capacity to ensure a good level of service
 - Safety of repair, ensuring the customers vehicles is repaired correctly
 - Cost of repair, ensuring sensible measures are taken to manage repair costs.
- (5.28) Aviva's decisions regarding the appointment of repairers are based on whether a repairer meets our acceptance criteria for quality and safety of the repairs (using PAS 125 as a marker of standards) followed by the price the repairer can offer within the context of the region where it is located.
- (5.29) In general, Aviva considers the repair market to be very competitive with surplus capacity driving competitive trading dynamics. However, it considers that there may be a very few isolated areas where competition is more limited and where prices for repair may be higher (such as the geographically isolated Highlands and Islands of the UK).
- (5.30) The maps below provide examples of two contrasting areas: Manchester (Figure 15) and Aberdeen (Figure 16). The Commission will see that in the Manchester area there are many repair options available (including the Solus site owned by Aviva). In this area Aviva sends work to many different repairers.

21 Aviva has no sole supplier agreements or other relationships with repairers, with the exception of the Solus sites which it owns. Approximately 95% of the repairs carried out at the Solus sites are directed by Aviva. However, Solus is not restricted from working with other insurers and in fact has made many attempts to work with other providers. In practice, the fact that Solus is owned by Aviva discourages other insurers from working with it.

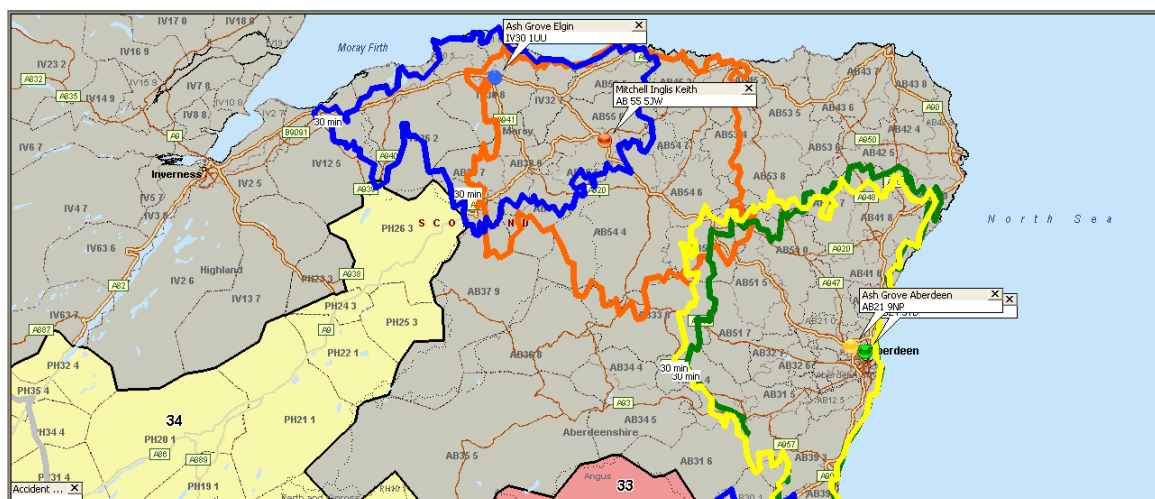
Theory of Harm 5

Figure 15: Manchester



(5.31) By contrast, in Aberdeen there is a choice of four suppliers, only one of which is PAS125 accredited (which all insurers look to use as a mark of safety and quality). This creates a different trading dynamic as there is surplus demand. To our knowledge there are no exclusive arrangements with any Insurer. Typically having only one Insurer's claims volume would not be enough for any of the businesses to thrive.

Figure 16: Aberdeen



(5.32) Given that repair is likely to be more concentrated only in a small number of geographically isolated areas, we do not consider that any higher costs are liable to have a material impact on claims costs and PMI premiums.

