DIRECT LINE INSURANCE GROUP PLC

COMPETITION COMMISSION PRIVATE MOTOR INSURANCE INVESTIGATION

RESPONSE TO PROVISIONAL FINDINGS

1. INTRODUCTION & EXECUTIVE SUMMARY

1.1 This document sets out the response of Direct Line Insurance Group plc (**DLG**) to the Competition Commission's (**CC**) Provisional Findings (**Provisional Findings**) published on 19 December 2013. DLG does not attempt to address every point raised in the Provisional Findings but rather focuses on the CC's key findings.[1] This response should be read together with DLG's response to the CC's Notice of Possible Remedies (**Remedies Notice**), submitted to the CC on 17 January 2014. DLG looks forward to discussing both of these responses with the CC at the response hearing.

1.2 By way of summary:

(a) 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 (**TRVs**) provided to non-fault parties, and does give rise to an adverse effect on competition (**AEC**). This accounts for the great majority of the net consumer detriment identified by the CC in relation to ToH1 and DLG believes that this is the area where the CC should be focusing its attention.

(b) ToH1 does also result in at-fault insurers being charged higher costs for repair, primarily due to the use of credit repair (the CC now recognises that the costs arising from non-fault insurer repairs are significantly lower than it had previously estimated). However, in contrast to the position with TRVs, DLG does not believe that the relatively modest level of net consumer detriment identified by the CC in relation to repair justifies the types of far-reaching, complex and costly remedies being proposed by the CC.

(c) The CC's conclusions on ToH2 are fundamentally flawed. It is evident that the CC's conclusions are largely based on the results of the MSXI Vehicle Inspection Report (**MSXI Study**), as well as a series of uncorroborated assertions from a small number of repairers, neither of which provides a reliable evidentiary base to reach any conclusions about the quality of insurer-managed repairs.

(i) The MSXI Study is based on a small, unrepresentative, and therefore biased, sample (as the CC acknowledges). It follows that the CC cannot, as it does in the Provisional Findings,[2] rely on the results of the MSXI Study to draw any meaningful conclusions on ToH2 including that "a considerable number of cars are not restored to their pre-accident condition";[3] there is no rational basis for such a conclusion.

(ii) The methodology used by MSXI is highly questionable, which in DLG's view means that it is unsafe to rely on the conclusions of the MSXI Study. Firstly, there appear to have been considerable lapses of time between the date of repair and the date of the inspection (on average the vehicles **[CONFIDENTIAL]** had covered

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1 To the extent that DLG does not address an issue raised by the CC in this response, this should not be regarded as indicating that DLG agrees with the CC's analysis or its conclusions.

2 Provisional Findings, paragraph 7.38.

3 Provisional Findings, paragraph 7.53.

more than 12,000 miles, and in one case almost 20,000 miles, between the date of repair and the date of inspection); added to this, the vehicles inspected **[CONFIDENTIAL]** were typically several years old. The MSXI Study took no account of this. Secondly, the inspectors conducted their assessments without reference to any objective technical standards, in many cases deeming vehicles to be non-PAC[4] for reasons that are trivial, or unconnected to the repair being assessed. DLG considers these and the other issues identified in section 4 below to be crucial weaknesses which go to the heart of the MSXI Study's credibility. In addition, it is unclear whether the MSXI inspectors are ATA-qualified,[5] which, if confirmed, would be a further reason for entertaining serious doubts about the reliability of the MSXI Study.

(d) In relation to add-ons, as set out in DLG's response to the CC's Remedies Notice, 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, DLG considers that the Financial Conduct Authority (**FCA**) is best placed to address any concerns in this area as this falls within the FCA's core remit (in addition to which the FCA is currently conducting a review of add-ons).

(e) DLG agrees with the CC's provisional finding that wide MFN clauses do give rise to an AEC. However, DLG does not agree with the CC's analysis of narrow MFN clauses and is strongly of the view that these also give rise to an AEC and should be prohibited. In particular, the CC is incorrect in its analysis that the anti-competitive effects of narrow MFNs impact only a limited part of the PMI market. This analysis is based on a flawed assumption (which contradicts the CC's own findings on barriers to entry in the PCW market) that a new entrant PCW would be able to acquire a significant (36%) market share. By applying alternative assumptions to the CC's modelling it can clearly be demonstrated that narrow MFNs would have an anti-competitive impact on a significant part of the PMI market. DLG also rejects the CC's contention that narrow MFN clauses are necessary for PCWs to be able to operate. This is inconsistent with the key marketing messages of three of the four leading PCWs, and the CC's comparison with Italian PCWs is misplaced and unconvincing.

4 In other words, not in their pre-accident condition.

5 For details of the Automotive Technician Accreditation scheme see: http://ata.theimi.org.uk/.

2. TOH1 – TEMPORARY REPLACEMENT VEHICLES

2.1 DLG agrees with the CC's provisional finding that the separation of cost liability and cost control does give rise to an AEC in relation to TRVs. The principal cause of this is the excessive daily hire rates (and hire durations) associated with credit hire. DLG believes that, aside from bodily injury, this is the largest driver of cost inflation in the PMI market. Accordingly, DLG is not surprised by the CC's findings that the extra cost associated with credit hire is on average between £640 and £830 per claim and that credit hire can be as much as 2.5 times more expensive than direct hire.[6] **[CONFIDENTIAL]**.

2.2 The significance of credit hire is clearly reflected in the CC's findings on net consumer detriment where the CC estimates the detriment deriving from credit hire to be between £140 and £180 million.[7]

2.3 The CC suggests that this estimate of detriment may, in fact, be an underestimate on the basis that transactional / frictional costs incurred by at-fault insurers in dealing with CMCs / CHCs are greater than the average cost of managing repairs that at-fault insurers would incur in the absence of separation, albeit the CC is unable to quantify this.[8] DLG has no reason to disagree with the CC's assessment.

2.4 A further reason why the CC's estimate of detriment may be understated is that the analysis does not take into account the longer duration of credit hire compared to direct hire (of 3.7 days).[9] DLG agrees that the longer hire period may, in part, be because credit hire often involves more serious accidents with longer repair times (a customer involved in a more serious accident is more likely to contact his or her own insurer or broker relatively quickly for assistance and therefore is more likely to be referred by a non-fault insurer into credit hire than be captured by the at-fault insurer). However, the longer duration may also be because CHCs unnecessarily extend credit hire (and the CC notes that this explanation may have some merit).[10] This is evidenced by the CC's finding that at-fault insurers most commonly challenge the duration of hire and subsequently agree reductions with CHCs on the basis of this. In DLG's view, therefore, the longer duration of credit hire does, on balance, adversely affect customers and should be taken into account in the CC's estimate of net consumer detriment.[11]

2.5 DLG notes CHCs / CMCs' comments that "… their presence act[s] as a deterrent to insurers providing a poor quality of replacement vehicle … and that in the absence of separation an insurer's incentive would be to minimi[s]e its costs – insurers would not have any incentive to provide non-fault claimants with a quality replacement car or indeed with a replacement car at all."[12] DLG refutes this and is unclear as to the basis on which the CC accepts this argument. As the CC acknowledges throughout the Provisional Findings, the PMI market is highly competitive.[13] In this context any insurer which provides a poor quality service to its customers (whether relating to TRVs or another product) would suffer significant reputational consequences (particularly given the prominence of brands in the PMI market). The existence of CHCs / CMCs has no bearing on insurers' incentives in this regard.

2.6 Overall, the Provisional Findings support DLG's view that there is a clear case for intervention in relation to credit hire. However, as explained in DLG's response to the Remedies Notice, this is a

6 Provisional Findings, paragraph 6.16.
7 Provisional Findings, paragraph 6.83.
8 Provisional Findings, paragraph 6.71(d) and Table 6.3, paragraph 6.72.
9 Provisional Findings, paragraph 6.14(b).
10 Provisional Findings, paragraph 6.15.
11 Provisional Findings, paragraphs 6.15 and 6.16.
12 Provisional Findings, paragraph 6.38.
13 Provisional Findings, paragraph 6.49.

highly complex area and the CC is considering potentially complicated and costly remedies, some of which risk giving rise to a conflict with principles of EU law. Any remedies must therefore be carefully considered and must also be targeted at reducing credit hire rates and durations (and not at simply tackling the symptoms of the problem, for example, referral fees).

3. TOH1 – REPAIR

Level of consumer detriment and proportionality

3.1 DLG recognises that the separation of cost liability and cost control can lead to higher costs for at-fault insurers, primarily as a result of credit repair. But it is striking that the net consumer detriment identified by the CC as relating to repair is significantly smaller than that accounted for by TRVs.

