Reforming Regulation Initiative

Response from the Competition and Markets Authority

July 2020

Contents

Introduction and summary

1. The CMA is the UK's primary competition and consumer authority. It is an independent non-ministerial government department with responsibility for carrying out investigations into mergers, markets and the regulated industries and enforcing competition and consumer law. The CMA's statutory duty is to promote competition, both within and outside the UK, for the benefit of consumers.

2. The CMA welcomes the opportunity to respond to the Department for Business, Energy and Industrial Strategy (BEIS) consultation on the Reforming Regulation Initiative (RRI), which is intended to help the government ensure that regulation is sensible and proportionate. The CMA supports the government's aim of ensuring that the UK remains a dynamic and competitive regulatory environment that encourages innovation and achieves the right balance between supporting excellent business practice and providing consumer protection.

3. In the exercise of its statutory duty (particularly through its markets and advocacy functions), the CMA seeks to ensure that regulation promotes competition in order to deliver a range of benefits for consumers and enhance productivity in the economy. This may involve the development of further pro-competitive, pro-consumer regulation, or the CMA making the case to government or public authorities for regulatory reform.[1]

4. From the CMA's perspective, whether there is 'more' or 'less' regulation overall matters less than the consequences of regulation for consumers. The characteristics of a market, or the nature of the objective government is seeking to achieve, may mean that well-designed regulation is the best approach available. In other cases, alternatives to regulation will be preferable, or best used in addition to other measures. In respect of the RRI, and in considering whether individual business regulations should be repealed or redesigned, the CMA recommends that the government looks principally at whether they promote or inhibit well-functioning, competitive markets. This is ultimately what matters for growth and productivity.

[1] The focus of this response is on the regulations governing markets, reflecting the CMA's expertise gained through its markets, advocacy and mergers work.

5. Drawing upon the CMA's markets and advocacy work, this response outlines that appropriately designed regulation need not stifle growth and productivity, and can in some cases promote it.[2] In particular, regulation can:

(a) **promote effective and 'healthy' competition:** regulation may be introduced in circumstances where there is clear evidence of market failure and/or where there is scope to enhance competition. The ability of regulation to promote and unlock competition and innovation has been identified for example through the CMA's Open Banking remedies, in the Furman Review and has been further detailed in the Online platforms and digital advertising market study final report. In the latter cases, regulation has the potential to limit anti-competitive actions by the most significant digital platforms while also reducing structural barriers that may currently hinder effective competition. Regulation can make it easier for consumers to move their data securely across digital services, to build systems around open standards, and to make data available for competitors, offering benefits to consumers and also facilitating the entry of new businesses. Furthermore, the health and stability of markets can be promoted through pro-competitive best practices in relation to public procurement rules and government contracts. Such practices seek to reduce barriers to entry and expansion and encourage smaller providers to enter a market and grow, as explained in the Cabinet Office's Market management guidance note. Pro-competitive practices can promote market health and stability by avoiding reliance on a few large suppliers and ultimately enhance value for money for taxpayers. In addition, security of supply can be protected in markets through profit benchmarking. This may be applied in situations where government face little or no choice in suppliers.

(b) **tackle ineffective or 'unhealthy' competition** (where firms are acting to disempower consumers; reduce engagement; reduce transparency or make it harder for consumers to switch providers) and to promote effective or 'healthy' competition (where firms are competing to provide the best goods and service, at the lowest prices to consumers). This point is identified in the CMA's loyalty penalty work, where the CMA set out a principles-based framework of conditions for healthy competition and acceptable behaviour by firms. This is designed to enhance consumer

[2] Examples of where the CMA has identified the pro-competitive, pro-consumer potential of regulation, as well as the detrimental impact on competition and consumers of poorly designed regulation, are provided in more detail in paragraphs 40 to 122.

engagement and tackle firm conduct that may deliberately be intended to obfuscate the process of consumer switching.[3]

(c) **enhance consumer protection where the full benefits of competition for consumers cannot be achieved**, for example because of natural monopoly characteristics or customer vulnerability. Such markets have frequently been shown to lead to worse consumer outcomes. As outlined in the Heat networks market study and noted below, incentivising investment can also be encouraged in such contexts through principles-based regulation.[4]

6. Alongside identifying the pro-competitive, pro-consumer potential of regulation, the CMA makes five broad recommendations to policy makers to be considered during the regulatory design, review and evaluation phase.

7. These recommendations are not exhaustive in that as part of the CMA's statutory function (in particular our advocacy and markets work) the CMA advises government on specific policy areas on an ongoing basis.

8. While not all regulation is about addressing competition and consumer issues – for example health and safety regulation or environmental standards have wider policy objectives – it is important that market impacts are considered; and that regulation is designed in a way which meets policy objectives while minimising potential distortions to competition. With this in mind, and as recently examined in Regulation and competition: a review of the evidence, the CMA recommends that policymakers should:

(a) **seek to understand the competitive dynamics of a market when contemplating, designing and reviewing regulation:** with a particular focus on whether regulation has the potential to raise barriers to entry, exit, growth and innovation; to limit suppliers' ability or incentives to compete; or to affect consumers' ability to access, assess and act on relevant information. [5] The CMA's Competition impact assessment

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[3] This distinction between healthy competition and unhealthy competition was made in the CMA's response to the Loyalty penalty super complaint, see paragraphs 72 to 74 and CMA 6-month progress update for further detail. The CMA set out a framework to give more clarity to businesses about the difference between healthy competition and unacceptable practices.

[4] As noted in the CMA's Heat network market study (see paragraphs 77-81), the CMA found heat network providers faced little competitive pressure to offer reasonable prices, reliable supply and high quality of service. The CMA therefore recommended BEIS establish a principles based regulatory framework, incorporating quality and price measures.

[5] The evidence from the CMA's paper: Regulation and competition: a review of the evidence and work carried out by the OECD indicates that regulation which creates significant barriers to entry can have the most significant impact on competition and innovation (see paragraph 1.38) and paragraphs 25 below. Features of regulation that

guidelines can assist at all stages of the policy cycle – including post-implementation – to help identify and mitigate some of the risks that regulation can pose to competition. [6] Acquiring and maintaining knowledge of the markets affected by regulation, and how they operate, will usually require engagement with a wide range of suppliers (particularly smaller firms), and work to understand consumer behaviour.[7]

(b) **consider more flexible forms of regulation to ensure regulation is future-proof, proportionate and not unduly restrictive**. In order to minimise distortions to competition and innovation (particularly in fast moving markets subject to rapid technological change), principles-based regulation (giving firms the flexibility to determine how best to comply with the principles), codes of conduct, participatory regulation and the application of regulatory sandboxes should be considered.[8] 'Rules-based' regulation should not be excluded as an option. However, as with all forms of regulation this should be targeted, appropriately risk-based and reviewed over time.[9] Furthermore, the use of reviews and 'sunset clauses' may be applied as a means of promoting more innovation-friendly regulation.

(c) **ensure the views of small and medium-sized enterprises (SMEs) are closely considered during the regulatory design and review phase:** with 99.3% of the UK's business population falling into the 'small' category (based on employee numbers between 0 and 49), assessing the impact of regulatory design on SMEs when regulation is being contemplated, designed and reviewed should be a priority for the government, particularly given the likely importance of SMEs to the economic recovery following COVID-19.[10]

(d) **seek to avoid certain features of regulation that may inhibit competition**: there are certain regulatory features that may inhibit competition and therefore harm consumers. These include: quantity-

act as a barrier to entry are also a reoccurring theme in the examples where the CMA has intervened through its market studies and advocacy work, such as in the CMA's airline slot allocation process work.

