

DIRECT LINE INSURANCE GROUP PLC
PRIVATE MOTOR INSURANCE INVESTIGATION
RESPONSE TO NOTICE OF FURTHER CONSULTATION ON REMEDY 1C

1. Introduction and executive summary

- 1.1 Direct Line Insurance Group plc (**DLG**) welcomes the Competition and Market Authority (**CMA**)’s Notice of Further Consultation on Remedy 1C (**Remedy 1C Notice**) published on 28 July 2014, and in particular the CMA’s decision to consider further the alternative proposal for Remedy 1C put forward by DLG prior to the CMA publishing its Provisional Decision on Remedies (**PDR**).
- 1.2 By way of summary:
- (a) DLG agrees with the CMA that the CMA does not have the legal powers to implement Remedy 1C as proposed in the PDR. However, DLG does believe that the alternative proposal (**Alternative Proposal**) set out in the Remedy 1C Notice to cap the rates charged by temporary replacement vehicle (**TRV**) providers to non-fault accident victims in a credit agreement (or similar) would be an effective way of reducing the inflated costs resulting from credit hire.
 - (b) DLG does not agree with the CMA and other respondents to the PDR that the Alternative Proposal would lead to distortions between credit hire companies (**CHCs**) and insurers in the provision of TRVs. The key legal question is whether the Alternative Proposal is proportionate and effective in resolving the detriment identified by the CMA. DLG’s view is that this is clearly the case. The Alternative Proposal:
 - (i) tackles the major issue identified by the CMA as causing the net consumer detriment associated with the CMA’s theory of harm 1, namely credit hire;
 - (ii) is the least onerous of the remedies considered by the CMA in the PDR; and
 - (iii) provides a continued place for credit hire within the market (if this is a concern for the CMA, which DLG believes should not be the case).
 - (c) Even if the CMA’s concern that more insurers move to a model of “insured hire” (as described in paragraph 3.1 below) were to transpire then this would not materially impact the effectiveness of the Alternative Proposal; it would still resolve a substantial proportion of the detriment identified by the CMA (DLG estimates that the current levels of detriment would still be reduced by approximately 75 to 80%). This is primarily because, as the CMA’s analysis of net consumer detriment associated with repair highlights, given the highly competitive nature of the private motor insurance (**PMI**) market, revenues generated by insurers from “insured hire” would be passed through to customers in the form of lower premiums. Also, based on the CMA’s analysis of repair, frictional costs relating to “insured hire” would be lower than for credit hire.
 - (d) DLG believes that the other options suggested by the CMA (which amount merely to recommendations with no legal force) would be ineffective. To pursue these in place of the Alternative Proposal would be a significant missed opportunity to resolve dysfunction in the PMI market. In the worst case, the implementation of these other options may, in fact,

encourage CHCs to withdraw from the General Trading Agreement (**GTA**) (which is merely a voluntary protocol without any legal force). This has the potential to increase credit hire rates and frictional costs.

- (e) As the CMA is aware, DLG has welcomed the PMI market investigation as a means to resolving the dysfunction relating to TRV provision. DLG strongly urges the CMA to pursue the Alternative Proposal: this is an effective and proportionate means of resolving the detriment the CMA has identified.

2. Alternative proposal is effective and will resolve a substantial amount of the detriment

- 2.1 The Alternative Proposal is a highly effective means of reducing most if not all of the net consumer detriment identified by the CMA.

(a) CMA has the legal power to implement the Alternative Proposal

- 2.2 Unlike the CMA's proposal for Remedy 1C set out in the PDR, capping the prices charged by a TRV provider to its customer under a hire agreement for credit hire (or similar services) would clearly and unambiguously fall within the CMA's powers under Schedule 8, paragraph 8, Enterprise Act (**EA**) 2002. It is therefore without question that the CMA has the legal powers to implement the Alternative Proposal.

(b) Alternative Proposal would resolve the net consumer detriment identified by the CMA

- 2.3 The Alternative Proposal would tackle the major cause of the net consumer detriment identified by the CMA in relation to TRVs: the costs of credit hire.