(a) The CC's estimate of net consumer detriment relating to repair appears to be approximately £30 million[14] or, using the CC's alternative methodology, £35 million (the latter figure relates entirely to credit repair). This equates to just over £1 per policy.

(b) For TRVs the CC's estimate of net consumer detriment appears to be approximately £115 million[15] or, using the CC's alternative methodology, between £140 and £180 million; equivalent to between £5 and £7 per policy.

3.2 The difference may be even starker. The CC flags that "... since frictional and transactional costs are greatest for replacement cars and management costs are greatest for repairs and write-offs … our estimated cost increase for replacement cars is very likely to be an underestimate while our estimated cost increase for repairs and write-offs may be an overestimate."[16]

3.3 The CC acknowledges this contrast: "… the effects are currently smaller in repairs and write offs …"[17] and "the bulk of the net effect was attributable to the extra cost of credit hire over direct hire for replacement vehicles."[18]

3.4 Whilst any net consumer detriment identified by the CC is of course a matter of concern to DLG, it is important to place the CC's findings in context: the CC's analysis of net consumer detriment is the basis for assessing the proportionality of any remedies the CC decides to impose. As set out in detail in DLG's response to the Remedies Notice, the CC has proposed significant and far reaching remedies in relation to repair. DLG does not repeat its comments on these remedies here other than to note its current view that the costs and unintended consequences associated with such remedies would appear clearly to outweigh the relatively small level of net consumer detriment identified by the CC for repair and so would not pass a 'double proportionality' assessment.[19]

3.5 DLG notes the references made by the CC to "… the ongoing litigation over repair costs and that, depending on the results of this litigation, frictional and transactional costs in repairs could increase."[20] The CC does not explain its thinking behind this, but as a preliminary reaction DLG cannot understand the basis for this statement. It is not clear from the recent Court of Appeal ruling in *Coles v. Hetherton*[21] why there should be any long term increase in frictional costs as the CC indicates could happen[22] as the judgment does not affect the separation of cost liability and cost control. At-fault insurers will still need to try to capture claims and control the cost of repairs as

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14 This estimate is based on the calculations in Tables 6.3 and 6.4 of the Provisional Findings. In these tables, the repair cost inflation estimate of £51 million is offset by referrals from credit repair (£6 million) and the profits of non-fault insurers (£23 million), but then inflated to some extent (not specified by the CC) due to frictional costs. Based on the CC finding that frictional costs are relatively less for repair (see note to table 6.4), Oxera have estimated this cost to be £8 million for the purposes of this response. The sum of these estimates (£51m – (£6m + £23m) + £8m) is equal to £30 million.

15 This estimate is based on the calculations in Tables 6.3 and 6.4 of the Provisional Findings. The vehicle replacement cost inflation of £193 million is offset by referrals from credit hire (£98 million), with some upward adjustment (not specified by the CC) due to frictional costs. Based on the CC finding that frictional costs are relatively more for vehicle replacement (see note to table 6.4), Oxera have estimated this cost to be £20 million for the purposes of this response. The sum of these estimates (£193m - £98m + £20m) is equal to £115 million.

16 Provisional Findings, note to Table 6.3, paragraph 6.72.

17 Provisional Findings, paragraph 10.8.

18 Provisional Findings, paragraph 6.82.

19 See the discussion of *Tesco plc v. Competition Commission* [2009] CAT 6, at paragraph 1.4 of DLG's response to the Remedies Notice.

20 Provisional Findings, paragraph 6.89.

21 *Coles v. Hetherton* [2013] EWCA Civ 1704.

22 Provisional Findings, paragraphs 6.92 and 10.8.

they do now, both with regard to non-fault insurer repairs and credit repairs. Indeed, it is possible that the judgment will decrease ongoing frictional costs if it gives market participants a clearer understanding of the legal position (meaning, for example, that insurers challenge repair costs less frequently).

Focus should be on credit repair

3.6 Leaving aside DLG's view that the level of net consumer detriment in relation to repair is modest and the CC's proposed remedies are not proportionate, DLG agrees with the implicit conclusion underpinning the CC's findings that any net consumer detriment identified in relation to repair is primarily driven by credit repair (as the CC notes, referrals to credit repair are "… made mainly by brokers …" and DLG does not refer customers or third parties to credit repairers).[23]

Non-fault insurer repairs

3.7 DLG is concerned that the CC's analysis of non-fault insurer repairs is overly generalised and does not take into account the incentives of insurers that own their own repair centres (**vertically integrated insurers**).

3.8 The CC identifies a number of different non-fault insurer "revenue streams" and assesses these together in the same way. These revenue streams include referral fees received from CHCs and CMCs as well as various practices by insurers which have the effect of increasing non-fault repair charges passed to at-fault insurers.[24]

3.9 The CC characterises these practices as examples of insurers seeking to earn a rent from non-fault claims and as being part of an inefficient supply chain.[25] DLG believes that this is a dangerous over-simplification. Whilst excessive referral fees can be seen as a symptom of ToH1, in that they are a mechanism for insurers to offset the higher costs of credit hire or credit repair, DLG does not agree that it is correct to describe, for example, discounts or rebates (or other benefits) received by vertically integrated insurers from input suppliers in the same manner, and to label these in the same way as referral fees, as these rebates are payable irrespective of whether any given claim is fault or non-fault.

3.10 As DLG has stated in previous submissions, it has invested significantly in its wholly owned repair centres as well as in its procurement function. DLG believes that these investments provide valuable benefits to its customers: DLG is able to ensure that customers receive a quality repair service (including in relation to the paints / parts used in repairs) whilst controlling costs, which helps it offer customers competitive premiums. For example, **[CONFIDENTIAL]**.

3.11 DLG does not believe that, within the context of the highly competitive PMI market, **[CONFIDENTIAL]**. In addition, if the CC sought to impose a remedy in relation to these types of arrangements this would involve many different players active in the broader repair supply chain and so would be extremely complex and expensive to implement and enforce. In DLG's view such a remedy would again fail the 'double proportionality' principle as set out by the Competition Appeal Tribunal in the *Tesco* case.[26]

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23 Provisional Findings, paragraph 6.19.
24 *Ibid*.
25 Provisional Findings, paragraphs 6.86, 6.88 and 6.91.
26 *Tesco plc v. Competition Commission* [2009] CAT 6, paragraph 139, stating 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."

3.12 The CC's approach to non-fault insurer repairs therefore risks ignoring these investments by vertically integrated insurers and the right of those insurers to be able to benefit from that investment and generate a reasonable return.

3.13 In any event, the CC has recognised that "… captured repairs may tend to require less extensive work than non-captured repairs …"[27] and so has revised its estimate of the increased cost of non-fault repairs compared with repairs managed by at-fault insurers down from an average of £200 per repair (as set out in the CC's working papers)[28] to an average of £95 per repair.[29] Moreover, as the CC itself acknowledges "… the revenue stream (from referral fees etc.) to insurers is likely to reduce motor insurance premiums …".

[27] Provisional Findings, paragraph 6.21.
[28] Working Paper, 'Over-costing and over-provision of repairs', paragraph 11.
[29] Provisional Findings, paragraph 6.22.

4. TOH2 – UNDERPROVISION OF SERVICES

4.1 The CC's thinking in relation to ToH2 has moved significantly from its Annotated Issues Statement and Working Papers where the CC found that: "Although our commissioned assessment of some post-accident vehicle repairs is ongoing … on the basis of the evidence we have seen and the analysis we have conducted so far, it does not appear to us that, overall, it is likely that claimants suffer material harm in relation to the post-accident repairs they receive or the TRV they receive due to another party … procuring those services on its behalf."[30] The CC now provisionally finds that insurers and CMCs do not monitor effectively the quality of repairs and that there are significant limitations to claimants' ability to assess the quality of car repairs, and that these features of the PMI market combine to give rise to an AEC. DLG is extremely surprised, and has serious concerns, that the CC has now come to this provisional view.

The legal standard

4.2 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.[31] This necessarily requires the CC to apply a 'balance of probabilities' threshold to its assessment, and address the question of whether it is more likely than not that a feature, or a combination of features, leads to an AEC.[32]

4.3 In the context of ToH2, the CC therefore has to be satisfied that it is more likely than not that the two identified features of the market described in paragraph 4.1 above lead to an AEC. DLG does not believe that the CC has sufficient evidence to reach this conclusion.

MSXI Study

4.4 It is clear that the MSXI Study has been crucial to the CC changing its mind and provisionally finding that the two features of the PMI market (that insurers and CMCs do not monitor effectively the quality of repairs and that there are significant limitations to claimants' ability to assess the quality of car repairs) give rise to an AEC.

