

PRIVATE MOTOR INSURANCE MARKET INVESTIGATION

Theory of harm 5: Impact of MFN clauses in contracts between PCWs and PMI providers

Introduction

1. Contracts between price comparison websites (PCWs) and private motor insurance (PMI) providers often contain clauses that restrict the price at which the PMI provider can sell a particular policy through other sales channels. These clauses are referred to as Most Favoured Nation (MFN) clauses.¹
2. In order to assess whether these clauses cause an adverse effect on competition and give rise to consumer detriment, we consider in this paper² the trade-off between the beneficial and harmful effects that they may have on competition.
3. We consider four main sources of harm:
 - MFN clauses may lift constraints on cost-per-acquisition (CPA) fees and therefore result in higher CPA fees and, if these higher fees are passed through by PMI providers, higher PMI premiums;
 - MFN clauses may lead to higher PMI prices irrespective of CPA fees because price reductions become more costly to PMI providers;
 - MFN clauses may restrict entry and innovation, and therefore choice and price competition, in the provision of PCWs; and
 - MFN clauses may shift competition from being based on prices to being based on advertising, thus causing excessive advertising, which in turn might raise barriers to entry.

¹ The term 'Most Favoured Nation' comes from multilateral trade negotiations, where one of the principles has been that a trading deal offered to one country (the most favoured nation) must also be offered to all other nations. Its use has been expanded to cover commercial arrangements in which the terms negotiated with one party (the most favoured) automatically become a part of the deal with other parties.

² This paper draws significantly on analysis in the OFT-commissioned research paper 'Can "Fair" Prices be Unfair? A review of Price Relationship Agreements' (2012), a report prepared by Lear, OFT1438.

4. MFNs may be pro-competitive on two grounds:
 - MFN clauses may enhance the search experience by reducing the need for consumers to shop around to find a cheaper price; and
 - MFN clauses may protect the sunk and fixed cost investments required for a good PCW offering.
5. In this paper we discuss all of these possible effects.

Summary

6. PMI providers sell policies via a large number of sales channels, including PCWs; and many contracts between PCWs and PMI providers include MFN clauses. These clauses apply to approximately $\frac{1}{3}$ per cent of PMI policies sold through PCWs.³
7. MFN clauses stipulate that the PMI provider cannot sell a policy on a particular sales channel at a cheaper price than it is available on the PCW.
8. MFN clauses vary in scope but for the purpose of our assessment we define three common scopes for an MFN:
 - (a) a PMI provider may not offer a particular policy on its own website for less than it is advertised on the PCW ('own website-MFN');
 - (b) a PMI provider may not offer a particular policy on any online sales channel for less than it is advertised on the PCW ('online-sales MFN'); and
 - (c) a PMI provider may not offer a particular policy on any sales channel for less than it is advertised on the PCW ('all sales-MFN').
9. The extent to which an MFN clause might give rise to harm (see paragraph 3) will depend on the scope of the clause.

³ See [Appendix 1](#), Table 2.

10. In the case of an own-website MFN, we do not expect substantial harm from at least three out of the four possible sources of harm:

(a) Competition over CPA fees is unlikely to be weakened by own-website MFNs.

Other channels, and especially other PCWs, continue to be a source of competition when an own-website MFN is in place. Moreover, our survey of PMI policyholders suggests that most consumers are likely to visit multiple channels, with 63 per cent of those who searched on one PCW visiting more than one PCW (see working paper 'Survey report'). We have no evidence that CPA fees are higher for policies with own-website MFNs than for those with no MFN.

(b) The degree to which an own-website MFN will make it costlier for a PMI provider to reduce its prices depends on the proportion of sales that go through PCWs covered by the MFN compared with the proportion going through the direct channel only. If sales exclusive to the direct channel are a small proportion of total sales, we would expect the own-website MFN to increase significantly the cost of a price reduction on the PMI provider's own website.

(c) Entry to the PCW market could be based on the ability to compete on CPA fees, with the expectation that PMI providers would pass through their lower costs to lower policy prices. An own-website MFN does not hamper this process.

(d) The mechanism by which MFNs might lead to high levels of advertising expenditure is directly related to the degree to which they allow for higher CPA fees.

Since we expect CPA-fee competition to be maintained by own-website MFNs, we would not expect them to lead to higher advertising expenditure.

11. An online-sales MFN has a wider scope, specifying that a PMI provider may not offer a particular policy on any online sales channel (as well as the PMI provider's own website) for less than it is advertised on the PCW. This type of MFN is more likely to lead to harm under our four theories:

- (a) Under an online-sales MFN, there is little scope for CPA fee competition being used to gain market share. Therefore, CPA fee competition between PCWs is effectively undermined. A PCW wishing to gain sales by lowering its CPA fee to a PMI provider in the hope of the PMI provider offering lower consumer prices will not be able to follow this strategy if another PCW has an online-sales MFN which applies to the policies concerned. The incentive for competing PCWs to lower their CPA fees is thus reduced. Moreover, a PCW with an online-sales MFN which is considering a rise in the CPA fee will not have to worry that such a rise will make its offering uncompetitive, since any pass-through of the CPA fee rise will need to be applied to all PCWs. Overall, there is thus less incentive to reduce CPA fees and less incentive not to raise them. Our empirical evidence suggests that CPA fees are higher on policies with online-sales MFNs than they are on policies with weaker or no MFNs, although we have not excluded alternative explanations of the data. We discuss more generally the negotiations between PMI providers and PCWs and the extent of the PCWs' bargaining power in the working paper 'ToH 3: Horizontal concentration in PCWs'.
- (b) We would expect that an online-sales MFN would make price cuts more costly for a PMI provider, and therefore that prices for PMI would be higher. We have observed that policies with wider MFNs tend to sell in smaller volumes than those with narrower MFNs, and this is consistent with them being more expensive. However, we have not excluded other causal accounts of this difference, for example that these policies are offered by niche PMI providers with lower bargaining power.
- (c) To the extent that entry is encouraged by the ability to pursue a strategy of lowering CPAs in an effort to offer lower overall premium prices, we would expect an online-sales MFN to reduce entry. We note that no PCW has entered the market with this strategy, despite the fact that PMI purchasers are known to be price sensitive. An online-sales MFN might also stifle innovation which was aimed at

reducing PMI premiums. For example, as a result of the MFN, a PCW would not see any direct benefit to its market share from improving its fraud detection or from enabling the more accurate pricing of risks. These innovations could plausibly reduce premiums by reducing the cost of provision but a PMI provider constrained by an online MFN could not reward the PCW which invested in such innovation by reducing PMI premiums through its website without also reducing PMI premiums to all PCWs with the MFN. Incentives to innovate are therefore reduced.