- (a) The CMA commented in its Provisional Findings that "the main reason for the inefficiencies due to the separation of cost liability and cost control were the excess transactional and frictional costs associated with credit hire"¹ and "...the bulk of the net effect was attributable to the extra cost of credit hire over direct hire for replacement cars."² The Alternative Proposal would deal squarely with this. By capping the prices charged by a TRV provider to its customer for credit hire (or similar) in the contract or hire agreement, this would have the effect of capping the contractual liability of the customer to pay TRV charges. This approach would mean that non-fault parties seeking to recover for credit hire could not claim any more than the (capped) amount set out in the hire agreement either in settlement negotiations with the at-fault insurer, or in any litigation.

- (b) Limiting credit hire claims to the capped rates would resolve most if not all of the net consumer detriment identified by the CMA.

- (i) DLG believes that applied appropriately, and using direct hire rates as a benchmark for setting the price cap as proposed by the CMA in the PDR, this remedy provides the most effective means of reducing the net consumer detriment identified by the CMA.

- (ii) Alternatively, if, as suggested by DLG previously, the CMA were to set the price cap so that 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) would be calculated on the basis of the average retail spot rates for a particular category of vehicle then analysis undertaken by DLG's economic advisors, Oxera,

¹ See para 6.82 of the CMA's Provisional Findings.

² See para 6.82 of the CMA's Provisional Findings.

suggests that this would substantially reduce credit hire rates to a level close to direct hire rates.

- 2.4 DLG continues to believe, however, that key provisions of the GTA (such as limitations on hire duration and inspection requirements in relation to repair) should be included in the CMA's remedy order. Perhaps most importantly, the Alternative Proposal should be supported by an electronic portal. As DLG set out in its response to the PDR,³ an electronic portal would provide a clear and certain mechanism for informing an insurer as to when a claimant is being provided with a TRV; it would 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 and more generally it would reduce the administrative burden and frictional costs for both insurers and CHCs. DLG's view is that the only realistic prospect of CHCs agreeing to this is if the CMA requires the establishment of such a portal as part of its enforcement order.

3. No distortion in relation to credit hire / "insured hire"

- 3.1 The CMA has repeatedly raised a concern that the Alternative Proposal would lead to a distortion between credit hire and the provision of TRVs by non-fault insurers. The CMA's reasoning is that the price cap would apply to credit hire but, given the limits of the CMA's legal powers under paragraph 8, Schedule 8, EA 2002, it could not apply to "insured hire" (where an insurer would provide a non-fault customer with a like-for-like TRV as a policy entitlement under the customer's PMI policy).

- 3.2 DLG strongly believes that the particular model of TRV provision and who supplies TRVs (e.g. whether it is CHCs, insurers or other suppliers) is not a concern for the purposes of the CMA's assessment of the Alternative Proposal and in particular its analysis of the proportionality of this remedy. Rather, as set out in the CMA's market investigation guidelines, the focus of any assessment of proportionality should be on whether the remedy:

- (a) is effective in achieving its legitimate aim;
- (b) is no more onerous than needed to achieve its aim;
- (c) is the least onerous remedy if there is a choice of remedies; and
- (d) does not produce disadvantages which are disproportionate to the remedy's aim.⁴

- 3.3 Each of the limbs of this test are clearly satisfied by the Alternative Proposal:

- (a) Effective:
 - (i) the aim of the Alternative Proposal would be to reduce the net consumer detriment identified by the CMA, the major cause of which is the cost of credit hire. As described in paragraphs 2.3 above, the Alternative Proposal would be effective in resolving this detriment; and
 - (ii) as described in paragraphs 4.5 to 4.7 below, even in the event that more insurers do decide to move to an "insured hire" model at some future point (which DLG believes is by no means certain) then using the CMA's own approach to calculating net consumer detriment the Alternative Proposal would still be highly effective in

³ DLG response to the PDR, para 3.22 to 3.24.

