PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)

Introduction

1. In our provisional findings we provisionally concluded that, in the context of separation between cost liability and cost control, the parties managing non-fault drivers' claims adopted various practices which were focused on earning a rent and gave rise to an inefficient supply chain, resulting in an adverse effect on competition in the private motor insurance market. We found that the direct effects of these practices were:

   - the earning of rents from the control of non-fault claims, in the form either of referral fees or of mark-ups applied to subrogated bills; and
   - excessive frictional and transactional costs, paid by the at-fault insurers through higher subrogated bills and higher management and litigation costs.

2. We provisionally found that insurers earned additional revenues when in the non-fault position, but incurred a larger increase in costs when they were at fault. We believed that these revenues and costs were passed through to policy premiums largely pro rata (see paragraph 28). However, as the additional costs were larger than the additional revenues, we found that the result was a net detriment to consumers.

3. Table 1 summarises our estimate of the detriment in the provisional findings, corrected for the treatment of VAT as in the Erratum.

TABLE 1 **Estimated detriment in provisional findings**

			£ million
	Insurers	*Brokers*	*Total*
Higher costs	224	-	224
Additional revenues	65	39	104
Net detriment			120

Source: Competition and Markets Authority (CMA).

4. Our general approach in the provisional findings was to assess effects on competition against a benchmark 'well-functioning market', ie a market which delivered consumers' legal entitlements in an efficient way.

5. This paper updates our estimates of the net consumer detriment. We have taken into account comments from parties and new evidence provided. We also estimate the detriment separately for different aspects of a claim (see paragraphs 122 to 129). We have also carried out sensitivity analyses to show how our main estimate of the net detriment is affected by different assumptions (see paragraphs 134 to 136 and Appendix G).

Summary of our approach and revised estimates

6. We estimated the net detriment as the difference between the higher costs incurred by at-fault insurers and the revenue obtained by non-fault insurers and brokers. This is the extent to which at-fault insurers pay more for replacement vehicles, repairs and write-offs than they would have paid if they managed the claims themselves (assuming non-fault claimants are provided with their legal entitlements, see paragraph 4). As a consequence, our estimated net detriment may include some costs which are unavoidably associated with the separation of cost liability and cost control, as well as potentially avoidable transactional and frictional costs. We take this point into account in our consideration of remedies.[1]

7. We computed the detriment separately for credit hires, credit repairs, credit write-offs, insurer-managed repairs and insurer-managed write-offs.

Assumptions

8. In order to estimate the net detriment, we had to make assumptions about the allocation of insurers' claim handling costs and about the pass-through of costs and revenue to premiums.

9. We obtained information from insurers on their incremental claim handling costs, according to whether they were driven by the provision of repairs/write-offs, the provision of replacement vehicles or by other factors. We allocated costs driven by other factors to repairs/write-offs. We did this because all claims involve a repair or write-off but not all claims necessarily involve the provision of a replacement vehicle.[2] This assumption affects our separate estimates of the net detriment (ie for credit hire, credit repair etc) but it does not affect our estimate of the total net detriment.

10. In relation to the pass-through of costs and revenue to premiums, we assumed that both the higher costs incurred by at-fault insurers, and the

[1] See provisional decision on remedies.
[2] See Appendix E, paragraph 6.

revenues earned by non-fault insurers and brokers, are fully passed through to policy premiums (see the provisional findings, Appendix 6.4).

Credit hire

11. To estimate the cost incurred by at-fault insurers because of the market features we have identified, we start from the average difference between credit hire and direct hire bills (paragraphs 113 to 117). In doing this:

    - we adjust the average direct hire bill to reflect the same distribution of vehicles and the same hire duration as under credit hire. We therefore do not take into account any differences between credit hire and direct hire in the quality of vehicle or the length of hire period.

    - we consider only the actual revenues received by credit hire companies (CHCs), not the billed amounts.[3]

    - we adjust the average credit hire bill to reflect the benefit at-fault insurers get from the longer delay in payments (see paragraphs 85 to 90).

    We obtain an average difference of £566 per hire claim. To this amount, we add the frictional and transactional costs incurred by a fault insurer when dealing with a CHC, which we estimate at £78 per claim. We then subtract the management cost that the insurer would have incurred if it had directly managed the provision of a replacement vehicle, which we estimate to be £27 per claim. The cost increase for a fault insurer is therefore £618. Multiplying this figure by the number of credit hire claims, we obtain an overall cost increase of £186 million.

12. Non-fault insurers and brokers receive revenue when referring a customer for credit hire in the form of referral fees, and additional services may be provided by CHCs to the insurers' customers, eg uninsured loss recovery (ULR) services (see paragraphs 65 to 71). We estimate these two components, taken together, to have an average value of £328 per claim, amounting to a total revenue to non-fault insurers and brokers of £99 million.

13. Using these figures, we estimate that the net detriment for credit hire arising from the features we identified in our provisional findings is about £87 million per year.

[3] Therefore the average credit hire revenue is computed including also those claims for which no revenue was obtained.

Credit repair and write-off

14. We estimate that the average difference between the cost to insurers of a directly managed repair and a credit repair, taking into account the benefit that at-fault insurers get from the delayed payment of credit repair bills, is about £290 per claim. We estimate this difference to be about £125 for CMC-managed write-offs per claim. To these figures we add the frictional and transactional costs incurred by an at-fault insurer in the case of a credit repair/write-off, estimated at £45 per claim, and subtract the management costs it would have incurred by directly managing the repair/write-off, which we estimate to be £111 per claim. Multiplying this figure by the number of credit repair/write off claims, we obtain an overall cost of £20 million per year.

15. When referring a customer for credit repair/write-off, non-fault insurers and brokers receive an average referral fee of £53. Their total yearly revenues from this amount to £6 million.

16. Using these figures, we estimate that the net detriment for credit repairs and write-offs arising from the features we identified in our provisional findings is about £15 million per year.[4]

Insurer-managed repair and write-off

17. Our starting point for the estimation of the higher costs incurred by at-fault insurers for insurer-managed repairs is the average difference between a subrogated repair bill and what insurers pay for a directly managed repair. We estimate this averages to £95 per claim across all insurers, although there are differences between insurers. We then add the estimated frictional and transactional costs of an at-fault insurer, subtract the estimated management costs the at-fault insurer saves by not managing the repair directly and multiply by the number of insurer-managed repairs, giving a total cost of £4 million per year.

18. Though there are differences between insurers, on average non-fault insurers achieve a mark-up of £95 when subrogating the cost of a repair (see paragraph 17). On the other hand, we estimate that they incur an average management cost of £113 per claim. As a result, across all non-fault insurers, receipts from at-fault insurers fall short of management costs by £17 per claim, which corresponds to a total of £5 million per year.

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[4] The net detriment for credit repair/write-off is not equal to the difference between the additional costs to at-fault insurers and the revenue to non-fault insurers and brokers due to rounding errors.

19. The net detriment for insurer-managed repairs arising from the features we identified in our provisional findings is the sum of the higher costs for at-fault insurers and the losses incurred by non-fault insurers, which, we therefore estimate to be about £9 million.

20. Our approach is the same for insurer-managed write-offs and this results in a net detriment of £2 million per year.

Sensitivity analysis

21. Given the uncertainties around the data, we have tested the impact of using data from alternative sources and of varying key assumptions (see paragraphs 134 to 136 and Appendix G). These suggest:

- an estimated net detriment of £70 million to £181 million for credit hire
- an estimate of £105 million to £217 million for the total net detriment

22. Our main estimates (£87 million for credit hire and £113 million for the total net detriment) are towards the lower end of these ranges.

Comments received from the parties

23. Comments from the parties can be divided into six broad categories:

- general criticism on our approach to estimation
- comments on the estimation of average credit hire rates
- other suggested adjustments to the estimation model
- remarks on the quality of data
- comments on offsetting benefits of the separation
- alternative estimates suggested by insurers (AXA, CISGIL)

General criticism on the approach to estimation

24. There have been four major points on our approach to the estimation of the detriment:

- Some parties commented that our benchmark was an idealised world of no frictional costs and it did not constitute the market outcome which would arise if the features leading to the AEC were not present (since in

that case fault insurers would have at best limited incentives to provide direct hire).

- Several parties told us that a large proportion of the frictional costs which arise in the interactions between insurers and CHCs was due to inefficiencies in the insurers' claim-processing procedures. The implication was that these costs should not be seen as arising from the separation.

- Two parties observed that our arguments on the pass-through of non-fault insurers' profits into premiums were based on an assumption for which we did not have empirical evidence.

- Accident Exchange commented that our estimation was based on a residual approach, ie the detriment was computed as the difference between estimated costs to at-fault insurers and estimated revenues to non-fault insurers and brokers. Accident Exchange said that, as both costs and revenues were uncertain, the difference between these figures was highly vulnerable to errors.

We consider these points in turn.

Benchmark

25. In Appendix A we consider in detail the issues raised in relation to the benchmark. In brief, the benchmark is just a tool for our analysis and is the situation without the features. Its purpose is to focus attention on the effects of the features. In reaching our conclusion on an AEC, we take these effects into consideration alongside other relevant factors or circumstances which are relevant to our assessment of the AEC. We then consider other relevant consumer benefits in our assessment of remedies. For instance, we recognise the point made in responses, that in the absence of separation (ie if at-fault insurers handled all claims from non-fault parties) insurers would have an incentive to under-provide on service as well as to control costs. However, it is not appropriate to take this into account in our assessment because the existence of a second potential problem (under-provision of service) does not preclude the existence of the problem we provisionally found (an inefficient supply chain involving excessive frictional and transactional costs). However, when we come to remedying the AEC, it is important to take into account all effects of our proposed remedies, including on the quality of service provided to consumers.

26. It is important also to understand the implications for our detriment calculation of non-fault claimants receiving their legal entitlements under our benchmark:

- First, it means that, in our main estimate of the detriment, we calculate the detriment on the basis of the current provision, including the class of vehicle and length of hire period currently provided under credit hire. In effect, we assume that claimants currently receiving a credit hire car get their legal entitlement regarding the class of vehicle and length of hire, and no more than that (though we relax this assumption in our sensitivity analysis).[5] We do not include in any of our calculations of the detriment any cost savings to insurers (and consequent benefits to consumers from lower premiums) from providing fewer replacement cars if there were no separation.

- Second, it means that we do not take into account, in our main estimate of the detriment, any quality differences between credit and direct hire associated with the class of vehicle and length of hire (though, again, this does not apply in some of our sensitivity analysis). We do not reflect in any of our calculations any benefits of separation to claimants who would otherwise not be provided with a replacement car, or would get only a courtesy car from a repairer.[6]

Those commenting on the implications of our benchmark for our detriment calculations tended to focus on the second set of implications, while ignoring the first set of implications.

Reasons for frictional costs

27. We noted that the relationship between fault insurers and CHCs generated friction and that this increased costs for both parties, and ultimately for final consumers. However, no party puts in place behaviours with the sole purpose of generating friction, and we believe that the main cause of friction is the nature of the interaction. In this context, even friction caused by the inefficiency of at-fault insurers when processing a claim must be considered in the estimation of the detriment from the separation, because such inefficiencies, and the implied friction, would not be present without the features of the market causing the AEC. Appendix B assesses the CHCs' comments on the sources of friction through an analysis of recovery rates. We acknowledge that certain costs may be an unavoidable consequence of separation, and therefore cannot be remedied without removing separation. This, and the

[5] See Appendix G, paragraphs 11–16.
[6] It would be illogical to include the benefits to claimants of getting a replacement car under separation when we do not take account of any costs saved from not providing these cars if there was no separation.

benefits to consumers arising from separation, are considered in our assessment of remedies.

Pass-through

28. In our provisional findings, we noted that, as a result of the features of the market causing the AEC, there were both higher costs to at-fault insurers and revenues obtained by non-fault insurers and brokers. We suggested that, since increases in non-fault insurers' revenues differed more between insurers than did cost increases to fault insurers,[7] it was plausible that the pass-through into premiums of revenues was less complete than the pass-through into premiums of the higher costs.[8]

29. We are aware that the evidence on the extent of pass-through is limited. The evidence we draw on is, first, the characteristics of the motor insurance market and, second, what insurers told us about how they treated the extra costs and revenue.

- The characteristics of the motor insurance market (ie strong rivalry, elastic supply, and highly inelastic market demand), support the idea that the pass-through ratio is close to 100%.[9]

- Responses to our information request by insurers suggested that pass-through may be more complete for the extra costs than for the revenues. While all insurers told us that the cost of a non-fault claim was reflected in their premium quotes, the evidence was somewhat less clear with respect to income on non-fault claims.[10]

30. Given the uncertainties involved in the precise determination of pass-through, we assume in our calculation of the detriment that both fault insurers' costs and non-fault insurers' revenues are fully passed through to premiums. In our sensitivity analysis, we calculate the impact on the detriment of a lower pass-through rate for non-fault insurers' revenues.[11]

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[7] The size of revenue increases depends on the ability of the single insurer to extract a rent from a non-fault position. The average size of the higher costs faced by a fault insurer depends on the average behaviour of its competitors.
[8] See provisional findings, Appendix 6.4.
[9] See provisional findings, paragraphs 6.42–6.65 and Appendix 6.4.
[10] As noted in provisional findings paragraph 6.58, five out of the ten leading insurers said that they treated referral fee and similar income as a negative expense; two said that they took it into account in determining target loss ratios or returns which would affect premiums over the longer term; and one said that such income was not factored into premiums (for the other two insurers, it was unclear how far such income affected premium).
[11] See paragraphs 134–136 below.

Residual approach

31. We recognise that there are uncertainties associated with the residual approach. To measure the likely magnitude of possible errors we have performed sensitivity checks, see paragraphs 134 to 136 below. Despite there being some uncertainties associated with our approach, we still consider that it is the best available and its use is warranted.

Comments on the estimation of average credit hire rates

32. There have been several comments on our approach to computing the average cost of direct hires.

- Several parties observed that the rates we used did not include the additional charges levied in the case of direct hires for services whose cost was, on the other hand, included in the credit hire rates.

- It was suggested that we did not adequately adjust for the differences in the quality of service between credit and direct hire. Adjusting for class of replacement vehicles, as we did in the provisional findings, was said not to be enough, as other dimensions of service quality should be similarly recognised, adjusting the rates accordingly.

- It was observed that the car classes used for direct hire were less granular than the GTA classes adopted by CHCs. It was suggested that the rates associated with those classes reflected the possibility for the direct hire provider to choose the cheapest model within the larger class. Those rates, therefore, should not be directly compared with the corresponding credit hire rates.

- Respondents also said that current direct hire rates were kept artificially low. Direct hire might not be profitable per se, being used to induce insurers to sign more profitable credit hire contracts with the same provider.

- In the Erratum, we included VAT for both credit and direct hires. Parties suggested that VAT should be excluded for both types of services.

33. These points are addressed in paragraphs 47 to 84.

Other suggested adjustments to the estimation model

34. Parties also suggested that the detriment calculation should be changed:

- to take into account the longer period insurers take to pay for credit hire than for direct hire
- to exclude from the detriment calculations claims against commercial insurers (given that our terms of reference were limited to PMI)
- to exclude from the calculation referral fees not paid to insurers or brokers (for example, referral fees paid to breakdown companies) because these would not be passed through into lower insurance premiums
- Accident Exchange told us that other CHCs may offer wider claims management services to insurers at no additional cost; and that the value of these services should therefore be deducted from the detriment

35. Addressing the first point requires a detailed analysis of the timing of payments for both credit and direct hire services (see paragraphs 85 to 90). The remaining points are briefly addressed below (see paragraphs 36 to 38).

