

PMI MARKET INVESTIGATION – SAGA SERVICES LIMITED**RESPONSE TO PCW AND MFN WORKING PAPERS****I. EXECUTIVE SUMMARY**

1 In this response, Saga Services Limited (**SSL**) considers the Competition Commission's (**CC's**) working papers (**WPs**) in respect of:

- (a) Theory of Harm (**ToH**) 3: Horizontal concentration in PCWs; and
- (b) ToH 5: Impact of Most Favoured Nation (**MFN**) clauses in contracts between Price Comparison Websites (**PCWs**) and Private Motor Insurance (**PMI**) providers; and vertical relationships involving PCWs.

2 SSL's comments on the WPs can be summarised as follows:

- (a) PCWs exercise considerable market power and are unavoidable trading partners for PMI providers. They set Cost Per Acquisition (**CPA**) fees to a large extent independently of the reaction of their customers, PMI providers and competitors.
- (b) The WPs significantly overstate the extent to which PCWs compete with each other. In particular, SSL's data shows that relatively few customers shop on multiple PCWs. Further, PCWs focus on maximising "click-to-sale" conversion rates, which blunts their incentives to compete with each other and results in wasteful levels of advertising expenditure, resulting in consumer harm.
- (c) SSL agrees with the CC that online sales MFNs and all-sales MFNs may have substantial adverse effects on competition. However, the CC's analysis significantly under-estimates the adverse effect which narrow MFNs have on competition in the supply of PMI, because it does not fully acknowledge:
 - (i) the collective impact of multiple narrow MFNs (or "network effects");
 - (ii) the fact that narrow MFNs prevent PMI providers from offering lower prices on their own websites (reflecting any differences in the costs and risk profile of customers acquired through direct channels);
 - (iii) the impact that narrow MFNs have on entry and innovation. For example, had the major insurance brokers had narrow MFNs in place with underwriters in the 1980s and 1990s, it is unlikely that PCWs would have been able to enter the market. Equally, the existence of narrow MFNs today may be hampering the emergence or expansion of alternative channels, such as social media; and
 - (iv) the distortionary effect which narrow MFNs have on efficient levels of advertising expenditure, both for PCWs and PMI providers selling directly.
- (d) The pro-competitive effects of MFNs which the CC identifies are either over-stated or can be achieved through other, less anti-competitive, means.

NON-CONFIDENTIAL

- 3 SSL encourages the CC to consider recent developments, which highlight the harmful effect of MFNs. Indeed, in its response to Amazon's decision to remove MFNs from its contracts, on 29 August 2013 the OFT stated that: "...such policies may raise online platform fees, curtail the entry of potential entrants and directly affect the prices which sellers set on platforms (including their own websites), resulting in higher prices to consumers".¹ In that case, both the OFT and the German competition authority expressed concerns about the restrictive effects of both wide *and* narrow MFNs on price competition.
- 4 As regards vertical relationships involving PCWs, SSL questions the CC's assumption that non-integrated PMI providers would be able to identify quote manipulation by integrated PCW-PMI providers. It also notes that, while the CC is correct that integrated providers do make data which they generate available to other PMI providers, it does not acknowledge the prohibitive way in which this data is priced.

II. THE MARKET POWER OF PRICE COMPARISON WEBSITES**PCWs have significant market power**

- 5 The four largest PCWs have very significant market power. This is evidenced by:
- (a) the CC's own analysis, which identifies that PCWs have achieved an aggregate operating profit margin of approximately 25% over the past three years (ToH 3 (PCWs) paragraph 16). As the CC notes, this is consistent with a finding of market power; and
 - (b) the PCW's ability to set CPA fees, to a large extent, independently of the reaction of their customers, PMI providers and competitors.
- 6 The CC's observation that "*CPA fees have risen only slightly during recent years, at near or below the rate of general inflation*" (ToH 3 (PCWs) paragraph 14), while technically correct, is of little relevance when set against the market context for the same period. In particular, as shown by Figure 1, below:
- (a) at no point in the past three years have underlying CPAs [REDACTED] done anything other than increase. This is difficult to reconcile with healthy, dynamic competition between PCWs; and
 - (b) inflation is an unhelpful measure in a market where, over the same period, premiums have been consistently falling. In a truly competitive market, as overall revenues fall, one would expect this to be reflected in a corresponding reduction in the CPA fees charged by PCWs.