⁴ See para 344 of the CMA's Guidelines for Market Investigations: Their role, procedure, assessment and remedies. (CC3, April 2013). These principles have been referred to by the CAT in various judgments including *Tesco v CC* [2009] CAT 6, *Barclays and others v CC* [2009] CAT 27 and *BAA v CC* [2009] CAT 35 and [2012] CAT 3.

reducing the vast majority of the net consumer detriment identified by the CMA in relation to TRVs.

- (b) Not onerous: DLG understands that the CMA's explicit intention is not to set the price cap at the lowest rate under consideration (i.e. direct hire rates). Rather DLG understands that the CMA's intention is either:
- (i) to impose a dual rate cap where the low cap would be set at a level above average direct hire rates (and the high cap would be double the low rate cap set at a point close to current GTA rates);⁵ or
 - (ii) to set the price cap so that 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) would be calculated on the basis of the average retail spot rate.

It is difficult to understand how either approach (which explicitly do not seek to reduce hire rates to the lowest possible level) could be regarded as more onerous than needed to achieve the remedy's aim of reducing the detriment caused by the cost of credit hire. Both approaches would allow CHCs to recover (and hence require insurers to pay) at rates markedly higher than those which insurers would have to pay if sourcing vehicles directly;

- (c) Least onerous remedy: the CMA has assessed the different remedy options proposed to resolve the net consumer detriment associated with TRVs. DLG agrees with the CMA's analysis that Remedies 1A and 1B would be disproportionate to the detriment identified.⁶ By contrast, Remedy 1C is based on an existing industry framework for reducing the cost of credit hire, the GTA; it would not involve a change in the law; nor, for the reasons explained in paragraphs 3.3(d)(iii) below, would it reduce the TRV provision to non-fault parties; and
- (d) Will not lead to disadvantages which are disproportionate to the remedy's aim: DLG notes that some respondents to the PDR suggest that the Alternative Proposal would lead to the "exit of credit hire" with the implication being that non-fault parties would lose out as their legal rights to a like-for-like TRV would no longer be fulfilled. DLG fundamentally disagrees with this assertion.
- (i) Any remedy must tackle the costs of credit hire: as set out above the remedy's aim is to resolve the net consumer detriment identified by the CMA. As the major cause of the detriment is the costs of credit hire any remedy must tackle the costs of credit hire and DLG believes that the Alternative Proposal is the least onerous means of doing this (as set out in paragraph 3.3(c) above).
 - (ii) Alternative Proposal would enable the continued provision of credit hire: the Alternative Proposal would enable the continued provision of credit hire.⁷ The two methodologies proposed for setting the price cap are not set at the lowest level under consideration, and so should enable an efficient CHC to be able to maintain a profitable business. A CHC can quickly and efficiently seek to capture non-fault parties, for example, through targeted marketing or referral fees. This is particularly given the new forms of reaching the non-fault customer which CHCs are developing. For example, as discussed with the CMA before, Quindell has recently reached an agreement with the RAC which will enable Quindell to install black boxes into RAC customers' vehicles. This will, in effect, mean that Quindell will

⁵ See para 2.88 (c) of the CMA's PDR.

⁶ See paras 2.168 and 2.187 of the CMA's PDR.

⁷ DLG further notes that the CMA's proposed remedies package does not seek to ban referral fees for credit hire. DLG agrees with this approach as it will act as a continuing constraint on the costs of credit hire for at-fault insurers.

know as soon as a customer has been in accident and will be able to contact that customer without needing a referral from an insurer, solicitor, broker or repairer.⁸

- (iii) *Non-fault parties would not lose out:* in any event, even if the amount of credit hire reduced as a result of the Alternative Proposal this would not mean that non-fault customers would lose out in the manner suggested by other respondents to the PDR. DLG's understanding is that the CMA's concern is that in the future more insurers would move to an "insured hire" model (rather than refer to credit hire). In this hypothetical scenario of "insured hire", non-fault customers would still be provided with like-for-like TRVs and their entitlements would continue to be fulfilled; there would simply be a change in the model of supply to their own insurers.
- (iv) *Any disadvantage must be set against the benefits achieved by the remedy:* if any disadvantage were to be identified, it would be very modest by comparison with the substantial benefits which are expected to be achieved by the remedy. This remedy is aimed at addressing net consumer detriment calculated at £87 million and it would be effective in its aim.

