

Private Motor Insurance

Report on the market study and proposed decision to
make a market investigation reference

May 2012

OFT1422

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1 EXECUTIVE SUMMARY

- 1.1 The Office of Fair Trading (OFT) has provisionally decided to refer the UK market for the supply or acquisition of private motor insurance and related goods or services to the Competition Commission (CC) for a market investigation. This report sets out the OFT's reasons for proposing to refer the market and gives interested parties the opportunity to make representations.
- 1.2 The provisional decision for a market investigation reference (MIR) follows the completion of a market study of the UK private motor insurance market, which has focused on the provision of repairs and replacement vehicles to drivers involved in road traffic accidents which were not their fault. This market study was launched in December 2011 following a three month call for evidence on the UK private motor insurance market.
- 1.3 The information gathered during the call for evidence gave the OFT reasonable grounds for suspecting that there are features of the market for private motor insurance in the UK that are preventing, restricting or distorting competition. The OFT suspected that these features were increasing the cost of repair and replacement vehicle claims made by drivers that were not at fault for road traffic accidents, causing higher motor insurance premiums. The aim of the market study was to gather further evidence before consulting on whether or not to make a MIR to the CC. In particular, the OFT aimed to clarify whether the scale of the problem is sufficient to warrant exercising our discretion to make a MIR and whether it would be more appropriate to address competition issues by way of a MIR or by other action by the OFT or other bodies.
- 1.4 In 2010 the UK private motor insurance market was estimated to be worth £9.4 billion,¹ with the cost of third party property damage,

¹ *UK Private Motor Insurance 2011*, Datamonitor, July 2011. This is an estimate of gross written premium for comprehensive and non-comprehensive motor insurance, excluding motorcycle insurance.

relating to the provision of repairs and replacement vehicles to not-at-fault drivers, being approximately £1.4 billion.²

Provisional market study findings

- 1.5 If a driver is found to be at-fault for a road traffic accident, his or her insurer is responsible for meeting the cost of repairs to the not-at-fault driver's vehicle and for the cost of providing a replacement vehicle to the not-at-fault driver if required.³ These services can be arranged and provided by insurers and their networks of suppliers, or by other market participants, such as brokers, credit hire organisations or credit repairers.⁴ No matter which market participant provides the service, the cost must be met by the at-fault driver's insurer.
- 1.6 Consideration of the further evidence gathered during the market study confirms the OFT's initial concerns that this market is not working well. The OFT continues to have reasonable grounds to suspect that there are features of the market that are preventing, restricting or distorting competition in connection with the supply or acquisition of private motor insurance in the UK, in particular:
- The insurers of at-fault drivers that are responsible for meeting claims for the provision of repairs or replacement vehicles to not-at-fault drivers often appear unable to exercise choice over how these

² This estimate is based on the total cost of not-at-fault drivers' claims for repairs and replacement vehicles for 10 major insurers in 2011, scaled up to in order to estimate costs for the UK private motor insurance market.

³ Under the Road Traffic Act 1988, a driver is legally required to be insured against their liability for damage to other people and their property in the event of a road traffic accident. This means that if that driver causes an accident, their insurer is responsible for meeting the costs of the not-at-fault driver's repairs, and for providing a replacement vehicle to the not-at-fault driver where one is required.

⁴ See Annexe B for a Glossary of all technical terms used in the report.

services are provided. Insurers of at-fault drivers also appear to find it difficult to assess the extent to which the costs claimed are reasonable, and appear to exercise only limited control over the cost of these services.

- The insurers of not-at-fault drivers, brokers, credit vehicle hire providers, credit repairers and others that supply services to motor insurers therefore have the opportunity, and the incentive, to take advantage of the insurer of the at-fault drivers' lack of control over costs. They do this by carrying out practices that allow them to generate revenues through referral fees or rebates, while simultaneously inflating the costs that the insurer of the at-fault driver has to meet.

- 1.7 As a result of these features, it appears that insurers of not-at-fault drivers and certain other market participants are not striving to provide the best value services available. Further, it appears that insurers of not-at-fault drivers actually have the individual incentive to procure more expensive services to raise the costs faced by their competitors. On the basis of data that the OFT has gathered, we estimate that the potential for consumer detriment is significant.

Replacement vehicles

- 1.8 The OFT considers that the following practices appear to be inflating the cost of replacement vehicles for not-at-fault drivers:
- Many insurers, brokers and repairers are referring not-at-fault drivers to credit hire organisations when credit hire vehicles tend to be charged at higher daily rates than other options, in exchange for a referral fee.
 - Not-at-fault drivers appear to receive replacement vehicles for longer periods than necessary, leading to further inflated costs for insurers of at-fault drivers.

Repair

1.9 The OFT considers that the following practices appear to be inflating not-at-fault drivers' vehicle repair costs:

- Some insurers of not-at-fault drivers are receiving referral fees and/or rebates from referring repair work on not-at-fault drivers' vehicles to specific approved repairers and credit repairers. Some brokers also have similar arrangements with credit repairers. It appears that the payment of these referral fees and rebates by approved repairers and credit repairers may be inflating the costs of those repair bills that are passed to insurers of at-fault drivers.
- Certain insurers are also earning additional referral fees and rebates from agreements with suppliers of paint and parts to their approved repair networks. It appears that the cost of paying these referral fees and rebates may be increasing the cost of paint and parts used in not-at-fault vehicle repairs leading to the final bill received by the insurer of the at-fault driver being inflated.
- Certain insurers also have agreements with approved repairers in their networks to charge higher labour rates for repairs where the cost will be passed on to an at-fault driver's insurer, than are charged for repairs that the insurer must pay because the driver it insures was at fault.

1.10 Insurers have developed a number of different approaches in order to mitigate the extent to which claims received from insurers of not-at-fault drivers and other market participants are inflated. These include:

- attempting to identify potential not-at-fault drivers swiftly following a road traffic accident and offering the services of the insurer's own suppliers
- challenging claims that appear to be higher than justified, and
- reaching bilateral agreements with rival insurers or credit hire organisations that aim to reduce the risks of bills being inflated.

- 1.11 Insurers also worked to introduce the General Terms of Agreement (GTA), a protocol which fixes the rates and other administrative charges that credit hire organisations and credit repairers can recover from the insurers of at-fault drivers.⁵
- 1.12 Each of these approaches appears to be having some limited positive impact in reducing insurers' costs, although success in mitigating claims costs appears to vary significantly from one insurer to another. The OFT is concerned that the significant resources that insurers are investing in such mitigation activities may be increasing the price of motor insurance premiums charged to consumers.

Impact on consumers

- 1.13 The overall impact of these practices is likely to be an increase in costs across the private motor insurance industry. The OFT estimates that the features of the market it has identified cost private motor insurers £225 million in 2011, which indicates that consumers could be paying an extra £10 per private motor insurance policy.
- 1.14 The OFT is also concerned that the features of the market we have identified encourage insurers to compete in a way that may cause further consumer detriment over the long term. Insurers appear have a focus on gaining a competitive advantage by becoming more successful at increasing revenues through referral fees and rebates, whilst raising their rivals' costs. The OFT would like to see insurers focused on the quality and value of the service that they provide to insured drivers.

Provisional decision to make a market investigation reference

- 1.15 After completing its call for evidence, the OFT provisionally decided that there were reasonable grounds to suspect that there are features of the UK market for private motor insurance that prevent, restrict or distort competition in the UK. The OFT considered therefore that the statutory

⁵ Further information on the GTA can be found in Chapter 5 of this report.

test for making a reference in section 131 of the Enterprise Act 2002 (EA02) had been met.

- 1.16 Having regard to all the evidence received during the market study, the OFT still considers that the statutory threshold test for a MIR to the CC is still met. The OFT proposes therefore to exercise its discretion to make a MIR to the CC for the UK market for the supply or acquisition of private motor insurance and related goods or services.⁶
- 1.17 The OFT considers that a reference to the CC is appropriate, given that the evidence gathered in the market study suggests that the features set out above are increasing private motor insurance premiums for consumers by increasing the cost of not-at-fault claims for repairs and replacement vehicles. The OFT has identified a number of potential remedies that might go some way to addressing the features that it has identified. However, there is no readily implementable, comprehensive solution available due to the complexity of the competition issues, the large number of diverse market participants with different business models and incentives, and the need for a remedy that addresses the features identified and applies to all market participants.
- 1.18 The OFT has therefore provisionally decided to make a reference to the CC under section 131 and 133 of the EA02 for an investigation into the market for the supply or acquisition of private motor insurance and related goods or services in the UK.

Consultation

- 1.19 The OFT is consulting on its proposed decision to make a MIR to the CC. It invites comments by 6 July 2012. Comments should be sent to:

⁶ For the purpose of setting the draft Terms of Reference, the OFT has included 'related goods or services' to ensure that the actions of other market participants are included within the scope of the potential MIR. See Annexe A for the draft Terms of Reference.

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2 INTRODUCTION

- 2.1 The OFT has provisionally decided to refer the UK market for the supply or acquisition of private motor insurance and related goods or services to the CC for a market investigation. The provisional decision for a MIR follows an in-depth market study of the UK private motor insurance market, launched on 14 December 2011, which has focused on the provision of repairs and replacement vehicles to drivers involved in road traffic accidents. The decision to carry out the market study followed the completion of a three month call for evidence on the UK private motor insurance market.
- 2.2 This chapter gives an introduction to the OFT and its work on the private motor insurance market to date. It also provides background information on the private motor insurance market and how the main participants operate.

OFT's mission and powers

- 2.3 The OFT's mission is to make markets work well for consumers. The OFT has a broad interpretation of consumers, including both businesses and final consumers. Market studies are one of a number of tools at the OFT's disposal to address competition or consumer protection problems, alongside its enforcement and advocacy activities.
- 2.4 Market studies⁷ involve the analysis of a particular market, or practices across a variety of goods and services, with the aim of identifying and addressing significant aspects of market failure. Market studies will consider competition issues, whether there is any consumer detriment and the effect of government regulations.

⁷ Market studies are conducted under the OFT's general function in section 5 of the Enterprise EA02, which includes the functions of obtaining information and conducting research. For more information on market studies, see: www.oft.gov.uk/OFTwork/marketswork/market-studies-further-info.

2.5 Possible outcomes of market studies include:

- future enforcement action by the OFT
- a reference of the market to the CC
- recommendations to the Government or regulators for changes in laws, regulations or policy
- voluntary action by industry participants to address any problems found
- campaigns to promote consumer awareness, and
- a clean bill of health.

Background to the OFT's market study

2.6 In September 2011, the OFT launched a call for evidence on the private motor insurance market to establish the facts behind reports that private motor insurance premiums in the UK had risen significantly, and to assess the potential reasons for any such increases.

2.7 Information requested by the OFT during its call for evidence suggested that private motor insurance premiums paid in the UK rose by around 12 per cent between 2009 and 2010, and by a further nine per cent in the first three quarters of 2011.⁸ Responses received by the OFT indicated that a key factor in these increases was a rise in the costs

⁸ OFT1397, Private motor insurance - summary of responses to the OFT's call for evidence, Dec 2011 www.oft.gov.uk/OFTwork/markets-work/othermarketswork/motor-insurance/

associated with personal injury claims.⁹ However, we also found that the increased cost of third party non-injury claims, which include the provision of replacement vehicles and repairs to not-at-fault drivers, was another factor that has had a notable impact.

- 2.8 Under section 131 of the EA02, the OFT may make a MIR to the CC where it has reasonable grounds for suspecting that any feature or combination of features of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. The OFT concluded that findings from the call for evidence on both replacement vehicles and repairs provided to not-at-fault drivers gave us reasonable grounds for suspecting that there are features of the UK market for private motor insurance that restrict, prevent or distort competition.
- 2.9 As a result, the OFT launched a market study into the supply of private motor insurance in the UK, with a specific focus on the provision of repairs and replacement vehicles. The aim of this market study was to gather further evidence before consulting on whether or not to make a MIR to the CC. In particular, we aimed to clarify whether the scale of the problem is sufficient to warrant exercising our discretion to make a MIR and whether it would be more appropriate to address competition issues through other action taken by the OFT or others, such as regulatory bodies.
- 2.10 Under section 174 of the EA02, the OFT has certain investigatory powers that it may use for the purpose of assisting it in deciding

⁹ On 2 May 2012, the Secretary of State for Transport, Justine Greening, hosted a motor insurance summit which committed the Government to working with industry to drive down motor insurance premiums, with a particular focus on dealing with whiplash and other personal injury claims costs. The OFT has liaised closely with the Department for Transport over the course of both the call for evidence and this market study to ensure that our resources are focused in a complementary way.

whether to make a reference (or to accept undertakings in lieu) if it believes it already has the power to make a reference to the CC. The OFT used these powers under section 174 during the market study in order to gather information quickly, and to increase the likelihood of receiving sufficient evidence.