[6] See Competition impact assessment guidelines checklist at paragraphs 131 to 134 for more detail

[7] As identified in paragraph 26 below, drawing upon paper Regulation and competition: a review of the evidence

[8] As identified in paragraph 27 below such approaches to regulation may limit distortions to competition and ensure regulation is more proportionate.

[9] The issue of regulation being proportionate was of concern in the legal services market study (discussed at paragraphs 104 to 110). The CMA identified the concern that the existing approach to regulation, which focuses on professional qualifications (what we called 'title-based model of regulation'), was not sufficiently flexible to apply proportionate, risk-based regulation reflecting differences across legal services areas and over time.

[10] For further details see paragraph 30 to 31.

restricted licensing regimes; rules that may have a disproportionate impact on new entrants or smaller firms compared to larger incumbents; self-regulation; and grants of exclusive rights. The government should seek to identify the existence of such features as part of the RRI, and assess their impact on competition.[11]

9. Lastly, **the CMA supports a broader approach to evaluating the cost of regulation, which should include the impact on the effective functioning of markets**. The CMA believes that the government should evaluate the overall performance of the Business Impact Target (BIT)[12] in achieving the government's objectives, as argued by the National Audit Office (NAO). This would inform decisions about how the government's approach to reducing the costs of regulation should evolve and make it easier for future governments to set appropriate targets.[13]

10. The recommendations made above are pro-competitive, and aimed at improving the effective functioning of markets. Competition should play an integral part of the government's plans to stimulate the economic recovery as and when the COVID-19 pandemic recedes. This is because competitive markets have been shown to lead to increased productivity and aid economic growth in the long term.[14] Competitive prices for goods and services will matter all the more in the coming months, particularly in the context of possible reduced household incomes and where firms will need competitively priced inputs to aid their financial recovery.

11. COVID-19 could have lasting impacts on consumer behaviour, business models, supply chains and much more. The extent and nature of these effects is, at this stage, highly uncertain. Although we are considering the implications for competition and consumers, given the continuing uncertainty, the CMA's response to this consultation does not include an assessment of the implications of COVID-19 for regulation more broadly. However, at this stage, a number of possible implications are worth noting:

    (a) The acceleration in the shift to online retail may increase the strength of digital platforms, reinforcing the need for a pro-competitive regulatory regime. The CMA-led Digital Markets Taskforce – announced in Budget 2020 – will provide advice to the government on the potential design and

[11] See paragraphs 91 to 102.

[12] The BIT relates to the economic impact on business of qualifying regulatory provisions ("QRPs") that come into force or cease to be in force during a parliament and seeks to calculate the equivalent annual net direct cost to business of regulation.

[13] See paragraphs 35 to 39.

[14] CMA, Productivity and competition: A summary of the evidence 9 July 2015

implementation of measures to improve competition in the online advertising, social media and general search markets.

(b) Changes to the global economy and to trade policy may lead to a reduction in international trade in the coming years, which would cause a reduction in competition in a number of sectors and an increase in market concentration. In such situations, there may be a case for intervention – either by government or the CMA – to preserve competitive conditions. In addition, and more importantly, barriers to domestic competition (regulatory or otherwise) will need to be identified and removed if competition from imports is reduced.

(c) The government's interventions– including exclusion orders, and cross-economy and firm-specific financial assistance and regulatory forbearance – have provided important short-term support to the economy during the crisis. Looking ahead, the effects of these measures on the effective functioning of markets will need to be closely monitored by the government and the CMA to identify and address any long-term distortions and constraints to competition they may create.

Our response

12. The CMA supports the government's aim of ensuring that the UK remains a dynamic and competitive regulatory environment that encourages innovation and achieves the right balance between supporting excellent business practice and providing consumer protection. The focus of this response is on the regulations governing markets, reflecting the CMA's expertise gained through its markets, advocacy and mergers work.

13. With this in mind, our response to this consultation covers the following five areas:

(a) an overview of the policy context and the relationship between regulation and competition;

(b) the pro-competitive, pro-consumer potential of regulation, drawing upon CMA markets and advocacy work;

(c) features of regulation that may inhibit competition and/or worsen outcomes for consumers;

(d) the possible detrimental impact of regulation for consumers and competition, and potential areas that could merit regulatory reform; and

(e) an outline of the Competition impact assessment: guidelines for policy makers, which aims to encourage policymakers to assess the impact of their proposals on competition.

Regulation and competition

The CMA and regulation – activities at a glance

The CMA is not a regulator, but in meeting its duty and performing its functions, it interacts in several ways with the regulatory environment, as described below.

Advice and recommendations on regulation to government, regulators, public authorities and the UK Regulators Network (UKRN)

- The CMA can make written recommendations to ministers on the impact of proposals for legislation on competition within any UK market(s) for goods or services (this power exists under Section 7 of the Enterprise Act 2002). See for example, Aviation 2050: Response from the CMA; where the CMA has advocated for changes to regulation more informally.
- The CMA can make recommendations to regulators and government as a result of market studies under section 5 of the Enterprise Act 2002. Market studies consider the extent to which a matter (including regulation) in relation to the acquisition or supply of goods or services in the UK has or may have effects adverse to the interests of consumers. Such recommendations are designed to remedy, mitigate or prevent any such adverse effects. This may include recommendations to reform or develop regulation. See the Heat networks market study and Legal services market study.
- The CMA can make recommendations to regulators and government as a result of super complaints submitted by a designated consumer body. In responding to super complaints, the CMA assesses whether features, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers. See Loyalty penalty super complaint for example.
- The government has committed to responding publicly to the CMA's recommendations within 90 days, clearly indicating the steps that it will take in response to each recommendation or the reasons that it is unable to take forward recommendations. There will be a presumption that the government will accept all the CMA's published recommendations unless there are strong policy reasons not to do so.
- The CMA also provides advice to regulators on the CMA's Competition Impact Assessment Guidelines.

Regulatory Remedies

- The CMA can impose requirements ('Orders') directly on businesses following market investigations, in cases where it finds there is an Adverse Effect on Competition (AEC).
- The CMA plays a continuing regulatory role in its Open Banking Initiative, a key remedy resulting from the Retail banking market investigation. This is delivered by the Open Banking Implementation Entity.
- The CMA plays an ongoing monitoring, compliance and review role in all remedies it produces across its tools.

Co-operation with sector regulators

- Under the regulators' concurrency powers, the sector regulators can enforce the prohibitions against anti-competitive agreements and abuses of a dominant position in the regulated sectors and can also carry out market studies and refer markets to the CMA for a detailed investigation.
- The CMA undertakes bilateral meetings with sector regulators and multi-lateral meetings through the UK Competition Network (UKCN) ensuring consistency in the application of the sector regulators' concurrency powers.
- Joint policy projects which seek to promote competition in the regulated sectors.
- The CMA plays a coordinative function in regulatory initiatives such as the Financial Services Regulatory Initiatives Forum. This is a forum to discuss major upcoming regulatory initiatives that may have a significant operational impact on the financial services sector. The CMA attends in order to ensure competition considerations are given weighing in discussions and outputs.
- Meetings with UKRN on matters of common interest, and of relevance to the CMA's work. For example, the CMA attends the UKRN's DCTs network which has played an important role in taking forward the recommendations that were addressed to all the regulators.

Appeals and redeterminations of decisions made by sector regulators

- The CMA provides an independent review of some decisions by economic regulators for their respective sectors (such as those relating to price controls and charges for access to regulated infrastructure). These decisions are reviewed and appealed according to bespoke regimes. For example, the CMA is currently reviewing Ofwat's price control decision on water companies.

