DIRECT LINE INSURANCE GROUP PLC

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

RESPONSE TO PROVISIONAL DECISION ON REMEDIES

1. Introduction and executive summary

1.1 Direct Line Insurance Group plc (**DLG**) welcomes the opportunity to respond to the Competition and Markets Authority's (**CMA**) provisional decision on remedies (**PDR**) published on 12 June 2014.

1.2 By way of summary:

(a) DLG broadly agrees with the CMA's proposal for Remedy A but has some practical points of detail which are discussed below.

(b) DLG strongly supports the CMA's intention to cap the cost of credit hire (or similar services) provided to non-fault parties. DLG believes that in the context of the net consumer detriment identified by the CMA, this type of remedy is the most proportionate way of tackling the inflated costs resulting from credit hire. However, DLG believes that as is currently contemplated in the PDR, the CMA does not have the power to impose Remedy 1C. There is a relatively easy solution to this, and DLG believes the remedy could work successfully if the CMA were to cap the charges for the provision of a temporary replacement vehicle (**TRV**) by a TRV provider such as a credit hire company (**CHC**) or other TRV provider under a credit hire (or similar) agreement to a non-fault claimant (thereby capping the liability of the non-fault claimant to pay those charges). This would then act as an automatic cap on the amount that could be claimed for credit hire in court proceedings against the at-fault insurer by way of damages for loss of use of a vehicle.

(c) DLG believes that an electronic portal would be critical to the success of Remedy 1C (to reduce frictional costs and to help insurers speed up the process of establishing liability). However, the dual-rate price cap proposed by the CMA will result in a misalignment of incentives as between CHCs and insurers: CHCs will want the high rate cap to apply to as many claims as possible and so will not want to continue to commit funding, resources and time to establishing a portal voluntarily. It is imperative therefore that the CMA requires insurers and TRV providers to establish and use an electronic portal as part of its remedial order.

(d) DLG supports the CMA's proposals to provide the implied price for no claims bonus (**NCB**) protection and information on step-back rules. However, DLG has very significant concerns about the CMA's proposals for disclosure of average NCB discounts and mandatory statements relating to NCB protection. These are confusing and misleading and would directly conflict with the Financial Conduct Authority's (**FCA**) approach to regulation (which focusses on improving consumer outcomes) and also with regulatory requirements, for example, to treat customers fairly. There is a real risk that insurers will not be able to satisfy both the CMA's order and the FCA's regulatory requirements. The CMA's proposal that the FCA should review the remedy in two years' time is entirely inadequate to resolve this. Given this, and in the absence of any proper consideration by the CMA of the net consumer detriment associated with NCB protection, and more generally of the proportionality of this remedy, DLG strongly advocates that this is something best dealt with by the FCA. This is consistent with the CMA's reasoning for not pursuing Remedy 4C (where the CMA has explicitly acknowledged that the FCA is better placed to deal with these issues).[1]

(e) DLG is pleased that the CMA proposes to ban not only wide most-favoured nation (**MFN**) clauses but also behaviour equivalent to wide MFNs. For this remedy to be effective, it is crucial that the CMA provides a robust monitoring and enforcement regime. It is not realistic to expect insurers to challenge any behaviour that potentially infringes the CMA's order by resorting to civil proceedings, given the importance of price comparison websites (**PCWs**) as a key distribution channel for all insurers (and the costs and uncertainties of litigation).

(f) DLG is surprised and disappointed that the CMA has chosen not to ban narrow MFNs given the potential harm the CMA has previously recognised that narrow MFNs can cause. DLG continues to believe that narrow MFNs do potentially impact a material part of the market. There is no evidence to support the CMA's contention that they are necessary to ensure the credibility of PCWs (despite the CMA's comments to that effect, it is clear that Italy is not an appropriate comparator). As a bare minimum, the CMA must, as DLG has proposed before, monitor the behaviour of PCWs so that if costs-per-acquisition (**CPA**s) do increase at unreasonable rates the CMA can then take the appropriate action.

1.3 In relation to the implementation of remedies, the CMA suggests that the six (to ten) month period during which the CMA will consult on and finalise its enforcement order can be used to initiate "… any administrative and IT changes."[2] This approach applies to each of Remedies A, 1C, 1F and 4B. However, as the CMA itself recognises, this six to ten month period will be before the enforcement order has been finalised. This will mean that the detail of these remedies (which will be critical to how they will be implemented) will not be known. It is therefore very difficult to understand what administrative and IT changes the CMA believes that parties will be able and willing to effect during that time. Businesses will be reluctant to make significant investments of this nature if there is a risk that those costs will be wasted as a result of changes to the detail of the remedy. At best it is realistic to expect only limited planning and preparations to be made until the remedial order is finalised.

1.4 The CMA must therefore allow more time following the making of the enforcement order for each remedy to be implemented. Whether a further six months is sufficient will depend on the nature of the changes required. Anything involving structural changes (to products, pricing, or the way that prices are returned to PCWs or insurers' own websites) is likely to take longer than six months. For example, if as proposed by DLG, the CMA requires the introduction and use of an electronic portal this will take significantly longer than six months to design, build and implement.

2. Remedy A

2.1 DLG is supportive of the CMA's intention to provide better information to consumers about their rights following an accident with the annual policy documentation and at first notification of loss (**FNOL**). In particular, DLG has consistently been of the view that the provision of information would have greater impact at FNOL,[3] and is pleased that one of the key findings from the GfK Report confirms this.[4]

2.2 DLG does have some practical points of detail that in its view need to be taken into consideration by the CMA in order to ensure that Remedy A is implemented in the most effective and cost efficient way.