4.5 The CC's non-fault consumer survey had indicated that the majority of respondents (81%) were happy that the repaired vehicle was worth the same or more compared with its value before the accident. The CC was apparently not concerned by the remaining 19% of respondents, 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". 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.

4.6 The MSXI Study puts a different complexion on matters. It finds that "Nearly half (45 out of 101) of the vehicles inspected were not returned to their pre-accident condition"[33] and that "… the proportion of non-pre-accident-condition vehicles was lower when the repairer was chosen by the claimant rather than when the repairer was chosen by the insurer."[34]

30 Annotated Issues Statement, paragraph 39.
31 Enterprise Act 2002, sections 134(1) and (2).
32 CC3: *Guidelines for Market Investigations* (April 2013), paragraph 319.
33 Provisional Findings, paragraph 7.33.
34 Provisional Findings, paragraph 7.36.

4.7 The CC acknowledges some underlying problems with the MSXI Study, noting that "the sample is small and not representative".[35] But the CC also states that "Independent assessment by MSXI experts has indicated that the proportion not repaired to pre-accident condition is considerably higher than suggested by consumers themselves"[36] and that "… we consider that [the MSXI results] give support to the submissions from repairers and others that claimants experience detriment from cars not having been repaired to the legal standard."[37] The CC explicitly places greater weight on the evidence of MSXI and the views of repairers, noting that it believes "more weight should be attached to the evidence from experts (i.e. from repairers and from the results of the vehicle inspections) than to evidence from consumers".[38] DLG takes issue with this approach.

4.8 Firstly, DLG does not believe that the CC can properly rely on the MSXI Study as there are a number of significant defects with the methodology and analysis applied by MSXI which fundamentally undermine its credibility.

4.9 Given the CC's acknowledgement that the sample of vehicles inspected by MSXI is small and unrepresentative, the MSXI Study does not provide a sound statistical or evidential basis for calling into question the findings of the survey of non-fault claimants. As described in more detail in the Oxera report attached at Annex 1, no meaningful conclusions can be drawn from the MSXI Study 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 PAC such as to justify a finding of an AEC based on under-provision of repair services.[39] The results of the MSXI Study do not even allow the CC to draw any conclusions about the overall level of under-provision, let alone a probability of more than 50%.

4.10 DLG's review of the information provided in the MSXI dataroom has also highlighted other key concerns with MSXI's experience and methodology which go to the heart of the study's credibility. More detail on DLG's assessment of MSXI's findings in relation to specific vehicle inspections is set out in Annex 2 attached.

(a) *Lapse of time between accident and inspection, and mileage / age of vehicle, not taken into account:*

(i) There appears to have been a considerable lapse of time between the date of a vehicle's repair, and the date of MSXI's inspection. On average the mileage of the **[CONFIDENTIAL]** had increased by 12,000 miles between these two dates, and in one case by nearly 20,000 miles.[40] This suggests that the lapse of time between the repair and the inspection could in some cases be as much as 12 months or more.[41] The MSXI Study makes no allowance for the possibility of further damage (for example, through subsequent accidents) or natural wear and tear to the vehicle having occurred during this time. This fact alone seriously undermines the probative value of the inspectors' conclusions.

(ii) In addition, the MSXI Study failed to take account of the age and/or mileage of the vehicles. This is a glaring omission, as the **[CONFIDENTIAL]** were on average approximately nine years old, with an average mileage (at the time of repair) of over 66,000 miles. It is normal for vehicles of this age and mileage to show signs of wear and tear but the MSXI Study makes no allowance for this.

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35 Provisional Findings, paragraph 7.38.
36 Provisional Findings, paragraph 7.43(d).
37 Provisional Findings, paragraph 7.42.
38 Provisional Findings, paragraph 7.44.
39 Provisional Findings, paragraph 7.40
40 **[CONFIDENTIAL]**.
41 According to the Department for Transport's National Travel Survey 2012 (page 21), the estimated average annual mileage per car in 2012 was 8,200 miles.

(b) *No reference to objective technical standards:* The MSXI Study was solely opinion-based. It would have been perfectly possible for MSXI to benchmark the repair work against a set of technical standards. These are publicly available and, whilst several different standards do exist, the CC could have mandated a specific standard, or sought views of insurers and repairers to agree on a standard that could have been used. This would have allowed for a more objective assessment to be made and it would also have provided MSXI with a more reliable means of comparing its results.

(c) *Minor cosmetic issues relied on:*

(i) As the CC acknowledges,[42] the issues raised by MSXI as to why the **[CONFIDENTIAL]** failed to meet the PAC standard were typically very minor cosmetic issues. No issues were raised about any vehicle's structure, safety or driveability. It is unclear how MSXI could justifiably rely on only minor cosmetic issues, which can be easily and quickly rectified, to deem a vehicle non-PAC.

(ii) In addition, in some cases, some repairs, properly carried out, can cause minor imperfections which are simply unavoidable (for example, some repairs have to be carried out manually rather than using the automated machinery originally used to manufacture the vehicle). MSXI again took no account of this in its assessment. In one case, a repair **[CONFIDENTIAL]** was considered to be non-PAC because "rear screen bonding [was] untidy".[43] However, the replacement of a windscreen will necessarily be a manual exercise and this may lead to minor imperfections, since the bonding surrounding a windscreen may not be as neat when applied manually as opposed to with a machine at the time of manufacture. It is not reasonable to use this as the basis for a finding of non-PAC.

(d) *Reporting on work outside the scope of the repair:* MSXI's inspections sometimes went beyond the scope of the repair job in question. This means that some of the individual MSXI vehicle reports listed poor quality repairs which had not been handled by **[CONFIDENTIAL]**, or reports flagged unrepaired damage to a vehicle which had clearly occurred as part of another accident.

(e) *Lack of detailed information on MSXI's concerns:* Very often MSXI's individual vehicle inspection reports describe issues in single, short sentences, or simply provide a summary of the issues without any further detail being provided on specific concerns. The lack of written detail means that in reviewing the individual reports DLG has been heavily reliant on the images which accompanied them. However, in some cases, MSXI fail to provide any images or, if images are provided, they are of a very poor standard (unclear or too small to review). As a result, the reports fail to substantiate a large number of the issues raised by MSXI. One (more extreme) example of these problems (where MSXI judged a vehicle to be non-PAC) is where the MSXI vehicle inspection report includes images of two, possibly three, different vehicles, each with different colours and each a different make of vehicle.

(f) *Poor and inconsistent inspection conditions:* As acknowledged in the MSXI Study "the inspections were not carried out under scientific or workshop conditions".[44] In order to produce a credible report of this kind, inspections should have been conducted in a controlled workshop environment.

(g) *Not ATA-accredited:* MSXI provided a summary of their inspectors' experience and accreditations. However, there was no reference to the inspectors being Automotive

42 MSXI Study at Table 1.
43 This relates to the repair of a **[CONFIDENTIAL]**.
44 MSXI Study, page 41.

Technician Accreditation (**ATA**) qualified (an accreditation awarded by the Institute of the Motor Industry (**IMI**)). As DLG made clear in its response to the CC's invitation to comment on suppliers for the vehicle inspection programme dated 3 May 2013, in order for someone to assess modern repair techniques he or she must be ATA-qualified. The ATA is the recognised industry standard (for example, all repairers within DLG's repair network have ATA-qualified staff and DLG would expect that other insurers demand the same from their repair networks). This qualification ensures that repairers have the knowledge necessary to understand vehicle repair and manufacturing processes and methods in order to be able to carry out and assess modern repair techniques. IMI describes the ATA as "an industry standard benchmark of competence".[45] If it is indeed the case that MSXI inspectors did not have this basic qualification, this in itself would call into question the reliability of the MSXI Study.

4.11 Based on DLG's review of the MSXI materials provided in the CC's dataroom DLG does not believe there is any basis for MSXI to have concluded that the **[CONFIDENTIAL]** were non-PAC. Further detail on DLG's assessment of **[CONFIDENTIAL]** is set out in Annex 2 attached. DLG further notes that **[CONFIDENTIAL]**.

4.12 Based on these wide-ranging and fundamental concerns, the MSXI Study is completely lacking in credibility and cannot reasonably be relied on by the CC as evidence of an AEC. It certainly cannot be used as evidence that "… when claimants do choose their own repairer … repair quality appears to be higher …",[46] or that insurers do not effectively monitor repairs. Indeed, for the repairs **[CONFIDENTIAL]** the opposite appears to be the case.

Repairers

4.13 The second piece of evidence relied on by the CC in reaching its provisional findings in relation to ToH2 consists of comments received from a small number of repairers (see paragraph 4.7 above). In fact, the CC appears to place great weight on "expert" repairer evidence.[47] However, this evidence is not independent, and is clearly not sufficient to support a finding of an AEC: it is mostly in the form of unsubstantiated anecdotal comments by three repairers and the National Association of Bodyshops (**NAB**). These comments cannot be said to be representative of the wider repair industry, nor completely unbiased.

