

BGL GROUP LIMITED
CC INVESTIGATION INTO THE PRIVATE MOTOR INSURANCE MARKET
RESPONSE TO THE STATEMENT OF ISSUES
January 2013

Introduction

BGL Group Ltd (**BGL**) welcomes this opportunity to submit its comments and evidence on the issues which the Competition Commission (CC) intends to consider as part of its investigation into the private motor insurance market.

Please note that these comments are not exhaustive. BGL may complement or develop its views with further detailed analysis and evidence as appropriate during the course of the investigation in order to assist the CC with any provisional findings.

BGL would also like to emphasise that the fact that BGL does not, in this document, expressly respond to a point in the CC's Issues Statement does not necessarily imply that BGL agrees with it. This document simply comprises initial thoughts and information.

About BGL

BGL is a privately owned UK company, employing 2,300 people and with 4.6 million customers. Founded in 1992 as an insurance underwriter, BGL has since diversified into a range of related activities including, in 1997, switching from underwriting to insurance broking. BGL has grown to become one of the leading personal lines insurance intermediaries, principally in the field of motor insurance, in the UK.

BGL, through its trading subsidiaries, comprises a number of distinct and independently functioning business units responsible for the arrangement and administration of personal lines general insurance products and associated services. The Group's business units include:

- Bennetts, the UK's number one provider of motorcycle insurance;
- Frontline, a leading provider of car, van and home insurance;
- 'comparethemarket.com' (ctm), the leading price comparison site;
- Junction, the Group's corporate partnerships division, which works with partners, to provide insurance propositions to their customers; and
- ACM, the group's market leading claims management service, which is responsible for the management of approximately 150,000 claims from motor insurance customers per annum.

Overview

This document sets out BGL's initial response to the Theories of Harm (ToH) relating to the Private Motor Insurance (PMI) market set out by the Competition Commission in its Statement of Issues (Sol) on 12 December 2012. There are three points that we would make at the outset before examining the specific ToH.

First, while we appreciate that the CC's remit is much wider than an assessment of insurance premium prices, the purported rise in premiums has arguably been the key motivating factor for the Office of Fair Trading's market investigation reference (MIR). Therefore, it should inevitably comprise an important part of the CC's subsequent review.

In this regard, aside from the fact that PMI is a cyclical sector and, therefore, the pricing of premiums is invariably in a fluid state, it is important not to underestimate the impact of factors such as the economic crisis and how PMI providers may have altered their pricing models, for example, to address declining investment returns.¹ Moreover, the market is already in the midst of a series of

¹ A report published by Ernst & Young in 2011 ('bringing profitability back from the brink of extinction – a report on the UK retail motor insurance market') (the EY Report) notes on p17 that *"Personal Motor is the largest single class of insurance business, with a Gross Written Premium (GWP) of £9.5 billion in 2009...It is*

major legal and regulatory upheavals – including the forthcoming LASPO² changes to the personal injury regime being implemented by the Ministry of Justice. All these factors might be expected to have a radical effect on premium pricing. As the CC rightly appears to acknowledge³, it is difficult to assess the foreseeable impact of these developments; however, an even greater risk may arise if they are excluded from any review or underplayed in terms of assessing the actual need for or proportionality of any solutions identified.

Our view is that these changes are likely to lead to a significantly different market outlook over the course of the CC's investigation. We, therefore, agree that the timing of the MIR is inopportune and, as far as the statutory timetable allows, it would be preferable for the CC to keep an open mind for as long as possible to assess the impact of these changes before recommending any further regulatory measures or other remedies.

Put simply, as part of any assessment of market dysfunction (and the solutions that might address them) proper recognition should be given to key features which may underlie the problems but which are already in the process of reform or, indeed, beyond reform. If proper weight is not given to such areas, then any additional solution is likely to be dis-proportionate or even entirely unnecessary. For this reason, while we acknowledge the very substantial difficulty the CC may have in predicting the impact of imminent regulatory developments, it should attempt to undertake further work in this area, or at least continue to factor such considerations into the assessment of any other market features and remedies.

