DIRECT LINE INSURANCE GROUP PLC

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

RESPONSE TO THE COMPETITION COMMISSION'S STATEMENT OF ISSUES

A. INTRODUCTION AND EXECUTIVE SUMMARY

Direct Line Insurance Group plc (**DLG**) welcomes the Competition Commission's (the **CC**) market investigation (the **Investigation**) into private motor insurance (**PMI**) and the opportunity to respond to the CC's Statement of Issues published on 12 December 2012 (the **Issues Statement**).

By way of summary:

- DLG's view is that the separation of cost liability and cost control – the CC's first theory of harm (**ToH**) – does lead to market dysfunction and can lead to increased costs. DLG believes that this should be the main focus of the CC's Investigation.

- ToH 1 is a complex area involving a mix of statutory provisions and case law precedents. DLG believes it is important that insurers and other industry players do not discriminate between fault and non-fault claims in the repair process. DLG is also conscious that ToH 1 is in part a natural consequence of the third party liability model and so is strongly of the view that any changes to combat this market dysfunction must be carefully considered.

- DLG agrees with the CC that issues relating to bodily injury are best dealt with by the Ministry of Justice but also believes that similar considerations apply to ToH 4: these issues fall within the remit of the Financial Services Authority (the **FSA**) / Financial Conduct Authority (the **FCA**). For example, the FSA has announced a study into general insurance products sold as add-ons and is also carrying out a thematic review of Motor Legal Expenses Insurance. DLG therefore suggests that ToH 4 is best dealt with by the FSA/FCA.

- DLG welcomes the CC's consideration of price comparison websites (**PCWs**), but believes that the use by PCWs of most favoured nation clauses (**MFNs**) has greater potential to create consumer detriment and to restrict competition (both between PCWs through price harmonisation, but also between insurers through restrictions on pricing between channels) than the CC has indicated in its Issues Statement. DLG believes that these clauses merit further investigation by the CC.

- The PMI market is highly competitive and DLG believes that consumers do and will continue to benefit from this competitive environment. This provides incentives for insurers to invest in their repair network – as DLG has done – in order to minimise the cost and maximise the quality of repairs. Any changes contemplated by the CC should not, therefore, disincentivise insurers from making these investments.

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DLG sets out in Section B below its response to each ToH raised by the CC.

B. THE CC'S THEORIES OF HARM

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

(a) ToH 1 should be the focus of the CC's Investigation

1.1 DLG agrees that the current structure of the PMI market – whereby in non-fault claims the person receiving a particular service (i.e. the repair of a vehicle or the provision of a replacement vehicle) does not pay for that service, but instead a third party (insurer) covers those costs – can create incentives which can cause market distortions and can generate cost inflation at a market-wide level. DLG believes that ToH 1 should be the focus of the CC's Investigation.

1.2 DLG believes it is important that insurers and other industry players do not discriminate between fault and non-fault claims. DLG does not:

(a) apply differentiated labour rates for fault and non-fault work; nor does it charge different labour rates dependent upon who is ultimately responsible for the payment of that repair cost, i.e. DLG or a third party insurer;

(b) differentiate between fault and non-fault work in the management of repair periods;

(c) differentiate in its specification, quality or supply of parts, paints and consumables for fault and non-fault repairs;

(d) receive referral fees from its network of repairers for referring repair work to them (e.g. through membership fees); or

(e) outsource third party repairs to credit repair agencies.

1.3 DLG notes, however, that this is a highly complicated area and that in assessing this ToH, the CC will need to take into account a number of different factors which DLG sets out below.

(a) The way in which the PMI market currently operates is based on statute and a series of English court decisions. These provide a clear legal precedent as to the rights of:

(i) the non-fault party, for example, who is entitled to receive a replacement vehicle of a similar standard to their own i.e. a like-for-like replacement rather than simply a courtesy car; and

(ii) the accident management companies, credit hire organisations (**CHOs**), credit repairers and other companies which provide services to non-fault parties. These providers, for example, are entitled – on behalf of the non-fault party – to use credit facilities to fund vehicle repairs and alternative transport.

(b) ToH 1 relates to the underlying cause of the dysfunction in the PMI market and not the symptoms nor the mitigants of this dysfunction. To some extent, this separation of cost liability and cost control is the necessary consequence of a third party liability model. Any material move away from such a model would have profound implications.

(c) A change to a first party model (of which there are a number of potential variants) would raise some important public policy questions, not least with regard to the pricing of PMI, which traditionally has been based on the cost of accidents expected to be caused by each policyholder. A change of this scale would in itself create very significant costs for the industry, which ultimately will be borne by consumers and it may also have unintended

consequences for the future pricing of PMI premiums. The CC would therefore need to carry out a full cost/benefit analysis before proposing such a radical form of intervention.

