DIRECT LINE INSURANCE GROUP PLC

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

RESPONSE TO COMPETITION COMMISSION'S NOTICE OF POSSIBLE REMEDIES

1. INTRODUCTION & EXECUTIVE SUMMARY

1.1 This document sets out the high level comments of Direct Line Insurance Group plc (**DLG**) on the Competition Commission's (**CC**) Notice of Possible Remedies (**Remedies Notice**) published on 17 December 2013. Given the short period of time that the CC has allowed for responses to the Remedies Notice, coupled with the fact that DLG is still working through the detail of the CC's Provisional Findings report (**Provisional Findings**), this document does not attempt to address every question posed in the Remedies Notice. Instead, DLG focuses on the key themes underpinning the CC's remedy proposals, highlighting areas where it agrees with the CC's analysis and other areas where it has concerns about what is proposed.[1] DLG looks forward to discussing these issues with the CC in greater detail at the response hearing.

1.2 DLG has consistently supported the CC's market investigation, and accepts that there are some aspects of the private motor insurance (**PMI**) market that do not work well for consumers, albeit that the market as a whole is highly competitive.[2] In particular, DLG agrees that the separation of cost liability and cost control associated with Theory of Harm 1 (**ToH1**) results in excessive costs for temporary replacement vehicles (**TRV**s) provided to non-fault parties. However, to the extent that there is market dysfunction resulting from ToH1, it relates to TRVs, not repair and DLG's view is that this is where the CC should be focusing its attention.

1.3 That said, it is striking that the level of consumer detriment identified by the CC in the Provisional Findings is relatively modest. The CC arrives at a figure of £150-200 million across the whole market, equivalent to just £6-8 per policyholder.[3] This is somewhat lower than the OFT's estimate (£220.3 million), and substantially below the indicative range suggested by the CC in its working papers.[4] The great majority of this claimed detriment relates to TRVs: the CC's estimate of detriment relating to repair represents just over £1 per policy. This is much smaller than the very substantial reductions in premiums that have taken place since the introduction of Government reforms relating to claims for bodily injury, and which are a direct consequence of competition in the market: according to the AA Shoparound index, comprehensive annual premiums have fallen from a high in January 2012 of £674 to £568 in October 2013, a reduction of £106.[5]

1.4 DLG does not seek to use these figures to argue that there is no case for intervention in the PMI market, but simply to place the issues in context and to make the point that any intervention needs to be proportionate to the level of consumer detriment, and tailored accordingly, as the CC recognises at paragraph 10 of the Remedies Notice. Applying the 'double proportionality' principle as

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1 The fact that DLG has not commented on certain specific questions raised by the CC should not be taken to imply that DLG agrees with the CC's analysis.

2 Indeed the CC observes in the Provisional Findings (paragraph 6.49) that rivalry in the market is strong overall, and that insurers' prices are constrained by rivalry from other insurers. The CC also notes that the market is fairly un-concentrated, with no evidence of excess profits, high levels of switching relative to comparable products, no obvious obstacles to switching and evidence that each individual insurer's demand is price elastic.

3 Provisional Findings, page 13 at paragraph 51.

4 In particular, the CC estimated in its working paper, 'Over-costing and over-provision of TRVs' (at paragraph 101), that: "the frictional costs incurred by CMCs/CHCs and fault insurers taken together amounts to between around £46 million and £186 million". Taking the higher end of this range combined with the other sources of consumer detriment found by the CC in its working papers, this suggests a total net detriment above the level indicated by the CC in the Provisional Findings (i.e. £200 million).

5 See: http://www.theaa.com/newsroom/bipi/201310-bipi.pdf.

formulated by the Competition Appeal Tribunal in the *Tesco* case, it follows that "the more intrusive, uncertain in its effect, or wide-ranging a proposed remedy is likely to prove, the more detailed or deeper the investigation of the factor in question may need to be."[6]

1.5 Clearly, the CC will need to conduct a full cost-benefit analysis before reaching any firm conclusions on remedies and DLG notes that this has not yet been done. That analysis will need to reflect the complexity of the market, with a wide range of market participants (with divergent interests), and factor in not just the direct implementation costs, but also possible unintended consequences which may ultimately feed through into higher PMI premiums, or which, for other reasons, may leave consumers worse off than they would be in the absence of intervention by the CC (e.g. by removing their ability to choose which insurer handles their claim, or otherwise reducing their legal rights). A further complication is that any remedies proposed by the CC must necessarily be limited to PMI, yet many insurers (including DLG) also provide commercial motor insurance; it would be operationally complex to introduce potentially far-reaching remedies that change the nature of a claimant's rights for PMI (e.g. by mandating a first party or a third party capture model for TRVs) whilst retaining the status quo for commercial motor insurance, and the CC will need to take account of the costs implied by such measures. Particularly complex issues would be likely to arise where an accident involves a private vehicle and a commercial vehicle. A possible way around this would be to introduce legislation applicable to all forms of motor insurance (i.e. not just PMI), but it is difficult to see how this approach could be justified on proportionality grounds, particularly in the absence of any investigation into, or any adverse finding relating to, other forms of motor insurance.