Second, the Sol takes as its basis the complexity and consequent lack of transparency of private motor insurance. We agree that insurance documents are sometimes necessarily lengthy and detailed. Nevertheless, the Sol goes on to raise the concern that the reliability of the provider is not typically visible to the consumer at the point of purchase. However, PMI providers are closely regulated by the FSA with detailed requirements as to conduct, capitalisation and prudential strength, all under-pinned by a comprehensive compensation scheme. Together this means that consumers can place a significant level of reliance upon the providers of these products.

It follows that, in our view, the reliability of the insurance provider is more of a 'given'; it is perhaps in respect of the different features of insurance products (and optional items that may be purchased alongside them) where consumers might benefit from increased awareness. On this point, we consider that price comparison sites, such as ctm, have already made significant advances in improving consumers' understanding and awareness of different insurance products and offering user-friendly mechanisms to sort, rank and compare key features of different policies. Indeed, the EY Report (see footnote 1 above) states (p21) that:

'The Customer is the winner – There is no question that the advent of aggregators has done a great deal to educate personal motor customers about price and the choice of provider. Our interviewees have differing views on their benefits to the industry as a whole; however, they are fairly unanimous in seeing customers as the main beneficiary of the rise of the aggregator.'

Finally, the principal concern expressed by the OFT in its report was of moral hazard: alleged harm arising from the separation of cost liability and cost control. However, in addressing this concern, it is important not to go too far in the other direction and protect the insurer of the at-fault driver at the expense of the victim.

If the CC concludes that further action is required in this area, one option could be through improvements to the General Terms of Agreement (GTA). If this were widened, subject to compliance

therefore, a critical market for any insurer with aspirations to be a major part of the UK insurance landscape. The desire to participate in this large revenue pool means that competition among insurers is high, leading to very slim profit margins. The insurance market has made almost no money at all from the underwriting of motor insurance in the past 25 years, relying on investment income and sales of ancillary products to create a return on invested capital." It follows that dramatically declining investment returns will inevitably have a very significant influence on premiums

² The Legal Aid, Sentencing and Punishment of Offenders (LASPO) Act 2012

³ Paras 36 and 37 of the Statement of Issues

with applicable competition law, to include the entire spectrum of market participants in establishing maximum charges and standardised terms of payment, in addition to being limited by the existing charging mechanisms currently set out in the GTA, this could represent a broader solution that will be sustainable for all market participants. It would also serve to balance the interests of consumers, service providers and insurers.

Theory of Harm 1 – Harm Arising from the Separation of Cost Liability and Cost Control (Moral Hazard)

Incentives Arising in Relation to Non-Fault Claims

The CC's analysis of this area in the Sol represents a reasonable starting point for further investigation, we would take issue with any early conclusion (see paragraph 32) that the likely net effect of referral fees on premiums is upwards.

The CC acknowledges that it is unclear whether there exists a more cost-efficient method by which the service providers (credit hire companies, solicitors etc) could attract business. Our contention is that any alternative method of attracting business is almost certain to be less cost efficient. An example to support this proposition may be the comparison between claimant personal injury law firms that do and do not pay referral fees. In our view, those that do pay referral fees are amongst the most profitable and financially stable law firms particularly when compared to other law firms undertaking similar work who do not pay referral fees. We should be happy to elaborate further on the issue of referral fees and the efficiency, or otherwise, of alternatives, if this would be helpful for the CC.

Measures to Mitigate this Harm

- (a) Bilateral agreements between insurers – these agreements are by their nature exclusive in that they differentiate between consumers insured by those insurers who have a bilateral agreement and the remainder. It is difficult to see how this cannot lead to a two tier service and a consequent potential for consumer harm, not least because it disregards the consumer's legal rights.
- (b) The GTA – again the GTA is to some extent exclusive in that it is essentially an agreement between the participants in a restricted membership organisation. Our view is that the GTA would be more effective if it were open to all sector participants. However, in order to be valuable it needs to be balanced and truly reflective of all of the requirements of the different stakeholders.

For this to be achieved the entire spectrum of market participants would need to be involved both in the establishment of maximum charges and standardised terms of payment (in addition to being limited by the agreed capped rates in terms of their charges). We would recommend that the CC investigates the possibility of developing, broadening and improving the GTA further, as this may represent a proportionate long term solution that is both sustainable for all market participants and will serve to balance the interests of consumers, service providers and insurers.