¹ See <http://www.of.gov.uk/news-and-updates/press/2013/60-13#.Uh-ZCcu9KSM> - "OFT welcomes Amazon's decision to end price parity policy."

Figure 1 – [REDACTED].

Figure 2 – [REDACTED].

The four large PCWs are unavoidable trading partners

7 The four large PCWs are unavoidable trading partners for PMI providers. This is evidenced by the following three propositions, each of which we discuss further, below:

- (a) the ability of PCWs to impose or vary contractual terms, backed by the threat of delisting;
- (b) the very significant direct impact, on a PMI provider, as a result of being delisted by a PCW; and
- (c) the fact that no major insurer can avoid trading with PCWs.

The ability of PCWs to impose or vary contractual terms, backed by the threat of delisting

8 [REDACTED].

9 [REDACTED]. It is fanciful to suggest, as the CC does in CC ToH 3 (PCWs) that a "PMI provider's bargaining position against a PCW will derive from the possibility that it could delist its products from the PCW ...".

The very significant direct impact, to a PMI provider, of being delisted by a PCW

10 The CC acknowledges that "*the four large PCWs have some bargaining power against PMI providers as PMI providers believe that they would lose a significant volume of sales by delisting from any of the large PCWs*" (ToH 3 (PCWs), paragraph 11).

11 SSL urges the CC not to underestimate the importance of such a loss of new business volume. [REDACTED].

No major insurer can avoid listing their PMI policies with PCWs

12 At paragraph 69 of the WP, the CC refers to the fact that some PMI providers (for example, DLG and Aviva) use the PCW channel to a lesser extent. Whilst that is correct, it is important to point out that, whilst the DLG and Aviva brands do not appear on PCWs, DLG (Churchill, Privilege) and Aviva (Quote Me Happy) have brands that do appear on PCWs. Aviva also sells through brokers on PCWs. This demonstrates that PCWs remain unavoidable trading partners for all of the major PMI providers.

III. PCWS DO NOT COMPETE WITH EACH OTHER AND BARRIERS TO ENTRY ARE HIGH**PCWs compete for new customers through advertising, but few customers shop across PCWs**

- 13 In SSL's view, the CC's Working Papers over-estimate the level of competition between PCWs. In particular:
- (a) the [§<] extracts, set out in Appendix 2, suggest the number of customers that receive a quote from two PCWs is considerably lower than the numbers produced by the CC's survey. In particular:
 - (i) [§<]% of customers have dropped out after receiving a quote but before purchase;
 - (ii) of whom [§<]% then search on another PCW; and
 - (iii) therefore only 13.5% actually receive a quote on more than one PCW;
 - (b) [§<] data obtained by SSL suggests that:
 - (i) [§<]; and
 - (ii) only 17% of SSL's PCW customers (all of which are over-50s) obtain quotes on multiple PCWs; and
 - (c) [§<].
- 14 This data contradicts the CC's findings that:
- (a) only 10% of consumers searched on only one PCW and did not shop around further (ToH 3 (PCWs), paragraph 12); and
 - (b) according to two other PMI providers, 30% and 42% (respectively) of business sold on one PCW could be recaptured on another PCW or sales channels (ToH 3 (PCWs), paragraph 66).
- 15 There are, however, reasons to question the reliability of the CC's data. For example:
- (a) the observation, by the board of Confused, that "*customers often can't remember which site they used, or even if they used a price comparison site*" (ToH 3 (PCWs), paragraph 41), makes it all the more important to rely on actual data (such as that in Appendices 2 and 3), rather than consumer recollections in survey evidence;
 - (b) indeed, in paragraph 32, when recognising the discrepancies with Datamonitor's research, the CC attributes these to different sample groups, which calls into question the adequacy of the CC's sample size and breadth; and
 - (c) the figures of 30% and 42% in paragraph 66 will inevitably be based on quote behaviour rather than policies sold, meaning they overstate the actual opportunity available. If a customer obtains two similar quotes on two PCWs they will be indifferent, purchasing on the second PCW, rather than bothering to retrieve their quotes from the first.

