COMPETITION AND MARKETS AUTHORITY (CMA)

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

RESPONSE OF SAGA AND THE AA TO THE CMA'S PROVISIONAL DECISION ON REMEDIES

I Introduction

1 This response to the CMA's Provisional Decision on Remedies (**PDR**) is submitted on behalf of Saga Services Limited (**Saga**) and The AA (**AA**). As the CMA may be aware, Acromas Holdings Limited (**Acromas**) is no longer a controlling shareholder in either Saga or The AA, following the recent flotations of Saga plc and AA plc on the London Stock Exchange. Although this is a joint response, we distinguish between Saga and The AA, where appropriate.

2 Saga and The AA agree with the CMA that the proposed package of remedies set out at paragraphs 7 and 10 of the PDR, coupled with the recommendations proposed at paragraph 12, provide a comprehensive and effective remedy to the adverse effects on competition (**AECs**) which the CMA has provisionally found in respect of Theory of Harm 1 (separation of cost liability and cost control) (**ToH 1**) and Theory of Harm 4 (asymmetries between motor insurers and consumers in relation to add-ons) (**ToH 4**). Saga and The AA have therefore restricted their comments on the remedies proposed in respect of ToH 1 and ToH 4 to design issues, in order to ensure that these remedies are both workable and proportionate to the harm identified by the CMA.

3 Saga and The AA agree with the CMA that there is no evidence to support a finding of an AEC in relation to Theory of Harm 2 (possible under provision of post-accident repair services) (**ToH 2**).

4 Saga and The AA strongly disagree with the CMA's provisional decision on remedies relating to Theory of Harm 5 (MFNs) (**ToH 5**) . In their view, the CMA has significantly underestimated the harm caused by narrow MFNs and is misplaced in its assertion that narrow MFNs produce benefits by ensuring the credibility of PCWs. The CMA has not undertaken any proper assessment of whether the PCW business model would in fact be threatened in the absence of narrow MFNs. To the contrary, when compared against the correct counterfactual, the evidence indicates that narrow MFNs would proliferate and that this would generate significant consumer harm, giving rise to an AEC which should be remedied by way of a prohibition on all MFNs (both wide and narrow).

5 If, notwithstanding the strength of the evidence set out in paragraph 4 above, the CMA does not extend the remedy in respect of ToH 5 to include narrow MFNs following the introduction of any enforcement order, Saga and The AA submit that:

(a) the remedy package for ToH 5 should include a mechanism for the remedy to be extended after two years to prohibit narrow MFNs if there is evidence that narrow MFNs have proliferated during that period and are having an effect which is equivalent to the AEC caused by wide MFNs. This extension would take effect if either:

(i) there is evidence that the prohibition on wide MFNs has not been effective in increasing competition between PCWs on commission rates; or

(ii) there is evidence that consumers are suffering significant harm (equivalent to the harm currently caused by wide MFNs) because narrow MFNs have

proliferated and competition from the online direct channel is being suppressed; and

(b) in any event, the prohibition on wide MFNs, which would take effect immediately following the introduction of any enforcement order, should be drafted broadly in order to include any behaviours which have the effect (directly or indirectly) of reducing competition between PCWs in a similar way to the harm caused by wide MFNs. Accordingly, Saga and The AA agree with the CMA that the carve out for narrow MFNs should be drafted as narrowly as possible and should exclude aggregator platforms such as Facebook.

II Remedy A

6 Saga and The AA support the CMA's proposal for Remedy A. In formulating its provisional decision, the CMA invited views on the three following issues:

(a) When should the information be provided to customers?

Saga and The AA agree with the CMA that providing information at FNOL would be likely to have more impact than providing information with the customer's policy documentation or online, providing this is targeted to the customer's needs and is delivered in a clear manner.

(b) What information should be provided to customers?

Saga and The AA support the provision of standardised wording in the form of a statement of consumer rights and responses to FAQs.

(c) *Which parties should be required to comply with the remedy?*

Saga and The AA agree that Remedy A should be binding on all PMI providers and all participants handling FNOL, as set out at paragraph 2.35 of the PDR. We believe an enforcement order would be the most effective mechanism to give effect to Remedy A , with a 3 month time limit for implementation following the making of the order (in line with the proposal at paragraph 2.39 of the PDR).

7 Saga and The AA support the requirement to provide an annual compliance statement to the CMA in respect of this remedy.

