

# Motor Legal Expenses Insurance (MLEI) Report on the thematic project

June 2013





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# Foreword from Simon Green, Head of General Insurance and Protection

Insurance has a unique and important role to play in the daily lives of millions of people. We all want an insurance industry that customers can trust, so that consumers can have confidence that the everyday services they need are provided in a straightforward way.

Achieving this is central to meeting our objective to make markets work well in the interests of consumers. We want to see a sustainable insurance sector, where firms compete by focusing on service and value as well as price – a market where the successful firms are the ones that respond most effectively to customers' genuine needs in the products and services they provide, and deliver on the promises they make.

This thematic project looked at a particular product – Motor Legal Expenses Insurance (MLEI) – from a number of perspectives including its value and usefulness, customer understanding, and the sales process. Thematic work is a fundamental part of our supervisory approach. We undertake thematic projects to assess current and future risks in relation to a particular issue or product. This may be across a number of firms, within a specific part of the sector, or at market level.

This report shows what you can expect from the FCA's approach to general insurance supervision. It is the first report on a range of thematic projects we will undertake this year and characterises the type of work we are doing with the general insurance industry and its customers. Working with consumers to understand their expectations and requirements and working with the industry to restore market trust and confidence are common threads running through everything we do. We will work hard with the insurance industry and consumer groups to deliver better outcomes for customers.

Enhancing trust and confidence in the UK motor insurance market is particularly important. According to the Department for Transport, there are 28.7 million cars licensed for use on the roads in Great Britain.<sup>1</sup> The consumer research we undertook as part of this project has provided invaluable insights into what those customers want and need. It has given customers a real, tangible 'voice', telling insurance companies in their own words what they think about MLEI and motor insurance in general. A key finding of this research is that there appears to be little or no relationship between consumers and car insurance providers. This remoteness may be compounded by a general lack of understanding of how both the core motor policy and MLEI work.

<sup>1</sup> [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/184694/vls-2012.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/184694/vls-2012.pdf)

We have discussed our findings with insurance firms, trade associations and consumer representatives. The firms that participated in the project are changing the way MLEI is sold. We now want all motor insurance providers to similarly reflect on our findings. We ask firms to pay particular attention to what customers are saying about their understanding of MLEI and motor insurance in general. We will revisit this work in 2014 to assess how the market has responded.

If you are reading this report as a customer I hope it will help clarify how MLEI works, so you can be well informed and confident the next time you buy insurance.

# 1.

## Our findings – the headlines

- 1.1** MLEI is a complex product, but can be useful for consumers in the current market. It packages together the services to enable consumers to pursue their legal rights following a motor accident for which they were not at fault. It enables them to recover their uninsured losses from the at-fault driver. In some cases it also provides legal representation for a driver being prosecuted for a motoring-related criminal offence, and access to a legal helpline.
- 1.2** MLEI's complexity makes it difficult for customers to understand. When it is sold as an add-on this is typically towards the end of a lengthy process devoted to the core motor policy. Our consumer research showed that, while people have a high level of awareness of MLEI, they do not understand it. And their engagement in the product and its explanation is very limited.
- 1.3** Our findings and consumer research demonstrate firms need to re-evaluate their approach to MLEI. There are three specific areas where firms should review their current practices to ensure they are meeting the needs of their customers. These are:
- The basis on which MLEI is provided.
  - The quality of explanation of MLEI at all stages of the customer journey, including the claims process, with an emphasis on providing clear, appropriate information.
  - The extent of cover provided.
- 1.4** MLEI is the add-on to the motor policy most commonly sold on an opt-out basis. This means the cover is pre-selected by the firm rather than actively selected by a customer. We have questioned with firms whether this practice is more motivated by generating revenue rather than meeting the needs of their customers. Behavioural economics suggests that at least some consumers will not have the confidence to override the 'authority' of the firms and de-select the cover.
- 1.5** We have played back the results of our consumer research and our other findings to participating firms. Firms have responded, demonstrating a willingness to make early changes to their business processes. We will revisit MLEI in a year's time to assess the overall effect of these changes.
- 1.6** The add-on nature of MLEI means that the work we have carried out for this review is very relevant to our work on the 'General insurance add-on study', announced in December 2012. The findings from this review will be considered as part of the study and as we develop our approach to general insurance add-ons.

## 2. Reasons for the project, its scope and format

### The genesis of the project

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- 2.1** In December 2011, the Office of Fair Trading published its report, *Private Motor Insurance – Summary of responses to the OFT’s call for evidence*. In this it called on the FSA ‘to work with the insurers and insurance brokers who sell this product to ensure that consumers are being provided with appropriate information when purchasing it’ (1.12).
- 2.2** The FSA’s *2012 Retail Conduct Risk Outlook* identified *Add-ons* (3.4.3) and *Products of limited value* (3.4.2) as emerging insurance risks. MLEI is generally sold as an add-on to private motor policies, though some firms include it as part of the core motor policy offering. Among the characteristics identified in the RCRO of products of limited value were that, ‘the monthly or annual cost of these products might often be relatively low, but there is usually a significant profit margin for the firm distributing the cover.’ The actual value of MLEI to consumers was one of the matters to be assessed in the project.