Theory of Harm 5

- (5.33) In addition, in all areas insurers use in-house desk and field engineers or independent engineers to help validate the reasonable nature of the costs.
- (5.34) It is also important to note that any vertical relationships between insurers and repairers will be restricted to cases where the insurer has the ability to control liability and direct claims to the repairer. For example, Aviva seldom exercises control over broker claims where it underwrites the policy (although it does control the Aviva direct and QMH branded products).

Insurer—parts/paint manufacturer/distributor relationships

- (5.35) This part of Aviva's response refers to paragraphs 103 to 108 of the Commission's Statement of Issues.
- (5.36) Aviva notes that the Commission intends to investigate whether harm may arise from vertical relationships between insurers and parts / paint providers because:
- contracts between large insurers with buyer power who are able to negotiate discounts with parts / paint providers have the effect of increasing the parts /paint costs of smaller insurers who are not able to negotiate similar discounts (*input foreclosure*); and / or
 - contracts between insurers and parts / paint providers which incentivise or require their repair networks to use that insurer's preferred parts / paint supplier mean that other parts / paint suppliers are denied access to repairers (*customer foreclosure*).
- (5.37) Many insurers including Aviva aim to ensure the quality and safety of car repairs for their customers by recommending parts and paints suppliers who provide the right quality products. In order to secure recommended status from an insurer, parts and paint suppliers may provide incentives to insurers to recommend them to repairers in the form of a rebate.²² For example, Aviva recommends (but does not mandate) the use of PPG paint products to its network of repairers in return for a financial rebate from PPG.
- (5.38) However, Aviva considers the impact of these rebates to be extremely limited. This is because any rebate is absorbed by the value chain. For example, if the full price for paint chargeable within the market is considered the retail price, then some repairers enjoy a discount from the manufacturers of over 80% of this retail price, whilst insurers typically receive a discount ranging between 5% and 25% of the retail price from the repairer on each repair invoice. Any rebate is, therefore, absorbed in the margins and discounts available throughout the value chain. The insurer simply sees an end cost and has no control over the margins taken by the manufacturer or distributor. It may be the case that a limited number of customers actually pay RRP as this seems to only be used as a basis for a range of discounts.

²² These relationships are not exclusive and paint and parts suppliers are likely to have similar arrangements with several insurers.