Policy context

14. Regulation can be defined as the rules or directives made and maintained by an authority. Regulation is important to the functioning of competitive markets for a number of reasons[15] and is often introduced to address some form of market failure and to support wider public policy objectives. Some markets are intrinsically likely to have conditions of imperfect competition and therefore may require regulation. An example of this would be markets with large network effects and economies of scale and so are prone to

[15] Following the OECD Indicators of product market regulation, well-functioning markets require: (1) a sound legal and judicial infrastructure; (2) an effective competition regime; (3) competition-friendly product market regulation; and, (4) an efficient insolvency regime

"tipping". This is an issue that was discussed in the CMA's Online platforms market study final report and in the Furman Review.

15. There is a risk of "regulatory failure" with all forms of regulation, i.e. the risk that the intervention designed to address a problem in a market can impose higher costs that the problem it was designed to address.

16. The risk of regulatory failure points to the need for policymakers to be alive to the possibility of unintended consequences from introducing new regulations or changing existing regulations. It also points to the need to monitor and review the effect of particular interventions to ensure that they remain relevant and effective. The aim should be to design and implement regulation that strikes the right balance and complements/supports competition and does not adversely affect incentives on firms to compete in the long and short run.

17. Key to creating the correct balance is also applying timely and targeted competition enforcement action. In the UK, many of the sectoral regulators have competition law powers held 'concurrently' with the CMA's powers, meaning that the sectoral regulators can enforce competition law breaches in the industries they are responsible for. However, as noted in the CMA's Online platforms and digital advertising final report, in view of the fast-moving nature of platforms and digital advertising markets, and the number and complexity of the issues arising in them, ex post enforcement is not always sufficient to protect competition but needs to be bolstered with stronger and clearer ex ante rules.

18. Whether there is 'more' or 'less' regulation overall matters less than the consequences of regulation for consumers. The characteristics of a market, or the objective government is seeking to achieve, may mean that well-designed regulation is the best approach available. In other cases, alternatives to regulation or additions will be preferable. This may include enhanced enforcement, further consumer information, and education and the incorporation of market mechanisms. This is evident across the CMA's markets and advocacy work.

Impact of regulation on competition

19. Effective competition matters because it improves outcomes for consumers. This takes place because firms compete to attract customers by offering lower prices and higher quality products and services, and firms compete through innovating to improve products and services over time. There is also

a large body of evidence indicating that competition in a market are associated with improvements to productivity.[16]

20. Well-designed regulation can complement, reinforce, or unlock competition and encourage innovation by improving the functioning of markets. This may take place, for example, by providing the legal and economic framework within which competition takes place. One example is the CMA's Open Banking remedies,[17] put in place to improve competition in the retail banking sector. In this case, the objective of the regulatory intervention was pro-competitive: namely, to ensure customers benefit from the emergence of new innovative products, and ensure that new entrants and smaller providers in the UK retail banking sector are able to compete more fairly.

21. While well designed regulation can enhance competition, poorly designed or outdated regulation (e.g. that does not reflect technological change), can stifle competition by holding back the competitive process –for example, by raising barriers to entry to a market, or advantaging certain business models or types of firms.[18] Often these effects are overlooked or under-analysed when regulation is being contemplated, designed, implemented and reviewed. Where competition is inhibited by regulation, the CMA may take the opportunity to make the case for regulatory changes or regulatory reform in specific markets.

22. The negative impacts regulation can have on competition underscore the need for there to be a focus on the process for designing and implementing "better regulation", taking into account the impact on competition and measuring the outcomes of regulatory interventions.

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[16] Competition can drive productivity in three main ways. First, within firms, competition acts as a disciplining device, placing pressure on the managers of firms to become more efficient. Secondly, competition ensures that more productive firms increase their market share at the expense of the less productive. These low productivity firms may then exit the market, to be replaced by higher productivity firms. Thirdly, and perhaps most importantly, competition drives firms to innovate, coming up with new products and processes which can lead to step-changes in efficiency. For further information, see CMA, Productivity and competition a summary of the evidence, 2015

[17] Following the CMA's Retail banking market investigation.

[18] As identified in the legal services market study. In addition in the airline sector. For example Guiomard (2017) analysed the relationship between airport slot regulation and aviation competition using the application of the EU slot rules at Dublin airport as a case study. He finds that the administrative slot controls actually act as a barrier to entry and that incumbent airlines have the incentive to resist investments in new airport capacity because this would increase the number of slots and possibly lower their market power. Indeed, the paper finds that airlines actually lobby to preserve the grandfather principle and to avoid relaxation of administrative slot rules. See Guiomard, C. (2018). Airport slots: Can regulation be coordinated with competition? Evidence from Dublin airport. Transportation Research Part A: Policy and Practice, 114, 127-138.

23. The CMA's recent paper Regulation and competition: a review of the evidence identifies a number of findings with regards to the relationship between regulation and competition.

24. First, there is no clear evidence on the overall balance between competition and regulation in different countries. That is, studies either focus on individual regulations or look more broadly using high-level indices of product market regulation and do not seek to capture wider benefits of regulation.

25. Second, the form of regulation has a significant bearing on the effective functioning of a market. Much of the harm to competition comes from regulation that creates or raises barriers to entry. This can restrict innovation and market disruptors and can have significant effects. A large number of studies have found that barriers to entry can come in a wide range of forms, not just absolute barriers to entry (e.g. in the form of restrictions on the number of firms in a market) but also through other aspects of product market regulation which can have the effect of raising barriers to entry e.g. excessive compliance or administrative costs.

26. Third, the proper design of regulation can substantially reduce the negative impacts on competition. The CMA's research has found that regulation can be used to incentivise innovation in a sector but, as with regulation and competition, the form of regulation can have an important influence on the type of innovation in a sector. The evidence from the research specifically points to the need to guard against regulations which disproportionately favour incumbent firms and which have a disproportionate impact on smaller firms. This is because this can lead to lower levels of innovation, higher prices and a resulting loss of consumer welfare. The CMA's literature review also identified the well known risk that only large incumbents have the necessary resources to engage consistently and effectively with regulatory processes. As a result, policymakers and regulators need to make sure that the development of regulation is not unduly influenced by this particular group of stakeholders and ends up favouring them or their specific business models. The evidence also indicates that where policymakers and regulators do not establish and maintain channels of communication with new entrants and firms with new technologies or different business models and small firms, this can lead to poorly designed regulation that harms competition.

27. Fourth, in dynamic markets more flexible forms of regulation can reduce the risk of deterring innovation and harming competition. In particular, there is a general sense that regulation can struggle to cope with changing markets

and innovation.[19] More flexible and dynamic approaches to regulation can include the use of sunset clauses for new regulation which is triggered after a fixed period of time or once certain criteria have been met. In addition, principles-based regulation can help to promote innovation.[20] Furthermore, codes of conduct, regulatory sandboxes[21] and participative regulation[22] could enable regulation to be made more responsive and better able to adapt to new challenges compared to detailed rules or rigid prohibitions on types of behaviour.

28. As of result of these findings the CMA recommended that policymakers and regulators should understand and take into account how regulatory measures affect new entrants and innovation,[23] and avoid regulation which favours incumbents or firms with specific business models, or that disproportionately harm smaller business models. Furthermore, policymakers should undertake strategic forward-looking reviews of regulation, and make greater effort to engage with a wide range of market and industry participants. This includes smaller firms, to better understand their issues. Lastly, more flexible forms of regulation should be considered to ensure regulation is proportionate. This includes principles-based regulation, codes of conduct and participative regulation.

29. The CMA also identified areas where further research would be useful. Firstly, on research into the impact of specific types of regulation – as opposed to the impact of regulation in general. Second, more research around how regulation can support and promote innovation. This is on the basis that the CMA's review of the literature in this area suggests that most of the recent research has been focused on environmental regulation and it would be useful to expand this to other policy areas. Finally, there should be

[19] For example, in England and Wales, as part of the CMA's Legal services market study, the CMA identified the concern that the existing approach to regulation, which focuses on professional qualifications, was not sufficiently flexible to apply proportionate, risk-based regulation reflecting differences across legal services areas and over time.