### Scope of the project

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- 2.3** We confined the scope of the project to MLEI, rather than extending it to include categories such as legal expenses policies sold alongside home insurance. This was because the types of incidents to which the motor and home legal expense policies respond are quite different. MLEI deals primarily with the pursuit of legal rights to recover uninsured losses from the driver who is at fault for a motor accident. Some MLEI policies additionally provide cover to defend the policyholder if they are involved in criminal prosecution for a motoring offence such as dangerous driving, and also access to a legal helpline. Home legal expenses insurance typically provides cover for legal action arising from: ownership of the property; employment; personal injury; and, contracts for the sale of goods and services.
- 2.4** Similarly, we decided to confine the scope of the project to Before the Event (BTE) MLEI and not include the After the Event (ATE) product. The circumstances to which the BTE and ATE products respond and in which they are bought are very different. ATE MLEI is by its nature sold once a claim event – such as personal injury – has occurred. The product is bespoke in that it is individually underwritten and priced. It is intimately linked with a Conditional Fee Agreement (CFA), a solicitor having evaluated the claim and being prepared to accept it under a CFA. By contrast BTE is a mass-marketed product that is not individually underwritten.



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## Format of the project

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- 2.5** The project had four main elements:
- Initial visits to a cross-section of firms .
  - Qualitative and quantitative consumer research.
  - A questionnaire to a wider group of motor insurers and intermediaries.
  - Engagement and feedback at both a firm and industry level, together with consumer-directed communication.

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## Initial visits to a cross-section of firms

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- 2.6** At the beginning of the project we visited a small number of firms comprising: direct-selling motor insurers; motor intermediaries; and comparison websites. These are the distribution channels for the MLEI. We also visited specialist legal expenses insurers as the manufacturer of the product. The purpose of these visits was to understand the MLEI market and how the product works, thereby ensuring that the questionnaire to be sent later to a wider cross-section of firms asked the right questions.
- 2.7** The visits proved invaluable, particularly in making clear how much the financial aspects of MLEI have historically been affected by the receipt of referral fees, for example for personal injury claims and credit hire of replacement vehicles. (Since 1 April 2013, firms have not been able to refer personal injury claims to another person or firm, and be paid for them. Neither will firms be able to receive personal injury claims and pay for them.)

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## Consumer research

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- 2.8** We undertook qualitative consumer research to provide empirical evidence of consumers' views and experiences. The formal objectives of the research were set as:
- To understand whether consumers are being given sufficient information about MLEI to enable them to make an informed choice as to whether the product might meet their needs and might deliver value for money.
  - To understand consumer experiences of using or trying to use MLEI at the point of claim.
- 2.9** We commissioned market research following a competitive tender. Consumers' views were elicited through a mix of group discussions and one-to-one depth interviews. A total of 66 consumers were interviewed. They varied by: socio-economic group; financial capability; age; and, geographical location. Those interviewed included people who had bought MLEI and those who had made a conscious decision not to purchase the product. The sample included a small number of people (16) who had sought to use MLEI in a claim.
- 2.10** The methodology used to elicit consumers' views, and what those views were, are set out in detail in the research report ([www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research](http://www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research)). At a headline level the main findings of the research were:

- Consumers have a relatively **high awareness** of MLEI but **little understanding** of what the product does and the benefits it provides. This finding is entirely consistent with those of Consumer Focus in its report: *In case of emergency – analysis of legal expenses insurance* (2011).
- Attitudes to add-ons to the motor policy varied between those that consumers felt they knew and understood (breakdown, windscreen, courtesy car and to some extent protected no-claims discount) and those they felt were more intangible and less well understood (MLEI, personal accident and medical cover).
- Consumers thought MLEI provided general protection in the event of litigation against them, this being their overriding concern. They were not able to distinguish between the cover provided under their motor policy (protection against being sued for damages) and the MLEI policy (pursuit of their legal rights to recover uninsured losses from the at-fault driver and, where provided, legal representation in the event of criminal prosecution).
- The experience of those who had sought to use MLEI at the point of claim was very variable. In some cases the process worked well with what would happen being explained at the outset, timeframes provided, and regular updates being given by the insurer, which handled the claim from start to finish. In other cases there was no explanation of what would happen and when, or any updates provided; the claimant had to chase the insurer and found the whole process stressful.
- The research also provided valuable insights into how consumers regard **price comparison websites** and consumers' attitudes to **motor insurance providers** (insurers and intermediaries): "Comparison websites are applauded for being independent and allowing consumers to undertake a search of many providers, quickly and easily. As such, they are largely trusted and allow consumers to feel they have shopped around and made a good decision. On reflection, however, many did express a concern that they rely too heavily on the comparison websites, and the way information is presented to them can stop them from interrogating the information further."<sup>2</sup> As set out in the FCA's 2013-14 *Business Plan*, we will review the risks that price comparison websites might present to consumers over the next year.
- For motor insurance in general, "there appears to be little or no relationship between consumers and car insurance providers". Among the reasons consumers gave for this were: "the lack of any reward or incentive for loyalty; the spiralling cost of car insurance; the lack of transparency in the way insurance is presented and sold; the tendency for providers to increase premiums but then later match a lower quote; and, the purchase process being dominated by selling extras and making more money for the insurer/intermediary rather than providing the appropriate cover, service or advice for the individual consumer's needs."<sup>3</sup>

**2.11** We then commissioned quantitative research to determine whether the outcomes of qualitative research represented those of consumers more generally. Over a thousand motor policyholders (498 of whom had MLEI) were questioned face-to-face in the omnibus survey undertaken by TNS Capi Omnibus in September 2012. The results are included in the research report. The main finding was that the quantitative research confirmed consumers' lack of understanding both of what MLEI provides and what is covered under their core motor policy. When asked whether MLEI would cover them in a number of specific situations:

<sup>2</sup> Atticus text in Executive summary of Research Report ([www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research](http://www.fca.org.uk/your-fca/documents/research/motor-legal-expenses-insurance-consumer-market-research))

<sup>3</sup> *ibid.*

- 81% of those who had the product said, incorrectly, that the policy would pay any legal costs associated with a motor accident if they were **at fault** for the accident.
- 78% said that MLEI would pay the costs of defending them if they were sued by another driver; this is again incorrect as this cover is provided under the core motor policy.