4. "Insured hire" would benefit customers and substantially reduce net consumer detriment

- 4.1 The CMA has suggested that "insured hire" could be a means of circumventing the Alternative Proposal if it were to be implemented. DLG has given further thought to the CMA's concerns and is of the view that even if insurers moved to a model of "insured hire" (which is in DLG's view by no means certain), then the Alternative Proposal would still resolve the great majority of the net consumer detriment identified by the CMA relating to TRVs.

(a) Not clear-cut that insurers would choose to move to an "insured hire" model

- 4.2 Moving to an "insured hire" model for non-fault drivers would involve potentially material costs for insurers. In particular, an insurer would have to incur costs in establishing such a model, including contracting with a hire company and changing policy wordings and marketing materials. Once it had established such a scheme, it would incur additional administrative costs in determining whether the policyholder qualified for such a TRV (especially if the policyholder's entitlement depended on him being non-fault in the accident). The non-fault insurer would also be taking the risk that it would not recover the capital outlay it had made in providing a TRV from the at-fault insurer. This risk would be heightened for those 25% of cases where liability is unclear (or considered to be split) at the point at which the non-fault party needs to have a TRV.⁹ Insurers would need to be reasonably confident in the majority of cases therefore that they would be able to recoup the costs of the TRV and this is by no means clear-cut.

(b) "Insured hire" would substantially reduce net consumer detriment

- 4.3 DLG understands the CMA's concern to be that more insurers would move to a model of "insured hire" (where insurers would not be prevented from seeking to recover from the at-fault insurer at a reasonable rate i.e. above the level of the price cap) and that some would move away from referral arrangements with CHCs. The CMA considers that this is possible because a subrogated claim brought by an insurer would not be affected by the proposed price-cap. The CMA has indicated a concern that this would limit the effectiveness of the proposed remedy.

⁸ See para 2.3 of DLG's Supplementary Paper on Possible Remedies. See also press Quindell press release available here: <http://www.quindell.com/item/ingenie-to-partner-with-the-rac-to-create-black-box>.

⁹ See para 21 of the CMA's Provisional Findings in which the CMA estimates that, at FNOL, insurers established who was at fault in 75 per cent of cases; 20 per cent of cases were categorised as split liability; and 5 per cent of cases were not decided.

- 4.4 DLG has given further thought to the CMA's concerns and is of the view that the Alternative Proposal would be highly effective in reducing the net consumer detriment identified by the CMA even in a hypothetical "worst case" scenario where all TRV provision currently provided through credit hire moves to a model of "insured hire".
- 4.5 DLG has estimated the net consumer detriment associated with "insured hire" (in this hypothetical "worst case") using the CMA's own analysis of repair which assists in making a comparison between benefits / services arranged by CHCs and those arranged by insurers. A full explanation of DLG's methodology is set out in Annex 1.
- 4.6 The CMA's analysis of repair is based on two key principles:
- (a) that the highly competitive nature of the PMI market means that revenues generated by insurers in repair are passed back to consumers through lower premiums;¹⁰ and
 - (b) the frictional costs associated with insurer-managed repairs are materially lower than those associated with credit repair (by approximately 30%).¹¹
- 4.7 Applying these principles to the data on credit hire compiled by the CMA suggests that in the hypothetical "worst case" the net consumer detriment associated with "insured hire" would be £17 million which is less than 20% of the CMA estimate of consumer detriment from credit hire (£87 million). Even if the frictional costs associated with "insured hire" were assumed to be the same as for credit hire (which would be a conservative assumption to make) then the net consumer detriment associated with "insured hire" would be £24 million, which is approximately 25% of the CMA estimate of consumer detriment from credit hire (£87 million). This suggests that even in the hypothetical "worst case" scenario the Alternative Proposal would still achieve most of the reduction in consumer detriment that the CMA hopes to achieve.
- 4.8 Additionally, as DLG has explained previously, 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. 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."¹² There seems no logical reason why the same mechanism could not be used to control TRV costs as between insurers.