(d) To the extent that online-sales MFNs increase CPA fees, they will tend to encourage competition for market share through advertising expenditure rather than through price competition. PCWs will spend on advertising as long as the cost of acquiring a customer is smaller than the CPA they can expect from a customer, so higher CPA fees imply higher advertising expenditure. This may constitute excessive advertising expenditure measured against a benchmark of price-based competition between PCWs, and may also raise barriers to entry. There are other possible benchmarks but this might be an appropriate benchmark, especially if any MFN-induced advertising is simply reallocating customers between similar PCWs.

12. We found that [REDACTED]. Prior to 2012, [REDACTED] had some similar MFNs.⁴ We would expect such MFNs to have similar, but stronger, potential for harm than online-sales MFNs.
13. Any increase in prices on one policy due to MFN clauses may change the pricing decisions of competing providers, both other PCWs pricing CPAs and other PMI providers pricing insurance products. Therefore, there is the potential for knock-on effects and price increases. We considered two types of knock-on effect:

⁴ [REDACTED].

- (a) If a policy is covered by just one online-sales (or stronger) MFN with just one PCW, then other PCWs have a reduced incentive to try to reduce retail prices through lower CPAs.
 - (b) If an MFN leads to higher PMI prices on one policy, then the best response from providers of competing policies is likely to be to raise prices as many policies are close substitutes and if the price of one policy increases, other 'close' policies will find that they are faced with higher demand and a price increase is likely to be their best response.
- 14. Some parties told us that it was possible to circumvent MFNs. However, many of these strategies are likely to be costly (eg a multi-brand strategy) or in fact restricted by MFN clauses (eg time-limited price-based offers).
- 15. While MFNs may give rise to some harms, they also give rise to some pro-competitive benefits. PCWs create a brand and a platform which allow consumers to search and compare a range of PMI policies online. MFNs may be pro-competitive on two grounds:
 - (a) They may enhance the consumer experience of searching for PMI products by reducing the need for consumers to shop around to find a cheaper price. With an MFN in place, consumers can reasonably infer that they are getting a good deal on the PCW, which reduces their search time and effort. This effect would be particularly strong if the MFNs are commonly known to be in place, but could also be the result of learning.
 - (b) They may protect the sunk and fixed cost investments required for a good PCW offering. If a PCW invested in offering good-quality search (including the investment required to advertise this product) but consumers discovered that the policy offered on the PCW was available cheaper elsewhere, they might use the search but not purchase the product through the PCW. The PCW might then reduce the

quality of its offering or go out of business. As a result, good search solutions might not be offered to consumers. An MFN acts to protect a sunk cost in the PCW and might allow a PCW to earn a return on its investment. In order to assess whether an MFN is a proportionate reaction to the problem of fixed and sunk cost recovery, we need to understand the scale of the cost recovery problem and alternative mechanisms which might address it. The fixed and sunk costs which need to be recovered may be lower than would appear from PCWs' actual costs to the extent that advertising expenditure is a substitute for price competition which would not occur in the absence of an MFN (see paragraph 11(d)). We note also that an MFN is not the only way by which PCWs might seek to protect their investment. Other possible solutions to this problem are:

- (i) fixed costs are covered by the CPA fees earned from consumers who do not switch to competing sales channels; or
- (ii) listing fees, minimum guaranteed CPAs or cookie-based affiliate marketing fees are used to reward PCWs irrespective of their sales-conversion rates.

16. We expect that both of the two types of pro-competitive effects of MFNs become stronger the wider the scope of the MFN: ie the comfort a consumer has from knowing that no alternative channel will offer the same product for cheaper will be enhanced the wider the scope of the MFN; and the probability that a PCW is used for search but is not the recipient of the conversion fee is lower if the chance of finding a cheaper similar product elsewhere is lower, as would be the case with a wide MFN in place.
17. We considered the evolution of MFN clauses in the industry and noted that their scope has tended to widen as competition has increased (ie as the number of PCWs has risen). This suggests that they may have been introduced with the intention of shielding PCWs from the full impact of competition.

18. Overall, it appears to us that own-website MFNs have weak anti-competitive effects and may have some pro-competitive effects. However, MFNs with wider scope appear likely to have more substantial impacts, both anti- and pro-competitive. We intend to consider this issue further in order to form a view on whether, on balance, the wide MFNs in contracts between PCWs and PMI providers are pro- or anti-competitive. Specifically, we intend to consider further:
- (a) the impact of MFN clauses on PMI premiums;
 - (b) the likely extent to which advertising expenditures might be reduced if price competition were to replace advertising-based competition; and
 - (c) the likely magnitude of the efficiency gains from wider MFNs.

The role of MFNs in the PMI market

19. Insurers and brokers ('PMI providers') are able to sell PMI policies via a large number of sales channels including: direct (online or telesales), on a PCW, via a broker (if an insurer), etc. Some of these sales options include both an online and offline channel.
20. PCWs are platforms which allow customers to search and compare across a range of PMI policies online (as well as other goods and services). If a customer finds a PMI policy which they wish to purchase, they click through to a PMI provider's website and make the purchase. The PMI provider typically pays the PCW a CPA fee for every PMI policy purchased.
21. Approximately [38] per cent of PMI policies sold through PCWs are under contracts which include some form of MFN clause stipulating that the policy may not be advertised for less through another sales channel.⁵ MFNs do not apply to quotes provided by an insurer to a customer on renewal. However, these clauses vary considerably, both in terms of the sales channels which are covered by the clause and

⁵ See [Appendix 1](#), Table 2.

the exceptions which may apply. For the purpose of our assessment, we define three MFN clauses with different scopes which broadly describe the main features of the majority of MFN clauses currently in force:

