

# UK Authority Publishes Preliminary Findings on Price Comparison Websites

April 11, 2017

In September 2016, the Competition and Markets Authority (“CMA”) launched a Market Study into digital comparison tools (“DCTs”). On March 28, 2017, the CMA published an update on the Market Study<sup>1</sup>, setting out its preliminary findings and areas of focus for the second part of the Market Study. The CMA found that there were hundreds of DCTs operating in the UK, including five large providers: Comparethemarket, Confused, GoCompare, Moneysupermarket, and uSwitch (the “Big 5”). The CMA has identified a number of ways in which DCTs benefit competition and consumers. It has also found areas for improvement. The CMA aims to tackle these issues through remedies and enforcement action at the end of the Market Study, but without the need for an in-depth Market Investigation.

The CMA’s research recognises the popularity of DCTs and the benefits they offer. It found that 97% of internet users were aware of DCTs, 85% had used a DCT, and most DCT users multi-home (shop around) to compare prices on a number of DCTs. This widespread use of DCTs benefits consumers in a number of ways: DCTs facilitate competition between suppliers who advertise on DCTs, they lower switching and transaction costs for consumers, increase consumer engagement, reduce acquisition costs for suppliers, and lower barriers to entry and expansion for new and small suppliers.

While recognising the benefits of DCTs, the CMA has identified a number of areas of concern. Although the CMA did not single-out any particular DCTs, it found that some could improve their consumer experience by improving transparency about the services they offer, their use of personal data, and their complaints procedures. It is considering whether DCTs have sufficient access to data from suppliers to allow them to offer accurate and comprehensive information on prices and services. It identified possible competition concerns from the use of most-favoured nation provisions and restrictions on how DCTs can advertise their services. It is also considering whether the practice of “hollowing out” (prominently advertising a low-price product that excludes features that might otherwise be included) is misleading or beneficial to consumers. Finally, the CMA notes that there is a patchwork of inconsistent regulation covering different sectors. It is considering whether aspects of this regulatory framework distort competition and limit innovation, and whether to introduce new principles for the regulation of DCTs across all sectors.

This alert memorandum summarises the CMA’s preliminary findings and the remedies it intends to consider over the second half of its Market Study.

<sup>1</sup> The case page for this Market Study containing all the documents published by the CMA can be found at: <https://www.gov.uk/cma-cases/digital-comparison-tools-market-study>.

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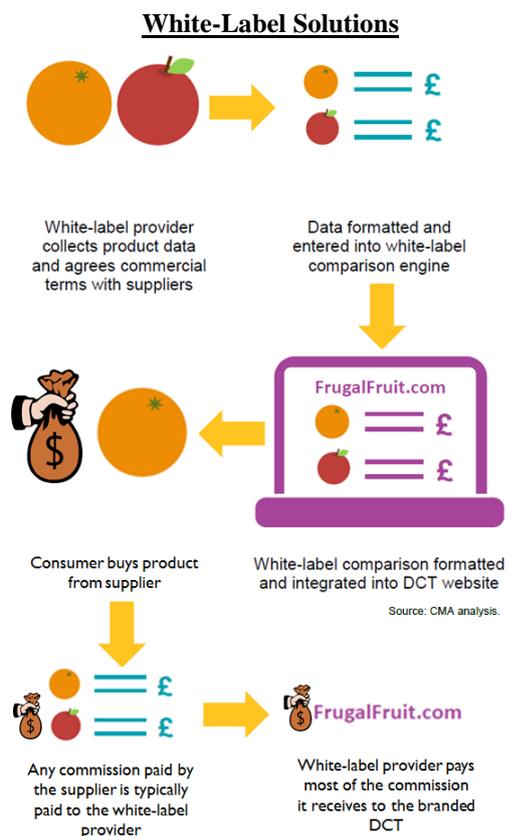
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## What are DCTs?

The CMA defines a DCT as a “web based, app-based or other digital intermediary service used by consumers to compare and/or switch between a range of products and services from a range of businesses.” This excludes search engines, retailer sites, and “review-only” websites. The CMA also excludes shopping DCTs from its scope, as these platforms compare products rather than services that are tailored to individual needs. The CMA focused its study on DCTs in the legal sector, broadband, credit cards, energy, flights, home insurance, and motor insurance sectors. DCTs generate revenue from commissions paid by suppliers on referral or completion of a transaction. For example, the CMA found that DCTs typically generate a commission of between 10% and 13% of the average premium for motor insurance, and between about 13% and 16% of the average premium for home insurance.