5. Possible that a court may follow the CMA's price cap

- 5.1 As DLG has explained to the CMA,¹³ it is possible (but by no means certain) that the courts may in practice limit the sums recoverable in subrogated claims to a level at or around that specified in the CMA's cost capping order.
- 5.2 It is worth noting, however, the differences between what can be recovered in relation to credit hire and what is likely to be recovered in relation to "insured hire".
- (a) In credit hire claims it is for the defendant (the at-fault insurer) to prove that the charges claimed exceed the "basic hire rate".¹⁴ In *Burdis v Livsey*,¹⁵ the Court of Appeal specifically

¹⁰ This assumption is confirmed in Paragraph 10, CMA Working Paper, 'Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)'.

¹¹ The CMA estimates that the frictional costs for at-fault insurers associated with credit repair average £45 per vehicle, whilst the frictional costs for at-fault insurers associated with insurer-managed repair average £32 per vehicle. Please see paragraphs 124 to 127 of CMA Working Paper, 'Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)'.

¹² PDR, para 2.217.

¹³ See para 3.9 (c) of DLG's Response to CMA's PDR.

¹⁴ *Pattni v First Leicester Buses* [2012] 1 Lloyd's Rep IR 577 at para. 35.

¹⁵ *Burdis v Livsey* [2003] QB 36 at paras. 134-150.

disapproved the use of the average of a sample in determining the basic hire rate, and said that it should represent the rate at which the particular claimant might reasonably have hired a car in his/her local area. The Court expressly acknowledged that the appropriate rate may be at the top of a range.¹⁶ The effect is that, even where a claimant is not impecunious and the defendant is able to furnish good evidence of the applicable “basic hire rate”, damages for credit hire are often (significantly) above the level of average retail hire rates.

- (b) Because the defendant facing a credit hire claim bears the burden of proving what is the applicable “basic hire rate”, there are some cases where the defendant’s evidence will be successfully attacked and the claimant will recover the full credit hire rate on the basis that the burden of proof has not been discharged. This is a real problem, in view of the complexities of hire rate evidence, especially in relation to unusual vehicles.
- (c) Where the claimant is found to be impecunious, which is a finding made in a significant minority of cases, the charges claimed are not limited to a “basic hire rate” and the claimant will often recover damages based on the claimed credit hire rates.
- (d) Subrogated claims under “insured hire” models, on the other hand, are regarded as general damages claims for loss of use. Damages are based on the “reasonable cost of hiring the temporary replacement.”¹⁷ The claimant, rather than the defendant, bears the burden of proof. Furthermore, the claimant will not recover more by showing that he is impecunious, because his own financial means is irrelevant where the vehicle has been provided by an insurer. These features typically mean that damages in subrogated claims are fixed at a level much closer to retail hire rates.
- (e) The consequence of the above points is that the level of damages awarded by a court in relation to “insured hire” would in any event be likely to be set at a lower level than for credit hire.

6. Proposed wording does not go far enough

- 6.1 DLG considers that the definition of business models covered by the proposed remedy should cover at least both the limbs of paragraph 18. However, it does not believe that paragraph 18 goes far enough to limit the possibilities of circumvention. In particular, the remedy needs to be drafted so as to cover not just credit hire, but all forms of TRV provision to accident victims for which the non-fault party is liable to pay the hire charges under a credit hire agreement or similar. This includes not only CHCs but also other companies providing hire services to motor accident victims on credit terms or under “payment on demand” agreements¹⁸ and all other forms of ‘indirect’ TRV provision.
- 6.2 The CMA should also periodically review any business involved in TRV provision to ensure compliance with the scope of the undertakings.