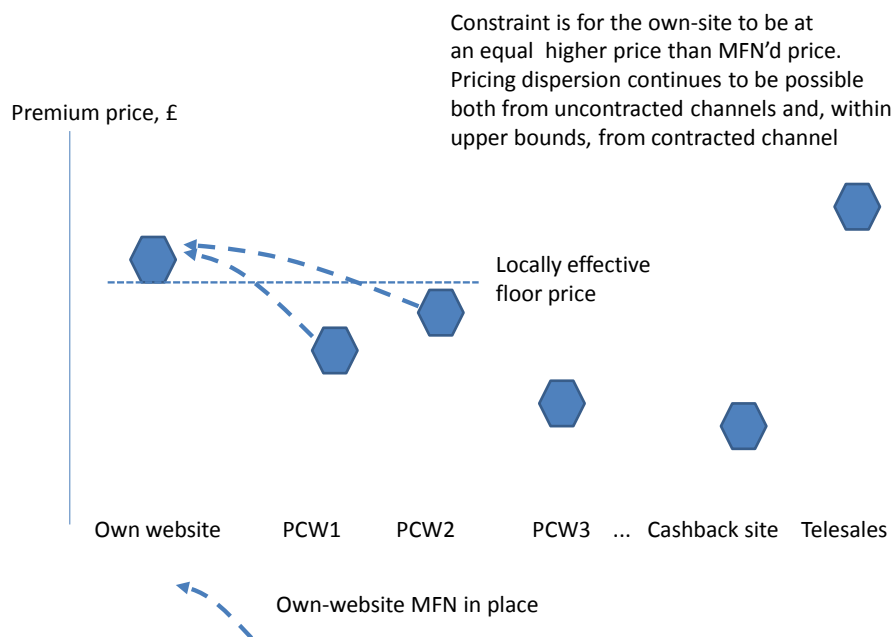
- (a) A PMI provider may not offer a particular policy on its own website for less than it is advertised on the PCW ('own-website MFN').
- (b) A PMI provider may not offer a particular policy on any online sales channel for less than it is advertised on the PCW ('online-sales MFN').
- (c) A PMI provider may not offer a particular policy on any sales channel for less than it is advertised on the PCW ('all-sales MFN').

22. In this paper, we discuss 'narrow' MFNs, referring to own-website MFNs and 'wide' MFNs, referring to online-sales and all-sales MFNs. We illustrate the different constraints imposed on PMI premium pricing by narrow and wide MFNs in Figures 1 and 2.

FIGURE 1

The constraint imposed by narrow MFNs

Network effects of own-website MFNs



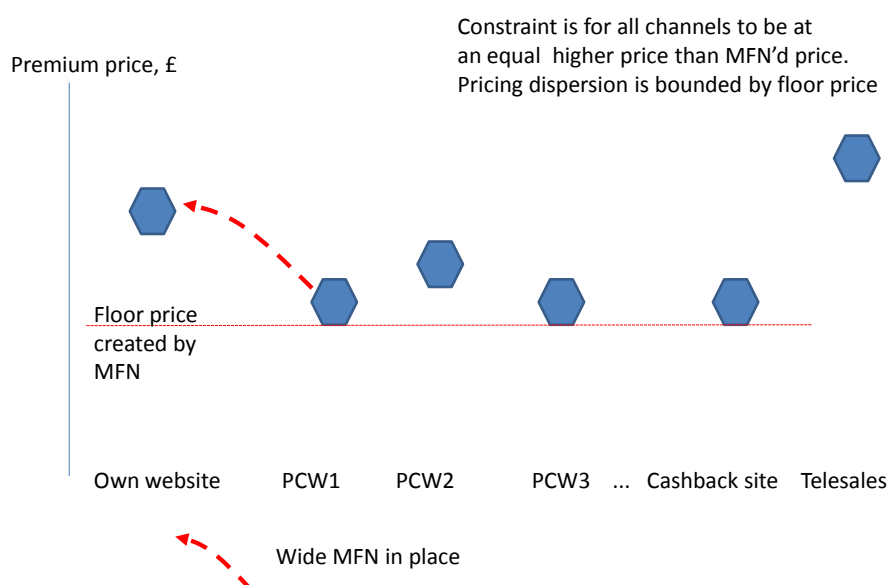
Source: CC.

23. In Figure 1, channels are represented on the horizontal axis, and premium prices on the vertical axis. PCW1 and PCW2 are assumed to have an own-website MFN with the PMI policy in question. They therefore know that their own prices will be no higher than those on the PMI provider's own website. However, there is no guarantee that PCW3, or the cashback website, will not be able to post lower prices on this policy. There is potential pricing competition from all channels except the own website. There is no 'network' or spillover effect from the own-website MFN for other channels.

FIGURE 2

The constraint imposed by wide MFNs

Network effects of wide MFNs



Source: CC.

24. In Figure 2, channels are represented on the horizontal axis, and premium prices on the vertical axis. PCW1 is assumed to have a wide MFN with the PMI policy in question. PCW1 knows that its prices will set a floor to the price that anyone can charge. There is no pricing competition from any channel covered by the wide MFN. This is a 'network', or spillover, effect.

25. The pro- and anti-competitive effects of an MFN will depend on its scope, so we consider each harm and each scope separately. Table 1 lists these possible effects and summarizes our view of the strength of them, which we discuss in more detail in the rest of this paper.

TABLE 1 Summary of mechanisms and impacts of MFNs

Effect	Type of MFN		
	Own site	Online	All-channel
Anti-competitive			
<i>CPA upward price pressure</i>			
Upward price pressure at PCW	X	√	√√
Absence of downward price pressure at other PCWs	X	√	√√
Absence of negotiating pressure from PMI providers threatening lower prices elsewhere	X	√	√√
Coordination between PCWs	X	√	√
<i>PMI upward price pressure</i>			
Direct	√	√	√
Dynamic	X	√	√√
Absence of PCW sales channel negotiating pressure for lower prices	X	√	√√
Entry restriction	X	√	√√
Excess advertising expenditure	X	√	√√
Pro-competitive			
Improvement of one-stop search	√	√√	√√
Protection of sunk costs investment	√	√√	√√

Source: CC.

Note: A cross indicates that we do not consider there to be a substantial effect. A single tick indicates a possibly substantial effect. Multiple ticks indicate that the effect is possibly stronger as the scope of the MFN increases.