Background on the UK private motor insurance market

- 2.11 Under the Road Traffic Act 1988, a driver is legally required to be insured against their liability for damage to other people and their property in the event of a road traffic accident. This means that if that driver causes an accident, their insurer is responsible for meeting the costs of the not-at-fault driver's repairs, and for providing a replacement vehicle to the not-at-fault driver where one is required. Legally, not-at-fault drivers are entitled to be put back in the position they were in before the accident took place, and so, for example, they are entitled to receive a replacement vehicle of a similar standard to their own, if required, rather than a standard 'courtesy' vehicle. The service an at-fault driver receives is determined by their motor insurance policy.
- 2.12 From the late 1980s onwards, credit hire organisations began to supply replacement vehicles to not-at-fault drivers on credit terms, recovering the cost from the at-fault driver's insurer. There appears to be a consensus among market participants that the development of credit hire has addressed a gap in the market, improving the quality of the service that those not-at-fault drivers requiring a replacement vehicle receive, although insurers have told the OFT that the cost of this service is too high.¹⁰ On the basis of information provided by credit hire firms, we estimate that 76 per cent of not-at-fault drivers that are provided with a replacement vehicle are provided with one on a credit hire basis.
- 2.13 Repairs to a not-at fault driver's vehicle can also be provided on credit terms, although this appears to be less common, and depends on the

¹⁰ See Chapter 3 and Chapter 6 of this report for further information on the cost of replacement vehicles provided to not-at-fault drivers after accidents.

individual business model of the insurer or broker that refers the work. On the basis of information provided, we estimate that in 2011, 32 per cent of repairs to a not-at-fault driver's vehicle were provided by credit repairers.

Competition in the UK private motor insurance market

- 2.14 The OFT's call for evidence report set out information on competition in the UK private motor insurance market. From the evidence gathered, we concluded that the private motor insurance market does not appear to be particularly concentrated, there appears to be a high degree of competitive rivalry between insurers and consumers are generally shopping around effectively for private motor insurance cover.¹¹
- 2.15 Evidence gathered by the OFT indicates that the accident repair market appears to be diverse and fragmented. In addition, the OFT considers that accident repairers have little market power compared to insurers, due to reliance on work provided by insurers. The replacement vehicle market appears to be more highly concentrated. Evidence gathered by the OFT indicates that during 2010-2011, there were five or six credit hire organisations that submitted over 70 per cent of all credit vehicle hire invoices received by insurers.¹²
- 2.16 The OFT is concerned that competition to provide replacement vehicles and repairs to not-at-fault drivers is currently focused on the speed with which not-at-fault drivers can be identified, with the cost of the service being provided a less significant consideration.

¹¹ OFT1397, Private motor insurance - summary of responses to the OFT's call for evidence, Dec 2011 www.offt.gov.uk/OFTwork/markets-work/othermarketswork/motor-insurance/.

¹² See footnote 111.

Scope of market study

2.17 Private motor insurance should be understood as insurance cover against damage to property and personal injury that is supplied to or acquired by drivers of privately owned motor cars designed and used for non-business (private) use. It excludes motorcycles.¹³ Private motor insurance makes up a significant proportion of domestic household expenditure, with the UK market estimated to be worth £9.4 billion in 2010.¹⁴

2.18 For these purposes, the OFT notes conduct of entities providing services relating to private motor insurance may have an impact on competition in the private motor insurance market including conduct of:

- credit hire organisations, repairers and other businesses providing services to drivers which have been involved in a road traffic accident
- businesses that manage the provision of these services to drivers which have been involved in a road traffic accident (such as accident management companies), and
- businesses that are involved in providing specific goods or services that are used by these providers and those who refer work to these providers.

¹³ We have not reached any firm conclusions on the definition of any relevant economic markets at this stage in accordance with paragraph 4.8 to 4.12 OFT 511 *Market Investigation*
References: Guidance about the making of references under Part 4 of the Enterprise Act, 2006:
www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft511.pdf.

¹⁴ See footnote 1

Research and analysis conducted

2.19 Since launching its market study, the OFT has gathered further evidence on the UK private motor insurance market in the following ways:

- We analysed responses to section 174 notices from insurers, brokers, businesses engaged in providing replacement vehicles on a credit hire basis, businesses engaged in providing credit repair, insurer approved repairers, paint manufacturers and paint distributors. These notices requested relevant revenue and cost data, internal strategy documents and relevant contractual agreements between market participants.
- We held bilateral meetings with insurers, credit hire organisations, credit repairers, repairers, paint companies, claims management companies, businesses involved in validating credit hire claims, solicitors and industry bodies among others.
- We held separate roundtable meetings with major insurance companies, credit hire organisations and brokers, and held a focus group with approved repairers.

Assistance provided during the market study

2.20 We are grateful for the assistance provided to us throughout our market study from insurers, brokers, repairers, credit hire organisations, credit repairers, paint companies, the representative bodies active in the motor insurance market and their various advisers. Throughout this market study, the OFT has liaised closely with the Ministry of Justice (MoJ), Her Majesty's Treasury (HMT) and the Department for Transport (DfT).

Structure of this report

2.21 This report presents the evidence and reasoning behind our provisional decision to refer the market to the CC. The remainder of the report is structured as follows:

- Chapter 3 sets out our analysis of the provision of replacement vehicles.
- Chapter 4 sets out our analysis of the provision of vehicle accident repair services.
- Chapter 5 examines how insurers appear to attempt to mitigate the impact of high-cost claims.
- Chapter 6 sets out our analysis on how the features of the market we have identified impact on consumers.
- Chapter 7 sets out potential remedies to the features we have identified in the market.
- Chapter 8 sets out our provisional decision to refer the UK private motor insurance market to the CC.
- Annexe A sets out the proposed terms of reference for the potential MIR.
- Annexe B is a glossary of technical terms used in this report.

3 REPLACEMENT VEHICLES

- 3.1 This chapter explains how the features of the UK private motor insurance market that the OFT suspects are preventing, restricting or distorting competition have impacted on the incentives of the market participants that are involved in the provision of replacement vehicles. It also sets out the specific practices carried out by some market participants that are leading to not-at-fault drivers' replacement vehicle claims costs being inflated.

Features of the market and the incentives they create

- 3.2 If a driver is at-fault for a road traffic accident, their insurance company is legally responsible for meeting the cost of providing a replacement vehicle to the not-at-fault driver, if required. If the insurer of the at-fault driver is able to acquire control over the not-at-fault drivers' claim,¹⁵ the insurer of the at-fault driver has greater control over the cost of the replacement vehicle.¹⁶ However, in the majority of cases, insurers of at-fault drivers that are responsible for meeting claims for the provision of repairs or replacement vehicles to not-at-fault drivers often appear unable to exercise choice over how these services are provided, and have only limited control over the hire costs incurred. The OFT considers that other market participants have the opportunity, and the incentive to take advantage of the insurer of the at-fault driver's lack of control over costs.
- 3.3 The insurer of the not-at-fault driver has the incentive to refer the not-at-fault driver to a credit hire organisation in order to generate referral fee income. This also has the advantage of simultaneously raising a rival

¹⁵ Methods by which the insurer of the at-fault driver may try to 'capture' (that is, control the process by which replacement vehicles are provided) the not-at-fault driver's claim, are described in Chapter 5.

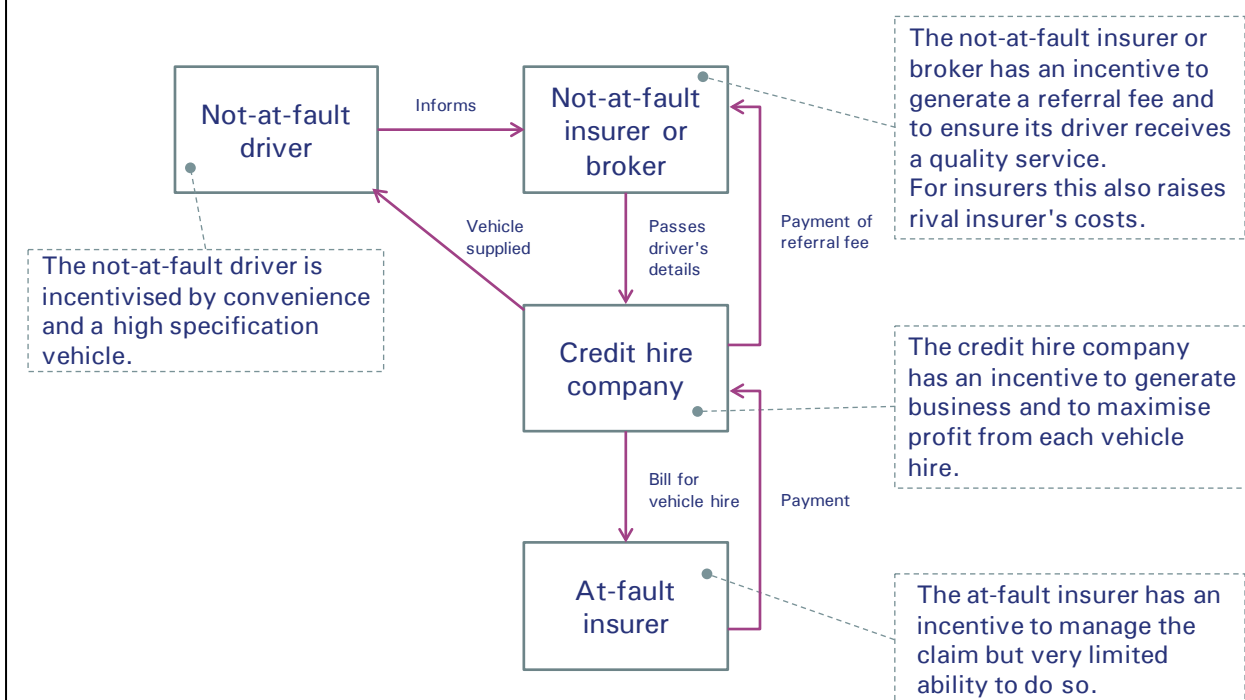
¹⁶ For example, the insurer of the at-fault driver may arrange a replacement vehicle through a car hire provider with whom it has a contract and agreed rates for such direct car hire.

insurer's costs because credit hire replacement vehicles tend to be more expensive than other alternative replacement vehicles. Similarly, brokers and repairers also have an incentive to refer not-at-fault drivers to a credit hire organisation in exchange for a referral fee.¹⁷

- 3.4 Given that the not-at-fault driver is not usually responsible for meeting the cost of a replacement vehicle, they have no incentive to keep the resulting claims costs low. Not-at-fault drivers are likely to prioritise convenience, obtaining the replacement vehicle as quickly and easily as possible, and quality, obtaining as high a specification vehicle as they are entitled to. They are likely to be less concerned with the potential cost of the service.
- 3.5 Credit hire organisations have the incentive to identify potential credit hire users by offering referral fees to insurers of not-at-fault drivers, brokers, repairers and others in exchange for leads. Each time a credit hire organisation identifies a not-at-fault driver they have an incentive to provide a high-quality replacement vehicle for as long as required.

¹⁷ Following an accident, not-at-fault drivers may make initial contact with a range of parties, including the broker who arranged their insurance or a repairer to have work carried out on their vehicle. The not-at-fault driver's first point of contact may not therefore be with their own insurer. Consequently, this may allow a broker or repairer an opportunity to refer the not-at-fault driver to a credit hire organisation, in exchange for a referral fee.

Figure 3.1: Incentives when the driver is not-at-fault



Source: OFT

3.6 The incentives described above and set out in Figure 3.1 mean that the type of replacement vehicle that a not-at-fault driver is offered will depend on whether the not-at-fault or at-fault driver's insurer controls the claim. Credit hire vehicles are usually supplied to not-at-fault drivers when the insurer of the not-at-fault driver keeps control of the claim. Credit hire is more expensive, on average, than other available options, due to higher daily hire charges and longer hire durations.¹⁸ Direct hire vehicles tend to be supplied to not-at-fault drivers when the insurer of the at-fault driver controls the claim. These vehicles tend to be like for like replacement vehicles, but are provided at lower daily rates.

¹⁸ The data we have collated on replacement vehicle costs and their impact on private motor insurance premiums is set out at Chapter 6.

Practices that inflate the cost of replacement vehicles provided to not-at-fault drivers

- 3.7 The OFT considers that the incentives described above are leading to a number of practices that are inflating the cost of replacement vehicles for not at-fault drivers, and thereby potentially leading to higher private motor insurance premiums for consumers.