1.6 While DLG is not yet in a position to provide any detail on the likely implementation costs of the remedies proposed by the CC in the Remedies Notice, DLG's current view is that a number of the proposed remedies under ToH1 would not pass a cost-benefit analysis or a 'double proportionality' assessment. This is particularly the case in relation to repair, where the Provisional Findings indicate a relatively small level of consumer detriment (equivalent to just over £1 per policyholder), which mostly relates specifically to credit repair. Despite this, the CC is proposing highly intrusive price control remedies (Remedy 1D) that would impact not only on credit repair (the main source of consumer detriment) but on insurers as well, and which would also present significant operational difficulties.

1.7 More generally, DLG's position may be summarised as follows:

(a) Remedy 1A would require legislation but there is a question mark as to whether this would be compatible with EU law. Remedy 1A also implies that the price charged to customers for insurance would change in order to reflect the risk of being *involved* in an accident as the non-fault driver (as opposed to *causing* an accident), which will inevitably result in both winners and losers in terms of the premiums paid. This change in risk-based pricing of motor insurance could have negative implications both in terms of adverse selection and moral hazard, as the link between high risk behaviour and higher premiums would be weakened.

(b) Remedy 1B, which again would require legislation, would fundamentally undermine the choice made by the customer when selecting his insurer and raises a number of practical problems relating to the workability of such a remedy.

(c) In order to address the concern about over-costing of TRVs, DLG considers that the CC should be focusing on reducing credit hire rates rather than banning referral fees. In relation to repair, DLG would have significant concerns about a remedy which seeks to prevent insurers from benefitting from efficient procurement practices.

[6] *Tesco plc v. Competition Commission* [2009] CAT 6, at paragraph 139.

(d) DLG is surprised and concerned that the CC appears to be placing so much weight on the results of the MSXI survey, which it regards as statistically flawed (Remedy 2A). The CC acknowledges that the sample size on which the MSXI survey is based is small and not representative,[7] but persists in drawing conclusions that are demonstrably not robust, owing to sample bias. The CC uses the results of the MSXI survey to argue that "a considerable number of cars are not restored to their pre-accident condition",[8] but there is no rational basis for such a conclusion. In addition, compulsory repair audits are likely to be expensive to carry out, and these costs will ultimately be reflected in premiums.

(e) DLG welcomes remedies which provider greater transparency for customers in relation to add-ons (Remedy 4A-4C), but believes that the Financial Conduct Authority (**FCA**) is best placed to lead on this given the extensive work it is already doing in this area.

(f) DLG welcomes the CC's proposal to ban wide most-favoured nation clauses (**MFN**s) (Remedy 5A), but considers that narrow MFNs, which are likely to lead to premium inflation in the medium to long term, are unnecessary to protect the business models of price comparison websites (**PCW**s), and have anti-competitive effects. DLG is concerned that the continued use of narrow MFNs will reduce competitive constraints preventing PCWs from increasing commission rates above competitive levels.

1.8 These issues are discussed further below.

[7] Provisional Findings, paragraph 7.38.
[8] Provisional Findings, paragraph 7.53.

2. REMEDY A: MEASURES TO IMPROVE CLAIMANTS' UNDERSTANDING OF THEIR LEGAL ENTITLEMENTS

2.1 DLG accepts that it can be relatively complex for consumers to understand their legal entitlements when making a claim, and is therefore broadly supportive of a remedy which provides greater clarity to claimants on their legal rights at each stage in the claims process. Although it would be useful for such information to be provided at the point of renewal or inception of the policy, DLG suggests that the information is likely to have greater impact when provided at first notification of loss (**FNOL**), as this is when it is most likely to be of immediate interest and relevance to the consumer.

2.2 DLG has not attempted to calculate the likely implementation costs of this remedy but considers it likely that there would be some adverse impact on average handling times at FNOL, and a requirement for additional training of staff at FNOL, resulting in increased administrative costs. On balance, DLG believes this is a remedy which could be beneficial to consumers and which should not be too impractical or expensive to implement. However, this is a matter which is best left to the FCA to pursue, given that its remit extends to ensuring that regulated firms treat customers fairly.

2.3 As to the suggestion in paragraph 20 of the Remedies Notice about including questions relating to legal entitlement in the driving theory test, this is an issue for the Department for Transport to consider. However, it would seem odd to 'fail' prospective drivers for providing incorrect answers to questions about motor insurance. In addition, it needs to be borne in mind that this proposal would only serve to educate new drivers who have yet to pass their test, so is unlikely in the short to medium term to produce greater levels of consumer awareness. There is also a significant risk that drivers would forget this information in the period between taking their theory test and being involved in an accident as a non-fault party. The CC will also have to justify any costs associated with including these questions in the driving test, which could be difficult given the limited benefit of this remedy.

2.4 In addition, care will need to be taken to ensure that any remedy does not undermine the 'non-advised' nature of PMI sales (i.e. that all sales of PMI policies by insurers are made on a 'non-advised' basis, which means that advice cannot, for regulatory reasons, be given on whether a customer should take out a particular policy).

3. TOH1: SEPARATION OF COST LIABILITY AND COST CONTROL

1A: first party insurance for replacement cars

3.1 The proposal to require TRVs to be insured on a first party basis could go some way towards solving the problems associated with ToH1. There is also some attraction in a measure which places the focus on the insurer's brand and the type of services an insurer can provide to its customers; for example, the ability for customers to choose different levels of TRV cover according to their needs.