PCWs' focus on conversion rates blunts their incentive to compete with each other

- 16 The CC states that "*PCWs compete to provide consumers with a better PMI policy than their rivals, whether in price or other features*" (ToH 3 (PCWs), paragraph 43). SSL strongly disagrees with this statement.
- 17 In order to maximise revenue, PCWs seek to:
- (a) maximise "click-to-sale" conversion ratios. These ratios are more important to PCWs than sales volumes because unconverted clicks take up time within the consumer's window of interest, meaning they are less likely to ultimately purchase a policy. [REDACTED];
 - (b) maximise CPA fees; and
 - (c) minimise marketing costs.
- 18 Accordingly, in order to maximise their profits, rather than lowering CPA fees to an efficient level to attract the best products at the lowest prices, PCWs:
- (a) have an incentive to delist those products which do not meet the conversion ratios they set, or to impose distortionary "conversion floors"; and
 - (b) focus their marketing campaigns on their ability to save customers money on renewal quotes (as well as on unrelated benefits, such as free toys), rather than competing directly with other PCWs.
- 19 Conversion floors, in particular, are becoming more prevalent. For example:
- (a) in paragraph 78 of Working Paper ToH 3 (PCW), the CC notes that RSA has been subject to conversion floors on more than one occasion;
 - (b) SSL understands that:
 - (i) [REDACTED].
 - (ii) [REDACTED].

Little constraint exists from other areas and barriers to entry are high

- 20 SSL considers that the CC's Working Papers overestimate the competitive constraint posed by other PCWs, direct sales and telephone sales. In particular:
- (a) call centres are often used by people after they have undertaken a PCW search, in order to transact with a particular provider that has quoted in their PCW search. For the vast majority of consumers, this is not an additional search method and, for this reason, the survey data summarised in paragraph 50 of WP ToH 3 (PCWs) is misleading;
 - (b) SSL agrees with the CC's observation in paragraph 53 of WP ToH 3 (PCWs), that "*the constraint on PCWs from sales made by phone is likely to have declined over recent years*"; and
 - (c) SSL notes that, in both paragraph 73 of WP ToH 3 (PCWs) and the multilateral hearing transcript from Tuesday 16 July 2013, eSure and Admiral have emphasised

the constraint exercised by Google and Tesco on other PCWs. SSL recommends that the CC weighs this evidence appropriately, on the grounds that neither eSure nor Admiral is independent: eSure owns 50% of GoCompare and Admiral owns Confused. Rather, SSL suggests that [§<].

IV. CONTRACTING WITH PRICE COMPARISON WEBSITES

Anti-competitive effects of wide MFNs

- 21 SSL agrees with the CC's conclusions that online-sales and all-sales MFNs may have a substantial anti-competitive impact (para 18 and Table 1 WP ToH 5 (MFNs)).