Referrals of not-at-fault drivers into credit hire

- 3.8 Many insurers, brokers and repairers appear to be referring not-at-fault drivers to credit hire organisations in exchange for a referral fee,¹⁹ when credit hire tends to be more expensive than other available options for providing replacement vehicles. Based on reviews of internal documents and submissions from insurers, it appears that referral fees paid by credit hire organisations are usually between £250 and £400 per car hire.
- 3.9 All of the major insurers that we gathered evidence from during our market study have arrangements in place that lead to their drivers being offered credit hire vehicles if they were involved in an accident where they were not-at-fault. A review of insurers' internal documents appears to show that often claims staff are provided with clear instructions to offer not-at-fault drivers credit hire vehicles where possible during the first notification of loss procedure,²⁰ and where not-at-fault drivers appear reluctant, to attempt to persuade them into credit hire.²¹ In addition, some insurers appear to encourage their approved repairers to pass not-at-fault drivers referred to them to credit hire organisations

¹⁹ This is based on submissions from insurers and reviews of insurers' internal documents.

²⁰ First notification of loss is the occasion when the policy holder alerts their insurer as to the possibility that they may have to make a claim on their policy.

²¹ For instance, the documents reviewed by the OFT appear to indicate that staff will outline policy holders' legal entitlements to a like for like vehicle, and stress that a credit hire vehicle will be better than a courtesy car and available for longer.

where possible, instead of providing a courtesy car.²² By contrast, insurers often will seek to place not-at-fault drivers in less expensive direct hire vehicles, when they insure the at-fault party and control the cost of the specific claim.

- 3.10 The majority²³ of the brokers we gathered evidence from also accept referral fees in exchange for referring not-at-fault drivers to credit hire organisations. When notified of an accident, certain brokers have confirmed that they refer an at-fault driver to the driver's insurer, whereas a not-at-fault driver is referred to a credit hire organisation for a replacement vehicle.

Duration of hire agreements

- 3.11 Credit hire agreements also tend to run for longer periods than direct hire arrangements.²⁴ The evidence we have gathered suggests this is because the not-at-fault driver's insurer has no incentive to control the duration of the credit hire period, given they are not responsible for the costs incurred. Credit hire agreements are not generally time limited, whereas insurers of at-fault drivers often ensure that direct hire arrangements expire within a defined time period. For example, a review of insurers' internal documents and contracts with vehicle hire providers indicates that direct hire periods are usually limited to a period of 14 or 21 days.

²² In exchange, the repairer receives a referral fee that may be split by arrangement with the insurer.

²³ The OFT gathered evidence from 11 of the major retail brokers on the level of referral fees that they received. Seven out of 11 brokers confirmed they receive referral fees for referring not-at-fault drivers to credit hire organisations.

²⁴ Chapter 6 of this report details the difference in hire periods.

Other practices that may be inflating the cost of replacement vehicles to not-at-fault drivers

3.12 We have received a limited amount of evidence from market participants that suggests that certain practices may be carried out by credit hire organisations that could further increase the cost of supplying replacement vehicles to not-at-fault drivers. Examples of such practices include:

- sending bills to insurers of at-fault drivers containing mistakes that require correction or investigation, or sending paperwork for insurers of at-fault drivers to the wrong address to increase the likelihood that the insurer will incur penalties for late payment²⁵
- extending the credit hire vehicle period by delaying repairs,²⁶ and
- providing higher specification credit hire replacement vehicles to the not-at-fault driver than is necessary, resulting in a higher daily hire rate being charged to insurers of at-fault drivers.²⁷

Claims handling by insurers

3.13 Credit hire organisations have told the OFT that there are improvements insurers of at-fault drivers could make to their claims handling processes, which could reduce the cost of claims. In particular, credit hire

²⁵ We heard of this practice from one insurer and another company that is involved in helping to manage claims on behalf of insurers.

²⁶ Two insurers provided information that suggests parts are sometimes ordered that are not required for the repair to the vehicle (waiting for parts can elongate the hire period), and that repairers sometimes (with the support of the instructing insurer) prioritise repairs to vehicles where the driver is using the repairer's courtesy car.

²⁷ Two insurers expressed concern that sometimes drivers are provided with unnecessary vehicle upgrades, and said that claims management staff are advised to scrutinise the credit hire organisations' choice of a like for like vehicle when checking the bill received.

organisations have said that inefficient management of claims by some insurers cause delays that lead to claims costs being higher than they would otherwise be.

- 3.14 Credit hire organisations have further told us that replacement vehicle hire periods tend to be shorter when they manage the requisite repairs in addition to providing a replacement vehicle. On the basis of relevant data collected, it would appear that the average length of hire is shorter for not-at-fault drivers when the credit hire organisation has managed both the repairs to the drivers' own vehicle and supplied a replacement vehicle.²⁸ However, we remain concerned that the overall duration of a credit hire period is still longer and therefore more costly, than a vehicle arranged on a direct hire basis by the bill-paying insurer of the at-fault driver.

Conclusion

- 3.15 The OFT considers that the features identified have a significant impact on the incentives of market participants. As a result of these features, market participants carry out a number of practices that mean not-at-fault replacement vehicle costs controlled by the insurer of the not-at-fault driver are significantly higher than not-at-fault replacement vehicle costs controlled by the insurer of the at-fault driver. The impact of this on the cost of replacement vehicles for not-at-fault drivers and the potential impact on premiums for consumers is considered in Chapter 6.

²⁸ This is based on an analysis of data supplied to OFT by four credit hire organisations. For those four organisations we found that the weighted average length of hire is 18 days when the credit hire organisation manages both the repair and hire for a not-at-fault driver, compared to 21 days when the credit hire organisation manages the hire only.

4 REPAIRS

- 4.1 This chapter explains how the features of the UK private motor insurance market that the OFT suspects are preventing, restricting or distorting competition have impacted on the incentives of the market participants involved in repair claims. It also sets out the practices carried out by market participants that appear to be leading to not-at-fault repair claims costs being higher than those for at-fault repair claims.

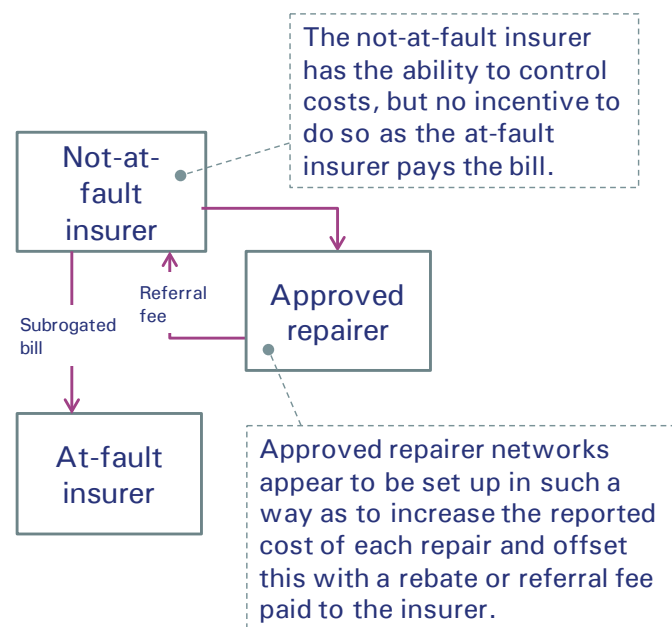
Features of the market and the incentives they create

- 4.2 If a driver is at-fault for an accident, their insurance company is legally responsible for meeting the cost of repairing the not-at-fault driver's vehicle. However, the insurer of the at-fault driver, while responsible for paying the repair bill, often appears to have little choice over the repairer instructed,²⁹ and limited control over the costs incurred. The OFT considers that, as with the provision of replacement vehicles, this lack of choice and control on the part of the insurer of the at-fault driver (which is paying the bill) allows other market participants to generate revenues in a way that simultaneously inflates the costs that the insurer of the at-fault driver has to meet.
- 4.3 The insurer of the not-at-fault driver has the incentive to generate as much revenue as possible from the claim, referring the not-at-fault driver either to a credit repairer in exchange for a referral fee, or to a repairer in its approved network which may allow the insurer of the not-at-fault driver to generate rebates and referral fees in a number of different ways. Brokers have a similar incentive to generate referral fee revenue by referring not-at-fault drivers to credit repairers.

²⁹ The at-fault driver's insurer may try to 'capture' the not-at-fault driver to offer to provide repairs to their vehicle directly, but this is often unsuccessful. See Chapter 5 of this report for more information on how insurer of the at-fault driver attempts to mitigate the inflation of not-at-fault drivers' claims.

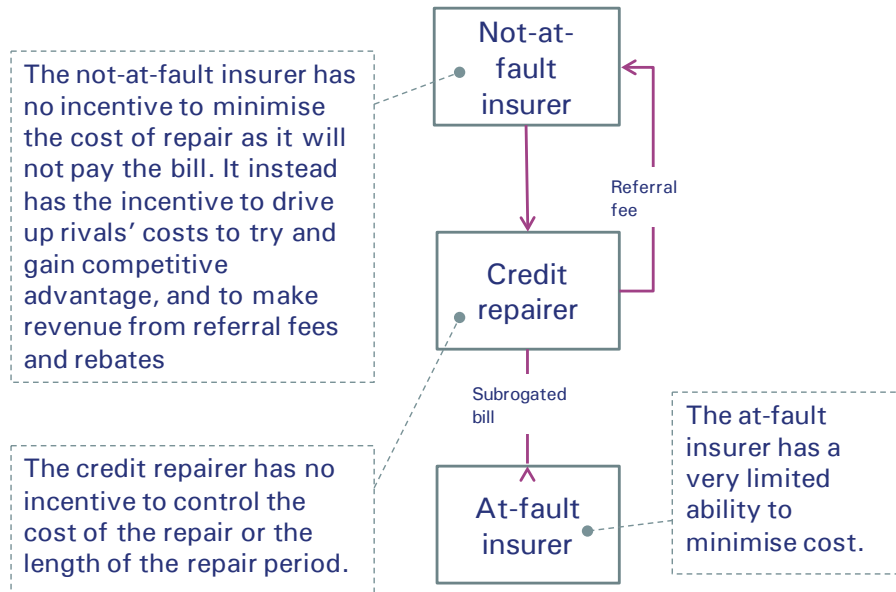
- 4.4 Given that a not-at-fault driver is not usually responsible for meeting the cost of the repair, they are likely to prioritise its quality and speed of repair, rather than the costs that will have to be met by the at-fault driver's insurer.
- 4.5 Credit repairers have an incentive to pay referral fees in order to generate leads from insurers and brokers. Credit repairers have a limited interest in controlling the cost of the repair, as the bill is paid by the at-fault driver's insurer, rather than directly by the source of their workflow. Approved repairers rely on insurance contracts to provide much of their work and therefore focus on carrying out repairs in line with the wishes of the insurer or broker that has referred the work.
- 4.6 The incentives on market participants are set out in Figures 4.1 and 4.2. Figure 4.1 illustrates the situation when the not-at-fault repairs are carried out by the insurer of a not-at-fault driver's approved repairer network. Figure 4.2 illustrates the situation when the not-at-fault vehicle repairs are carried out by a credit repairer.

Figure 4.1: Incentives for repairs carried out by approved repairer



Source: OFT

Figure 4.2: Incentives for repairs carried out by credit repairer



Source: OFT

Practices that inflate the cost of repairs provided to not-at-fault drivers

- 4.7 The OFT considers that the incentives set out above have influenced the development of a number of practices that appear to be inflating the cost of repairs to not-at-fault drivers' vehicles.

Referral fees and rebates from credit repairers and approved repairers

- 4.8 Some insurers and brokers appear to be receiving referral fees or rebates from referring repairs to approved repairers and credit repairers. It appears that the payment of these referral fees and rebates by approved repairers and credit repairers may be inflating the costs of the repair bills that are passed to the insurers of at-fault drivers.
- 4.9 Not-at-fault drivers' vehicles are sometimes passed to credit repairers, depending on an insurer or broker's business model. Credit repairs are performed outside an insurer's approved repairer network on credit terms, with the bill being passed from the credit repairer to the at-fault

driver's insurer. Data gathered by the OFT indicates that approximately one third of not-at-fault vehicle repairs in 2011 were carried out by credit repairers,³⁰ which appears to be more expensive than repairs being carried out by an insurer approved repairer.³¹ There are several benefits to following this course of action for the insurer of the not-at-fault driver. In addition to generating a referral fee, the insurer will save on administrative costs as the credit repairer will deal with the claim directly, including pursuing the at-fault driver's insurer for the bill for the repairs.

Rebates from suppliers

- 4.10 The majority of insurers the OFT has gathered information from appear to have agreements in place with a number of different businesses that are involved with the supply of goods to their approved repair networks. These include parts suppliers, paint marketing associations, paint distributors and paint manufacturers. Certain insurers appear to recommend or mandate the use of a specific manufacturer's part or paint, and may even require the repairers to purchase from a specific supplier, in exchange for a rebate paid directly to the insurer by that supplier.
- 4.11 During its market study, the OFT has seen examples of paint and parts contracts where the insurer receives a rebate from a paint manufacturer or supplier for the use of a particular paint or part by the insurer's approved repair network. Data supplied to the OFT shows that in 2011

³⁰ Data supplied by insurance companies to the OFT indicates that 68 per cent of the not-at-fault claims settled by the insurer of the at-fault driver comes from other insurers. This is an estimate based on information provided by 10 insurers who told us that as the insurer of the not-at-fault driver they collectively subrogate 263,000 repair claims to insurers of at-fault drivers for settlement, while as the insurer of the at-fault driver they collectively settle 386,000 claims. We therefore assume that the remaining 32 per cent of repair jobs were done by credit repairers.