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1 PDR, para 3.90.
2 See for example, PDR, para 2.39.
3 DLG response to Notice of Possible Remedies, para 2.1.
4 GfK Report, para 1.2.

(a) The CMA will need to make clear in its order which party should be responsible for making the FNOL statement.

(b) The CMA proposes that the company performing FNOL should offer to send the non-fault party a link to the statement of consumer rights and FAQs. The FAQs relate to the non-fault party's policy entitlements. However, as the CMA recognises, often the FNOL party is not the non-fault insurer and in these circumstances it would be odd for a company which is not the non-fault insurer to have to send the non-fault party a link to FAQs potentially of a competitor. It may therefore be preferable to place the obligation to provide this information on the non-fault insurer only.

(c) There should be a separate FAQs document for CHCs which sets out responses to key questions which consumers may have (or information which should be available to them) about credit hire, for example, relating to the nature of the credit agreement.

(d) DLG understands that the CMA's intention is for the statement of consumer rights to set out (rather than change or supplement) consumers' existing legal rights as non-fault claimants whereas the FAQs will explain customers' contractual entitlements under a policy. Assuming this is correct, DLG does not believe that the statement of consumer rights should state that a non-fault claimant is entitled to have the repair carried out using original equipment (**OE**) parts. In some cases a part that needs to be replaced may not be an OE part (particularly if a vehicle is old). If the CMA were to require all repairs to be carried out using OE parts, this would lead to the non-fault party being put back into a better position than he/she was before the accident. In addition, OE parts will not always be available within the required time period for a repair and therefore it will not always be possible to meet a non-fault claimant's request to repair a vehicle using OE parts. Separately, DLG notes that where a customer is claiming under his/her policy the customer's entitlement to use of OE parts may differ depending on the terms of the policy.

3. Remedy 1C

(a) DLG is highly supportive of Remedy 1C in principle

3.1 DLG has consistently supported Remedy 1C throughout the CMA's investigation and so welcomes the CMA's provisional decision to pursue this remedy as the principal means of combatting the net consumer detriment associated with theory of harm (**ToH**) 1.

3.2 As DLG has discussed with the CMA previously, DLG does believe that a price cap on the costs of TRVs provided to non-fault parties would be an effective and proportionate way of reducing the inflated costs resulting from credit hire. However, DLG is concerned to ensure that any remedy ultimately adopted by the CMA should be robust and capable of withstanding potential legal challenge. As the CMA's proposals for Remedy 1C currently stand, DLG believes that they would leave the CMA vulnerable to challenge, on the ground that by seeking to cap the amount which can be claimed from an at-fault insurer, the CMA is exceeding its legal powers.

(b) Legal basis for an order

CMA's price capping powers only apply to provision of goods or services

3.3 The CMA proposes that Remedy 1C would apply at the point the claim is submitted by the TRV provider to the at-fault insurer. DLG understands this to mean that the CMA intends to cap the amount that a CHC or other TRV provider could seek to recover from an at-fault insurer at the point at which the claim is first submitted to the at-fault insurer. DLG does not believe there is a sound legal basis for this approach.

3.4 The CMA's powers under Schedule 8, paragraph 8 of the Enterprise Act 2002 (**EA02**) enable it to "regulate the prices to be charged for any goods or services." However, when a CHC presents a claim for settlement by an at-fault insurer, it is not charging the insurer a price for a service that the CHC has provided (nor, as a legal matter, is it subrogating a claim i.e. standing in the shoes of the claimant as the CMA suggests in the PDR).[5] Rather, it is exercising a contractual right to present and settle its customer's (i.e. the non-fault party's) claim in tort for damages for loss of use of the claimant's vehicle. The claim is made in the name of the CHC's customer against the assured of the relevant insurer (i.e. against the at-fault party) and is quantified by reference to the customer's liability for hire charges incurred, which counts as a substituted expense.

3.5 As proposed by the CMA, Remedy 1C would not, therefore, involve the CMA regulating the price that could be charged for a service; rather, the CMA would be purporting to regulate the amount that could be claimed in tort against an at-fault party. This is not something that is contemplated by Schedule 8, paragraph 8, EA02 and DLG does not believe that the CMA has the requisite power under Schedule 8, paragraph 8, EA02 to make such an order. DLG has also consulted Leading Counsel, who has confirmed that the CMA would lack the power to make such an order.

Remedy 1C must cap the rates charged to the non-fault party

3.6 DLG believes, however, that this issue could be relatively easily resolved. As DLG has proposed to the CMA previously, rather than capping the amounts recoverable from the at-fault insurer, this remedy would work if it were to cap the amount that could be charged by the TRV provider for credit hire (or other forms of hire arrangements for accident victims) to its customer (i.e. the non-fault party).[6]

3.7 There are a number of significant benefits to this approach.

(a) Capping the prices charged by a TRV provider to its customer for credit hire would clearly and unambiguously fall within the CMA's powers under Schedule 8, paragraph 8, EA02. There can be no room for argument about this.

(b) Capping the prices charged by a TRV provider to its customer for hire (in the contract or hire agreement) would have the effect of capping the contractual liability of the customer to pay TRV charges. This approach would mean that the non-fault party (i.e. the claimant) could not claim more than the rate cap either in settlement negotiations with the at-fault insurer or in any litigation.