The CMA found that there were hundreds of DCTs operating in the UK. Many of these providers rely on white-label solutions. White-label solutions decrease barriers to entry by allowing new players to establish DCTs without upfront investment in creating a comparison engine or obtaining the underlying data.



## Market Studies

The CMA’s primary duty is to promote competition for the benefit of consumers. Market studies are conducted under formal powers granted to the CMA under the Enterprise and Regulatory Reform Act 2013.<sup>2</sup> This power allows the CMA to investigate markets as a whole without any suspicion of unlawful behaviour.

One possible outcome of a market study is a more in-depth Market Investigation. The CMA has the power to make a Market Investigation reference where it has reasonable grounds for suspecting that any feature, or combination of features, of a market or markets in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.

### Market Study Timeline



## The Benefits of DCTs

The CMA found that the widespread use of DCTs was beneficial for competition and consumers. Its findings are based on a broad consultation across the industry and consumers: as well as desktop research, the CMA received around 100 responses to its Market Study notice; it met with 50 DCTs, suppliers and other interested parties; and it contracted third parties to perform an online survey of around 4,000 consumers, in-depth interviews with 32 individuals, and a mystery shopping assessment of more than 50 DCTs.

### Increasing Supplier Competition

DCTs can achieve lower prices for consumers by increasing the competitive pressure on suppliers. Consumers using DCTs are more sensitive to price differences than consumers in other sales channels. The CMA estimates that DCTs allowed consumers to

<sup>2</sup> **The Office of Fair Trading** (the predecessor to the CMA) conducted Market Studies using informal information-gathering powers.

make savings of at least £2 billion in 2016. Consumers who do not use DCTs may also benefit indirectly, as other sales channels are forced to compete with the prices offered by DCTs.

### Facilitating entry and expansion of suppliers

DCTs facilitate the entry and expansion of smaller suppliers. By advertising on a DCT, new suppliers (and less well-known suppliers) are able to reach a wider customer base. For example, the CMA's recent Market Investigation into the energy sector found that smaller suppliers represented a higher proportion of acquisitions facilitated by a DCT than the six largest energy firms.

### Reducing costs for suppliers

The cost of acquisition for suppliers advertising via DCTs is generally lower than the cost of "direct" acquisitions. For example, the CMA found that the cost of "direct" acquisition could be around 30% higher than the DCT commission both for private motor insurance and home insurance. DCTs also present a cost-effective way of testing new products. These lower acquisition costs should result in lower prices for consumers.

### Increasing consumer engagement

DCTs offer the greatest benefits in sectors where consumers would not otherwise shop around. Many DCTs have made significant efforts to advertise the benefits of shopping around and switching suppliers. They also seek to encourage consumer engagement by making their websites fun and accessible, and by offering rewards to consumers, such as cash-back, cinema tickets, or toys.



## What Might Limit These Benefits?

### Hollowing out

The CMA considered whether competition concerns could arise from the practice of "hollowing out."

#### *Hollowing out by unbundling*

This practice involves separating out an offering into its component parts and pricing them separately. Unbundling usually helps customers tailor products to their needs, but it can lead to consumer harm if the components are not presented transparently, particularly in complex products.

#### *Pure hollowing out*

Pure hollowing out occurs when consumers focus on one product feature (typically price) and stop comparing products on other important aspects (typically quality). Although this may result in lower priced products, it can result in reduced competition on quality.

The CMA intends to investigate the effects of hollowing out further during the remainder of its Market Study.

## Competition Concerns

### How do DCTs compete?

Since DCTs do not set the prices of the products sold on their websites, they mainly compete by:

- Marketing campaigns aimed at driving traffic and increasing brand recognition;
- Providing a good comparison service;
- Offering customer rewards; and
- Negotiating favourable terms with suppliers.

### Most Favoured Nation Clauses

The CMA identified a number of contractual clauses between DCTs and suppliers that could have an adverse effect on competition.