(b) Bilaterals and the GTA are aimed at mitigating costs

1.4 The CC has confirmed that bilateral agreements between insurers and the General Terms of Agreement (the **GTA**) are measures aimed at mitigating the harm arising from the separation of cost liability and cost control. DLG agrees with this: DLG's bilateral agreements are designed to improve efficiency and control the cost of providing replacement vehicles to non-fault parties, whilst the GTA has provided a helpful check on rates (albeit that rates have continued to increase) and also promotes early and efficient settlement.

1.5 DLG does not, however, agree with the characterisation of these agreements as part of the 'harm' and does not believe that there is any evidence that these act as anything other than a mitigant against cost inflation. Indeed insurers would have no reason to enter into them if they did not believe that they would control costs overall.

1.6 The CC raises a concern that where a fault insurer captures a non-fault party this may result in the non-fault party receiving a lower quality of service than that to which they are entitled and would otherwise choose. DLG disagrees with any suggestion that it offers a lower quality of service to non-fault parties (although it is unable to comment in relation to other market operators). As set out in paragraph 2.4 below, DLG prioritises quality of service and provides the same repair service for fault and non-fault claims alike. For example, DLG offers a guarantee of five years (or DLG will match a manufacturer's guarantee period if longer) for any repairs done by its network of repairers; this applies equally to fault and non-fault claims.

1.7 Equally, DLG's supplier of replacement vehicles, Enterprise-Rent-A-Car (**ERAC**), must meet clear service specifications including in relation to quality and safety requirements, and detailed performance measures and targets. **[CONFIDENTIAL]**

(c) Bodily Injury

1.8 With regard to bodily injury, as set out in its initial submission dated 16 October 2012, DLG agrees with the CC that given the reforms in train, the Ministry of Justice are best placed to consider this. Bodily injury should therefore not form part of the CC's Investigation.

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

(a) Customers receive significant information from a variety of sources

2.1 There appears to be some conflict between ToH 2 and ToH 1.

(a) The incentives described under ToH 1 mean that in practice the beneficiaries of post-accident services may receive services that if anything are ***unnecessarily beneficial***. For example, a non-fault party is entitled to receive a like-for-like replacement vehicle when they may only require a courtesy car.

(b) ToH 2 suggests that customers are ***less well informed*** about the services available to them and may not be fully aware of their rights.

2.2 Post-accident services comprise only a limited set of services: roadside recovery, repair and provision of a replacement vehicle. Even if some customers may not fully understand the intricacies of their legal rights when taking out a policy, DLG's view is that this is much less of an issue by the time customers come to make a claim on their policy. There are a variety of ways in which

customers are made aware of their rights and the range of services available to them. When DLG customers contact DLG to make a claim, they are guided through all of their entitlements and the appropriate steps to take for the circumstances they are in. In addition, there is a broad range of different industry players, including insurers, brokers and PCWs, as well as other players such as CHOs, accident management companies, solicitors and garages. Each of these is a potential source of information for customers and each of these actively compete for these customers. Whilst DLG can see the theoretical argument that there is potential for harm, in practice, with this range of providers DLG believes this potential is extremely low.

(b) ToH 2 underplays the importance of providing a good repair service

2.3 DLG is concerned that the CC's description of ToH 2 does not give sufficient weight to the competitive imperative for insurers to provide a good repair service to their customers. As with any business service, DLG needs to seek the right balance between quality and cost, but an inadequate repair service (whether on fault or non-fault claims), and therefore an inadequate customer experience, is likely to lead to customer dissatisfaction, complaints and a loss of brand equity.

2.4 Providing a good repair service is therefore a very important part of DLG's PMI offering to customers. DLG believes that its repair network is a key way in which it achieves this:

(a) approved repairers are selected and assessed on the basis that – amongst others – they achieve certain service levels (e.g. customer satisfaction, cycle times, complaints, etc.) and quality standards (e.g. ability to produce repairs to defined quality standards notably standard PAS 125 which is independently audited by the British Standards Institute);

(b) scheduled and ad-hoc inspections are undertaken by DLG motor engineers of network repairers to check the quality of repairs and action is taken to address any concerns identified during an audit. This quality monitoring is the same for fault and non-fault cases – there is no differentiation between fault and non-fault repairs. Where a customer chooses a garage outside of the network, DLG is not able to carry out this type of quality monitoring and is only able to agree the scope of the repair work to be carried out (a further reason why DLG believes that repairer networks are key to quality of service and control of costs);

(c) DLG ensures that any complaints against network repairers are all logged, investigated and progressed to resolution. Statistics are recorded and incorporated in the network repairer performance reviews, which are undertaken by DLG's Network Performance Management team; and

(d) DLG guarantees repairs made by its approved repair network – for fault and non-fault claims alike – for five years (or if a manufacturer's guarantee period is longer, DLG will match that). DLG offers this as it represents a clear customer benefit.