(i) At present a claimant who is not classified as "impecunious" would ordinarily be entitled to recover in court proceedings the TRV charges which he/she had contracted to pay, subject to issues of mitigation of loss, and subject to the hire rate being no greater than what the courts have dubbed the "basic hire rate" (broadly speaking, the retail daily rate charged for the relevant vehicle by a typical retail hire company, such as Hertz or Avis).

(ii) Consequently, if the CMA were to limit the amount for which a claimant could be liable under his/her contract with the TRV provider for hire then any claim in litigation against the at-fault party's insurer for a sum greater than the contractual amount (i.e. for more than the customer's actual liability) would not succeed: the loss of use of the vehicle would have been remedied (through the provision of a

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[5] In this context, subrogation refers to the legal doctrine whereby an insurer which has indemnified its assured in respect of a loss may exercise any legal right of the assured for the purpose of recouping its outlay.

[6] In order to reduce the potential for circumvention, the remedy would need to be drafted so as to cover not just credit hire, but all forms of hire arrangement under which a TRV is made available to a non-fault victim of a road traffic accident, and under which the non-fault party is liable to pay the hire charges. References to 'credit hire' in this document should be interpreted as including such other forms of hire.

TRV) and no more than the actual cost incurred for the TRV could be recovered in court proceedings. The amount which could be claimed in settlement negotiations would be similarly limited.

(c) The remedy would be simple to police, unlike the CMA's own proposal, which presupposes that it is possible to distinguish between (a) a claim pursued by the TRV provider in the customer's name; and (b) a claim pursued by the customer without the involvement of a TRV provider. In practice, it is very difficult to make this distinction: CHCs operate in different ways with some, for example, not pursuing damages claims themselves but rather referring the customer to a panel law firm which will then pursue the claim in the name of the customer but effectively for the benefit of the CHC.

3.8 DLG therefore proposes that the rate cap should apply to the amounts charged by a CHC (or any other provider of TRVs for accident victims) in its contractual agreement with its customer. This would address the main cause of consumer detriment in the private motor insurance (**PMI**) market, namely inflated credit hire charges.

3.9 In discussions with the CMA about the design of Remedy 1C, the question was raised by the CMA as to how DLG's remedy proposal would work in a situation where the non-fault party's entitlement to a TRV was met by the non-fault insurer (for example, under the terms of the insurance policy), rather than pursuant to a separate credit hire arrangement with a CHC.[7] DLG's analysis of this scenario is as follows:

(a) The non-fault claimant would typically have no liability to pay for the TRV because the TRV would be provided to the non-fault party as an indemnifying benefit in kind under the terms of the insurance policy. The insurer would therefore not apply a charge (e.g. daily hire rates) to the non-fault party at the time of hire.

(b) If the non-fault insurer were to bring a subrogated damages claim against the at-fault party, both the provision of the TRV and the cost to the insurer of providing the TRV would be irrelevant from a legal perspective (under the *res inter alios acta* principle). In these circumstances, the claim would be regarded by the courts as a claim for loss of use of the claimant's vehicle and the measure of damages would be assessed by reference to a reasonable retail hire rate.[8] The sum recoverable by the non-fault insurer could not be limited to the amount for which the claimant was liable (if indeed it was liable at all), because of the principle that the insurance benefit is ignored in assessing damages for loss of use.[9]

(c) It is possible (but by no means certain) that the courts might in practice limit the sums recoverable in such subrogated claims to a level at or around that specified in the CMA's cost capping order; the chances of that happening might be greater if the order were to cap TRV rates by reference to average retail rates rather than by reference to direct hire rates, as this could be regarded as being more consistent with established case law, but again this is not certain.

3.10 However, even if the CMA's price capping order were not capable of directly controlling the amounts that could be claimed by insurers in the circumstances described in paragraph 3.9 above, DLG does not believe that this would, in practice, undermine the effectiveness of DLG's proposed approach.

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7 In practice, the insurer might outsource the actual provision of TRVs to a hire company, as occurred in *Bee v. Jenson* [2008] 1 Lloyd's Rep IR 221.

8 See *Bee v. Jenson* [2008] 1 Lloyd's Rep IR 221 at 234-36 (paras. 18-25).

9 See *Coles v. Hetherton* [2013] EWCA Civ 1704, at para 46 (and, at first instance, [2012] EWHC 2848 Comm at para 29).

(a) In these circumstances, insurers would have every incentive to control TRV costs for which they are liable and although they may see advantages in seeking to recover at prevailing (reasonable) retail rates when they are acting for the non-fault party, they will recognise that the incentives are reversed when they are acting for the at-fault party.

(b) To the extent that there were to be any asymmetry between the level of TRV costs which insurers would seek to recover from one another it would be open to them to negotiate bilateral agreements with each other to ensure parity of treatment.

(c) This approach is consistent with the CMA's analysis in relation to repair where the CMA expressly notes that: "… the solution to removing this asymmetry was in [insurers'] own hands through reaching bilateral agreements with the other insurers."[10] There seems no logical reason why the same mechanism could not be used to control TRV costs as between insurers.