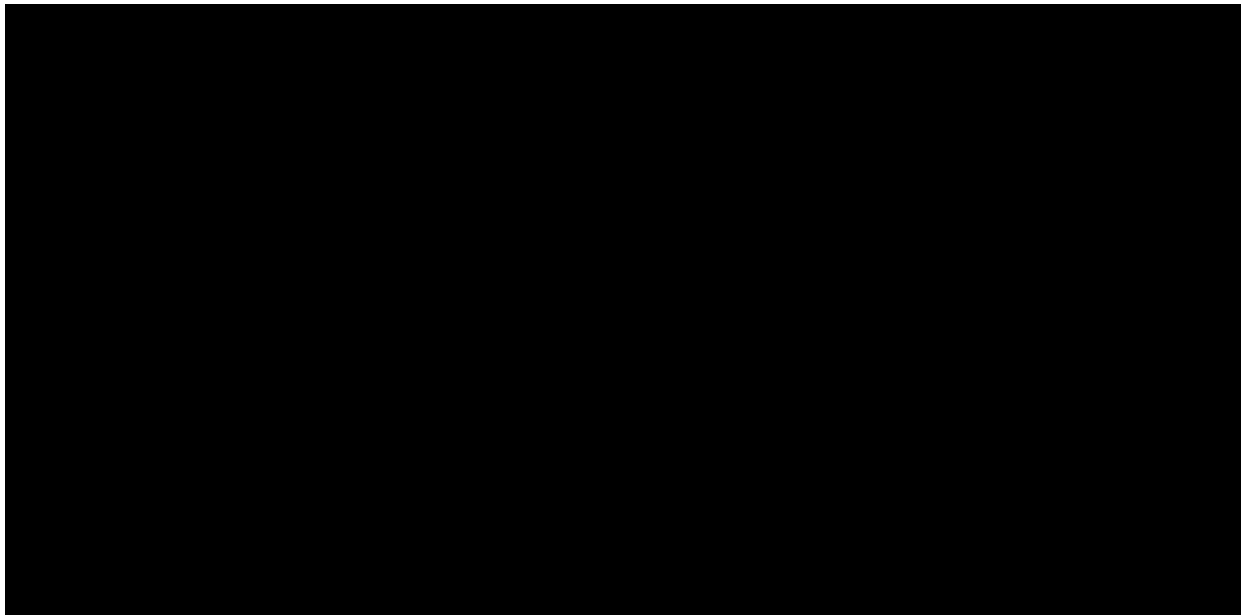
Theory of Harm 5

- (5.39) Therefore, the net cost of the paint for insurers is not likely to be significantly different whether they receive a rebate or not. This fact led Aviva to terminate its paint rebate arrangements in 2012, and work with repairers on reducing costs instead.
- (5.40) Furthermore, owing to the limited contribution of paint to the overall repair bill, any rebate the insurer does receive is unlikely to make a material difference to their overall motor claims spend as illustrated below:



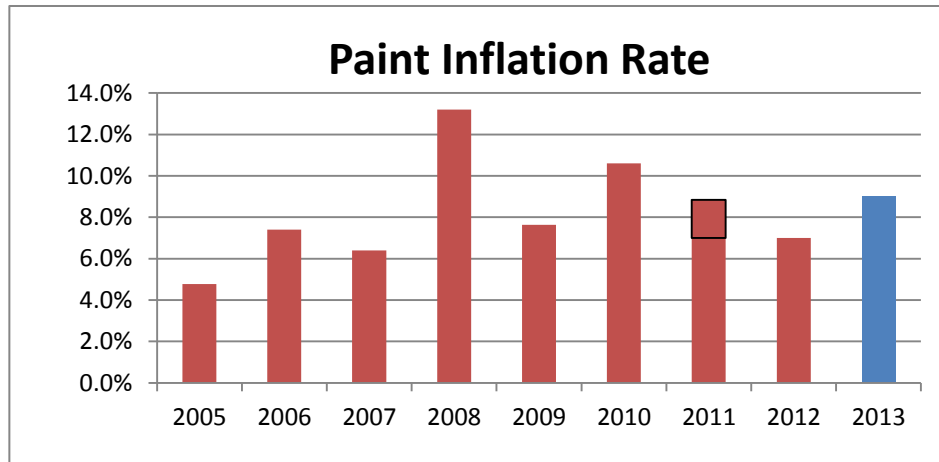
- (5.41) Although Aviva does not consider that harm derives from insurer relationships with parts or paint manufacturers, it does have concerns regarding the price increases implemented by parts and paint manufacturers year on year which have dramatically increased costs for the industry.
- (5.42) In recent years the retail price of paint has typically seen price increases in excess of the rate of inflation up to three times in a year. Often this has resulted in double figure percentage increases. Aviva has produced the graphs below from information provided by AZT on paint inflation (Figure 18) and [redacted] in relation to parts (Figure 17).