III Remedies 1C and 1F - measures to address features relating to replacement vehicles

Remedy 1C

8 Saga and The AA agree that this package of remedies would be effective in addressing the AECs identified by the CMA. Our comments are limited to certain aspects of the design of the remedy proposals to ensure that they are proportionate to the harm identified by the CMA and do not lead to unintended consequences or give rise to material circumvention risk.

Rate cap

9 The proposed rate cap should be effective in reducing the cost of non-fault replacement vehicle claims, reducing administrative and frictional costs and (over time) reducing differential effects between higher and lower risk drivers. However, Saga and The AA have the following comments on the design of the rate cap:

To whom and what should Remedy 1C apply?

10 Throughout its discussion of Remedy 1C, the CMA makes reference to subrogated claims made by insurers. It should be noted that the term "subrogation" is specific to recoveries made by insurers in the name of the policyholder *after* the insurer has made an indemnity payment to that policyholder. This is distinct from credit recovery claims as made by CHOs. Remedy 1C should apply to both forms of recovery to avoid any risk of circumvention.

How should a rate cap be set?

11 Saga and The AA agree with the CMA's view at paragraph 2.66 of the PDR that the low rate cap should be set above the level of cost efficiently incurred in providing a replacement vehicle in order to provide the best balance of incentives. Although the precise method of provision should be determined by competition, and it is not the CMA's intention to favour one business model over another, the low rate cap needs to be set at a level which achieves a balance between incentivising providers to become more efficient, whilst ensuring that non-fault claimants continue to receive a replacement vehicle in a timely manner which meets their needs, in line with their tortious rights. We would therefore support an initial rate cap which incorporates a reasonably generous margin. The level of the low rate cap could then be reappraised periodically to take account of the way in which competition is working in the provision of replacement vehicles. This would have the added benefit of enabling CMCs and CHCs to make an orderly transition to the new arrangements.

12 Saga and The AA agree with the proposal at paragraph 2.69 of the PDR to include a fixed replacement vehicle arrangement element and a variable daily cost element in calculating the cap. We agree that using direct hire rates would be the most appropriate starting point, and support the CMA's proposal at paragraph 2.76 of the PDR. Whilst this is the most practical starting point, it is important to ensure that there is sufficient flexibility so that the use of the average (median) daily hire rate does not render shorter term hires unviable. This could also be a matter that is reappraised periodically.

13 We agree with the CMA's proposed cut-off at paragraph 2.78 of the PDR of three days for the determination of liability, with the low cap applying where the at-fault insurer accepts liability. Three days should be an appropriate "window" for these purposes and will challenge at-fault insurers to become more efficient.

14 A potential issue with the three day time-frame arises where a claim involves a PI element. When a decision on liability is made in the commercial context of the three day time-frame, but a PI claim is notified late to the insurer, the admission of liability may prejudice the outcome of the PI claim. The CMA should consider the possibility of a carve-out to admissions of liability (either as a part of the order, or on a statutory basis) when an insurer is presented with a PI claim, or where fraud is suspected.

15 Saga and The AA agree that it would be appropriate to prohibit replacement vehicle providers from using financial inducements to encourage claimants to take a replacement vehicle at rates above the cap.

16 The CMA is proposing that the high rate cap would be set at approximately double the level of the low rate cap (noting that daily GTA rates are currently about twice the level of direct hire daily rates). We agree with the CMA that this seems broadly appropriate. However, it is important to ensure that the methodology used to calculate the low rate cap provides a sufficient incentive in practice for credit hire organisations to provide a replacement vehicle (i.e. that they truly reflect the level of efficient costs incurred but also provide an appropriate margin, as noted above).

Subsequent determinations of the rate cap

17 Saga and The AA support the proposal at paragraph 2.96(b) of the PDR for the rate cap to be indexed, with periodic reviews two years following implementation and three years thereafter. This would enable the CMA to tighten the lower rate cap over time if there is evidence that supra-competitive profits are being made by CMCs and/or CHCs on the provision of replacement vehicles.

What other measures need to be put in place to support the effectiveness of Remedy 1C?

18 Saga and The AA broadly support the CMA's use of GTA provisions in formulating an order, including those set out in the PDR at paragraphs 2.107 and 2.114-2.129 of the PDR. Specifically these include:

(a) Vehicle hire duration provisions;

(b) Customer acceptance;

(c) Monitoring by CHCs during hire and payment arrangements (payment packs and late payment penalties); and

(d) Payment arrangements, including penalties for late payments.