3.2 However, as the CC has recognised, a remedy of this type would require primary legislation to override the current common law position in the UK, where the non-fault party is entitled to bring a claim against the at-fault driver in negligence and where the non-fault insurer can exercise rights of subrogation against the at-fault insurer. In addition, secondary legislation (as a minimum) would be necessary to override the current statutory position where the non-fault party is entitled to bring a (statutory) claim against the at-fault insurer, to the extent to which the insurer is liable to the at-fault driver.[9] The CC highlights the need to consider the feasibility of such a change in the law, having regard to the EU Directive (2009/103/EC) relating to insurance against civil liability in respect of the use of motor vehicles. The CC will no doubt take its own advice on the interpretation of that Directive, and DLG has not in the time available examined the legal position in detail. However, DLG's initial assessment is that imposing a first party model for TRVs may not be entirely straightforward from an EU law perspective, as one of the requirements of the Directive is that persons who suffer loss or damage as a result of an accident should have a direct right of action against the at-fault insurer.[10] The CC's proposal would remove that right in relation to TRVs and this would require an amendment to Regulation 3(2) of the Rights against insurers Regulations.

3.3 Recital (30) to the Directive sets out the general principle that:

> "In order to facilitate an efficient and speedy settlement of claims and to avoid as far as possible costly legal proceedings, a right of direct action against the insurance undertaking covering the person responsible against civil liability should be provided for victims of any motor vehicle accident."

This is then reflected in Article 18, which provides that:

> "Member States shall ensure that any party injured as a result of an accident caused by a vehicle covered by insurance as referred to in Article 3 enjoys a direct right of action against the insurance undertaking covering the person responsible against civil liability."

In addition, Article 3 requires Member States to ensure that compulsory third party liability insurance covers damage to property as well as personal injury.

3.4 It is clear from the French language version of the Directive that the expression "party injured" in Article 18 is intended to carry the same meaning as an "injured party" in Article 1 (defined as "any person entitled to compensation in respect of any loss or injury caused by vehicles").[11] In other words, it is clear that Article 18 applies to persons suffering damage to a vehicle and is not limited to claimants who have suffered personal injury.

3.5 Although Member States are permitted under Article 28(1) to bring into force provisions of national law which are more favourable to injured parties than the provisions needed to comply with the

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[9] Under UK law, this right is contained in Regulation 3(2) of The European Communities (Rights against insurers) Regulations 2002 (SI 2002/3061) (**Rights against insurers Regulations**).

[10] The Directive was implemented in the UK by the Rights against insurers Regulations: see Regulation 3(2).

[11] The French language version uses the expression "*personne lésée*" in each case.

Directive, it is not clear whether a first party model for TRVs could be said to be "more favourable to injured parties" than the current system (which is assumed to be in compliance with the Directive). There is therefore a question mark as to whether the UK could lawfully implement such a change as a matter of EU law.

3.6 At the very least, it seems clear there may be scenarios in which some customers would be worse off under Remedy 1A than under the current system. Non-fault claimants who elect either to purchase no replacement car cover, or who purchase only courtesy car cover, would no longer have the right to claim a like-for-like vehicle from the at-fault insurer. The CC appears to acknowledge this point, noting at paragraph 30 that individuals would have the option "to trade off their legal entitlement with a lower premium". This is likely to be an issue of most relevance to claimants who cannot afford to, or for other reasons elect not to, buy TRV cover but who then find that they need a TRV following an accident. These claimants will be unprotected if Remedy 1A is implemented.

3.7 Leaving aside questions of compatibility with EU law, this remedy would have implications for the structure and design of PMI products (for example, the provision of a TRV may be provided as an add-on to a policy), and this would naturally generate implementation and change costs which would need to be taken into account in any cost-benefit analysis.

3.8 This remedy also raises public policy issues, which would need to be weighed in the balance before reaching any conclusions on the viability of this remedy option. Firstly, given that the CC's jurisdiction is limited to the PMI market, it follows that Remedy 1A could only apply to PMI, and could not extend to commercial motor insurance. Careful consideration would therefore need to be given to the operational impact of this for insurers **[CONFIDENTIAL]**, as well as the legal complexities in cases where a private vehicle is involved in an accident with a commercial vehicle. Although a possible way around this would be to introduce legislation applicable to all forms of motor insurance (i.e. not just PMI), it is difficult to see how such an approach could be justified on proportionality grounds, particularly in the absence of any investigation into, or any adverse finding relating to, other forms of motor insurance.

3.9 Secondly, although DLG does not wish to over-state the case, insurance premiums would (at least in part) need to be based on a different assessment of risk. Under the current system, premiums are based on the risk of the policyholder *causing* an accident, and therefore needing a replacement car, but under the CC's proposal premiums would have to be based on the risk of the policyholder being *involved* in an accident, including being the *victim* of an accident caused by a third party. Potentially this could have a number of consequences which would need to be carefully considered:

(a) some careful drivers could see an increase in their premiums as the costs of providing TRVs would need to be socialised across 'careful' and 'careless' drivers (meaning that drivers may derive less benefit from being careful and so minimising their risk of causing an accident); and

(b) there could be a potential distortion to pricing as 'dangerous drivers' may be charged less than under the current system, reducing costs of being a 'bad driver' and, at the margin, encouraging high risk drivers to drive more powerful vehicles.