Potential anti-competitive effects of MFN clauses

26. We consider the harm that MFN clauses might cause under four broad headings:

- increased pressure for high CPA fees;
- increased pressure for high PMI premium prices;
- restrictions on entry and innovation on the PCW market; and
- excessive advertising expenditure.

27. The first two of these issues each comprise a number of distinctive mechanisms which we discuss in turn. In each case, the scope of the MFNs will affect the degree to which the harm is likely.

Pressure for higher CPA fees

Upward price pressure at the PCW possessing an MFN clause

28. Without an MFN, a PCW should be constrained in the CPA fee it charges by the fear that a higher fee would lead to higher PMI premium prices on that PCW and therefore a loss of market share. With a sufficiently wide MFN, that fear is reduced, since the PCW knows that it will always be at least as competitive as any channel included in the scope of the MFN. The lessening of the competitive constraint can be expected to lead to higher CPA prices.
29. The degree to which an alternative channel constrains CPA fees ought to be related to the probability that a consumer visits that alternative channel. If it is very unlikely that an alternative channel is visited, then the pricing on that channel is unlikely to exert a strong constraint on the CPA fees. Our survey of PMI policyholders found that only 4 per cent of respondents checked just one PCW and at least one PMI provider website (see working paper ‘Survey report’). This suggests that, without any MFN in place, the PMI provider website price is unlikely to be much of a constraint on the PCW price.⁶ On the other hand, 63 per cent of respondents visited at least two PCW sites. This suggests that competition from other PCWs is likely to be a considerable constraint to the pricing of PCW fees.
30. The constraint on CPA fees from a PMI provider’s website is unlikely to be significant. Therefore, an MFN with an own-website scope is unlikely to alter any existing upward pricing pressure on CPA fees. However, the constraint on CPA fees from other PCWs is likely to be significant. Therefore, a wide MFN is likely to lead to substantial upward pricing pressure on CPA fees.

⁶ Our survey results report behaviour in the presence of MFNs. It may be that without the MFNs, different behaviour would arise. Therefore, we should not put too much weight on survey evidence when coming to conclusions about what behaviour would be like without MFNs.

31. If an MFN is of great value to a PCW, then it may accept a lower CPA fee in exchange for an MFN. This effect might mean that wide MFNs are associated, at least at first, with low CPA fees rather than the high CPA fees suggested by the pricing constraints argument. If we assume (as seems to be the case) that negotiations over the scope of the MFN are less frequent than negotiations over the level of CPA fees, then we might expect that wider MFNs may be associated with lower CPA fees at first but with a higher growth rate in CPA fees than if the MFNs were not in place as PCWs take advantage of the reduction in pricing constraint that they create.
32. Figure 3 shows the evolution of CPA fees for [X] between 2010 and 2012 for policies covered by narrow (and no) MFNs and those covered by wide MFNs. Wide MFNs have higher average CPA fees, which is consistent with the view that the pricing constraints are weaker on wider MFNs. However, we note that this evidence does not separate out the effects of the MFN from simple bargaining-strength effects. It might be that higher CPAs and wider MFNs are jointly caused by the stronger bargaining position of PCWs relative to some insurers.⁷

FIGURE 3

Changes in CPA fees over time for [X] for wide and narrow-MFN policies

[X]

Source: CC analysis.

33. We examined the hypothesis that a widening of the MFN might lead to an acceleration in the growth rate of CPA fees. During 2010, [X] introduced wider MFNs into its contracts with [X] insurers. In Figure 4 we plot the evolution of the CPA fees for these [X] insurers compared with the evolution of the fees of narrow and wide MFNs in general.

⁷ The relative bargaining strengths of the participants is discussed in greater detail in our working paper 'ToH 3: Horizontal concentration in PCWs'.

FIGURE 4

Changes in CPA fees over time for [X], showing prices for those insurers for which MFNs have widened during 2010

[X]

Source: CC analysis.

34. The top line in the chart shows the CPA fees for those insurers which had wide MFNs introduced into their contracts during 2010. The growth rate of their CPA fees accelerated after the introduction of the wider MFN. While this is consistent with the argument that wider MFNs lessen a pricing constraint, it does not provide support for the argument that PCWs might accept lower CPA fees in exchange for a widening of the MFN. We note that there are a very small number of changes in the data set and, for this reason, we put little weight on this evidence.
35. We examined further the possible joint determination of MFN clauses and CPA fees by looking at the impact of insurer size on these variables. In Figure 5, we compare CPA fees for the largest 50 per cent of insurers measured by total sales against the CPA fees for the smallest 50 per cent.⁸ The average CPA fees are between 6 and 8 per cent lower for the large insurers than for the small insurers, which is consistent with the view that lower CPA fees are the result of weaker PCW bargaining positions.

FIGURE 5

CPA fees for large and small insurers*

[X]

Source: CC analysis.

*[X].

36. Figure 6 compares the proportion of sales conducted under wide MFNs for the largest 50 per cent of insurers against the proportion for the smallest 50 per cent.

⁸ This only includes insurers who use all [X].

Large insurers have fewer sales under wide MFNs than small insurers. This is consistent with the view that the scope of MFNs is affected by the relative bargaining strength of the parties.

FIGURE 6

Prevalence of wide-MFN clauses for large and small insurers*

[✂]

Source: CC analysis.

*[✂].

37. In Figure 7, we compare CPA fees charged to large and small insurers depending on whether they are under wide or narrow MFNs. For all the PCWs for which we had data, there was an impact on CPA fees from widening MFNs for both large and small insurers.

FIGURE 7

CPA fees for large and small insurers under wide and narrow MFNs*

[✂]

Source: CC analysis.

*[✂].

38. Overall, the evidence suggests a correlation between wide MFNs and higher CPA fees. However, the evidence does not exclude the possibility that higher CPA fees and MFNs are jointly a matter of bargaining strength, rather than MFNs being a partial cause of the higher CPA fees. It could be that wide MFNs are one of the mechanisms through which a stronger bargaining position is used to increase CPA fees. We discuss the way negotiations work between PMI providers and PCWs in the working paper 'ToH 3: Horizontal concentration in PCWs'. In that paper, bargaining strength is analysed in terms of the dependency of an insurer on any one specific PCW and vice versa. The fact that small insurers tend to face higher CPA fees and tend to have wider MFNs than large insurers is consistent with bargaining strength

jointly determining both variables; but it is also consistent with wider MFNs being the direct cause of higher CPA fees. We note that even large insurers on average face higher CPA fees on policies that have wider MFNs.