### Questionnaire to wider selection of firms

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**2.12** Following the initial visits, we drafted a questionnaire to elicit information from a wider cross-section of firms. The questionnaire differed slightly depending whether the recipient was a direct-selling motor insurer or an intermediary. Copies of the questionnaires can be found in the Annex.

**2.13** The main areas probed in the questionnaire were:

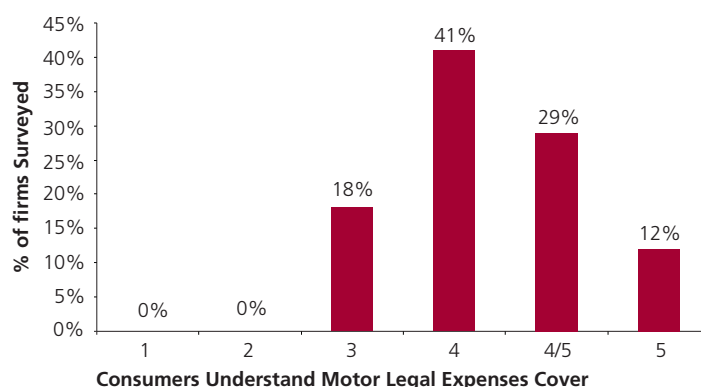
- Firms' views of the benefits of MLEI for customers.
- Firms' views on how well customers understand MLEI.
- Information about the importance of MLEI to firms' business models, including penetration rates and revenue generated for the last three years.
- Information about sales processes, including copies of sales scripts for telephone sales and screen shots for on-line sales.
- Details of the targets for sales staff and financial incentives related to sales performance.
- Information about how MLEI works at the point of claim. More specifically, how the 'Reasonable Prospect of Success' (RPS) test is applied by legal expenses insurers (and the panel of solicitors to which they refer cases) before they will take on a case, and how it is explained to the policyholder.
- Information about referral fees received by the firm, in aggregate and on a case-by-case basis.
- Firms' views on the impact of significant legal and regulatory changes such as the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO), potential changes to the Ministry of Justice Road Traffic Accident (RTA) portal on both the market in general and their own business model.

**2.14** Firms were also asked to provide MLEI policy wordings.

**2.15** The questionnaire was sent to 16 firms in September 2012. Firms were selected against two criteria. One was market presence; participating insurers accounted for about 75% of the UK private motor market by gross written premium. The other was diversity; intermediaries were selected to ensure coverage of a range of business models and market segments. This included motor bike insurance, which is heavily intermediated. Participating firms provided full responses, co-operated fully and were generally highly engaged with our work.

- 2.16** Perhaps the most noteworthy individual observation from the questionnaire was the disparity between firms' views of how well customers understood MLEI and what our consumer research had revealed. In the questionnaire firms were asked to indicate on a scale of 1 to 5 – with 1 being *Strongly disagree* and 5 being *Strongly agree* – whether they agreed or not with the statement “Consumers understand MLEI”. Firms generally provided a score of 4, 4/5, or 5.

**On a scale of 1 to 5 (1 being strongly disagree, 5 being strongly agree) – do you agree with the following statement: Consumers understand MLEI**



- 2.17** The questionnaire also revealed the diversity of names under which MLEI is marketed. These include: *Legal Assistance Plan, Legal Protection, Drivers' Legal Protection, Legal Assistance, Motor Legal Cover*. This diversity of labels, and the connotations they carry, is likely to fuel consumer misunderstanding.

### Communication and feedback

- 2.18** We communicated our findings quickly through a programme of engagement and early feedback. For the insurance industry this entailed:
- Meetings or conference calls with those firms that had been sent the questionnaire. We used these meetings to report on the overall findings of the project and to explain how firms compared with their peers and to set out where, in our judgement, business practices did not appear consistent with good consumer protection. Firms responded well to this early feedback and agreed to make changes to their business practices. Section 4 of the report provides detail of these changes.
  - A seminar for the wider industry (motor and legal expense insurers, intermediaries and comparison websites) and key external stakeholders. The seminar, held at the FSA on 19 February 2013, was aimed at chief executives and others in executive management positions in firms. This audience was invited because the seminar did not just report on the MLEI project and the implications for firms. We also took this opportunity to discuss the wider issues arising from the research about consumers' attitudes to motor insurance providers. The seminar was an important step in beginning the process of engagement with the industry to develop an agenda to restore consumer confidence.

- Collaborative and productive engagement with the Association of British Insurers (ABI) and the British Insurance Brokers Association (BIBA).

**2.19** It was also important to provide consumers with information about MLEI, given their evident confusion about the product. Communication to consumers has been through three channels:

- Information about MLEI has been made available on the consumer part of our website. This gives a succinct explanation of what the product provides, compared to alternatives, and the variations in cover of which consumers need to be aware.
- We have communicated the results of the project to the consumer organisations with an interest in financial affairs so that they are able to inform their constituents.
- Through the media.

## 3. Detailed findings

### 3.1 Investigatory work focused on two areas:

- assessing the value of the product for consumers; this included the extent of cover provided; and
- evaluating the quality of sales practices and whether appropriate information was being provided to consumers; this included looking at what sales targets firms set for MLEI and what the financial incentives were for sales staff.

### Value of the product

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**3.2** Our starting point for testing the value MLEI delivers for consumers was to assess the product's profitability. We did this by analysing the loss ratio (the ratio of claims to earned premium), and the margin for distribution and insurers' administrative costs. For other products a low loss ratio has been an indicator that consumers have encountered difficulties in claiming successfully.

