

RESPONSE TO COMPETITION COMMISSION WORKING PAPERS

PART A: INTRODUCTION AND SUMMARY

- 1.1 In esure's view, the Competition Commission's ("CC") market investigation into private motor insurance ("PMI") ought to focus predominantly on the unjustifiably high cost of credit hire vehicles, which esure considers has the most significant impact on PMI premiums, as well as the high cost of credit repair (CC theory of harm 1). esure also considers the existence of most favoured nation ("MFN") clauses in agreements between price comparison websites ("PCWs") and PMI providers (CC theory of harm 5) requires further analysis.
- 1.2 esure does not consider that the CC needs to continue to investigate add-ons (CC theory of harm 4) and disagrees with certain aspects of the CC's analysis of add-ons.
- 1.3 This response is focused on four of the CC's working papers, but also refers to others as relevant. A summary of esure's position on these four working papers is as follows.

Working Paper: overcosting and overprovision of repairs (the "Repairs Working Paper")¹
- 1.4 esure considers that a contrast occurs between:
 - (i) insurer subrogated repairs, where a broadly efficient system exists between insurers and where the CC's analysis overstates the affect of the limited cost control on repair costs when the repair is handled by a non-fault insurer; and
 - (ii) credit repairers, who, in practice, are not liable for the costs of the repairs and therefore do not face the cost constraints that may be expected in a well-functioning market.
- 1.5 The latter results in increased industry costs without any resultant consumer benefits.
- 1.6 esure has concerns about potential difficulties in drawing accurate conclusions from the CC's methodology for analysing claims data and notes that it is extremely hard to perform like-for-like comparisons across different insurers and different types of claims. Furthermore, esure is concerned that the approach adopted by the CC can be expected to introduce biases and overstate the degree of overcosting of insurer-to-insurer subrogated repairs. This applies across CC theory of harm 1, extending to the

¹ Since the issues raised are substantively largely the same, esure's comments on the working paper "Theories of harm 1 and 2: Vehicle write-offs", are included, where relevant, in its discussion of repairs.

conclusions drawn from claims data in the CC's working papers on overcosting and overprovision of temporary replacement vehicles ("TRVs") and vehicle write-offs.

Working Paper: overcosting and overprovision of TRVs (the "TRVs Working Paper")

- 1.7 esure considers that this is the most significant area of competitive concern, in terms of both the magnitude of excess costs involved and the extent of the problem. The PMI industry has not been able to control the costs of credit hire effectively, despite the introduction of the Association of British Insurers' General Terms of Agreement (the "GTA"). This has resulted in significantly higher costs for credit hire, which are reflected in the unjustifiable referral fees paid by credit hire companies.

Working Paper: analysis of add-ons (the "Add-ons Working Paper")

- 1.8 esure considers add-ons to be a highly beneficial element of the PMI industry for customers, allowing them to purchase only the cover they consider necessary for their own risk appetite. The CC's assessment of profitability on the basis of claims ratios does not take into account the volatility of such claims, nor the proportionately significant administrative costs associated with these low premium products, and is therefore not informative.

Working Paper: impact of MFN clauses in contracts between PCWs and PMI Providers (the "MFN Working Paper")

- 1.9 esure agrees with the CC's distinction between wide and narrow MFNs and considers that the potential anti-competitive effects arising out of these different forms of MFN clauses are likely to differ. The CC ought therefore to conduct a careful analysis of relative pro-competitive and anti-competitive effects arising out of wide and narrow MFN clauses.

Working paper: statistical analysis of claims costs (the "Statistical Analysis Working Paper")

- 1.10 esure has integrated its comments on the Statistical Analysis Working Paper in its commentary on the Repairs Working Paper and TRVs Working Paper respectively. Separate comments are not therefore provided.
- 1.11 However, the CC's own conclusions in this regard emphasise and accept that the approach to assessing the claims data relied on in its working papers on CC theory of harm 1 faces some inherent statistical challenges (Statistical Analysis Working Paper, §9). It therefore may not provide a meaningful like-for-like comparison in a way that isolates reliably the effects of overcosting. These problems are, in part, inherent in the nature of the industry (where claims can differ substantially in terms of the severity of the accident and where data allowing these differences to be identified is not always available), but also arise due to the inability of the CC's chosen analytical approach to account reliably for such key differences.
- 1.12 For these reasons, esure would welcome clarification from the CC on how its conclusions in the Statistical Analysis Working Paper affect the emphasis the CC will place on the analysis of overcosting outlined in its working papers on theory of harm 1.