36. In the case of claims against commercial insurance, the detriment from separation affects a commercial insurer and not a private one. However, the detriment is generated by the practices and conduct of the parties managing the non-fault claim, as we recognised in the provisional findings. Therefore, the detriment for these claims arises in the PMI market and must be included in our estimation. The Enterprise Act 2002 states that a detrimental effect on customers can occur in any market in the UK, whether or not it is the market to which the features relate.[12]

37. A similar point can be made with respect to the referral fees paid to dealers, recovery agents, etc. Although these referral fees are not passed to consumers through lower insurance premiums, there may nevertheless be pass-through to consumers in other markets. However, we believe the percentage of credit hire or repairs not referred by insurers or brokers is small.[13]

38. The last point was raised by Accident Exchange not in reference to its own business, but to the business of other operators. However, no other CHC mentioned this issue.

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[12] Section 134(1).
[13] In practice, we have only been able to include in our calculations claims managed by insurers or brokers and/or claims referred by insurers or brokers to CMC/CHCs.

Remarks on the quality of data

39. Some parties said that the data we used in our provisional findings was based on small samples or on information which was not up to date. In particular:

    - Direct hire rates were based on a small sample of insurers.
    - By using 2012 data, we did not take into account the improvements in the efficiency of the GTA and the increased use of bilaterals which had taken place since then.
    - Accident Exchange told us that its figures for credit hire revenues were based on provisional data for the year 2012, while more precise data was available.

40. Since our provisional findings, we have obtained more information on direct hire rates. In this working paper we use data from direct hire companies, covering all vehicles provided under direct hire to non-fault claimants, either captured third party or first party. We also collected direct hire rates from the ten largest insurers. Although we have not used them in our calculations, we have verified that our results would be very similar if we had.

41. We do not think that using data for 2013 would be practical because many of those claims are likely still to be open and CHCs' 2013 revenue is consequently subject to significant uncertainty. Another issue is that changes occurring during 2013 may have been influenced by our inquiry which started in September 2012. We have obtained updated 2012 data from Accident Exchange.

Comments on offsetting benefits of the separation

42. Other comments did not address our estimation model directly, but dealt with benefits from separation which, according to the parties, should be included in our overall assessment of the detriment. Among the points made were that:

    - The presence of CHCs caused liability to be resolved more often and more quickly.
    - Quality of services was lower when direct hire was provided under bilateral agreements between insurers for the provision of replacement vehicles than when CHCs provided the replacement vehicle.
    - Consumers obtained benefits from ULR services, which were offered by many CHCs to claimants free of charge, but were not offered in the case of direct hire.

- Kindertons pointed out that captured claimants were not protected to the same extent as the 'treating customers fairly' principle, as they technically were not regulated clients of the at-fault insurer.

- Quindell said that the provision of a replacement car increased the pressure the at-fault insurer could exert on captured claimants. For example, the at-fault insurer could threaten to withdraw the replacement car in the case of disagreement on total loss valuation.

43. We have compared actual outcomes against a benchmark where non-fault claimants receive their legal entitlements (see paragraphs 4 and 26). However, quality differences are still relevant to our net detriment calculation if they result from claimants receiving a higher quality of provision than their legal entitlement and if the claimants derive a benefit from that higher quality.[14] We have therefore considered these points further, as follows:

- In regard to the first two points in paragraph 42, we have collected and analysed data on the resolution of liability, and we have studied the impact of bilateral agreements on the quality of service. Our analysis and its results are presented in paragraphs 92 to 107.

- On the third point, we assess the benefits from ULR services in paragraphs 65 to 71.

- With regard to the fourth point from Kindertons, we acknowledge that certain regulatory provisions, which protect policyholders in their contractual relationship with their own insurer, do not apply to claims managed by at-fault insurers since there is generally no insurance contract between the at-fault insurer and the claimant. However, we note that if the at-fault insurer which manages the claim fails to put the claimant back into their pre-accident condition, it will remain liable for the damage suffered by the claimant as a result of the accident and of the provision of an inadequate service.

- Finally, the fifth point, which was made by Quindell, relates to under-provision and does not affect our calculation of the net detriment. As discussed above (see paragraph 25 and Appendix A discussing the benchmark), we agree that the at-fault insurer may have an incentive to

[14] On the other hand, quality differences are not relevant to our calculation of the net detriment if they result from claimants with direct hire getting less than their legal entitlement since our calculation assumes claimants receive their legal entitlement.

underprovide in the absence of separation and that this is an issue to be taken into account in considering the proportionality of remedies.

Alternative estimates

44. In its response to the provisional findings, CISGIL suggested a different estimate of the detriment. According to CISGIL, the detriment from credit hire and credit repair is approximately £22 per policy, about four times our estimate. We noted that this estimate does not take into account the offsetting effect of referral fees and other revenue streams for non-fault insurers under the separation. It is also unclear whether the management costs incurred by an at-fault insurer in capturing a claim are included.

45. A similar estimate of the detriment arising from separation was provided by AXA, according to which the net detriment is £[✂] per policy. However, we identified several issues with this estimate:

- First, the mark-up on insurer-managed repairs (£[✂] per policy) was added to the net detriment, while, in the absence of additional frictional costs, we believe this constitutes a transfer between insurers and should be ignored.

- Second, [✂]. We calculated that if we applied the frequency implied by our estimated number of credit hires (1.2%) to both referrals and bills received, the detriment estimate from AXA's model is reduced to £[✂] per policy.

- Finally, the cost of direct hire in AXA's calculation is based on the assumption that only a 'category A' courtesy car is provided. Our calculation, in contrast, assumes the provision of a replacement vehicle in line with legal entitlement. On the other hand, AXA assumes that this courtesy car would be provided to a number of claimants much higher than the number of those currently receiving a credit hire replacement vehicle.

46. Overall, we believe that the two alternative estimates suggested by CISGIL and AXA are significantly overstated.

Quality differences between direct and credit hire and the cost of additional services

47. In this section we analyse the implication for the detriment estimation of three issues related to the level of service offered under credit and direct hires:

- Replacement vehicles are generally categorised in different ways under credit and direct hire arrangements.

- Some parties said that delivery and collection services were not consistently provided under direct hire.

- Direct hire rates do not include the cost of additional services which we included in the calculation of credit hire rates.

Different categorisations and 'bracketed rates'

48. We noted that Enterprise, the largest direct hire provider, does not categorise cars according to the classes used for credit hire under the GTA. Enterprise uses its standard car hire classes, some of them corresponding to more than one GTA class, and applies a single direct hire rate for all the models in the same class. Some other direct hire providers use the more granular GTA classification but, as Enterprise accounts for a large share of the direct hire market, the impact of its practice must be considered when comparing credit hire and direct hire services.

49. When we want to estimate the cost difference between credit and direct hire, the different categorisations give rise to two issues:

    - A business model based on a smaller number of classes may be more efficient, even in the absence of systematic differences in the quality of service. The larger flexibility allowed by a less granular classification is likely to reduce costs for direct hire since it is easier and less costly to quickly source a car within a larger group than to do so under a more constrained model.

    - The quality of service provided under credit and direct hire may not be the same if credit hire claimants get a more directly comparable vehicle to their own than do direct hire claimants.

50. On the first issue, any such cost savings will be reflected in our net detriment estimates as they are based on the difference between the cost of credit hire and that of direct hire.

51. On the second issue, the most direct way to evaluate the presence of quality differences would be to compare the distributions of replacement vehicles among the GTA classes for credit and direct hire. Unfortunately, we could not get the numbers of cars provided under direct hire according to the GTA classification. Therefore we have estimated the maximum size of the problem, assuming that Enterprise always provides the cheapest car within each of its classes. Looking at the cars provided under credit hire in 2012, we computed the total fraction of hire days for GTA classes which do not correspond to the cheapest models within one of Enterprise's classes. We have found that a

quality difference may potentially arise in at most 20% of cases. The potential mismatches between GTA classes and direct hire vehicles are mostly concentrated in the ‘premium’ and ‘sport’ segments.

52. The issue for us is that, under the more granular GTA classification, some claimants may benefit from a higher quality replacement car. However, quantifying such benefit is not easy. We found that the GTA and Enterprise classes match quite closely on size of vehicles, power and the number of doors. What may not always be matched precisely is the ‘prestige’ of a car. Although this may be an important characteristic for some claimants, its relevance appears to be lower than other features and there is room for doubt about how important more precise matching is for the relatively short period of a typical replacement car hire.

53. Our consumer survey suggests that the benefit for claimants from a having a replacement car which is better than their own car is likely to be small. We found that the fraction of non-fault claimants who thought their replacement vehicle fell short of their needs was 19% for captured claims, compared with 13% for claims managed by a non-fault insurer or a claims management company (CMC) (which were likely to involve credit hire), with the differences being due to replacement cars falling ‘slightly’ short of needs more often for captured claimants, rather than to them falling ‘well’ short of needs.[15] However, the higher proportion for captured claimants may be for other reasons, not just because the GTA classification is more granular than the Enterprise classification (eg it could be because captured claimants received a lower class of car even under the Enterprise classification, or because of other aspects of service).

54. In summary, our estimates of the extra cost of credit hire over direct hire are based on the standard car hire classes used by Enterprise for direct hire, which are broader than the GTA classes used for credit hire. The difference in classification mainly affects the ‘premium’ and ‘sport’ segments. While the more granular GTA classification is likely to benefit some claimants needing replacement cars in these segments, evidence from our survey suggests that the impact of quality differences is small (affecting no more than 6% of non-fault claimants).

[15] More respondents whose claims were managed by at-fault insurers considered that the replacement car fell slightly short of their needs. The proportion considering the car fell well short of their needs was similar (see provisional findings, Table 6.1).

Delivery and collection

55. Some parties told us, with specific reference to Enterprise, that delivery and collection services were not usually provided under direct hire. Since such services are always provided by CHCs, their cost should be deducted from the detriment.

56. However, Enterprise told us that it always offered delivery and collection to non-fault direct hire customers. Enterprise said that many of its customers chose to pick up the replacement vehicle at the site of the rental company instead of having it delivered to their own premises because they could obtain the car more quickly. [✂]

57. We noted that there would still be an issue if the time Enterprise needed to arrange a delivery were much longer than for other CHCs. If so, although the service is available in theory, it would not be offered in practice. However, this does not seem to be the case. Other CHCs told us that they need between 2 and 4 hours to arrange a delivery. Therefore it appears to us that, with respect to delivery and collection, credit and direct hire provide a very similar level of service.

Additional charges

58. The direct hire rates we used in our provisional findings did not include some charges for additional services or special types of vehicles, while these services are offered to credit hire customers and the charges were included in the credit hire rates we used. Since in this paper we now derive the direct hire rates from the main providers' total revenues, adjusting for these additional charges is no longer necessary.[16] However, it is still interesting to see what these charges are and what impact they have on hire rates.

59. Kindertons told us that the most common charges are due to additional premiums for young or high-risk drivers, automatic cars, and estate cars. There are also charges for tow bars, baby seats, roof racks, etc, but such services are provided in few cases. Table 2 shows a list of the main charges and the proportion of credit hire claims handled by Kindertons to which they apply.

[16] We note that there could still be an effect on the comparison of credit and direct hire rates if the frequency with which additional charges were applied differed between credit and direct hire customers.

TABLE 2 **Frequency of major extras in credit hire (Kindertons, 2012)**

Extra	*Percentage of claims*
Young/high risk driver	[✂]
Automatic	[✂]
Estate	[✂]
Tow bar	[✂]
Child seat	[✂]
Roof rack	[✂]

Source: Kindertons.

60. There are several other services which are also sometimes charged to insurers under direct hire. These include additional driver, after-hours collection, one-way rental, delivery at airports, etc. However, each of these services is provided in a very limited number of cases. Therefore we have focused our analysis on the six extras listed by Kindertons (see Table 2). Table 3 shows the amounts charged for each of these services to the ten insurers in our sample.

TABLE 3 **Daily charges for major extra services under direct hire (VAT included)**

£

	Admiral	*Ageas*	*Aviva*	*AXA**	*CISGIL*	*DLG*	*esure*	*LV*	*RSA*	*Zurich*
Young/high -risk driver		[✂]	[✂]		[✂]	[✂]	†			[✂]
Automatic	[✂]	[✂]			[✂]	[✂]	[✂]†	[✂]†	[✂]	[✂]
Estate	[✂]	[✂]			[✂]	[✂]	[✂]†	[✂]	[✂]	
Tow bar or roof rack					[✂]			[✂]†		
Child seat					[✂]					

Source: Insurers.

Notes:
*[✂]
†[✂]

61. From this (incomplete) information, we estimate an approximate average daily charge of £8 for young/high-risk drivers, and of £6 for each of the other services. Using the frequencies provided by Kindertons, we can then compute the average increase of daily rates due to these extras, as shown in Table 4.

TABLE 4 **Average increase in daily direct hire rates due to extra charges**

	Frequency in credit hire according to Kindertons (2012) *%*	*Average cost per day under direct hire* *£*	*Average increase of daily rates due to additional services* *£*
Young/high-risk driver	[✂]	8.00	[✂]
Automatic	[✂]	6.00	[✂]
Estate	[✂]	6.00	[✂]
Tow bar	[✂]	6.00	[✂]
Child seat	[✂]	6.00	[✂]
Roof rack	[✂]	6.00	[✂]
Total average charge			**2.59**

Source: CMA.

62. Table 4 suggests that the approximate average effect of additional charges is to increase direct hire rates by £2.60 per day.

63. Finally, we note that collision damage waiver (CDW) is an additional protection which is offered to both credit hire and direct hire customers under similar terms. Usually, it is the customer who pays for CDW, even under credit hire,[17] though there are two notable exceptions:

- Accident Exchange offers CDW to all its credit hire customers free of charge.
- CDW is included in the basic rates Enterprise has agreed with some insurers.

64. With respect to the estimation of the detriment, it appears to us that these two effects tend to offset each other. Any remaining difference is then likely to be small and of uncertain direction.

Uninsured loss recovery

65. Some CHCs offer ULR services free of charge to their customers.[18] The losses which CHCs help non-fault claimants to recover include their excess (which is sometimes deducted from repair, or recovery and storage, costs that non-fault insurers subrogate to the at-fault insurer), damage to property, loss of earnings, travel expenses, etc. Under the GTA, the cost of this service cannot be recovered from the at-fault insurer.

66. Some CHCs told us that claimants obtained benefits from ULR services which they would not obtain in the absence of separation, and which we had not included in our detriment calculations.

67. The effects of the provision of ULR services by CHCs depend on whether the client has purchased motor legal expenses insurance (MLEI), which assists policyholders with pursuing their legal rights to recover uninsured losses:

- If the client has purchased MLEI, the provision of ULR services by CHCs results in a benefit to the MLEI insurer which otherwise would have to provide ULR services to the claimant. Given competition between CHCs to obtain referrals from non-fault insurers, this would most likely be reflected

[17] CDW cannot be recovered from the fault insurer under the GTA. Outside of the GTA, CDW is sometimes charged to the fault insurer.
[18] See provisional findings, paragraph 6.36.

in CHCs paying a lower referral fee than they would pay if they did not provide ULR services.[19]

- If the client does not have MLEI, the client receives a benefit which is either the value of the uninsured loss (if the client would not try to recover the loss in the absence of CHC intervention) or the opportunity cost of the time spent recovering the loss from the at-fault insurer (if the client would try to recover the loss in the absence of CHC intervention).[20]

68. In the first case (benefit to the MLEI provider), the quantum of the benefit would be the average cost to CHCs of providing the ULR service to each client times the number of CHC clients who both receive ULR services and have MLEI. This would also be the impact on our detriment calculation.[21]

69. In the second case (benefit to the client), the benefit depends on whether the client would try to recover the loss from the at-fault insurer. If so, the client receives a benefit equal to the opportunity cost of recovering the loss from the at-fault insurer. If not, the client receives a benefit equal to the value of the loss, but in this case there is an offsetting loss to the at-fault insurer which may be passed through to consumers in the form of higher PMI premiums. Hence, assuming full pass-through of higher costs, there would be no impact on our net detriment calculation. The quantum of the impact on our detriment would be the average opportunity cost of attempting to recover the loss times the number of CHC clients who both receive ULR services and would attempt to recover the loss themselves in the absence of receiving ULR services from the CHC.