**3.3** However, it became apparent early in the project that we needed to consider the entire MLEI value chain and the overall importance of the product to firms' business models. There were two reasons for this:

- i.** Referral fee income has historically distorted the financial parameters of MLEI. Referral fees have historically been paid primarily by solicitors in return for the referral of bodily injury claims and by car hire companies providing replacement vehicles to the not-at-fault driver on credit terms. The contribution of referral fee income makes it difficult to establish the true risk premium a legal expenses insurer needs to charge to deliver underwriting profitability. Some major motor insurers underwrite their own MLEI product, but where it is provided to a distributing intermediary or insurer by a specialist legal expenses insurer, the risk premium is nominal (typically £1 or less). This compares to a premium of around £5 to £6 charged by legal expenses insurers before the advent of referral fees.

Our firm visits revealed that the fees paid by solicitors for personal injury cases to be referred to them have historically ranged from £800 to £1100 (in England and Wales). The fees paid for credit hire referrals are lower, typically £300 to £400 per case.

In the questionnaire we asked firms for details of the revenue they had received for each of the last three years for personal injury, credit hire and other categories of referral. This showed that referral fees for personal injury cases are the most important source of income and the revenue generated is significant. Under LASPO, firms will not be able to refer personal injury claims to another person or firm, and be paid for them. Neither will firms be able to receive personal injury claims and pay for them.

- ii. MLEI is an unusual general insurance product. Most products provide financial compensation, whether for damage or financial loss the policyholder has themselves suffered (first party insurance) or damage or financial loss someone else has suffered and for which the policyholder is legally liable (third party insurance). By contrast MLEI provides a service – legal assistance, whether to help recover uninsured losses from the driver at fault for an accident or (where included in the policy) defence for a driver facing criminal prosecution or access to a legal helpline.

- 3.4** We also sought to determine what proportion of the typical gross premium of £25-30 at which MLEI is retailed represents profit for the distributor. One intermediary and two insurers were able to provide information about the costs they incur in selling MLEI (including due apportionment of overheads). The figures were quite consistent, being about £8-9 per policy, suggesting a profit margin of £17 to £21 per policy. However, discussion with firms also revealed the complexity of distribution pricing models. All sources of revenue – including sales of add-ons, premium financing, administration charges for adjustments, referral fees – are taken into account over the projected ‘lifetime’ of the consumer. Revenue from other sources can be used to discount the cost of the motor policy, to make the price of this competitive. One intermediary said it takes a **negative** commission of 9% on the motor policy. Thus, distribution margins earned on MLEI cannot necessarily be regarded as pure profit, and need to be considered in the context of firms’ wider proposition. We will continue to focus on the risks to consumers arising from the individual and collective viability of firms’ business models and strategies in our supervisory and sectoral analytical work.
- 3.5** Uninsured loss recovery is the core function of MLEI. In trying to determine the use of the product for consumers, a natural question was to ask about the quantum of recoveries that had been made from at-fault drivers. Most firms did not have management information to answer this question. One motor insurer did have the data to do so. This showed that personal injury cases are by far the most important category of uninsured losses where recovery is made using MLEI. For the period 2009-11 this insurer recovered eight times as much in relation to personal injuries suffered by policyholders as it did for all other categories of uninsured losses put together.
- 3.6** In our initial visits, firms emphasised that MLEI enabled the not-at-fault policyholder’s excess to be recovered from the insurer of the at-fault driver. However, responses to the questionnaire showed that **some** motor insurers would, depending on the circumstances of the accident – such as how clear cut fault was, or the preparedness of the other party’s insurer to admit fault – try to recover their own policyholders’ excess from the at-fault driver, even where no MLEI was in place. Other motor insurers said they did not do this.
- 3.7** Just under half (47%) of the firms included in our survey provide cover for motoring prosecution defence in the MLEI product they offer. We did not specifically ask consumers in our research about how much they valued this cover. However, given consumers’ overriding concern to be protected against litigation against them, it can be inferred that this cover would be regarded as important.
- 3.8** The basis of cover for motoring prosecution defence also varied between firms. For example, a number of firms exclude claims arising from drink or drugs. Two firms apply a Reasonable Prospect of Success test. We asked those firms whether such a condition is consistent with the purpose of providing the cover in the first place – to stand beside the policyholder and provide them with legal representation when they are facing criminal prosecution. One firm’s policy excludes “Any legal costs arising from ...something the insured did when they knew it to be wrongful or ignored that possibility”. We pointed out to the firm that if interpreted widely, this condition could be used to deny almost any claim under this section of the policy, for example where a driver facing prosecution for dangerous driving had been exceeding the speed limit.