4.14 It is of concern to DLG that the CC places greater emphasis on the uncorroborated comments of a small minority of (three) repairers and the NAB than the results of the non-fault consumer survey. The CC simply reports their comments but offers no analysis of the arguments being put forward and seems not to have tested the points being raised. This is not a sound basis for reaching conclusions on whether ToH2 gives rise to an AEC.

4.15 DLG cannot comment on practices of other insurers but disputes any contention that it encourages repairers to "cut corners" or reduce quality in order to save costs. In terms of auditing the quality of repairs, as detailed by the CC in Annex B to Appendix 7.3 of the Provisional Findings, DLG does assess the quality of repairs and carries out a number of different checks to ensure repairers are fulfilling DLG's expected high service levels.

Weak evidentiary base

4.16 In summary, DLG is concerned that the CC is relying in particular on two very weak sources for its finding of an AEC which, neither individually nor in combination, fulfil the legal standard for finding an AEC.

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45 See http://ata.theimi.org.uk/about-ata.
46 Provisional Findings, paragraph 7.54.
47 Provisional Findings, paragraph 7.44.

PAS 125 Accreditation

4.17 As part of its findings on ToH2, the CC also concludes that "PAS 125 accreditation and manufacturer approvals [are] unlikely in themselves to ensure a high quality of repair."[48] DLG strongly refutes this and believes that the PAS 125 standards are a central means of ensuring high quality repairs.

4.18 As the CC acknowledges, PAS 125 sets out the requirement for repairers to follow suitable documented repair methods. These repair methods are developed by the likes of Thatcham or car manufacturers and they cover different types of repairs for different vehicles. They also prescribe the quality of repair materials which should be used, impose minimum requirements for personnel (which include a sufficient proportion of staff being ATA-qualified), as well as requiring repairers to use appropriate and well-maintained equipment. These are a crucial way of ensuring that each repair is carried out properly and safely. For example, it means that a technician carrying out a welding operation must be properly trained and certified, must be using correct equipment and quality materials and must follow the manufacturer's (or Thatcham's) technical specifications for the particular job at-hand. DLG believes that the CC is therefore wrong to dismiss PAS 125 as simply being "… focussed on processes and procedures."[49] Compliance with PAS 125 standards provides an assurance that a repair has ensured the structural integrity and safety of the vehicle. This is a fundamental requirement of any vehicle repair and is therefore key to providing a high quality repair.[50]

4.19 PAS 125 also covers key cosmetic issues, such as the replacement and proper alignment of bumpers and panelling, albeit not paint work. However, whilst DLG cannot comment on the practices of other insurers or repairers, DLG does conduct regular audits and post-repair inspections on its repair network to check the quality of repairs (as the CC has recognised).[51] These audits assess the whole vehicle to ensure that it is returned in PAC, including minor cosmetic issues.

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48 Provisional Findings, paragraph 7.28.

49 *Ibid.*

50 The PAS 125 standards also ensure that a vehicle's Euro NCAP rating is maintained. The European New Car Assessment Programme, or Euro NCAP, was established in 1997 and is composed of seven European Governments as well as motoring and consumer organisations in every European country. Euro NCAP organises crash-tests and provides motoring consumers with a realistic and independent assessment of the safety performance of some of the most popular cars sold in Europe. Euro NCAP rates the safety of all new vehicles against a scale of one to five (five being the highest). PAS 125 is the only standard which, if followed, allows a potential buyer to know that a second-hand vehicle which has been repaired has retained the Euro NCAP rating which it was originally awarded when first manufactured.

51 Provisional Findings, Annex A of Appendix 7.3.

5. TOH4: THE SALE OF ADD-ON PRODUCTS

5.1 As emphasised in DLG's response to the CC's Remedies Notice, 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, DLG considers that the FCA is best placed to address any concerns in this area, added to which add-ons are currently under review by the FCA. DLG has set out the specific reasons, in its response to the CC's Remedies Notice, as to why the FCA is the most appropriate regulator, and does not repeat those arguments here.

Transparency and complexity of information provided to consumers

Description of add-ons

5.2 The CC has identified five add-ons which it considers to be complex and difficult for consumers to understand: personal injury cover, NCB protection, extended foreign use cover, key loss cover and courtesy car cover. As DLG does not offer extended foreign use cover or key loss cover, it does not comment on those particular add-ons.

5.3 The CC has concluded that the current level of detail on add-ons provided to customers appears to be insufficient. The CC draws a comparison between the description of enhanced courtesy car cover provided by CISGIL and DLG,[52] to illustrate the variation in descriptions between insurers. The CC does not state directly whether it considers CISGIL's longer description to be preferable to that provided by DLG, but that is the clear implication. In DLG's view, the comparison drawn by the CC is artificial because the CC fails to take account of the significant amount of additional information available on DLG's website about the add-ons that DLG offers.[53]

5.4 There is a careful balance to be struck between the provision of simple, clear language and ensuring accuracy of detail, a point the CC acknowledges.[54] It is particularly important to be mindful of information disclosure in the context of a customer's buying journey, as there is a balance to be struck between the amount, timeliness and complexity of information disclosed and ensuring customers have a clear understanding of what this information means in practice at different points in the buying journey. It does not necessarily follow that more information results in better customer understanding. DLG would welcome any measures which improve informational transparency for customers and allow comparisons of add-ons to be made. But DLG believes the practical implementation of any remedy related to add-ons should be left to the FCA, given the work it is already doing in this area, and its over-arching statutory remit to ensure that markets function well, and to ensure that consumers are provided with an appropriate degree of protection.

Customer survey evidence

5.5 The CC's conclusion that customers have limited understanding of selected add-ons is predominantly based on the CC's survey of motor insurance policyholders. The CC states that 59% of respondents who claimed to understand NCB protection, "wrongly thought that NCB protection

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52 Provisional Findings, paragraph 8.31.

53 The language quoted by the CC comes from the 'Optional Extras' page of DLG's website, which provides a list of add-ons from which the customer can choose, and a short summary of the cover provided by each add-on. The customer can then find out more details about each of these add-ons by clicking through onto separate pages. For example, by clicking on the 'Ask a question' section of the 'Car' home page, the customer will be taken to a series of 'FAQs', a number of which explain: the eligibility criteria for GHC and GHC+, whether an excess is payable if the customer has an accident, and what is meant by 'a similar physical sized car'. In addition, once the customer clicks through to 'Get a Quote' he will be taken to the 'Motor Premium' page, which contains a summary of the benefits provided by each add-on. Details of how customers can access these pages, as well as the specific information that these pages communicate to customers have already been provided to the CC. Further, when offering customers the opportunity to purchase add-ons over the phone, DLG has call scripts in place which detail the necessary information that must be communicated to a customer. Relevant sections of these call scripts have also been provided to the CC. It would therefore be wrong to suggest that DLG customers are not provided with sufficient information to make an informed decision about what they are buying.

54 Provisional Findings, paragraph 8.29.

would prevent their motor insurance premium going up as a result of a claim."[55] But as DLG pointed out in its response to the CC's Annotated Issues Statement,[56] the way in which the question seems to have been put to respondents ("Does the protection prevent your premium going up as a result of a claim?") does not necessarily lend itself to a binary 'Yes/No' answer.

5.6 NCB protection limits the extent of any increase in premium as a result of a claim, and prevents it from increasing as much as it would in the absence of NCB protection. It is therefore entirely understandable that customers should answer 'Yes' to this question; conversely, for the CC to describe this as the 'wrong' answer is an over-simplification. There is also the point that it is not clear whether this result reflects a misunderstanding of the product or a misunderstanding of the CC's survey question. It is possible, for example, that survey respondents misunderstood the question as to whether they have 'NCB protection' to be asking whether they benefit (in terms of lower premiums) from having an NCB.

5.7 In addition, as the CC itself acknowledges, the survey response rate was remarkably low, at only 5%, giving rise to possible concerns about response bias.[57]

5.8 As explained in DLG's response to the Remedies Notice, NCB protection enables customers to make significant savings on premiums.[58] It is doubtless for this reason that NCB protection is considered such a valuable add-on by many customers, and indeed the CC's survey shows that NCB protection is rated highest amongst the various add-ons in terms of value for money.[59]

5.9 In these circumstances, the CC should be cautious about drawing any conclusions relating to the level of customers' understanding of NCB protection, based on evidence from the customer survey.