PART B: THE REPAIRS WORKING PAPER

1. Executive summary

- 1.1 esure's experience confirms that, when credit repair is involved, the costs to esure as an at-fault insurer are substantially higher (Repairs Working Paper, §5). esure submits that credit hire companies ("**CHCs**") and claims management companies ("**CMCs**") have no incentive to control costs of repairs because, unlike insurers (which act both for at-fault and non-fault drivers), CHCs and CMCs only act for non-fault parties and have no responsibility for the payment of repair costs. Moreover, CHCs and CMCs introduce additional layers of claims management, so the use of credit repair ultimately gives rise to higher costs.
- 1.2 By contrast, since insurers are generally as likely to represent the at-fault party as the non-fault party, it would be esure's expectation – and certainly its own experience – that such overcosting would be much less a feature of insurer-to-insurer claims owing to insurers' greater incentive and superior ability to control costs.² esure's view is that the CC may have overstated the extent to which repair bills are inflated in insurer-to-insurer claims (Repairs Working Paper, §12); the difficulties in meaningfully comparing like-for-like repairs, which the CC has indeed recognised in the Statistical Analysis Working Paper, may well go some way to explain part of the difference (Statistical Analysis Working Paper, §§12 to 15).
- 1.3 To the extent there are certain efficiency savings that insurers are able to generate across their claims portfolio, which they do not pass to at-fault insurers (e.g. rebates across their repairer network), these can both help ensure incentives for efficiency in managing repairs and cover some of the costs of claims management that are not subrogated.³ Moreover, competition between insurers should ensure that such cost savings are, in any event, ultimately translated into lower PMI premiums.
- 1.4 The same logic applies, *inter alia*, to the CC's analysis of the costs of vehicle write-offs when handled by an insurer (the "**Vehicle Write-offs Working Paper**"), in which the CC concludes that there is extensive overcosting of write-offs when a non-fault insurer that is different from the at-fault insurer is responsible for handling the write-off (Vehicle Write-offs Working Paper, §6).
- 1.5 For these reasons, while credit repair introduces unnecessary inefficiencies into the provision of PMI, in esure's view these inefficiencies are removed, to a significant degree, in insurer-to-insurer subrogated claims when credit repair is not used.

² Many insurers, including esure, make no distinction between at-fault and non-fault claims when managing repairs.

³ The CC has recognised that there are indeed substantial costs in managing a non-fault repair. See Repairs Working Paper, §11.

2. Credit repair

2.1 While, as discussed below, esure does not consider that captured non-fault claims are a sound benchmark against which to compare subrogated claims (whether those are subrogated by third party insurers relying on CHCs and CMCs or not), it is not surprised that the costs of repairs handled by CHCs and CMCs are substantially more expensive than for non-fault customer repairs or captured repairs (Repairs Working Paper, §4). It is esure's own experience that the average repair bill received by esure when its customer was at-fault and where a credit repair was involved was £[CONFIDENTIAL], while the average bill it paid in the same circumstances where a credit repair was not involved was £[CONFIDENTIAL].

2.2 esure believes that this is likely to result from the fact that CMCs' and CHCs' customers – who are either the non-fault drivers or their insurers – are never liable for the costs of the repairs, meaning they do not exercise the same level of cost constraint as insurers, who have a mix of at-fault and non-fault claims and therefore stronger cost control incentives. It is these market failures, stemming from the use of CHCs and CMCs, that esure considers lead to overcosting of PMI repair claims and to the subsequent upward pressure in the pricing of PMI premia.

3. Non-fault insurer managed repairs

3.1 In contrast with credit repair costs, esure considers that the CC's analysis overstates the impact of the limited cost control on both repair costs and write-off costs when they are handled by the non-fault insurer (who is different from the at-fault insurer). The potential for the CC's approach to overstate the possibility of "overcosting" is borne out by esure's own data submitted to the CC.

3.2 In particular, esure questions the benchmarks used by the CC to assess both: (i) the costs of subrogated claims (i.e. those claims where there is a separation between cost liability and cost control); and (ii) the costs where such separation of cost liability and cost control does not occur.

3.3 As regards the former, the CC compares the average costs of repairs received by the largest insurers from all other insurers with the repair and vehicle write-off costs they themselves incur when managing a repair where they are liable for the cost (Repairs Working Paper, §38). Therefore, the benchmark for cost separation will be drawn from a range of insurers (who may well vary in their efficiency as well as in the value of the cars that their customers are likely to own), while the benchmark where there is no such separation is based on the costs of only one insurer. Indeed, the CC recognises this potential for bias (Statistical Analysis Working Paper, §7). Obviously, if the CC has obtained data from the more efficient insurers, or from insurers that have a lower average car value in their customer policy portfolio, this approach will overstate the cost differential between those claims that have a separation of cost liability and cost control, and those that do not.