2.5 Customers of DLG have the option to use their own repairer, but DLG strongly believes that use of its own network is the best way to ensure that repairs are carried out with appropriate control of both quality and cost. Any intervention that led to a material reduction in the proportion of repairs managed by insurers' networks would, DLG believes, lead to consumer detriment through inflation and an overall reduction in quality.

(c) ToH 2 is a secondary issue

2.6 ToH 2 suggests that harm may arise because third parties such as accident management companies, brokers, CHOs, credit repairers, insurers, etc., act on behalf of customers to procure repair and replacement vehicle services. DLG believes that this is a secondary issue (a symptom of the underlying problem), which arises primarily because of the separation of cost liability and cost

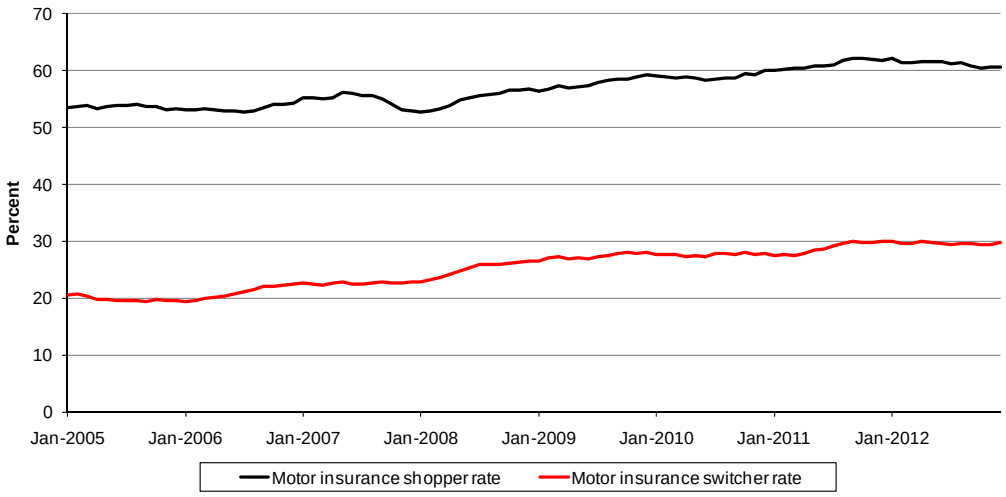
control (i.e. ToH 1). It is this separation of cost liability and cost control (and the legal rights and duties which underpin this) which DLG believes drives the incentives and behaviour – and in some cases the existence – of these companies. As set out in paragraph 1.1 above, DLG therefore believes that the CC's Investigation should focus on ToH 1.

3. Harm due to horizontal effects (market concentration)

(a) There is strong competitive rivalry between insurers

3.1 The provision of insurance is highly competitive and there is strong rivalry between insurers as acknowledged by the CC in its Issues Statement.[1] There is a wide range of suppliers which have plenty of capacity and access to customers through a range of different distribution channels. Obstacles to customer switching are relatively low (borne out by much higher switching rates in PMI than, for example, in retail banking and utility markets). It is therefore extremely easy for customers to shop around and switch. As illustrated by Chart 1 below, annual switching rates are currently around 30%. It is clear therefore that even the largest insurers in the market do not have significant market power.

Chart 1: Rates of shopping around and switching by motor insurance consumers, 2005-2012



Source: © GfK NOP Financial Research Survey[2] (FRS) based on, an average c.19,381 adults interviewed with a motor insurance policy on a 6 months ending period.

3.2 DLG would be happy to support any detailed analysis the CC chooses to conduct on this subject. DLG is confident that the conclusion will be that there is plentiful competition in all segments of the market. PCW and broker models provide consumers with easy access to a wide range of insurers, ranging from big, well-known brands to small, niche players that focus on specialist needs. Direct insurers also make significant marketing and advertising investments to ensure customers are aware of their portfolio of products.

(b) PCWs

3.3 DLG believes that provided that there is free and open price competition between PCWs and other channels, the relative concentration of PCW providers should not present any real detriment to consumers. In addition, given the lack of real differentiation between the websites, the significant investment required from insurers to set them up as sales channels, and the cost inflation they have

[1] Issues Statement, para 47.

[2] The GfK Financial Research Survey covers on average approximately 32,924 motor insurance premium payers per year. It covers main PMI only. The survey is GB-wide.

driven in marketing channels (particularly digital), it is not clear that the emergence of additional competitors in the PCW aggregator market would work to the benefit of consumers.