[20] This approach entails moving away from a reliance on detailed, prescriptive rules and instead relying on high-level, broadly stated principles to set the standards by which regulated firms must conduct business. As a result, this approach leaves firms with the flexibility to determine how they comply with those principles.

[21] This is an arrangement in which parts of the usual regulatory framework are temporarily suspended to give firms the opportunity to work with the regulator to trial innovative products, services and business models with consumers. It offers firms the ability to carry out trials in a controlled environment without immediately incurring all the normal regulatory consequences of engaging in the activity in question.

[22] Regulation in which there is a greater degree of engagement between firms and the regulator in a market, with firms making formal proposals to the regulator e.g. in relation to the introduction of new services or products. This can be particularly helpful for new entrants wanting to bring products to a market, particularly if the regulator can then forbear from regulating, until there is a better sense of whether intervention is needed / what form that intervention should take.

[23] See 1.29 to 1.38 of the CMA's Paper, Regulation and competition a review of the evidence

more research into the overall balance of regulation and the burden of regulation on firms.

30. In response to this consultation the CMA further notes that many of the problems related to the impacts of regulation on small businesses can be linked to characteristics commonly associated with these enterprises. This includes the fact that they have little influence over their external conditions. In addition, while they may have factual knowledge of regulations they may not have practical knowledge regarding the application of regulation.[24] This is consistent with the CMA's findings from its review that only large incumbents have the necessary resources to engage consistently and effectively with regulatory processes.[25] In addition, there is very limited empirical evidence on the firm-level effects of regulation on SME growth.[26]

Recommendation

31. With 99.3% of the UK's business population falling into the 'small' category (based on employee numbers between 0 and 49), assessing the impact of regulatory design on SMEs and greater communication with SMEs during regulatory design and review phase in particular should be a priority for the government.[27] This is all the more important in the current climate given SMEs will be key to the financial recovery after COVID-19. Furthermore, the fact that SMEs are likely to have lower cash reserves relative to larger companies makes them less resilient and therefore less able to weather the economic downturn.

Evidence from the design and implementation of regulation

32. The CMA's paper Regulation and competition: a review of the evidence also found that that there is scope for the impact of regulation on competition to be better incorporated into the Regulatory Impact Assessment process. In

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[24] Wapshott, R. and Mallett, O. (2016). Managing human resources in small and medium-sized enterprises: Entrepreneurship and the employment relationship. Abingdon: Routledge and see Mallett, O., Wapshott, R. and Vorley, T. (2018). Understanding the firm-level effects of regulation on the growth of small and medium-sized enterprises. London: Department for Business, Energy & Industrial Strategy. BEIS Research Paper Number 10. URL:https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/712010/sme-growth-regulation.pdf

[25] Paragraph 1.33 Regulation and competition a review of the evidence

[26] Understanding the firm-level effects of regulation on the growth of small and medium-sized enterprises. London: Department for Business, Energy & Industrial Strategy. BEIS Research Paper Number 10. URL:https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/712010/sme-growth-regulation.pdf

[27] ONS / BEIS (2019). Business Population Estimates for the UK and Regions 2019 – Statistical release. URL: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/836550/Business_Population_Estimates_for_the_UK_and_regions_-_2019_Statistical_Release.pdf

particular, the CMA found that there is insufficient prominence given to the impact of proposed regulation on dynamic competition and the process of innovation in the template used by government officials to produce Regulatory Impact Assessments. In cases where competition is not sufficiently considered, there is a higher risk that a regulatory measure could have significant unintended impacts on competition and innovation in a market.

33. Moreover, the CMA found that this would provide a better baseline against which ex post evaluations of the impact of regulation can take place and subsequent regulatory interventions can be improved. The CMA's experience of reviewing remedies to address competition issues points to the importance of keeping regulatory interventions under review to ensure that they can be adapted or lifted as markets develop.

34. As a result of these findings the CMA recommended that policymakers and regulators update the guidance for assessing the impact of regulation on competition, with a particular focus on competition and innovation. In addition, that there be enhanced scrutiny of Regulatory Impact Assessments.[28]

Measuring the impact of regulation on businesses

35. Since the coalition government of 2010, there has been a specific focus on reducing the regulatory burden on business, with a specific target of reducing the impact of regulation on business (the "Business Impact Target" or "BIT") by a specified amount each parliament. A number of types of regulatory provisions are exempt from the BIT, including those which are deemed to have a pro-competitive impact.

36. The Secretary of State has a duty to publish a BIT for each parliament.[29] The BIT relates to the economic impact on business of qualifying regulatory provisions ("QRPs") that come into force or cease to be in force during a parliament and seeks to calculate the equivalent annual net direct cost to business of regulation.[30] The BIT concerns the regulatory activities of all central government departments and regulators.[31]

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[28] See paragraph 1.39 to 1.47 of Regulation and competition a review of the evidence.

[29] Under section 21 of the Small Business, Enterprise and Employment Act 2015 (SBEE Act).

[30] This covers amendments to existing regulations.

[31] This includes central government departments, Ministerial Regulators carrying out functions on behalf of Ministers, and Relevant Regulators. The latter means those regulators listed in regulations made by the

37. While the CMA supports the government in reducing the cost burden of regulation to businesses, the CMA considers that the BIT has a number of shortcomings, which have also been raised by other organisations. A few of these are highlighted below.[32]

38. First in terms of the BIT set, there is no accurate understanding of the current costs business incur as a result of existing regulations. This means that the government is unlikely to know how ambitious its target for reducing regulatory costs is when setting the annual BIT. Second, regulators and government departments undergo a lengthy and stringent process when calculating the BIT for their regulatory activities, which may not be making best use of regulators and government departments' resources.[33] Third, the focus on direct impacts could give a misleading picture of the effects of regulation, for instance when a regulation is important in promoting consumer confidence and enabling markets to operate effectively.[34]

Recommendation

39. The CMA supports a broader approach to evaluating the cost of regulation, which should include the impact on the effective functioning of markets. Furthermore, the CMA believes that the government should evaluate the overall performance of the BIT in achieving the government's objectives, as argued by the NAO. This would inform decisions about how the

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Secretary of State, which includes all the sector regulators and the CMA http://www.legislation.gov.uk/uksi/2017/344/schedule/made

[32] NAO, The Business Impact Target: Cutting the cost of regulation June 2016.

[33] As noted in the NAO's report (paragraph 3.21), several departments raised concerns that the costs they incur in meeting the BRE's rules do not contribute to the overall objective of reducing regulatory costs. One department claimed that "80% of the resource dedicated to delivering against our budget and the Business Impact Target goes directly on managing better regulation accounting". It said that it had to move resources away from valuable Cutting Red Tape reviews into a BRE-facing team to deal with expanded better regulation rules.

[34] Two examples are identified below of where a focus on direct costs to business may provide a misleading picture of the overall impact of regulation. First with respect to 'Consumer Rights Act: Goods', recorded in the BIT Final Report 2015-17. This provision is designed to modernise and simplify consumer rights in relation to goods. The BIT score (ie the annualised net cost to business) is calculated as £14.0 Million. While there may be direct costs to business such as familiarisation costs, compliance costs and those costs caused by changes to contracts/literature issued by businesses, there may also be indirect benefits to businesses that should be taken into account when assessing the cost of regulation. For example, the Consumer Rights Act may lead to improving business standards and levels of consumer trust in an industry, which may thereby increase the amount of business that fair dealing businesses receive. Second, in 2019 the FCA put in place 'PS19/11: Product intervention measures for retail binary option', to prohibit the sale, marketing and distribution of binary options to retail consumers by firms that carry out activity in the UK. This was on the basis that the FCA found evidence of substantial consumer harm from aggressive and/or misleading marketing of these products, lack of transparency and level (and speed) of retail consumer losses experienced when trading binary options. The consumer loss was calculated to be an average loss of around £17m on an annual basis when trading binary options (see FCA's consultation paper here). As well as PS19/11 removing this consumer detriment, the CMA considers that there may be further indirect benefits of this provision such as increasing consumer trust and confidence in markets more broadly. This not only has benefits to consumers but also to businesses. However, given the narrow construction of the BIT, which focuses on direct business costs, the Total Net Present value (millions) of the provision is assessed as -£128.8 million and the BIT score is calculated at £74.8 million (see BIT interim final report 2019 here).

government's approach to reducing the costs of regulation should evolve and make it easier for future governments to set appropriate targets.