70. The information available to us (see Appendix C) suggests that ULR services are provided to no more than 12,000 claimants in a year, while CHCs' estimates of the cost of providing the service varied between an unspecified 'small value' and £45 per claim. We do not have information on the opportunity cost to claimants without MLEI of claiming uninsured losses themselves, but it seems to us the average opportunity cost is unlikely to exceed £45 per ULR claim.[22] On this basis, the impact of CHCs' ULR recovery is to

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[19] If the MLEI provider is different to the non-fault insurer receiving the referral fee from the CHC, the MLEI provider would also pay a bigger fee to the non-fault insurer which would offset the lower referral fee received by the non-fault insurer from the CHC.
[20] Both benefits would be relevant if the client tried and failed to recover the uninsured loss from the at-fault insurer.
[21] The provision of ULR by CHCs results in referral fees being understated compared with what they would be if referral fees and ULR services were charged separately. The understatement of referral fees leads to the net detriment being overstated; hence the required adjustment to remove the overstatement of the net detriment is equal to the understatement of referral fees.
[22] We took into account that the opportunity cost involved would essentially be that of contacting the at-fault insurer and requesting return of the excess. Those most daunted by this, and hence likely to have the highest

reduce our calculation of the net detriment by no more than £1.60 per credit hire claim, or £0.5 million in total.

71. Our revised estimates of net detriment take into account CHCs' provision of ULR services by reducing the net cost of credit hire by £1.60 per claim.[23]

72. We noted that the most important ULR service provided by CHCs tended to be helping clients recover their excess. We noted too that the need for this service often arose because some non-fault insurers were failing to provide customers with their entitlements under tort law, for example by deducting the excess when subrogating repair bills to the at-fault insurer.[24] We found it difficult to understand why insurers adopted this practice which appeared to disadvantage their own customers.

Profitability of direct hire services

73. CHCs said that direct hire rates were kept artificially low, with companies using these contracts to make a non-fault credit hire referral relationship more attractive to insurers. According to this view, direct hire is an ancillary service to credit hire. However, most insurers disagreed.

74. We focused on Enterprise, which currently has a large share of direct hire. We noted that Enterprise faces competition from other large car hire companies (eg Avis, Hertz and Europcar) and that, despite its large share of direct hire, insurers did not consider there was a lack of competition in direct hire.[25]

75. It was unclear to us why Enterprise, which has a large share of direct hire and a smaller share of credit hire, should wish to price direct hire low and credit hire high. Enterprise's incentive would rather seem to be to keep its credit hire rates low in order to build its share in credit hire. However, we considered the available evidence on Enterprise's pricing.

76. Enterprise told us that it did not cross-subsidise between credit and direct hire. It said that it offered the same direct hire rates irrespective of whether an insurer tendered for direct hire only or jointly for direct and credit hire. [✂], as shown in Table 5.

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opportunity cost, would be those for whom MLEI was most attractive. In this context, we considered it relevant that take-up of MLEI was high (Table 8.2 in the provisional findings shows 76% in 2012).

[23] Since coverage of MLEI is high (see previous footnote) we do this by increasing the referral fee.

[24] See provisional findings, paragraph 6.34.

[25] Three insurers referred to the fact that there were only four large car hire companies. None suggested that Enterprise's large share of direct hire itself limited competition.

TABLE 5 **Enterprise's data on the profitability of its hire services**

£

	Third party direct hire	*Credit hire*
Average daily rate	[✂]	[✂]
Non-essential functions, referral fees and uncollectable debts	[✂]	[✂]
Net daily rate	[✂]	[✂]

Source: Enterprise.

77. We also note that there is at least one provider of direct hire, Europcar, which does not offer credit hire services. We found that [✂].

78. Overall, we found no evidence that Enterprise was pricing direct hire low in order to increase its credit hire prices.

79. We also considered whether Enterprise could be pricing direct hire below cost in order to gain a monopoly position in direct hire. However, this seemed to us implausible since there seemed to us few obstacles to other large hire companies competing for this business. While Enterprise might temporarily obtain a large share of direct hire by pricing below cost, if it subsequently tried to increase its prices, its competitors would be able to increase their share of direct hire.

80. Considering all the evidence, we see no reason to believe that current direct hire prices are unsustainably low.

VAT on hire services

81. The average difference between credit hire and direct hire bills estimated in our provisional findings was affected by an error in the treatment of VAT. The estimated credit hire rates included VAT, while direct hire rates did not. We have already published revised figures, including VAT for both credit and direct hires.[26]

82. Some CHCs told us that the correct approach would be to exclude VAT from all hire rates. The difference so computed would be significantly smaller than the one we have determined. However, we believe that VAT should be included since motor insurance is VAT-exempt, and insurers consequently cannot reclaim from HMRC the VAT paid on hire services.

83. Insurers pay the full VAT on hires unless the claimants are VAT registered. In this case, however, credit and direct hires may be treated differently. For

[26] See Erratum (17 February 2014).

credit hire, if the claimant is VAT registered, CHCs do not invoice the full VAT to the at-fault insurer. Rather, the VAT is paid by the claimant who then can reclaim it, at 100% for vehicles that are solely for business use and at 50% for a standard company car. Some insurers pay the percentage of the VAT cost which the customer is unable to deduct. The same can in principle happen under direct hire. However, it appears that at least some insurers pay VAT for direct hires even if the claimant is VAT registered. For example, [✂].

84. It appears to us that the proportion of PMI replacement vehicle cases in which VAT is not paid by the insurer is small. Zurich estimated that this happened in [✂] of hires. Therefore it seems that, in the estimation of the detriment, it is correct for us to consider payments for replacement vehicles inclusive of VAT.[27]

Benefits to insurers from the delayed payment of credit hire and repair services

85. Payments for direct hires are quicker than those for credit hires, as shown in Table 6. The longer payment period for credit hire than direct hire results in additional costs for CHCs (because they have to finance the additional debt) and a benefit to at-fault insurers (because they have an additional source of funds and hence require less debt than would otherwise be the case). The benefit to at-fault insurers of lower debt offsets to some extent the higher price of credit hire. The comparison between the average bills for credit and direct hires therefore should be corrected for the benefit to at-fault insurers from the difference in the timing of payments.

[27] Allowing for VAT to be deducted from credit hire bills in up to 5% of cases would reduce the net estimated detriment for credit hire by less than £3.3 million (see Appendix G, paragraph 9).

TABLE 6 **Timing of payments for credit hire and direct hire services in 2012**

Number of days between invoicing the bill and receiving the payment	*Percentages of payments for credit hires in 2012 %*	*Percentages of payments for direct hires in 2012 %*
0–30	38.90	98.14
31–60	17.73	0.18
61–90	8.59	0.66
91–120	5.11	
121–150	3.10	1.03
151–180	2.33	
181+	14.71	
Outstanding debt at March 2014	9.52	0

Source: CHCs and insurers.

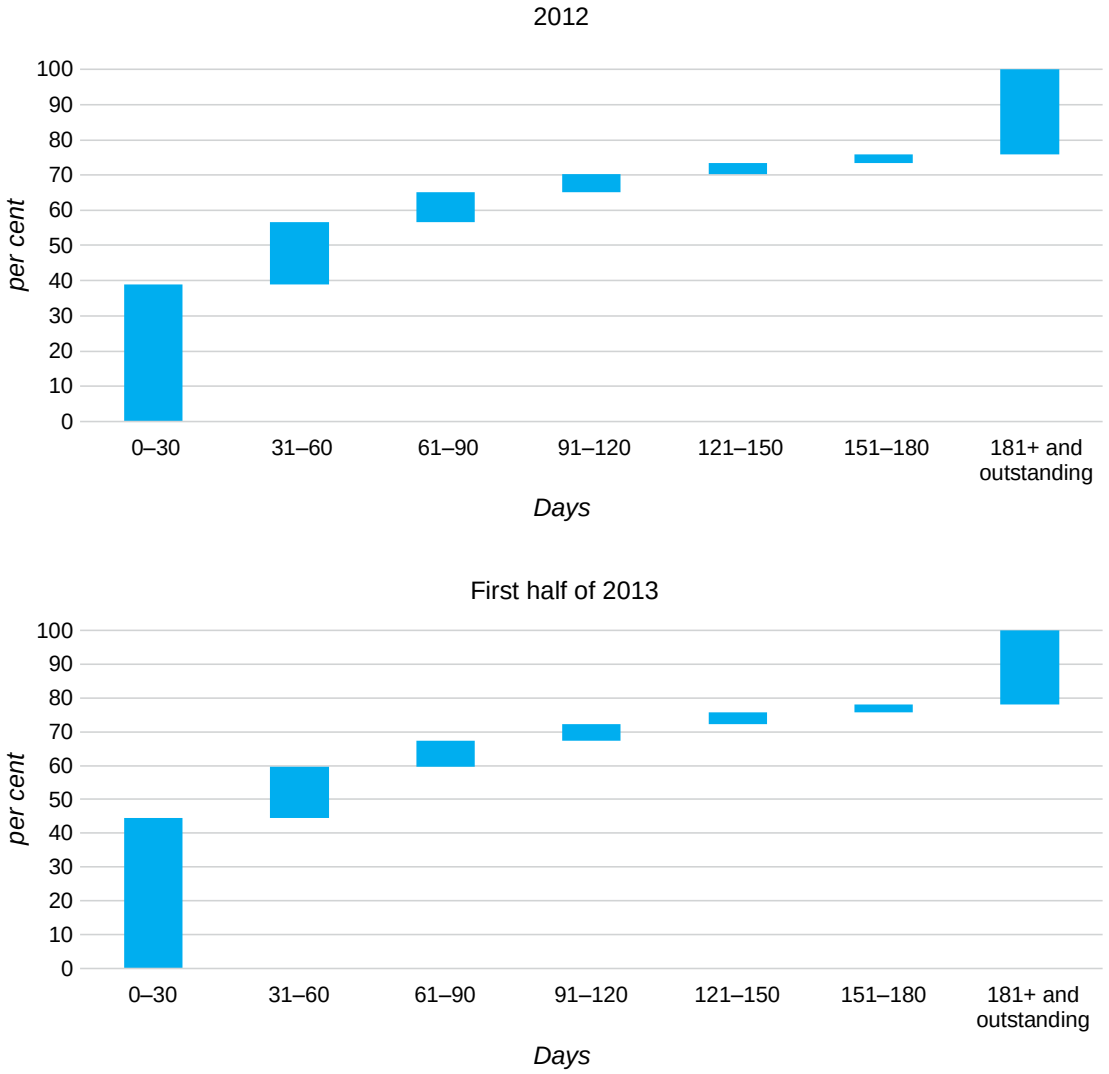
Notes:
1. We have assumed a recovery rate on outstanding debt equal to that of bills recovered in more than 180 days (this is probably an overestimate). The percentages in the table are with respect to total payments received, including expected payments for outstanding debts.
2. The data provided by two CHCs include revenues from credit repair. The weight assigned to these CHCs is therefore too high. The effect is a slight increase in the average delay.

86. Table 6 divides the payments for credit and direct hire services according to when the providers receive them. Almost all direct hire bills are paid within 30 days; the average delay is approximately 13 days. On the other hand, in 2012 less than 40% of revenues from credit hires were received by CHCs within 30 days of issuing the invoice. A substantial debt from 2012 claims was still outstanding in March 2014.

87. Figure 1 below suggests that the percentage of payments received within 30 days increased in the first six months of 2013. This may have reflected an increase in the efficiency of GTA arrangements, or the introduction of new bilateral agreements between CHCs and insurers.

FIGURE 1

Timing of payments for credit hire services



Source: CMA.

88. In order to compare the timing of payments between credit hire and direct hire, we also take into account the difference in the average number of days between the end of a hire and the issue of an invoice. This takes an average of 7 days for direct hire and 11 days for credit hire.

89. Therefore, the average total delay for direct hire is around 20 days (7 days between the end of the hire and the invoicing of the bill, plus 13 days for the payment). Not all CHCs could provide detailed information about the day in which payments were received. We have computed the average day within each of the categories in Table 2 above using daily data from one CHC. We found that, for most categories, we could take the midpoint, though the average within the 0–30 category was higher (18 days for the CHC we have considered). We have taken 20 days as a reasonable average. The average for the 180+ category is around 330 days for the CHC in examination. For the

outstanding debt, we have assumed a recovery rate of 85% and an average delay of 900 days.

90. The delay in payments associated with credit hire reduces insurers' debt. Table 7 summarises our calculations on the benefit of delayed payments, assuming an approximate cost of debt of 5%.[28] It shows that the benefit is approximately equivalent to a 2.2% discount on the overall payments. In our calculation of the detriment we have therefore discounted the average credit hire rate by 2.2%.

TABLE 7 **Benefit from delays in the payment of credit hire services**

Number of days between invoicing the bill and receiving the payment	*Fraction of credit hire payments (%)*	*Average delay between invoicing the bill and receiving the payment (days)*	*Average difference between total delays for credit and direct hire (days)*	*Benefit from delay (as a percentage of overall payments) (%)*
0–30	38.90	20	11	0.06
31–60	17.73	45	36	0.09
61–90	8.59	75	66	0.08
91–120	5.11	105	96	0.07
121–150	3.10	135	126	0.05
151–180	2.33	165	156	0.05
181+	14.71	330	321	0.65
Outstanding	9.52	900	891	1.16
				2.20

Source: CMA.

91. We have not collected data on the timing of payments for credit repair. However, the factors which cause delay in relation to credit hire apply also to credit repair. Therefore, we have applied the same discount of 2.2% to the average credit repair bill of £1,576.[29]

The impact of CHCs on the resolution of liability

92. Some CHCs told us that the presence of credit hire caused liability to be resolved more often and more quickly. Their point was that a prompt and accurate assessment of liability was essential in reducing the risks of non-recovery of the costs incurred in the provision of replacement vehicles. Insurers disagreed, arguing that the assessment of liability depended on the nature of the accident and not on the presence of CHCs.

93. Testing these two contrasting views is not straightforward. Most insurers do not record the time needed for the resolution of liability; and CHCs only hold data for the claims in which they were involved. Moreover, it would not be informative to compare the claims in which CHCs provided a replacement vehicle with those in which they were not involved. Since CHCs have to

[28] This is the approximate average suggested by analysis of insurers' reports and accounts.
[29] See provisional findings, Appendix 6.2, Table 2.

minimise the risk of non-recovery, they tend to accept relatively more clear-cut cases, in which the determination of liability is less problematic. Therefore, we would expect the cases where a CHC is involved to show a lower proportion of split liability settlements and a quicker resolution of liability. The difference in such cases, though, cannot be attributed to the presence of the CHC.

94. More interesting results can be obtained when comparing claims in which CHCs may decide to intervene with those for which this possibility is absent. The latter is the case when the insurers involved in a claim have signed a bilateral agreement for the provision of replacement vehicles. In this case, the non-fault insurer does not refer the claimant to a CHC, but directly provides the vehicle through direct hire. By comparing claims in which bilaterals are applicable with those in which they do not apply, we sought to observe the differences in the frequency and timing of the resolution of liability due to the presence of the CHC.