³¹ Based on data provided by nine insurers that indicate that the amounts they recover as the insurer of the not-at-fault driver are lower than the amounts they pay as the insurer of the at-fault driver for repairs.

insurers received £11.5 million in rebates from paint manufacturers and distributors and a further £6 million in rebates from parts suppliers.³²

- 4.12 The benefit of these rebates received by insurers of the not-at-fault drivers do not always appear to be passed on to rival insurers of at-fault drivers when repair bills are passed across for settlement, unless a bilateral agreement to do so has been reached between the relevant insurers. This could potentially increase the cost of paint and parts used for not-at-fault repairs while generating additional revenues for insurers of not-at-fault drivers.
- 4.13 In 2010, parts accounted for 43 per cent and paint for 21 per cent of the average total repair bill and so these practices could potentially have a significant impact on repair costs.³³
- 4.14 The OFT is also aware that some paint contracts stipulate the volume or value of paint to be used by an insurer's approved repairers per job or per month. Certain insurers appear to receive a rebate from the paint company, the size of which depends on the amount of paint used. The OFT has heard that the amount of paint that some repairers are required to purchase and use can be more than required for most average repairs. Repairers have told us that this further inflates their overall costs.

Differentiated labour rates

- 4.15 Certain insurers instruct approved repairers in their networks to charge higher labour rates for not-at-fault repairs compared with the labour rates charged for at-fault repairs. This activity inflates the cost of the repairs to not-at-fault drivers' vehicles, which are paid for by rival at-fault

³² This is based on net referral fees, rebates, discounts, other similar payments and benefits-in-kind received by the top 10 insurers surveyed by the OFT, scaled up to estimate the total value of such payments received across the market.

³³ 'UK body repair industry yearbook 2011-2012,' 2011, ABP Club.

drivers' insurers.³⁴ One repairer submitted evidence to the OFT that shows that an insurer that provides it with work instructs the repairer to charge a labour rate for not-at-fault work that is around 20 per cent higher per hour than its labour rate for at-fault work, while another repairer told us that an insurer that provides it with work instructs the repairer to charge approximately 30 per cent more per hour for not-at-fault work than for its at-fault work. Given that labour costs appear to make up 36 per cent of the average total repair bill,³⁵ these differences in labour rates may have a significant impact on not-at-fault repair costs.

Adding administrative charges

- 4.16 It also appears that at least one insurer adds additional charges onto not-at-fault repair claims bills, through its use of a subsidiary, before sending the claims bill to the insurer of the at-fault driver for payment. This activity is currently the subject of an ongoing legal dispute,³⁶ so is not covered in detail in this report.

Conclusion

- 4.17 The OFT considers that the lack of control that the insurers of at-fault drivers have over the costs of not-at-fault drivers' repairs, for which they are liable, leads to certain practices that appear to have the potential to increase the cost of not-at-fault repair claims significantly. The impact of this on overall costs of repairs and the potential impact on the premiums charged to consumers is considered in Chapter 6.

³⁴ The OFT has seen evidence from a number of sources, including insurers' and repairers' submissions, that show the use of differentiated labour rates.

³⁵ See footnote 33

³⁶ We understand that the case of *Woodward vs Ward* is to be heard in 2012 at the High Court, Queens Bench Division.

5 MITIGATING CLAIMS COSTS

5.1 Insurers have developed different ways of trying to mitigate the impact that the features of the UK private motor insurance market that the OFT suspects are preventing, restricting or distorting competition are having on the costs of not-at-fault claims. These broadly fall into three main groups:

- capturing the not-at-fault driver's claim
- challenging the bill for not-at-fault drivers' claims when presented with it, and
- forming various bilateral and/or multilateral agreements, including the GTA.

5.2 However, success in mitigating claims costs appears to vary significantly from one insurer to another, and the OFT is concerned that the significant resources that insurers are investing in such mitigation activities may be increasing the price of motor insurance premiums charged to consumers.

Capturing the not-at-fault driver's claim

5.3 When an insurer's policy holder is found to be at-fault following a road traffic accident, it appears that the insurer of the at-fault driver attempts quickly to 'capture' the not-at-fault driver's claim so that it can control the claims cost it will incur. This involves the insurer of the at-fault driver identifying and contacting the not-at-fault driver and then offering its services in supplying a replacement vehicle and providing repairs. If successful in capturing the not-at-fault driver's claim, the insurer of the at-fault driver can use its own suppliers (for repairs and any replacement vehicle that might be needed) to keep the claims cost as low as possible. This also removes the threat of receiving an inflated bill from the insurer of the not-at-fault driver or another market participant.

5.4 Market participants have told us that succeeding in third party capture can reduce the final bill received in relation to a not-at-fault claim by

between a half and two thirds. As a result, many insurers now invest in specialist third party capture or 'not-at-fault recovery' teams.

- 5.5 The success of such capture of the not-at-fault claim, however, appears generally to be limited due to the number of other market participants that also attempt to capture the not-at-fault claim rapidly. These other market participants include the rival insurer of the not-at-fault driver, the broker that sold the insurance policy to the not-at-fault driver, claims management companies, credit hire organisations, credit repairers, breakdown services, repairers and solicitors.³⁷
- 5.6 Some insurers appear better at capturing not-at-fault drivers than others. Data the OFT received during its market study indicates that the insurers of at-fault drivers that are most successful in capturing not-at-fault drivers' claims in order to manage the supply of a replacement vehicle appear to be approximately seven times more likely to do so than those insurers that are least successful. Similarly, insurers of at-fault drivers that are most successful at capturing drivers to manage their repair are approximately four times more likely to be successful than those insurers that are least successful. Those insurers of at-fault drivers with a higher success rate tend to be larger insurers that offer policies direct to consumers. 'Direct' insurers³⁸ are more likely to be informed of an accident by their policy holders than insurers using intermediaries, such as brokers, and are therefore in a better position quickly to obtain a not-at-fault driver's contact details.

³⁷ Market participants try to capture the claim so that they have the opportunity to refer the claim to another market participant, in exchange for a referral fee.

³⁸ Direct insurers are those insurers that sell policies direct to consumers, not via an intermediary.

Challenging the bill for a not-at-fault drivers' claim

- 5.7 In certain circumstances, there are steps insurers of at-fault drivers can take in an attempt to challenge a not-at-fault driver's claims presented to it which it considers to be inflated and/or erroneous.
- 5.8 When challenging credit hire rates claimed, insurers of at-fault drivers may look to query:
- **need for a vehicle** – the claimant has a common law duty to mitigate their losses, and has to have an established 'need' for a replacement car³⁹
 - **type of vehicle provided** – to check that the claimant has been put into a class of replacement vehicle that they are entitled to
 - **rates** – to confirm whether rates charged are reasonable, or as agreed, and
 - **hire period** – to check that the hire period is reasonable or in line with the repair duration.
- 5.9 When challenging repair costs, insurers look at whether charges for parts, paint and labour are in line with average costs, and whether any unnecessary additional charges have been added. However, the extent to which an insurer of the at-fault driver can scrutinise an invoice appears to differ, depending on the transparency of materials sent in support of the claim.

³⁹ Where the claimant can prove that he or she has no other means of obtaining a vehicle, or is 'impecunious', the claimant is entitled to a credit hire vehicle. Impecuniosity means an inability to pay for car hire charges without having to make unreasonable sacrifices. This was explored in the House of Lords case of *Lagden v O'Connor* [2003] UKHL 64.

- 5.10 Following scrutiny of the invoice for the not-at-fault claim and the circumstances in which services were provided, the insurer of the at-fault driver can challenge the insurer of the not-at-fault driver, credit hire organisation or credit repairer through established dispute resolution processes. In certain cases, if discussions fail, the insurer of the at-fault driver will sometimes refuse to pay the bill, which can result in legal action being taken against them. Alternatively, insurers can launch legal proceedings against the credit hire organisation.⁴⁰
- 5.11 The OFT has heard from some insurers that it is often uneconomic for them to pursue potential discrepancies in lower value not-at-fault claims. In some circumstances, insurers appear to opt to pay inflated claims rather than finance the necessary scrutiny of bills and dispute resolution, and may also prefer to settle claims quickly so as to remove the risk of having to pay penalty fees for late payment, or risk litigation for non-payment.
- 5.12 It therefore appears that while insurers can take certain actions in an attempt to challenge a bill, there is a risk that any action taken may instead result in increased overall expenditure.

Forming agreements

- 5.13 Insurers have also formed both a multilateral agreement, in the form of the General Terms of Agreement (GTA), and various bilateral agreements in attempts to mitigate the impact of the identified features.

⁴⁰ Data received by the OFT from six credit hire organisations indicates that legal proceedings were launched by insurers against them in nine per cent of hire cases in 2010.

GTA

- 5.14 The GTA was introduced on 1 September 1999 in an attempt to curb the number of legal disputes between insurers and credit hire organisations on the need for and costs relating to credit hire.⁴¹
- 5.15 Through the course of the market study, market participants have told the OFT that the GTA has had some constraining impact on claims costs and thereby on the level of motor insurance premiums charged to consumers. It also appears that the GTA has reduced the number of claims resulting in litigation.
- 5.16 However, we have also heard that the GTA's impact is limited in some respects. In particular, insurers have told the OFT that the rates set by the GTA for credit hire are higher than direct hire rates. We have also heard that the GTA does not set out any rules on the length of hire periods, and that it prevents insurers of at-fault drivers from challenging the claim once a GTA subscribed credit hire organisation is involved, thereby limiting the scope for third party capture.
- 5.17 Membership of the GTA is voluntary, and not all insurers are members. Many insurers do subscribe to the GTA, on the grounds that it generates reduced claims costs when they are the insurer of an at-fault driver. However, some insurers do not subscribe on the basis that they are able to achieve better cost control through alternative means.

⁴¹ The ABI notified the GTA to the OFT in November 2002 under Chapter I of the Competition Act 1998 (CA98). In April 2004, the OFT granted a conditional exemption. It found that the GTA was a price-fixing agreement but that benefits to consumers would outweigh anti-competitive effects if the ABI made some minor changes to the wording and operation of the protocol. The ABI refused to change the GTA and appealed to the Competition Appeal Tribunal (CAT). The CAT set aside the OFT decision to grant conditional exemption by consent and, at the CAT's request, the OFT gave undertakings to the CAT that it would reconsider the effect of the GTA on competition. In January 2007, the OFT decided that the file should be closed on the grounds that the matter was no longer an administrative priority.

Bilateral agreements

- 5.18 Certain insurers have put in place bilateral agreements with other insurers, the purpose of which is to agree to offer similar levels of redress to not-at-fault drivers at a specified cost. This serves to reduce the cost of the final not-at-fault claims bill received by each insurer. An additional benefit to forming these agreements, apart from agreed lower rates, is that insurers, in theory, do not have to expend further resource on capturing the not-at-fault policy holder of their bilateral counterpart, or checking and challenging the relevant not-at-fault claims bills received.
- 5.19 Bilateral agreements are usually made to 'top up' the conditions of the GTA. Each bilateral agreement is individually negotiated and includes an agreed process for the supply of a replacement vehicle and repairs to the not-at-fault driver's vehicle. The prices of various elements of the repair are also agreed, such as the labour rate, along with daily hire rates for a replacement vehicle that are lower than those prescribed by the GTA.
- 5.20 However, while such bilateral agreements may guarantee a reduced cost for some of the not-at-fault claims bills received by insurers, it appears that not-at-fault claims made within bilateral agreements only represent a small percentage of the total number of claims made.⁴² Insurers have told us that bilateral agreements can also be resource intensive to uphold, as both parties need to review regularly the terms of these agreements to ensure they remain beneficial. It is for this reason that insurers have told us that there is a limit to the number of agreements it is possible to have in place at any one time. This indicates that the positive effects of bilateral agreements are therefore limited.
- 5.21 Also in order to put in place a mutually beneficial bilateral arrangement, we have heard that the insurers usually need to have a similar market

⁴² Six insurers reported bilateral agreements for dealing with third party claims.

presence⁴³ and have similar abilities to capture not-at-fault drivers.⁴⁴

Should an agreement be entered into where the insurers differ in size and capability, the smaller insurer, or an insurer that is less successful at capturing third parties, will sometimes be required to make a rebalancing payment to the other insurer every month. Insurers have told us that these 'rebalancing' payments are extremely difficult to calculate, and so agreements between insurers that differ in size and capability are not common.