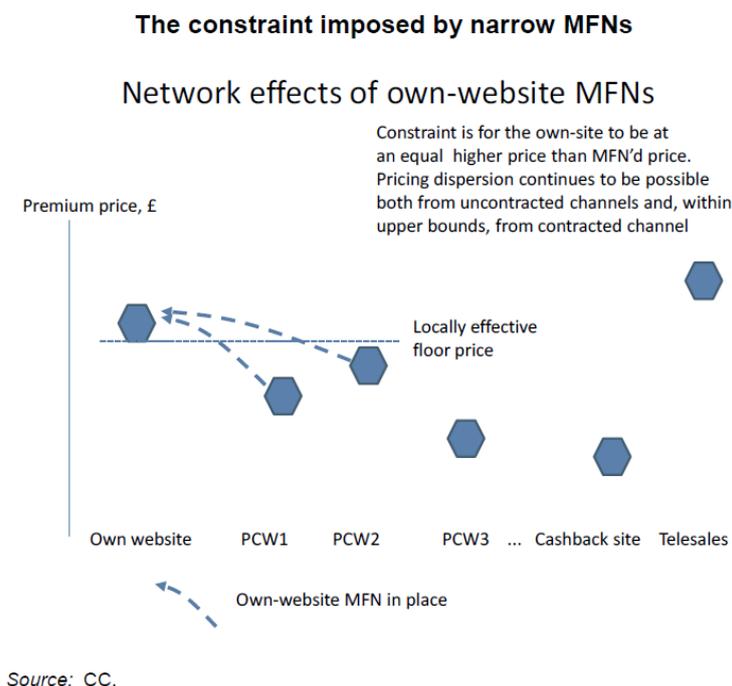
Anti-competitive effects of narrow MFNs

- 22 In SSL's view, the CC's analysis under-estimates the anti-competitive impact of narrow MFNs. The following paragraphs analyse the impact of a network of narrow MFNs, before considering, in turn, the four sources of harm which the CC identifies in ToH 5 (MFNs).

The network effects of own website ("narrow") MFNs

- 23 The CC's analysis of "network effects" considerably underestimates the harm caused by "networks" of narrow MFNs.
- 24 In particular, the chart on page 9 of WP ToH 5 (MFNs) is labelled "*network effects of own-website MFNs*" but does not actually appear to address network effects. That chart is set out in Figure 3, below, for reference.

Figure 3 – Taken from figure 1, page 9 of WP ToH 5 (MFNs)



25 In a market without any MFNs, every PMI provider is free to price dynamically. Each PMI provider is therefore free to act as a constraint on the PCW channel. Figure 3, above, reflects that each narrow MFN creates a floor price. It does not, however, reflect the following important issues relating to "network effects":

- (a) *Every PCW benefits from every single narrow MFN that is entered into across the market, regardless of whether or not it is a party to that MFN:*

In Figure 3, only PCW 1 and PCW 2 have entered into narrow MFNs with the PMI provider. Nevertheless, PCW 3 (and PCW 4, were it represented in Figure 3) will still benefit from the narrow MFNs into which the PMI provider has entered with PCW 1 and PCW 2, because they blunt the constraint the PMI provider can be on the market as a whole. This is because the PMI provider cannot price below the "floor price" (and it is, therefore, misleading to refer to this floor price as "locally effective");

- (b) a PMI provider is removed from being a constraint on the market as a whole as soon as it enters into its first narrow MFN with a single PCW. For an adverse effect on competition to arise, it is not necessary for a PMI provider to enter into multiple MFNs.

26 As a result of these two principles, the PMI providers are prevented from using the direct channel as any form of competitive constraint on the prices of PCWs, as soon each PMI provider has entered into just a single narrow MFN with any PCW. In basic terms:

- (a) in a world without MFNs, each PCW might be constrained by 3 other PCWs and (e.g.) 12 PMI providers;
- (b) as soon as that PCW enters into a narrow MFN with just one PMI provider, each PCW will be constrained by the other 3 PCWs and only 11 PMI providers; and