3.10 DLG's assumption is that under this model, recovery would not be permitted (i.e. costs incurred by non-fault insurers for TRV provision could not be recovered from the at-fault insurer). However, if liability for repair and provision of TRVs is separated, as appears to be envisaged by Remedy 1A, this may result in uncontrollable costs for non-fault insurers. The premise of Remedy 1A is that the non-fault insurer would be responsible for providing a TRV for a claimant, but the at-fault insurer could be responsible for repair if it was able to capture the claim. However, if responsibility for handling the claim were split in this way, it would mean the non-fault insurer would have no control over the length of time needed to carry out the repair, yet would be obliged to provide a TRV for the

entire period during which the vehicle was being repaired. Conversely the at-fault insurer would not be bearing the cost of the TRV so would have no incentive to minimise the duration of the hire period by ensuring that repairs were carried out as quickly as possible. Non-fault insurers could therefore be exposed to the separation of cost liability and cost control that underpins ToH1.

3.11 A further risk associated with Remedy 1A is that it would be more difficult for at-fault insurers to capture the repair element of the claim if the TRV claim is already being handled by the claimant's own insurer. Assuming the non-fault claimant contacts his own insurer at FNOL in order to arrange a TRV, it seems likely that the non-fault insurer would at that point seek to handle the entire claim. This would therefore do nothing to solve ToH1 and in fact would exacerbate the problem.

1B: at-fault insurers to be given first option to handle non-fault claims

3.12 As an alternative to Remedy 1A above, the CC is proposing a number of different mandatory third party capture options. Under the first variant of this remedy, at-fault insurers would be given the first option to handle non-fault claims, but the claimant would not have to take up the offer from the at-fault insurer. As the CC rightly observes in paragraph 38, the risk with this proposal is that it does nothing to solve ToH1 as the claimant will (presumably) make his decision on the basis of brand or service rather than price considerations. To address this risk the CC proposes removing the claimant's right to choose the service provider. While this would solve the immediate problem associated with ToH1 it would lead to the risk of under-provision by the at-fault insurer, which is at the heart of the CC's ToH2. To mitigate this risk the CC suggests limiting the remedy to TRV provision, with the claimant being free to choose the TRV provider, subject to the caveat that if the at-fault insurer could provide the TRV more cheaply than the price quoted by the non-fault insurer, the claimant would have to pay the difference if he accepted the offer from the non-fault insurer.

3.13 DLG has considerable misgivings about these remedy proposals. First, it is unclear what is intended to happen in the immediate aftermath of an accident. The at-fault insurer is to be given "a limited period of time" to make an offer, but the CC gives no guidance on what the claimant is supposed to do in the meantime, or indeed on how long the period should be for the at-fault insurer to make the offer. The CC seems to assume that it will be obvious whether the claimant is at-fault or not, but in practice there are some cases where the determination of liability is not straightforward and takes a long time to resolve, or where liability is split. It is unclear how these cases would be handled under the CC's proposals (and it is possible the proposals could change incentives encouraging behaviour designed to delay decisions on liability). For customers, this could also cause further uncertainty and confusion at a time of heightened stress following a road traffic accident.

3.14 More fundamentally, from a consumer perspective, it is in DLG's view profoundly unsatisfactory to impose a remedy under which consumers lose their ability to have a claim handled by their own insurer. PMI purchasing decisions are made on the basis of price and service quality, yet under the CC's remedy proposals, a consumer who has made a conscious decision, based on price and service levels, to buy insurance from a particular insurer could end up having his (non-fault) claim handled by an entirely different organisation, in an entirely arbitrary manner. If a claimant has previously experienced poor quality of service with an insurer and then makes a deliberate decision to switch to another provider at renewal, that switching decision might turn out to have been largely pointless if in fact his next claim ends up being handled by his former insurer. In theory, the consumer could of course complain to the at-fault insurer if the service provided is not satisfactory, but the at-fault insurer has absolutely no incentive to worry about quality of service provided to someone who is not one of its own customers. This is likely to result in a negative customer experience and more complaints, resulting in damage to insurers' brand equity, as customers will not differentiate between their own insurer and the at-fault insurer carrying out the repairs. DLG also notes that the customer journey set out by the CC at paragraph 40 (a) – (d) of the Remedies Notice is very complicated and likely to be a source of confusion for many customers.

3.15 As with Remedy 1A, this would require primary legislation because the non-fault claimant's right of choice would be constrained. A change of this nature implies a fundamental change in the common law principles underpinning contract law. Effectively the contract between a non-fault claimant and his insurer to provide repair and TRV cover in the event of an accident would have to be overridden to allow the at-fault insurer to handle the claim instead. Again, as with Remedy 1A, careful consideration would need to be given to situations where an accident involves a private vehicle and a commercial vehicle.

1C: measures to control the cost of providing replacement cars to non-fault claimants

3.16 DLG agrees that measures to control the costs of TRVs are needed, and supports the CC's proposal for guidance on acceptable hire duration and a cap on daily hire rates. DLG considers this remedy proposal to be preferable to (and more robust than) the GTA, which has failed to control credit hire rates effectively because participation is voluntary.