- 5.22 Certain insurers that the OFT gathered evidence from also appear to have agreements with credit hire organisations in order to negotiate lower not-at-fault claims bills. In exchange for being charged consistently lower rates, it appears that certain insurers pay credit hire organisations a certain sum per annum. This would indicate that insurers are prepared to spend significant sums of money on attempting to reduce the final claim presented.

Conclusion

- 5.23 It appears that if insurers wish to try and mitigate the impact of inflated and/or erroneous not-at-fault claims costs, they must be prepared to invest significant resource into doing so. This resource could, in theory, otherwise be channelled into reducing premiums for consumers and improving customer service.

⁴³ Larger insurers are able to negotiate bigger discounts from their suppliers, in exchange for a higher volume of work. This means that the invoice provided to the smaller insurer when it insures the at-fault driver will always be smaller than the bill it provides to the larger insurer.

⁴⁴ This is because insurers that are more successful at capturing not-at-fault drivers stand to gain less from a bilateral agreement than less successful rivals.

6 IMPACT ON CONSUMERS

6.1 The data the OFT has gathered from insurers and other market participants suggests the features of the UK private motor insurance market that the OFT suspects are preventing, restricting or distorting competition are potentially increasing the cost of motor insurance premiums paid by consumers. While the precise impact of these features is difficult to assess, the OFT has generated estimates of the potential consumer detriment in order to decide whether it is sufficient to warrant exercising our discretion to make an MIR to the CC.

6.2 This chapter sets out:

- the OFT's approach to assessing the impact of our identified features on consumers
- the OFT's analysis of the extent to which the cost of claims for repairs and replacement vehicles for not-at-fault drivers are being inflated
- the OFT's consideration of other additional costs that potentially arise from the identified features
- the extent to which the additional costs that arise from the features identified are offset by referral fees and similar receipts that insurers are able to generate from practices that inflate rivals' costs
- our estimate of the overall effect the features of the market we have identified might be having on private motor insurance premiums, and
- the impact that the features of the market may have on the way that competition in the market develops in the long term.

OFT's approach to assessing the impact of our identified features on consumers

- 6.3 As set out in Chapters 3 and 4, in the majority of cases, the insurer of the at-fault driver is not able to control the way that claims for repairs to the not-at-fault driver's vehicle and any replacement vehicle that may be required are handled. This enables the insurer of the not-at-fault driver and/or other market participants (such as brokers, credit hire organisations and credit repairers) to engage in activities which earn them revenues and increase the costs faced by the insurer of the at-fault driver. We have assessed the extent to which these practices impact on insurers' costs. We have also taken into account the additional costs generated by activities that insurers carry out in order to mitigate the impact of the features we have identified, as set out in Chapter 5. The impact of these costs is, however, offset to some extent by the additional revenues that insurers earn from these activities through referral fees and rebates.
- 6.4 The net increase in costs for insurers that result from the identified features is likely to be passed through to consumers in the form of higher premiums. We would expect that a significant proportion of costs would be passed through given factors such as the apparently intense competition in the market (which is likely to result in premiums being broadly cost reflective) and the compulsory nature of the third party cover aspect of motor insurance.
- 6.5 In addition to the impact on premiums from inefficient activities set out above, there is also likely to be a long term effect on competition. We have, therefore, considered the impact that the identified features of the market have on how insurers compete in the market and, in particular, how they are likely to respond to incentives generated.

Increased costs faced by insurers

- 6.6 On the basis of the evidence we have gathered during the market study, the OFT has assessed whether the features of the market it has

identified are inflating the cost of not-at-fault claims for replacement vehicles and repairs.⁴⁵

Replacement vehicle hire

- 6.7 In order to establish the extent to which not-at-fault replacement vehicle claims are being inflated, the OFT has compared the cost of replacement vehicles when the identified features of the market take effect with their cost when they do not.⁴⁶ We have done so by comparing the cost of replacement vehicles provided to not-at-fault drivers that the insurer of the at-fault driver (that is, the bill payer) controlled, with the cost of these vehicles when the insurer of the at-fault driver does not control the service.
- 6.8 The OFT has found that replacement vehicles for not-at-fault drivers are on average 106 per cent more expensive when the insurer of the at-fault driver does not control the process, compared to the costs when it does. This amounts to a difference of £560 per hire on average (See Table 6.1).

⁴⁵ We asked insurers to provide costs relating to hire and repairs in instances where there was no total loss and no split liability.

⁴⁶ When the process is controlled by the not-at-fault driver's insurer the not-at-fault driver tends to be referred to a credit hire organisation and provided with a like for like replacement vehicle. Where the insurer of the at-fault driver has assumed control of the provision of the replacement vehicle they may have not provided a like for like replacement vehicle. However, we have heard from market participants that drivers are increasingly aware of their rights and, if they were to be offered a replacement vehicle that was not a satisfactory model by the insurer of the at-fault driver, they may refuse it and take a credit hire vehicle instead.

Table 6.1

Arrangement of replacement vehicle for not-at-fault drivers controlled by:	Average daily hire rates	Average hire period ³	Average cost of hire ⁴
Insurer of the at-fault driver	£39 ¹	14 days	£530
Insurer of the not-at-fault driver	£59 ²	19 days	£1090

1. These figures are weighted averages based on data provided by six credit hire organisations.
2. These figures are weighted averages based on data provided by five credit hire organisations.
3. These figures are weighted averages based on data provided by six credit hire organisations.
4. This is the average daily rate multiplied by the average hire period. Any discrepancies are due to rounding errors.

Source: OFT analysis of data supplied by market participants

6.9 The reasons for these increased costs appear to be:

- Based on the information gathered, hire periods appear to be longer for not-at-fault replacement vehicle claims controlled by the insurer of the not-at-fault driver.⁴⁷ When the at-fault drivers' insurer has control

⁴⁷ See Chapter 3 for details of practices that credit hire organisations may carry out in order to extend hire periods.

over the arrangement of the hire vehicle for a not-at-fault driver, hire periods tend to be time-limited.⁴⁸

- Daily hire rates are also higher when replacement vehicles are arranged by the insurer of the not-at-fault driver. There appear to be a number of factors that may explain this difference:
 - Credit hire involves the risk that liability may have been assessed incorrectly, and that the driver may not be entitled to a replacement vehicle. This would leave the credit hire organisation with a financial loss.⁴⁹
 - Insurers of at-fault drivers sometimes challenge credit hire bills or delay payment, losing the opportunity to benefit from prompt payment discounts and/or incurring late payment penalties.⁵⁰
 - Credit hire organisations pay a referral fee of between £250 and £400 to the insurer of a not-at-fault driver for the referral of a not-at-fault driver, whereas referral fees paid to obtain direct hire work are lower, if paid at all.
 - It is not necessarily the case that not-at-fault claims controlled by insurers of at-fault drivers will always involve the provision of a

⁴⁸ We note that there may be circumstances where having access to a replacement vehicle for longer than 14 or 21 days may be of benefit to not-at-fault drivers.

⁴⁹ However, it should be noted that under a credit hire agreement the consumer is liable if the credit hire organisation cannot recover its costs from the insurer of the at-fault driver. Data supplied to the OFT by five credit hire organisations indicates that consumers became liable for credit hire costs less than one per cent of the time in 2011.

⁵⁰ One credit hire organisation has told us that in 34 per cent of its cases insurers take between 30 and 90 days to settle claims, and in 36 per cent of its cases insurers take over 90 days to settle claims. They also note that some claims can take over a year to settle.

like for like replacement vehicle if the not-at-fault driver agrees to accept a lower specification vehicle.⁵¹

Repairs

- 6.10 In order to establish the extent to which not-at-fault repair claims are being inflated, the OFT has compared the cost of repairs when the identified features of the market take effect with their cost when they do not. We have done so by comparing the average cost of not-at-fault repair claims paid for by the insurer of the at-fault driver (where the insurer of the at-fault driver ordinarily has little control over costs) with the average net cost of repairs to the at-fault driver's vehicle⁵² after accidents that involved a third party.⁵³ Based on the data that the OFT collected, in 2011 the average cost⁵⁴ of not-at-fault repairs settled by an insurer of the at-fault driver (where it has little control over costs) was £1530, while the adjusted average net cost of an at-fault repair after an accident involving a third party (where the insurer of the at-fault driver has control over costs) was £1375.⁵⁵ This comparator suggests that the

⁵¹ We therefore note that not-at-fault drivers will benefit if provided with a like-for-like replacement vehicle by a credit hire firm that he or she would not have otherwise been provided with had the insurer of the at-fault driver managed the claim.

⁵² In order to establish the average net cost of an at-fault repair to the insurer of the at-fault driver following an accident involving a third party, we have adjusted the weighted average reported cost of these repairs for the average value of rebates and referral fees that the insurer of an at-fault driver would receive in association with an average repair.

⁵³ This approach removes at-fault claims where the accident did not involve another vehicle because these claims may not have involved comparable levels of damage.

⁵⁴ This is a weighted average based on cost information supplied by 10 major insurance companies.

⁵⁵ In 2011, the weighted average cost of at-fault repair after an accident involving a third party, based on cost information supplied by 10 insurance companies, is £1415. We have adjusted this for the average value of rebates and referral fees that the insurer of an at-fault driver would receive in association with each of these repairs, which we estimate to be approximately £40.

features identified may have inflated the cost of not-at-fault repairs by 11 per cent on average during 2011.⁵⁶

Other costs faced by insurers due to features of the market

- 6.11 In addition to inflating the costs of not-at-fault repairs and replacement vehicles, the features identified generate other additional costs for insurers. Insurers carry out a number of practices aimed at mitigating the inflation of not-at-fault claims costs, as set out in Chapter 5. If the features of the market did not exist, insurers may not need to invest resources or management time on these activities to the same extent. We have estimated some of the costs associated with these activities below.
- 6.12 As discussed in Chapter 5, many insurers have invested significant resource in third party capture in order to gain, where possible, control of replacement vehicle and repair costs that they are liable for as the insurer of the at-fault driver. We estimate that as much as £35 million per annum could be being spent on third party capture by insurers.⁵⁷
- 6.13 Certain major insurers appear to be investing significant resources in checking and validating claims for replacement vehicles for not-at-fault drivers. We estimate this may be costing insurers approximately £5

⁵⁶ It is possible that this is an underestimate. We have been told by some market participants that at-fault repairs after accidents that involve a third party are generally more expensive than not-at-fault repairs due to differing levels of damage to vehicles. However, this statement has been contradicted by other insurers who have told the OFT that costs of at-fault repairs after accidents that involve a third party and not-at-fault repairs are broadly similar.

⁵⁷ This estimate is based on data provided by insurers with less than 40 per cent of the market by gross written premium. In order to obtain an estimate for the entire market, we assumed the remaining insurers, for which data is not available, incurred proportionate costs on third party capture based on their market shares. The OFT notes that insurers use third party capture for reasons other than controlling third party repairs and hire costs, such as for controlling third party bodily injury costs. However, we believe that if insurers were not carrying out third party capture in order to control third party bodily injury costs they would likely continue to do so in order to attempt to control repair and hire costs.

million per annum.⁵⁸ As discussed in Chapter 5, some insurers appear to invest significant resource in challenging not-at-fault vehicle replacement and repair costs on the basis that they might be inflated or erroneous. We estimate that as much as £25 million per annum is spent by insurers of at-fault drivers on challenging the cost of replacement vehicles provided to not-at-fault drivers.⁵⁹

Referral fees and rebates

- 6.14 Although insurers may receive inflated not-at-fault replacement vehicle hire and repair bills to settle in their capacity as insurer of the at-fault driver, they are also able to generate referral fees, rebates and other similar receipts from similar activities when they are the insurer of the not-at-fault driver. Insurers are likely to face competitive pressure to use these revenues to reduce premiums, offsetting (at least to some extent) the costs that arise from the features we have identified.
- 6.15 We estimate that, in 2011, insurers' net receipts from such referral fees, rebates and similar payments relating to the provision of replacement vehicles and repairs to not-at-fault drivers were approximately £105 million.⁶⁰ Of this amount, around £85 million related to payments received for making referrals relating to replacement vehicles, while £20

⁵⁸ We have estimated this based on data provided by one major insurer on the amount of money spent on validating claims, and scaled it up for the approximately 60 per cent of the market that we are aware use such validating services.

⁵⁹ This estimate is based on data provided by insurers with less than 20 per cent of the market by gross written premium. In order to obtain an estimate for the entire market, we assumed the remaining insurers, for which data was not available, incurred proportionate costs based on their market shares.