(d) As the CMA has also acknowledged in relation to non-fault insurer repairs, bilateral agreements also provide "… benefits in reducing frictional costs. In our view, these bilateral agreements can provide a route to reducing the net detriment we identified."[11]

(e) In the case that insurers seek to recover at prevailing (reasonable) retail rates when they are acting for the non-fault party in the circumstances described in paragraph 3.9 above, there would be no harm to consumers. This is because the highly competitive nature of the PMI market will ensure that any additional revenues received by insurers are passed on to consumers. The CMA's own detriment calculations assume full pass through from insurers to policyholders.[12]

3.11 The CMA refers to the desirability of ensuring that the courts are aware of the CMA's findings and the role of Remedy 1C in addressing the adverse effect on competition (**AEC**) associated with ToH1.[13] DLG agrees with the suggestion that the CMA should produce an explanatory memorandum to accompany the order under Schedule 8, explaining the rationale for the remedy. For completeness, however, DLG does not see any place for judicial guidance in this process. Indeed, as DLG has already made clear in a previous submission to the CMA,[14] DLG's view is that the nature and role of judicial guidance have been fundamentally misunderstood by certain parties who have advocated its adoption in this investigation. The purpose of judicial guidance is to distil existing case law into a convenient format so that it can be taken into account by courts in future cases. However, it is crucial to appreciate that in the absence of a statutory enabling provision, courts would remain free to reach their own decisions in individual cases (subject to established principles and binding judicial precedents), and any judicial guidance could not limit their ambit of judgment.

(b) Methodology for calculating rate cap

3.12 DLG is generally supportive of the CMA's proposal to use average direct hire rates as a benchmark for setting the CMA's proposed rate cap. DLG believes that applied appropriately by the CMA this provides the most effective means of reducing the net consumer detriment identified by the CMA.

3.13 DLG has previously proposed an alternative methodology to the CMA which would require each element of the capped rates (including the basic hire rate and any fee charged for waiving the usual level of excess associated with the hire of a TRV) to be calculated on the basis of the average retail

10 PDR, para 2.217.
11 PDR, para 2.216.
12 Working Paper 23, para. 30 notes that: "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."
13 PDR, para 2.139.
14 DLG's Supplementary Paper on Possible Remedies, 9 May 2014, para 5.5.

spot rates for a particular category of vehicle. The analysis undertaken by DLG's economic advisers, Oxera, showed that if the capped rate were to be calculated based on an average (not the highest) retail spot rate, and if the fee charged for excess waivers were to be based on the fee for the same or similar product provided by an independent stand-alone provider, this would substantially reduce credit hire rates to a level close to direct hire rates. While DLG does continue to see benefit in this approach (including that a court may possibly be more amenable to assessing damages for loss of use by reference to this type of benchmark which relates to retail rates), DLG acknowledges that using direct hire rates is likely to be a more direct and straightforward means of tackling the net consumer detriment identified by the CMA.

3.14 In terms of the vehicle arrangement fee, DLG agrees that the GTA administration fee is an appropriate measure of administrative costs. Regarding upfront costs DLG considers that the costs for TRV preparation and delivery should be considered as part of the daily rate and there should be no additional charge for this. DLG also believes the rate needs to be inclusive of all additional charges, such as excess waivers, damage waivers etc.

(c) Period during which low rate cap will apply should be extended to five working days

3.15 DLG supports the CMA's intention to implement a dual rate price cap whereby a low rate would apply if liability is agreed within a short period of the at-fault insurer being informed that a TRV is being provided to the non-fault party. However, the success of the remedy is dependent upon insurers being able to agree liability within that initial window, such that the low rate will apply in the majority of cases. DLG believes that a period of three days is insufficient to achieve this but that a period of five working days will ensure that the low rate cap will apply in a materially higher proportion of cases.

3.16 The CMA appears at least partly to base its three day proposal on "… the evidence from insurers that there was not a large amount of disagreement about liability" (this is a key reason given for why the CMA "…would expect the high rate cap to occur rarely").[15] However, the CMA does not appear to take into consideration the time it takes insurers to decide on liability.

3.17 In a **[CONFIDENTIAL]** proportion of cases (DLG estimates approximately **[CONFIDENTIAL]** of fault claims) a claim is first reported to DLG by a third party (the CHC or the non-fault party). DLG does make an initial assessment of liability at that point but it does not take a decision on liability (and it cannot agree liability with any other party) until it has verified the third party's account of events with its own customer. It can take some time to make contact with the customer and obtain the necessary information. For example, if DLG is unable to speak to the customer at FNOL it will send a letter to the customer asking them to call DLG. This process can take a number of days.

3.18 This is reflected in the number of working days between the date on which DLG uploads a claim on to its systems and the date on which DLG accepts full liability.[16] In **[CONFIDENTIAL]** of cases DLG accepts full liability on the third working day after the claim has been uploaded on to its systems or sooner. In **[CONFIDENTIAL]** of cases it accepts full liability on the fifth working day or sooner. This means that based on DLG's present approach **[CONFIDENTIAL]** of claims would fall within the low rate cap. In the context of the CMA's goal to reduce as much of the net consumer detriment as possible this is a material number. It should be noted that in order to achieve these figures, DLG uses an online portal. Without the portal, it would generally take longer for liability to be accepted.

15 PDR, para 2.90.

16 For these purposes, working days are defined as Monday to Friday inclusive. The analysis presented in this paragraph does not count public holidays as non-working days. The data covers GTA and non-GTA claims.

3.19 In any event, any time period must be set in working days not calendar days. Insurers are often reliant on other parties for the information needed to come to a view on liability. Often these will be CHCs. Any time period must therefore be in working days to allow for this.

3.20 The CMA will also need to consider during its remedies consultation how the cap would apply to claims that are suspected to be fraudulent. Insurers should not be expected to be liable for TRV cover in such cases. In addition, DLG believes it important that a statement relating to the consequences of making a fraudulent claim needs to be included in the mitigation declaration (which can be signed by non-fault claimants using electronic signatures).