95. We asked each of the ten insurers in our sample to provide information on all its claims with more than one vehicle involved, divided into three categories:

(a) claims in which all vehicles were insured by it;

(b) claims involving another insurer, but not where it had a bilateral agreement with the other insurer; and

(c) claims involving one of the insurers with which it had a bilateral agreement for the provision of replacement vehicles to non-fault claimants.

96. Insurers were asked their total number of claims for each category and their corresponding number of claims which resulted in split liability. The comparison between categories (b) and (c) would show the impact of the presence of CHCs on the frequency of resolution of liability.

97. The figures for the [✂] insurers in our sample which have bilateral agreements are shown in Table 8. The percentage of cases with split liability is similar under categories (b) and (c) and even slightly lower in the case of bilateral agreements. In other words, the presence of CHCs does not seem to have any impact on the frequency of resolution of liability.

TABLE 8 **Percentage of split liability in the 'same insurer, 'no bilateral' and 'bilateral' scenarios**

			%
	Same insurer	*No bilateral*	*Bilateral*
[✂]	[✂]	[✂]	[✂]
Weighted average	13.76	15.66	13.63

Source: Insurers.

Note: Aviva's data is relative to liability assessment at FNOL.

98. With regards to the speed of resolution of liability, only one insurer ([✂]) was able to provide data on the timing of liability determination. [✂]'s average length of liability determination was lower under bilateral agreements. While this observation needs to be treated with caution, we have seen no evidence to suggest that a higher speed of liability resolution is currently associated with separation.

The impact of bilateral agreements on the quality of service

99. A related point raised by CHCs was that bilateral agreements between insurers for the provision of replacement vehicles were used as a mechanism to reduce the level of service below that to which non-fault claimants were legally entitled.

100. We identified three different ways in which the quality of service could be reduced:

(a) settling a larger fraction of claims with split liability;

(b) providing replacement vehicles to a smaller proportion of non-fault claimants; and

(c) providing replacement vehicles of a lower category or with an inferior service.

101. We reviewed the bilateral agreements which exist between some insurers in relation to the provision of replacement vehicles to non-fault claimants. The main purpose of these bilateral agreements is to set up rules for the subrogation of costs. No agreement requires the adoption of practices with the aim of denying non-fault claimants the services to which they are entitled. However, it is still possible that insurers' replacement vehicle provision is worse when there is a bilateral agreement. Therefore, in order to test the above hypotheses, we compared claims falling under bilateral agreements with those which did not.

102. We have already seen that the frequency of resolution of liability is not much different in the two cases. In fact, split liability cases are slightly more common

when bilateral agreements do not apply. A similar comparison is also relevant to point (b). Table 9 shows the proportion of non-fault claimants receiving a replacement vehicle (excluding courtesy cars) in the three categories of claims described above: ‘same insurer’, ‘no bilateral’, and ‘bilateral’.

TABLE 9 **Provision of replacement vehicles in the ‘same insurer, ‘no bilateral’ and ‘bilateral’ scenarios**

			%
	Same insurer	*No bilateral*	*Bilateral*
[✂]	[✂]	[✂]	[✂]
Weighted average	51.85	49.65	55.04

Source: Insurers.

*[✂]
†[✂]

103. The evidence on this aspect is difficult to interpret. It appears that for some insurers ([✂]) the proportion of non-fault claimants provided with a replacement vehicle is significantly lower under bilateral agreements than for other claims. Other insurers, however, show different patterns, with a small difference for [✂], and a higher provision rate under bilaterals for [✂].

104. With regard to point (c) in paragraph 100, it appears to us that, individually, insurers do not have an incentive to under-provide in the service they give their non-fault claimants. In arranging a replacement vehicle, they are providing a service to their own customer, while subrogating the cost to the fault insurer. On the other hand, if both parties to a bilateral agree to reduce provision, they can both gain through lower costs.[30]

105. [✂] told us that its higher provision of replacement cars under its bilateral agreements was driven by the following factors: [✂].

106. Overall, much of the evidence is unclear regarding the provision of replacement vehicles under bilaterals compared with when no bilateral agreement is in place.

107. We do not have evidence that the vehicles provided under bilaterals are of a lower category than that to which non-fault claimants are legally entitled, nor that the service they receive is generally worse than their entitlement.

[30] Such implicit agreements may be easier to negotiate between insurers of similar size, which can get similar cost benefits from the other insurer’s under-provision. On the other hand, a large insurer might be more reluctant to agree on these terms with a much smaller competitor, as the smaller insurer has more to gain from the agreement.

Summary of the adjustments to the detriment estimation

108. Following our analysis in response to the parties' comments, we have made the following changes to our estimation model:

   (a) Direct hire rates are now based on the total revenues of four large providers ([✂]). They include extras for additional services and cover a large proportion of the insurance market.

   (b) The cost of ULR services is added to the revenues obtained by non-fault insurers and brokers, increasing the average referral fees for credit hires.

   (c) Credit hire rates and credit repair bills are discounted by 2.2% to compensate for the difference in the timeliness of payments between credit and direct hires.

109. In addition, we use new estimates of fault insurers' costs to separately compute the detriment from credit hires, credit repairs and write-offs, and insurer-managed repairs and write-offs. Details on these estimates are provided in Appendix E.

110. As discussed in our provisional findings, our survey results suggest that separation is associated with a small proportion of consumers receiving a higher quality of replacement vehicle. Our calculations control for the most obvious sources of quality difference (see paragraph 26), though there are some aspects for which we have not been able to control (see paragraph 52). In any event, the quality difference appears to be small relative to the net detriment associated with replacement vehicles.[31]

111. We included in our calculations all the hire claims managed by our sample of CHCs in 2012 but only the actual or expected revenue associated with those claims. Thus our figures allow for the fact that CHCs recover only a proportion of the amount billed as they settle some claims for less than the amount billed, for example when they accept that their customer was partially or fully liable. Therefore the risks to CHCs of providing replacement vehicles when liability is unclear are reflected in our figures as the average revenue per credit hire is lower than the billed revenue per hire.

Updated estimate of the detriment

112. This section presents the results of our revised detriment estimation. We first present the new estimate for the average difference between credit hire and

[31] See paragraph 53.

direct hire bills. We then summarise our estimates of insurers' management and frictional costs. Finally, we provide estimates of the detriment from credit hires, credit repairs, credit write-offs, insurer-managed hires and insurer-managed write-offs. A more detailed analysis is presented in Appendix E.

Difference between credit hire and direct hire bills

113. We used the revenues earned by direct car hire providers ([✂]) to estimate direct hire rates. In order to compare rates, we aggregated the data into the standard car hire classes used by Enterprise (see paragraphs 48 to 54). We excluded the most prestigious vehicles (GTA classes F9, P11, P12, P13, SP11, SP12, and SP13) because several insurers have specially contracted or on-demand rates. For the purpose of the calculation, we assumed that there is no difference between credit and direct hire rates for these classes of vehicles.

114. Table 10 shows the average credit hire rates for a sample of seven large CHCs and the average direct hire rates for our sample of providers. As in our provisional findings, the rates are obtained by dividing the providers' total revenues by the number of hire days. To compute overall averages, the classes of vehicles are weighted according to the respective numbers of credit hire days in 2012, so that the distribution of vehicles provided under credit hire is also used to compute the average direct hire rate. With this adjustment, credit hire rates are 2.1 times higher than direct hire rates.

TABLE 10 **Comparison of credit hire and direct hire daily rates**

Vehicle class	*GTA class*	*Credit hire average £*	*Direct hire average £*	*Credit hire to direct hire ratio*	*Weights (number of credit hire days) %*
A	S1	39.87	[✂]	[✂]	4.83
B	S2	42.90	[✂]	[✂]	17.77
C	S3	46.45	[✂]	[✂]	14.23
D	S4	47.95	[✂]	[✂]	13.88
E	S5, P1, SP1	59.90	[✂]	[✂]	9.85
F	S6, S7, P2, SP2	63.82	[✂]	[✂]	13.57
MMPV	M, M1, M2	65.70	[✂]	[✂]	7.28
MPV	M3-M6	89.05	[✂]	[✂]	1.47
SPREM	P3-P5, SP3-SP6	130.86	[✂]	[✂]	9.37
MPREM	P6, P7, SP7, SP8	204.88	[✂]	[✂]	1.96
EPREM	P8-P10, SP9, SP10	274.02	[✂]	[✂]	0.66
S4X4	F1, F2	107.78	[✂]	[✂]	2.38
L4X4	F3-F5	154.83	[✂]	[✂]	2.00
E4X4	F6-F8	229.19	[✂]	[✂]	0.61
F9, P11-P13, SP11-SP13		492.97	*492.97*		0.15
Weighted average		69.37	33.09	**x2.10**	

Source: CHCs and direct hire companies.

115. We compensated for the difference in the timing of payments between credit hire and direct hire bills by decreasing credit hire rates by 2.2% (see

paragraph 90). With this adjustment, credit hire rates are 2.05 times higher than direct hire rates.

116. We noted that hire periods are on average shorter under direct hire than credit hire. Since the daily cost of hire tends to be lower the longer is the hire period, applying current direct hire rates to the number of credit hire days may slightly overestimate the cost of direct hire. In other words, if the average length of direct hires was the same as for credit hire, direct hire rates would be lower than those used in our calculation. However, we have not been able to adjust for this.

117. Dividing the total revenues for the CHCs in our sample by the total number of credit hire claims managed by them, we estimated the average credit hire revenue to be approximately £1,105. Since credit hire rates are about 2.05 times higher than direct hire rates, we estimated that under direct hire the same services could be provided for about £539. The average cost difference is approximately £566 per claim.

118. We compared our estimate of credit hire and direct hire bills with that provided by a CHC (Helphire), see Appendix D. The CHC's figures showed [✂].

Estimates of insurers' costs

119. We estimated the costs incurred by insurers in managing hires and repairs/ write-offs and in dealing with the third party insurer and/or CMC/CHC, and with their own customers. Table 11 show the estimates relevant for our calculation of the detriment (see Appendix E for further details).

TABLE 11 **Insurers' management and frictional costs**

Credit hires	Frictional costs incurred by the fault insurer	£78
	Management costs saved by the fault insurer	£27
Credit repairs and write-offs	Frictional costs incurred by the fault insurer	£45
	Management costs saved by the fault insurer	£111
Insurer-managed repairs and write-offs	Management and frictional costs incurred by the non-fault insurer	£115
	Frictional costs incurred by the fault insurer	£32
	Management costs saved by the fault insurer	£111

Source: CMA.

120. Although there is some uncertainty around these figures, it was clear to us that:

(a) the frictional costs incurred by the fault insurer are highest in the case of credit hire;

(b) credit repairs and write-offs involve lower frictional costs, but they are still higher than for insurer-managed repairs and write-offs; and

(c) the costs at-fault insurers incur in managing a repair (or write-off) for a captured claim are higher than those of managing a hire.[32]

121. We have estimated that the costs incurred by a non-fault insurer when managing a repair are higher than the costs an at-fault insurer incurs when managing a captured claim. These two types of claim involve different costs. In the case of at-fault insurers, capturing the claim is costly, but there is no need for subrogation and no additional frictional costs. In contrast, non-fault insurers can gain control of a claim at a much lower cost but incur the costs of subrogating the bill and defending it.

Individual estimates of detriment

122. The tables in this section summarise the results of our detriment estimation. Additional details can be found in Appendix E.

Credit hire

123. Net detriment for credit hire = difference between credit and direct hire bills
− referral fees
+ frictional costs incurred by the fault insurer
− management costs saved by the fault insurer

TABLE 12 **Detriment for credit hire**

	Profits to non-fault insurers and brokers	*Higher costs to fault insurers*				
	Referral fees	*Difference between credit and direct hire bills*	*Frictional costs*	*Saved management costs*	*Total costs*	*Net detriment (costs less profits)*
Average values (£)	328*	566†	78‡	(27)	618	290
Total values (£m)	**98.8**	170.3	23.5	(8)	**185.9**	**87**

Source: CMA.

*See provisional findings, Appendix 6.6; cost of ULR has been added (see paragraph 71).
†See paragraph 117.
‡See Table 11.

[32] The difference is affected by the allocation of 'other' claim handling costs not driven by the number of repairs/write-offs or replacement vehicles (see Appendix E, paragraph 6).

Credit repair

124. Net detriment for credit repair = difference between credit repair bills and cost of directly managed repairs
− referral fees
+ frictional costs incurred by the fault insurer
− management costs saved by the fault insurer

TABLE 13 **Detriment for credit repair**

	Profits to non-fault insurers and brokers	*Higher costs to fault insurers*				
	Referral fees	*Difference between credit repair bills and at-fault insurer's costs*	*Frictional costs*	*Saved management costs*	*Total costs*	*Net detriment (costs less profits)*
Average values (£)	53*	290†	45‡	(111)‡	224	171
Total values (£m)	**4.6**	24.8	3.8	(9.5)	**19.1**	**14.6**

Source: CMA.

*See Appendix E, paragraph 13.
†See Appendix E, paragraph 12.
‡See Table 11.

Credit write-off

125. Net detriment for credit write-offs = over-costing of CMC-managed write-offs
− referral fees
+ frictional costs incurred by the fault insurer
− management costs saved by the fault insurer

TABLE 14 **Detriment for credit write-offs**

	Profits to non-fault insurers and brokers	*Higher costs to fault insurers*				
	Referral fees	*Over-costing of CMC-managed write-offs*	*Frictional costs*	*Saved management costs*	*Total costs*	*Net detriment (costs less profits)*
Average values (£)	53*	125†	45‡	(111)‡	59	6
Total values (£m)	**1.1**	2.7	1	(2.4)	**1.3**	**0.1**

Source: CMA.

*See Appendix E, paragraph 16.
†See Appendix E, paragraph 15.
‡See Table 11.

126. The difference in bills is smaller for credit repair/write-off than for credit hire (though referral fees are also lower), and other net costs to the at-fault insurer are also lower. These factors, together with the fact there is less credit repair/write-off, mean the net detriment is considerably lower for credit repair/write-off than for credit hire (£15 million compared with £87 million).

Insurer-managed repairs and write-offs

127. Net detriment for insurer-managed repairs and write-offs
= over-costing of insurer-managed repairs and write-offs
− mark-up retained by non-fault insurers
+ management and frictional costs incurred by the non-fault insurer
+ frictional costs incurred by the fault insurer
− management costs saved by the fault insurer

TABLE 15 **Detriment for insurer-managed repairs**

	Profits to non-fault insurers			*Higher costs to fault insurers*				
	Mark-up	*Management and frictional costs*	*Total profits*	*Over-costing of insurer-managed repairs*	*Frictional costs*	*Saved management costs*	*Total costs*	*Net detriment (costs less profits)*
Average values (£)	95*	(113)†	–17	95‡	32†	(111)†	17	34
Total values (£m)	23	(27.1)	**–4.2**	23	7.8	(26.6)	**4.1**	**8.9**

Source: CMA.

*See Appendix E, paragraph 19.
†See Table 11.
‡See Appendix E, paragraph 18.

TABLE 16 **Detriment for insurer-managed write-offs**

	Profits to non-fault insurers			*Higher costs to fault insurers*				
	Mark-up	*Management and frictional costs*	*Total profits*	*Over-costing of insurer-managed write-offs*	*Frictional costs*	*Saved management costs*	*Total costs*	*Net detriment (costs less profits)*
Average values (£)	53*	(113)†	–59	53‡	32†	(111)†	–25	34
Total values (£m)	3.4	(7.2)	**–3.8**	3.4	2.1	(7.1)	**–1.6**	**2.4**

Source: CMA.