⁶⁰ We asked the top 10 insurers to provide data on the total net value of referral fees, rebates, discounts, other payments and benefits-in-kind that they received and paid to other parties and then scaled this up in order to reach an estimate for the entire market. It should be noted that in some instances insurers were unable to separate referral fees and discounts paid to them for commercially insured cars from those paid to them for privately insured cars, so this number is likely to be an overestimate.

million relate to receipts for making referrals relating to not-at-fault repairs, including payments from repairers and paint and parts suppliers.

- 6.16 In addition, based on the data that the OFT has collected from brokers, we estimate that brokers received approximately £25 million in referral fees and rebates relating to not-at-fault claims in 2011.⁶¹ Given that the UK private motor insurance market appears to be reasonably competitive, including competition between brokers acting as intermediaries, we would anticipate that these payments may be used to discount the premium offered by the underwriting insurer, reducing the premiums paid by the consumer.

Impact on consumer premiums

- 6.17 We have used the data that we collected during the market study to produce a financial estimate of the impact that the identified features have on UK private motor insurance premiums overall. In order to do this, we have estimated the extent that the not-at-fault drivers' replacement vehicle and repair claims are being inflated, increasing insurers' costs. We have also taken into account the additional cost to insurers of carrying out practices that attempt to mitigate cost inflation. We have then offset against this against the revenues that insurers generate from referral fees, rebates and similar payments relating to not-at-fault vehicle replacement and repair claims.

Claims cost inflation

- 6.18 We estimate that not-at-fault replacement vehicle costs are being inflated by around £215 million per annum. This estimate is based on:

⁶¹ Nine of the 11 brokers who provided data to the OFT received referral fees for referring their not-at-fault drivers to credit hire and/or credit repair companies in 2011. We estimate that these 11 brokers sold seven million out of the 23 million policies that were sold during 2011. Given that approximately one third of insurance policies are sold via a broker we are confident that this figure captures the large majority of referral fees received by brokers.

- the £560 difference between the average cost of replacement vehicles provided to not-at-fault drivers when the insurer of the at-fault driver controls the process compared with the average cost when the insurer of the not-at-fault driver controls the process, and
- data provided by credit hire organisations which indicates that credit hire organisations provided approximately 380,000 replacement vehicles in 2011 to not-at-fault drivers where the insurer of the at-fault driver does not have control.⁶²

6.19 We estimate that insurers pay out £80 million more per annum for not-at-fault repair claims than they could have paid if they had managed those repairs themselves. This is based on:

- the £155 difference between the average cost of not-at-fault repair claims paid for by the insurer of the at-fault driver (where the insurer of the at-fault driver has little control over costs) and the average net costs⁶³ of repairs to the at-fault driver's vehicle after accidents that involved a third party, and
- information provided by repairers that indicates that there were approximately 500,000 not-at-fault repairs performed during 2011.⁶⁴

⁶² In order to produce this estimate we made the starting assumption that all replacement vehicle hires for not-at-fault drivers that insurers of the not-at-fault driver assumed control over were provided on a credit hire basis and adjusted our estimate where submissions from credit hire organisations made it clear that this was not the case.

⁶³ See paragraph 6.10 for details.

⁶⁴ This is based on information provided by insurers on the number of repair claims that they settle, scaled up to reflect the whole market. These were circumstances where there was clear liability for the accident and the car was repairable, that is there was no total loss.

Including other costs associated with mitigating the impact of the features of the market

- 6.20 In order to estimate the overall impact that the features of the market have, we think that the costs that insurers incur by attempting to mitigate the impact of inflated third party costs also need to be taken into account. We have estimated that insurers may be spending as much as £60 million per annum on attempting to mitigate not-at-fault repair and replacement vehicle hire costs. These include an estimated £35 million per annum being spent on third party capture processes, an estimated £20 million per annum being spent on challenges and a further estimated £5 million per annum being spent on validating credit hire claims.
- 6.21 We therefore estimate that the features of the market identified cost private motor insurers £355 million per annum before offsetting the revenues that insurers generate from referral fees, rebates and similar payments.

Offsetting referral fees, rebates and similar payments received

- 6.22 In the course of our market study both insurers and credit hire organisations have indicated that in order to assess the net impact on premiums of the features of the market that the OFT has identified, the OFT should take into account the level of referral fees, rebates and similar payments received by insurers and brokers⁶⁵ in relation to the provision of replacement vehicles and repairs to not-at-fault drivers.
- 6.23 As set out in paragraphs 6.15 to 6.16 above, we estimate that £130 million of revenue from these sources was received in 2011, £110 million of these receipts relate to not-at-fault replacement vehicle hires

⁶⁵ Eleven of the largest retail brokers provided data to the OFT on the level of referral fees that they received. We have incorporated the income that brokers receive in the offset because we assume that a significant proportion of this income is being used to discount premiums offered by underwriting insurers

(with insurers gaining £85 million and brokers gaining £25 million) and £20 million relates to not-at-fault repairs (with insurers gaining approximately £20 million and brokers gaining a minor amount). If the £130 million total net level of referral fees is offset against the estimated additional £355 million that insurers are having to pay due to the features of the market that we have identified, we estimate that insurers' costs are increased by approximately £225 million per annum.

Total estimated impact on private motor insurance premiums

- 6.24 We therefore estimate that, overall, the features of the market that we have identified are costing private motor insurers £225 million per annum. If these additional costs are being passed on to consumers, this may have raised the price of every private motor insurance policy sold in the UK by £10.⁶⁶
- 6.25 This estimate appears to be broadly in line with the estimates of the impact of the features of the market that insurers have submitted to us during the market study. One insurer that submitted its own estimate of the cost to insurers caused by the features of the market estimated that the market was making a net loss of between £150 million and £200 million in 2011. Another insurance company told us that inflated replacement vehicle hire costs alone were costing their policy holders an extra £8.40 per policy. Neither of these estimates took into account the additional costs that insurers incur by attempting to mitigate the impact of inflated third party costs.
- 6.26 However, the potential impact on consumers' motor insurance premiums could be far greater than, in fact, this estimate suggests for two key reasons:

⁶⁶ We have assumed that there are 23 million private motor insurance policies in force. *UK Private Motor Insurance 2011*, Datamonitor, July 2011 reports that the top 10 insurers had 18.5 million policies in force. We have scaled that up for the whole market to estimate that there are 23 million policies in force.

- The approach that we have used assumes that all motor insurers are impacted by the inflation of not-at-fault claims in a similar way, which may not be the case. The OFT considers that insurers are likely to differ in their ability to generate referral fees and rebates from the practices that are inflating rivals' costs and in their ability to successfully mitigate their losses by investing in third party capture, bilateral agreements and challenging inflated costs. Some insurers are likely to gain a competitive advantage over their rivals in this way. This could mean that some insurers will provide a weak competitive constraint on rivals, and means that these rival insurers may not therefore have to pass all of the financial advantage that they gain back to consumers in lower premiums.
- Some of the costs of mitigating the features of the market are difficult for the OFT to estimate based on the data that we have collected. Other costs that may be incurred that we have not reflected in our estimates include the resource and management time involved in forming and administering bilateral agreements and the GTA, and employing and training staff to handle not-at-fault third party claims.

Long term impact

- 6.27 In addition to the impact on premiums from inefficient activities set out above, there is also likely to be a long term effect on competition. In order to improve their competitive market positions relative to one another, insurers may invest progressively more resource into improving their ability to identify and control not-at-fault claims, in order to generate referral fees and rebates when they insure the not-at-fault driver and to mitigate inflated costs when they are the at-fault driver's insurer.
- 6.28 Investment in these types of activities could raise costs in the market overall and may not be the most efficient method of managing the cost of repairs and replacement vehicles for not-at-fault drivers to the detriment of consumers.

Quality of service provided to not-at-fault drivers

- 6.29 Although the focus of this chapter is the impact that the identified features are having on motor insurance premiums, the OFT recognises that it is also important to consider the quality and appropriateness of the services that are being provided to those not-at-fault drivers in need of replacement vehicles and repairs after a road traffic accident.
- 6.30 The features we have identified lead to not-at-fault drivers currently having a number of parties competing to identify them rapidly in order to offer them a replacement vehicle and repair services after a road traffic accident. Credit hire organisations have told us that the service that not-at-fault drivers receive has vastly improved since credit hire organisations entered the market. Not-at-fault drivers are now likely to be offered a like for like replacement vehicle shortly after their accident, whereas before credit hire organisations entered the market in the late 1980s, not-at-fault drivers could either pay upfront for a hire car and attempt to reclaim this cost from the insurer of the at-fault driver, or, if their policy allowed, claim a courtesy car, which would be unlikely to be a like for like replacement.
- 6.31 Further, we have highlighted examples of a number of circumstances where the identified features may be leading to not-at-fault drivers receiving a better service than when their claims are not controlled by the insurer of the at-fault driver, including:
- a replacement vehicle for the length of time that the not-at-fault driver requires it, even where the repair period runs for longer than 14 or 21 days, and
 - a like for like replacement vehicle where the insurer of the at-fault driver may have been offered a lower specification model.
- 6.32 The OFT, nevertheless, remains concerned that, due to the lack of control of the insurer of the at-fault driver has in many situations, suitable replacement vehicles and appropriate repairs are being provided

for at a cost higher than an insurer of the at-fault driver would have paid if they had retained control of the process.

Conclusion

- 6.33 The overall impact of the features we have identified is likely to be an increase in costs across the insurance industry. In turn, these costs are likely to be passed through to consumers as higher premiums.
- 6.34 On the basis of the evidence we have gathered, we estimate that the identified features of the market are costing private motor insurers £225 million per annum. If these additional costs are being passed on to consumers, this may have raised the price of every private motor insurance policy sold in the UK by £10. The OFT therefore considers that its estimate indicates that potential consumer detriment is significant, and would substantially outweigh the costs and burden of an investigation by the CC.
- 6.35 The OFT is also concerned that the features of the market we have identified encourage insurers to compete in a way that may cause further consumer detriment over the long term. Insurers appear to have a focus on gaining a competitive advantage by becoming more successful at increasing revenues through referral fees and rebates, whilst raising their rivals' costs. The OFT would like to see insurers focused on the quality and value of the service that they provide to insured drivers.

7 POTENTIAL REMEDIES

- 7.1 A number of different potential remedies to the features the OFT has identified in the private motor insurance market have been suggested to us throughout the course of the market study. These remedies could be applied either individually or in combination, and seek to address the features of the market that the OFT has identified.
- 7.2 The OFT held a series of roundtables and bilateral meetings with the motor insurance industry to discuss potential remedies, and to gauge whether there was a solution the OFT could successfully implement.
- 7.3 This chapter considers each of the suggested remedies in turn, and gives an assessment of how effective they might be in addressing the problems identified.

Approaches that reduce incentives to raise insurers of at-fault drivers' costs

- 7.4 One of the features identified is that insurers of not-at-fault drivers, brokers, credit vehicle hire providers, credit repairers and others that supply services to motor insurers have the opportunity, and the incentive, to take advantage of the insurer of the at-fault driver's lack of control over costs. They do this by carrying out practices that allow them to generate revenues through referral fees or rebates, while simultaneously inflating the costs that the insurer of the at-fault driver has to meet. We have considered whether the following remedies address this feature.

Ban on referral fees

- 7.5 It has been suggested that implementing an industry-wide ban on the receipt and payment of all relevant referral fees could remove the incentive for brokers and insurers of not-at-fault drivers to refer work to providers of repairs or replacement vehicles that pay the largest referral

fees (which may, as a result lead the service be more expensive than other potential options).⁶⁷ Instead, suppliers could potentially compete on the quality and value of service offered. It could also reduce other market participants' incentives to attempt to capture not-at-fault claims and inflate their costs, thereby leading to insurers facing lower costs when their policy holder is found to be at-fault following a road traffic accident.

- 7.6 However, the OFT has concerns that this potential remedy would not fully address the underlying features of the market identified, particularly if this was the sole remedy implemented. For example, in relation to credit hire and credit repair, a ban might remove the incentive of insurers to refer a claim in order to gain revenue, but it does not remove the incentive or opportunity for insurers to refer work in order to raise costs for competitors. Nor does it address the insurer of the at-fault driver's inability to manage the cost of claims once they have been referred to credit hire organisation or credit repairers.
- 7.7 We were told during the roundtables held at the OFT that referral fees represent a form of 'marketing spend' for organisations supplying goods and services to insurers, and that a ban on the payment of these fees would simply mean such money potentially being spent on other forms of marketing, rather than being saved and used to reduce rates and prices offered. For example, we heard that if credit hire organisations were banned from paying referral fees, insurers of not-at-fault drivers would lose a revenue stream, and credit hire organisations would potentially use the money previously spent on paying referral fees on other forms of marketing to generate new business, such as advertising. It does not follow, therefore, that a ban on referral fees would automatically mean that credit hire rates would be reduced.
- 7.8 Market participants also suggested that any such ban would be fairly easy to avoid, due to the difficulty in creating a definition of a 'referral fee' that would capture all of these types of payment. The OFT has also

⁶⁷ The incentives referred to here are covered in more detail in Chapters 3 and 4.

gathered evidence of other similar payments or other equivalent benefits being passed between market participants such as rebates and discounts which may also have to be captured by such a ban.