3.4 However, this analysis rests on the assumption that PCWs will not start to exercise undue market power. The four main PCWs currently account for approximately 60% of PMI new business origination (they are therefore the largest distribution channel) and DLG does have some concerns that PCWs may, in the future, acquire increasing market power, giving them the ability to raise commissions and restrict price competition between insurers.

(a) **[CONFIDENTIAL]** PCWs tend to have panels of 50 or more brands/insurers and so the threat of withdrawal of a particular brand or insurer from a PCW's panel is not an effective competitive constraint. This lack of reliance on having leading brands is highlighted by the fact that DLG's brands Churchill and Privilege have only been available on comparethemarket.com since July 2012.[3] Prior to this between October 2010 and April 2012, comparethemarket.com went from being the fourth largest PMI aggregator to being the biggest, with 27% of the PMI aggregator market.[4]

(b) An insurer's main mechanism for restraining a PCW's market power is its freedom to distribute and price its PMI products as it sees fit through alternative distribution channels. However, the use of MFNs is undermining insurers' ability to do this.

(i) Some MFNs require an insurer to match the lowest quote that it offers for a particular brand on a rival PCW. As these are increasingly enforced by PCWs, this will inevitably lead to price harmonisation across PCWs and therefore consumer detriment. Other MFNs require an insurer to match the lowest quote that it offers for a particular brand through alternative distribution channels. This again will lead to consumer detriment as in circumstances where an insurer could afford to offer a lower price through an alternative channel than it would on a PCW it would be unable to do so (the different costs and potential access to market through a PCW may mean that a price reduction which is possible through, for example, the direct online channel may be unsustainable through the PCW channel).

(ii) MFN clauses can also be an inflationary factor because they remove or constrain the ability of an insurer to respond to varying commission levels between channels through differential pricing. For example, if a PCW demanded a commission that was materially higher than their competitors, an insurer in a free and open market would be able to reflect the extra cost in its pricing, which in turn would lead to a competitive disadvantage for the PCW, whose customers would be able to get cheaper quotes through other channels. MFN clauses can prevent insurers from doing this. Furthermore, if an insurer is subject to MFN clauses it may have to raise prices in other channels because of an increase in commission costs for an individual PCW.

(iii) DLG is therefore surprised that the CC is so sanguine about MFN clauses.[5] MFNs are discussed further below, under ToH 5.

(c) Other sectors

3.5 DLG agrees with the CC that the supply of other goods and services in other sectors of PMI does not give rise to scope for harm from horizontal effects.

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3 See http://www.directlinegroup.com/media/news/company/2012/11-07-2012.aspx.
4 Source: eBenchmarkers.
5 Issues Statement, paras 90 to 95.

4. Harm arising from providers' strategies to soften competition

(a) FSA/FCA is best placed to assess issues raised under ToH 4

4.1 In general, DLG believes that the issues raised under ToH 4 are best addressed by the FSA/FCA in the course of their normal regulatory duties. In December 2012, the FSA announced a study into general insurance products sold as add-ons, which it aims to complete by Q3 2013. The FSA is also carrying out a thematic review of Motor Legal Expenses Insurance, which is expected to be concluded in Q1 2013.

4.2 Moreover, the issues are complex, and providers need to find the appropriate balance between on the one hand enabling consumer understanding and easy comparability across providers, and on the other hand offering consumers choice, quality of cover, and the ability to configure their cover to their needs. The FSA/FCA is therefore best placed to guide and supervise firms in achieving this balance, and DLG is actively working with it on these issues (which are pertinent to the core insurance product as well as add-ons). DLG would therefore suggest that the CC should apply the same arguments for this as it has done with regard to bodily injury and the Ministry of Justice reforms.

(b) Strategic product differentiation of PMI

4.3 DLG does not consider that strategic product differentiation of PMI results in net consumer harm, or that consumer search costs are raised as a result of product differentiation. The CC raises concerns that PMI providers may unnecessarily differentiate products to ensure consumers do not switch away to a rival insurer. DLG is unable to comment on the brand strategy of its competitors, and the extent to which they may or may not engage in this type of practice. However, DLG is confident that its own brand strategy, and the portfolio of brands it holds, increases choice and quality to customers. Furthermore, DLG does not believe there is any merit in the CC's suggestion that the 'complexity' of PMI policies may result in net consumer harm.

4.4 On the contrary, DLG would agree with the CC's alternative hypothesis; namely that product differentiation can yield consumer benefits through offering a policy that will be tailored to fit a consumer's need. This is the exact rationale behind DLG's brand strategy. DLG targets its brands across distinct consumer segments, seeking to offer its customers the combination of brands, channels, product features, prices and services that best address their needs. This is achieved by tailoring the distribution channel mix for each product including over the phone and online via the internet and PCWs, through banks and other partners and brokers.