7. No impact on the provision of hire vehicles to retail customers

- 7.1 DLG understands from the CMA¹⁹ that a further concern which it has been considering is that the Alternative Proposal would in some way prevent retail hire providers (such as Avis or Hertz) from offering vehicle hire through credit agreements. DLG cannot see how this would be the case. The Alternative Proposal does not prohibit or prevent the use of credit agreements, and neither does it

¹⁶ *Burdis (loc. cit.)* at para. 148.

¹⁷ *Bee v Jenson* [2008] Lloyd’s Rep IR 221 at para. 23 of the CA judgment.

¹⁸ Agreements between a non-fault claimant and a credit hire company for the provision of a hire vehicle which defer the payment of the hire charges until these become payable ‘on demand’ sometime in the future.

¹⁹ Call with the CMA, 31 July 2014.

affect the rates payable by customers who are not accident victims. It simply imposes a price cap on certain types of TRV provision to non-fault accident victims.

- 7.2 The CMA has suggested it is possible that retail hire providers decide that they should ask prospective customers whether they have been the victim of an accident before a hire agreement is signed. However, DLG cannot see how this could in any way be described as a distortion of the retail hire market.
- 7.3 DLG certainly does not believe that the Alternative Proposal could result in an increase in the price of hire for retail customers. The CMA has provided no evidence to demonstrate a waterbed effect of this type and with the exception of Enterprise-Rent-A-Car, there are very few material providers of retail car hire that are also active in the credit hire market.

8. CMA's alternative to Remedy 1C

- 8.1 The CMA sets out two options it may consider instead of seeking undertakings or making an order. Both options focus on encouraging certain market practices in order to reduce friction between at-fault insurers and parties representing non-fault claimants. DLG does not believe that either option provides an effective or realistic remedy to the problems that have been identified. DLG sets out its views on both options below.

(a) Encourage the GTA to adopt aspects of Remedy 1C and 1F

- 8.2 The CMA has explicitly stated that it does not intend to make the GTA mandatory, and that there may be legal issues if it were to try and do so. While DLG understands the CMA's caution related to its legal powers, this means the CMA's proposal is merely to 'encourage' additional improvements to the GTA, for example to the portal. However, this 'encouragement' will have no legal basis, and would take the form of, for example, a recommendation with no enforcement powers behind it.
- 8.3 DLG does not believe this is an effective remedy proposal. The GTA is a voluntary non-binding protocol, and CHCs are not compelled to be signed up. DLG consequently foresees that in the absence of a legally binding remedy by the CMA there is a very real risk that CHCs would be incentivised to withdraw from the GTA, which could potentially result in increased friction between the parties and therefore increased costs.

(b) More common use of bilateral agreements

- 8.4 The CMA's second proposal encourages insurers to reduce frictional costs by increased use of bilateral agreements between CHCs and insurers. DLG does believe that bilateral agreements have a place in the market particularly in the event that the CMA decides to implement the Alternative Proposal (as described above). However, DLG believes that on their own (without a cap on credit hire rates) bilaterals are an insufficient solution to the issue.
- 8.5 DLG is particularly concerned with the CMA's comment that PMI policies should be extended to cover TRVs provided by CHCs. This would simply add costs for insurers and, without the Alternative Proposal, would increase profit margins for CHCs without any corresponding reduction in credit hire rates.

4 August 2014

ANNEX 1

Annex setting out an estimate of net consumer detriment that hypothetically could arise as a result of insured hire

The CMA has expressed concern about “A possible distortion in the provision of temporary replacement vehicle provision between CHCs and non-fault insurers, if non-fault insurers would still be able to make subrogated claims at average retail rates which are above the actual cost of vehicle provision.”¹

This Annex assesses what the potential consumer detriment would be in the worst case scenario i.e. where non-fault insurers substitute insured hire for credit hire and then subrogate claims for amounts similar to current CHC rates. This Annex provides an estimate of the level of consumer detriment in this scenario, and compares it to the existing level of detriment as estimated by the CMA. The Annex first summarises the CMA evidence on current consumer detriment, and then uses this evidence to estimate consumer detriment under the Alternative Proposal. The analysis makes use of the CMA’s methodology for assessing the consumer detriment associated with insurer-managed repairs and credit repairs, but applies data for credit hire costs, as well as adjusted estimates for frictional and management costs, as explained below.