19 However, the GTA also contains provisions on credit hire relating to the areas listed below, which as currently drafted the PDR does not make reference to. These may provide opportunities for parties to increase costs, and could subsequently form the basis of disputes. Saga and The AA therefore suggests that the CMA incorporate these areas of the GTA into the enforcement order:

(a) Extras (e.g. USB ports, satellite navigation systems and tow bars)

(b) Non-standard insurance; and

(c) Delivery and collections costs.

20 Additionally, the proposal at paragraph 2.107 of the PDR to allow no recovery of hire costs 24 hours after the completion of the repair or 7 days after submission of the total loss payment does not sufficiently address the incentives to complete the repair in a timely and efficient fashion.

Distortion risks

21 Saga and The AA do not agree with the CMA's provisional conclusion at paragraph 2.132 of the PDR that any distortion to competition caused to other (non-PMI) areas of motor insurance is likely to be small. In excluding commercial and other vehicles from the scope of the remedies, careful consideration should be given as to how commercial vehicles are defined. Some examples of where definition may become difficult include:

(a) Vehicles owned and used by small traders for personal and business use, whether insured using a commercial vehicle policy or not; and

(b) Multi-car policies, which could fall into the definition of 'fleet'.

Monitoring and enforcement

22 Saga and The AA agree with the CMA's provisional decision at paragraph 2.146 that an independent panel within the CMA should set the rate cap and should be responsible for reviewing this on a periodic basis.

Circumvention risks

23 The PDR does not contain any remedies in relation to credit repair services. This leaves a significant opportunity for circumvention - there is a risk that insurers may inflate subrogated credit repair claims in order to replace credit repair fees, whilst CHOs may also inflate claims in order to increase margins. Although the Court of Appeal's decision in *Coles v Hetherton*[1] provides for a reasonableness requirement for credit repair claims, in that case reasonableness was assessed by reference to average retail rates. This still allows for labour rates to be inflated, as well as allowing insurers or CHOs to recover repair costs greater than those incurred by the repairing garage. We would encourage the CMA to consider this in finalising its proposed remedy package.

24 Another implication of not providing for the regulation of credit repair costs is that insurers will continue to maintain intervention teams for credit repair claims, whilst these same teams are likely to fall away for credit hire. Therefore, inefficiencies and frictional costs for credit repair claims will not be addressed. Additionally, it could lead to the situation where repairs and hires are managed by different firms – neither of which are the non-fault insurer – which may be confusing for customers

Remedy 1F

25 Saga and The AA have no comments on the scope of Remedy 1F. We agree with the CMA's proposal to incorporate a mitigation declaration into existing processes within 3 months of making an enforcement order.

26 Saga and The AA also support the CMA's draft mitigation statement set out at Appendix 2.3

IV ToH 2

27 Saga and The AA agree with the revised finding in respect of ToH 2 (as set out in paragraph 4 of the PDR).

V Remedies to address ToH 4 (sale of add-on products)

28 Provisional Remedy 4B includes requirements to list the implied price of NCB protection, step-back procedures and average NCB discounts per NCB years at the point of sale. We agree with the scope and design of the proposal, but have a number of comments on its design and 'timeliness', as set out below.

Design

29 As the CMA has noted in the PDR, both NCB scales and step-backs are dynamic (i.e. they depend upon the risk data entered and will therefore vary for each customer). It is therefore important that both the NCB scales and step-backs that are published show the actual scales for each specific customer quote, rather than an average for the insurer.

[1] [2013] EWCA Civ 1704

Timeliness

30 The AA believes that the proposed timetable for implementation of Remedy 4B is too short. The AA is structured as a broker with a panel of insurers, each of which operates different NCB scales. Under the CMA's provisional remedy, the relevant NCB scales would need to be disclosed every time a quote is based on an insurer's rates. If a customer requests a number of quotes, then different insurers on the panel may be cheapest for each quote iteration, and each iteration will lead to a change in the disclosed NCB scales. The dynamic element of such changes will require complex adjustments to the AA's website.

31 Step-backs also vary by insurer, however, step-back information is not currently held by the AA in tabular, or any other suitable format. In order to comply with the provisional remedy the AA would have to create and maintain a database containing step-back data for each insurer in formats suitable for publication.