3.17 DLG also favours the concept of an online portal for the exchange of documentation if this is technically feasible. The creation of an independent body to determine hire rates/acceptable durations would avoid any competition law concerns that might otherwise arise if there were a collective agreement or information exchange between industry participants on hire rates, but the CC will need to consider carefully the one-off and on-going implementation costs associated with what is essentially a regulated price control model.

3.18 Considerable care would need to be taken with the design of this remedy and, in particular, the risk of collusion or attempted market manipulation among market participants when submitting information on rates would need to be addressed.

3.19 A possible consequence of a price cap and a limit on maximum hire durations (which would need to be managed by whichever body is ultimately responsible for overseeing this) is that, unless additional controls are put in place, all TRV providers will charge the regulated price and seek to make TRVs available for the maximum permitted duration for credit hire in order to recoup any loss of revenue from having to charge the regulated price (indeed, it is not immediately obvious why any TRV provider would have any incentive to under-cut the regulated price cap). Periodic adjustments to the regulated price, benchmarked against direct hire rates would go some way towards ensuring the reasonableness of the regulated tariff. Other market mechanisms, such as referral fees, could help insurers to claw back excessive rents being earned by TRV providers.

3.20 A variant of Remedy 1C would be to specify the number of days for which a TRV could be provided (rather than setting the maximum hire duration), beyond which the TRV provider would need to give an update to the insurer explaining why the duration has been extended. This update could be given through a portal, and would help to mitigate excessive hire durations, at the same time as increasing transparency.

3.21 Although this remedy would need to be carefully designed, DLG's current view is that issues of remedy design are not insurmountable and, particularly given the complex legal issues and significant implementation costs associated with Remedies 1A and 1B, some variant of Remedy 1C is probably the most appropriate solution for controlling TRV costs.

1D: measures to control non-fault repair costs

3.22 The CC has not provided much detail on how these remedy proposals would work in practice, but as a matter of principle DLG has serious concerns about them, and the implications for vertically integrated insurers that own their own repair networks. Both proposals represent highly interventionist measures to address a relatively small level of consumer detriment (£35 million, or just over £1 per policy) and neither proposal addresses the over-costing of credit repairs. There is

therefore a serious question as to whether these remedies would pass not just a cost-benefit analysis, but the 'double proportionality' test laid down in the *Tesco* case.

3.23 Furthermore, both proposals would appear to be (potentially) inconsistent with the recent Court of Appeal ruling in *Coles v. Hetherton*, which acknowledges the right of a non-fault insurer to charge up to the price which the claimant would have had to pay for repairs on the open market (i.e. the reasonable cost of repairs, which is taken to be a proxy for the diminution in value caused by the negligence of the at-fault driver).[12]

3.24 The CC would need to provide more colour on how the 'administration charge' is to be calculated in order for DLG to be able to comment in detail on Remedy 1D(a). Read literally, Remedy 1D(a) would imply that insurers could pass on the exact cost shown on the invoice, plus an allowance for an administration fee, which DLG assumes is intended to be a proxy for a reasonable return on capital. However, this would not be straightforward where insurers are vertically integrated, and DLG has concerns that this is an intrusive form of price regulation that would be very complicated to administer. As a general point, **[CONFIDENTIAL]**.[13]

3.25 As regards Remedy 1D(b), DLG would need to understand how the standardised costs are to be calculated **[CONFIDENTIAL]**. However, as a matter of principle, DLG struggles to see at this stage how a remedy explicitly imposing price control could be justified for repair. In particular, the imposition of price control would be costly to implement and would impose a significant regulatory burden not just on the industry but on the body that would need to be given responsibility for overseeing the price control.

3.26 In addition, the repair market involves a highly fragmented supply chain, with a significant number of small players operating within it, each working with multiple suppliers. The implication of Remedy 1D(b) is that both the purchasers and providers of repair services would have to be regulated, as it is difficult to see how the remedy could work only by regulating the purchasers of those services (i.e. insurers). Enforcing price regulation on both repairers and insurers would be manifestly disproportionate and would be highly costly and complicated to implement. Assuming that these costs would need to be funded by the industry, and that the burden of compliance would be placed on insurers, this is likely to feed through to higher insurance premiums. Moreover, even if the remedy only applied to insurers, these costs would be likely to be disproportionately large compared to the CC's estimates of the net consumer detriment associated with repair (equivalent to just over £1 per policyholder), and even more disproportionate for insurers, given that most of the net consumer detriment in repair arises from credit repair, whereas DLG assumes the costs would apply across all insurers and repairers.

1E: measures to control non-fault write off costs

3.27 DLG has no particular issues with the CC's proposal and does not therefore see any need to comment in detail on this remedy.

1F: improved mitigation in relation to the provision of replacement cars to non-fault claimants

3.28 DLG is generally supportive of the intent behind the CC's proposed remedy to require more detailed enquiries as to a non-fault claimant's actual need for a TRV. However, DLG believes there is a risk of circumvention as CMCs/CHCs may encourage claimants to exaggerate their needs, albeit the fact of having a declaration in writing would assist in challenging the claim if necessary. In addition, there are likely to be practical difficulties under the Data Protection Act in sharing call records, which may further weaken the effectiveness of this remedy.