3.4 While esure does not have the information on costs, either paid or received, of the other insurers from whom the CC has obtained data:

- (i) the CC itself suggests that it has received data on own costs from the more efficient insurers in terms of repairs;⁴
 - (ii) esure's own data indicate that it is more efficient than the average insurer, with the effect that comparing its captured non-fault claims with the non-fault claims costs it received when it was the at-fault insurer would be expected to overstate any degree of overcosting:
 - (a) esure's average repair costs (as at-fault insurer) received from other insurers was, in the last three years, £[CONFIDENTIAL],⁵ while the average cost it billed to third party insurers in the same period was £[CONFIDENTIAL].⁶
 - (b) Similarly, the average write-off costs received by esure from a third party insurer when esure's customer was at-fault was £[CONFIDENTIAL], while the average cost it subrogated to third party insurers was £[CONFIDENTIAL].
- 3.5 The CC considers the relevant benchmark for situations where there is no separation of cost control and cost liability to be claims where the at-fault insurer does not also insure the non-fault driver, but has succeeded in capturing the non-fault claim. However, esure's own experience suggests that insurers are more likely to be able to capture claims where the damage, or the value of the vehicle, is lower. As above, this may lead to an overstatement of the impact of the separation of cost control and cost liability on repair costs in insurer-subrogated claims.
- 3.6 esure considers that a more relevant benchmark for this comparison would be the repair bill paid by insurers where they are the insurers of both the at-fault and the non-fault parties. In particular, esure's own data suggest that while the average cost of a captured non-fault repair in the last three years was £[CONFIDENTIAL], the average cost of a non-fault repair where both parties were esure's customers was £[CONFIDENTIAL].⁷
- 3.7 This is as much the case in relation to vehicle write-offs as to repairs. Further evidence that captured claims are not a relevant benchmark is seen in that while

⁴ See Statistical Analysis Working Paper, §7. However, esure would be wary of making the assumption that larger insurers are necessarily always more efficient. esure believes that the differences in costs of other insurers are likely to be due to other factors, including the customer mix.

⁵ Please note that esure does not always record whether a repair bill was received from a third party insurer or a CMC/CHC. To attempt to include only repair bills received from other insurers, esure has therefore excluded all claims where a credit hire vehicle was provided.

⁶ See esure's response to the CC's claims data request of 6 June 2012.

⁷ Note that the average rebate of £[CONFIDENTIAL] per repair that esure has received from repairers in its network in the last three years has been deducted from the original cost for claims that were handled via esure's repairer network.

[CONFIDENTIAL] of all claims it subrogated to a fault insurer in the last three years (when its customer was the non-fault party) were considered a total loss (and resulted in a write-off payment), only [CONFIDENTIAL] of all its captured claims in the same period were total losses.

- 3.8 In addition, the repair bills received by insurers from other insurers may include bills received from sources other than the at-fault insurer (such as, for example, CMCs).⁸ This will imply that the actual costs of repairs that are handled only by third parties' insurers may, in fact, be lower than the costs reported by the CC (Statistical Analysis Working Paper, §7).
- 3.9 esure's own data strongly suggest that the CC's approach is very likely to overstate the magnitude of any insurer-to-insurer "overcosting". esure therefore considers that both of the CC's benchmarks are liable to overstate the impact of cost separation and cost control (the CC itself appears to reach this conclusion, noting that the differences in repair costs are generally lower than those found in Repairs Working Paper (Statistical Analysis Working Paper, §7)). The CC finds that the costs subrogated by an insurer are on average only between £7 and £200 higher than the costs it incurs when it is the insurer for both the at-fault and the non-fault parties in an accident (Statistical Analysis Working Paper, §4). esure would therefore welcome clarification from the CC on how it proposes to interpret the analysis.
- 3.10 In esure's view, an alternative, and a simpler, approach may be to consider "bottom up" the potential sources of difference between the costs that are incurred and those that are subrogated by insurers. In esure's case:
- (i) As noted in its response to the CC's questions to insurers submitted on 19 April, repairers in esure's repairer network do not bill esure differently depending on the fault of the driver, or whether it was captured or not.⁹ The CC also found that the data confirmed the large insurers' submissions that they manage at-fault, non-fault and captured non-fault repairs in the same way (Repairs Working Paper, §45). Therefore, any differences in the average repair bill received from repairers are likely to be driven by factors that affect the mix of cars and damages that are involved in each of the categories listed above, and not by esure's different treatment of each driver category.
 - (ii) Excluding the differences in the repair bill from esure's repairer network, the difference in costs between esure's subrogated non-fault repair bills and the repair bills it is liable for (either because it captured a claim or because the at-fault driver was esure's own customer) will be the rebate received by esure from its repairer network, which is not subrogated. This rebate was, on average, only

⁸ As noted in esure's previous submissions to the CC, esure is not always able to identify correctly whether a repair bill it has received was managed by a CMC/CHC (see, for instance, esure's response to the CC's claims date request of 6 June 2012). esure would expect that to be the case with other insurers as well.