4.5 DLG offers PMI through the Direct Line, Churchill and Privilege brands, as well as through the brands of a range of partners e.g. Sainsbury's Bank.

(a) ***Direct Line:*** was launched in 1985, with the aim of bringing new standards of service and simplicity to the private motor insurance industry. Customers are dealt with directly over the telephone or through the internet channel, cutting out the middle man and offering a faster, more efficient and convenient service. The Direct Line brand is not available through PCWs. The Direct Line brand targets customers who have a lower need for support, but high brand affinity. The focus is on a quick and simple customer experience.

(b) ***Churchill:*** is marketed directly to customers through various channels including telephone, the internet and PCWs. The Churchill brand targets customers with a higher need for support and reassurance, as well as high brand affinity. The focus is on a reassuring and supportive customer experience.

(c) ***Privilege:*** is marketed directly to customers through various channels including telephone, the internet and PCWs. The Privilege brand targets customers who have a lower need for support and who buy predominantly through PCWs. The focus is on providing a quick customer experience at the best possible price from a recognisable brand.

4.6 DLG would be strongly opposed to any intervention which had the effect of limiting innovation in the PMI market. The use of different brands by insurers to appeal to different customer segments helps rather than hinders the competitive environment. For example, DLG's uninsured driver and vandalism promises were introduced to differentiate DLG's service, but due to their consumer appeal they have now been matched by several competitors. Under DLG's uninsured driver promise, if a claim is made for an accident by a non-fault driver and the fault driver is not insured, the customer will not lose his or her no claims bonus (**NCB**) or have to pay any excess. [6] Similarly, the vandalism promise ensures that customers will not lose their NCB if a claim is made for damage that is as a result of vandalism.[7] Competition between insurers over quality of cover therefore drives innovation and acts to the benefit of consumers, who are better protected as a result.

4.7 DLG does not support the CC's suggestion that PMI customers cannot switch easily or effectively between insurance providers. A clear distinction can be drawn between PMI and markets such as retail energy or personal current accounts where competition authorities and regulators have in the past found low levels of switching to be a concern.

(a) First, there is a clear distinction on levels of switching and shopping around (see Chart 1 above), with annual switching rates for motor insurance currently around 30%, compared to gas and electricity customers at around 15-17% and approximately 6% as quoted by the OFT in relation to personal current accounts.[8]

(b) Second, in markets where switching is limited, there are often clear reasons for the lack of switching. In gas and electricity retailing, there is evidence to suggest that customers are unable to determine whether or not an alternative supplier would actually be cheaper, which limits the incentive to switch. In the case of personal current accounts, the lack of customer switching has in part been driven by the perceived 'hassle factor' of arranging for direct debits to be transferred etc., as well as the relatively limited financial gains to be had from switching. By contrast, no significant switching barriers exist in the case of PMI. For example, an NCB can be transferred to new providers; pricing is bespoke and based on the characteristics of the consumer and the product that is chosen, which means that consumers can easily compare premiums of PMI with coverage (excess, etc.) and add-ons of their choice. The price of PMI does not vary with usage, unlike for example, retail energy tariffs, so comparing offers from different providers is straightforward. Consumers are reminded in writing well ahead of policy renewal dates in order to give them sufficient time to shop around. DLG does not impose any surcharge on customers who choose not to renew their policy on expiry and any mid-term cancellation fees are limited by regulation so that they cannot be greater than the costs incurred by the insurer. Further, the financial gains from switching PMI provider can be significant, which adds to the incentive for customers to shop around and switch.

(c) Drip-in pricing

4.8 As set out in paragraph 4.1 above, DLG believes that the FSA/FCA is best placed to investigate drip-in pricing for additional products and services (where additional price increments are introduced through the sales process) and related issues. However, in response to the concerns raised by the

[6] It may be that any policy excess will need to be paid, and NCB may be lost temporarily until DLG receives confirmation that the accident was the fault of the uninsured driver.

[7] It may be that any policy excess will need to be paid, and NCB may be lost temporarily until DLG is supplied with a relevant crime reference number.

[8] See http://www.oft.gov.uk/shared_oft/reports/financial_products/OFT1005.pdf.

CC,[9] DLG notes that the points based on insights from behavioural economics, such as drip-in pricing and loss aversion/endowment effects, are unlikely to present a concern in the case of PMI. In particular, the underlying concerns which arose in previous cases relating to drip-in pricing (such as payment protection insurance (**PPI**), extended warranties on domestic electrical goods, and the payment charge surcharges for airline tickets) which were identified as giving rise to consumer detriment do not apply in relation to PMI.