Absence of downward price pressure at other PCWs

39. Without MFNs, a PCW might seek to gain market share from other PCWs by lowering its CPA fees and negotiating with PMI providers for them to offer consumers lower PMI prices on its PCW. This would create downward pricing pressure on CPA fees. However, in the presence of a wide MFN, a PCW (even one not covered by an MFN) would see no competitive reason to reduce its CPA fees. The PMI provider bound by a wide MFN would be unable contractually to offer premiums lower than its competitors' in exchange for lower CPA fees. Therefore, a wide MFN reduces downward pricing pressure from other PCWs and may lead to higher CPA fees.
40. Evidence that the PCWs perceive MFNs as fulfilling the role of limiting competition from lower-cost providers is suggested by the experience of cashback websites. These websites offer to share referral fees between consumers and the website by offering post-purchase payments to consumers who have earned the website a fee. When these websites started to offer PMI policies, [REDACTED] expanded the scope of [REDACTED] wide MFNs to include cashback websites.⁹ The cashback websites were effectively offering discounted premiums by taking a lower CPA fee. The widened MFNs were intended to stop insurers offering premiums that would lead to post-cashback prices being lower than the prices on the PCWs. Cashback websites have not been successful entrants in PMI sales but we do not have evidence on whether this lack of success can be attributed to the operation of MFNs.

⁹ [REDACTED]

41. A number of PCWs have sought to engage PMI providers in exclusive offers by reducing CPAs in return for a lower premium being published. [X].

Absence of negotiating pressure from PMI providers threatening lower prices elsewhere

42. A PMI provider facing a request for a higher CPA fee can be expected to try to resist the increase. With no or narrow MFNs in place, the PMI provider can threaten to offer the policy at a lower premium through alternative channels. This would mean that, as consumers learned that the policy was available cheaper elsewhere, the PCW asking for the CPA fee rise would see lower sales of that policy through its own site, and therefore lower CPA fee revenues. DLG said that the freedom to price more competitively on alternative channels (other PCWs and direct channels) would [X]. However, that negotiation tactic is eliminated by the presence of a wide MFN.
43. Where there is a wide MFN, the negotiating option left to a PMI provider is to threaten to delist the policy entirely from the PCW.¹⁰ However, there appears to be little evidence of PMI providers voluntarily delisting from PCWs. DLG told us that, given that PCWs now account for around 60 per cent of new business sales in the UK PMI market, and given that their use is a feature of consumer search behaviour, it would be very difficult for a large insurer to maintain its sales volume whilst not making its products available through PCWs. Aviva also told us that, to remain competitive, it was necessary to quote on a minimum of three of the four large PCWs (although it was desirable to quote on all four). AXA also said that it was essential to be listed on all four large PCWs. We noted that both DLG and Aviva had one or more brands which did not sell through PCWs but other brands which did.

¹⁰ Another option would be to renegotiate the scope of the MFN. We assume in this part of the discussion that the PCWs have sufficient bargaining power to maintain the wide MFNs which are currently in place.

Coordination between PCWs

44. Coordination requires the simultaneous fulfilment of three conditions:¹¹

- the ability to reach and monitor terms of coordination;
- internal sustainability, with it being in each firm's interest to maintain the coordinated outcome; and
- external sustainability, with the coordinating firms being able to exclude competition that could undermine the coordinated outcomes.

45. We considered the hypothesis that coordination could be with regard to setting a floor price for the price of PMI policies.¹² We discuss each condition for this coordination in turn in relation to the operation of an MFN:

- If a policy is covered by a wide MFN, then the floor price of the policy is determined by its price on the PCW which has the wide MFN clause. Monitoring is effectively carried out through the monitoring of MFNs by the PCWs which have them.
- Internal sustainability requires that deviations from the coordinated outcome be punished. To the extent that deviation breaks the MFN clause, it is punishable in law and thus the MFN provides a very strong mechanism for internal sustainability.
- External sustainability requires that entry be constrained or that fringe competitors who are not covered by the MFN be unable to disrupt coordination. The MFN helps to do this by softening the competitive constraint from other sales channels/PCWs and excluding a common entry strategy based on offering lower prices. Indeed, in the absence of price competition, entry requires substantial investment in advertising, which is likely to create a barrier to entry.

¹¹ See the CC *Guidelines for market investigations*, CC3, April 2013, [paragraph 250](#).

¹² It is possible that PCWs could try to coordinate over CPA fees rather than final PMI prices. It is also possible that MFNs would help this task. We focus on coordination on PMI prices because this is the most direct way that MFNs might affect coordination. Our hypotheses on the effects of MFNs (CPA upward price pressure, PMI upward premium price pressure, and restrictions on entry) all suggest that they could lead to an increase in PMI premiums.

46. Overall, it appears to us that MFN clauses can be thought of as potentially reproducing conditions akin to coordination, but doing this in a fragmented market using bilateral contracts. We would usually think of coordination as involving the adjustment of the behaviour of each party in response to the history of the behaviour of all other parties to the coordinated outcome. However, MFNs do not require that sort of adjustment; they simply require that bilateral contracts be honoured. It appears to us that wide MFNs potentially replicate the outcomes of coordination, ie increased upward pressure on PMI premiums for all PCWs.

Conclusions on CPA upward pricing pressure

47. It appears to us that there are three mechanisms by which MFNs could lead to upward pricing pressure on CPA fees. A wide MFN:
- removes a means for PMI providers or other PCWs to punish a PCW for increasing its CPA fees;
 - removes the rewards to competing PCWs from lowering CPA fees; and
 - lessens the bargaining power of PMI providers facing increased CPA fees.
48. It appears to us that the evidence we have seen is consistent with wide MFNs being associated with higher CPA fees. However, the evidence is not conclusive as alternative explanations are available. We have also considered evidence based on the contracting behaviour of PCWs in the face of increased competition.
49. Overall, it appears to us likely that wide MFNs create upward pricing pressure for CPA fees.