*See Appendix E, paragraph 22.
†See Table 11.
‡See Appendix E, paragraph 21.

128. The net detriment for insurer-managed repairs/write-offs is smaller than for credit repair/write-offs (£11 million compared with £15 million) despite there being almost three times as many insurer-managed repairs/write-offs as credit repairs/write-offs. This reflects that, on average, transactional/frictional costs are lower for insurer-managed repairs/write-offs than for credit repair/write-offs. Reduction in Paper Exchange (RIPE) agreements, to which many insurers subscribe,[33] reduce transactional/frictional costs. For example, one insurer [✂]. Nevertheless, even when two insurers have a RIPE agreement

[33] See provisional findings, paragraphs 6.8 & 6.9.

with each other, they incur some costs associated with the subrogation process which they would not incur in the absence of separation.

Overall net detriment

129. The overall detriment is given by the sum of the components. The overall profit to non-fault insurers and brokers is £96 million, while the increase in the costs incurred by at-fault insurers is £209 million. The net detriment is therefore approximately equal to £113 million.

130. There is some evidence that separation is associated with better quality of service on replacement vehicles (see paragraph 110). We believe our calculations control for the most obvious sources of quality difference (see paragraph 26), though there is one small effect which we have not been able to control for (see paragraphs 52 to 54).

131. In our provisional findings, we considered alternative estimates of the detriment using available figures for credit hire and credit repair revenue.[34] For credit hire revenue, we used a published estimate of 2011 credit hire revenue by the Credit Hire Organisation (CHO). However, the CHO told us that this was produced as part of an exercise to show trends as opposed to being a reliable quantification of credit hire revenues. The CHO also said that it did not think we should rely on its estimate of 2011 revenue without substantial further work to test its robustness. In the light of these points, we sent a questionnaire to CHCs requesting information on their turnover and the number and value of their credit hires. The results are set out in Appendix F and we have taken these figures into account in our analysis.

Distributional effects

132. We noted in our provisional findings that the impact of the features we identified in our provisional findings was likely to differ for different categories of drivers. As high-risk drivers are more likely to be at-fault in accidents, the higher costs to at-fault insurers will have a larger impact on their premiums compared with lower-risk drivers. On the other hand, the revenues insurers get when managing non-fault claims are likely to be passed through more evenly to their customer base. As a consequence, while premiums for high-risk drivers are higher, those for low-risk drivers may be lower than in the absence of rent-seeking practices.

[34] ibid, paragraph 6.83.

133. The revised estimation presented in this paper allows for a separate assessment of the distributional effects due to credit hire, credit repairs and write-offs, and insurer-managed repairs and write-offs. There are no clear distributional effects in relation to repairs and write-offs as, although there is a cost to at-fault insurers, the net profit to non-fault insurers from credit repairs and write-offs is broadly offset by the loss they suffer on insurer-managed repairs and write-offs.[35] However, there are clear distributional effects in relation to credit hire, since there is both a cost to at-fault insurers and a profit to non-fault insurers (from the receipt of referral fees).

Sensitivity analysis

134. Given the uncertainties around some of the data used in our detriment estimation, we tested the impact of using data from alternative sources and of varying key assumptions.

135. A detailed analysis is presented in Appendix G. The main points are:

(a) An alternative allocation of the management costs of captured claims slightly reduces the estimated net detriment for credit hire from £87 million to £78 million, while increasing the net detriment for repairs and write-offs by a similar amount. Using the average credit hire revenue we obtained from a larger set of CHCs increases the net detriment for credit hire to a value between £103 million and £118 million, depending on how direct hire rates are adjusted.

(b) Using the number of credit hire claims estimated using data from CHCs (see Appendix F) decreases the credit hire detriment by £3 million to £84 million.

(c) If VAT on credit hire services is excluded in 5% of claims to account for VAT-registered claimants (see paragraphs 83 and 84), the net detriment is also reduced by £3 million to £84 million.

(d) The benefit claimants get from the smaller vehicle classifications used under credit hire (see paragraphs 48 to 54) is likely to amount to less than £2 million.

[35] Tables 12–14 show that, when credit hire or repair is involved, non-fault insurers and brokers make profits. This is not the case, on average, for insurer-managed repairs and write-offs, in which non-fault insurers make a small loss, as shown in Tables 15 & 16. The reason is that, while some insurers charge a mark-up higher than the management costs they incur, others do not and instead make losses when managing a non-fault repair.

(e) If we assume that hire length in the benchmark is similar to the current direct hire average, rather than the current credit hire average, the net detriment for credit hire increases by £25 million to £112 million.

(f) If we assume that classes of replacement vehicle in the benchmark have the same distribution as they currently have under direct hire, rather than under credit hire, the credit hire net detriment increases by £20 million to £107 million.

(g) Assuming a lower pass-through of the revenue earned by non-fault insurers significantly increases the net detriment, especially for credit hire. A pass-through of 90% leads to a net detriment for credit hire of £97 million; if pass-through is only 80%, the net detriment increases to £107 million.

136. Table 17 shows the ranges of possible net detriment values obtained from the combination of different assumptions above. The high and low estimates in the table are based on sensitivities with all the assumptions generating the highest and lowest net detriments respectively.

TABLE 17 **Ranges of possible net detriment values**

		£ million
	High estimate	*Low estimate*
Credit hire	181.4	70.4
Credit repair	17.9	14.6
Credit write-off	1	0.1
Insurer-managed repair	20.4	8.9
Insurer-managed write-off	4.9	2.4
Total	216.9	104.6

Source: CMA.

Note: Since the assumptions on the allocation of common costs have an impact on the estimated total detriment, the high and low estimates of the total detriment are not the sums of the high and low estimates for the various components.

The benchmark for assessing separation of cost liability and cost control

1. This appendix discusses some conceptual issues raised in responses to the provisional findings on ToH 1, in particular the 'benchmark' against which we assess whether there is an AEC. These conceptual issues can be distinguished from the more empirical issues concerning our calculation of detriment, which are dealt with in the main paper.

2. In this appendix, we first set out our guidelines, then the approach taken in our provisional findings, the main responses received and our assessment of them.

CMA guidelines

3. The CC guidelines (adopted by the CMA) state the following regarding concluding the AEC test:

> 319. Having considered evidence of all kinds, the CC comes to a rounded judgement on what may be causing any adverse effects on competition. This judgement entails the CC reaching a finding on whether there is a feature, or combination of features, of a relevant market that 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. If so, it will find that there is an AEC. In forming its judgement the CC will apply a 'balance of probabilities' threshold to its analysis, ie it addresses the question: is it more likely than not that features or a combination of features lead to an AEC?
>
> 320. In identifying some features or combination of features of the market that may give rise to an AEC, the CC has to find a benchmark against which to determine how the market may be judged to be performing. In the absence of a statutory benchmark, the CC defines such a benchmark as 'a well-functioning market' (see paragraph 30)—ie one that displays the beneficial aspects of competition as set out in paragraphs 10 to 12 but not an idealized perfectly competitive market. The benchmark will generally be the market envisioned without the features. But there may sometimes be reasons to depart from that general concept,

for example, if features are intrinsic to the market but nevertheless have anticompetitive effects (as in the case of a natural monopoly) or if the nature of competition in the market is defined by arrangements put in place by Government, eg as in rolling stock leasing.[1]

4. We consider that the benchmark/counterfactual is a tool for our analysis – it is not the whole basis for deciding on an AEC. Our duty is to consider the whole picture in our findings (and remedies). In this context, we note three main points:

- the benchmark is generally the market envisioned without the features
- the benchmark is not an idealised perfectly competitive market
- there may sometimes be reasons to depart from that general concept

5. It is important to recognise that, while the benchmark is generally not a perfectly competitive market, it may not always be possible to identify a feasible well-functioning market outcome.[2] In these cases, the benchmark is used to inform our analysis, but does not represent the desired market outcome that we seek to achieve through our remedies. The Enterprise Act 2002 clearly envisages two separate stages of a market inquiry: first, the CMA decides whether there is an AEC; second, if there is an AEC, the CMA decides on the remedies. Alternative feasible market outcomes are considered not as part of the AEC, but as part of the remedies process.

6. AECs in our market inquiries may therefore involve either of the following circumstances:

- The situation absent the feature(s) is a feasible alternative market outcome. This will tend to be the case only when the problem is particular contractual terms (for example, wide most-favoured nation clauses)[3] or tacit collusion. In such cases, the remedy is likely to involve trying to get to that alternative outcome, though in the case of tacit collusion this may not be easy.

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[1] *Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3)* (adopted by the CMA), Part 3: Section 4—Concluding the AEC test.
[2] For example, in the case of a natural monopoly (such as water distribution) the benchmark is not the market outcome when there are two or more suppliers (which would involve high costs due to scale diseconomies) but a hypothetical situation where there is no natural monopoly.
[3] It is not, however, normal for a market inquiry to focus on contractual terms since these are covered by chapter 1 of the Competition Act 1998 and/or Article 101 of TFEU.

- The situation absent the feature(s) is not a feasible alternative market outcome. The remedies involved will then tend to be more complex, involving the consideration of alternative market outcomes that are not purely the world without the features; for instance, it may involve an outcome where the AEC is mitigated rather than prevented or an alternative outcome where the features(s) remain but the detrimental effect on customers is removed or mitigated. For example, in the case of a natural monopoly, the remedy may involve mitigating the detrimental effect on customers through price control.

Approach taken in our provisional findings

7. Our issues statement set out, as one of the theories to be tested, that there was harm arising from the separation of cost liability and cost control (separation).

8. Initially, we sought to assess the effect of separation compared with a benchmark where there was no separation. This raised a number of issues, of which perhaps the most important were associated with quality differences, as follows:

- Some parties argued that quality of service was much better with separation. However, our survey of non-fault claimants suggested that the difference was fairly small, with respondents whose claims were captured by the at-fault insurer experiencing only slightly worse service. Comparing captured claims (no separation) with others (separation), the survey results suggested that no more respondents felt the replacement car fell well short of their needs; that only 6% more felt it fell slightly short of their needs; and that no more felt they had access to a replacement car for a shorter time than needed (provisional findings, Table 6.1).[4]

- Parties argued that the quality of service currently offered by at-fault insurers to captured claimants was better as a result of the existence of CMCs/CHCs but that in the absence of separation CMCs/CHCs would not exist. In particular it was argued that, in the absence of separation, at-fault insurers would offer lower quality replacement cars or would not offer them at all. In relation to this point, we noted that it meant both that there were benefits to non-fault claimants (better quality of replacement vehicles) and costs to all drivers (higher costs of providing replacement vehicles which would be passed through to higher premiums); that neither was taken into account in our estimate of detriment (which was based on like-for-like

[4] There was even less evidence of quality difference for repairs (provisional findings, Table 6.2).

replacement vehicles); and that there was no clear evidence on whether the benefits did exceed the costs.

- There appeared to be some quality benefits associated with captured claims and hence with non-separation, in particular non-fault claimants getting their car repaired by the fault insurer without having to pay the excess themselves (as sometimes appears to happen when the non-fault insurer manages claims, though not when a CMC manages a claim).

9. Ultimately, we provisionally found two features that in combination had AEC: separation and the practices and conduct of other parties managing non-fault drivers' claims which gave rise to an inefficient supply chain. This was reflected in the benchmark, which assumed consumers received their legal entitlements.

10. The following paragraph was therefore included in the provisional findings:

> 6.3 In assessing the effect on competition, we considered a benchmark 'well-functioning market' to be a market which delivered consumers' legal entitlements in an efficient way. We therefore looked at two dimensions: (a) how separation affects insurers' costs and revenue streams and ultimately its effect on the price paid by consumers; and (b) differences in the quality of service received by claimants that were associated with separation to understand any impact of separation on the quality of service received by consumers. We took both into account in reaching our provisional view on the effect on competition.

Responses to the provisional findings

11. The main response of relevance to this issue has come from Accident Exchange, which summarised its main points as follows:[5]

- The CMA's benchmark for conducting the AEC analysis is extreme. It is an idealised world of no frictional costs and is neither shown to be a market outcome in general nor is it the specific market outcome that would arise if the features allegedly leading to the AEC were not present (since in that case fault insurers would have at best limited incentives to provide direct hire). The CMA's adoption of this benchmark

[5] Some of Accident Exchange's points were also raised by other respondents.

does not explain why at-fault insurers would provide direct hire absent separation or why consumers would not have to incur frictional costs themselves to receive their legal entitlement.

- The CMA should have included in its estimates of net impact the frictional costs incurred by consumers to realise their legal entitlement in the absence of separation. Alternatively, the CMA should recognise that adopting such an extreme benchmark for the AEC assessment creates a bias towards finding an AEC and the imposition of remedies, which must be taken into account in any remedy assessment.

- The CMA has not correctly applied its conceptual benchmark (one of legal rights being maintained) in practice as the CMA recognises that absent separation there will be a shortfall in quality and service provision but the CMA does not adjust its quantification to account for this. In particular, when assessing the effects on competition of separation against its benchmark the CMA has failed to consider the costs to consumers of making up the quality and service shortfall of direct hire compared to credit hire so that they do in fact realise their legal entitlement as postulated in the benchmark.

- Since the CMA's benchmark assumes that consumers' legal entitlements are maintained, the CMA's analysis of the AEC cannot form an adequate basis to assess any remedies that do change consumers' legal entitlements or the degree to which consumers would realise their legal entitlements.

- The AEC identified by the CMA has distributional implications for consumers, ie there would be winners and losers in the status quo compared to the CMA's benchmark, given quality and service differentials. In particular non-fault drivers may be worse off since they would suffer the quality and service differentials. The CMA has failed to address this because it has only considered consumers in aggregate (ie it has conceptually averaged benefits across all consumers rather than only those who receive them). It is highly unusual for a competition authority to reach an AEC finding that creates winners and losers among different groups of consumers based on changing their legal entitlements since such a finding includes implicit value judgments (more usually AEC findings are based on features of the market that make at least some consumers worse off and no consumers better off).

Assessment of responses

12. The key issue mentioned in Accident Exchange's response is associated with the type of AEC we have found. Where the problem in the market is weak rivalry, the benchmark can be the market with stronger rivalry (though depending on the features this may or may not be a feasible market outcome, see paragraph 6). However, when, as here, market rivalry is strong and the problem is elsewhere, the benchmark needs to be the hypothetical situation where the problem does not occur.

13. While the CMA guidelines state that the benchmark is 'not an idealised perfectly competitive market', this reflects that the CMA would not find a problem just because there is imperfect rather than perfect competition in a market. The guidelines do not say that the benchmark cannot be idealised in any sense, ie that it has to be a feasible market equilibrium.

14. It is worth noting that Accident Exchange's points about ToH 1 would apply at least as strongly to the AEC we found under ToH 4. In regard to ToH 1, Accident Exchange argued that our benchmark assumed that non-fault claimants receive their legal entitlements but we do not take into account the costs non-fault claimants would incur in obtaining their legal entitlement from at-fault insurers. But a similar argument can be applied to ToH 4. Under ToH 4, we provisionally found a problem associated principally with information asymmetries but we did not attempt to compare the current situation against a benchmark taking into account the costs that consumers would incur in acquiring sufficient information to overcome the information asymmetries.