4.9 Any application of insights from behavioural economics should take into account the specific characteristics of the product and market concerned. The reasons drip-in pricing was found to have caused consumer detriment in the aforementioned markets are not present in the case of PMI. In particular:

(a) Add-on products in the case of PMI will not typically be seen by the consumer to provide 'protection' for the main product, as there should be no perception that PMI will not provide protection without the add-on products (unlike, for example, PPI which provides protection for the loan). PMI add-on products are more akin to a basket of different products purchased from the same supplier, rather than providing protection for the primary product (and therefore raising issues of loss aversion). Instead, some add-ons enhance the coverage of the PMI cover, while others provide protection for additional events or deliver additional benefits, for example, Protected NCB, which protects the NCB in the event that a driver needs to make a claim.

(b) Consumers are in a good position to compare prices of PMI products and selections of products, including add-on products. DLG ensures that each product is itemised separately at point-of-sale. The price of additional products, such as legal expenses cover, can be added to the premiums for the primary product, allowing for easy comparison of price levels. This is in contrast to the findings of the CC investigation into PPI, where comparing the cost of the PPI with the cost of the credit was found to be difficult for most consumers.

(c) PMI customers also typically have available extensive information comparing the cost of add-on products from different insurers, due to the information that is readily available directly from insurers and from PCWs, which typically provide a range of quotes setting out whether each quote includes the main add-on products. For example, moneysupermarket.com provides details on the first results page for the price and coverage of products for the excess, windscreen cover, courtesy car, breakdown insurance, personal accident cover and legal cover. Directline.com uses an alternative approach of allowing the customer to alter the range of products and recalculate the quote instantly, allowing the customer easily to determine the cost of different selections of products.

4.10 This assessment would suggest that the concerns regarding drip-in pricing raised by the CC under ToH 4 have a much lower level of relevance for PMI than in the cases described above.

(d) Transparency and complexity of add-on products and services

4.11 DLG believes this falls under the remit of FSA investigations into PMI and the sale of related add-ons.

(e) Obstacles to consumers switching PMI provider

4.12 As described above in paragraphs 3.1 and 4.7, the high levels of switching (and high levels of mid-term cancellation) illustrate clearly that there are no material barriers to switching in PMI in the UK. Indeed the process used by insurers is set up specifically to make switching straightforward. Customers receive a renewal notice at least three weeks before renewal, and they have a wide range

[9] Issues Statement, paras 59 to 65.

of options for shopping around for an alternative cheaper rate. If customers want to shop for a cheaper rate, they will do so. If they find a better deal, they can cancel the renewal on their existing policy with a single phone call. This is highlighted by Chart 1 above.

4.13 Automatic renewal represents a critical consumer protection, as driving without insurance amounts to a criminal offence. The detriment that would be caused by limiting or removing automatic renewals would dramatically outweigh the very mild inconvenience associated with the customer having to make a phone call to cancel their renewal.

4.14 Mid-term cancellation fees also fall under the remit of the FSA and so DLG believes that the FSA is best placed to consider this. Insurers are required under the Insurance Conduct of Business Source Book and Treating Customers Fairly principles (a) to charge fees that only reflect the cost of cancellation; and (b) not to create barriers to switching. Although mid-term cancellation fees vary across the market, **[CONFIDENTIAL].**

4.15 The NCB model is an imperfect mechanism for establishing the claims history of a customer, for the reasons outlined in the Issues Statement. **[CONFIDENTIAL]** As such, it actually facilitates switching in the market, by making customers aware that their claims history is not the exclusive property of their existing insurer. Far from acting as a barrier to switching, NCB encourages competition.

5. Harm arising from vertical relationships (vertical integration)

(a) Ownership of PCWs by insurers - undercutting rivals' prices or manipulating quotes

5.1 DLG agrees that in practice the risk of PCW-integrated insurers using their PCW to try to gain a better understanding of rival's pricing models is likely to be limited. DLG also does not believe it likely that PCWs will limit access by insurers.

5.2 DLG's view is that – apart from the issues of future market power and MFNs, which are dealt with in paragraphs 5.6 to 5.9 below – the most relevant ToH relates to undercutting of prices and manipulation of quotes. DLG considers that the CC should carry out a more thorough, evidence based investigation before it can conclude with any confidence that the potential for harm is limited. For example, it is not clear whether sufficient systems and controls are in place that would prevent any manipulation from happening.

5.3 The CC seems to rely significantly on the ability of insurers to withdraw from a PCW; this is cited as a mitigant against the risk of customer detriment.[10] The extent to which insurers see each of the main PCWs as 'must have' is a question that the CC should investigate further. As explained in paragraph 3.4 above, the threat of withdrawal is likely to be a limited competitive constraint because of the number of alternative brands/insurers available to PCWs. In addition, as highlighted by the OFT in its report on PCWs (referred to in the Issues Statement by the CC) "*PCWs are a key choice tool for consumers. … PCWs are also often seen by suppliers as a cost-effective way to reach large numbers of consumers.*"[11] There are therefore significant commercial disadvantages for an insurer in withdrawing from such a powerful distribution channel.