Pressure for higher PMI premium prices

Direct effect

50. If an MFN is introduced on a policy which previously had none, then the policy provider may need to make some pricing adjustments. For example, if the policy was available on the provider's own website at a lower price than elsewhere, after the introduction of an MFN (even a narrow, own-website MFN) the PMI provider will either have to increase the price on its own website or reduce the price on the PCW with which it has the MFN.¹³ If most sales come from PCWs rather than the own website, then increasing the price on the own website will tend to be preferred, since reduced prices on a channel responsible for most sales will cause a large reduction in profits, while lost sales from a price increase through a channel that has fewer sales is likely to reduce profits less. Given that sales through PCWs account for [redacted] per cent of online sales,¹⁴ we would expect that the direct effect of the introduction of MFNs would be to increase PMI prices rather than to reduce them.
51. [redacted] told us that it had introduced a specific product aimed at the PCW market. [redacted] said that, if it had not introduced this product ([redacted]), specifically designed for sale on PCWs, and had instead sold its existing [redacted] product via PCWs, it is likely that the presence of MFN clauses preventing [redacted] from offering a lower price on its own direct sales website would have caused that price to increase. (Although this is an example of a circumvented direct effect, it illustrates the danger.)
52. LV told us that MFN clauses restricted insurers' ability to apply different prices to PCWs and other sales channels to reflect their relative risk performance. For example, although the direct online channel may yield more profitable business, the insurer would not have the freedom to reflect this in a lower price.

¹³ This argument applies also to wider MFNs.

¹⁴ Ebenchmarkers Online Car Insurance Benchmark, Autumn 2012 Report.

Dynamic effect

53. MFNs can also increase the cost to a PMI provider of reducing premium prices. For example, faced with the choice of reducing a policy price in order to win a specific customer (or customer type), a PMI provider without an MFN could opportunistically reduce the price for that one customer without a concern about the knock-on effects on other customers; but, with a wide MFN in place, the decision to reduce prices for just one transaction then applies to all transactions. A wide MFN effectively establishes a floor price for a policy across all the channels within its scope. A lowering of price which might make sense without an MFN in place could become unprofitable with an MFN such that the MFN has the effect of lowering the probability of premium price reductions.
54. [X].¹⁵ This appears to us to be an attempt to introduce the kind of opportunistic price reductions described above. However, it has not occurred and it is possible that the reason why is because it would contravene the MFN clauses in PMI providers' contracts with other PCWs.

Coordination between PMI providers

55. An MFN clause reduces the variation in the prices of PMI providers' policies (ie across different online sales channels). In theory, this could increase the ability of PMI providers to monitor each other's prices, and in turn their ability to coordinate.
56. However, it is not clear that a reduction in pricing variation across channels would significantly improve the ability of PMI providers to monitor each other's prices. This is because premiums charged (online at least) are publicly available. Collecting and evaluating price information across online sales channels may therefore not be diffi-

¹⁵ [X] indicated to us that it believed [X] had developed this technology. [X] told us that it had considered the option in 2012 but had decided not to implement it.

cult, especially if only a subset of prices needs to be monitored. Moreover, it is also not obvious how PMI providers would be able to coordinate PMI policy prices given that they are specific to individual customers. The large number of PMI providers and the differentiation of policies also suggest that it is unlikely that PMI providers would be able either implicitly or tacitly to coordinate on premiums.

57. For these reasons, we do not intend to consider this issue further.

Absence of PCW sales channel negotiating pressure for lower prices

58. If PCWs were competing to offer PMI policies at the best prices for the final consumer, we could expect them to use any negotiating strength they might have to put pressure on PMI providers to offer policies at lower premiums. A successful negotiation of a lower premium for a specific PCW would mean higher market share and higher revenues from CPA fees.

59. However, in the presence of a wide MFN this strategy cannot work. As long as a policy is covered by even just one wide MFN, PCWs will not be able to negotiate a price advantage. Therefore, there is reduced pressure from the sales channel for lower PMI premium prices.

Conclusion on MFNs' contribution to upward pricing pressure on PMI premiums

60. We have identified three mechanisms by which MFNs might lead to upward pricing pressure on PMI premiums, and we have some evidence of direct effects limiting price competition in PMI premiums (see paragraphs 50 to 52). However, we do not currently have econometric evidence that wider MFN clauses are associated with higher PMI premiums.

Restriction on entry and innovation

Entry

61. A frequent strategy for entry in many markets is for the entrant to offer a cheaper price. Datamonitor reported that 74 per cent of PMI policyholders listed price as a main factor for choosing their current provider,¹⁶ and PCWs told us that around 60 per cent of their customers purchased the cheapest PMI policy. Therefore, as the majority of consumers of PMI appear to be price sensitive, this strategy might be the obvious route to successful entry.
62. Entry and the threat of entry would have a number of pro-competitive consequences:
- potentially lower premiums (to the extent that lower prices are used to gain market share);
 - increased consumer choice of platforms; and
 - innovation (to the extent that competition is on features as well as on price).
63. However, a wide MFN undermines an entry strategy based on lower premiums. An entrant cannot offer consumers lower PMI policy prices as long as those policies are covered by a wide MFN.
64. An example of attempted entry of this sort is that of some cashback websites. An internal document from [X] identified the threat posed from cashback sites such as Quidco, which, it noted, if they continued to grow, could erode [X] profits. The document mentioned using a 'best price guarantee' (among other things) to achieve a competitive advantage over cashback websites, and we noted that the contracts that [X] with a number of PMI providers specifically mentioned cashback websites being within the scope of the MFN clause. The inclusion of cashback websites [X].

¹⁶ UK Private Motor Insurance 2011 (Datamonitor), p72.

65. There has been entry into the PCW market, specifically by Google and Tesco. However, neither has been particularly successful in gaining market share. Nevertheless, [X] told us that it did not consider MFNs to be problematic, saying that they added credibility to attempts to offer a PCW service, since its consumers could be confident that prices on [X] were at least as good as they were elsewhere.
66. Overall, we would expect effective entry to be pro-competitive and we would expect entry based on price competition to be particularly pro-competitive in the price-sensitive PCW market. However, the evidence we have seen suggests that entry on the basis of price competition has been limited by wide MFN clauses. Therefore, it appears to us that wide MFNs are likely to constitute a barrier to entry.