- 3.9** Firms including a motoring prosecution cover usually also provide access to a helpline. Whether consumers have used, have a need for, or would value, access to a helpline was not raised during our research, so it is not possible to form a view of the value attached to this facility.
- 3.10** Another strand of our questioning was to ask firms what MLEI provides which is not available elsewhere, for example through a CFA or credit hire agreement. While much of what the product provides can be sourced elsewhere there are some unique benefits such as:
- i.** Pursuit of personal injury claims valued below £1,000. These cases are processed through the Small Claims Court. As the Court's rules do not allow recovery of costs from the unsuccessful litigant, solicitors are unlikely to accept these cases under a CFA. The Ministry of Justice (MoJ) has consulted on increasing the £1,000 threshold for personal injury case but no decision on this has yet been made.
  - ii.** Claims involving non-UK registered drivers involved in an accident in the UK and accidents abroad involving UK motorists. Neither of these types of case is likely to be accepted by a solicitor under a CFA because of the unlikelihood of their costs being recovered.
- 3.11** It was also suggested by legal expense insurers that the test they apply in terms of the likelihood of successful recovery is lower than that applied by independent solicitors determining whether to accept a personal injury case under a CFA. They suggested the test, in numerical terms, was 51% compared to a figure of 75% chance of successful recovery from the at-fault party.
- 3.12** **Our conclusion** – Overall, we came to the conclusion that in the current market context MLEI is a product which can be useful for consumers. It enables them to pursue their common law legal rights to recover their uninsured losses following a motor accident for which they are not at fault. There are the additional benefits, where provided in the policy, of motoring prosecution defence and access to a legal helpline. MLEI is a 'convenience' purchase in that it packages together these legal services upfront.
- 3.13** Historically recovery of uninsured losses could often be sourced through other means, notably a CFA with a solicitor for pursuit of a personal injury claim. However, in such cases, the not-at-fault motorist would have to search out a solicitor after the accident and it could be difficult for the consumer to determine whether the solicitor was in fact a specialist in personal injury claims or not. In this regard another benefit of MLEI is that the legal expenses insurer performs a quality assurance role. Cases referred through them will be to specialist solicitors, which is likely to increase the chance of successful recovery.
- 3.14** Moreover from 1st April 2013 changes made by the Ministry of Justice to the cost rules mean that CFA claimants are now liable for paying their own lawyer's success fee (capped at 25% of general damages) and any ATE insurance premiums relating to their claim. Previously, lawyers were able to claim a 100% success fee and any ATE premiums from the losing defendant on top of their base costs. These changes mean that whilst CFAs are still available they may now be less commonly used as a means to pursue personal injury claims than in the past.
- 3.15** As part of the package of reforms introduced by the MoJ Damages Based Agreements have been introduced as a new means to enable claimants to pursue personal injury cases, though at the expense of losing part of their damages if successful (also capped at 25% of general damages).
- 3.16** Many firms we spoke with believe the importance of MLEI as providing a means of access to justice is likely to increase. Though he did not specifically mention MLEI, Lord Justice Jackson in his report, *Review of Civil Litigation Costs* (2010), recognised the future importance of BTE legal expenses insurance generally in providing consumers with access to justice.



### Sales practices

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**3.17** Our investigation into sales practices covered five areas:

- the basis on which MLEI is provided;
- the quality of sales calls;
- evaluation of firms' websites and comparison websites;
- evaluation of policy wordings; and
- targets and financial incentives.

### The basis on which MLEI is provided

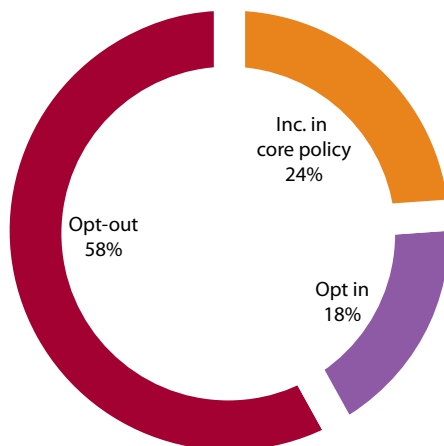
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**3.18** The product is provided in three ways:

- It is included as part of the core motor policy offering.
- It is sold as an add-on, and is pre-selected by the firm for consumers, who have to actively de-select it if they do not want it. We term this practice '**opt-out**' selling.
- It is sold as an add-on, but is not pre-selected by the firm. It is left to the consumer to decide whether they want to buy the product. We term this practice '**opt-in**' selling.

Responses to our questionnaire showed that most firms (58% of respondents) sell the product on an opt-out basis.

#### ***Basis on which firms included in project provide MLEI***




- 3.19 MLEI is the add-on most commonly sold on an opt-out basis. Other add-ons to the motor policy are more often sold on an opt-in basis.
- 3.20 The information provided by firms showed that some consumers do have the confidence to de-select MLEI when it has been pre-selected for them by a firm. However, it remains likely – as behavioural economics would suggest – that some consumers do not have the confidence to override the ‘authority’ of an insurance company or intermediary that has decided that the consumer needs MLEI. The information provided by one large insurer tended to confirm this. Under one of the firm’s brands MLEI is sold on an opt-out basis and the penetration rates achieved is about 80%. Under another brand, where MLEI is sold on an opt-in basis, the penetration rate is around 40%.
- 3.21 The pop-up messages that confront the consumer when they try to deselect MLEI compound the problem of the consumer not feeling confident to override what the insurance company or intermediary has ‘chosen’ for them. At worst the messages are alarmist and misleading. For example they give the impression that the consumer might find themselves liable for legal costs they cannot afford. These messages play on consumers’ concerns – highlighted during our consumer research – of being involved in expensive litigation against them. The following are slightly anonymised examples of the more alarmist types of pop-up message.

Could you really afford **NOT** to select motor Legal Expenses?

Do you have up to **£100,000** ready to assist you in recovering losses not covered by your Car Insurance policy following a non-fault accident?

Could you cover any potential loss of earning if your vehicle is rendered undrivable following an accident?

I'll take the risk      No, add this cover




## Important Cover

Are you sure you would like to remove **Legal Cover**?

This important cover is taken by 85% of our customers.

On average 35% of claims are disputed every year, if someone hits you and says it’s your fault, this cover will help you fight the dispute and claim back your excesses.