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12 *Coles v. Hetherton* [2013] EWCA Civ 1704, at paragraph 44.

13 UK Assistance Accident Repair Centres Limited (**UKAARC**).

1G: prohibition of referral fees

3.29 In isolation, banning referral fees would do nothing but allow CMCs/CHCs to retain higher profits. Referral fees can be seen as a barometer of whether CMCs/CHCs are earning rents; if they can afford to pay certain levels of referral fees this may indicate that they are generating excessive profits. The right approach is therefore to reduce credit hire rates and hire durations, since this will have as a necessary consequence that referral fees will reduce and may ultimately disappear.

3.30 The CC suggests that Remedy 1G may be necessary to support Remedy 1D(a) in order to mitigate the risk of repairers submitting inflated bills to insurers in return for referral fees. Paragraph 63 of the Remedies Notice mentions the prohibition of referral fees paid by "CMCs/CHCs/repairers/others" to "non-fault insurers/non-fault brokers/others" for referrals in relation (inter alia) to the provision of paint. It is unclear whether the CC is intending to prohibit the payment of rebates and other commissions to insurers by paint manufacturers, **[CONFIDENTIAL]**. DLG would have concerns if the proposal were to be extended to rebates and other discounts from input suppliers that are not specifically directed towards non-fault insurers and seeks clarification from the CC on exactly what is envisaged by way of this remedy proposal. There is no compelling reason to prevent insurers from being able to negotiate discounts and rebates from paint manufacturers; this would simply raise insurers' input costs and provide a windfall benefit to paint manufacturers.

4. TOH2: UNDER-PROVISION OF SERVICES

2A: Compulsory audits of the quality of vehicle repairs

4.1 DLG is at a significant disadvantage in providing comments on the CC's proposed remedy for vehicle repairs as it has only had access to the data room, containing the evidence on which the MSXI working paper is based, in the last 24 hours. DLG therefore reserves the right to submit further comments once it has completed its analysis of the materials in the data room.

4.2 As a general point, however, DLG is very surprised and concerned that the CC is contemplating the imposition of remedies in this area, given that the legal test for a finding of an adverse effect on competition (**AEC**) based on under-provision of repair services is clearly not met.

4.3 In forming its judgment as to whether an AEC exists in any given case the CC is required to make a 'decision' on that question; this calls for a binary 'yes/no' answer to the statutory question of whether an AEC exists, since the CC is not permitted to sit on the fence and decline to answer the question, or give a 'maybe' answer.[14] This necessarily requires the CC to apply a 'balance of probabilities' threshold to its assessment, and address the question of whether is it more likely than not that a feature, or a combination of features, leads to an AEC.[15] In the present case, the CC has provisionally concluded that the following 'features' of the PMI market lead to an AEC: "(a) insurers and CMCs do not monitor effectively the quality of repairs; and (b) there are significant limitations to claimants' ability to assess the quality of car repairs."[16] This conclusion is based in part on the CC's provisional view that "a considerable number of cars are not restored to their pre-accident condition".[17] However, the evidence for such a finding is, in DLG's view, highly questionable, and certainly falls a long way short of a 'balance of probabilities' standard.

4.4 In its working paper on under-provision of repairs, the CC said that it had to date found no evidence of under-provision of repairs, but that in order to investigate this issue further it had commissioned the MSXI study.[18] The CC's non-fault consumer survey indicated that 11% of respondents believed their vehicle to be in worse condition after the repair (though only 1% described this as "much worse"; the remaining 10% saying "slightly worse"), and 7% were dissatisfied with the repair. The CC was apparently not concerned by these results, noting that it "did not consider that these results in themselves suggested that insurers generally failed to provide non-fault claimants with the quality of service to which they were legally entitled".[19] The December 2012 survey carried out by the General Insurance Market Research Association (GIMRA) likewise seems to have given the CC no cause for concern, as fewer than 1% of repairs resulted in a complaint about repair quality and only 6% of respondents were dissatisfied with the repair service overall.[20]

4.5 The CC refers to anecdotal evidence from three repairers and the National Association of Bodyshops,[21] but this is clearly not an adequate basis from which to draw conclusions about the possible existence or extent of under-provision. It is evident therefore that the CC is basing the weight of its conclusions almost entirely on the results of the MSXI survey, which DLG finds alarming, given the very small and non-representative sample on which it is based. The MSXI survey does not provide a sound statistical or evidential basis for calling into question the findings of the survey of non-fault claimants: in relying on the MSXI results the CC has fallen into the trap of ignoring the issue of sample bias. No meaningful conclusions can be drawn from the MSXI survey

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14 Enterprise Act 2002, section 134(1) and (2).
15 CC3: *Guidelines for Market Investigations* (April 2013), paragraph 319.
16 Provisional Findings, paragraph 10.9.
17 Provisional Findings, paragraph 7.53.
18 Provisions Findings, paragraph 7.42.
19 Provisional Findings, paragraph 7.17.
20 Provisional Findings, paragraph 7.19.
21 Provisional Findings, paragraphs 7.24 and 7.26.

precisely because the sample of respondents is biased. It follows that there is no rational basis for the CC's implicit conclusion that there is a greater than 50% probability that "a considerable number of cars are not restored to their pre-accident condition" such as to justify a finding of an AEC based on under-provision of repair services. The results of the MSXI report do not even allow the CC to infer that there is a 'possibility' of under-provision, let alone a probability of more than 50%. There is therefore no legal basis for the CC to impose remedies to address ToH2.