#### *Wide MFNs*

Wide most-favoured nation ("MFN") clauses prevent a supplier from advertising the same product at a lower price through any other sales channel. Wide MFNs can reduce competition in a number of ways:

- *Reducing incentives to compete on commissions.* Wide MFNs may allow DCTs to increase the commission they charge to suppliers without the risk that the supplier will set a lower price on a competing DCT. This can also make it harder for new DCTs to enter the market.
- *Reducing incentives for DCTs to innovate.* DCTs that do not fear suppliers switching to other DCTs will have reduced incentives to innovate.

#### *Narrow MFNs*

Narrow MFNs prevent the supplier from selling the same product more cheaply on its own website but do not restrict sales through other channels. Narrow MFNs are a common feature of DCTs in all sectors. Narrow MFNs are less likely to result in competitive harm.

- *Helping to preserve DCTs' credibility.* Narrow MFNs can allow DCTs to ensure they are not undercut by direct sales.
- *Preventing free-riding.* Narrow MFNs can prevent free-riding on investment by DCTs by consumers who use a DCT to identify suppliers and then purchase elsewhere.

The CMA will nevertheless consider whether narrow MFNs may cause harm by eliminating competition from direct sales channels or by replicating the effects of a wide MFN (if prices converge at the highest price charged on any DCT).

#### **Non-brand bidding and negative-matching agreements**

The CMA is considering three types of agreements between DCTs and suppliers that limit the way DCTs can use search advertising:

##### *Narrow non-brand bidding*

Where one DCT agrees not to bid on another DCT's brand name when the search term includes only that brand name.

##### *Wide non-brand bidding*

Where one DCT agrees not to bid on another advertiser's brand name when the search term

includes that brand name alone or with other (non-brand related) words.

##### *Negative matching*

Where one DCT agrees to add another DCT to its "negative keywords", thereby preventing its own ads appearing when the search term includes the other's brand name alone or with other (non-brand related) words.

The CMA's preliminary view on these agreements is that they may lead to a reduction in competition by reducing DCTs' visibility to consumers using the restricted brand names.

#### **Non-resolicitation agreements**

The CMA is considering clauses in contracts between DCTs and suppliers that prevent DCTs from contacting consumers about products that they had previously purchased via their platform. These agreements are more prevalent in the home insurance and energy sectors than in other sectors. The CMA's initial view is that these agreements have the potential to reduce competition and switching between suppliers, and a reduction in the incentive for DCTs to innovate.

The CMA welcomes views and evidence both on how DCTs effectively compete with one another, but also on how effective their relationship is with suppliers.

#### **Consumer Experience – Facts and Figures**

- 97% of internet users are aware of DCTs.
- 85% of internet users have used a DCT.
- There is a high level of satisfaction with DCTs, with over 90% of recent users very or fairly satisfied. Most users (and a substantial amount of non-users) thought that DCTs allowed them to make better choices.
- 82% of DCT users thought that the coverage offered by DCTs was sufficient for their needs.
- Only 11% of respondents mistakenly thought that DCTs covered the whole of the market.

- Most users find it easy to re-order or filter the results in DCTs. However, in practice, many users do not do so and many only look at the top three offers ranked according to price.
- 84% of users compared products on the basis of price alongside other factors.
- 64% of recent DCT users said they multi-homed.
- Usage of DCTs varies by demographic, with consumers aged between 25 and 64, those on higher income, those in employment as well as those with higher qualifications being the most likely to use DCTs.
- 86% of UK adults have access to the internet at home.
- Only 54% of DCT users trusted DCTs to ensure their data is not shared with third parties without their permission.

**Inputs to DCTs**

There are three key inputs for DCTs: access to product information, access to consumer usage information, and integration with supplier systems.

**Access to product information**

Access to product information is crucial for DCTs to function effectively and provide accurate information to consumers. Suppliers that have chosen to use DCTs as a sales channel have greater incentives to provide sufficient information to DCTs. Suppliers hoping to direct consumers towards other sales channels have lower incentives to provide complete and accurate data.

The CMA also identified problems in aligning DCT questionnaires with the information provided by suppliers. This can lead to inconsistent or unhelpful quotations for consumers.