Remove      Keep cover

- 3.22** Against this background we came to the view that it is hard to see opt-out selling of MLEI as consistent with good consumer protection. Firms' reaction when we relayed this view to them is covered in Section 4 of the report.
- 3.23** Some firms have adopted an extreme example of opt-out selling – **bundling**. When a consumer accessed the firm's website a bundle of two or more add-on products – such as MLEI and courtesy car cover – was automatically added to the core motor policy, increasing the total premium by, say, £50 to £60. The bundle of add-ons was in some cases labelled 'Essential'. De-selecting the bundle required the consumer, in the most extreme case, to go through five steps. The following is an anonymised example of the kind of bundling we found.

Option 1	Option 2	Option 3
<ul style="list-style-type: none"> <li>✓ £100,000 Motor legal expenses</li> <li>✓ 21 day car hire</li> <li>✓ Lost key replacement</li> </ul>	<ul style="list-style-type: none"> <li>✓ £100,000 Motor legal expenses</li> <li>✓ 21 day car hire</li> <li>✓ Lost key replacement</li> <li>✓ £100,000 personal injury</li> </ul>	<ul style="list-style-type: none"> <li>✓ £100,000 Motor legal expenses</li> <li>✓ 21 day car hire</li> <li>✓ Lost key replacement</li> <li>✓ £100,000 personal injury</li> <li>✓ Wrong fuel cover</li> </ul>
<p><b>£4 monthly</b></p> <p><input type="radio"/> <b>Select</b></p>	<p><b>£5 monthly</b></p> <p><input checked="" type="radio"/> <b>Select</b></p>	<p><b>£6 monthly</b></p> <p><input type="radio"/> <b>Select</b></p>

- 3.24** Bundling also occurred where consumers clicked through from a price comparison website to a firm's own website. In such instances, there was particularly high scope for confusion; the premium that had been displayed on the price comparison website (for the motor policy only) had been increased by the addition of the bundle of add-ons.

### The quality of sales calls

- 3.25** We listened to both live and recorded sales calls. To ensure the recorded calls were a random sample some motor insurers and intermediaries were asked to provide a list of all calls that occurred during a one-hour period on a specified day. A sample of calls was then selected.
- 3.26** The quality of explanation of MLEI provided during the calls varied, even within a single firm. In some cases it was made clear that the policy was to help recover uninsured losses from the driver at fault for an accident. In other cases the explanation was vague, unclear, and hurriedly delivered.
- 3.27** The calls also served to confirm the very limited degree of attention consumers tend to devote to deciding whether to buy MLEI or not. The product (and other add-ons) is sold at the end of a lengthy process devoted, necessarily, to obtaining information and dealing with coverage

options in relation to the main motor policy. Typically, the customer listened to the description of MLEI, asked how much it cost, and then made a snap decision whether to buy or not. No supplementary questions were asked. Consumers' appetite to receive more information appears very limited. This led us to conclude that the clarity and quality of the information provided about MLEI at all stages of the sales process, was probably more important than the volume.

### Evaluation of websites

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**3.28** Our examination of websites included:

- The quality of explanation of their MLEI product on firms' own websites.
- The generic description of MLEI on price comparison websites, where the purchasing journey often begins.
- The accessibility, structure and clarity of information a consumer can access, depending on how much detail about the product they require.

**3.29** This evaluation showed that the quality of explanation, both on firms' and the comparison websites, could in almost all cases be improved to some degree:

- By far the most common deficiency was a failure to make it clear that the uninsured loss recovery element of the policy only operates when the policyholder is not at fault for the motor accident.
- In a number of cases it was also less than explicit that the uninsured losses are to be recovered from the at-fault driver.
- In only two instances was the RPS test brought to consumers' attention at an earlier stage than the policy document. In many policy documents the RPS test was not given sufficient prominence.

**3.30** We carried out a detailed analysis of firms' sales figures to see whether the failure to mention 'not at fault' made any difference to the penetration rates achieved. There was no discernible effect.

### Evaluation of policy wordings

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**3.31** Firms supplied copies of their MLEI policy wordings. We found these to be of variable quality. In some cases they were clear and succinct. Where this was not the case typical problems were that:

- The wording was long, legalistic and in some cases could be very difficult for a consumer to understand.
- Insufficient prominence was given to the most important elements of the wording – the key elements of cover and major exclusions or significant terms.

- It was not made clear that the uninsured loss recovery part of the policy only operated when the policyholder was not at fault for an accident
- Insufficient prominence was given to the Reasonable Prospects of Success test that legal expense insurers apply in determining which cases they will take on and pursue.

**3.32** We also considered the motor policies, to which MLEI is added. Here again we found that, in some cases, there was considerable scope for the wording to be improved, something firms acknowledged during our feedback meetings. In general firms appear to struggle to achieve the appropriate balance in their policies between wordings being a means to help consumers understand what they are, and are not, covered for, against the policy being a contractual document.

### Targets and financial incentives

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**3.33** In their responses to the questionnaire firms were asked to provide details of the targets set for sales staff in relation to MLEI and other motor add-ons, together with details of the financial incentives/bonus plans for sales staff.

**3.34** This did not generally reveal remuneration structures that might lead to hard selling of MLEI, for example because bonuses only become payable when high penetration levels had been achieved or bonuses increase as higher penetration levels are achieved. There were, however, two exceptions. In one case the firm amended its structure in the light of the guidance published by the FSA. In the other case specific regulatory action is being taken.

**3.35** Indeed, our discussions with firms revealed a general trend away from specific, narrow, sales targets to broader measures such as overall consumer satisfaction as measured by Net Promoter Scores. Some large firms have moved wholly away from incentivising sales performance. In part this is because of the impact of price comparison websites on purchasing behaviour. A number of firms commented that call centre staff are now “order takers” – the consumer having already made their decision what to purchase having carried out their research through a comparison website – rather than sales staff.