- (c) Intervention by Third Party Insurers – far from mitigating any issues in relation to PMI, we consider this proposal to be misconceived and unsupportable and the practice itself to be potentially harmful to consumers for the following reasons:-
 - (i) The interests of the third party insurer and those of the not at fault customer are diametrically opposed and allowing third party insurers to control the outcomes for such customers in the absence of a “safety net” provides potential for consumer detriment.
 - (ii) We do not consider that there is any substantive evidence that the existing adversarial system for recovery of damage, which applies right across UK law should not continue to operate in relation to PMI.

- (iii) We can see no justification for departure from the principal that the victim who has suffered damage should be unfettered in his/her choice of representation or restitution, particularly in view of the legal duty upon each claimant to mitigate losses and costs.
- (iv) All of the above points are exacerbated by the significant discrepancy in terms of financial strength and access to the law between individual claimants and defendant insurers.

Practical Implications of Statutory and Regulatory Changes

Our view would be that these changes are likely to lead to a significantly different market outlook which is far from certain to be positive to the consumer experience. However, adverse consumer effects aside, given the potential impact of these changes on costs, it is difficult to disregard these features (and the effects of any imminent regulatory changes) when considering the magnitude of any other issues within the scope of the CC's review or the proportionality of any potential remedies.

Theory of Harm 2 – Harm Arising from the Beneficiary of Post-Accident Services being different from and possibly less well informed than the Procurer of those Services

In this section the CC groups together all of the wide-range of market participants with whom the consumer may interact at the point of claim. We consider it an over-simplification to suggest that potential consumer detriment exists simply by virtue of the fact that each of those parties is better informed than the consumer for whom the accident management process will inevitably be a rare occurrence. Equally, it does not follow that the fact that any of those parties receives income as a result of the occurrence of accidents, renders them unlikely to act in the consumer's best interest. For the majority of these parties such assumptions are no more true than they would be for a doctor/patient or solicitor/client relationship in any other sector. The professional involved is always rewarded partly as a result of the unfortunate circumstances of his/her client/patient.

Furthermore, these conclusions overlook two fundamental aspects of the structural provision of these services which we consider important. Firstly, there is a significant distinction between the parties who stand to profit from providing an inadequate service or product to a consumer and those whose interests are directly aligned with those of the consumer. The best example of this distinction is that of the broker and the third party insurer. For a broker such as BGL (particularly one trading through a number of well-known and highly reputationally sensitive financial services/retail brands), ensuring the consumer has the best possible experience whilst making a claim is the key consideration.

The availability of income whilst naturally important is in no way incongruent with the interests of the consumer. Accordingly, all claims management and third party supplier agreements entered into for the benefit of BGL clients, have closely managed, consumer-led, service levels aimed at procuring optimum consumer outcomes. The expertise and collective purchasing ability of a business like BGL compensates for the lack of knowledge on the part of the consumer and at the same time ensures these services are provided within GTA rates.

The position of businesses such as BGL is aligned with the interest of the beneficiary of post-accident services because the consumer claims experience is the acid test of product value. Particularly where the consumer is the injured party BGL is obliged (contractually in the majority of cases) to ensure that the consumer receives all of the services to which he/she is entitled. This requirement is heightened by more recent developments in consumer behaviour including the growth of website, social media and blogs sharing consumer experience and brand perception.

This is in stark contrast to the position of at fault insurers whose interests are diametrically opposed to those of the beneficiaries of post-accident services and revolve principally around cost reduction.

Secondly, there is the regulatory aspect of the provision of services which is relevant to some but not all of the providers. A fundamental difference between the approach taken by a broker such as BGL to securing services on behalf of customers and that taken by a third party insurer, is the regulatory obligation to secure the best consumer outcome, which is a duty that applies to BGL, but not the

insurer. This obligation is supported by a wide-ranging regulatory structure including, approval and oversight and a statutory complaints and redress process culminating in the Financial Ombudsman Service. Our position would be that the optimum outcome for the beneficiary is obtained by the procurement of post-accident services by knowledgeable and experienced specialists in this field where meaningful safeguards exist to protect consumers.