The result of this analysis is an estimate of consumer detriment of £17 million, which is less than 20% of the CMA estimate of consumer detriment from credit hire (£87 million). This suggests that even this ‘worst-case scenario’ would still achieve most of the reduction in consumer detriment that the CMA hopes to achieve. The significant reduction in consumer detriment is primarily the result of vehicle hire being internalised within the insurance system, so that profits made by non-fault insurers are passed on to consumers through lower premiums. This is based on a key assumption of the CMA analysis, which states that:

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 revenues earned by non-fault insurers and brokers, are fully passed through to policy premiums (see the provisional findings, Appendix 6.4).²

CMA estimates of current consumer detriment

The CMA prepared estimates of the current consumer detriment arising from:³

- Credit hire;
- Credit repair;
- Credit write-offs;
- Insurer-managed repairs;
- Insurer-managed write-offs.

In order to estimate the total consumer detriment under an insured hire scenario, the difference in management and frictional costs between insurer managed hire and credit hire must be estimated. However, as this data is not available, the estimate considers how these costs differ between insurer managed repair and credit repair and then applies this difference to credit hire estimates.

¹ Paragraph 17(b), CMA, Notice of further consultation on Remedy 1C

² Paragraph 10, CMA, ‘Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)’

³ See CMA, ‘Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)’

Although the focus of the analysis is credit hire, the results for credit repair and insurer-managed repair are relevant as they provide the estimates of the differences in frictional costs between CHC and insurer-managed situations, which are then applied to TRVs. The results are reproduced in tables 1, 2 and 3 below.

Table 1 Credit hire consumer detriment calculations

	Profits to non-fault insurers	Costs for at-fault insurers				
	Referral fees	Cost inflation	Frictional costs	Saved manage- ment costs	Total costs	Net detriment
Average values (£)	328	526	78	-27	618	290
Total values (£m)	98.8	170.3	23.5	-8	185.9	87

Source: Paragraph 123, CMA Working Paper, Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)

The consumer detriment associated with credit hire arises from the 'leakage' to the CHCs, equal to the cost inflation minus referral fees ($170.3 - 98.8 = 71.5$), plus the additional net frictional costs ($23.5 - 8 = 15.5$).

Table 2 Credit repair consumer detriment calculations

	Profits to non-fault insurers	Costs for at-fault insurers				
	Referral fees	Cost inflation	Frictional costs	Saved manage- ment costs	Total costs	Net detriment
Average values (£)	53	290	45	-111	224	171
Total values (£m)	4.6	24.8	3.8	-9.5	19.1	14.6

Source: Paragraph 124, CMA Working Paper, Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)

The consumer detriment associated with credit repair similarly arises from the 'leakage' to the CHCs, equal to the cost inflation minus referral fees ($£24.8\text{m} - £4.6 = £20.2\text{m}$), plus the additional net frictional costs ($£3.8\text{m} - £9.5\text{m} = -£5.7\text{m}$), which is negative in this case (i.e. at-fault insurers actually save money on management costs).

Table 3 Insurer-managed repair consumer detriment calculations

	Profits to non-fault insurers		Costs for at-fault insurers					
	Mark-up	Management and frictional costs	Total profits	Cost inflation	Frictional costs	Saved management costs	Total costs	Net detriment
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: Paragraph 127, CMA Working Paper, Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)

The consumer detriment associated with insurer-managed repair arises only due to frictional and management costs. The cost inflation is entirely offset by the mark-up for non-fault insurers, which has no impact on consumer detriment as the money remains in the system (i.e. there is no 'leakage').

The CMA estimates that the frictional costs for the at-fault insurer are lower, per vehicle, with insurer-managed repairs (£32) than they are with credit repair (£45). Additionally, the leakage of money from the system per vehicle with credit repair (£290 - £53 = £237) is higher than the management costs of non-fault insurers (£113), which are close to the avoided management costs for at-fault insurers (£111).