5.10 DLG acknowledges, however, that some customers may not realise that the effect of an accident even with NCB protection may be to increase their premium at renewal, irrespective of fault. DLG would be happy to work with the FCA to ensure clarity in the provision of insurers' add-on descriptions in order to address this point. NCB protection is a product that offers significant customer benefits and the CC should be wary about proposing remedial measures that would risk leaving customers under-provided.

Transparency of NCB offered to customers

5.11 The CC has concluded that there is a lack of transparency in relation to NCB protection, because insurers do not provide customers with their NCB scales.[60] DLG does not believe that the publication of NCB scales is the most desirable or appropriate means of helping customers to make informed buying decisions. DLG has explained in its response to the CC's Remedies Notice why publication of NCB scales would be confusing for customers,[61] and does not repeat those comments here. Again, the CC needs to be wary of imposing remedies that may result in insurers no longer offering NCB protection due to the risks of customer misunderstanding.

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55 Provisional Findings, paragraph 8.33.

56 DLG's response to the Annotated Issues Statement at Annex 4, paragraph 3.

57 The CC also notes a higher response rate among older policy holders, and oversampling in Wales, Scotland and Northern Ireland (albeit this is said to have been corrected for) (Provisional Findings, paragraph 8.32, footnote 11).

58 Response to Remedies Notice, paragraph 5.6, referencing Q3 of DLG's response to the CC's follow up questions dated 3 July 2013, where DLG stated **[CONFIDENTIAL]**.

59 69% of respondents thought NCB protection represented good value for money (Provisional Findings, Table 9 of Appendix 8.1).

60 Provisional Findings, paragraph 8.37.

61 Response to Remedies Notice, paragraph 5.6.

Possible point-of-sale advantages for motor insurers

Comparing add-ons on a PCW

5.12 The CC argues that, to the extent that consumers are unable to compare add-ons on a PCW, insurers have a point-of-sale advantage at the point when the consumer clicks through to the insurer's website to purchase his or her chosen add-ons.[62] This point-of-sale advantage is said to arise because "it is hard and costly in terms of time for consumers to compare the price of basic motor insurance policies and add-ons together across different providers". According to the CC this is "a source of market power for insurers".[63] DLG does not accept this analysis.

5.13 Indeed it is striking that the CC's own customer survey evidence contradicts this finding: the CC reports that most policyholders who said that they had compared add-ons offered by different insurers found them easy to compare.[64] The CC seeks to downplay this finding by arguing that, with the exception of NCB protection, almost half of respondents did not make any such comparison. Even accepting the limitations of the CC's survey, the proportion of customers who compared insurers for NCB protection was 62% (almost two-thirds), which would suggest that the barriers to search are not insurmountable, and certainly nowhere near as high as suggested by the CC. As for breakdown cover, which along with NCB protection are the two add-ons generating the highest amounts of net earned premium, the CC's survey evidence shows that just over half (52%) of customers compared insurers. At first sight this might suggest higher barriers to search, but the CC acknowledges that there are many stand-alone breakdown cover products available,[65] and the CC has offered no evidence suggesting that customers face search costs in comparing prices for stand-alone breakdown cover.

5.14 More generally, as explained in its response to the Remedies Notice, **[CONFIDENTIAL]**.[66] However, the precise treatment may vary across PCWs, and it is up to the individual PCW to decide how (if at all) this information is displayed to customers. As the CC notes, PCWs currently provide only a generic description of the add-on, and a representative price. But PCWs need to be encouraged by the FCA to find a clear and transparent way to display the information insurers provide relating to these add-ons, including specific prices. In principle a quote could be adapted to include add-on cover where a customer has indicated a desire to purchase it through the PCW.

Experience of purchasing add-ons on a motor insurer's website

5.15 DLG is committed to helping customers make informed buying decisions, and is keen to work with the FCA to provide details of its add-ons in a clear, accurate and comprehensive manner. However, DLG would urge the CC not to implement overly prescriptive requirements at point-of-sale, and to leave the FCA, bearing in mind the FCA's concurrent market study into the sales of general insurance add-on products, to find a flexible solution to ensure customers have a clear understanding of the add-ons they wish to purchase.

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62 Provisional Findings, paragraph 8.41.
63 Provisional Findings, paragraph 8.56.
64 Provisional Findings, paragraph 8.48.
65 Provisional Findings, paragraph 8.59.
66 Response to Remedies Notice, paragraphs 5.2-5.3.

Outcomes of the sale of add-ons

Profitability of add-ons

5.16 The CC has concluded that the very low level of claims ratios for some add-ons means the higher expense ratio of add-ons overall does not preclude insurers from earning higher profits from the sale of add-ons than from the sale of basic motor insurance.

5.17 As DLG has explained to the CC,[67] **[CONFIDENTIAL]**.

5.18 DLG notes the CC's intention to carry out further work to ascertain the level of detriment arising from the claimed AEC in add-ons. As a general comment, since add-ons are typically sold as a bundle of products with basic cover, appropriate cost allocation (and therefore assessment of profitability) on a product-by-product basis would be very difficult.

67 DLG's response to the CC's follow up questions on add-ons dated 14 August 2013.

6. TOH5: PCWS AND MFNS

Wide MFNs

6.1 DLG agrees with the CC that wide MFNs (which prohibit lower pricing across multiple sales channels) do give rise to an AEC by restricting entry into the PCW market, reducing innovation by PCWs and increasing premiums for customers. It is reasonable 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. DLG does not repeat its comments on the CC's Remedies Notice here other than to note that wide MFN clauses (and any practices which have the same effect as such clauses) should be prohibited.

Narrow MFNs

6.2 DLG disagrees with the CC's conclusions set out in paragraph 9.92 of the Provisional Findings that narrow MFNs do not give rise to an AEC and believes that they should be prohibited. PCWs already enjoy a position of market power (as a key distribution channel for insurers) and narrow MFNs only serve to reinforce this market power. Evidence of their market power can be seen in the fact that **[CONFIDENTIAL]**.[68] In addition, the CC has found that PCWs enjoy high levels of profitability, with operating margins of around 25% and low capital costs, which is consistent with a degree of market power against insurers.[69] The continued existence of narrow MFNs removes a key competitive constraint on PCWs (an insurer quoting lower premiums on its direct channel) and therefore leads to the risk of PCW commission rates increasing further and consequently PMI premiums increasing.

6.3 The CC acknowledges that narrow MFNs can reduce competition in the motor insurance market: "Under some conditions [narrow MFNs] … may both reduce the incentives for a motor insurance provider to innovate on their own website and soften competition between PCWs."[70] The CC suggests, however, that any anti-competitive effects are likely to be weak.[71]

6.4 DLG disagrees with this assessment. The CC's finding, based in part on its illustrative channel pricing model, that the impact is felt by only a small number of brands, is flawed and understates the anti-competitive effects of such clauses. In particular, the CC assumes that a new entrant PCW can capture a large share (up to 36% in one of the scenarios presented by the CC) of the PCW market,[72] but this appears to contradict the CC's own assessment of barriers to entry into the PCW market (which the CC considers to be high). As Oxera show in their paper attached at Annex 3, using alternative assumptions it can be clearly demonstrated that the anti-competitive effects of narrow MFNs would have a significant impact on the market (affecting brands which Oxera estimate to account for around 30% of total online sales).

6.5 DLG also rejects the CC's contention that narrow MFNs may be necessary for PCWs to survive. The comparison drawn by the CC with the Italian market, stating that PCWs had been unable to grow due to a lack of MFN clauses, is misplaced and unconvincing: 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 a strong incumbency position. It follows that they do not need the protection of narrow

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68 Oxera paper accompanying DLG's response to the Annotated Issues Statement at Table 3.2.
69 Provisional Findings, paragraph 9.8 and paragraph 9 in Annex H to Appendix 9.3.
70 Provisional Findings, paragraph 9.66.
71 *Ibid*.
72 Provisional Findings, Table 2 at Annex B to Appendix 9.3

MFNs. Furthermore, the CC provides no evidence that a lack of growth among PCWs in Italy was caused by the absence of narrow MFN clauses. **[CONFIDENTIAL]**.[73]

6.6 DLG agrees with the CC's comment (when considering some PCWs' concern that in the absence of narrow MFNs, insurers could free-ride on PCWs' marketing investments) that an "… alternative charging model or quote poaching clauses may provide a less restrictive mechanism for PCWs to overcome the problems of free-riding by insurers and consumers [than narrow MFNs]."[74] DLG notes that in its overall conclusions, the CC states that narrow MFNs may be necessary for PCWs to survive as they prevent free-riding.[75] However, this appears to be at odds with the CC's own analysis (and DLG is therefore unclear as to the basis on which the CC could have provisionally reached this conclusion). DLG's view is that all of the alternatives to free-riding set out at paragraph 9.77 of the Provisional Findings are potentially workable alternatives to narrow MFNs (and are certainly less anti-competitive), albeit the CC would need to be careful to ensure that they do not lead to circumvention.