## 4.

# Action required of firms

- 4.1** Our findings and consumer research demonstrate firms need to re-evaluate their approach to MLEI. There are three specific areas where firms should review their current practices to ensure they are meeting the needs of their customers. These are:
- The basis on which MLEI is provided
  - The quality of explanation of MLEI at all stages of the customer journey, including the claims process, with an emphasis on providing clear, appropriate, information.
  - The extent of cover provided
- 4.2** In addition, as set out above, we found two instances of financial incentive schemes that might lead to inappropriate pressures on staff to sell MLEI. Firms should continue to ensure that their incentive schemes are consistent with good practice as set out in the FSA's guidance, *Risks to Consumers from Financial Incentives*.

### The basis on which MLEI is provided

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- 4.3** As explained in 3.18, firms sell MLEI in one of three ways: opt-in; opt-out; or, by including it within the core motor policy.
- 4.4** The basis on which MLEI is provided is central to effective product delivery. Firms should ask themselves two key questions:
- How can they satisfy themselves that they are selling the product so that consumers understand enough to allow them to make an informed choice about whether they need the product or not?
  - Whether they are achieving the right balance between revenue generation and meeting customer needs?
- 4.5** Identifying and responding effectively to genuine needs is central to demonstrating the customer is at the heart of firms' business models. Several of the consumers who took part in our research said that the decision as to whether they needed MLEI was too difficult for them to make. They felt the decision should be taken out of their hands and that cover should automatically be included within the core motor policy. We considered this in our findings, and discussed the feasibility and appropriateness of automatic inclusion with participating firms. This is clearly a decision for individual firms to take based on a demonstrably clear understanding of how their business model responds to customer needs. This may differ by business structure and channel, for example where firms have integrated legal services firms under an Alternative Business Structure. However, inclusion in the core policy should not simply 'bury' the problem that customers may not understand the product; firms that automatically include MLEI still

need to provide a clear explanation of what the product covers and what it does not.

- 4.6** A number of insurers and intermediaries have, as a result of their own review, decided to move away from opt-out selling. Other firms have decided to shift from opt-out to opt-in as a direct result of our feedback and subsequent discussions. The majority of those firms have also extended this approach beyond motor to, for example, add-ons to their household product.
- 4.7** We do not consider bundling products in the way identified in this report to be consistent with fair customer treatment. Our expectation is that firms engaging in the practices described will cease to do so.

### Quality of product explanation

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- 4.8** The chart at 2.16 evidences the gap between insurance industry perceptions of consumer understanding and the confirmation from our consumer research. In reviewing the explanation they give of MLEI, firms should review their practices to achieve the optimum balance between:
- Providing the appropriate **amount** of information so that, for example, consumers who want to obtain more detail than is provided in the headline explanation of MLEI are able find this easily, including accessing the policy document.
  - The explanation of the product being as **clear** as possible at each stage of the sales journey, whether this explanation is provided over the phone or online. This should include both the MLEI policy wording and the motor policy.
- 4.9** In particular, the explanation of MLEI should:
- Make it clear that the policy operates when the policyholder is not at fault for an accident. Phrases such as 'non-fault accident' could be made easier to understand by the use of plain language such as 'an accident for which the policyholder is not at fault'.
  - Make it clear that the recovery of uninsured losses is from the driver at fault for the accident.
  - Give appropriate prominence to the RPS test. The explanation of what exactly the RPS test is should be explained in a way that is clear and understandable.

### Extent of cover

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- 4.10** Given what has emerged from our research about what is important to consumers, firms should reflect on the scope of cover provided in their MLEI offering. Firms that do not provide cover for motoring prosecution defence and access to legal helplines should consider whether it would be appropriate to do so.
- 4.11** Firms that do provide motoring prosecution cover should reflect on the basis on which cover is provided as this varies across the market. Some firms exclude claims arising from drink and drugs. A small number of firms apply a RPS test in deciding whether they will act to defend the policyholder. Yet a motorist facing criminal prosecution will want legal representation whatever the circumstances of the case. By contrast one firm goes so far as to say it will provide legal representation even if the motorist has pleaded guilty to the offence.

## 5. Follow-up actions

- 5.1** The issues for firms to consider in the marketing of MLEI, and what changes this may require to their business practices, have been communicated clearly to them – whether through feedback meetings, the industry seminar, and this report.
- 5.2** The FCA will look again at the MLEI market in one year's time to assess the extent to which firms have improved their marketing. At that time firms that have not amended their business practices will stand out and are likely to face further regulatory action.
- 5.3** Firms need to be able to give a clear account of the nature of the review they have undertaken and the reasoning for any decision, particularly if this is not consistent with the general industry direction of travel - for instance, in the retention of opt-out selling or providing sales incentives heavily geared to the selling of MLEI and other add-ons.
- 5.4** The add-on nature of MLEI means that the work we have carried out for this review is very relevant to our work on the 'General insurance add-on study', announced in December 2012. Therefore, the findings from this review will be considered as part of the study and as we develop our approach to general insurance add-ons.



## 6. Messages to consumers

- 6.1** Building on what emerged from the consumer research our communication to consumers is focused on explaining:
- What legal protection is provided in the core motor policy – that is, against the policyholder being sued for damages.
  - What MLEI additionally provides – primarily the services to enable the policyholder to pursue their legal rights and recover their uninsured losses following a motor accident for which they were not at fault.
  - That there are variations in the scope of MLEI and, if defence against criminal prosecution for a motoring offence or access to a legal helpline is important to a consumer, then they should check whether these are provided in the MLEI policy.
  - To check whether MLEI is automatically included as part of the core motor policy offering, this being the practice of some car insurance and most motorbike insurance providers.
- 6.2** We are working with consumer groups to ensure these messages about MLEI reach as many people as possible. We have also discussed the findings of our review, and the action we are expecting firms to take, with consumer organisations.