32 Notwithstanding the period between publication of the CMA's final report and the making of an enforcement order, the AA will not be in a position to implement the proposals until the precise details of the requirements are decided upon by the CMA in its enforcement order.

33 The AA envisages that such changes would take up to one year to implement effectively and would therefore encourage the CMA to provide for a 12 month period for implementation following the making of any enforcement order.

VI Theory of Harm 5

Saga and The AA do not accept the CMA's provisional conclusion that the harm from narrow MFNs is limited

34 The CMA has given insufficient weight to the harm that brand loyal customers suffer as a result of narrow MFNs While Saga and The AA still consider this number to be too low, they note that the CMA's own estimates suggest that 1.2 million customers might be affected by narrow MFNs (A4(2)-3, paragraph 14).

35 The CMA accepts these customers may be harmed as a result but concludes that any such harm is "limited" because:

"*Evidence from PMI providers suggests that the price elasticity of demand for consumers who do not visit PCWs is much lower than for those who do … . Therefore, it is likely that those who do not use PCWs to buy their policies, even if only as a research tool, would be offered higher prices rather than lower prices.*" (A4(2)-3, paragraph 14)

36 If this were the case, Saga and The AA would already be charging their direct customers more than their PCW customers, which is not the case. [REDACTED]

In the absence of narrow MFNs, therefore, direct prices would either stay the same or go down.

The CMA has not taken the correct counterfactual into account

37 Paragraph 320 of CC3 provides that:

"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' … i.e. one that displays the beneficial aspects of competition … The benchmark will generally be the market envisioned without the features."

38 The CMA has given inadequate consideration to Saga and The AA's concerns that, by not prohibiting narrow MFNs, the CMA is in effect imposing narrow MFNs, because they would have been given implicit regulatory approval. At paragraph 16 of A4(2)-3, the CMA concludes:

"Acromas provided us with several of its correspondences with PCWs to support this point in relation to both narrow and wide MFNs. However, it was difficult to conclude that any narrow MFNs had been resisted up to now on the basis of legal uncertainty in relation to them."

39 In fact, Acromas provided at least seven emails that demonstrated that narrow MFNs had been resisted on this basis. [REDACTED].

40 [REDACTED]

41 As stated within Acromas' submission, much of the communication concerning MFNs took place orally during the course of commercial negotiations (for example, [REDACTED]. Accordingly correspondence concerning wide MFNs was also included to help demonstrate the context in which such negotiations took place, and the arguments made by insurers.

42 Further, at paragraph 17 of Appendix 4.2, the CMA sets out its prediction that *"as a result of this remedy, many wide MFNs will be re-negotiated as narrow MFNs"*. It is clear that not only will wide MFNs be re-negotiated as narrow MFNs, but that contracts that previously contained no MFNs will now become subject to them. Insurers and brokers have little commercial choice but to work with PCWs given their market power, so there is no realistic prospect of resisting narrow MFNs if they are 'endorsed' by the CMA. This will significantly increase the total number of MFNs in PMI contracts. [REDACTED].

The CMA has afforded insufficient weight to the issue of risk selection

43 As Acromas has previously highlighted, amongst other things, the persistency of poorer risk selection and high cost per acquisition on price comparison websites typically lead to two to three per cent higher costs when selling through PCWs compared with direct channels. Narrow MFNs mean that these higher prices are reflected in the direct online channel, and direct online customers are unable to benefit.

The harm from banning narrow MFNs would not outweigh the negative effects of narrow MFNs

44 Saga and The AA do not accept that the harm from banning narrow MFNs would outweigh any negative effects of narrow MFNs.

45 The CMA accepts that there are other business models which could avoid the free-riding problem. In particular, as Simon Douglas explained at the remedies hearing:

(a) PCWs have grown and achieved significant market power without narrow MFNs; and

(b) there are other models which avoid the free-riding problem, such as anti-quote poaching clauses. Saga and The AA agree, and explain below how the same mechanism that could be implemented in support of an anti-quote poaching clause would also effectively address the credibility concerns of PCWs.

46 PCWs use insurers' or brokers' own websites to obtain a quote when a customer enters their details. Accordingly, that customer information is then stored by the insurance provider. If the

same customer went to that provider's own website and re-tendered for a quote, the provider would recognise that customer from their details. Accordingly it could ensure that the customer was presented with the same price-quote as they were given on the PCW. Conversely, if the customer visited the insurance provider's own website directly before using a PCW, if that customer then re-tendered on the PCW, the insurance provider could ensure that the price it offered on its own website, if lower, was presented to the customer through the PCW as well. Therefore, PCWs would not be undermined by a perception that direct-channel prices are cheaper.