⁹ See esure's response to the CC's questions to insurers, submitted on the 19 April 2013, §7.3.

£[CONFIDENTIAL] per repair over the last three years – substantially lower than the £200 differential found by the CC.

- 3.11 Indeed, the average rebate for esure was not substantially different from: (i) the costs the CC has estimated insurers incur in managing the non-fault repair (£100); and (ii) esure's own estimated costs of managing a non-fault claim (£[CONFIDENTIAL]).¹⁰ The above differential allows esure to guarantee that its own costs are recovered and that it is not unfairly disadvantaged when its customer is a non-fault party to an accident.
- 3.12 As observed by the CC, the costs of managing a repair are generally not subrogated to the at-fault insurer (Repairs Working Paper, §11). esure would note that: (i) these costs are indeed savings for the at-fault insurer, as it has to manage the repair itself if a claim is captured; and (ii) it is esure's view that it ought to be able to recover the costs of any claims it handles as a non-fault insurer. esure therefore believes that any analysis of overcosting should take into account the subrogated repair costs net of any costs incurred by the non-fault insurer in managing the repair.
- 3.13 Subrogated claims also include all accidents where the responsibility of esure's customer may, at first, be contentious and where esure will ultimately have to pay for the frictional costs involved in assessing its customer liability, as well as assessing that it is able to recover the repair costs on behalf of its customer. For example, esure notes that where it is forced to litigate to recover the repair costs incurred on behalf of its non-fault customers, this cost equated to an extra £[CONFIDENTIAL] per litigated claim in 2012.¹¹
- 3.14 Furthermore, retaining some of the repairer rebates can also give rise to efficiencies, and therefore be pro-competitive: if non-fault insurers are able to retain a part of the cost savings from creating efficiencies from their repairer networks, they will have a greater incentive to seek those efficiencies from its repairers. However, esure considers that there is less of a pro-competitive efficiency justification for credit repairers', CHCs' or CMCs' referral fee payments.
- 3.15 Finally, esure is, as a general rule, less concerned by (minor) overcosting by insurers, since they would have the incentive and the ability to compete away any such costs through the PMI premia charged to customers.
- 3.16 However, esure would support measures by the CC to curb any significant excesses it identifies in this respect. In particular, esure would welcome any measures from the CC that would limit referral fees paid out by CMCs/CHCs, or that would make it easier for at-fault insurers to challenge repair overcosting (namely through the courts).

¹⁰ See Repairs Working Paper, §11, and esure's response to the CC's questions submitted 1 May 2013, §16.5.

¹¹ See esure's response to the CC's questions on insurers, submitted 19 April 2013, §6.2.

PART C: TRVs WORKING PAPER

1. Executive summary

- 1.1 In line with many of the comments that esure outlined above in response to the Repairs Working Paper, esure considers that the potential for overcosting and overprovision of TRVs, in particular due to credit hire, is the primary source of cost inflation in the PMI industry. Indeed, it is esure's own experience from all claims where its customer was at-fault in the last three years, the average cost of credit hire was more than three times higher than the average cost of direct hire.
- 1.2 While esure agrees with the CC that, as a matter of pure arithmetic, this cost differential arises due to two main reasons – the higher average daily rates charged by credit hire suppliers and the longer hire duration (TRVs Working Paper, §6) – contrary to CC's preliminary conclusions in the TRVs Working Paper, both these higher daily average rates and the longer hire duration are partially the result of overprovision of services.
- 1.3 esure notes that while the CC has preliminarily concluded that there is no evidence of overprovision of hire services (TRVs Working Paper, §§165 to 167), the CC has itself listed substantial evidence of this overprovision (detailed at §§2.3 to 2.5 below). esure would request the CC reconsider this evidence because esure considers that, when taken as a whole, there is a clear pattern of overprovision of hire services by CHCs/CMCs.
- 1.4 In terms of overcosting, esure agrees with the CC's view that one of the main reasons that credit hire costs are higher than direct hire costs is the lack of cost control available to at-fault insurers. CMCs and CHCs gain business by offering the highest referral fees, while the level of credit hire costs (for which at-fault insurers are liable) is only limited by the wide parameters of reasonable costs determined by tort law.
- 1.5 esure agrees with the CC that while the GTA was intended to mitigate the costs of credit hire, it is not sufficient to prevent the level of overcosting present in credit hire (TRVs Working Paper, §93). While esure also agrees that bilateral agreements also serve to mitigate the costs of credit hire, these are still not fully mitigated to a truly reasonable level.