(d) Time periods must be clearly defined

3.21 In addition to the duration of the low cap time period, the starting point of that period must be clearly defined by the CMA in order to avoid the risk of disputes as to which rate applies. At present, the CMA proposes that the three day period would start at the point the insurer is "… informed that a replacement vehicle is being provided to the non-fault claimant."[17] DLG's view is that it should start at the point when the insurer receives notice from the TRV provider that the TRV provider has agreed (or received an instruction) to provide the customer with a TRV (with the day of receipt of notice being day zero for the purposes of the low rate cap). The analysis presented in paragraph 3.18 above uses this interpretation of the CMA's wording.

(e) Establishment of an electronic portal must be included in the remedies package

3.22 An electronic portal will help reduce the concerns described in sub-sections (c) and (d) above.

(a) It will provide a clear and certain mechanism for informing an insurer as to when a claimant is being provided with a TRV and so when the low rate time period will start running (thereby reducing the likelihood of disputes).

(b) It will enable insurers to assign liability for a claim more quickly by providing a mechanism for CHCs to provide insurers with the information that they need to decide on liability within a shorter timescale.

(c) More generally it will reduce the administrative burden and frictional costs for both insurers and CHCs.

An electronic portal is therefore critical to the success of Remedy 1C.

3.23 However, the CMA does not require the establishment and use of an electronic portal as part of its remedies package. Rather the CMA "…expect[s] that … the industry would be able to work together to implement … a portal". The CMA's view is based on "… the work performed to date by the GTA Technical Committee in assessing the feasibility of a credit hire portal …" and the CMA assumes that this work will continue once its remedies package is implemented.[18]

3.24 DLG fundamentally disagrees with this. The CMA's remedies package, and in particular Remedy 1C, will result in a misalignment of incentives as between CHCs and insurers: CHCs' incentives will be to ensure that the high rate cap applies in as many cases as possible and so they will have no commercial desire voluntarily to commit funding, resources and support to an initiative which will enable insurers to take decisions on liability more quickly. The only way, therefore, that an electronic portal will be agreed with CHCs is if the CMA requires the creation of such a portal and its use by all TRV providers and insurers as part of its remedial order.

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17 PDR, para 2.78(a).
18 PDR, para 2.129.

(f) GTA provisions must be incorporated into the CMA order

3.25 DLG is pleased that the CMA intends to incorporate a number of GTA provisions into its remedy (for example a requirement that TRV hire must stop 24 hours after the end of a repair or seven days after a total loss payment has been issued). However, there are a significant number of further provisions which the CMA has not considered but which should also be included in the CMA's remedy order. For example, to provide absolute clarity as to when and how a TRV provider should notify an insurer of a claim, DLG considers that the CMA should adopt (or adapt) the GTA's New Claim Advice Form. Similarly, in order to mitigate the risk of extended repair periods, the CMA may wish to incorporate the GTA requirement that where a CHC is also managing the claimant's repair the CHC must arrange an inspection of the vehicle within 24 hours of the claimant electing the repair to be carried out by an independent repairer and an independent engineer must carry out that inspection within two working days of instruction. The CMA should consider these points as part of its remedies consultation process following publication of its final report.

4. Remedy 4B

4.1 DLG agrees with the CMA's objective of improving consumers' understanding of NCB protection.[19] In particular:

(a) DLG agrees that providing the implied price of NCB protection would be helpful for consumers and so is supportive of this proposal.

(b) DLG supports the principle of making available to customers details on what would happen to their NCB discount in the event that they make a claim through the step-back rules.

4.2 DLG is also pleased that the CMA has recognised that it would be impractical for insurers to publish an NCB scale showing the percentage discount applicable to the number of NCB years, due to the various rating and risk factors that determine an individual policy holder's NCB.

4.3 However, DLG has very significant concerns relating to the new proposal to provide information on average NCB discounts and also on the standardised descriptions the CMA proposes to mandate. DLG believes not only that they are themselves likely to cause consumer detriment, which is likely to outweigh any benefits of these proposals, but also that these will create a conflict with regulatory requirements and the FCA's very different approach to regulation. Furthermore, the CMA has not properly assessed the net consumer detriment which these remedies are intended to resolve and so cannot properly assess the proportionality of this remedy. These points are discussed more fully below.

(a) Average NCB discounts and standard wording will cause regulatory conflict with the FCA

4.4 The CMA's proposals mean that there would almost certainly be regulatory conflict with the FCA.

4.5 The FCA imposes the following regulatory requirements on insurers:

(a) To take reasonable steps to ensure that any communications made to customers are "clear, fair and not misleading" when they are made (i.e. at the point of sale). Moreover if, subsequently (i.e. after the point of sale), an insurer becomes aware that a financial promotion is not fair, clear and not misleading it must withdraw its approval and notify any person that it knows to be relying on its approval as soon as reasonably practicable.[20]

[19] DLG notes that, as set out in its response to the Provisional Findings (at para. 5.12), DLG does not agree with the CMA's view that insurers have a point of sale advantage in the sale of add-ons.

[20] FCA Insurance: Conduct of Business Sourcebook 2.2.2R and 2.2.3R.

Failure to comply with these requirements may lead the FCA to take disciplinary action against an insurer (the FCA also has the power to amend misleading financial promotions).

(b) To treat consumers fairly and to "pay due regard to the information needs of clients, and communicate information to them in a way which is clear, fair and not misleading".[21] To ensure that authorised firms treat customers fairly the FCA has identified a number of relevant outcomes, one of which provides that customers need to be "kept appropriately informed before during and after the point of sale".[22]

4.6 In terms of its approach to the application of regulatory requirements, the FCA assesses whether a statement is "fair" or "misleading" based on the actual outcomes of those statements (i.e. the actual impact on consumers). The FCA does not assess whether wording is "fair" or "misleading" simply by considering the wording used.