**Access to consumer usage information**

For many services where pricing is determined by a consumer’s usage patterns, DCTs may be able to offer a better comparison service if they can access information on a consumer’s consumption or behaviours. DCTs may need access to other

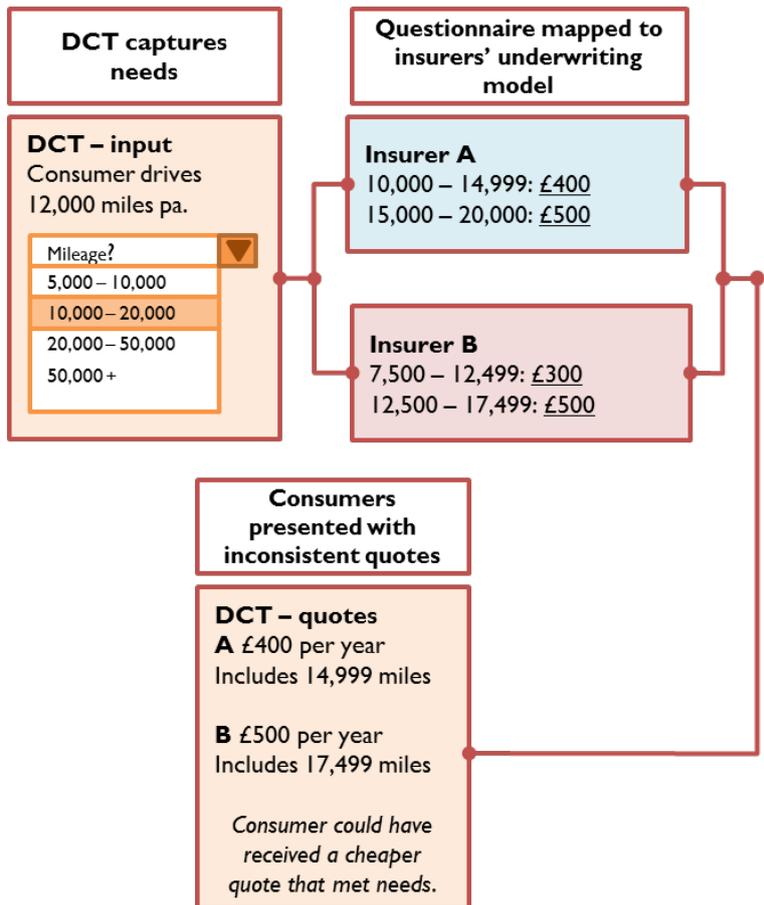
information about consumers, such as their creditworthiness.

**Integration with supplier systems**

DCTs can also play a role in the consumer journey by allowing consumers to complete their purchases on the DCT or by redirecting a consumer to a supplier’s website. Where a transaction cannot be completed on a DCT, the consumer experience will be affected by how integrated the DCT is with the supplier’s platform.

In sectors with finite inventories or where pricing is dynamic, comparisons can quickly become out of date. Delays in the purchasing journey may result in price changes or suppliers selling out before the purchase is completed. Improving underlying technology and more actively integrating the DCT’s and supplier’s ecosystems may reduce both these delays and consumer frustration.

The CMA has identified ways in which access to inputs could be improved in almost every DCT sector.



## Regulation

DCTs may be subject to sector-specific regulation (e.g., in the financial services sector). In other sectors, such as energy and telecoms, DCTs are not directly regulated but may comply with voluntary accreditation schemes.

### Concerns with the current framework

Respondents to the CMA's consultation raised the following concerns:

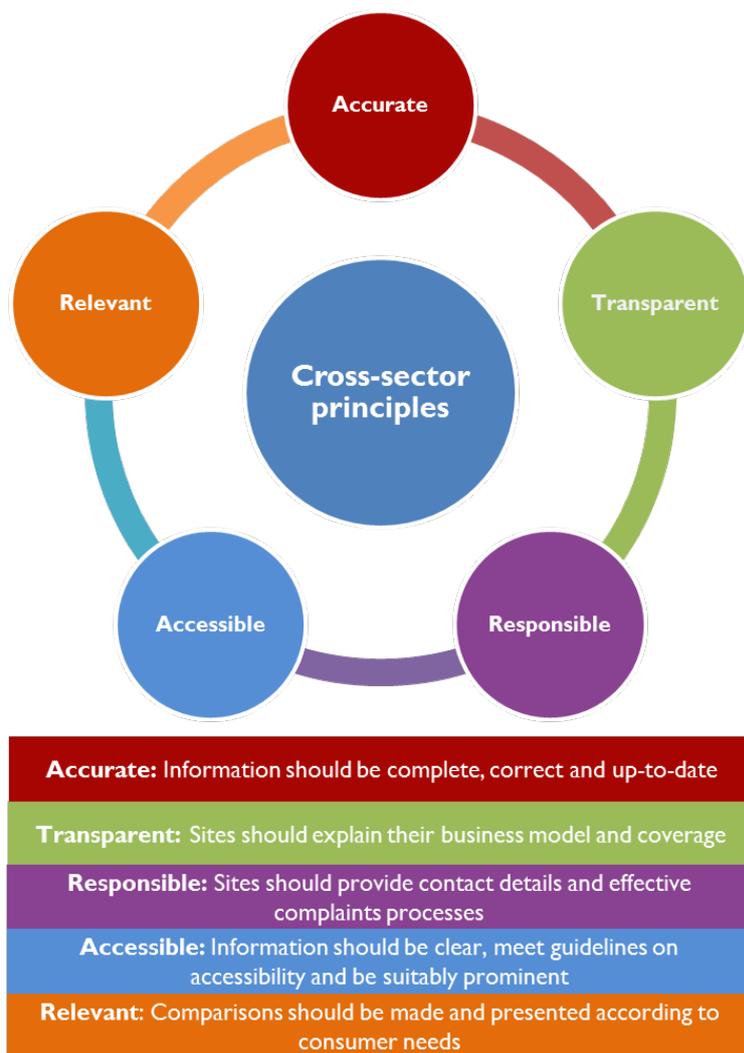
- *Excessive barriers to entry.* The complex framework makes it difficult for new entrants to navigate the sector-specific regimes (especially DCTs that are active in more than one sector).
- *Inconsistencies.* Even though DCTs perform similar functions across different sectors, there are inconsistencies in regulation and accreditation between sectors and within sectors.
- *Too prescriptive and not future-proof.* Sector-specific obligations are overly prescriptive and insufficiently flexible to accommodate new technologies, new business models, or changes in consumers' attitudes.
- *Boundary issues.* Some sector rules apply directly to suppliers but not to DCTs.
- *Insufficient enforcement.* Voluntary schemes lack formal enforcement mechanisms, and the prospect of losing accreditation may not have a sufficient deterrent effect to ensure compliance.
- *"Whole of the market rules."* Rules requiring DCTs to have full market coverage (for example in the energy sector) are seen by the CMA as having a negative impact on competition between DCTs, which would otherwise compete to offer broader market coverage. These rules also weaken DCTs' ability to negotiate with suppliers.

### Cross-sector approach

The CMA is considering whether to introduce a set of cross-sector principles for the regulation of DCTs. It has identified possible advantages of a cross-sector approach, including lower regulatory burdens, more flexibility, and an increase in good practice amongst DCTs on important areas such as transparency and accuracy. The CMA is also wary that cross-sector

principles may pose some risks, including a potential loss of sector-specific requirements, inconsistent interpretations of how principles should be implemented, and possible inconsistencies with other regulatory standards.

Cross sector principles could be based on the following themes:



## The Future of DCTs

The CMA recognises a number of trends in the way consumers are using DCTs, as well as possible longer-term innovations.

### Immediate future

The CMA predicts that there might be an increase in automated switching DCTs, a model that has yet to penetrate the market.

It also notes the upward trend in the use of mobile devices. The CMA is considering whether limitations in mobile screen size could hamper consumers from comparing products thoroughly without changes in user interfaces.

**Longer term**

The CMA will also consider the possible impact of innovations over the longer term, such as advances in voice recognition, artificial intelligence (allowing consumers to subscribe to automated advice or decision-making services), advances in personalisation of both products and advertising, and the use of big data to construct complex user profiles and consumption patterns.

**Next Steps**

Interested parties can submit responses to the CMA's interim report until April 24, 2017. The CMA will publish its final report by September 28, 2017, including its decision on what remedies it has decided to pursue.

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