Pro-competitive, pro-consumer regulation

40. Drawing upon a range of examples from the CMA's work, this section outlines how regulation can be pro-competitive and pro-consumer.

Retail banking market investigation: promoting competition through designing regulation around new technology

41. The Open Banking example below highlights that regulation can help to promote the adoption of measures that open up markets and promote competition. This can be achieved by making use of new technologies in designing market interventions i.e. working with the grain of industry developments.

42. In August 2016, the CMA published its final report following its investigation into the supply of retail banking services to personal current account (PCA) customers and to small and medium-sized enterprises (SMEs) (retail banking market).

43. The CMA found that older and larger banks did not have to work hard enough to win and retain customers and that it was difficult for new and smaller banks to grow. To address these issues the CMA proposed a number of remedies including Open Banking, which enables customers and small and medium-sized businesses to share their current account information securely with other third-party providers from January 2018.

44. Central to the CMA's Open Banking remedy were measures to require the largest banks in Great Britain and Northern Ireland to adopt and maintain common API standards through which they would share data with other providers and with third-party providers (TPPs) including Price Comparison Websites ("PCWs"), account information service providers (AISPs) and payment initiation service providers (PISPs).

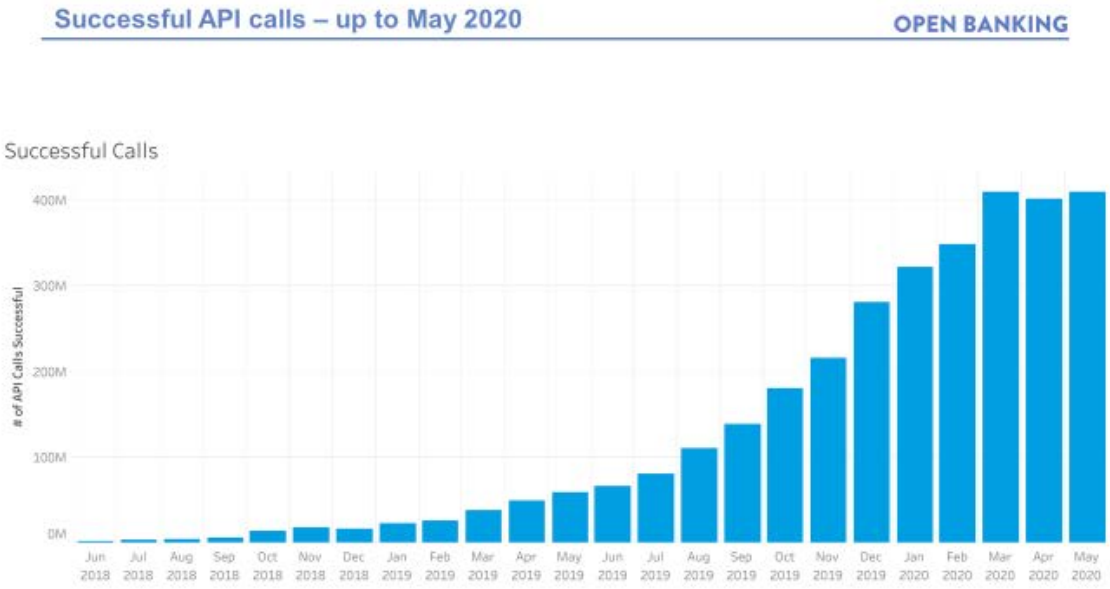
45. The CMA's final report stated that: "Of all the measures we have considered as part of this investigation, the timely development and implementation of an open API banking standard[35] has the greatest potential to transform

[35] An open API standard entails UK banks developing a single and common API, which is publicly available and can be used by any FinTech company or app developer, to design products or apps which would work for all UK banks.

competition in retail banking markets. We believe that it will significantly increase competition between banks, by making it much easier for both personal customers and SMEs to compare what is offered by different banks and by paving the way to the development of new business models offering innovative services to customers."

46. It is too early to assess Open Banking's full impact. However, there have been significant improvements to the process that enables customers to authorise new TPPs.[36] New technologies have developed, this includes products launched to help people manage their finances – whether through better budgeting, automating savings, comparing products, or finding ways to clear debt.

47. As of May 2020, Open Banking product usage continues to grow with over 400 million successful API calls[37] made by customers to TPPs in March. The graph below illustrates the rapid increase in successful API calls from June 2018 through to May 2020 with a levelling off in April/May which may be connected to the effect of the pandemic.



48. Furthermore, around 30 other jurisdictions are now either contemplating or implementing Open Banking. Some countries, for example Australia, are

[36] Open Banking – report published by the OBIE Posted July 22, 2019.

[37] An API call can be described as follows. Where a customer has downloaded an app, before using the app, a customer will be required to fill in an email or password. The moment the "enter button" to submit details is hit, the customer has made an API call.

now using the UK approach and standards as a blueprint for their own Open Banking projects.

49. While good progress has been made with Open Banking, the European Payment (PSD2) Directive[38] may hinder retention of open banking services by customers as well as the development and growth of open banking. For example, the Regulatory Technical Standards under PSD2 require that consumers re-affirm to their bank every 90 days that they wish to continue sharing their data with a TPP. While it is important to ensure that consumers' data is only used for the purposes to which they have consented and for the period they have agreed with the TPP, there is evidence that consumers and SMEs are failing to re-authenticate, leading them to lose access to the service. In many instances, this is not because they no longer value the service but because they may be unaware of this requirement or find it too complex or burdensome.

50. The CMA considers that if an EU remedy has not been identified to rectify this issue before Brexit, after the Brexit transition period the government should seek to identify as frictionless a solution as is consistent with data privacy and security considerations. The CMA notes that in this regard the FCA has published a call for input on Open Finance in 2019, asking for stakeholders' feedback on Open Banking, with a view to propose or consult on possible changes or make recommendations where appropriate and desirable.

Pro-competitive regulation in digital markets: unlocking and enhancing competition through regulatory design

51. There is currently a global debate about the correct regulatory approach to digital markets, to address concerns not just about the promotion of competition and innovation, but also issues such as online harms, privacy and fake news.[39] These factors need to be carefully considered when

[38] Payment services (PSD 2) - Directive (EU) 2015/2366. PSD2 is a set of rules intended to increase competition in payments, reduce the fraud risk created by screen scraping, and complete the creation of the Single European Payments Area by harmonising rules across its members. PSD2 requires EU banks to give authorised third-party payment initiation and account information service providers access to customers' accounts. PSD2 also mandates the use of strong customer authentication in order to initiate electronic payments, and to grant access to transaction data. PSD2 was passed in 2015, and first came into effect in January 2018.

[39] Furthermore, in ensuring the security risks, such as breaches to connected devices, are managed and mitigated, as well as ensuring the sustainability of journalism in the digital age as considered in the Cairncross Review.

designing any regulation in these markets, and there could be various trade-offs involved.[40]

52. The CMA is considering the competition implications of any potential regulatory approach to digital platform markets through its Digital Markets Taskforce and in July the CMA published the final report to its Online platforms and digital advertising market study. Digital platform markets have a unique set of characteristics, including strong network effects and strong economies of scale and scope. For this reason, in many cases, digital markets are subject to 'tipping' in which a winner will take most of the market. As a result, such markets can result in limited competition and the presence of a small number of large firms.