47 The CMA asserts that the negative effects of a prohibition will exceeds its positive effects. The main argument the CMA relies on is that narrow MFNs ensure the credibility of PCWs. However, there is no proper cost/benefit analysis which underpins this contention.

48 Acromas explained in its response to the Provisional Findings that the Italian PCWs are not true PCWs, in that they do not allow consumers to purchase from the PCWs directly. As a result, the IAA was concerned to ensure that prices are not *higher* on the insurers' direct channels, rather than lower. Moreover, the Italian PMI market is very different to that of the UK, both in terms of structure, and in consumer habits – with only 4.7% of policies sold on the internet, including the direct channel.

49 Accordingly, it is clear that: narrow MFNs result in an AEC; the proposed remedy would distort the market by exacerbating rather than addressing that AEC; such distortion could be adequately prevented by the prohibition of all MFNs; and the negative consequences of prohibition are far less substantial than the CMA has previously considered in its analysis.

The CMA has given inadequate weight to the unintended consequences of only banning wide MFNs

50 It is clear that MFNs will proliferate into areas other than PMI. [REDACTED].

51 Moreover, PCW fees are flat for each scale of insurance, and weigh disproportionately on smaller premiums. The direct online channels could offer better value to consumers than PCWs through the use of appropriate pricing structures. In the absence of competition from the direct online channel, PCWs will have no interest in innovating as regards their pricing models, with a consequent adverse impact on large numbers of customers. We would encourage the CMA to consider these issues in finalising its proposed remedy package.

Mechanism to extend the prohibition to narrow MFNs after two years if there is evidence of competitive harm

52 If, notwithstanding the strength of the evidence set out above, the CMA does not decide to extend the remedy in respect of ToH 5 to narrow MFNs, Saga and The AA submit that the remedy package should include a mechanism to review how the prohibition on wide MFNs has operated for the first two years following the introduction of the enforcement order, and for the remedy to be extended to include a prohibition of narrow MFNs if there is evidence that narrow MFNs have proliferated and that these are having an effect on competition which is equivalent to the AEC caused by wide MFNs. Hence, this extension would take effect if either:

(a) there is evidence that the prohibition on wide MFNs has not been effective in increasing competition between PCWs on commission rates; or

(b) there is evidence that consumers are suffering significant harm (i.e. broadly equivalent to the level of harm currently caused by wide MFNs) because narrow

MFNs have proliferated and competition from the online direct channel is being suppressed.

The risk of circumvention means that it is critical to capture all "equivalent behaviours"

53 In any event and without prejudice to the arguments set out above, the prohibition on wide MFNs should be broad in scope in order to include any behaviours which have the effect (directly or indirectly) of reducing competition between PCWs in a similar way to the harm caused by wide MFNs. Accordingly, Saga and The AA agree with the CMA that the carve out for narrow MFNs should be drafted as narrowly as possible and should exclude any possible constraint upon non-PCW models outside of the online direct channel, for example possible aggregator platforms or potential new channels, such as social media platforms like Facebook.

54 Saga and The AA agree that there are other mechanisms, over and above the threat of delisting, which could be used by PCWs to create effects which are equivalent to a wide MFN. These are cited at paragraph 4.45 of the PDR. It is critical that the definition of "equivalent behaviours" is sufficiently flexible in order to prevent any of these methods being used by PCWs. We would encourage the CMA to clarify, both in the order and in any explanatory note accompanying the order, that "equivalent effects" would capture all such behaviours.

Robust monitoring is essential

55 Saga and The AA do not agree with the CMA's provisional decision that the use of civil proceedings would be an effective means of enforcing the order. This would be a highly costly and burdensome process in practice for PMI providers and would, when coupled with the significant circumvention risk in defining "equivalent behaviours" in any enforcement order, give rise to significant risk in practice for PMI providers. We prefer the adjudication mechanism set out in paragraphs 4.68 and 4.69 of the PDR, given the market power of the PCWs and the need to ensure there is an effective channel for seeking redress in practice. We also believe that there is an important role for the FCA to play in this regard in monitoring the behaviour of PCWs and their compliance with the terms of the order.