Innovation

67. A PCW might be in a position to offer cost-saving innovations to PMI providers by, for example:
- putting in place questions and filters which reduce the rate of fraud in policy sales (eg through misrepresentation); or
 - using the non-questionnaire information it gathers about users through its website to contribute to better overall assessments of risk by the PMI provider.
68. This sort of innovation has the potential to offer customer benefits through lower PMI premiums, with the prospect of generating more sales for the PCW. However, lower premiums are excluded by wide MFNs, with the effect that there is no incentive for a PCW to engage in the development of such innovative solutions.¹⁷

¹⁷ We recognize that PCWs continue to have an incentive to innovate to make their platforms more attractive to consumers of PMI, for example through a better user experience or through branding strategies.

Excess advertising expenditure

69. It appears to us that wide MFNs soften price competition between PCWs (see paragraph 49). Without MFNs, we would expect to see more price competition and lower CPA fees, and as a result we would expect lower CPA fees to justify lower advertising expenditure. Hence, if we compare outcomes with and without wide MFNs, we would expect a market with lower CPA fees and lower advertising in the no or narrow MFN case, and higher fees and higher advertising in the wide MFN case.
70. If the MFN is having the effect of channelling competitive pressures from price-based competition to non-price, advertising-based competition, the MFN may be creating a wasteful level of advertising. We do not suggest that the industry does not need advertising as there are clearly pro-competitive aspects to consumers being well informed about the availability of PCWs; however, MFNs may increase the level of advertising beyond this amount. Moreover, it is possible for advertising expenditure to be used by the PCWs to make entry unprofitable. In such a case, a combination of MFNs and increased advertising expenditure could be restricting competition through limiting entry.
71. Several PMI providers told us that PCWs had reached (or were near to reaching) saturation and that additional investment in advertising was only taking share from other PCWs rather than increasing the number of customers using PCWs as a whole. Indeed, PMI providers told us that additional expenditure on advertising and marketing had been the reason given by some PCWs for increases in CPA fees. Swinton told us that additional volume from a PCW as a result of advertising did not necessarily guarantee additional revenues for Swinton overall as, in many cases, it simply took business from another PCW. DLG said that the harmonizing effect of MFN clauses on prices across PCWs mitigated the risk of PCWs losing business to

their competitors, with the result that PCWs competed more on the basis of non-price benefits to customers (eg cuddly toys or nectar points).

72. We have not analysed advertising expenditure to establish how much might be due to MFN clauses. However, we intend to consider this issue further.

Summary on anti-competitive effects of MFN clauses

73. It appears to us that wide MFN clauses might lessen pricing constraints on CPA fees and on PMI premiums. They might also restrict entry and switch competition from price-based competition to advertising-based competition, possibly incentivizing excessive advertising expenditure. In summary, it appears to us that wide MFN clauses might have considerable anti-competitive effects.
74. It does not appear to us that narrow MFN clauses are likely to be problematic in the same ways, although we have identified one way in which even narrow MFNs might have a direct impact on PMI premiums.

Potential pro-competitive effects of MFN clauses

75. We consider two ways in which MFNs might enhance competition: first, wide MFNs might improve the quality of the search experience by assuring consumers that the price they obtain is the best price for that policy available; second, MFNs, by reducing cross-channel competition, might allow fixed and sunk investments in channels to be recouped. We consider each of these effects in turn.

MFN clauses and improvement of the search experience

76. MFNs may enhance the consumer experience of searching for PMI products by reducing the need for consumers to shop around to find a cheaper price. With an MFN in place, consumers can reasonably infer that they are getting a good deal

when the PCW returns its quotes. This reduces the consumer's search time and effort. This effect would be particularly strong if the MFNs are commonly known to be in place, but could also be the result of learning.

77. We would expect this efficiency benefit of MFNs to increase with the scope of the MFN. If there were only own-website MFNs in place, then a consumer would still need to check all the other channels apart from the PMI provider's own website to ensure that they had the best deal. In Italy, the Autorità Garante della Concorrenza (Italian Competition Authority) investigated PMI and found that PCWs had not been able to grow in Italy because, among other reasons, there were no mechanisms to ensure that the premiums quoted by PCWs were the same as the premiums quoted directly by each insurer.¹⁸ As a consequence, PCWs had a lower-quality customer experience. This provides an example of what might happen in a market with no MFNs but other interpretations of the Italian market are also possible, eg that insurers in strong bargaining positions do not want to be subject to the competition that PCWs bring.
78. We note that, even in the presence of a large number of wide MFNs, 63 per cent of respondents to our survey who visited one PCW went on to visit at least one more, and only 20 per cent who used a PCW used just one PCW and no other sales channel. This suggests to us that PCWs are not currently effective at making consumers believe that they offer the best prices available.
79. Overall, it appears to us that MFNs are likely to improve the consumer search experience. However, we have not tried to quantify this consumer benefit, and we intend to consider this issue further.

¹⁸ Final Report of the Autorità Garante della Concorrenza (Italian Competition Authority), 22 February 2013.

MFN clauses and the ability to recover fixed and sunk costs

80. MFNs may protect the sunk and fixed cost investments of a PCW. If a PCW invested in offering good-quality search but consumers discovered that the policies offered were cheaper elsewhere, they might use the search but not purchase products through the PCW. The PCW might reduce the quality of its offering and indeed go out of business. As a result, good search solutions might not be offered to consumers.
81. Esure and Admiral (both with ownership stakes in a PCW) told us that own-website MFNs were a core part of a PCW's proposition.
82. One PCW told us that if it became widely known that PMI providers' own websites offered better prices than PCWs then consumers may search for policies on a PCW but purchase the policy direct. Another PCW told us that [✂].
83. Although the diversion of consumers from the PCW to the PMI provider's own website might be the most obvious danger to a PCW, diversion to other PCWs would have the same effect. For example, if one PCW were known for its good search experience while another were known for low prices, then a sufficient number of consumers might search on the first but buy through the second for the investment in search functionality by the first to become unprofitable.
84. In order to assess whether an MFN is a proportionate reaction to the problem of fixed and sunk cost recovery, we need to understand the scale of the cost recovery problem and alternative mechanisms that might address it. We note that the fixed and sunk costs that need to be covered may be lower than would appear from PCWs' actual costs to the extent that advertising expenditure is a substitute for price competition which would not occur in the absence of an MFN. We have not tried to

assess what advertising expenditure might be in the absence of MFNs but we intend to consider this issue further (see paragraph 72).