2. Credit hire overprovision

- 2.1 esure agrees with the CC that credit hire costs are significantly higher than direct hire costs (TRVs Working Paper, §6): in the past three years, the average cost paid by esure when its customer was at-fault for a direct hire to the non-fault party was £[CONFIDENTIAL], while the average it paid for credit hire (where its customer was at-fault) was £[CONFIDENTIAL].

- 2.2 The CC finds that the separation of cost liability and cost control in hire costs leads to an overcosting of between £570 and £1,400 when a hire is not handled by the at-fault party's insurer (Statistical Analysis Working Paper, §30). esure observes that this difference is driven by credit hire, as, in general, the non-fault insurer will only manage a direct hire in a very limited number of cases, especially given that the CC has excluded hires provided pursuant to a bilateral agreement.¹²
- 2.3 Contrary to the CC's findings, esure considers that the high costs of credit hire are driven mostly by the overprovision of services. In particular, esure notes that a number of the CC's findings are themselves consistent with the overprovision of TRV services by CHCs and CMCs:
- (i) the CC itself finds that there is a difference in the length of hire of 3.7 days when repairs and hires are handled by a CHC/CMC: since the average direct hire lasts for 11.8 days (TRVs Working Paper, §49 and Table 8) this difference already represents a hire duration that is 31% longer than average direct hire durations. Contrary to the CC's assertion that this is unlikely to be due to overprovision (TRVs Working Paper, §134), esure submits that – to the extent that the CC data are statistically robust in this area – the only sensible explanation for such a substantial difference relates to overprovision (rather than, for example, an inherent bias in the types of claims that are handled by CHCs requiring longer duration);
 - (ii) further, esure considers that this is likely to be an underestimate of the difference between the two, at least in esure's experience, for example where the CHC is also responsible for the repair;
 - (iii) esure's experience suggests that CHCs/CMCs do not generally make an effort to tailor the TRVs to the customers' needs. This is supported by the CC's initial analysis of the call records of insurers and CMCs, which suggests that CMCs are more likely to offer a higher quality TRV to its customers than insurers (TRVs Working Paper, §148), who, by contrast, make a concerted effort to match the TRV to the customer's actual needs;
 - (iv) the CC finds that customers are much more likely to receive an upgrade when they are given a credit hire TRV (17%) than when they receive a direct hire TRV (10%) (TRVs Working Paper, §137 and Table 23). While the CC dismisses this as an example of overprovision because the CHC/CMC is only able to recover the hire charges applicable to the class of the customer's own vehicle (TRVs Working Paper, §137), this will lead to an increase in the average costs of CHCs/CMCs, and therefore will further contribute to the overcosting of the service as a whole; and

¹² esure's own data show that when it is the non-fault insurer and it does not have a bilateral agreement with the at-fault insurer, it provides a hire vehicle itself in less than **[CONFIDENTIAL]** of the cases. This is also recognised by the CC (TRVs Working Paper, §22).

- (v) while the CC finds that CHCs/CMCs were forced to write-off 20%, on average, of their gross credit hire revenues in 2012 (TRVs Working Paper, §104), it fails to recognise that this is itself a clear sign of the overprovision of credit hire services by CHCs/CMCs. As noted by the CC, credit hires are seldom terminated after a reassessment of liability, due to the significant resources spent by CMCs/CHCs in establishing liability prior to the provision of a TRV (TRVs Working Paper, §111). The fact that, despite serving only non-fault customers, CMCs/CHCs are still unable to recover 20% of their costs is a clear sign that they are providing TRVs at a cost above what is reasonable.