4.6 Although DLG does not accept the CC's premise that there is any evidence of systematic under-provision in relation to repairs, without prejudice to the arguments set out above, if an AEC were to be established based on robust evidence, DLG would not oppose the introduction of measures to ensure that high standards of quality, such as those offered by DLG, are maintained across the industry. However, there are a number of caveats that need to be borne in mind:

(a) Individual repair audits are costly to carry out, and these additional costs will ultimately feed through into insurance premiums. These additional costs would need to be weighed carefully against the scale of the alleged consumer harm that the CC is seeking to remedy.

(b) Compulsory repair audits may be impractical to manage given the limited pool, and capacity, of auditors who would be sufficiently qualified to carry out the inspections. If there is a lack of competition among the providers of these inspections, that can be expected to result in higher audit costs.

4.7 As an alternative to the CC's remedy proposal, it may be more appropriate to mandate PAS 125 as the industry standard for all insurers. This should result in an increase in standards across the industry, with yearly audits of the repairer being conducted (in line with current PAS 125 requirements) and use of a clearly measurable standard that is already in place.

4.8 If ratings of repairers are to be compiled and published, DLG considers that they should be published by insurers at an aggregated level, rather than by repairer, as consumers make purchasing decisions based on the brand of the insurer, not the repairer.

5. TOH4: ADD-ONS

5.1 As a general comment, DLG is strongly supportive of the CC's objectives to improve transparency and customer understanding and to facilitate price comparison that goes beyond the core insurance premium. However, as add-ons are currently under review by the FCA, DLG considers that the FCA is best placed to address any concerns in this area. The reasons for this are set out below.

(a) Delivery of appropriate customer outcomes is a core element of the FCA's remit. It has already initiated a review of PCW sales, conducted thematic reviews of add-ons generally and more specifically Motor Legal Expenses Insurance. These reviews run alongside and indeed inform the FCA's on-going regulatory interactions with insurers and have led directly to improvements in the way add-ons are described and presented to customers.

(b) The particular risks to customer understanding will vary over time and between insurers, who may have different product features, price structures and target customers. It follows that the appropriate remedies will also vary. Any remedy that is too prescriptive runs the risk of being inappropriate in the circumstances, becoming obsolete or leading to unintended consequences. In particular, customer communications must strike a delicate balance between simplicity and accuracy. Too much detail, included with the intention of increasing customer understanding, can lead to worse customer outcomes because the critical points are lost or the information is simply not read. Similarly, insurers must also balance the competing risks of under-provision (customers not purchasing the level of cover they need or expect) and over-provision (customers buying more cover than they need). This involves offering choices to customers, but not to the extent that they are unable to make an informed decision or are forced to spend longer than they wish to in making a buying decision.

(c) The FCA, as a new regulator, is taking the approach of focusing on customer outcomes. Where previously firms may have been tempted to over-load customers with information in order to tick regulatory boxes, the FCA is now encouraging firms to strike a more appropriate balance overall. DLG warmly welcomes this development, and is working constructively with the FCA in pursuing this agenda. Prescriptive wording or disclosure rules (for example, of the type suggested for Protected NCB) would run counter to this positive trend.

4A: Provision of all add-on pricing from insurers to PCWs

5.2 **[CONFIDENTIAL]** and ultimately Remedy 4A is for PCWs to implement, in conjunction with the FCA. In this context, for DLG, there are different considerations for different 'add-ons' (using the CC's approach).

(a) *Protected NCB:* **[CONFIDENTIAL]**.

(b) **[CONFIDENTIAL]** *add-ons such as Motor Legal Protection, Guaranteed Hire Car and Guaranteed Hire Car Plus:* **[CONFIDENTIAL]**. How this information is displayed to customers and whether it is displayed is generally up to the PCW. In theory, a quote could be adapted to include add-on cover where a customer has indicated a desire to purchase it on the PCW. DLG would need to conduct a more thorough analysis on how much, if any, investment would be required to deliver this on each of the PCWs. However, to ensure full transparency and ease of comparison, it will be critical to ensure that customers can easily see the different component price of each add-on within the overall quote.

(c) **[CONFIDENTIAL]** *add-ons such as Breakdown cover:* **[CONFIDENTIAL]**, but necessarily creates more technical challenges and may require additional investment.

However, as acknowledged by the CC, there is a strong independent market for breakdown cover and it may not be necessary to include it within the scope of this remedy.

5.3 Overall, DLG believes that the main challenge to this remedy will be the ability of PCWs to display all of the relevant information in a clear and transparent way that enables customers to make informed buying decisions. But insurers have a responsibility at point of sale to ensure that customers know what they are buying. It will therefore be important to ensure that customers actually engage sufficiently on arrival at the insurer's website to understand specifically what they are purchasing, as opposed to a situation where their only engagement with an add-on purchase is the answer to a generic question on a PCW. This reinforces the need for the FCA to oversee the implementation of this remedy on an on-going basis, and in a flexible manner (that is not overly prescriptive) and is focused on customer outcomes and adaptable in the light of emerging risks.