Theory of Harm 3 – Harm due to Horizontal Effects (Market Concentration)

Price Comparison Websites (PCW)

We would challenge the basic premise that underpins this ToH. In particular, fundamental to any potential harm is the view that higher costs per acquisition (CPA) would, in and of themselves, result in harm. This view fails to take cognisance of the position and evolution of PCW's. Historically, price comparison websites have represented only a peripheral element of the sector representing only a fraction of those consumers who wished to change provider. CPA charges were set during that period commensurate with the value of this distribution route. Subsequently PCW's and particularly ctm have embarked upon a massive investment exercise both in terms of marketing and, equally importantly, customer proposition to ensure that they have become a more significant distribution route and source of consumer information.

However, the impact of this investment has not been to increase the acquisition cost to PMI providers. Marketing media spend for PMI has diminished over the last five years and at the same time consumers are now able to make informed choices more quickly and efficiently. Additionally, the increased prevalence of the internet as a method of research and purchase for PMI products has allowed for a reduction in resource requirements (call centres etc) within the PMI sector. Taken as a whole, it is evident that the acquisition costs in the PMI sector are reducing.

We would concur with the CC's point that the PCW model is, to a large extent, self-regulating - in that a PCW, in order to be viable, requires a broad panel of providers meaning that its CPA must be such that it remains a more efficient method of acquiring consumers than the alternatives. As recognised by the FSA the sector *"remains increasingly competitive on price, particularly in light of the increased role played by price comparison websites as a distribution channel"*⁴.

Of equal importance is the fact that PCWs have removed the major obstacle to entry to the market for new PMI participants - being the advertising spend required to access a viable number of potential consumers. It follows that large insurers have, as a result of the low barriers to market entry facilitated by PCWs, faced increased competition from a wider range of market participants.

To illustrate this, between January 2010 and November 2012 the share of overall sales of the top 5 PMI participants on ctm steadily reduced from 65 per cent to just over 50 per cent. Meanwhile, 15 brands which did not utilise ctm in January 2010 now account for around 15 per cent of ctm sales⁵.

This suggests that the PCW commercial model (certainly the ctm model, where brands only pay on a per policy basis) has made it easier for new and 'internet only' brands to acquire customers and market share.

Finally, although price comparison activity may currently be most closely associated with a limited number of leading and recognisable PCW brands, we do not consider that this would confer any particular market power on such PCWs (not simply for the reasons identified in the Sol and outlined above), but also because barriers to market entry remain low.

This conclusion was reached by the FSA who found in 2011: *"price comparison websites (also known as 'aggregators') continue to have an important and growing role. There are now around 16 main price comparison websites with around 40 'white label' sites"*.

⁴ Financial Services Authority Retail Conduct Risk Outlook 2011, p41

⁵ ctm insurer share data – Schedule 1

Since these findings were published, the OFT has also considered PCWs and the same point was highlighted in the OFT's recent merger clearance of Google Inc/BeatThatQuote.com Ltd⁶:

OFT decision (p28): Figure 2 Market entry in consumer finance PCSs in the UK, 2000-2010



In this decision, the OFT further noted that: "barriers to entry in the PCS [Price Comparison Site] market are relatively low, as evidenced by the large numbers of new entrants in this sector over the past five years"⁷

Theory of Harm 4 – Harm Arising from Providers' Strategies to Soften Competition

Strategic Product Differentiation of PMI

We would be unsure of the evidence upon which the CC has based its conclusion that there is a significant degree of product differentiation in PMI policies. Basic PMI policies are, of course, prescribed by statute. Also, whilst certain product features are highlighted to a greater or lesser extent by different market participants, we would not consider that there is significant product differentiation in relation to the operational impact of core PMI products.

If products were so widely and significantly differentiated one from another then one would not expect the relative success of PCWs to have taken place.

Drip-In Pricing (Partitioned Pricing)

The approach to the provision of PMI products whereby the "core" product features from the outset and is then supplemented by a number of separate but additional products is a consequence of how the market has historically developed.

On one level, it is not unusual in that one starts, for PMI products, with the core element of the product which is compulsory and, again, historically, three basic variants third party, third party fire and theft, and comprehensive have developed. A consumer would expect and receives a clear delineation as to which basic product is being provided. Thereafter, different consumers will have a range of different requirements related to their choice of vehicle, personal circumstances or financial circumstances, the number of miles they cover and what access to other vehicles they have etc. These differing requirements are met by a range of alternative additional products.