2.4 esure challenges the CC's view that the longer average length of credit repairs is not due to the overprovision of services:

- (i) First, CHCs are also often responsible for the repair, which in theory gives rise to an incentive on their part to increase the time a repair lasts, so as to increase the duration of credit hire. For instance, the IFF's report on the PMI market commissioned by the CC (the "**IFF Report**") shows that repairs handled by parties other than an insurer (including CMCs) on average took 19 days, longer than repairs handled by the non-fault insurer (14 days) or repairs handled by the at-fault insurer (13 days).¹³
- (ii) Second, when a vehicle is a total loss, CHCs are able to lengthen the process of writing-off vehicles, thus lengthening the hire duration. esure's own data show that the differential between the cost of TRV provision through credit and direct hire is considerably higher when the claim ultimately results in a write-off. While esure does not record the duration of hire services that are subrogated to esure, of all claims where esure's customer was at-fault (and the non-fault party was not insured by esure) in the last three years, the average cost paid for a credit hire provided replacement vehicle was £[CONFIDENTIAL], while the average cost when the replacement vehicle was a direct hire was £[CONFIDENTIAL]. These data suggest that, when a write-off is involved, credit hire costs are more than [CONFIDENTIAL] times higher than the costs of a direct hire vehicle, while they are [CONFIDENTIAL] times higher when no write-off is involved.

2.5 esure believes that, considered in the round, the above factors indicate overprovision of services by CMCs. It is esure's view that this inefficient overprovision of services is an important component of the higher prices that are charged by CHCs and CMCs for the provision of TRVs, and the higher costs that are ultimately subrogated to at-fault insurers.

2.6 esure therefore invites the CC to reconsider its conclusions in relation to the overprovision of credit hire services by CMCs and CHCs and would welcome any

¹³ See IFF Report, figure 3.56.

attempt by the CC to curb these excesses. In particular, esure would welcome any measures from the CC that would limit referral fees paid by CHCs and CMCs.

3. Constraints on the pricing and overprovision of credit hire TRVs

- 3.1 esure agrees with the CC that the fundamental problem arising in relation to credit hire is that, while direct hire firms compete with each other to provide a cheaper price to the at-fault party, CMCs compete with each other to provide the highest referral fee. As a result, CHCs have no incentive to control the costs that they provide, while they have an incentive to overprovide the quality of TRVs relative to the non-fault driver's need (or to what they would be willing to pay for, were they directly responsible for the costs in question).
- 3.2 Indeed, the only constraint currently active on CHCs is the reasonable cost parameters determined as matter of tort law. The existing case law on credit hire rates has clearly not proven effective as a means of controlling the costs of credit hire. Indeed, the PMI and credit hire industries referred to existing judicial precedent to establish the context and level of rates under the GTA. As the CC's analysis shows, the rates for credit hire under the GTA are still significantly higher than direct hire TRVs (TRVs Working Paper, §47). The GTA's provisions have thus not been sufficiently successful in lowering the costs of credit hire. This is evident in the continued effort by insurers to mitigate the costs of credit hire, even when already subject to the GTA, as noted by the CC (TRVs Working Paper, §§93 to 94). As a result, esure agrees with the CC that the GTA is not fit for purpose to mitigate the costs of credit hire.
- 3.3 esure believes that a set of Judicial Guidelines, drafted by an independent body, applying across the industry, would have a much more significant impact on the way in which credit hire is organised and priced, as would banning referral fees for credit hire. Judicial Guidance could be drafted to identify: (i) a range of acceptable hire rates for each class of vehicle; and (ii) the reasonable length of time for a credit hire arrangement. This would provide a degree of consistency across claims and allow insurers quickly and inexpensively to check the reasonableness of each claim.

PART D: ADD-ONS WORKING PAPER

1. Executive summary

- 1.1 The CC has expressed concern that harm may arise due to consumers being unable to estimate the value of add-on products or compare prices due to complexity and a lack of clarity on what is included (Add-ons Working Paper, §2).
- 1.2 esure considers that add-ons are a highly beneficial aspect of the PMI market for customers, because they enable customers to tailor a PMI policy to their specific needs and only pay for additional cover that they desire.
- 1.3 Moreover, esure is careful to ensure that its customers have available to them all of the necessary information to compare and evaluate the scope and value of an add-on.
- 1.4 The CC also expressed concerns over the profitability of add-ons on the basis that the claims ratios for add-on products tend to be lower than for the basic PMI policy. The profitability of add-ons cannot be assessed meaningfully by reference to lower claims ratios alone (as the CC seeks to do). In particular, esure submits that:
 - (i) the CC's analysis does not take account of the fact that the lower value and take-up rates of add-ons means that the administrative costs of many add-ons will be high relative to the premium price;
 - (ii) the low take-up rates for some add-ons and the high potential payments pursuant to these add-ons mean that claims ratios can be very volatile and fluctuate substantially over time, so a longer time period is necessary for a meaningful analysis to account for these fluctuations; and
 - (iii) in any event, esure does not consider it sensible to analyse the pricing and profitability of add-ons as separate from the assessment of the profitability of basic PMI cover. The overall value proposition (and cost) of the policy is the relevant benchmark. A focus on the profitability of add-ons alone is not informative.