6.7 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 three of the four 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.

6.8 DLG's view is that narrow MFNs restrict intra-brand competition by removing the pricing freedom of brands that are sold both through PCWs and direct through an insurer's own website. In the absence of any evidence that narrow MFNs are necessary for the survival or continued success of PCWs, it is not clear why the CC favours the continued use of such clauses. If insurers with significant direct sales, as well as PCW sales, were allowed to price freely, and in some cases undercut prices offered on PCWs where the PCW's costs were too high, this would increase competition and reward low cost PCWs.

6.9 Further detail as to why narrow MFN clauses give rise to an AEC is set out in the Oxera paper attached at Annex 3.

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73 Figures from Eurostat show that 71% of UK customers have made an internet purchase (any goods or services) in the last three months. This compares to the EU average of 38% and 14% for Italy.

74 Provisional Findings, paragraph 9.78.

75 Provisional Findings, paragraph 9.92(b).

ANNEX 1: Issues with the MSXI survey results

Note prepared for Direct Line Insurance Group plc

7 February 2014

1 Background

The Competition Commission (CC) initially commissioned a survey of non-fault claimants to test whether there may be under-provision of services under theory of harm (ToH) 2. The CC concluded that:

> It appears to us from these results that there is no compelling evidence overall of underprovision to non-fault claimants of repair services. [1]

The CC also commissioned MSXI to perform audits of vehicles that had been repaired after an accident. On the basis of this survey, the CC departed from the view expressed in the working paper, concluding that,

> (c) Evidence from consumers themselves suggests that the great majority of non-fault claim vehicles are repaired to their pre-accident condition, but many consumers might not be able to assess accurately the quality of repairs. This is supported by the level of disparity in MSXI findings between MSXI's assessment and consumers' own assessment of the quality of repairs.
>
> (d) Independent assessment by MSXI experts has indicated that the proportion not repaired to pre-accident condition is considerably higher than suggested by consumers themselves.[2]

This suggests that CC believes the MSXI results are sufficiently robust in order to supersede the findings of the survey of non-fault claimants. This decision is surprising given that the MSXI survey is based on only 104 vehicles and the CC itself concludes that the sample is biased (see below).

This note considers whether the CC's finding is valid and supported by statistically reliable findings.

[1] Paragraph 4 of CC Working Paper entitled, 'Theory of harm 2: Analysis of the results of the non-fault survey in relation to under provision'. The CC also notes in the same paragraph that 'some repair work might be hard for consumers to assess so we interpret these results, which reflect the perceptions of consumers, with some caution.'

[2] Provisional Findings, paragraph 7.43

2 The Competition Commission's approach

Oxera understands that the CC commissioned the MSXI survey as it was concerned that the previous survey of non-fault claimants may have under-estimated the frequency of under-provision of services due to consumers being unaware of such under-provision. The MSXI survey asked for consumers' own assessment of the quality of repairs and then compared that with the MSXI assessment of the quality of repairs.

The CC found that whilst 20% of the consumers in the sample reported that the vehicle had not been returned to its pre-accident condition, the MSXI assessment found that 45% of the vehicles had not been returned to the pre-accident condition. From this, the CC essentially concluded that the frequency of actual under-provision of repair services is somewhat more than twice as great as that reported by consumers.

Applying these findings to the original survey of non-fault claimants, which found that 11% believed that their vehicle was not returned to its pre-accident condition, would suggest that the actual rate of under-provision of services is 25%.[3] The CC then concludes that under-provision of services is much more frequent that the original survey suggested.

3 Statistical reliability of the MSXI survey

In response to the MSXI Vehicle Inspection working paper, DLG expressed concerns about misinterpreting the results of the study, due to its clear limitations. DLG noted that:

> In particular, the small sample size, the fact that the sample was not designed to be (and was not) random, that captured claims were over-represented, and that there may well be sample selection biases in the steps leading to the selection of the 104 vehicles to be inspected out of the 13,000 vehicles covered by the original non-fault survey, means that no statistically significant conclusions can be drawn from these results.

In the Provisional Findings, the CC acknowledges that the MSXI sample is not representative.

> We noted that respondents' own assessment of the condition of these cars was somewhat worse than average for all cars in our non-fault survey—20 per cent of vehicles inspected by MSXI were considered by respondents to be in worse condition than before the accident, compared with 11 per cent for all respondents (see Table 7.1). We also noted that nearly half of the inspected vehicles had been previously returned to the repairer for rectification. In the light of these points and the composition of the sample (see previous two paragraphs), **it would not be appropriate to take the MSXI inspections to be a representative sample of non-fault repairs as a whole**.[4] (Emphasis added by Oxera)

It is therefore surprising that the CC has suggested in the Provisional Findings that conclusions can be drawn from the results.

[3] The CC explains this calculation in footnote 19 on page 7-17 of the Provisional Findings.
[4] Provisional Findings, paragraph 7.32.

The CC assumes that it can safely draw conclusions about the relative frequency of consumer reported under-provision compared to the results of the MSXI audits, based on this biased sample. But this is not a safe assumption, as it is not safe to assume that the sample bias will be the same for consumer detection of problems as it is for MSXI detection of problems.

This is particularly the case given the issues with the sample selection raised by the CC, which noted that the sample was dependent on prior opinions about the vehicle condition of both the non-fault claimant and MSXI itself.

> The sample of vehicles to be inspected was derived from respondents to our non-fault consumer survey who had said they were prepared to have their vehicle inspected by a professional assessor. A database of contact details of these owners, together with repair estimate documentation were provided to MSXI for review. MSXI prioritized inspections according to the type and scale of repairs undertaken and its ability to assess the repairs from documentation provided.[5]

Whilst information is not available on what affect these biases had, it is possible that the proportion of claimants declaring that the car had not been returned to its pre-accident condition (as opposed to suspecting that it may have not been returned to its pre-accident condition, and wanting an expert to check) was systematically lower than the findings of MSXI specialists, whose selection process may have inadvertently favoured vehicles which were more likely to be below their pre-accident condition (as indicated by the bias in the sample). Whatever the situation, it is clear that the two biases need not operate in parallel, and therefore the ratio used by the CC is open to question.

Given the small sample size and the considerable uncertainty surrounding the ratio applied by the CC, it is difficult to draw any meaningful conclusions about the proportion of vehicles that do not meet pre-accident conditions, and it is not possible to conclude, as the CC does, that, ‘the proportion not repaired to pre-accident condition is considerably higher than suggested by consumers themselves’.

4 Conclusions

The CC acknowledges that the small sample of the MSXI survey is biased, but continues to draw strong conclusions from it.

The MSXI survey cannot be safely used to draw meaningful conclusions about possible under-provision of services under ToH2. The MSXI survey results therefore do not provide a sound basis for superseding the findings of the survey of non-fault claimants.

[5] Provisional Findings, paragraph 7.30

DIRECT LINE INSURANCE GROUP PLC

COMPETITION COMMISSION PRIVATE MOTOR INSURANCE INVESTIGATION

RESPONSE TO PROVISIONAL FINDINGS

ANNEX 2: REPORT FROM MSXI DATA ROOM

[CONFIDENTIAL]

ANNEX 3: Most Favoured Nation (MFN) clauses

Note prepared for Direct Line Insurance Group plc

7 February 2014

1 Introduction and main findings

This note sets out some observations on the Competition Commission's (CC's) conclusions regarding MFNs and in particular its recommendation to prohibit wide MFNs, but to allow narrow MFNs.

The CC accepts that 'network effects' can result in narrow MFNs having a detrimental impact on competition in the case of brands that rely to a significant extent on both direct and PCW online sales. However, the CC states that,

- these 'network effects' only affect a small number of brands (and therefore the negative impact is limited); and
- narrow MFNs may be necessary for survival of PCWs in order to persuade consumers not to go directly to insurers' websites instead.

This note tests both of these propositions. The main findings are as follows:

Narrow MFNs have an effect on a significant proportion of the online market

- the CC's conclusion that the issue with narrow MFNs only affects a small number of brands is questionable; the CC's illustrative channel pricing model appears to overstate the extent to which an affected brand would need to rely on direct online sales, which results in an under-estimate of the number of affected brands;
- using alternative assumptions to determine the affected brands, the CC consumer survey data suggests brands that rely to a significant extent on both direct and PCW online sales account for a significant proportion of total online sales (around 30%).