⁶ No. ME/4912/11

⁷ P12

Transparency and Complexity of Add-On Products and Services

See above.

Increasing the Obstacles to Customers Switching PMI Provider

We do not consider that there are significant obstacles to customers switching between PMI providers. We consider the following to be the salient considerations in this regard:-

- (i) PMI products are relatively short term in duration running for a maximum period of one year.
- (ii) The impact and effectiveness of price comparison websites illustrate the relative ease with which consumers can switch between provider.
- (iii) Cancellation fees are applicable only to changes in provider part way through the term of a policy. Given that the overriding majority of policies are annual in duration, this is only a factor in a small minority of cases. Such cases largely involve situations where the customer has a specific requirement, for example, a change of vehicle.

We are unaware of any practice involving the reduction and the quality of policies offered to consumers on renewal. This is not a practice in which any part of the BGL Group has or would be involved, nor have we experienced this practice in our widespread interactions across the sector. In any event, any change or proposed change in terms of a consumer's coverage at renewal will need to be highlighted by the consumer by way of a "statement of change".

Automatic Renewal

We have seen no evidence that automatic renewal is a barrier to switching or causes customer detriment. Whilst we cannot speak for all automatic renewal processes, BGL obtains explicit consent from the customer at inception of the policy for the subsequent renewal process. A renewal offer is provided to the customer one month prior to expiry of the existing policy and, following renewal, the customer receives confirmation and new policy documentation.

The view expressed by the CC that the potential harm of uninsured drivers would be mitigated by a simple reminder letter to the insured is wholly misplaced. The replacement of a renewal process which involves three explicit elements of customer contact with simply a reminder letter would significantly increase the likelihood of uninsured drivers. Our experience is that despite our current process involving 3 contact points, some customers still do not respond to these calls to action. The current consequence is simply that the renewal is cancelled and the premium refunded. The consumer is assured continuity of cover throughout.

In any event, should a customer have obtained insurance with another provider, the renewal will be cancelled and the full premium refunded. We should be happy to provide the CC with further information in this respect if required.

Any increase in the number of uninsured drivers would contradict the public policy considerations that continue to ensure that PMI remains a legal requirement to which strict liability principles apply. A greater proportion of uninsured drivers would also have the impact of potentially increasing insurer costs as cover continues to be provided indirectly via the Motor Insurers Bureau Scheme. We should also be happy to provide the CC with further information in this respect if required.

Charging a Cancellation Fee

Again such fees are closely regulated.

Cancellation fees are charged where a customer decides to cancel a policy mid- term. This has no bearing on whether customers would shop around on renewal. FSA ICOBS 6.2.5 sets out the pre-sale disclosure rules for cancellation fees. Customers are made clearly aware of any cancellation

changes at point of sale. These fees are a representation of the cost involved in cancelling the policy. If these costs were not paid by customers wishing to cancel their policies they would need to be met elsewhere by other customers leading to a situation where cross subsidy exists. This would have an overall detrimental impact upon competitiveness. .

Protected No Claims Discounts

We acknowledge that practices in relation to protected no claims discount vary amongst PMI providers. However, we would not consider these practices to be a significant obstacle to customers switching between PMI providers.

Theory of Harm 5 – Harm Arising from Vertical Relationships (Vertical Integration)

Ownership of PCWs by Insurers/Brokers

Whilst we understand the theoretical possibility of the gaining of competitive advantage by ownership of a PCW, in practice this is, once again, largely self-correcting as the success of a PCW is overwhelmingly based upon the extent to which it is able to engender trust both from the consumer and from other market participants (i.e PMI providers). Furthermore, in the case of BGL, these concerns disregard the complexity of the nature of the relationship that BGL enjoys with various other market participants.

As a broker, BGL is only able to arrange and administer policies to the extent that it is able to persuade underwriters, virtually all of whom have alternative consumer propositions, to underwrite policies via its various brands. This relationship of co-dependency is based on an on-going level of trust which is enhanced by the transparency and predictability of the operation of its PCW. Further, the success of a PCW (or broker), regardless of ownership, is predicated on the PCW being able to attract as many participants (insurers etc) as possible, so there is little if any incentive to limit access to the relevant platform.