4.7 The CMA's proposals in relation to average NCB discounts and mandatory statements are at odds with these requirements and the FCA's approach to them.

4.8 The CMA's proposal for average NCB discounts involves customers being provided with an approximate figure of what level of discount they might expect to get for the NCB years they have accumulated. The CMA itself recognises that there are likely to be some continued information asymmetries between insurers and consumers as "the average discount would not necessarily reflect the discount that an individual consumer would actually get."[23] The result may be some customers not purchasing NCB protection when it might be in their interests to do so, and other customers purchasing NCB protection when their discount was not as high as the average.

4.9 The CMA accepts this risk of detriment for certain consumers, provisionally concluding that, overall, the average NCB discount would still be of benefit to consumers.[24] However, given the FCA's outcomes-based approach to applying the regulatory requirements described above, DLG's concern is that the FCA would take a very different view, as it would not accept some customers losing out as a result of this remedy. DLG believes, therefore, that the FCA could want to intervene and potentially amend DLG's disclosure obligations, which would cause a direct conflict between the CMA order and FCA requirements. The potential negative impact on customers will be clear from the outset of the remedy and so DLG does not believe that the CMA's proposal that the FCA should review the remedy after two years (and if it is not working well, recommend that the CMA should review the remedy) is sufficient to guard against this.[25] DLG believes there is a very real risk that insurers will be left unable to comply with both the CMA's order and the FCA's requirements.

4.10 The mandatory wording proposed by the FCA is also at odds with the FCA's approach. Martin Wheatley, the Chief Executive of the FCA commented in May 2014: "A major challenge it seems to me is that we know the pre-crisis reliance by regulators on disclosure has largely failed. Or at least, we know that consumers don't engage with it, even if it has been embraced by our legal community … the standard industry response [pre-crisis] was effectively to provide more information and provide it more quickly. So, if someone didn't appreciate a product we extended the description."[26] As such, the FCA is increasingly supporting less prescriptive ways of providing customers with the necessary information and encouraging firms continually to improve information disclosure in order to improve customer outcomes. For example, the FCA decided in May 2014 that it would give waivers to firms to make changes to product disclosures if the firms could show that they are better for customers. The CMA's proposal to require mandatory wording prevents this.

21 FCA Principles for Business 2.1, Principles 6 and 7.
22 Outcome 3 from FSA Treating Customers Fairly Report.
23 PDR, para 3.30.
24 PDR, para 3.30.
25 PDR, para 3.62.
26 See http://www.fca.org.uk/news/good-conduct-and-market-integrity.

4.11 DLG therefore strongly advocates that the FCA is better placed than the CMA to work with insurers to improve the descriptions provided to customers in relation to NCB protection and to assess how information on average NCB discounts can be provided to customers. This is something that the CMA has itself acknowledged in relation to Remedy 4C (clearer description of add-ons): "In light of the role of the FCA in regulating the role of insurance add-on products, including the descriptions provided by insurers, brokers and PCWs for those products, we do not think it would be appropriate for us to pursue [Remedy 4C] ourselves". DLG believes that the same approach should apply to Remedy 4B.[27] One option open to the FCA, for example, would be to open a thematic market review into NCB protection if the FCA had significant concerns.

(b) Informational remedies should balance simplicity and accuracy

4.12 As DLG has emphasised in previous submissions,[28] remedies related to consumer understanding must not be too prescriptive, or they run the risk of being inappropriate in the circumstances, becoming obsolete or leading to unintended consequences.

4.13 In particular, it is important that customer communications strike a careful balance between simplicity and accuracy. Too much detail can lead to worse customer outcomes because the critical points are lost or the information is simply not read. For example, encouraged by the FCA, DLG has been reviewing the use of excessive wording in the sales process (both on the telephone and online) as it does not support customer understanding. In particular, long and dense 'important statements' pages are often ignored by consumers, who typically scroll straight to the bottom of the page to click through to the next screen. A more edited approach, which enables customers to find the information they need, is far more conducive to good customer understanding.

4.14 DLG's preference is consequently for a linear sales process, where customers are provided with sufficient information to make an informed choice, but also told where they can find more detailed information if required.

(c) Providing average NCB discounts through telesales will increase confusion

4.15 DLG believes that the CMA's proposal to provide customers with information on average NCB discounts during the telesales process would neither ensure simplicity nor increase accuracy. Rather, DLG believes it will cause confusion for customers and will either likely trigger a number of additional questions or, because of the volume and complexity of the information being provided, will be largely ignored by customers.

4.16 DLG's view is that to the extent that the CMA has concerns in relation to NCB protection, the FCA is far better placed to deal with such concerns (and so this is not an appropriate remedy for the CMA to implement). However, to the extent that the CMA does choose to implement this type of remedy, DLG strongly believes that the CMA must be less prescriptive in terms of when and how this information is provided to its customers.

4.17 In addition, it is critical that any requirement to provide average NCB discounts should be based on recent or current data and not simply on annual historical averages, as this significantly increases the risk of inaccuracy (the annual compliance statement must not therefore require insurers to provide information on the average NCB discounts that they will be using in the forthcoming year). For example, there may be circumstances where an insurer knows that last year's average discounts are misleading (e.g. where an insurer has changed its NCB pricing following a change in marketing messages or based on its claims experience). Insurers must therefore be free to alter the information on average NCB discounts provided to customers. As such, DLG believes that it would be better if

[27] PDR, para 3.90.