4B: Transparent information concerning NCB

5.4 DLG acknowledges that the level of customer understanding of Protected NCB varies. DLG is committed to helping customers make informed buying decisions, and is keen to work with the FCA on communicating the benefits of Protected NCB in a clear, accurate and comprehensible manner. However, DLG is not convinced that the specific remedies proposed by the CC represent the best way of achieving this end.

5.5 DLG is open-minded about enhancing communications with the intention of helping customers understand that they are not protecting the premium itself, but rather the NCB (a large and important input into the calculation of the premium). The specific form of words should be the responsibility of each insurer, overseen by the FCA. DLG is concerned that the generic form of words suggested by the CC might confuse customers more than enlighten them.

5.6 However, DLG does not believe that publication of NCB scales is a desirable or appropriate means of helping customers to make informed buying decisions. When customers protect their NCB, **[CONFIDENTIAL]**. Any published NCB scales would at the very least need to be accompanied by a warning that the scale was indicative only and should not be taken as any kind of commitment that this would be used in the customer's future premiums. Publication of scales in this way would be confusing for customers, and would probably make it more difficult for them to make an informed choice. The CC will doubtless be mindful of imposing remedies that may result in insurers no longer offering NCB protection due to risks of consumer misunderstanding, as this would cause significant consumer detriment. On the other hand, DLG would be comfortable with the publication of illustrative examples of savings made by customers in a given period as a result of having bought NCB protection.[22]

4C: Clearer descriptions of add-ons

5.7 DLG would welcome any measures which improve informational transparency for customers and allow comparisons of add-ons to be made. However, there is a balance to be struck between simplicity of language and accuracy of detail, and this needs to be carefully considered. DLG would be happy to work through the detail of implementing this remedy with the FCA but, as noted above, believes that the FCA is the best placed authority to take this forward.

[22] See Q3 of DLG's response to the CC's follow up questions dated 3 July 2013, where DLG stated: **[CONFIDENTIAL]**.

6. TOH5: PCWS AND MFNS

5A: Prohibition on wide MFN clauses

6.1 DLG welcomes the CC's focus on the market power enjoyed by PCWs. The CC is right to say that 'wide' MFNs (which prohibit lower pricing across multiple sales channels) are anti-competitive, and DLG is fully supportive of the CC's proposed prohibition of these clauses. DLG also agrees that this remedy will need to be supported by measures to prevent PCWs from using their market power to behave in ways that have the same effect as wide MFNs. It is vital that PCWs that charge lower commissions should be able to benefit competitively from doing so by securing lower premiums from insurers and thereby gaining market share.

6.2 However, DLG disagrees with the CC's view that 'narrow' MFN clauses (which prohibit lower pricing only on an insurer's own website) are unproblematic. DLG has already explained in its previous submissions to the CC why 'narrow' MFNs have the same effect in practice as 'wide' MFNs, at least for any brand that also has a direct distribution channel (or spends money on marketing). DLG does not repeat these arguments here.

6.3 DLG's concern is currently **[CONFIDENTIAL]**. Rather, DLG has a concern that there are insufficient constraints on the ability of a PCW operating a 'narrow' MFN to increase commission rates above competitive levels. **[CONFIDENTIAL]**.[23] The continued existence of 'narrow' MFNs would mean that there will be a reduced constraint on commission rates represented by the ability of an insurer to quote lower premiums on its direct channel, leading to the risk of commission rates increasing, with a corresponding increase in PMI premiums.

6.4 DLG also disagrees with the CC's view that 'narrow' MFN clauses are necessary for the continued success of PCWs, and believes that the CC has overstated the risks to PCWs' success in the market. The comparison drawn by the CC with the Italian market,[24] stating that PCWs had been unable to grow, is misplaced; the Italian and UK markets are not comparable as PCWs in the UK are now a well-established distribution channel, with high consumer awareness. The four leading PCWs now account for around two-thirds of new sales and clearly enjoy market power; it follows that they do not need the protection of narrow MFNs. The CC has also not provided empirical evidence to support its claim that it is vital for PCWs to convince consumers that their prices are at least as low as on the insurer's own website. The key marketing messages of PCWs suggest that their focus is actually on the amount of money consumers could save compared to their current insurance policy, not compared to insurers' own websites. The CC has therefore failed to provide evidence to support its claim that the benefits of 'narrow' MFN clauses outweigh the harm to competition that they cause.

6.5 DLG therefore believes that all forms of MFNs, 'wide' and 'narrow', should be prohibited. Failing that, DLG's view is that if the CC is minded to allow the continued use of 'narrow' MFNs, this should be conditional on the imposition of some form of price monitoring to ensure that PCW commission rates are kept within reasonable bounds (e.g. linked to inflation), and that if rates increase beyond this, the MFN can no longer be enforced.

17 January 2014

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23 See the Oxera paper accompanying DLG's response to the annotated issues statement, at Table 3.2.

24 Provisional Findings, paragraph 9.74.