The CC has not presented evidence to show that narrow MFNs are necessary for PCWs to survive

- the CC does not provide 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 insurers' own websites;
- the CC does not present or reference any empirical evidence to support its claim that a lack of narrow MFNs has prevented the development of PCWs in Italy;

- an empirical assessment of the primary marketing messages of the four largest PCWs shows that they tend to focus on the amount of money consumers could save compared to their current insurance policy, not compared to insurers' own websites.[1]

Narrow MFNs restrict intra-brand competition

- therefore, in the absence of any evidence that narrow MFNs are necessary for the survival of PCWs as a business model, it is not clear why the CC would favour the continued use of such clauses;
- if insurers with significant direct sales as well as PCW sales were allowed to price freely and in some cases undercut prices offered on PCWs where the PCW's costs were too high, this could increase competition and reward low cost PCWs.

2 Proportion of the online market negatively affected by narrow MFNs

The CC finds that there are conditions under which 'network effects' can lead to narrow MFNs causing the same harm to competition as it found for wide MFNs. The CC suggests that this would affect just four brands (Churchill, Saga, Sainsbury and Tesco). It notes that:

> We examined the statements that insurers made about their advertising strategies in the light of their advertising expenditure and share of direct sales they achieved (see Appendix 9.3, paragraph 12 and following), and concluded that there are just four brands that have significant direct sales and which the insurers are trying to maintain both on PCWs and through their own sales channels. These are the cases where competition between the direct channel and the PCW is materially significant. It is a configuration in which narrow MFNs can lead to the same sort of harm to competition as we found with wide MFNs. These accounted for a small proportion of all policies sold on PCWs. However, one of the four brands is sold by an insurer with multiple brands, some of which would not be affected by narrow MFNs in the same way. Thus, in the vast majority of cases, narrow MFNs do not impose significant network effects.[2]

The CC does not specify minimum thresholds for advertising expenditure and share of direct sales that are required for a brand to be affected by these 'network effects'. It does, however, present an 'illustrative channel pricing model'[3] that finds that the proportion of direct online sales needs to be very significant before the 'network effects' of a narrow MFN result in a detrimental impact on competition (the scenario presented by the CC shows direct sales accounting for 70% of total online sales).[4]

The results of any model of this kind depend on the assumptions used, and the CC acknowledges that the model is illustrative. Critically, however, the CC model

[1] The evidence presented in Appendix 2 shows that only one of the four main PCWs mentions in its primary marketing messages that its prices are at least as low as going direct to the insurer's website.

[2] Provisional Findings, paragraph 9.48.

[3] See Annex B of Appendix 9.3 to the Provisional Findings. Oxera notes that the modelled scenarios presented in the Annex appear to contain errors, such as profits that are higher than revenues in scenario 1.

[4] See Annex B of Appendix 9.3, Table 3.

assumes PCWs that charge a low commission (as reflected in the 'average channel cost') are able to enjoy large market shares. For example, the 'entrant' PCW captures 36% of all sales in Scenario 2; which does not fit with reality. Indeed, capturing 36% of the market is not consistent with the CC's conclusion that 'Entry and expansion appear to be limited threats'[5] in the PCW market.[6] Without such a threat of significant entry, the issue of network effects in the CC's model is likely to arise for brands with much lower dependency on direct sales.

Another crucial assumption of the model is that commissions charged by a PCW and consumer preferences towards that channel are uncorrelated. For example in Scenario 1, PCW4 charges a commission that is 43% lower than PCW1 yet the channel preferences for each PCW are the same (0.18). One would normally expect PCWs to be able to charge an insurer larger commissions the stronger the relative preference that consumers have for that PCW (for example as a result of marketing investments made by the PCW).

Oxera has altered some aspects of the CC's model in order to assess the effect that the aforementioned issues might have on the results. This exercise suggests that an alternative threshold for 'network effects' to occur would be when around 25% of total online sales were direct rather than via a PCW. See Appendix 1 of this note for an illustration of the impact of Oxera's changes to the model.

Brands with significant own-website sales: evidence from CC consumer survey data

The CC's Provisional Findings do not present data for the split of online sales by brand. However, an analysis can be conducted using the results of the CC's consumer survey of existing policyholders (i.e. not only new sales). The consumer survey data can be used to identify which brands may be reliant on both PCWs and own website sales.

Table 11 of the CC consumer survey results sets out the number of respondents by brand who purchased motor insurance from 'Online PCW' and 'Online other', where the latter category is interpreted to mean direct online sales. [7,8] Oxera has used this data to calculate the proportion of survey responses accounted for by brands for which at least 25% of the online sales are direct rather than through a PCW.[9,]

Such brands account for approximately 30% of survey respondents who purchased their insurance online and are therefore likely to represent a significant proportion of online sales.

[5] Provisional Findings, paragraph 9.24

[6] Although the CC's conclusion may be due in part to the existence of wide MFN clauses.

[7] See page 130 of the customer survey tables published alongside the CC customer survey working paper.

[8] Table 11 does not provide a breakdown of 'Online other', but the consumer survey working paper (page 118) makes it clear that the vast majority of this category involves the consumer going directly to the website of the retail distributor of the insurance policy.

[9] The CC survey lists 'Aviva / Aviva Direct' as having significant PCW sales (more than 50% of online sales). Oxera understands that while the Aviva Direct brand is not available on PCWs, other Aviva owned brands are available on PCWs. On a cautious basis, Oxera has assumed that all Aviva online sales are direct. This assumption may lead to an underestimate of the proportion of online sales affected by 'network effects.'

3 The extent to which PCWs rely on MFNs

The CC concludes that narrow MFNs may be necessary for PCWs to survive on the basis that:

- the Italian competition authority has suggested that the lack of narrow MFNs has hindered the growth of motor insurance sales through PCWs in Italy; and
- PCWs rely on customers believing that they cannot get a cheaper deal directly from the insurer's own website, accepting the PCWs' argument that 'narrow MFNs provide reassurance to retail consumers that the prices that they find on PCWs cannot be beaten by searching directly on insurers' websites. Without such reassurance, consumers would not use PCWs.'[10]
- they may be necessary for PCWs to survive as they prevent free-riding by motor insurance providers

Italian PCWs and MFNs

The CC references a report by the Italian competition authority.[11] However, the Italian report does not provide any empirical evidence to support the claim that MFNs would have been beneficial for the growth of PCWs in Italy; it merely makes a claim to that effect.

Oxera's understanding from DLG, which has operations in Italy, is that:

- The reasons for lower use of PCWs in Italy than in the UK are varied, but are linked to clear differences in the prevalence of the insurance broker model. In Italy, direct sales by insurers make up only 10% of all policies sold. The difference may also be due in part to differences in the growth of online commerce generally, which means that compared to the UK, Italian consumers are less likely to make purchases online, including insurance products, and so are less likely to use PCWs.[12]
- Within the direct channel PCWs are growing fast as a source of business. **[CONFIDENTIAL]**.
- **[CONFIDENTIAL]**.

Primary marketing messages of PCWs

The CC's conclusion on the need for narrow MFNs suggests that in order to remain viable, PCWs must convince customers that their prices are not higher than those on insurers' own websites. In reality, the primary marketing message of PCWs appears to concern the amount of money consumers could save compared to their current insurance policy, not the price compared to insurers' own websites.

[10] Provisional Findings, paragraph 9.70.

[11] Final Report of the Autorità Garante dellla Concorrenza (Italian Competition Authority), 22 February 2013.

[12] Statistics from Eurostat indicate that there are large differences between UK and Italy in terms of online shopping habits. In 2013, 19% of UK consumers bought online shares/financial services or insurance. The European Union average (28 countries) was 6%. In Italy 3% of consumers bought any of those services online. More generally, 71% of UK consumers have made an internet purchase (any goods or services) in the last three months. This compares to the EU average of 38% and 14% for Italy.

Table 1 sets out the primary marketing messages shown on the front page of the car insurance sections of each of the four main PWCs (screenshots are included in Appendix 2 to this note). The primary message is that customers can save money relative to their current motor insurance policy. Only in one case (Confused.com) is there a mention of prices relative to insurers' websites ("You won't find cheaper going direct to the insurer"), after explaining customers can save money relative to their current policy.