15. Accident Exchange raises some important points regarding the benefits consumers obtain from separation. We do take account of quality benefits in our analysis of net detriment, but this is subject to the point that the benchmark assumes consumers receive their legal entitlements (see paragraphs 9 and 10). The potential role of CHCs in ensuring consumers receive their legal entitlements is of course important and needs to be taken into account in the assessment of the proportionality of remedies. For example, if we considered a remedy which had the effect of non-fault claimants receiving a lower-quality replacement car, we would need to take that into account as an indirect cost of the remedy.

16. We would also make the following comments on Accident Exchange's specific points (see paragraph 11):

    - The benchmark is just a tool for our analysis and is the situation without the features; it does not have to be a feasible market outcome. Furthermore, our AEC is the result of two features, not just separation.

- We agree that our remedies analysis should take into account all relevant costs, including any indirect costs, such as non-fault claimants obtaining lower-quality replacement vehicles which meet their legal entitlement (this could occur, for example, if some non-fault claimants currently receive a quality of replacement vehicle that is in excess of their legal entitlement).

- We agree that, in the absence of separation (which is one of the two features that in combination cause an AEC), non-fault claimants may not obtain their legal entitlement to a like-for-like replacement vehicle (subject to need). As a matter of logic, the existence of this problem (in the hypothetical situation where there is no separation) does not imply there is no existing problem associated with rent-seeking by third parties and an inefficient supply chain. That is why our benchmark assumes that claimants receive their legal entitlement.

- We agree that our provisional findings provide no basis for including in the net detriment any lower premiums resulting from non-fault claimants receiving a level of replacement vehicle lower than their legal entitlement.[6] This is a corollary of our benchmark assuming that claimants receive their legal entitlement.

- We agree that our AEC involves distributional implications – ie some consumers may be better off as a result of the features while others are worse off and the net effect is negative. Indeed, we stated this in the provisional findings. This is not unusual. A merger could well involve price reductions for some customers (due to cost savings) but price increases for others (due to enhanced market power in some but not all market segments). A practice such as Payment Protection Insurance (PPI) may have adverse effects for many consumers but would tend to benefit consumers purchasing the primary product (eg loans) but not PPI due to the 'waterbed' effect. The Financial Conduct Authority referred to this in relation to insurance add-ons in its recent market study.

Conclusion

17. In our provisional findings we stated that we considered a benchmark 'well-functioning market' to be a market which delivered consumers' legal entitlements in an efficient way. We recognise the point that in the absence of separation (ie if at-fault insurers handled all claims from non-fault parties) insurers would have an incentive to under-provide on service as well as to

[6] Such benefits could arise if the extra cost of direct hire of a vehicle meeting non-fault claimants' legal entitlement was greater than the benefit obtained by non-fault claimants (compared to some alternative level of entitlement eg that under their own policy, usually a courtesy car).

control costs. However, we do not believe it is appropriate to take this into account in our assessment of whether there is an AEC because the existence of a second potential problem (the under-provision of service) does not preclude the existence of the problem we provisionally found (an inefficient supply chain involving excessive frictional and transactional costs).

18. We believe that it is important we take into account any effects of our proposed remedies on the quality of service provided to consumers. We do this as part of our assessment of remedies.

Sources of friction

1. As noted in paragraph 25 of the working paper, whatever the reason for the excessive frictional costs arising from the interaction between insurers and CHCs, these represent part of the detriment from the separation. However, a better understanding of the sources of friction can be useful, especially in view of the evaluation of proposed remedies. In this regard, CHCs said that an important source of friction was the insurers' inefficiency in settling subrogated bills. It is not easy to verify to what extent the delays in payments result from inefficiency and to what extent they reflect the rational behaviour of cost-minimising insurers. Looking at the recovery ratio of credit hire bills can provide a useful insight.

2. Table 1 shows the recovery rate (ratio of amounts received over amounts initially billed) for credit hire claims in 2012, as a function of the timing of payments, for six large CHCs. The evolution of the recovery ratio provides us with some evidence that may be relevant to the reasons for delays.

TABLE 1 **Recovery rates for 2012 credit hire claims**

Number of days between invoicing the bill and receiving the payment	*Recovery rate for 2012 claims %*
0–30	93.6
31–60	94.3
61–90	92.5
91–120	91.0
121–150	91.1
151–180	90.1
181+	83.9
Average	82–91*

Source: CMA.

*Lower figure assumes no recovery on outstanding debt; higher figure assumes 84% recovery on outstanding debt similar to recovery rate for bills paid 181 or more days after issue of invoice.

3. We note that the average recovery rate declines with payment delay, except that recovery increases when payment is delayed between 31 and 60 days compared to where there is no delay (from 93.6% to 94.3%). The general decline in recovery rate is consistent with more justified challenges to credit hire bills taking longer to resolve.[1] The increase in average recovery rate as a percentage of amount initially billed when payment is delayed between 31 and

[1] The pattern is influenced by the higher proportion of non-GTA claims among late payments. Non-GTA claims are challenged more often and more successfully.

60 days is surprising because it implies that on average successful challenges resolved within this period do not compensate for delay penalties.[2] It could be suggestive of a certain degree of inefficiency on the side of insurers in making payments, rather than just their successfully challenging CHCs' bills. This is consistent with data provided by Helphire, according to which more than half of delayed payments under the GTA are not due to any form of challenge.

4. Whether insurers benefit from delaying payments, and the extent of any benefit, depends on the level of late payment penalties, on insurers' cost of debt and the level of litigation costs.

[2] Under the GTA a payment delay of between one and two calendar months results in a late payment penalty of 7.5% (12.5% after 15 June 2012).

The cost of uninsured loss recovery services

1. Table 1 shows the data on ULR services we have received from six CHCs. Two of them (Crash Services and Enterprise) do not offer these services. Among the other four (Accident Exchange, ClaimFast, Helphire and Kindertons) the number of claims in which ULR services are provided varies significantly. Kindertons appears to be the only CHC providing ULR as a service to its referring insurers and brokers even in the absence of a credit hire claim (in 2012 there were [✂] such claims).

TABLE 1 **Number and cost of ULR claims in 2012**

	Number of ULR claims	*Average cost per claim*	*Total number of hires*
Accident Exchange	[✂]*	[✂]	[✂]
ClaimFast	[✂]	[✂]	[✂]
Crash Services	[✂]		[✂]
Enterprise	[✂]		[✂]
Helphire	[✂]†	[✂]‡	[✂]
Kindertons	[✂]§	¶	[✂]
Total in our sample	between 6,286 and 9,944		246,604
Total in the market			300,970

Source: CHCs.

Notes:
*[✂]
†In the case of Helphire, we have excluded all the claims in which the customer was covered by a 'Before the Event' policy arranged through Albany Assistance, as they do not constitute a service to the insurers or brokers referring for credit hire.
‡The cost is an average for all claims, including those in which the customer is covered by a 'Before the event' policy. The service provided to these customers is better and, presumably, more costly. The average cost for the other claims is likely to be lower.
§Kindertons does not record separately the recovery of repair costs and pre-accident value for the cases in which credit repair is provided and for the cases in which the customer arranges the repair independently and asks Kindertons to recover the costs. Only the second category of claims is relevant for our calculation. [✂]
¶[✂]

2. The uncertainties on the number of relevant claims and on the incremental cost of ULR services makes it difficult to compute an accurate estimate of their total cost. We have adopted a conservative approach, taking the higher number of claims (9,944) and assuming an average cost of £40 per claim. The estimated total number of ULR claims for the entire credit hire market is therefore 12,136,[1] implying a total cost of approximately £485,000.

3. Dividing this amount by the total number of credit hires, we get an average cost per hire of £1.61. This implies that referral fees for credit hire are on average £1.61 lower than what they would be if ULR services were not

[1] 9,944*(total number of hires in the market)/(total number of hires in the sample).

provided. This reduces our estimate of the detriment from the separation by £0.5 million.

Data provided by Helphire

1. Helphire provided us with a breakdown of its credit hire and direct hire revenue (see Table 1 below). Helphire's figures suggest that its credit hire revenue is [✂][1] than our current estimate of £591 (this figure is slightly greater than the £566 quoted in the working paper because, for comparison with Helphire's figure, the effects of timing differences have been ignored). It should also be noted that Helphire quotes an average referral fee of [✂] than our figure of £327.

TABLE 1 **Comparison of average credit hire and direct hire charge excluding timing differences**

			£ including VAT	
	Credit hire	*Direct hire*	*Difference*	*Ratio*
Figures from provisional findings				
Adjusted average (incl VAT) 2012	1,130*	539	591*	2.1
Helphire figures (see PMI 291)				
Average (excl VAT) 2012	[✂]			
Average (incl VAT) 2012	[✂]			
Average (excl VAT) 2014 budget	[✂]	[✂]		
Like-for-like adjustment		[✂]		
Hire length adjustment		[✂]		
Adjusted average (excl VAT) 2014	[✂]	[✂]	[✂]	[✂]
Adjusted average (incl VAT) 2014	[✂]	[✂]	[✂]	[✂]

Source: Helphire.

*Figures exclude the timing benefit to insurers of longer payment period on credit hire. Including this benefit reduces the difference to £566.
Note: Figures include supplementary charges such as CDW; adjusted average charge is for average credit hire length and vehicle.

2. Helphire also provided some data on its costs of credit and direct hire, see the Annex. We have used this data to analyse the difference between credit and direct hire charges, see Table 2 below. There are four columns in this table.

- The first column shows our analysis of the £[✂] difference between credit hire and direct hire charges. This is based on Helphire's information on costs and revenue (see Annex).

- The second column adjusts the first column so that it reflects our own data on average referral fees (£327) and the difference between credit hire and direct hire charges (£472 excluding VAT, and £566 including VAT). We have done this by adjusting the acquisition cost per claim to our average referral fee of £327 and by adjusting the contribution to overheads and

[1] Helphire's direct hire revenue for 2012 is not available. As shown in the table its budgeted 2014 direct hire revenue is slightly [✂] our 2012 revenue.

profits so that the total sums to the difference between credit hire and direct hire charges of £472 excluding VAT. [✂]

- The third column adds VAT to the second column, so that the total sums to the gross difference between credit hire and direct hire charges including VAT.

- The fourth column removes the average referral fee, so that the total sums to the difference between credit hire and direct hire charges net of the referral fee. The reason for this further analysis is that it is the difference net of the referral fee which drives our net detriment calculation. It should be noted that in this analysis the VAT on the referral fee continues to account for part of the difference between credit hire and direct hire charges. This is because insurers are VAT-exempt and hence pay VAT on credit and direct hire charges but cannot recover VAT on referral fee income.

TABLE 2 **Analysis of difference between credit and direct hire charges, £ per claim**

	Helphire excl VAT	*Adjusted excl VAT*	*Adjusted Plus VAT*	*Adjusted net of referral fee incl VAT*
Acquisition costs (referral fees)	[✂]	327	392	65
Sales overhead	[✂]	[✂]	[✂]	[✂]
Liability and claims	[✂]	[✂]	[✂]	[✂]
Collection/recovery	[✂]	[✂]	[✂]	[✂]
Litigation costs	[✂]	[✂]	[✂]	[✂]
Other allocated costs	[✂]	[✂]	[✂]	[✂]
Total allocated costs	[✂]	[✂]	[✂]	[✂]
Contribution to fixed overheads*	[✂]	[✂]	[✂]	[✂]
Total	[✂]	472	566	239

Source: CMA calculations based on Helphire data (see Appendix D).

*Includes profit.

3. The final column suggests that, of the £239 net difference between credit and direct hire including VAT, about £65 is due to VAT on referral fees, £[✂] to other costs incurred on credit, but not direct hire, plus VAT on those costs (though readily identifiable items [✂] of this) and [✂].

Information on Helphire's costs

Revenue less fleet costs, 2014 (excluding VAT)	*Credit hire*	*Direct hire*	*£ per claim* *Difference*
Hire revenue	[✂]	[✂]	[✂]
Settlement adjustments	[✂]	[✂]	[✂]
Net hire revenue	[✂]	[✂]	[✂]
CDW & FSC	[✂]	[✂]	[✂]
Salvage	[✂]	[✂]	[✂]
Total hire-related income	[✂]	[✂]	[✂]
Fleet costs*	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]
Other costs and contribution, 2014 (excluding VAT)			
Acquisition costs	[✂]	[✂]	[✂]
Sales overhead	[✂]	[✂]	[✂]
Litigation costs	[✂]	[✂]	[✂]
Operational overheads (allocated)	[✂]	[✂]	[✂]
Other overheads (allocated)	[✂]	[✂]	[✂]
Total allocated costs	[✂]	[✂]	[✂]
Contribution to fixed overheads†	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]
Breakdown of additional credit hire costs, 2012 (excluding VAT)			
Referral fees			[✂]
Sales – staff costs			[✂]
Liability assessment/claims management			[✂]
Claim recovery management system			[✂]
Overhead of claims management			[✂]
Collection costs – Staff costs			[✂]
Overhead cost of recovery (PPS/IT/Tel)			[✂]
Litigation costs			[✂]
Additional legal costs			[✂]
Staffing – compliance/technical			[✂]
Additional operational staff costs			[✂]
CHO subscription			[✂]
Regulatory subscriptions			[✂]
Unrecoverable disbursements			[✂]
Finance costs			[✂]
Total			[✂]
Contribution to fixed overheads†			[✂]
Total			[✂]

Source: Helphire.

*Includes contracted vehicle purchasing.
†Includes profit.

Estimation methodology

1. This appendix explains the methodology we have adopted in estimating the detriment and presents the results in greater detail. Although the overall analysis is different from how it was presented in Appendix 6.6 of the provisional findings, some parts of it have not changed. This is the case in particular for:

   - The weights assigned to the data from the insurers and brokers in our sample. For a detailed explanation, see the provisional findings, Appendix 6.6, Annex A.

   - The analysis of referral fees for credit hire and credit repair. This appendix presents only the aggregate figures, while a detailed discussion can be found in the provisional findings, Appendix 6.6.

The estimation of insurers' management and frictional costs

2. Unlike in our provisional findings, in this working paper we estimate the detriment from the separation separately for credit hire, credit repair, credit write-offs, insurer-managed repairs, and insurer-managed write-offs. This is possible because we have obtained new data on the management and frictional costs incurred by fault and non-fault insurers. Our cost estimates are presented in paragraphs 119 to 121 of the working paper. In this appendix we explain how we have calculated those estimates.

3. We asked insurers to estimate their claim handling costs for different categories of claims. We requested the average incremental cost that would be determined by a significant number (1,000) of extra claims, including both the internal claim handling costs and any external cost due to litigation.

4. Table 1 shows the information we obtained on at-fault insurers' costs. We asked for the costs involved in the management of a captured claim and for the costs of managing and, potentially, litigating subrogated claims. The values in the table are weighted averages, with weights given by the GWP of each insurer in 2012.[1]

[1] Since 'captured claims' are the basis for our benchmark, it is not appropriate to weight insurers based on their current capture rates, but on their potential for capturing claims. Ideally, we would like to weight insurers according to the numbers of at-fault claims. The same would be the preferred weights for the cost of subrogated claims. However, we could not obtain reliable data on the numbers of at-fault claims. Using GWP, we take into account both the size of the insurers and the average risk level of their policyholders (and so their likelihood of being the fault party in an accident).

TABLE 1 **Information on at-fault insurers' costs**

£

		Subrogated claims	
	Captured claims	*Claims managed by non-fault insurers with the hire component referred for credit hire*	*Claims managed by CMCs*
Repair/write-off	53	32	45
Replacement vehicle	27	78	78
Other	57		

Source: Insurers.

Note: The 'other' category includes the costs of capturing a claim that cannot be easily allocated to either the repair or the replacement vehicle components. Different insurers adopted different approaches with respect to these costs. Some allocated all or most of them, others reported high figures under this category.