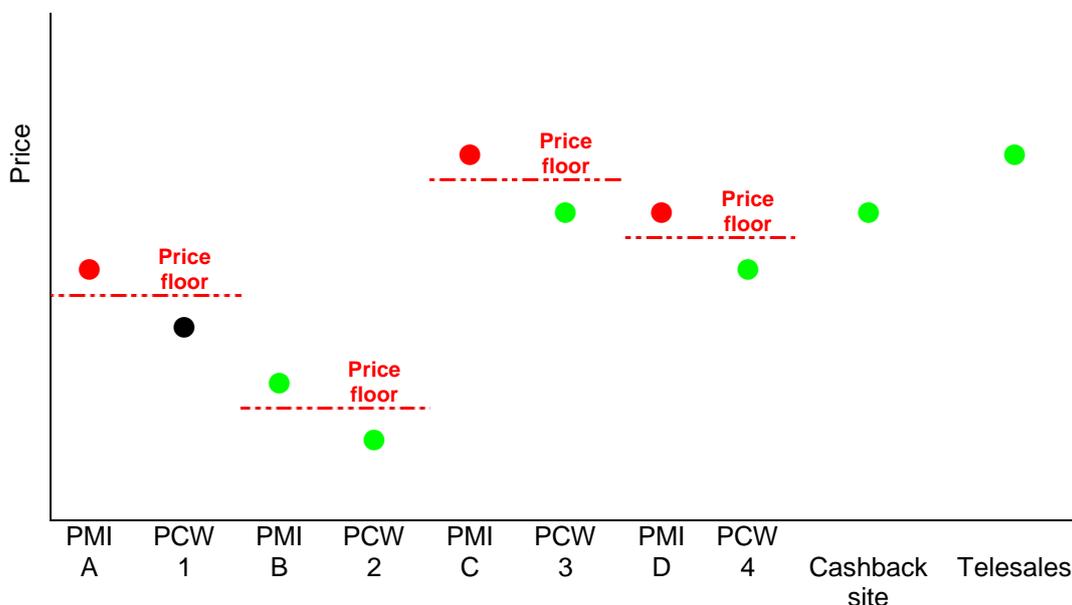
NON-CONFIDENTIAL

- (c) if each of the PMI providers enters into a narrow MFN with 3 different PMI providers, the "network effect" is that all 4 PCWs are now only constrained by each other.

27 Figure 4, below, amends the CC's chart to illustrate this effect on PCW 1. PCW 1 enters into a narrow MFN with PMI provider A. PCW 2 enters into a narrow MFN with PMI provider B, etc. As a result, PCW 1 is:

- (a) still constrained by PCWs 2-4 (in green), which are free to price below PCW 1;
- (b) no longer constrained by PMI C or PMI D (in red), because of the floor price created by the narrow MFNs they have signed; and
- (c) only constrained by PMI B (in green) because PCW 2 is currently pricing below PCW 1.

Figure 4 - The network effect of narrow MFNs on PCW 1



Pressure for higher CPA fees

- 28 In SSL's view, regardless of the position on MFNs, the CC's thinking on this point also needs to capture the limited competition (between PCWs) on CPA fees, described in section II, above.
- 29 Further, in paragraph 30 the CC observes that *"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."*
- 30 There is an element of circularity to this statement. As can be seen from Figure 4, above, one of the main reasons that this constraint is insignificant is the network of (even narrow) MFNs. Prior to the introduction of MFNs, the direct channel imposed a considerable constraint on the behaviour of PCWs.
- 31 For the same reasons as those set out in relation to network effects, above, narrow MFNs (just like wide MFNs) remove an important competitive constraint on CPAs. If the PMI

providers can no longer use the direct channel to compete with the PCWs, in effect they have no recourse when PCWs continually increase CPAs, free from constraint.

Pressure for higher PMI premium prices

- 32 SSL agrees with the CC's finding that a narrow MFN may significantly increase the cost of a price reduction on a PMI provider's own website. It wishes, however, to emphasise a number of points, to which it feels the CC has not accorded sufficient weight.

Narrow MFNs prevent certain savings which can only be made on direct business

- 33 The risk profile of the average SSL customer purchasing through the PCW channel is higher than that of the average customer purchasing direct. We note the point (made by CIS General Insurance Limited at its bilateral hearing on 19 July 2013) that the difference has narrowed over time. Even now, however, in the absence of any MFN clause, the difference would result in a [REDACTED]% saving by direct customers. The presence of either a wide or narrow MFN prevents SSL from reducing its prices in order to reflect these cost savings.
- 34 SSL notes from paragraph 52 WP ToH 5 (MFNs) that LV has also brought this point to the CC's attention, albeit in the wider context that "*although the direct online channel may yield more profitable business, the insurer would not have the freedom to reflect this in a lower price.*"

Risk transfer

- 35 [REDACTED].