53. Concentration in digital markets can have benefits but also can give rise to substantial costs. A large part of the reason for the emergence of one or a small number of dominant firms is that it may be more efficient, for example where a firm is able to take advantage of large economies of scale. However, concentration can have substantial downsides as well. For example, it can lead to higher prices, narrower choice, or lower quality.

54. The Furman Review (commissioned by the Treasury) considered that digital markets will only work well if they are supported with strong pro-competition policies that open up opportunities for innovation, and counter the forces that can lead to high concentration and a single winner. The Furman Review was followed by the launch of the CMA's Digital Markets Taskforce and the Online platforms and digital advertising market study.

55. In its 2020 Budget on 11 March the UK government announced it was accepting the Furman Review's strategic recommendations for unlocking competition in digital markets. The government has launched a dedicated 'Digital Markets Taskforce', led by the CMA, which will provide advice to the government on the potential design and implementation of measures to improve competition in the online advertising, social media and general search markets.

Online platforms and digital advertising market study final report

56. The CMA's Online platforms and digital advertising market study final report found that there is a compelling case for the development of a pro-competition ex ante regulatory regime, to oversee the activities of online

[40] However, decisions on these matters go beyond the remit of the CMA and are for Government and Parliament and will require broad involvement from HMG, other regulators and a range of stakeholders.

platforms funded by digital advertising. The CMA has therefore recommended that the government brings forward legislation to introduce such a regime. A Digital Markets Unit (DMU) would be empowered to enforce a code of conduct to govern the behaviour of platforms with market power. In addition, the DMU would also have powers to tackle sources of market power and increase competition, including powers to increase interoperability and provide access to data, to increase consumer choice and to order the breakup of platforms where necessary.

57. The CMA found that both Google and Facebook grew by offering better products than their rivals.[41] However, they are now protected by such strong incumbency advantages – including network effects, economies of scale and unmatchable access to user data – that potential rivals can no longer compete on equal terms. These issues matter to consumers. This is because weak competition in search and social media leads to reduced innovation and choice and to consumers giving up more data than they would like. Weak competition in digital advertising increases the prices of goods and services across the economy and undermines the ability of newspapers and others to produce valuable content, to the detriment of broader society.

58. The CMA found that the concerns identified in these markets are so wide ranging and self-reinforcing that its existing powers are not sufficient to address them. The CMA therefore proposed a new, regulatory approach – one that can tackle a range of concerns simultaneously, with powers to act swiftly to address both the sources of market power and its effects, and with a dedicated regulator that can monitor and adjust its interventions in the light of evidence and changing market conditions.

Pro-competitive regulatory regime

59. The regulatory regime recommended comprises two broad categories of intervention. These are discussed in turn below.

Enforceable code of conduct

60. The enforceable code of conduct, is designed to protect competition by governing the behaviour of platforms that have market power over an

[41] Google and Facebook are the largest such platforms, with over a third of UK internet users' time online spent on their sites. Google has more than a 90% share of the £7.3 billion search advertising market in UK, while Facebook has over 50% of the £5.5 billion display advertising market. Both companies have been highly profitable for many years.

important online gateway. The CMA recommended that an enforceable code of conduct be established to govern the behaviour of SMS platforms funded by digital advertising.

61. The CMA considered that the code should apply to the small number of platforms whose conduct raises the most significant competition concerns. The government has asked the Digital Markets Taskforce to recommend the criteria by which a platform would be designated as having SMS, taking account of a broad range of online platforms. For the purposes of the market study, the CMA have considered which platforms funded by digital advertising should be considered to have SMS. Based on the principles set out in the Furman Review and the extensive evidence the CMA have gathered on their market power, the CMA outlined that it would expect both Google and Facebook to be designated with SMS.

62. The CMA proposed that the code should take the form of high-level principles rather than detailed and prescriptive rules. Given the complex and rapidly changing nature of the markets within scope and the issues the CMA identified, there is a risk that overly prescriptive rules would soon become redundant or fail to anticipate important new developments. The code would have a statutory basis, with powers given to the DMU to suspend, block and reverse decisions of SMS firms and order conduct in order to achieve compliance with the code, backed up by financial penalties for non-compliance. The DMU's investigations would be completed quickly so as to act before there is significant competitive harm.

63. In addition the CMA considered that the code should be based around three high-level objectives (**fair trading, open choices, trust and transparency**).The fair trading principles are intended to address concerns around the potential for exploitative behaviour on the part of the SMS platform, the open choices principles are intended to address the potential for exclusionary behaviour, while the trust and transparency principles are designed to ensure that SMS platform provides sufficient information to users, so that they are able to make informed decisions.

64. Overall, the CMA believes the code would have a number of advantages over existing ex post enforcement tools in competition, consumer and data protection law, including: the ability to cover a much wider range of concerns holistically; the ability to address concerns more rapidly and before they result in competitive harm; a greater focus on remedies and remedy design; and greater clarity for platforms and other market participants over what represents acceptable behaviour when interacting with users and

competitors. Having a dedicated DMU focus on the sector should also help develop regulatory expertise and understanding over time.

Range of pro-competitive interventions

65. In addition to the code, **the CMA recommended the DMU have the power to introduce 'pro-competitive interventions'** to transform competition in digital platform markets. While the key objective of the code is to mitigate the effects of market power by governing the behaviour of platforms with SMS to stop the exploitation of users and the exclusion of competitors, the pro-competitive interventions would aim to tackle sources of market power directly, by overcoming barriers to entry and expansion. Consistent with the transformational nature of pro-competitive interventions, they would require greater opportunities for consultation with affected parties and longer timescales for analysis and decision-making.

66. The Furman Review recommended that the DMU should have powers to implement a range of data-related remedies including data mobility, systems with open standards and open data. The CMA agreed that data-related remedies are key in digital platform markets, reflecting the fundamental role that data plays in the business models of online platforms, particularly those funded by digital advertising, and the fact that differential access to data is at the heart of important barriers to entry and expansion.

67. The main data-related interventions that the CMA assessed in its study, and which the CMA considered should be part of the DMU's toolkit, are the following: increasing consumer control over data,[42] mandating interoperability;[43] mandating third-party access to data;[44] and mandating data separation / data silos.[45]

68. The CMA also considered that powers to introduce two additional forms of intervention are necessary. First, to address the power of defaults in the markets the CMA have reviewed, the DMU should have the power to **introduce consumer choice and default interventions,** which would allow it to restrict platforms' ability to secure default positions and to introduce choice screens. Second, to address potential conflicts of interest arising from vertical integration, the DMU should have the power to introduce different

[42] which includes providing choices over the use of data and facilitating consumer-led data mobility.

[43] to overcome network effects and coordination failures.

[44] where data is valuable in overcoming barriers to entry and expansion and privacy concerns can be effectively managed.

[45] in particular where the data has been collected by the platforms through the leveraging of market power.

forms of **separation intervention**, from operational separation, to full ownership separation.

CMA's response to the Loyalty penalty super-complaint: promoting healthy competition, enhancing consumer engagement and protecting vulnerable consumers

69. In response to the Loyalty penalty super-complaint brought by Citizens Advice in September 2018, the CMA made recommendations to government and regulators (in particular Ofcom and the FCA) to help address the loyalty penalty. The loyalty penalty is where companies penalise longstanding customers by charging them higher prices than new customers, or those who renegotiate their deal for the same goods/services. The CMA considered different aspects of loyalty penalty pricing, such as automatic renewal of services as found in the broadband or home insurance market. Such practices increase the risk that customers that get rolled over yearly will pay a loyalty penalty.[46]

70. In responding to the super-complaint in December 2018, the CMA set out a package of reforms to help tackle the loyalty penalty, which included recommendations for regulators to: take action against harmful business practices (through effective enforcement of consumer law alongside recommendations to strengthen consumer protection law); protect vulnerable customers by using targeted pricing regulations where needed; publish the size of the loyalty penalty by provider in their markets to hold firms to account and to help people navigate the market to get better deals. The CMA also made recommendations in the five markets where particular concerns had been raised; mobile, broadband, cash savings, home insurance and mortgages.