## **Annex 1**

# **The questionnaires sent to direct selling motor insurers and motor intermediaries**



## **Motor legal expenses insurance (MLEI) – market survey (intermediaries)**

### **1. MLEI policy**

1.1 Who is your MLEI provider? Has this changed in the last three years? Please provide a copy of the MLEI policy you sell (or policies if there are variants).

1.2 What do you see as the benefits of MLEI for customers?

1.3 As regards the statement “Consumers understand MLEI” please indicate on a scale of 1 to 5 – with 1 being strongly disagree and 5 being strongly agree – whether you agree or disagree. What do you base this on?

### **2. Place of MLEI in the firm’s business model**

2.1 Please provide a list of all the add ons you sell to the motor policy.

2.2 For each of the last three years provide details, differentiated by distribution channel (eg own website, comparison website, telephone) and by brand (if relevant) of:

- penetration levels for MLEI
- the number of policies sold for MLEI
- the gross premium per policy at which MLEI is sold and whether there is any capability to vary this in the sales process
- the costs you incur in selling MLEI (so that an estimate of the net revenue per policy can be made)
- the contribution of sales of MLEI and other add ons to overall profit. For MLEI please differentiate between the contribution of premium and referral fees.

### **3. Sales**

3.1 Are MLEI and other motor add ons sold on an opt-in basis (ie the consumer has to actively select the cover) or an opt-out basis? Does this vary by distribution channel?

3.2 Please provide copies of the sales scripts used for telephone sales.

3.3 Please provide screen shots of the explanation of MLEI for on-line sales

3.4 What targets are there for sales staff for MLEI and other motor add ons? How are sales staff remunerated? Is their remuneration affected by achievement of targets? Please provide copies of any formal incentive/bonus plan.

3.5 How do you ensure compliance with ICOBS and ensure the quality of sales?

#### **4. Claims**

4.1 How does the Reasonable Prospect of Success test in your MLEI policy work? Example of cases which would pass and fail the test would be useful.

4.2 How, and when, is the Reasonable Prospect of Success test explained to policyholders?

4.3 Please describe the role your firm plays when a claim is first notified to you, and then subsequently during the course of the claim.

4.4 If you are involved in the claim notification process, in an accident scenario where your customer is clearly not at fault, please summarise the claims service provided to a customer who does not have MLEI compared to a customer who has taken MLEI. Eg Do you try to recover the customers' excess etc where there is no MLEI?

4.5 What revenue in aggregate have you generated from referral fees for each of the last three years? Please also break this down by category of referral fee: personal injury, credit hire, etc.

4.6 What are the referral fees that you receive per case? Has this changed over the last three years?

4.7 What impact do you consider the various strands of legal reform (the Jackson reforms, review of the fixed cost regime, referral of private motor insurance to the Competition Commission) will have on motor claims, the motor insurance market in general, and your firm's business model?

#### **5. Complaints**

5.1 How many complaints have you received in respect of MLEI for each of the last three years? What proportion of overall complaints is this?

5.2 What has been the nature of the MLEI complaints? How have they been resolved?



## **Motor legal expenses insurance (MLEI) – market survey (direct selling motor insurers)**

### **1. MLEI policy**

1.1 Do you underwrite your own MLEI? If not who is your MLEI provider? Has this changed in the last three years? Please provide a copy of the MLEI policy you sell (or policies if there are variants).

1.2 What do you see as the benefits of MLEI for customers?

1.3 As regards the statement “Consumers understand MLEI” please indicate on a scale of 1 to 5 – with 1 being strongly disagree and 5 being strongly agree - whether you agree or disagree. What do you base this view on?

### **2. Place of MLEI in the firm’s business model**

2.1 Please provide a list of all the add ons you sell to the motor policy.

2.2 For each of the last three years provide details, differentiated by distribution channel (eg own website, comparison website, telephone) and by brand (if relevant) of:

- penetration levels for MLEI
- the number of policies sold for MLEI
- the gross premium per policy at which MLEI is sold and whether there is any capability to vary this in the sales process
- the costs you incur in selling MLEI (so that an estimate of the net revenue per policy can be made)
- the contribution of MLEI and other add ons to overall profit. For MLEI please differentiate between MLEI premium and referral fees contribution.

### **3. Sales**

3.1 Are MLEI and other motor add ons sold on an opt-in basis (ie where the consumer has to actively select the cover) or an opt-out basis? Does this vary by distribution channel?

3.2 Please provide copies of the sales scripts used for telephone sales.

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3.4 What targets are there for sales staff for MLEI and other motor add ons? How are sales staff remunerated? Is their remuneration affected by achievement of targets? Please provide copies of any formal incentive/bonus plan.

3.5 How do you ensure compliance with ICOBS and ensure the quality of sales?

#### **4. Claims**

4.1 How does the Reasonable Prospect of Success test in your MLEI policy work? Example of cases which would pass and fail the test would be useful.

4.2 How, and when, is the Reasonable Prospect of Success test explained to policyholders?

4.3 Please describe the process when a claim is first notified and the respective actions undertaken under the main motor policy and the MLEI policy.

4.4 In an accident scenario where your customer is clearly not at fault, please summarise the claims service provided to a customer who does not have MLEI compared to a customer who has taken the MLEI. Eg Do you try to recover the customers' excess etc where there is no MLEI?

4.5 What revenue in aggregate have you generated from referral fees for each of the last three years? Please also break this down by category of referral fee: personal injury, credit hire, etc.

4.6 What are the referral fees that you receive per case? Has this changed over the last three years?

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