Harm to more vulnerable consumers

- 36 Given that SSL's customer base is restricted to over 50s, it assists a greater number of pensioners than the average PMI provider. This demographic is more wary of PCWs. Approximately [REDACTED]% of SSL's PMI internet sales are made on its own website, which it understands to be considerably higher than the industry average. It is these more vulnerable consumers which suffer most from the way that narrow MFNs increase the price at which PMI can be sold through the direct channel.

Restrictions on entry and innovation on the PCW market

- 37 SSL read the CC's findings in relation to cashback websites with interest (paragraph 40 WP ToH 5 (MFNs)). In particular, it notes that 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.*"
- 38 In the view of SSL, all new innovation should be afforded a level playing field. In particular, it wishes to stress that:
- (a) had the major insurance brokers had narrow MFNs in place with underwriters in the 1980s and 1990s, it is unlikely that PCWs would have been able to enter the market; and
 - (b) as noted by Aviva in the summary of its bilateral hearing on 19 July 2013, the existence of narrow MFNs today may be hampering the emergence or expansion of alternative channels, such as social media.

- 39 SSL urges the CC to continue to investigate how the existence of MFNs affects the incentives for new entry and innovation (in addition to the price effects set out above).
- 40 Separately, as set out above, SSL notes that MFNs prevent PMI providers from using the direct channel to constrain PCWs. This gives rise to an adverse effect on competition not only for the reasons set out above, but because customers who do not wish to obtain PMI through PCWs (perhaps because they require particular product features or innovations) are directly disadvantaged.
- 41 SSL agrees with the statement, made by CIS General Insurance Limited in its bilateral hearing with the CC on 19 July 2013, that MFNs serve to discourage innovation, prevent product differentiation and remove incentives for insurers to invest in their own distribution channels. In turn, this prevents innovation and the introduction of product features which are responsive to customer needs.

Excessive advertising expenditure.

- 42 SSL agrees with the CC's observation that "*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*" (WP ToH 5 (MFNs), paragraph 70).
- 43 One point which appears to be missing from the CC's analysis is that the combination of MFNs (even narrow MFNs) and aggressive advertising expenditure by PCWs, is likely to lead *PMI providers* to invest in advertising *below* an efficient level.
- 44 In the CC's own words, "*there are clearly pro-competitive aspects to consumers being well informed about the availability of PCWs*" (WP ToH 5 (MFNs) paragraph 70). If this holds true for PCWs, it must also hold true for direct channel provision, particularly given that direct products are likely to be more sophisticated, given the levels of disaggregation required to win business on a PCW.
- 45 However, the combination of narrow MFNs and aggressive advertising expenditure by PCWs has almost entirely removed the incentive for PMI providers to invest in and promote their own online distribution channels.

Pro-competitive effects of MFNs

- 46 SSL notes the CC's explanations of the pro-competitive benefits offered by MFNs. Below, it considers the benefits set out in paragraph 15 of WP ToH 5 (MFNs), in turn.

MFNs allow consumers to reasonably infer that they are getting a good deal on the PCW

- 47 SSL is consistently confronted with this argument in its negotiations with PCWs, yet:
- (a) if MFNs are as necessary as they claim, it is unclear why PCWs don't generally advertise their existence. Only Confused.com advertises that their policies cannot be obtained more cheaply direct; and
 - (b) PCWs entered the PMI market successfully without MFNs (partly, perhaps, because the large brokers at the time did not have equivalent MFNs constraining their entry – on which see above). It was only after they had become established that PCWs began to impose MFNs in their agreements.

MFNs prevent "quote poaching" – i.e. using the PCW search facility before buying direct

- 48 It is entirely possible for a PCW to prevent quote poaching through the use of audit rights, without the harmful effects of a MFN (whether narrow or wide). For example, by using:
- (a) "poaching clauses" which require the PMI provider to pay the applicable CPA to the PCW if a customer uses the PCW to identify the insurer, before purchasing direct; and
 - (b) a more limited form of MFN, which would prevent a PMI provider from offering a lower price on its own website in respect of any customer for which it has previously provided a quote on a PCW. This limited version could operate for a window of, e.g., 30 days and would require only the parameters of a customer to be defined (e.g. vehicle registration, postcode and date of birth).
- 49 Either of these clauses would deal with the free rider problem, without blunting the constraint which the direct channel can impose on PCWs. As such, they represent a far more efficient outcome.