Understanding Competitors Risk and Pricing Models

No such practises are or have been operated by ctm or any part of BGL. More generally, aside from the natural protection afforded by the likely structural and operational separation of an insurer's or broker's PCW business from its core activities and the strict competition law compliance procedures in place to regulate employee conduct and guard against information exchange, it is difficult to see how significant information as to competitors' risk models could be obtained from prices returned.

Our experience in operating a panel of insurers is that risk considerations will vary significantly from insurer to insurer and it is a combination of these multiple risk factors that results in a price. The likelihood, therefore, of being able to reverse-engineer a price in order to understand the underlying insurer risk analysis is extremely low. In relation to the potential harm from understanding competitors' pricing models once again, whilst an understanding of prices returned may theoretically be possible, there is no evidence that this would help necessarily to understand those pricing models.

The overriding point, however, is that the facility to compare quotes based on different variables is, of course, available to all market participants, not simply those that might operate a PCW. Simply by entering sample data and obtaining the requisite number of quotes on any PCW, any market participant is able to identify which other market participants are or are not returning prices and when returned what those consumer prices are; however, this is likely to be of only very limited benefit in terms of informing subsequent conduct – irrespective of the recipient - because the recipient does not know how different variables and risks (which may change frequently) are balanced or weighted by others and how this informs pricing. Any, even theoretical, benefit attributable to insurers or brokers who own PCWs is, therefore, marginal at best. More generally, the transparency afforded by PCWs to consumers and the real benefits delivered in terms of empowering customer to assess prices (which, in turn, results in downward pressure on the pricing of premiums), is likely to far outweigh any theoretical harm in this area. As noted by the EY Report:

“There is no doubt that online sales have opened up pricing to customers’ scrutiny and helped them understand how rating factors affect the cost of their insurance. Customers using the

web to obtain quotations can see for themselves the pricing effect of postcodes, garaging, vehicle use, theft protection and other factors.”⁸

Price Undercutting or Direct Manipulation of Quote Ranking

No practices of the type set out by the CC are or have been carried out by ctm or any part of BGL. While we concur with the point raised by the CC here - that this behaviour is, in principle, more likely to result in consumer benefit rather than detriment - the manipulation of third party prices or quotes by a PCW in favour of any connected underwriting business is not, in any event, sustainable.

Indeed, if there was any evidence of such practices, the detrimental impact upon the relevant PCW would be substantial both in commercial terms and in terms of reputation. The continued reputation of a PCW operating in a highly regulated sector such as insurance - and the trust that it has to engender from consumers, underwriters and brokers - is the overriding consideration from a commercial perspective.

Limiting Access to PCWs

For the reasons set out by the CC, namely the necessity for every PCW to have as broad market coverage as possible and the other potential routes to market for any insurer including other PCWs, this approach is not a realistic consideration. ctm operates independently of the remainder of BGL and each negotiation transaction between ctm and a PMI provider is a confidential, independent and separate arrangement between participants in a highly regulated sector.

PCWs Requiring Insurers and Brokers to Accept MFN Clauses

Here again we would concur with the CC in its articulation of the benefit of most favoured nation (MFN) clauses and the alternative routes to market available for PMI providers. We would add to those benefits identified, the fact that we believe there to be a correlation between the existence of MFN clauses and the success of PCW in terms of providing customers with access to truly competitive prices. Furthermore, for the reasons set out above – under the sections ‘Price Comparison Websites’ and ‘Limiting Access to PCWs’ – we do not consider that the presence of an MFN would confer any greater incentive on a PCW to increase its CPA. Irrespective of the presence of an MFN, a PCW’s CPA is only sustainable to the extent that it presents the most cost-effective means for the insurer to acquire business.

Going back to the basis of the proposition being one of consumer trust, where the consumer is selecting on the basis of a price that it has been offered, it is imperative that the consumer should understand the extent to which that price is or is not the best available.

We would be happy to provide further information and to meet with the Inquiry team during the course of the market investigation. If you would like any further information, please contact Ron Simms, Director of Corporate Services at ron.simms@bglgroup.co.uk or on (01733) 845409.

⁸ P23