71. The CMA is continuing to engage with regulators and government on their work in this area. While progress continues to be made, work in this area is still ongoing and some has necessarily been postponed due to COVID-19. Given the importance of protecting consumers now more than ever, where possible the CMA encourages regulators to continue to progress their work and ensure that effective interventions to address the problems are put in place. For full details on progress made by sector regulators and recent developments see the CMA's Loyalty penalty update July 2020.

[46] The loyalty penalty can arise through a variety of ways. In some markets there is a sharp increase after the introductory price ('price jump') like in energy; in others there are successive price rises ('price walking') as in insurance; and elsewhere customers on older tariffs sometimes pay higher prices for similar services ('legacy pricing'), as in broadband.

Restoring trust in markets

72. Offering introductory deals is not necessarily harmful, but the CMA found that the loyalty penalty is particularly problematic when businesses make it harder than it needs to be for people to switch, and then exploit their longstanding customers. Such harmful business practices undermine consumer trust in markets.[47] Trust is critical to a well-functioning competitive market: it means consumers shop around with confidence and switch providers to get the best deals. Consumer research undertaken by the CMA identified that where consumers consider it unfair that loyal customers pay more, or where they are surprised and feel 'ripped off' as a result, they can be left frustrated and develop distrust in markets. This can make consumers even less likely to engage in future, which may mean they continue to get poorer deals.

73. To help address this and improve engagement, in its six-month update the CMA set out a principles-based framework to give more clarity to businesses and regulators about the difference between healthy competition and unacceptable practices. The framework built on the 'effective nudge' theories developed by Professor Richard Thaler, a renowned behavioural economist. It set out principles which included: ensuring that auto-renewal is explicitly agreed to by the consumer when signing up to contracts; that consumers are properly notified before any renewal – in good time for them to take action; that changes to important terms such as price have the consumer's express agreement; and lastly an exit/entry equivalence principle – namely, that consumers should find it as easy to exit a contract as it was to enter. These principles are designed to ensure firms compete fairly and do not deliberately obfuscate the process of consumers switching between providers.

74. In addition to these principles, the CMA considered that regulators and other enforcers should be taking enforcement action under consumer law to tackle these type of harmful practices, where possible.[48] As we set out in the CMA's super-complaint response, there is scope for consumer law and the CMA's powers to be strengthened to enable the CMA to more effectively tackle different types of harmful pricing practices like loyalty penalties. The

[47] Maintaining trust in markets is a priority area in the CMA's annual plan.

[48] The CMA has launched two consumer enforcement cases in the anti-virus and online video gaming sectors, examining whether some of the business practices and terms and conditions of the companies involved, are fair in relation to auto-renewal, cancellations and refunds, which are ongoing.

CMA welcomes the government's support for giving the CMA new powers to fine businesses for breaking consumer law.[49]

Vulnerable consumers

75. While not all consumers likely to be affected by the loyalty penalty are vulnerable, the CMA found that vulnerable consumers (such as those with low incomes, mental health problems and the elderly)[50] are more likely to be longstanding customers and stay with their provider out of contract, on auto-renewed or roll over contracts. Vulnerable consumers are therefore more likely to pay a loyalty penalty where it arises.[51] While regulators (including the CMA) have in the past been reticent to introduce pricing interventions because these can distort markets, the CMA considered there was a case for targeted price regulation where there is clear harm, particularly in order to protect vulnerable consumers who are unable to switch providers. Furthermore, the CMA considered that distortionary effects are likely to be more limited when pricing interventions are targeted to an identifiable customer group subject to the greatest financial harm. The CMA therefore made recommendations for targeted pricing interventions to be considered by regulators as part of their ongoing work in the five markets.

76. The exit/entry equivalence principle identified above (paragraph 73) is also relevant to vulnerable consumers. For example, where a supplier permits consumers to sign up online, the same facility should be offered to all customers to exit, without being required to speak to their provider to do so. This could be particularly helpful for vulnerable consumers such as people with mental health problems, who can struggle to communicate via phone. This reflects the principle of 'inclusive design', whereby measures are designed to be accessible to, and usable by, as many people as possible and in so doing, can be beneficial to vulnerable groups of consumers, as well as consumers generally.

[49] In June 2019 the government announced that it would consult on giving the CMA new powers to fine businesses who have broken consumer law directly, without the need to go through a court.

[50] Protecting vulnerable consumers is core to the CMA's Annual Plan for 2019/2020. The CMA has undertaken extensive work to better understand the challenges vulnerable consumers can face in markets, and how it can help to address them.

[51] The CMA made a recommendation to regulators to identify whether vulnerable consumers are indeed paying a loyalty penalty, and whether they on average pay a higher penalty than others.

Heat networks market study: protecting consumers in the absence of competition and balancing the need for industry investment through regulatory design

77. In the Heat networks market study, the CMA found that many heat network customers are provided with efficient supply of heat and hot water at prices at the same or lower than other potential sources of supply. However, to the detriment to some consumers, some heat network providers face little competitive pressure to offer reasonable prices, reliable supply and high quality of service.

78. Given these concerns the CMA made the case for greater consumer protection and recommended that BEIS and the Scottish government set up a flexible, principles based statutory framework that underpins the regulation of all heat networks. This recommendation, which is currently being consulted upon by BEIS,[52] is designed to provide heat network customers with the same level of consumer protection as those afforded to gas and electricity customers. It is also designed to enhance price transparency by providing consumers with enough information to allow them to make appropriate decisions when considering whether to live in a property with a heat network and to understand and act upon bills.

79. The CMA considered that a regulatory regime which protects consumers would reduce the risk that poor networks could harm the wider reputation of the sector and, in turn, discourage investment. Investment in the industry was a particularly important consideration as heat networks form a key part of the UK's plan to reduce carbon emissions and cut heating bills for customers.

80. The CMA was also conscious of the possible impact on investment in heat networks from price regulation. The CMA considered that sector-wide price caps would be unsuitable due to the variety of different size and models of heat networks that exist. Furthermore, in other countries, the entry of private operators and greater investment in the industry had been discouraged in the heat networks market because suppliers were not permitted to charge customers more than the cost of providing heat. In order to allow for a flexible approach that encouraged investment but also protected consumers, the CMA recommended principles-based rules and guidance on pricing rather than a specific price cap. The CMA expected that pricing rules could

[52] https://www.gov.uk/government/consultations/heat-networks-building-a-market-framework

be either based on pricing by reference to cost (including a reasonable margin) or by reference to a suitable benchmark.

81. In order to ensure protection for customers within this approach, the CMA recommended that Ofgem should have enforcement powers where heat network operators do not comply with pricing rules.[53] This means that it would be feasible for a regulator to intervene to reduce prices in limited cases where networks are pricing too high.

Promoting market health and stability through regulation

Promoting market health through government procurement practices and contracts

82. The CMA understands that post-Brexit, there may be an opportunity for reform to public procurement rules. Regardless of the future regulatory arrangement, the CMA advocates pro-competitive best practice in the application of public procurement rules and regulations. These practices seek to promote market health and competition in the markets where goods and services are procured.