[28] DLG's response to Remedies Notice, para. 5.1(b).

insurers are able to disclose a range of discounts, to maximise the probability that the information being supplied to customers is meaningful.

(d) Mandatory wording is likely to lead to under-provision

4.18 Although DLG is supportive of the CMA's general intention to improve consumer understanding of how NCB protection works, as emphasised in previous submissions,[29] DLG does not believe it is appropriate to mandate a particular form of wording to describe NCB protection. Each description needs to be individually tailored for different insurers, depending on the risk factors and pricing elements used. For example, DLG's product is "No Claims Discount" (not bonus).

4.19 Moreover, as proposed, the prescribed wording may cause customers not to purchase NCB protection even though they would be expected to benefit from purchasing it. The wording devised by the CMA risks giving the impression to consumers that NCB protection has very little or no value. In reality, as demonstrated by DLG in previous submissions, NCB protection does in fact deliver substantial value to consumers who make a claim.[30]

4.20 This risk of under-provision is reflected in the results of the GfK Report commissioned by the CMA. This suggests that many consumers have a strong reaction to the CMA's proposed wording. However, the emotional reactions of consumers[31] suggest that many of these consumers would be unwilling to buy NCB protection even if it provided good value to them. This implies there is a serious risk of under-provision caused by the CMA's proposed wording, which in DLG's view does not present a balanced picture of the pros and cons of purchasing NCB protection.

4.21 In particular, DLG is concerned about the inclusion of the phrase, "accident in which you are not at fault" in the mandatory wording.

(a) The issue of insurers using evidence of past non-fault accidents as a risk factor in setting premiums is a separate consideration from NCB protection. It should not therefore be included as a mandatory requirement in the NCB protection sales script at the point at which NCB protection is purchased. If it were required to be included, it would provide an unbalanced and confusing picture for consumers (and increase the risk of under-provision).

(b) While the statement may be true for some insurers or brands, when presented in isolation it is highly misleading. The reality of competitive motor insurance pricing is that many risk factors are taken into account in order accurately to price risk, some of which consumers may not necessarily consider 'fair' without a detailed understanding of how those factors correlate to the risk.

(c) For some insurers this statement will not be accurate. If the CMA does choose to go ahead with this remedy, it must therefore allow insurers the flexibility to implement it only if the prescribed wording is true for them (pricing is constantly changing and evolving and at any point in time this statement may or may not be true).

(e) CMA has not established the scale of net consumer detriment

4.22 In any event, the CMA has not calculated the scale of any detriment caused by the AEC it has identified in relation to the sale of NCB protection and so it cannot properly assess the proportionality of its remedy.

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[29] DLG response to Q5 of FP4.

[30] As explained in DLG's response to the Remedies Notice **[CONFIDENTIAL]** see Q3 of DLG's response to the CC's follow up questions dated 3 July 2013.

[31] GfK Report, para. 4.6.

4.23 The CMA has estimated net earned premiums of £210 million per year for NCB protection sales in the UK.[32] It has also estimated that, of this figure, £120 million is sold to consumers who do not understand the product (i.e. 59 per cent., of customers who claimed to understand the product but apparently did not understand it fully). However, neither of these figures (even if accurate, which as DLG has commented previously to the CMA, they are unlikely to be)[33] provides any indication of the likely scale of any consumer detriment, and it would be quite wrong to imply that the figure of £120 million could be used as a proxy for this calculation. If, for example, the identified AEC adds only 1 per cent. on average to NCB protection prices then the scale of harm would be only £1.2 million per year. In order to calculate the harm caused by the AEC it has identified, the CMA would need to carry out testing of the extent to which consumers would behave differently when in possession of a reasonable understanding of how the product works.

(f) Potential harm may outweigh any benefit derived from the remedy

4.24 Once the CMA has established the scale of any detriment, this would have to be balanced against the initial and on-going costs of implementing the proposed remedy and the potentially severe unintended consequences.

(a) The CMA recognises the proposal to provide customers with information on average NCB discounts carries a significant risk of unintended consequences (either that customers will purchase NCB protection when their own discount may be lower than the average or that customers will not purchase NCB protection when their own discount would be higher than the average).

(b) In addition, the mandatory wording element of the proposed remedy may cause under-provision of NCB protection relative to the level of sales that would be achieved when purchases are based on a full, clear, and balanced information set. The CMA will be aware that in its judgment in the payment protection insurance (**PPI**) appeal, the Competition Appeal Tribunal (**CAT**) found the Competition Commission (**CC**) had failed, when conducting its proportionality analysis, to give any consideration to the impact its point of sale prohibition remedy would have on the take-up of PPI. The CAT concluded that this constituted a failure to take into account a relevant consideration and upheld the appeal against the CC.[34]

(c) The CMA's remedy may therefore create customer detriment that in itself outweighs any AEC.

4.25 In addition, the CMA has not quantified the expected cost for insurers to implement the remedy as proposed (the CMA has asked insurers for some details related to costs for providing information to PCWs but they were asked for in isolation without the full context of what would be required for this remedy).

5. Remedy 5

(a) Wide MFNs

5.1 DLG welcomes the CMA's recognition of the market power enjoyed by PCWs and the CMA's conclusion that wide MFNs are anti-competitive. DLG agrees that, through prohibiting lower pricing across multiple sales channels, wide MFNs restrict entry to the PCW market, reduce innovation, and ultimately increase premiums.