5.4 PCWs control an increasing share of the PMI market and as more business moves online in the future, their existing market power may be further strengthened. Furthermore, the scope for manipulation is likely to increase as technological sophistication develops and as PCWs develop their role as providers of data analytical services to insurers. As such, the structural risk to fair competition is material and high, and the risk of market distortions and customer detriment far

[10] Issues Statement, para 83.

[11] See http://www.oft.gov.uk/shared_oft/706728/Tool-landing-pages/consumer-protection/pcw-items-banners/PCWs-report.pdf and Issues Statement, para 51.

higher than under ToH 2, 3 or 4. On a related point, the CC should investigate further the ability and incentives of PCW-integrated insurers to increase their rivals' costs. It is possible that by increasing cost per acquisition (**CPA**) for rival insurers, PCW-integrated insurers may benefit from higher fees and also from less competitive prices offered by rivals — assuming that part of the increased CPA is passed on by rival insurers in the form of higher premiums. Insurers may find it difficult to negotiate lower CPAs since their only credible alternative, delisting themselves from the PCW, would result in their foregoing the sales they would otherwise achieve through the PCW. A proper evidenced based assessment is required in order to draw meaningful conclusions on this issue.

5.5 The CC raises the issue of whether PCW-integrated insurers could use their position to undercut rivals or manipulate prices to their advantage.[12] DLG does not have visibility of the commercial arrangements between integrated insurers and their PCWs. However, if there are arrangements which are particularly favourable to PCW-integrated insurers, these could potentially have distortive effects. Again this is a question that the CC would be able to answer relatively easily by requesting relevant evidence from PCWs and undertaking an empirical analysis. For example, if the CC were to find that non-PCW-integrated insurers perform less well on integrated PCW sites than on fully independent PCWs, this may suggest that integrated PCW websites do not offer a level playing field.

(b) Ownership of PCWs by insurers – MFN clauses

5.6 As set out in paragraph 3.4 above, there are two principal types of MFN clauses: the first (which is potentially more restrictive) requires an insurer to match the lowest quote that it offers for a particular brand on a rival PCW; the second requires an insurer to match the lowest quote that it offers for a particular brand through certain alternative distribution channels (DLG has had to agree to the second type of clause with certain PCWs). DLG believes that both types of MFN clauses may lead to consumer detriment (for the reasons described in paragraph 3.4 above) and are an unfair mechanism through which PCWs may gain market power and distort competition. The power of the insurer in this instance is based solely on its willingness to sacrifice market share by withdrawing from the channel altogether. But this threat is of limited potency, as a PCW with a reasonably broad panel can happily live without a selection of an individual brand.[13] Furthermore, the CC's arguments that restrictive clauses are acceptable in order to enable PCWs to generate returns[14] are not at all convincing, and are not consistent with the standards applied elsewhere in the Issues Statement.

5.7 The CC suggests that that MFN clauses strengthen PCWs' incentives to invest in their websites, and that PCWs' investments would benefit competition and consumers in the online market.[15] However, the CC does not present any evidence to support this point. The CC's argument rests on MFN clauses increasing the certainty of PCWs' recouping their investment costs, as, once attracted to their website, consumers will be captured: because as consumers are aware of 'you won't find it cheaper elsewhere online' advertising, they lack incentives to switch to other online sales platforms.

5.8 In order to substantiate the CC's claim it would have to be demonstrated that MFN clauses strengthen PCWs' incentives to invest. This should not simply be taken for granted. For example, it could be argued that in the absence of MFN clauses, PCWs would compete with each other more fiercely and this competition would force PCWs to invest in making their websites attractive for insurers and consumers alike. It may also lead to innovation, as PCWs (and insurers' own websites) would be able to compete on the basis of exclusive low price offers, which MFN clauses currently prevent them from doing. Overall, a more thorough assessment of PCWs' incentives to invest is needed to reach any conclusion concerning the impact of MFN clauses on market outcomes.

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12 Issues Statement, paras 81 – 84.

13 By way of example, as set out in paragraph 3.4 above, comparethemarket.com grew substantial share of the PMI market while DLG's multi-channel brands were not available on it.

14 Issues Statement, para 93.

15 Issues Statement, para 93.

5.9 The CC also suggests that the continued use of call centres by consumers provides a constraint on the competition dampening effect of MFN clauses.[16] However, this will only be the case if consumers actually shop around by telephone, which is a declining channel for obtaining PMI **[CONFIDENTIAL]**

(c) Insurer – broker relationships

5.10 DLG agrees with the CC that insurer-broker vertical relationships are unlikely to give rise to competition concerns. DLG no longer uses brokers within its PMI business, having ceased writing new personal lines broker business in Q4 2010.