2. Add-ons represent a significant benefit to customers

- 2.1 esure considers it important to set the Add-ons Working Paper into context, namely by acknowledging the benefits of add-ons for PMI consumers. Add-ons allow customers to purchase a 'basic' policy with the option to select any additional products they desire. This allows consumers to tailor their PMI policy to reflect their specific needs and risk appetite, taking into account the benefits offered by an add-on product and the price of that product.
- 2.2 The alternative would be a broader 'basic' comprehensive policy. This would result in some customers paying more for their policy in return for additional cover that they either do not desire or, worse still, have no need for (e.g. breakdown cover). Such customers would be cross-subsidising the policies of those who desire additional elements of cover. As the effect of this would be to make a standard PMI policy more expensive, customers may turn to lower cost alternatives (e.g. not purchasing

comprehensive cover, insuring fewer members of the household or not purchasing a motor vehicle).

- 2.3 esure's experience aligns with the CC's survey findings that customers prefer to be able to purchase add-ons separately, rather than having the additional coverage included within the basic policy.¹⁴
- 2.4 Some add-ons (e.g. breakdown cover) are also offered by third party sources for purchase separately from PMI. With clear pricing information for each add-on product, customers are able to conduct their own analysis of the value offered by the additional cover provided by their PMI provider compared with the stand-alone product.¹⁵ In this respect, esure agrees with the findings of the CC's survey (Add-ons Working Paper, §25 and Table 4) that the availability of PCW services allow consumers to select their chosen add-ons and compare easily the overall premium (including the additional price of the selected add-ons) across a large number of PMI providers.
- 2.5 If these add-ons formed part of the 'basic' cover, this would prevent third parties from competing for the stand-alone cover.

3. Customers' understanding of add-ons

- 3.1 The CC's customer survey "*asked questions to test consumers' understanding of some add-ons*" (Add-ons Working Paper, §10). esure makes the following observations on the reliability of the evidence from that survey:
 - (i) the IFF Report's analysis warns of the low base size of respondents for three of the four add-on products considered (personal injury cover, foreign use cover and key loss cover). As such, there is a high likelihood that these responses are not reliable;
 - (ii) a number of the questions that the CC's survey asks in relation to the customers' understanding of add-ons are too specific (on non-essential aspects of the cover) to provide a reliable indicator of the customer's understanding. For example, it is clear that 75% of respondents were aware that key cover would pay for replacement keys and locks if they lost their keys, although a proportion of these customers also assumed that the cover provided for the insurance company to come out and fix the problem. This should not be interpreted as meaning that the respondents did not understand the policy;

¹⁴ Add-ons Working Paper, §22 states that "*most respondents, 53 per cent, said that they had either a slight or strong preference for add-ons to be offered separately, while 32 per cent said that they preferred them to be included in the basic policy.*"

¹⁵ This is reflected in the CC's survey results, which shows that 23% of respondents who considered breakdown cover add-ons did not take them up (Add-ons Working Paper, §23). As the Report suggests, a large number of these respondents may have chosen a third party breakdown provider.

- (iii) the survey asked customers to recall very detailed aspects of their car insurance policy during a telephone conversation, often many months after they will have last looked at the terms of their policy. The responses are therefore likely to have been very different from the respondents' understanding of the add-on products at the point of purchasing or renewing their policy (i.e. when the information is readily available and it is important for a consumer to understand fully their selected add-on products); and
 - (iv) when a consumer is considering the price and scope of their policy and evaluating the benefits of each available add-on product, they have been provided with significant amounts of information (through PCWs, the insurer's direct website or call centre staff).
- 3.2 As stated at §10 of the Add-ons Working Paper, *"a significant proportion of customers who claimed that they understood an add-on did not, or did not fully understand it."* However, esure does not consider that this is evidence that consumers do not have access to information on the details of add-on products.
- 3.3 esure provides customers with clear and detailed information about each available add-on to allow them to understand and evaluate the product (without providing excessive detail to the point where consumers do not find the information accessible). In particular, esure is careful to ensure that its customers understand fully the pricing implications of adding optional cover to the policy prior to purchase.¹⁶ Customers also have a 14 day 'cooling off' period after entering into or renewing a policy, which allows them to further consider the terms and value of their add-ons and the value proposition of their overall PMI policy. During this period, customers can cancel their entire policy or any add-on product, as desired.
- 3.4 esure notes that the Financial Conduct Authority is currently conducting a market study into add-ons for general insurance and has issued a call for evidence.¹⁷ esure would be concerned if these parallel reviews led to inconsistent outcomes.