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32 PDR, para 3.101.

33 DLG's response to Provisional Findings, para 5.5.

34 *Barclays v. Competition Commission* [2009] CAT 27, para. 137.

5.2 DLG believes it is vital that PCWs that charge lower commissions should be able to benefit competitively from doing so by securing lower premiums from insurers, and thereby gaining market share. DLG is therefore strongly in favour of the CMA's proposed remedy to ban wide MFNs.

(b) Banning of MFN-equivalent behaviours is crucial

5.3 DLG is pleased that the CMA has recognised that PCWs can engage in a variety of behaviours equivalent to wide MFNs i.e. behaviour which is for the purpose of stopping insurers from pricing differentially based on different commission rates and other costs of doing business.

5.4 DLG has previously voiced its concerns that PCWs do engage in aggressive tactics to leverage their market power in order to ensure price harmonisation, even in the absence of wide MFN clauses.[35] DLG is therefore strongly supportive of the proposal to prohibit behaviours equivalent to wide MFNs. However, the success of the remedy will be contingent on the CMA drafting the order in such a way that all current, and future, equivalent behaviours are captured. The CMA has recognised that the definition of 'equivalent behaviours' needs to be sufficiently flexible for circumvention not to occur. It is therefore imperative that the CMA's order is drafted sufficiently widely to deal with all varieties of delisting or equivalent threats.

(c) Robust monitoring and enforcement is critical

5.5 In order for the CMA's proposed remedy to be effective, monitoring and enforcement mechanisms must be sufficiently robust to ensure that PCWs will comply. The CMA has proposed that enforcement for this remedy could be done through an order requiring PCWs to submit compliance statements complemented with directions given by the CMA and recourse to civil proceedings.

5.6 DLG is not convinced that these enforcement options are sufficiently strong to deter circumvention by PCWs. In particular, DLG does not believe that it is realistic to expect that insurers, even large insurers, will choose litigation as a means to resolve concerns about compliance with commercial partners with whom they work on a day-to-day basis. This is particularly given PCWs' fundamental significance to insurers as a key distribution channel. The PCWs will understand this commercial dynamic and this may encourage behaviours intended to be prohibited by the CMA.

5.7 One option would be for the FCA, which in any event is the day-to-day regulator for both insurers and PCWs, to monitor the on-going behaviour of PCWs. This approach should dis-incentivise PCWs from adopting the types of aggressive behaviours which would conflict with the remedy. Failing this, the CMA itself will need to be prepared to play a hands-on role in monitoring compliance (for example, the CMA could provide a mechanism for insurers to provide evidence of non-compliance to the CMA as part of the CMA's review of PCWs' annual compliance statements), and enforcing breaches through civil proceedings where necessary.

(d) Narrow MFNs

5.8 DLG is surprised and disappointed that the CMA has chosen not to ban narrow MFNs given the potential inflationary impact on premiums to which these clauses can give rise. DLG does not agree with the CMA's assessment that narrow MFNs have only limited anti-competitive effect and that there is a risk to the survival of PCWs without them. 'Narrow' MFNs (which prohibit lower pricing on an insurer's own website) have the same effect in practice as wide MFNs for any brand that also has a direct distribution channel, or spends money on advertising. The CMA's argument does not appear to take into account the indirect effect that own-website MFNs can have on the insurer's pricing. The additional cost from a unilateral increase in CPAs ends up being spread across the

[35] As DLG has explained in a previous submission (see DLG response to E17 Questionnaire dated 24 October 2013) **[CONFIDENTIAL]**

direct channel, and indirectly across other PCWs, protecting the PCW from the competitive effect of its actions and leading to premium inflation.

5.9 DLG has previously put forward a number of arguments setting out why the CMA's reasoning in relation to narrow MFNs is flawed. However, it would seem that the CMA has either not understood, or else has failed properly to deal with these arguments.

(a) The CMA has failed to recognise that more insurers would be affected by network effects than the number estimated by the CMA.

(b) The CMA continues to rely on the examples of Italy and the US as evidence of markets where PCWs have not yet become established for the sale of PMI. However, there is no empirical evidence to support the claim that MFNs would have been beneficial for the growth of PCWs in other countries, or that lack of narrow MFNs would lead to their decline in the UK. As DLG has emphasised in previous submissions, the reason for lower use of PCWs in Italy are varied, but are linked to clear differences in the prevalence of the insurer broker model and the fact that Italian customers are less likely to make purchases online. The CMA has failed to deal with these arguments, and has chosen instead to make its case based on one carefully selected quote[36] which only serves to demonstrate the weakness of the CMA's position in relation to the benefits of narrow MFNs.

(c) The CMA does not appear to have addressed the points raised by DLG in relation to narrow MFNs and free-riding, despite the CMA's own acknowledgement that alternative, less restrictive, mechanisms are available to prevent the risk of free-riding.

(d) The CMA has also failed to provide any empirical evidence to support the assumption that narrow MFNs ensure the credibility of PCWs. DLG has submitted evidence to challenge this conclusion directly, by demonstrating that the most popular reason for using PCWs was ease of use and convenience rather than finding the lowest price. In addition, around half of customers on PCWs do not choose the cheapest quote but consider other factors such as trust or quality.

5.10 DLG therefore strongly supports a ban on narrow MFNs. As an absolute minimum, DLG believes that it is critical that the CMA should continue to monitor PCWs to ensure that narrow MFNs (and behaviour equivalent to this) do not lead to unreasonable rises in CPAs.

4 July 2014

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36 PDR, Appendix 4.2, para 26.