(d) Repairer – insurer relationships

5.11 Overall, the repairer market is a highly fragmented market and has a large number of potential suppliers. DLG believes this is likely to be reflected in the vast majority of local areas in the UK. In any event, **[CONFIDENTIAL]** as far as DLG is aware they typically have capacity to work for other insurers.

5.12 The CC notes that it is currently unclear as to how repairers compete for work from insurers.[17] DLG cannot comment on other insurers' practices, **[CONFIDENTIAL].** Rather as set out in paragraph 2.4 above, DLG selects its repairers on the basis of specific criteria relating to total repair costs, service levels and quality standards.

5.13 DLG believes that consumers do and will continue to benefit from the competitive environment. This provides incentives for insurers to invest in their repair network – as DLG has done – in order to minimise the cost and maximise the quality of repairs. If rival insurers face higher repair costs because they have chosen not to make this investment, there is nothing to stop them from addressing the issue by making more investment in the future. That is simply a function of a competitive market at work.

(e) Insurer – paints/parts/distributor relationships

5.14 The CC indicate that contracts between insurers and suppliers may worsen terms of supply to smaller insurers and customers. DLG refutes this. The buying efficiencies that DLG achieves through economies of scale produce economic benefits:

(a) DLG's Tier A and Tier B (third party) repairers obtain discounts which they are highly unlikely to be able to achieve on their own, due to DLG's scale;

(b) by reaching agreement with particular suppliers of well known good quality products (such **[CONFIDENTIAL]**) this ensures that DLG's repairers are using high quality products in their repairs; and

(c) DLG does not require its repairers to purchase from particular suppliers other than for paint; and, for example, with paint, repairers are able to use any additional paint they purchase for non-DLG work.

5.15 There are a wide range of suppliers of paints and parts to insurers and repairers, **[CONFIDENTIAL].** Suppliers of paint and parts will naturally seek to obtain the highest prices they can from all their customers, **[CONFIDENTIAL].** Moreover, DLG believes that it is important for insurers such as DLG to be encouraged to invest in their repair network in order to reduce costs

[16] Issues Statement, para 94.
[17] Issues Statement, para 102.

and maximise quality; this is pro-competitive and provides significant customer benefits. **[CONFIDENTIAL]**

5.16 The CC also suggest that suppliers of paints and parts may suffer harm as a result of customer foreclosure. Again DLG refutes this. As set out in relation to ToH 3 above, the PMI market is fragmented and highly competitive. DLG does not believe that any single insurer's repair network (or individual approved repairers) could be regarded as a sufficiently significant portion of a supplier's customer base for this concern to be anything other than theoretical.

6. Possible countervailing effects: entry and barriers to entry - insurers

6.1 The CC hypothesises that a potential barrier to entry is the economies of scale that existing players in the market benefit from and argues that having a large number of customers from a particular segment could enable an insurer to understand the risk of drivers in that segment and price the risk more profitably.[18] However, data-sharing by insurers through the Association of British Insurers (**ABI**) on a number of risk factors facilitates new entry and mitigates the gain that incumbents could enjoy from scale. Furthermore, certain types of price data broken down by risk factor are also shared within the insurance industry, which further facilitates new entry, as pointed out in a recent investigation by the OFT into information sharing in the insurance industry.[19]

6.2 DLG agrees with the CC's observation that barriers to moving from one market segment into another are likely to be quite low.[20] Online-only insurance provider easyMoney (underwritten by Zurich) entered the market in 2005 to offer products to the low-cost motor insurance segment. Zurich had no presence in this segment prior to underwriting the easyMoney venture, so the partnership enabled it to expand and diversify its motor insurance product range.

6.3 More generally, the supply of PMI is highly competitive and does not feature substantial barriers to entry or expansion either for new entrants or existing players wishing to enter particular segments. There are many examples of brands that have successfully entered and/or expanded.

6.4 For example, Zenith Insurance has rapidly expanded its presence in motor insurance, increasing its range of products from one to fifteen between 2008 and 2012. The entry of More Than (underwritten by RSA) in 2001 shows the ability of an existing provider of other insurance products to enter the UK motor insurance market, attract business and grow its market share.

6.5 The widespread and increasing use of PCWs by consumers enables a brand quickly to gain market share if it is listed on a PCW. Swiftcover and eCar are examples of internet-only brands that have successfully entered the market in the last decade; both were noted by the OFT in its market study.

[18] Issues Statement, para 109.
[19] See http://www.oft.gov.uk/shared_oft/market-studies/private-motor-insurance/OFT1422.pdf
[20] Issues Statement, para 110.