5. We have used these figures to compute the estimates in Table 11 in the working paper for the frictional costs incurred by at-fault insurers and for the management costs they save by not directly managing a claim. Table 2 summarises the underlying calculations.

TABLE 2 **Estimation of relevant at-fault insurers' costs**

Component of the claim	*Type of costs*	*Calculation method*
Credit hires	Frictional costs incurred by the at-fault insurer	Average of the costs incurred on replacement vehicles for non-fault insurer-managed and CMC-managed claims. The weights used are the estimated numbers of insurer-managed repairs and credit repairs respectively.
	Management costs saved by the at-fault insurer	Costs incurred on replacement vehicles for captured claims.
Credit repairs and write-offs	Frictional costs incurred by the at-fault insurer	Costs incurred on repairs/write-offs for CMC-managed claims.
	Management costs saved by the at-fault insurer	Costs incurred on repairs/write-offs for captured claims, plus 'other' costs.
Insurer-managed repairs and write-offs	Frictional costs incurred by the at-fault insurer	Cost incurred on repairs/write-offs for non-fault insurer-managed claims.
	Management costs saved by the at-fault insurer	Costs incurred on repairs/write-offs for captured claims, plus 'other' costs.

Source: CMA.

6. Computing the saved management costs requires the allocation of the 'other' costs incurred in capturing a claim. These costs are driven by the number of claims rather than the number of repairs/write-offs or replacement vehicles provided. In our main estimates of detriments, we have attributed these costs to repairs/write-offs since all claims involve a repair or write-off but not all claims involve the provision of a replacement vehicle (because the circumstances of some claimants are such that they do not need a replacement vehicle for the period their own vehicle is unavailable).

7. Table 3 shows the resulting estimated management costs saved by the at-fault insurer for replacement vehicles and repairs/write-offs, together with an alternative estimate assuming an equal split of 'other' costs between the two activities.

TABLE 3 **Estimates of management costs saved by the at-fault insurer**

	Allocation of 'other' costs	
	All to repair/ write-off	*Equal split*
Saved management cost of replacement vehicles	£27	£55
Saved management costs of repair/write-off	£111	£82

Source: CMA.

8. We also obtained information on the management and frictional costs incurred by a non-fault insurer when managing a repair. These include the costs of dealing with the customer, arranging the repair, subrogating the bill and, if necessary, defending it. The value in Table 11 of the working paper is an average of the costs provided by the insurers in our sample, weighted by the respective numbers of non-fault repairs in 2012. Similarly to the at-fault insurer's costs, we have attributed the non-fault insurer's other costs to repairs/write-offs.

Credit hire

9. As shown in paragraph 117 of the working paper, we estimated that the average difference between a credit hire and a direct hire bill is £566. Compared with the case of a captured claim, with separation a fault insurer incurs additional frictional costs when dealing with a CHC. We have estimated this cost to be £78 (see Table 11 in the working paper). On the other hand, the insurer saves the costs it would have incurred in directly managing the hire. We have estimated this cost to be approximately £27 (see Table 3). Table 4 multiplies the average cost increase faced by a fault insurer by our estimated number of credit hires. The total cost increase amounts to £186 million.

TABLE 4 **The extra cost of credit hire**

	Our sample			*Average difference between credit and direct hire bills*	*Average frictional costs*	*Average saved management costs*	*Average total costs per claim*	
	Number of credit hires '000	*Share of supply %*	*Estimated total number of credit hires '000*	*£*	*£*	*£*	*£*	*Estimated total cost £m*
Referred by insurers	151	82	184					
Referred by brokers	76	65	117					
Total			301	566	78	(27)	618	186

Source: CMA.

10. Non-fault insurers and brokers get a referral fee when referring a claimant for credit hire. The costs associated with a referral are negligible. The analysis here is the same as presented in the provisional findings, Appendix 6.6, with the only difference being the addition of the costs incurred by CHCs in the provision of ULR services. The new estimate for the total amount of referral fees for credit hire paid to insurers and brokers is £98.8 million.

11. The net detriment for credit hire is therefore £87 million.

Credit repair

12. The average difference between credit repair bills and the cost of directly managed repairs was estimated in the provisional findings at £324. If we compensate for the benefit insurers get from delayed payments by discounting the average credit repair bill by 2.2%, then the cost difference decreases to £290.[2] In addition to this cost, a fault insurer also incurs frictional costs when dealing with a CMC, at an average amount of £45 (see Table 11 in the working paper). On the other hand, it saves the cost of directly managing the repair, which we have estimated to be £111. Considering all the claims referred by insurers and brokers in 2012, the total cost increase is £19.1 million, as shown in Table 5.

TABLE 5 **The extra cost of credit repair**

	Our sample							
	Number of credit repairs '000	*Share of supply %*	*Estimated total number of credit repairs '000*	*Average difference between credit repair bills and at fault insurer's costs £*	*Average frictional costs £*	*Average saved management costs £*	*Average total costs per claim £*	*Estimated total cost £m*
Referred by insurers	33	82	40					
Referred by brokers	30	65	46					
Total			85	290	45	(111)	224	19.1

Source: CMA.

13. Non-fault insurers and brokers incur negligible costs when referring a claimant for credit repair, while receiving a referral fee in return. In the provisional findings we estimated the average referral fee to be £53 for both insurers and brokers. Multiplying this by the total number of credit repairs (85,000), we get a total amount of approximately £4.6 million.

14. The net detriment for credit repair is therefore £14.6 million.

[2] £324 – £1,576*0.022.

Credit write-offs

15. The average mark-up on write-offs for CMCs was estimated in the provisional findings to be £125. Both the additional frictional costs incurred by fault insurers and the management costs they save are the same as in relation to repairs. Table 6 shows the total extra costs due to credit write-offs using their estimated numbers in 2012.

TABLE 6 **The extra cost of credit write-off**

	Our sample							
	Number of credit repairs '000	*Share of supply %*	*Estimated total number of credit write-offs '000*	*Average over-costing of CMC-managed write-offs £*	*Average frictional costs £*	*Average saved management costs £*	*Average total costs per claim £*	*Estimated total cost £m*
Referred by insurers	8	82	10					
Referred by brokers	7	65	11					
Total			21	125	45	(111)	59	1.3

Source: CMA.

16. The referral fee non-fault insurers and brokers receive in case of credit write-off is the same as for credit repair (£53 on average). Given a total of 21,400 credit write-offs in 2012, total revenues are approximately £1.1 million.

17. The net detriment for credit write-offs is therefore £0.1 million.

Insurer-managed repairs

18. When the non-fault insurer manages the repair, the fault insurer saves the costs of doing it itself (£111), but incurs frictional costs (£32) and is charged the mark-up that the non-fault insurer generates, which we estimated to be £95 in the provisional findings. The total cost increase is shown in Table 7.

TABLE 7 **The extra cost of insurer-managed repair**

Our sample							
Number of repairs '000	*Share of supply %*	*Estimated total number of repairs '000*	*Average over-costing of insurer-managed repairs £*	*Average frictional costs £*	*Average saved management costs £*	*Average total costs per claim £*	*Estimated total cost £m*
198	82	240	95	32	111	17	4.1

Source: CMA.

19. Non-fault insurers generate an average mark-up on repairs of £95. It should be noted that, while for some insurers the figure is much higher, others charge nothing or very little. Insurers, on the other hand, bear the cost of dealing with the customer, managing the repair and subrogating the bill. We estimate these costs to be about £115. The aggregate net revenue of non-fault insurers is shown in Table 8.

TABLE 8 **Non-fault insurers' revenue from directly managed repairs**

Our sample						
Number of repairs '000	*Share of supply %*	*Estimated total number of repairs '000*	*Average mark-up £*	*Average management and frictional costs £*	*Average total profits per claim £*	*Estimated total profit £m*
198	82	240	95	(115)	(19)	(4.8)

Source: CMA.

20. The net detriment for insurer-managed repairs is therefore £8.9 million.

Insurer-managed write-offs

21. The analysis of the cost increase attributable to insurer-managed write-offs is the same as for repairs. The only difference is that the average mark-up is lower (£53). Table 9 presents our estimate of the overall extra cost.

TABLE 9 **Extra cost of insurer-managed write-off**

Our sample							
Number of write-offs '000	*Share of supply %*	*Estimated total number of write-offs '000*	*Average over-costing of insurer-managed write-offs £*	*Average frictional costs £*	*Average saved management costs £*	*Average total costs per claim £*	*Estimated total cost £m*
52	82	64	53	27	(111)	(25)	(1.6)

Source: CMA.

22. The analysis of non-fault insurers' revenues is also the same as for repairs, except for the lower average mark-up (£53). It should be noted that this is an average figure, with some insurers charging significantly more and others not generating any mark-up. Table 10 shows the aggregate net revenue.

TABLE 10 **Non-fault insurers' revenue from directly managed write-offs**

Our sample						
Number of write-offs '000	*Share of supply %*	*Estimated total number of write-offs '000*	*Average mark-up £*	*Average management and frictional costs £*	*Average total profits per claim £*	*Estimated total profit £m*
52	82	64	53	(115)	(61)	(3.9)

Source: CMA.

23. The net detriment for insurer-managed write-offs is therefore £2.4 million.

Survey of credit hire companies

1. In order to obtain further information about credit hire and credit repair, we sent a questionnaire to CHCs.

2. The names and addresses of the CHCs was provided by the Credit Hire Organisation (CHO). The questionnaire was also sent to one large CHC which is not a member of the CHO. We are very grateful to the CHO for its help in carrying out the questionnaire, including valuable advice on the drafting of the questionnaire and chasing the CHCs for a response.

3. The questionnaire was sent out in March 2014. A copy of the questionnaire is shown at the end of this appendix.

4. We sent the questionnaire to 41 CHCs and received responses from 36 CHCs. The results below are based on the 36 responses received. We have not attempted to estimate figures for non-respondents, though as it is likely that the non-respondents are smaller CHCs the exclusion of their numbers is unlikely to make much difference to the overall estimates. We have also not made any attempt to include data for any CHCs which were operating during 2011 to 2013 but have subsequently ceased trading (this would be most likely to affect the data for 2011).

5. Respondents were asked their turnover,[1] and the number and value of closed claims, for credit hire and credit repair during 2011 to 2013. In relation to closed claims, respondents were asked to provide figures both for total credit hire/repair and for credit hire/repair where the client's vehicle was not privately owned and insured (ie where the client was a limited company or it was a commercial vehicle or part of a fleet).

6. We have used responses to estimate total credit hire and repair (see Table 1). The following points should be noted about these estimates:

   (a) Many respondents did not have financial years ending in December and, in these cases, data is for the actual financial year ending during the year concerned. Hence, totals are aggregated across slightly different periods.

[1] Respondents were requested to provide their turnover after provisions for under/non-recovery as shown in their accounts. Turnover is likely to differ from the value of closed claims because of a timing difference (turnover reflects claims for which revenue accrues during the year rather than claims closed during the year); because it includes an estimate of under/non-recovery which may turn out to be incorrect; and because it may include adjustments for under/non-recovery in previous years.

(b) In some cases, respondents had individual financial years which were longer or shorter than 12 months. In these cases we pro-rated the data to calculate a 12-month financial year.

(c) We requested turnover and value of closed claims excluding VAT. In some cases, companies provided the value of closed claims including VAT. In these cases, our estimates assume 20% VAT for privately-owned and insured vehicles, and no VAT if the vehicle was not privately owned and insured.

(d) Some respondents were unable to provide all the information requested. In these cases, we made estimates as follows:

(i) Where respondents were unable to provide any data for 2011, we estimated 2011 figures by pro-rating 2012 aggregate totals for the bulk of companies which provided data for both 2011 and 2012.

(ii) Where respondents were unable to provide any data on the value of closed claims or on turnover, we used turnover as an estimate of the value of closed claims or vice versa.

(iii) Where respondents were unable to separate the number and value of closed claims according to whether they were on privately-owned and insured vehicles, we pro-rated according to the aggregate proportion for respondents who did at least make an estimate of the number and value of closed claims according to whether they were on privately-owned and insured vehicles.

TABLE 1 **Results of questionnaire to credit hire companies**

Year	*2011*	*2012*	*2013*
*Average month of year end**	*June*	*July*	*July*
Credit hire			
Value of closed claims (total) (£m)†	380	387	405
Turnover (£m)†	379	350	373
Number of claims closed in year (total)	363,974	373,997	373,824
Of which: limited company or fleet	83,338	82,891	84,707
Number of closed claims – private	280,636	291,107	289,117
Average £ per closed claim (private)‡	1,208	1,188	1,235
Credit repair			
Value of closed claims (total) £m†	131	149	168
Turnover (£m)†	159	157	169
Number of claims closed in year (total)	106,125	116,478	123,367
Of which: limited company or fleet	22,958	24,582	25,719
Number of closed claims – private	83,167	91,897	97,648
Average value per closed claim (private)‡	1,461	1,501	1,601

Source: CMA based on information from respondents to the questionnaire.

*Weighted average month of year end (weights used are number of credit hire closed claims).
†Excluding VAT.
‡Including VAT at 20%.

7. The estimated value of closed claims exceeds turnover in 2012 and 2013. There are a number of possible reasons for this, including timing differences and that turnover may be affected by adjustments for previous years.[2]

8. The most recent data (for financial years ending during 2013) suggests there were about 370,000 closed credit hire claims, with a total value of about £460 million including VAT, and that just over 20% of these claims were where the client was a limited company or which concerned a commercial or fleet vehicle. The largest five CHCs accounted for about 80% of the total number and value of claims.

9. The comparable data for credit repair suggests there were about 125,000 closed claims, with a total value of about £200 million including VAT. Again, just over 20% of these claims were where the client was a limited company or which concerned a commercial or fleet vehicle, and the largest five CHCs accounted for about 80% of the total number and value of claims.

10. Table 2 compares the data we use in our main estimate of the detriment with the results for closed claims in Table 1. The data we use in our main estimate of the detriment is for claims during the calendar year 2012. In our view it is reasonable to compare these with estimates from the CHC questionnaire for claims closed during the financial year ending during 2013. On average, CHCs' financial years ended on 4 July but typically claims are closed some considerable time after the accident concerned (see paragraph 90 and Table 7 in the working paper).[3] Thus many of the claims closed during the financial year ending during 2013 will relate to accidents during calendar 2012, though some will relate to accidents during 2013 and some to accidents during 2011 and earlier years.

TABLE 2 **Comparison of information used in main estimate of detriment with information from CHCs**

	Main estimate	*CHCs*
Credit hire		
Number of claims (thousand)—insurers/brokers data	301	
Number of claims (thousand)—total		374
Number of claims (thousand)—private clients		289
Average value per claim (£ including VAT)	1,105	1,235
Credit repair		
Number of claims (thousand)—insurers/brokers data	106*	
Number of claims (thousand)—total		123
Number of claims (thousand)—private clients		98
Average value per claim (£ including VAT)	1,576*	1,601

Source: CMA based on information from insurers, brokers and CHCs.

*Includes write-offs.

[2] See previous footnote.
[3] The weighted average delay between issue of invoice and claim closure is around 170 days.

11. In regard to credit hire, our figure of 301,000 claims used in our main estimate of the detriment is below the total number of claims handled by CHCs but slightly above the estimated number from private, rather than commercial, customers. The average value per claim used in our main estimate of the detriment is lower than the average value based on CHC data.

12. In regard to credit repair, our figure of 106,000 claims used in our main estimate of the detriment is below the total number of claims handled by CHCs and slightly higher than the estimated number from private, rather than commercial, customers. The average value per claim used in our main estimate of the detriment is similar to the average value based on CHC data.