85. Alternative mechanisms by which PCWs might seek to protect their investment include:

- Doing nothing, as some proportion of consumers will not switch to another channel, and some proportion who do switch may switch back, having failed to find a better deal. These proportions may be sufficient to cover the fixed and sunk costs of a PCW.
- Listing fees, minimum guaranteed CPAs or cookie-based affiliate marketing fees could be used to reward PCWs irrespective of their sales-conversion rates. As PCWs provide a service to PMI providers irrespective of the sales they generate (ie by informing consumers that a given policy is reasonably good value), PMI providers could pay for this service directly. We note that there appear to be some moves in the industry in this direction, with minimum guaranteed CPA rates becoming more common.¹⁹

Summary on pro-competitive effects of MFN clauses

86. It appears to us that MFN clauses may help to solve two issues in the market for PCWs: search trustworthiness and fixed/sunk cost recovery. However, we have not estimated the magnitude of these effects or evaluated whether they might be sufficient to counteract the anti-competitive effects of MFNs. Also, it appears to us that other mechanisms might exist which could solve these problems, although we have not examined those alternative mechanisms in detail.

¹⁹ [X]

Prevalence and characteristics of MFN clauses in contracts between PCWs and PMI providers

Introduction

1. This appendix discusses the prevalence of the different types of MFN clauses in contracts between PMI providers and PCWs.

Summary

2. The least restrictive type of MFN, the own-website MFN, is currently the most frequently used MFN (in [%] per cent of PMI sales through PCWs), while more restrictive online MFNs are less prevalent ([%] per cent of PMI sales through PCWs) and the most restrictive, the all-channel MFNs, are least frequent ([%] per cent of PMI sales through PCWs).
3. Although these are the current proportions, we note that the use of MFNs seems to be a point of current discussion between some PCWs and PMI providers. We found that a recent request by some PCWs to extend the scope of their MFNs was strongly resisted by PMI providers. We also found that some PCWs had relaxed their MFN clauses, possibly due to increased interest by competition authorities in these clauses.

Background

4. The vast majority of contracts signed by PMI providers and PCWs have an MFN clause which prevents the PMI provider offering the same policy at a cheaper price via some other channel(s).
5. PCWs present consumers with quotes provided by PMI providers. PCWs ask consumers questions and the answers are passed on to PMI providers, which they map

on to variables to enable them to assess risk. The MFN applies to prices that are quoted for identical inputs to the PMI provider risk model, with each different set of variables effectively being a different product.

6. The four large PCWs (Confused, CTM, GoCompare and MoneySupermarket) all use MFNs in at least some of their contracts and some of the smaller PCWs [redacted] do as well.

Prevalence of MFN clauses

7. All the insurers and brokers from which we gathered evidence have MFN clauses in almost all of their PCW contracts. Ageas Insurance is an exception because it does not sell policies directly through PCWs.²⁰
8. Table 1 summarizes the type of MFN clause for each PMI provider in each of its contracts with a PCW in 2012. We classify MFN clauses according to three categories: ‘own website’, ‘online’ and ‘all sales’. We note that this classification may not be fully reflective of pricing constraints because some MFNs are informal agreements. For example, [redacted].

TABLE 1 Type of MFN clause with the four largest PCWs for each PMI provider in 2012

	CTM	Confused	GoCompare	Money Supermarket
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]





























































































































²⁰ Ageas Insurance’s PMI policies are available through brokers (including Ageas Retail (its wholly-owned broking business)), many of which sell through PCWs, and through “affinity” brands.

[✂]

[✂]

[✂].

TABLE 2 Number of policies sold through PCWs in 2012

Note: The MFN clauses have been classified based on the PMI providers' responses as well as on the basis of the contracts submitted. Where we found a discrepancy between the contract and the response, we have classified the MFN clause according to the provisions in the contract.

10. In our sample, [X] per cent of PMI policies sold through PCWs included the least restrictive (own-website) MFN; [X] per cent of the policies sold through PCWs were

covered by an online MFN; and [X] per cent were covered by an all-sales MFN.²¹

However, we note that the proportions for some PMI providers were different from these averages. For example, [X].

11. We note that PCWs do offer policies from some PMI providers without an MFN in place. [X]. However, PMI providers told us that they did not believe they had sufficient bargaining power against the PCWs to resist an MFN clause where a PCW insisted on it. PMI providers said that they felt obliged to accept MFNs if they wanted to sell their products on PCWs.
12. It appears to us that differences in the scope of MFNs are due largely to differences in the bargaining power between PMI providers and PCWs. For PMI providers, strong bargaining power might stem from their reputation and their position in the market, as well as the need for PCWs to compare as many PMI providers as possible; while PCWs' bargaining power might stem from their ability to refuse to list a provider's PMI policies.²²

Extensions/change of scope of MFN clauses

13. Some PMI providers told us that in 2012 they had received requests from PCWs for the scope of the MFNs in their contracts to be extended. They each told us that they had resisted this change. Moreover, some PMI providers told us that they were trying to change the MFNs in their contracts to make them less restrictive.
14. Some PCWs told us that they had recently lessened the scope of the MFNs in some of their contracts. A PMI broker told us that, in October 2012, MoneySupermarket

²¹ These percentages have been calculated on the basis of PMI policies sold through the four largest PCWs under an MFN clause compared with the total number of PMI policies sold through these PCWs. However, the sales under MFNs through PCWs other than the four largest were a small share of the total. On average, the share was about 1 per cent of total sales.

²² The negotiations between PCWs and PMI providers are discussed in greater detail in the working paper 'ToH 3: Horizontal concentration in PCWs'.

wrote to all the PMI providers listed on its site to say that it was relaxing its MFNs and to encourage PMI providers to challenge the MFN clauses they had in their contracts with other PCWs. Commenting on this statement, MoneySupermarket explained that this was an attempt to encourage PMI providers to review the MFN clauses they had in their contracts with other PCWs to ensure that they were compliant with competition law. [✂].