Table 1: Summary of main marketing messages on PCWs

PCW	Marketing messages
Moneysupermarket.com	• Our research tells us that 98% of Britons saved on the cost of their car insurance when they used MoneySuperMarket • On average, drivers who use MoneySuperMarket save £300 on their car insurance renewal quote • MoneySuperMarket is the UK's #1 price comparison website. We are 100% independent • You can compare over 139 car insurance quotes in less than five minutes, making sure you get the best deal
Compare the market	• At comparethemarket.com we provide insurance quotes for a wide range of cars. So whether you drive an Alfa or a Volvo – or most motors in between – take a look at the links below and start your journey to insuring your car. We try to provide car insurance for as many manufacturers as possible. If the car you own isn't listed here, don't worry: get in contact with us, tell us how you roll and we'll see what we can do. • Whether you're looking for fully comprehensive motor insurance to third party only, we could help you save money - it could be up to £244
Go Compare	• Compare cheap car insurance quotes and you could save up to £243 • Compare quotes from over 125 insurance brands • 97% of our customers could save on their car premiums with Gocompare.com • Get a quote for your chance to win your bills paid for a year - on us!
Confused.com	• Compare cheap quotes from up to 141 providers • 60% of car insurance customers could save up to £170* • You won't find cheaper going direct to the insurer • Get discounts with our MotorMate app.

Source: Collected by Oxera on January 3rd 2014 at 1pm UK time.

This evidence does not support the conclusion of the CC.

Concerns about insurers free riding on PCWs' marketing efforts

The CC considers whether, in the absence of narrow-MFNs, insurers could free ride on PCWs' marketing efforts by using them as an advertising platform but avoiding commission charges by offering consumers a discount for purchasing direct.

The CC concludes that free riding concerns could be addressed in ways that are less restrictive than narrow MFNs, noting that 'we have identified two potential alternative mechanisms by which a PCW might prevent an insurer from free-riding'.[13] The two mechanisms described by the CC in Appendix 9.3 (alternative charging models, to which some PCWs are already beginning to migrate; anti-poaching clauses, which are already used by some PCWs and insurers) appear to be credible and less restrictive alternatives to narrow MFNs.

[13] Provisional Findings, paragraph 9.79

In its overall conclusions, the CC notes that narrow MFNs may be necessary for PCWs to survive as they prevent free-riding.[14] However, this appears to be at odds with the CC's own analysis.

[14] Provisional Findings, paragraph 9.92 (b)

Appendix 1

Using the spreadsheet model provided by the CC, Oxera has adjusted the assumptions on the 'average channel cost' and its relationship with the fixed channel-specific preference parameters. It has been assumed that channels for which consumers have a stronger preference are able to charge insurers higher commissions. No other changes have been made to the model structure or assumptions.

The table below illustrates an alternative scenario to the CC's model.

Table A1

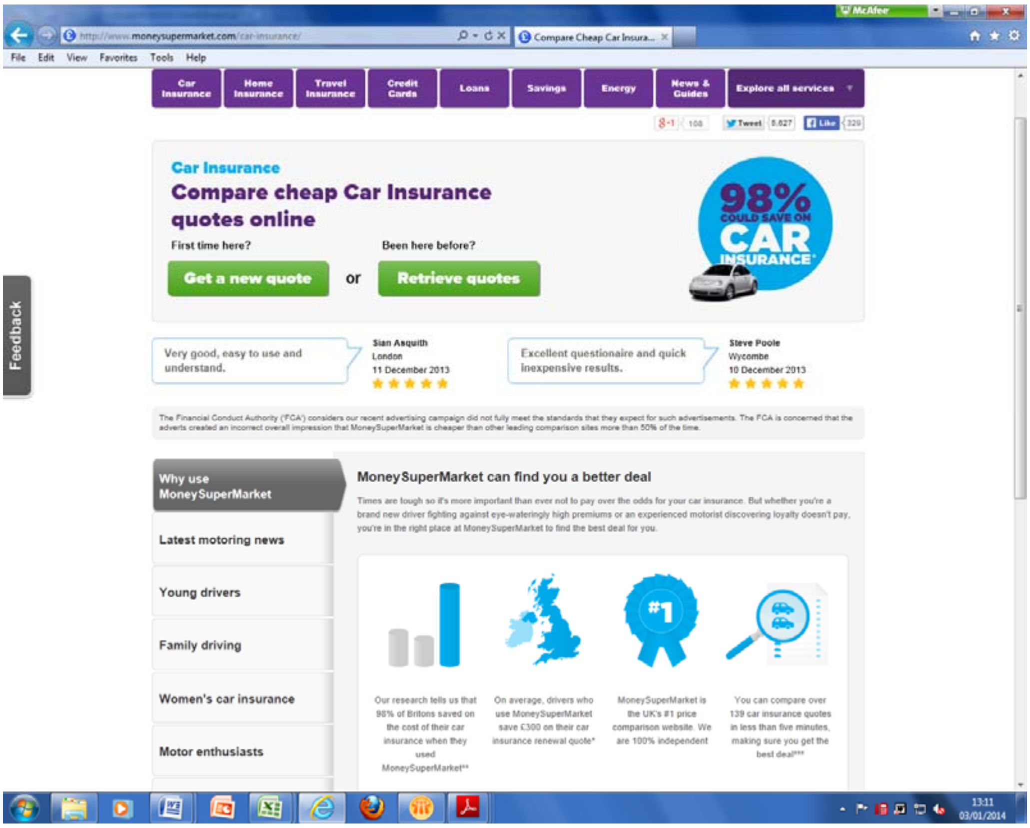
Channel	Channel preference	Average Channel cost	Premium	Sales	Market share	Total cost	Total revenue	Profit
Own	0.25	4.0	10.00	2.50	25%	9.88	25.00	15.13
PCW1	0.22	6.5	10.00	2.15	22%	13.98	21.50	7.53
PCW2	0.21	6.3	10.00	2.09	21%	13.04	20.87	7.83
PCW3	0.17	6.0	10.00	1.66	17%	9.98	16.63	6.65
PCW4	0.10	5.8	10.00	1.00	10%	5.75	10.00	4.25
Entrant	0.06	5.0	10.00	0.60	6%	3.02	6.00	2.98

Source: Oxera analysis of CC Illustrative Channel Pricing model

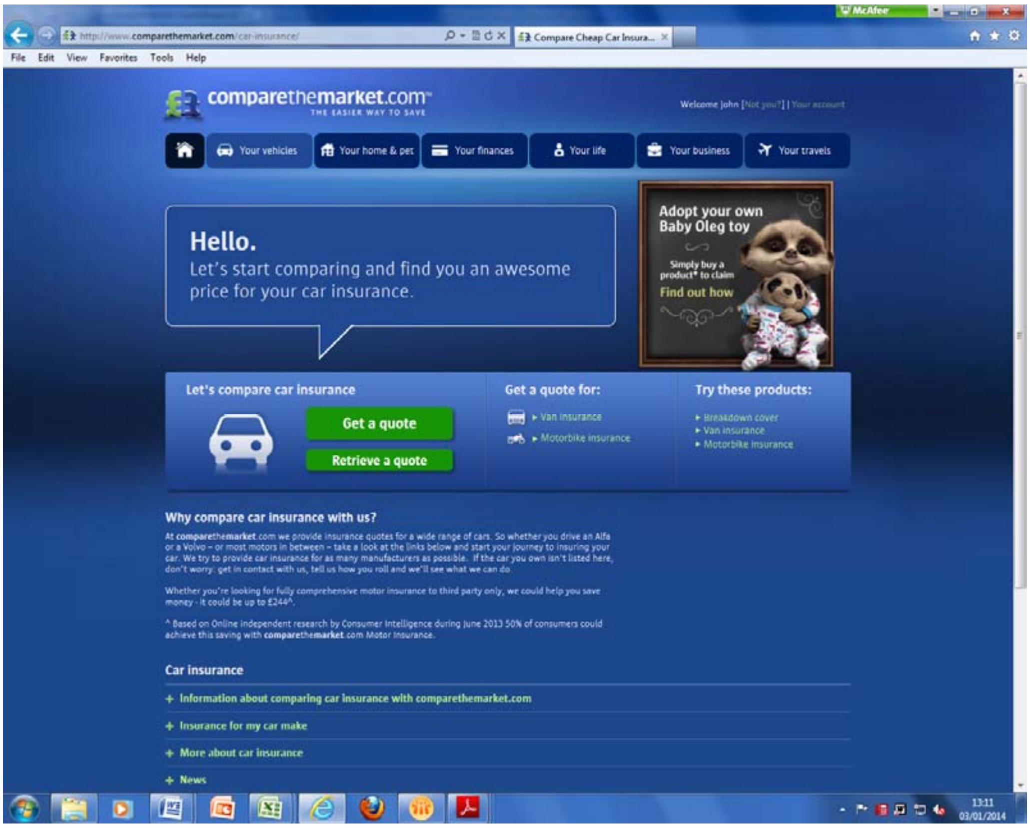
This example suggests that network effects resulting from narrow MFNs would affect brands whose direct online sales make up 25% or more of their total online sales.

Appendix 2

Moneysupermarket.com



Compare the market



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OR
Retrieve Quotes
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