4. Profitability of add-ons

- 4.1 The CC's analysis of the claims ratios and net earned premiums for add-on products relies on aggregating data across a number of different insurers. This may not provide an accurate assessment of the overall market, because the scope and coverage of add-on products provided by each insurer are not identical. Furthermore, as acknowledged by the CC (Add-ons Working Paper, §20), some insurers have included 'additional' cover within their basic policy (e.g. windscreen cover), but it is not clear how this has been accounted for in the CC's analysis.

¹⁶ See esure's response to questions 1 and 2 of the CC's questions on add-ons, dated 6 September 2013.

¹⁷ <http://www.fca.org.uk/news/general-insurance-addon-products-market-study>

- 4.2 In esure's view, the lower claims costs calculated by the CC are not necessarily indicative of the overall profitability of add-ons. Due to the low premium (for example, esure's misfuelling cover is just £7 annually), relatively low take-up rates and the level of exposure, claims ratios for add-ons can be highly volatile. The CC's information does not appear sufficient to reflect the significant movements in claims ratios resulting from relatively small changes in claim frequency and/or severity.
- 4.3 The CC identifies a number of potential reasons for the difference in claims ratios (Add-ons Working Paper, §11). esure agrees that the third reason identified by the CC underlines why lower claim ratios are not indicative of increased profitability: the low premium charged for add-on products means that the fixed costs incurred in offering those products represent a significantly higher proportion of the add-on price. These costs include one-off IT development costs to bring the product to market, ongoing marketing costs, sales and service, claims handling, and underwriting and pricing.¹⁸ Moreover, since add-on claims involve a significantly higher proportion of lower value claims, total administrative costs related to such claims will also represent a higher proportion of the claims costs.
- 4.4 In any event, esure does not consider it appropriate to assess the profitability of add-ons as separate from the overall profitability of the provision of PMI. First, customers are not able to buy the add-ons offered by insurers without purchasing the core PMI policy. Second, as the CC's survey highlights, customers are able to compare easily the total cost of different policies, including any add-ons, through, for example, PCWs. Ultimately, esure is concerned with the attractiveness (and therefore competitiveness) of its overall PMI offering: if the profitability of add-ons were higher, it would be expected to give rise to incentives to compete, either by lowering the price of add-ons, and/or by lowering the price of the basic cover that it offers. A stand-alone analysis of the profitability of add-ons is therefore not informative.

¹⁸ esure does not currently allocate these non-indemnity costs fully to each individual add-on, so is unable to provide accurate figures for this.

PART E: MFN WORKING PAPER

1. Executive summary

- 1.1 PCWs are by far the most significant sales channel for PMI providers. In 2012, **[CONFIDENTIAL]** of esure's new PMI business was sold through a PCW. This means that it is crucial to the competitive functioning of the overall PMI market that MFN clauses in agreements between PMI providers and PCWs do not restrict or distort competition.
- 1.2 The CC therefore ought to consider carefully the potential anti-competitive effects of MFN clauses, including the potential sources of harm outlined in the MFN Working Paper (§3):
- (i) increased pressure for high CPA fees;
 - (ii) pressure for higher PMI prices;
 - (iii) restrictions on entry and/or innovation; and
 - (iv) excessive advertising prices.

2. Potential anti-competitive effects of MFN clauses

- 2.1 In considering the potential anti-competitive effects that arise out of the operation of MFN clauses, esure agrees it is appropriate to distinguish between:
- (i) narrow MFNs, referring to own-website MFNs ("**Narrow MFNs**"); and
 - (ii) wide MFNs, referring to online-sales MFNs and all-sales MFNs ("**Wide MFNs**").
- 2.2 Moreover, as the CC acknowledges (MFN Working Paper, §§75 to 86) any potential anti-competitive effects identified by the CC need to be weighed against the potential pro-competitive effects of MFN clauses in this context. esure agrees that such pro-competitive effects potentially include the improvement of the consumer search experience and the ability to recover sunk and fixed costs incurred by PCWs.
- 2.3 It is difficult for esure to assess the extent of the net risks to competition that arise from MFN clauses in agreements with PCWs. However, esure is clear that the net risks to competition are likely to vary materially between Wide MFNs and Narrow MFNs. In particular, in esure's view, the more restrictive nature of Wide MFNs means they have the potential to lead to greater anti-competitive effects in the form of the potential sources of harm outlined by the CC (set out at §1.2 above).
- 2.4 esure therefore invites the CC to carry out a detailed assessment of the net anti-competitive effects of MFNs, with a particular focus on Wide MFNs.

6 September 2013

517336310