- 7.9 A cap on referral fees, instead of an outright ban, has also been suggested to the OFT as a means of reducing the amount of money channelled into marketing spend, while ensuring that not-at-fault drivers retain access to credit hire services, should they be needed. However, as with a ban, it is unclear that a cap on referral fees, as a stand-alone remedy, would address the underlying features of the market identified by the OFT. Insurers would still have the incentive to refer the supply of goods and services to other market participants to gain revenue.
- 7.10 Due to the uncertainty of the outcomes of a ban or cap on referral fees, it would be premature for the OFT to make a recommendation on this remedy, without in-depth enquiry into the potential effects.

Controlling costs that are passed to insurers of at-fault drivers for settlement

- 7.11 Several methods of controlling the cost of claims that are passed to insurers of at-fault drivers for settlement were proposed to us, including improvements to the existing GTA, setting mandatory tariffs for replacement vehicles and repair costs, and setting up an independent monitoring and rate-setting scheme.
- 7.12 It was suggested by insurers that improvements to the GTA could be made to reduce the cost of credit hire and credit repair claims, and the efficiency with which claims are processed. The OFT heard from insurers that this could lead to lower overall claims costs, and potentially lead to fewer disputed claims, and associated costs.
- 7.13 However, there is mixed support for any changes to the GTA among market participants due to conflicting interests. Certain credit hire organisations, for example, told the OFT that should the daily credit hire rates be set much lower, or other clauses be inserted allowing insurers to intervene once a not-at-fault driver is already in a credit hire vehicle, they would withdraw from the agreement as it would not make

commercial sense for them to remain in it. Concerns have also been raised that this approach would not address the underlying incentives to refer work to credit hire organisations or address all of the practices that appear to be inflating claims.

- 7.14 Another potential option is a 'tariff model', under which each insurer would deal with its own policyholder, and vehicle and repair costs would be recovered according to agreed tariffs. This model could help to control the overall cost of claims by setting the price for claims components, and by outlining procedures for processing claims to reduce administrative costs. This model may, however, also raise significant competition concerns because the tariffs set would act as a price 'floor', and would be difficult to set and maintain at competitive levels.
- 7.15 The OFT also considered that an independent monitoring and rate-setting scheme for not-at-fault claims could be implemented. It is possible that increased independent scrutiny of the settlement of not-at-fault claims might reduce incentives to inflate costs. Also, recoverable costs could be limited to an agreed rate, leading to fewer disputed claims and generally lower claims processing costs. However, there appears currently to be limited industry support for this option, and it is possible that this option could only apply to credit hire costs; repair costs might be more difficult to address through this method given the greater range of variables to control.
- 7.16 Other variations of monitoring and arbitration schemes have also been suggested to adjudicate disputed claims. Again, the rationale for these remedies is that increased independent scrutiny might reduce incentives to inflate costs. However, this method would add an extra administrative burden onto market participants.
- 7.17 It would be therefore be premature for the OFT to make a recommendation on any of these remedies that are aimed at controlling costs that are passed to insurers of at-fault drivers for settlement, without further in-depth enquiry into their potential effects.

Approaches that improve the ability of at-fault drivers' insurers to control not-at-fault claims costs

- 7.18 The second market feature identified is that at-fault drivers that are responsible for meeting claims for a not-at-fault driver's repairs or replacement vehicle often appear unable to exercise choice over how this service is provided. The at-fault driver's insurer also appears to find it difficult to assess the extent to which the costs claimed are reasonable, and appears to exercise only limited control over the cost of these services. We have considered whether the following remedies address this feature.

First option to control the claim

- 7.19 Under this system, the insurer of the at-fault driver would be given the first opportunity to address the not-at-fault driver's detriment, by providing repairs and a replacement vehicle using its own network of suppliers. This would give the party responsible for meeting repairs and replacement vehicle costs the option of having control over how those services were managed.
- 7.20 Concerns have been raised by insurers, however, that although this remedy would enable the insurer of the at-fault driver to keep costs low, the quality of service provided to the not-at-fault driver might suffer as a result of the increased downward pressure on cost. The OFT has heard from some market participants that the insurer of the at-fault driver would have little incentive to provide a competitor's policy holder with, for example, high quality customer service, or a like for like replacement vehicle. It is possible that, if this potential remedy were to be introduced, more responsibility could be given to a designated body to regulate the quality of service received.
- 7.21 The OFT considers that further in-depth consideration of any such potential remedy, how it would operate, and the resultant costs involved is needed before any recommendations could be made.

Changing the current liability regime

- 7.22 Another remedy that has been suggested is to create a system where insurers are responsible for meeting the claims costs of their policy holders, regardless of who was responsible for a road traffic accident. This 'first party insurance model' would not require bills to be passed to the insurer of the at-fault driver by the insurer of the not-at-fault driver, and would mean that the party responsible for meeting the bill would have control over costs. In theory, insurers would therefore have the incentive to keep costs as low as possible, yet also offer a high quality service to their customers.
- 7.23 A voluntary first party model of this nature did exist in the UK (the 'knock for knock' agreement) until the mid-1990s. However, the agreement fell away because new entrants to the market refused to be party to the agreement because it did not fit their business models, which were based on targeting low risk drivers that were less likely to be involved in accidents. The agreement then became financially unsustainable for those remaining in it.
- 7.24 The adoption of any such remedy would involve a fundamental change to the current system, and, unless thoroughly researched and examined, is likely to generate unintended consequences, and costs, due to the impact of insurers having to move away from an established risk-based pricing model. The OFT is also concerned that it could adversely affect the motor insurance premiums of statistically safer drivers because under a 'first party' model their insurance companies will have to meet the cost of repairs and a replacement vehicles whenever they are involved in an accident, rather than whenever they are responsible for an accident. This could have a negative effect on premiums offered to such drivers. Further, the adoption of this model would require new legislation in order to change the current law, which requires the not-at-fault driver to be put back into the position they were in prior to a road traffic accident by the at-fault driver's insurer.
- 7.25 The OFT considers that it is possible that a legislated first party model could potentially address some of the existing market features that have

an impact on motor insurance premiums. However, the OFT also believes that further in-depth consideration of this remedy, how it would operate and the resultant costs involved is needed, before any recommendations could be made.

Conclusion

7.26 We have discussed these potential remedies with a large number of market participants through a series of roundtables, and it remains clear that there is no comprehensive, stand-out remedy which could be implemented in the short term for the following reasons:

- Some of the potential solutions identified would not be easy to implement without fundamentally altering the way that the market currently works and thereby potentially create significant unintended consequences. Further, in-depth research is needed to negate the risk of potentially creating other incentives that could result in increased cost, and therefore reduce potential efficiency savings from eliminating the features of the market. It will also be important to consider any other potential adverse effects of remedies, including reducing the quality of the service received by not-at-fault drivers.
- There is little consensus over how the features of the market that we have identified could be addressed.
- Some motor insurance companies obtain a competitive advantage from operating under the current system and therefore have limited incentive to develop, or to successfully implement and adhere to any potential solution adopted.

7.27 The market appears to be captured in a stable but adverse equilibrium that will be difficult for market participants to evolve away from without external intervention. The OFT considers that a much more detailed analysis of the market and potential remedies is now required before any comprehensive and effective solution can be successfully implemented.

8 PROVISIONAL DECISION ON A MARKET INVESTIGATION REFERENCE

- 8.1 The OFT has identified a number of specific concerns during its call for evidence and market study on some aspects of competition in the UK private motor insurance market. The OFT has therefore considered whether it would be appropriate to refer this market to the CC for further investigation. In light of the OFT's call for evidence findings and further information gathered during this market study, the OFT has provisionally decided to exercise its discretion to refer the UK market for the supply or acquisition of private motor insurance and related goods or services to the CC.
- 8.2 This chapter explains why the OFT is minded to refer this market to the CC and details:
- the legal test for referring the market to the CC (the section 131 reference test)
 - the OFT's consideration of this test, including features of the market
 - the OFT's consideration of the criteria relevant to exercising its discretion to refer the market to the CC, and
 - the OFT's provisional decision to exercise its discretion to refer this market to the CC.

Section 131 reference test

- 8.3 To refer a market to the CC under section 131 of the EA02, the OFT must have reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or part of the UK.

Market for private motor insurance

- 8.4 Private motor insurance should be understood as insurance cover against damage to property and personal injury that is supplied to or acquired by drivers of privately owned motor cars designed and used for non-business (private) use. It excludes motorcycles.⁶⁸ As outlined in Chapter 2, private motor insurance makes up a significant proportion of domestic household expenditure, with the UK market estimated to be worth £9.4 billion in 2010.
- 8.5 The OFT notes conduct of entities providing services relating to private motor insurance may have an impact on competition in the private motor insurance market, including the conduct of:
- credit hire organisations, repairers and other businesses providing services to drivers that have been involved in a road traffic accident
 - businesses that manage the provision of these services to drivers that have been involved in a road traffic accident (such as accident management companies), and
 - businesses that are involved in providing specific goods or services that are used by these providers and those that refer work to these providers.
- 8.6 For the purpose of setting the draft Terms of Reference, the OFT has therefore included 'related goods or services' to ensure that the actions of other market participants (set out above) are included within the scope of the potential MIR. See Annexe A for the draft Terms of Reference.

⁶⁸ We have not reached any firm conclusions on the definition of any relevant economic markets at this stage in accordance with paragraph 4.8 to 4.12 OFT 511 *Market Investigation References: Guidance about the making of references under Part 4 of the Enterprise Act*, 2006: www.oft.gov.uk/shared_of/business_leaflets/enterprise_act/oft511.pdf.

Features of the market that prevent, restrict or distort competition

- 8.7 Section 131(2) of the EA02 provides that a feature of the market is to be construed as a reference to:
- the structure of the market concerned or any aspect of that structure
 - any conduct (whether or not in the market concerned) of one or more than one person that supplies or acquires goods or services in the market concerned, or
 - any conduct relating to the market concerned of customers of any person that supplies or acquires goods or services.
- 8.8 Under section 131(3), 'conduct' includes any failure to act (whether or not intentional) and any other unintentional conduct.
- 8.9 After completing its call for evidence, the OFT concluded that the section 131 reference test was met; that is, the OFT considered it had reasonable grounds for suspecting that two features, relating to the conduct of firms in the UK market for private motor insurance prevented, restricted or distorted competition.⁶⁹ Following its market study, the OFT remains of the view that the section 131 reference test is met.
- 8.10 The two features identified are:
- The insurers of at-fault drivers that are responsible for meeting claims for the provision of repairs or replacement vehicles to not-at-fault drivers often appear unable to exercise choice over how these services are provided. Insurers of at-fault drivers also appear to find it difficult to assess the extent to which the costs claimed are reasonable, and appear to exercise only limited control over the cost of these services.

⁶⁹ OFT1397, Private motor insurance - summary of responses to the OFT's call for evidence, Dec 2011 www.oft.gov.uk/OFTwork/markets-work/othermarketswork/motor-insurance/

- The insurers of not-at-fault drivers, brokers, credit vehicle hire providers, credit repairers and others that supply services to motor insurers therefore have the opportunity, and the incentive, to take advantage of the insurer of the at-fault drivers' lack of control over costs. They do this by carrying out practices that allow them to generate revenues through referral fees or rebates, while simultaneously inflating the costs that the insurer of the at-fault driver has to meet.

8.11 The OFT's analysis, based on its call for evidence findings and further evidence obtained during the market study, supports its characterisation of these features and the competition issues arising. The OFT found that insurers largely agreed with the OFT's characterisation, but that certain credit hire organisations thought the OFT's analysis did not fully take into account the high quality of service received by not-at-fault drivers under the current system. The OFT recognises that the quality and appropriateness of the services that are being provided to not-at-fault drivers in need of replacement vehicles and repairs after a road traffic accident are an important consideration. However, the OFT remains concerned that the identified features of the market are leading to the cost of suitable replacement vehicles and repairs being higher than they should be, to the detriment of consumers.

8.12 During the OFT's market study, as examined in Chapter 3, the OFT found evidence that not-at-fault drivers' replacement vehicle costs appear to be being inflated because:

- Many insurers, brokers and repairers are referring not-at-fault drivers to credit hire organisations when credit hire vehicles tend to be charged at higher daily rates than other options, in exchange for a referral fee.
- Not-at-fault drivers appear to receive replacement vehicles for longer periods than necessary, leading to further inflated costs for insurers of at-fault drivers.