Figure 17



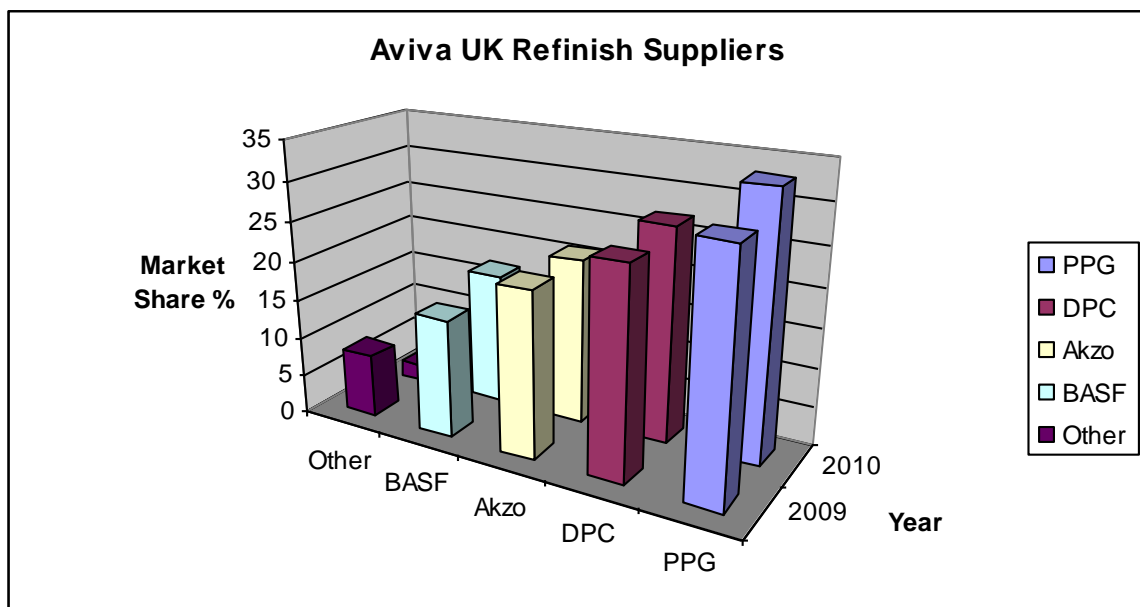
Theory of Harm 5

Figure 18



(5.43) Aviva has also observed that price increases in paint are often of the same order of magnitude and are implemented by paint manufacturers at the same time. They are implemented to the market via a Paint Index table in the estimating system houses (used by repairers and engineers to cost repairs) which is an average of all the market increases/prices. So a compounded effect of all manufacturers placing increases at a similar time, applied to the users via an 'average' Index. This makes any differentiation or competitive trading difficult. The graph below (Figure 19) shows the market share of the main 4 manufacturers up to 2010, this has not changed significantly since then.

Figure 19





Theory of Harm 5

(5.44) Aviva continually tracks initiatives deployed by vehicle and paint manufacturers and works with repairers to see how these cost increases could be mitigated. The initiatives below are examples of vehicle manufacturer actions which drive repairs and more specifically parts back to the manufacturer:

- Cost of approvals (i.e. the combined cost of the manufacturer approval license and mandatory training and equipment) which could be a barrier for independent body-shops;
- Deploying their own repair networks to ensure the manufacturer's own parts are used in the repair of branded vehicles (which could reduce independent repairer choice and further restrict the ease of entry into the replica parts market); and
- Branded insurance schemes which insist the underwriting insurer directs all the branded vehicles within the branded scheme and the insurer's existing book to their network using their parts.



Appendix

Appendix of documents supporting our submission

Aviva has classified all documents in this section as "Confidential" due to disclosure of this information would be considered as causing significantly harm to Aviva's legitimate business interests.

As documents have been supplied as held within Aviva's archive system, this may mean that the documents appear of incomplete or altered. Only documents clearly marked as "REDACTED" have been amended in any way so as to remove irrelevant content.

To support the identification of where files start and finish, **labels have been adhered to the first page of each document** as listed in the Appendix of each section. These labels carry the file name as it appears within the Aviva archive system.

Appendix of Documents Supporting Theory of Harm 1

ToH1-Project Polo- Aviva Press Releases - Quotations 2012.docxe



Appendix

Appendix of Documents Supporting Theory of Harm 2

ToH2-Project Polo-ABI Code of Practice Third Party Assistance.docx

ToH2- Project Polo-Extracts from Aviva UK Direct Policy.docx



Appendix

Appendix of Documents Supporting Theory of Harm 3

ToH3-eBenchmarkers Spring 2012 online insurance report -Car Aviva.ppt



Appendix

Appendix of Documents Supporting Theory of Harm 4

ToH4-Project Polo-Confidential-UKDI.pdf

ToH4-Table of Cancellation Fees.docx



Appendix

Appendix of Documents Supporting Theory of Harm 5

None