Recent developments

- 50 SSL would encourage the CC to consider the impact of recent developments before the OFT and the German competition authority, which highlight the harmful effect of both wide and narrow MFNs. In particular:
- (a) The OFT has recently announced its decision to close its investigation into Amazon's price parity policy, which restricted its sellers from offering lower prices on other online sales channels. The OFT had opened a formal investigation, following numerous complaints that the policy had anti-competitive effects and restricted their ability to set prices on their own websites or other online sales channels. The OFT co-operated closely with the German competition authority, which had launched a parallel investigation.
 - (b) The OFT announced that it was closing its investigation following Amazon's decision to end its Marketplace price parity policy in the European Union. In particular, Amazon informed the OFT that, from 30 August 2013, it will: (i) discontinue enforcement of contractual price parity obligations as to all European Union Marketplace sellers; (ii) remove the Marketplace price parity policy clauses from all current versions of Amazon's click-through agreements across the European Union; and (iii) notify all other current European Union Marketplace sellers on individually negotiated agreements that it has ceased enforcement of the price parity obligations with the intention of removing the provisions from those agreements when they are next renewed.
 - (c) In its response to Amazon's decision to remove MFNs from its contracts, the OFT stated that: "*Such policies may raise online platform fees, curtail the entry of potential entrants, and directly affect the prices which sellers set on platforms (including their own websites), resulting in higher prices to consumers*".² The OFT was therefore clearly concerned in that case about the restrictive effects of both wide *and* narrow MFNs on price competition.

² See <http://www.of.gov.uk/news-and-updates/press/2013/60-13#.Uh-ZCcu9KSM> - "OFT welcomes Amazon's decision to end price parity policy."

NON-CONFIDENTIAL

- (d) Similarly, in its ongoing hotel booking case, the German competition authority has issued a statement of objection to the online portal HRS, in respect of its MFN clauses with hotels. The FCO alleges that the clauses restrict market entry, innovation and competition between hotels.

51 These developments are significant in the context of the CC's current investigation, particularly in light of the position of the main PCWs (which are unavoidable trading partners) and the network of narrow MFNs which exists in the market. The intervention of the OFT and the German competition authority in the hotel booking and Amazon Marketplace cases support SSL's argument that, in the context of the PMI market, the existence of narrow MFNs harms competition.

V. VERTICAL RELATIONSHIPS INVOLVING PRICE COMPARISON WEBSITES

52 It seems clear from the CC's Working Paper on ToH 5 (Vertical relationships involving PCWs) that integrated PCW-PMI providers have the *capability* to use commercially sensitive pricing information, obtained as a result of their relationship, to engage in price undercutting and quote manipulation (paragraphs 3, 11 and 16).

53 The CC has, however, found "*no evidence to suggest that such a distortion has occurred to date*" and "*no basis for expecting integrated PCW-PMI providers to engage in the undercutting of prices or the direct manipulation of quotes in the future.*" As part of this finding, the CC appears to rely on the proposition that non-integrated PMI providers would be able to identify such practices by monitoring sales performance and identifying unexpected changes.

54 SSL wishes to emphasise that, in practice, this behaviour would be almost impossible to detect. A non-integrated PMI provider has no way of identifying whether a decrease in sales volume is the result of gradually increasing quote manipulation, more PMI providers quoting on a particular PCW, or general changes to competitor prices over time.

55 The CC also notes that some integrated PCW-PMI providers use data from their own PCWs to support analysis, but states that this data is available to other PMI providers (paragraphs 11 and 12). The Working Paper does not, however, recognise that this data is only made available to other providers at considerable cost. [REDACTED].

[REDACTED].

[REDACTED].

NON-CONFIDENTIAL

APPENDIX 1 [REDACTED].

[REDACTED].

[REDACTED].

NON-CONFIDENTIAL

APPENDIX 2 – [REDACTED].

[REDACTED].