8.13 In Chapter 4, the OFT found evidence that not-at-fault drivers' vehicle repair costs appear to be being inflated by practices including:

- Some insurers of not-at-fault drivers are receiving referral fees and/or rebates from referring repair work on not-at-fault drivers' vehicles to specific approved repairers and credit repairers. Some brokers also have similar arrangements with credit repairers. It appears that the payment of these referral fees and rebates by approved repairers and credit repairers may be inflating the costs of the repair bills that are passed to the insurers of at-fault drivers.
- Certain insurers are also earning additional referral fees and rebates from agreements with suppliers of paint and parts to their approved repair networks. It appears that the cost of paying these referral fees and rebates may be increasing the cost of paint and parts used in not-at-fault vehicle repairs leading to the final bill received by the insurer of the at-fault driver being inflated.
- Certain insurers also have agreements with approved repairers in their networks to charge higher labour rates for repairs where the cost will be passed on to an at-fault driver's insurer, than are charged for repairs that the insurer must pay because the driver it insures was at fault.

8.14 The overall impact of these practices is likely to be an increase in costs across the private motor insurance industry. The OFT estimates that the features of the market it has identified cost private motor insurers £225 million in 2011, which indicates that consumers could be paying an extra £10 per private motor insurance policy.

8.15 The OFT is also concerned that the features of the market we have identified encourage insurers to compete in a way that may cause further consumer detriment over the long term. Insurers appear have a focus on gaining a competitive advantage by becoming more successful at increasing revenues through referral fees and rebates, whilst raising their rivals' costs. The OFT would like to see insurers focused on the quality and value of the service that they provide to insured drivers.

- 8.16 It is the OFT's view that the section 131 test for making a reference is met and, therefore, the decision on whether to make a MIR rests on the exercise of the OFT's discretion.

Appropriateness of a reference

- 8.17 The OFT's guidance on market investigation references⁷⁰ sets out four criteria, all of which must be met before the OFT will exercise its discretion to make a reference to the CC:

- **alternative powers:** it would not be more appropriate to deal with the competition issues identified by applying the CA98 or using other powers available to the OFT or, where appropriate, making recommendations to sectoral regulators
- **the scale of the suspected problem:** the adverse effect on competition is significant, such that a reference would be an appropriate response to it
- **availability of remedies:** there is a reasonable chance that appropriate remedies will be available, and
- **undertakings in lieu of a reference:** it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference.

- 8.18 The OFT's assessment of each of these four factors follows.

Alternative powers

- 8.19 The OFT has considered whether some of the possible competition concerns it has identified could be addressed more appropriately through enforcement and/or through OFT recommendations to industry, regulators and the Government. However, the OFT considers that neither

⁷⁰ *Market Investigation References – Guidance about the making of references under Part 4 of the Enterprise Act*, March 2006.

enforcement nor recommendations would provide a means to a sufficient, comprehensive solution to the features identified for the reasons outlined below.

- 8.20 The OFT has conducted some analysis, based on the information received in this market study, as to whether some of the activities identified may be addressed more appropriately through CA98 enforcement action. In principle, some of these activities may fall within the scope of the CA98. However, we have not identified a suitable potential CA98 enforcement case that would potentially address the features sufficiently, and that would set a clear precedent to guide market participants.
- 8.21 Further, any such CA98 action would not address the underlying features, especially insurers' lack of control over third party costs, and so would not provide a comprehensive solution. As such, in taking forward a programme of CA98 action, the OFT may only treat the symptoms of the features of the market identified, rather than the cause. The OFT considers that the need to achieve a comprehensive solution to the features identified, as well as the need for an approach that applies to all market participants, necessitates the OFT referring the market to the CC.
- 8.22 Further, it appears that it would not be possible for the OFT to attempt to resolve the features that we have identified by way of a set of recommendations to the industry or to the Government, given the complexity of the issues raised and the further in-depth analysis required to determine appropriate potential remedies.⁷¹ Such recommendations are not likely to be possible without an in-depth CC investigation.

Scale of the suspected problem

- 8.23 OFT guidance sets out three factors relevant to determining the significance of adverse effects on competition: the size of the market,

⁷¹ See Chapter 7 for further information on the remedies considered.

the proportion of the market affected by the feature, and the persistence of the feature.

8.24 The OFT considers that referring the market to the CC would be an appropriate response given both the scale and the complexity of the suspected problems identified in this market, for the following reasons:

- The size of the market is significant and estimated to be worth £9.4 billion in 2010, with the cost of third party property damage, relating to the provision of repairs and replacement vehicles to not-at-fault drivers, being approximately £1.4 billion.
- A large proportion of the market appears to be affected by the features identified.
- Although the market is likely to experience a degree of flux due to the Government's focus on reducing personal injury costs, the features we have identified relating to replacement vehicles and repairs are likely to persist, absent any regulatory or government intervention. Such recommendations are not likely to be possible without an in-depth CC investigation, given the complexity of the competition issues identified.

8.25 The significant overall impact of the features discussed is likely to be an increase in costs across the private motor insurance industry. The OFT considers that these costs are likely to be passed through to consumers as higher premiums under their individual motor insurance policies. In particular, as discussed at paragraphs 8.13 and 8.14, the OFT estimates that the features of the market it has identified cost private motor insurers £225 million in 2011, which is equivalent to an extra £10 per private motor insurance policy sold.

Availability of remedies

8.26 It is not for the OFT in a market study to determine which remedies would or would not be appropriate for the CC to consider. In the context of a market study, the OFT is required to assess whether there is a reasonable chance that appropriate remedies would be available to the

CC, if it finds one or more adverse effects on competition in the market. In the event of a reference, it is for the CC to perform an independent investigation, to decide whether there is an adverse effect on competition and if so, to decide what remedy or remedies are capable of achieving as comprehensive a solution as is reasonable and practicable to any adverse effects and any detrimental effects on customers identified.

- 8.27 However, as a result of its efforts to find solutions in the context of the market study, the OFT has identified a number of potential remedies, ranging from a move to a 'first party' private motor insurance model to modifications of existing mechanisms for controlling costs, such as the GTA.⁷² The OFT considers there is no readily implementable, comprehensive solution that it would be able to take forward, due to the complexity of the competition issues, the large number of diverse market participants with different business models and incentives, and the need for a remedy that addresses the features identified and applies to all market participants.
- 8.28 The OFT considers that a much more detailed analysis of the market and potential remedies, which can be achieved by a second-phase in-depth investigation by the CC, is required before any solution can be implemented.⁷³ The OFT considers that this indicates that there are likely to be a number of potential remedies open to the CC, should it find adverse effects on competition in the market.
- 8.29 It is also possible that during any second phase in-depth investigation, the CC uncovers evidence that may identify potential competition infringements, and that the CC would remit these to the OFT for

⁷² See Chapter 7 for further information on the potential remedies identified.

⁷³ The prospective value of a CC investigation and report is an issue which the OFT may take into account when considering a market reference. See OFT's *Market Investigation References – Guidance about the making of references under Part 4 of the Enterprise Act*, March 2006, paragraphs 2.30 to 2.32.

consideration. The OFT would be keen to consider whether to prioritise any such evidenced potential infringements as soon as possible thereafter.

Undertakings in lieu of a reference

8.30 Undertakings in lieu of a reference⁷⁴ could potentially provide a tool for addressing the features identified through binding undertakings or being offered commitments by industry participants drawing on the potential remedies described in Chapter 7. However, to date, the OFT's efforts have not led to consensus on the appropriate course of action within the market study's timescale. The OFT's provisional view is that the competition issues are complex and require further consideration, although we will of course consider any proposals for undertakings in lieu of a reference that may be made during the course of the consultation.

Conclusion

8.31 In conclusion, the OFT considers that the section 131 reference test is met in relation to the UK market for the supply or acquisition of private motor insurance and related goods or services.

8.32 The OFT has identified features of the market as:

- The insurers of at-fault drivers that are responsible for meeting claims for the provision of repairs or replacement vehicles to not-at-fault drivers often appear unable to exercise choice over how these services are provided. Insurers of at-fault drivers also appear to find it difficult to assess the extent to which the costs claimed are reasonable, and appear to exercise only limited control over the cost of these services.

⁷⁴ The OFT has powers under Section 154 EA02 to accept undertakings in lieu of a reference to the CC.

- The insurers of not-at-fault drivers, brokers, credit vehicle hire providers, credit repairers and others that supply services to motor insurers therefore have the opportunity, and the incentive, to take advantage of the insurer of the at-fault drivers' lack of control over costs. They do this by carrying out practices that allow them to generate revenues through referral fees or rebates, while simultaneously inflating the costs that the insurer of the at-fault driver has to meet.

8.33 For the reasons set out above, the OFT has provisionally decided to exercise its discretion to refer this market to the CC.

A DRAFT TERMS OF REFERENCE

- A.1 The OFT, in exercise of its powers under Sections 131 and 133 of the EA02, hereby makes a reference to the CC for an investigation into the supply or acquisition of private motor insurance and related goods or services in the UK.
- A.2 The OFT has reasonable grounds for suspecting that a feature or a combination of features of the market or markets for the supply or acquisition of private motor insurance and related goods or services in the UK prevents, restricts or distorts competition in connection with their supply or acquisition.
- A.3 For the purposes of this reference, 'private motor insurance' means insurance cover against damage to property and personal injury that is supplied to or acquired by drivers of privately owned motor cars designed and used for non-business (private) use. It excludes motorcycles.

B GLOSSARY

Terms relevant to the OFT's report on the Private Motor Insurance market study

Approved repairer/approved repairer network: A vehicle repairer selected by an **insurer** as a preferred supplier of repairs to policy holders' damaged vehicles. Each private motor insurer has a nationwide network of approved repairers.

At-fault claims: Claims that are made by or on behalf of an **at-fault driver** and that are **settled** by the insurer of the at-fault driver. **At-fault claims** might arise from accidents that involve **not-at-fault drivers** (which also give rise to **not-at-fault claims**).

At-fault driver: A driver responsible for a road traffic accident whose **insurer** settles the **claim** of the **at-fault driver** and the **not-at-fault driver**, where a **not-at-fault driver** was involved.

Bilateral agreement: Agreement between rival insurers to offer similar levels of redress to each other's not-at-fault drivers claims.

Brokers: A retail intermediary arranging private motor insurance policy agreements between **underwriting insurers** and private motor insurance consumers.

Claims costs: All costs incurred in the settlement of vehicle-on-vehicle road traffic accident. The OFT's market study has focused primarily on claims costs related to the repair of vehicles and the provision of replacement vehicles to drivers.

Courtesy car: a replacement vehicle usually provided by an **approved repairer** or garage to a driver while their own vehicle is being repaired.

Credit hire: the term used to describe **replacement vehicles** provided on 'credit' usually to **not-at-fault drivers** involved in accidents while their own vehicles are being repaired or new cars are being supplied to them.

Credit hire organisations: Businesses that provide **replacement vehicles** to drivers involved in accidents while their own vehicles are being repaired or new cars are being supplied to them. Credit hire organisations provide vehicles to drivers on deferred payment terms and generally receive payment from the **insurer of the at-fault driver** rather than directly from a driver.

Credit repair: a repair carried out to a vehicle following a road traffic accident, on a credit basis, usually to **not-at-fault driver's** vehicle, in a similar manner to **credit hire**. The **credit repair** bill is usually passed to the **insurer of the at-fault driver** for settlement.

Direct hire vehicle: a replacement vehicle provided by a car hire company who has agreed to supply vehicles on behalf of an **insurer** at agreed rates and terms.

General Terms of Agreement (GTA): a voluntary protocol which fixes the hire rates and other administrative charges that credit hire organisations can recover from the **insurer of the at-fault driver**.

Insurers: Insurance companies active in the market for the supply of private motor insurance in the UK.

Insurer of the at-fault driver: The **insurer** who provides private motor insurance cover to the **at-fault driver**.

Insurer of the not-at-fault driver: The **insurer** who provides private motor insurance cover to a driver who has been involved in a road traffic accident that was not their fault.

Not-at-fault claims: Claims that are made by or on behalf of a **not-at-fault driver** and that are **settled** by the **insurer of the at-fault driver**.

Not-at-fault driver: A driver involved in, but not responsible for, an accident that leads to a claim being **settled** under the **at-fault driver's** insurance policy.

Rebate: a payment made from one business to another, in exchange for agreement to use or recommend that others use a type of service or product over a specified period.

Referral fee: a payment made from one business to another, in exchange for referring a customer who agrees to use a product or service.

Settled/Settlement/Settling: An **insurer** settles a claim when it ultimately pays over monies to meet the **claims costs** related to it, regardless of whether or not any other party has borne those costs in the interim.

Third party cover: Insurance cover against claims that are made by or on behalf of a **not-at-fault driver** against an **at-fault driver**.

Underwriting Insurers: Insurance companies active in the market for private motor insurance in the UK.

Vehicle repairs: The process of fixing a vehicle, including any towing, replacement of parts, bodywork, and vehicle repainting. It does not include costs relating to salvage and total loss.