Copy of questionnaire sent to CHCs

In order to inform our statutory inquiry into private motor insurance, please would you provide the following basic information on your credit hire and credit repair business. You are required to provide a response by **Friday 4 April 2014**.

Instructions for completion Please fill in unshaded cells in the table below to the best of your ability.			
Name of credit hire company responding Name of audited company (if different) Name and telephone number for queries			
Accounting period ending *Length of accounting period†*	*Month* 2011*	*Month* 2012*	*Month* 2013*
Turnover (£) after provisions for under/non-recovery (excluding VAT) as shown in accounts			
Credit hire			
Credit repair			
Other‡			
Total from accounts			
Further information on credit hire			
Total number of claims closed in this accounting period			
of which: limited company or fleet vehicles§			
Total cash received for closed claims (all vehicles)			
of which: limited company or fleet vehicles§			
Further information on credit repair			
Total number of claims closed in this accounting period			
of which: limited company or fleet vehicles§			
Total cash received for closed claims (all vehicles)			
of which: limited company or fleet vehicles§			
Notes *Please replace "month" with actual month in which accounting period ended. †Please enter length of accounting period eg 12 months. ‡Other turnover included in accounts. Please explain any significant sources of other turnover. §Please show claims closed where your client's vehicle was **not** privately owned and insured (ie where the client was a limited company or it was a commercial vehicle or part of a fleet). Please explain the basis of your data. The reason for requesting this information is that our terms of reference are limited to private motor insurance.			

It would be most convenient if you used the attached Excel spreadsheet for your response and emailed it to the CC. However, if you prefer, you may enter the answers in the table above.

Our purpose in obtaining this information is to estimate total credit hire and credit repair turnover of all companies. If you have already provided the information, please cross-refer as appropriate. The CC is under strict constraints regarding the disclosure of commercially sensitive information and it is not our intention to publish individual company figures, only aggregated figures for all companies.

Further information about the inquiry and our policy on information disclosure can be found on our website:

Motor insurance inquiry http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/private-motor-insurance-market-investigation

Information disclosure http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/publications/cc7_revised_.pdf

We are very grateful for your time in providing this information.

Sensitivity analysis

1. In our main calculation we have used the best data we could obtain from the parties and we have made the most plausible assumptions, given our knowledge of the market. However, because of the uncertainties involved in some of the data we have used, we have checked the sensitivity of the estimate to changes in the data or on the assumptions we have made.

2. In this appendix we analyse the impact of uncertainty about:

   - insurers' estimates of handling cost
   - our assumptions regarding the existing level of provision and costs
   - our assumptions regarding the benchmark level of provision and costs
   - our assumptions regarding the extent of pass-through of insurers' profits on non-fault claims

Cost estimation by insurers

3. As explained in Appendix E, we asked insurers to estimate their costs of handling claims and used the average of the available estimates in our calculation of the net detriment. There was substantial variation between insurers in their ability to estimate these costs and, for those insurers which were able to estimate these costs, there was also substantial variation in responses. The variation in responses may reflect genuine cost differences between insurers, but it may also reflect different approaches to cost estimation. In order to understand uncertainty associated with the latter point, we show in Table 1 the effect on total net detriment and the net detriment from credit hire of using figures from the insurer which implied the highest and lowest figures for total net detriment and the net detriment from credit hire respectively.

TABLE 1 **Detriment estimates using costs figures from individual insurers (and change compared with main estimate of net detriment)**

	£ million	
	Total net detriment	*Net detriment from credit hire*
Highest figure	180.4 (+67.4)	119.3 (+32.3)
Lowest figure	88.5 (–24.4)	67 (–20)

Source: CMA.

4. One insurer gave us very low estimates of the frictional costs it incurs when at fault and relatively high estimates of the cost of managing captured claims. This results in a low net detriment, both on credit hire and overall. On the other hand, another insurer provided very high figures for frictional costs and low estimates of management costs. These figures result in a very high detriment.

5. As discussed in Appendix E, our main estimate of the net detriment assumes that all the management costs related to captured claims which cannot be directly attributed to the provision of replacement vehicles should be allocated to repairs/write-offs (see Appendix E, paragraph 6). Table 2 below shows the changes in the net detriment estimate if instead these costs are allocated equally between repairs/write-offs and replacement vehicles.

TABLE 2 **Net detriment under equal split of common costs between repair/write-offs and replacement vehicles (and change compared with main estimate of net detriment)**

	£ million	
	Credit hire	*Total*
Cost data from all insurers in the sample	78.4 (–8.6)	116.1 (+3.2)
Cost data from one insurer (highest figures)	66 (–21)	88.9 (+24.1)
Cost data from one insurer (lowest figures)	115.3 (+28.3)	181.8 (+68.9)

Source: CMA.

Note: We test the impact of a different allocation of per-claim management costs which are common to repairs/write-offs and to the provision of replacement vehicles. Since the overall number of claims involving repairs/write-offs is larger than the number of claims in which a replacement vehicle is provided, the different assumption has an impact on the size of the total net detriment.

Existing level and cost of provision

6. We have considered the following areas of uncertainty in regard to the existing level and cost of provision:

- average credit hire bill
- number of credit hires and credit repair/write-offs

- VAT may not be charged on some credit hire bills
- credit hire claimants receive a benefit from the GTA classification of cars being narrower than the standard car hire classification

7. Using data on revenue from our sample of CHCs, we have estimated that the average cost of a credit hire in 2012 was £1,105. Other data suggests the average cost was higher than this. Data from insurers suggests an average cost of about £1,400[1] and our survey of CHCs suggests an average bill close to £1,235.[2] We found that the figures from insurers might not be comparable with those used in our main estimate and so we used the average bill from our survey of CHCs as an alternative basis for our net detriment calculation.[3] Table 3 shows estimates of the detriment for credit hire adopting this higher value in two ways:

- Using the same ratio of credit and direct hire bills as in the baseline calculation (appropriate if the actual average credit hire bill is higher due to longer hire lengths or more expensive car classes which would also affect our estimated average direct hire bill).
- Using the same average direct hire bill as estimated in the baseline calculation (appropriate if the actual average credit hire bill is higher for other reasons, which would not affect our estimated average direct hire bill).

TABLE 3 **Net detriment for credit hire under alternative average bill**

	Average credit hire bill £	*Credit hire £m*
Fixed credit/direct rate ratio	1,209	103 (+16)
Fixed average direct rates	1,209	118.3 (+31.3)

Source: CMA.

8. The number of credit hires and credit repair/write-offs used in our main estimate of the net detriment was based on grossing up estimates for a sample of insurers and brokers.[4] We noted the estimated number of private credit hires from our survey of CHCs was slightly lower, at 289,000,[5] than the 301,000

[1] See provisional findings, paragraph 6.14(a).
[2] See Appendix F. Taking into account the benefit insurers get from delayed payments, this amount reduces to £1,209.
[3] We did not calculate an additional sensitivity for credit repair as the average credit repair bill used in our main estimate (£1,576) was very similar to the average credit repair bill suggested by our survey of CHCs (£1,601, or £1,572 after taking into account delayed payments).
[4] See provisional findings, Appendix 6.6, Annex A.
[5] See Appendix F.

used in our main estimate.[6] While the figures from the CHC survey also involved estimation, in particular for the proportion of credit hires by privately insured claimants, we noted they would reduce the credit hire net detriment to £83.5 million and the total net detriment to £109.5 million (£3.5 million lower than our baseline estimate).

9. As discussed in paragraphs 81 to 84 of the working paper, the credit hire rates we have considered are inclusive of VAT. This is because, as insurers are VAT-exempt, they cannot reclaim from HMRC the VAT paid on hire services. The only exception is when the claimant is VAT-registered, in which case VAT is paid by the claimant themself. However, this happens rarely for privately-insured claimants. One insurer told us this happened in less than 5% of claims. If we exclude VAT in 5% of hire claims, the credit hire net detriment is reduced by £3.3 million to £83.7 million and the total net detriment to £109.6 million.

10. Credit hire claimants may receive a benefit from the GTA classification of cars being narrower than the standard car hire classification (see paragraphs 48 to 54 of the working paper). This is not captured in our model, because we adopt the standard classification for both credit and direct hire. Estimating this benefit is not easy, as we do not know how many claimants are affected and what additional value they assign to the slightly better models potentially received under credit hire. Results from our survey showed that about 6% more respondents whose claims were managed by at-fault insurers felt the car fell slightly short of their needs.[7] If we assume that the less good quality of service to these respondents is worth £100, the average benefit from separation is £6 per hire (6% of £100). While it seems implausible that this benefit is entirely due to the broader classification of vehicles under direct hire,[8] if we do assume this to be the case, the effect is to reduce the credit hire detriment by £1.8 million to £85.2 million (the total net detriment would be £111.2 million).

Benchmark level and cost of provision

11. For our main calculation we assumed that, in the benchmark, claimants receive the same kinds of vehicles as currently provided under credit hire, and

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[6] We did not calculate an additional sensitivity for credit repair as our main estimates assumed 85,000 credit repairs and 21,000 credit write-offs (a total of 106,000), whereas the CHC survey showed 98,000 private credit repairs but this may or may not have included credit write-offs. It therefore was not clear whether our main estimate of credit repairs and write-offs was higher or lower than implied by the CHC survey.
[7] See paragraph 53 of the working paper.
[8] The part of this benefit due to other factors (eg getting a replacement vehicle in a lower standard hire category) should not be taken into account, because the adjustments to direct hire rates adopted in our calculation already account for those factors.

for the same number of days. This is appropriate if credit hire claimants currently receive their legal entitlement and no more than that. However, we have considered two alternative approaches as sensitivities:

- The type of vehicle provided under the benchmark is similar to those currently received by credit hire claimants but the benchmark length of hire is reduced to the current direct hire average.
- The benchmark type of vehicle is assumed to be similar to the current direct hire average but hire lengths remain in line with current credit hire averages.

We consider each of these in turn.

12. As regards hire length, our main estimate of the net detriment assumes that, in the benchmark, direct hires would have the same length as credit hires do currently. The data we received from car hire providers shows, however, that currently direct hires are on average shorter. Although we did not find convincing evidence that this difference was due to unreasonably long credit hires, we noted in our provisional findings that this explanation was a possibility.[9] Furthermore, existing credit hire lengths may be affected by difficulties coordinating the hire and repair process when two different companies are involved (insurer managing repair/write-off and CHC managing the replacement vehicle provision), which would not occur in our benchmark situation (where claimants receive their legal entitlement but there is no separation). It is therefore possible that in our benchmark hire lengths would be similar to the current direct hire average rather than the current credit hire average.

13. If we multiply the average direct hire rates for each class of vehicles by the corresponding ratio between the average durations of credit hires and direct hires, we obtain an average £648 difference between credit hire and direct hire bills. Using this value, the net detriment for credit hire increases to £111.7 million (£24.7 million higher than our baseline estimate).

14. With regard to the type of vehicle (see the second bullet in paragraph 11), our main estimate of the net detriment assumes that, in the benchmark, car hire classes are similar to current credit hire car classes, ie that currently credit hire claimants receive their legal entitlement and no more than that. On average, direct hire currently involves less expensive car classes than credit hire and this may be associated with a higher level of mitigation under direct

[9] See provisional findings, paragraph 6.15.

hire.[10] Therefore we considered an alternative assumption, under which hire classes in our benchmark situation (where claimants receive their legal entitlement but there is no separation) were similar to existing direct hire averages. We recognised that an implication was that credit hire claimants on average received a higher quality of replacement car than their legal entitlement (ie the benchmark assumption) and we took this into account.

15. The data from direct hire providers implies an average bill of £468 based on existing direct hire classes and credit hire lengths.[11] Subtracting it from the average £1,105 credit hire bill, we get an average difference of £637. To this we must subtract an estimate of the average benefit claimants get from the better cars provided under credit hire. On the assumptions set out above (see paragraph 10), the average benefit is £6 per hire reducing the average difference to £631. As a consequence, the net detriment for credit hire becomes £106.6 million (an increase of £19.6 million over our main estimate).

16. If we assume that, in the benchmark, both direct hire lengths and car classes are in line with current direct hire averages, rather than current credit hire averages, the net detriment for credit hire becomes £130.3 million (an increase of £43.3 million).

Pass-through of non-fault insurers' profits

17. We have assumed that both the additional costs incurred by at-fault insurers and the additional profits made by non-fault insurers (and brokers) are passed through in PMI premiums pro rata. However, there is greater uncertainty on the level of pass-through of non-fault insurers' profits. We expect this pass-through to be high but Table 4 shows the impact of assuming a pass-through of 90% or 80% rather than 100% as in our main estimate.

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[10] Credit hire providers have an incentive to provide a class of car that is more expensive than needed because their profit is likely to increase with the class of car (the ratio of credit hire cost to direct hire cost is broadly constant across car classes (see Table 10 in the working paper), but additional credit hire costs, including referral fees, are broadly constant per claim). Our review of a small number of call records indicated there was less mitigation under credit hire than under direct hire (see provisional findings, Appendix 6.5, paragraphs 64–69).
[11] We have weighted the direct hire rates for each vehicle category by the number of direct hire claims in 2012 and have multiplied the average by the average length of credit hires. The fact that we cannot identify the number of direct hires involving vehicles in the GTA classes F9, P11–P13, and SP11–SP13 (see Table 10 in the working paper) creates minimal distortions.

TABLE 4 **Net detriment under alternative pass-through of non-fault insurers' profits**

£ million

Pass-through	*Credit hire*	*Credit repair*	*Credit write-off*	*Insurer-managed repair*	*Insurer-managed write-off*	*Total*
90%	96.9 (+9.9)	15 (+0.5)	0.2 (+0.1)	11.2 (+2.3)	2.7 (+0.3)	126 (+13.1)
80%	106.8 (+19.8)	15.5 (+0.9)	0.4 (+0.2)	13.5 (+4.6)	3 (+0.7)	139.1 (+26.2)

Source: CMA.

Net detriment ranges

18. We have calculated the range of possible values of the net detriment combining the effects analysed above (except for those using the claim handling costs of individual insurers).[12] Table 5 shows the assumptions used to generate the upper and lower values of the ranges. The values are then shown in Table 6.

TABLE 5 **Assumptions used to determine the ranges of possible net detriment estimates**

	Credit hire		*Repairs and write-offs (either credit or insurer-managed)*		*Total*	
	High level	*Low level*	*High level*	*Low level*	*High level*	*Low level*
Allocation of common costs	All to repair	Equal split	Equal split	All to repair	Equal split	All to repair
Average credit hire bill	£1,209 (fixed average direct rates)	£1,105			£1,209 (fixed average direct rates)	£1,105
Number of hire claims	301,000	289,000			301,000	289,000
VAT on credit hire	Always included	Excluded in 5% of claims			Always included	Excluded in 5% of claims
Adjustment for different classifications	No	Yes			No	Yes
Adjustments to direct hire rates	None	For vehicle models and duration			None	For vehicle models and duration
Pass-through of revenues	80%	100%	80%	100%	80%	100%

Source: CMA.

[12] We have not used the claim handling costs of individual insurers as they may be outliers.

TABLE 6 **Ranges of possible net detriment values**

	£ million	
	High estimate	*Low estimate*
Credit hire	181.4	70.4
Credit repair	17.9	14.6
Credit write-off	1	0.1
Insurer-managed repair	20.4	8.9
Insurer-managed write-off	4.9	2.4
Total	216.9	104.6

Source: CMA.

Note: Since the assumptions on the allocation of common costs have an impact on the estimated total detriment, the high and low estimates of the total detriment are not the sums of the high and low estimates for the various components.