Consumer detriment under the Alternative Proposal

These results can be used to assess the hypothetical situation in which credit hire is replaced by insured hire, but cost inflation is maintained. For the purposes of this hypothetical analysis it is assumed that the CMA's concerns are valid and insurers raise their rates in order to subrogate the same daily rates as CHCs currently use. The results of this assessment are presented in Table 4.

Table 4 Hypothetical insurer-managed hire consumer detriment calculations

	Profits to non-fault insurers		Costs for at-fault insurers					
	Mark-up (1)	Management and frictional costs (2)	Total profits	Cost inflation (1)	Frictional costs (3)	Saved management costs (4)	Total costs	Net detriment
Average values (£)	526	-27.5	498.5	526.0	55.5	-27.0	554.5	56.0
Total values (£m)	170.3	-8.1	162.2	170.3	16.7	-8.0	179.0	16.9

Source: Paragraph 127, CMA Notice of further consultation on Remedy 1C

Each of the assumptions involved in this calculation (indicated in brackets in the table) are explained below.

Assumption (1)

The mark-up and the cost inflation are both the same, and both equal to the results of cost inflation for credit hire (by assumption). This hypothetical situation simply

assumes the same prices and volumes as credit hire, but on an insured hire rather than a credit hire basis. The critical assumption here was provided by the CMA analysis, namely that additional revenues earned by non-fault insurers are fully passed through to policy holders.⁴ This scenario also involves the non-fault insurer being in full control of the hire and therefore capturing all of the mark-up. This implies that the non-fault insurer is able to source vehicles at the direct hire cost, just as they do for at-fault vehicle provision.

Assumption (2)

The management and frictional costs for the non-fault insurer (£27.5 per vehicle) are estimated based on the saved management costs of the at-fault insurer with credit hire (£27 per vehicle), inflated according to the ratio of non-fault management costs for insurer-managed repair (£113) relative to saved at-fault management costs (£111). It is a reasonable expectation that the non-fault insurer management costs are broadly similar to the at-fault insurer management costs avoided, which is supported by these findings.

Assumption (3)

The frictional costs for the at-fault insurer (£55.5 per vehicle) are estimated based on the frictional costs for the at-fault insurer with credit hire (£78 per vehicle), deflated to reflect the lower frictional costs observed with insurer-managed repair compared to credit repair (the ratio of £32 to £45 per vehicle respectively). This assumes that the lower costs for at-fault insurers when dealing with non-fault insurers for repair, compared to dealing with a credit repair, are also relevant in the case of vehicle hire. For example, if less time is needed to deal with a non-fault insurer whatever the nature of the claim, then this assumption would be relevant. If on the other hand, the differences in frictional costs between credit repair and insurer controlled repair are specific to repair, applying the £32:£45 ratio may not be appropriate. However, this assumption is not critical to the results. Even if frictional costs are assumed to be the same for insured hire as they are with credit hire, then the consumer detriment estimate under the Alternative Proposal increases from £16.9 million to £23.6 million, which remains much lower than the CMA's estimate of the current level of detriment (£87 million).

Assumption (4)

The management costs avoided by the at-fault insurer (£27 per vehicle) are assumed to be exactly the same in the insured hire scenario as they are in the credit hire case; the CMA data shows no difference between the management costs avoided with credit repair (£111) compared to insurer-managed repair (£111). This would seem a prudent assumption, as in both cases (credit hire versus insured hire), the at-fault insurer avoids the same costs in terms of not needing to manage the hire.

Conclusion

As presented in Table 4 above, these estimates produce profits for the non-fault insurer of £162 million and costs for the at-fault insurer of £179 million. The net detriment is therefore £17 million, representing only 19% of the net detriment for credit hire (£87m).

⁴ Paragraph 10, CMA Working Paper, 'Estimation of the detriment from the separation of cost liability and cost control (theory of harm 1)'