83. Public procurement accounts for around 14 per cent of the UK economy, and includes essential goods and services such as pharmaceuticals and defence.[54]

84. Due to the magnitude of the spending involved, public procurement strategies and contract design can have an impact on markets for goods and services. Through its procurement decisions, the public sector can affect the structure of the market and the incentives of firms to compete more or less fiercely in the long run. The CMA's interest in procurement policy, strategies and contracts is ensuring that the government achieves best value for money and has a positive influence on competition in markets to the benefits of the wider economy.

85. The Market management guidance written by the Cabinet Office in conjunction with CMA secondees encourages government to monitor and promote market health in procurement exercises and contracts. In particular, the CMA has encouraged government to look beyond individual contracts

[53] This aspect of the CMA's recommendation is also being consulted upon by BEIS.

[54] Report 'After Carillion: Public sector outsourcing and contracting' (July 2018).

and consider designing commercial strategies and contracts that promote healthy markets over short and medium term.[55]

86. The Market management guidance suggests a number of measures to promote market health. This may include measures to address possible barriers to entry. For example, streamlining complex and burdensome procurement rules and, in the absence of significant economies of scale and scope, the disaggregation of contracts for different services to encourage greater supplier participation may be considered. Furthermore, ensuring outcome-based contracts do not place excessive risk with suppliers or dissuade new/smaller suppliers from entering the market.

87. Periods of market turbulence, such as the present one, demonstrate the importance of pro-competitive practices in relation to procurement regulation in building and maintaining healthy, resilient markets which are not over reliant on a small number of suppliers.

88. Furthermore, stimulating the participation/entry of smaller suppliers into public procurement through pro-competitive practice is also likely to be key to the financial recovery post COVID-19.

Protecting security of supply through regulation

89. Government may wish to use regulation to protect the security of supply in certain industries. It has recently done so to add a new public interest consideration[56] in merger control which could be used to protect security of supply, for example if a vaccine that is or might be needed to treat a significant section of the population is at risk. While government can use a range of approaches, it should remain mindful of the risk that in the longer term these may distort markets and reduce competition or, in the case of overuse of interventions in relation to merger control, harm investment.

90. Even where government faces little or no choice in its choice of supplier, regulation can help manage this through benchmarking. The Single Source Procurement Framework overseen by the Single Source Regulations Office,[57] for example sets an acceptable baseline of profit that firms participating in non-competitive defence contracts. Similarly, in regulated industries such as utilities, the government, or sector regulator can and do

[55] Page 14, Market management guidance note, July 2019.

[56] The need to maintain in the UK the capability to combat, and to mitigate the effects of, public health emergencies.

[57] For further details on the duties of the Single Source Regulations Office see Section 13 of the Defence Reform Act 2014

take similar steps to ensure good outcomes for individuals and businesses where a natural monopoly exists.

Features of regulation that may inhibit competition and/or worsen outcomes for consumers

91. There are certain regulatory features that may inhibit competition and therefore harm consumers. These are outlined below, and the government should seek to identify the existence of such features as part of its RRI, and assess their impact on competition.

Quantity-restricted licensing regimes

92. Quantity-restricted licensing regimes act as a barrier to entry by limiting the number of suppliers that can participate in a given market. This eliminates or severely restricts market entry, thereby protecting incumbents from competition.

93. This concern was identified by the CMA in taxi and private hire vehicle (PHV) licensing conditions.[58] While licence conditions play a crucial role in ensuring the safety of passengers, the CMA found that some licensing conditions are likely to restrict or distort competition in ways that may result in higher prices and/or worse service for consumers. This is as a result of restricting supply and impeding new entrants.

Rules that may have a disproportionate impact on new entrants or smaller firms compared to larger incumbents

94. Such rules may have the effect of entrenching the market power of incumbents by limiting the degree to which they are exposed to competition. This can allow incumbents to increase price and reduce quality of service offering and limit innovation.

95. As noted below, in the Retail banking market investigation, the CMA considered that the proportion of a bank's cost in compliance with regulations will be greater for smaller firms than larger firms and that disproportionate regulation can be an impediment to effective competition and a barrier to expansion for smaller firms.

[58] CMA, Guidance - Regulation of taxis and private hire vehicles: understanding the impact on competition Published 12 July 2017

Self-regulation

96. Self-regulation involves an industry or professional association taking full responsibility for regulating the conduct of its members, without government legislative backing. Self-regulation can provide benefits by ensuring technical standards are appropriate and that standards advance with technology.

97. However, self-regulation can cause a dampening of competition between firms. In particular, industry/professional associations may adopt rules that reduce incentives or opportunities for intense competition between firms.

98. An example of where self-regulation may give rise to competition concerns has been identified in relation to the pharmacy sector in Canada. The Canadian Competition Bureau found that restrictions on business structure are intended to maintain the independence of pharmacists from other professionals in order that commercial pressures associated with multidisciplinary ownership and management do not compromise pharmacists' professional practice or judgment. Aside from trying to avoid conflicts of interest when drug prescribers, such as doctors, dispense drugs, the Canadian Competition Bureau found that it was difficult to understand why some of these restrictions exist.

99. The concern about such rules from a competition perspective are that they force many pharmacists into the same business model. This has the effect of ensuring that pharmacists face a similar cost structure, making meaningful competition less likely to occur and possibly preventing entry of new market participants.[59]

100. Furthermore, such structures may also only be voluntary. This was the case in the CMA's Heat networks market study. Here, the CMA found that a voluntary scheme provided for standards on quality both in service, design and build of heat networks. However, given the scheme was voluntary, it lacked enforceability, meaning some heat network providers had little incentive to maintain quality or price competitively.

[59] See section 7, Competition Bureau Canada, Self-Regulated Professions—Balancing Competition and Regulation.

Exclusive rights

101. Granting exclusive rights to produce a particular good or provide a certain service results in the establishment of a monopoly. The grant of an exclusive right has occurred frequently in the context of a 'natural monopoly'.[60] This is particularly the case in goods and services produced in the regulated sectors. Exclusive rights, if granted for a long duration, are often considered as a means of encouraging investment in infrastructure that might not occur without the incentive of a guaranteed market that an exclusive right provides. However, exclusive rights may result in monopoly pricing and other problems associated with the exercise of market power.

102. In the Heat networks market study, the CMA considered that the substantial, upfront fixed costs of heat networks may lend them some of the characteristics of natural monopolies, in that it may not be economically efficient for there to be more than one heat network in a given area. Given this, the CMA found that customers may have no alternative sources of heat and be locked into long term contracts. The CMA therefore recommended enhanced consumer protection regulation in this market.

Detrimental impact of regulation on competition and consumers

103. This section identifies how and where regulation may affect competition, drawing upon examples from the CMA's work. It also identifies approaches the CMA has recommended to improve competition through regulatory design and market mechanisms. Lastly, it identifies potential scope for future regulatory reform.

Legal services: the need for proportionate risk-based regulation

104. One of the key purposes of sector-specific regulation in legal services is to provide consumer protection in this sector, which is characterised by information asymmetries that present risks for consumers when accessing these services.[61] Furthermore, regulation of legal services helps secure public interest benefits such as the fundamental public interest in supporting the rule of law. However, as with any such system of regulation,[62] there is a trade-off between protecting consumers from poor-quality provision and

[60] A monopoly exists when a good or service can reasonably be purchased from only one supplier. In a "natural monopoly", one supplier can produce the desired output more efficiently and at a lower total cost than two or more suppliers.

[61] For example, see Decker, C and Yarrow, G (2010), Understanding the economic rationale for legal services regulation, commissioned by the LSB.

[62] See CMA (2015), Competition impact assessment guidelines – in particular, paragraphs 3.20–3.23.

securing the public interest on the one hand, and allowing access to a range of lower-cost alternative providers on the other. Failures in making an appropriate trade-off between these two considerations can lead to regulations that can dampen competition, restrict entry and inhibit innovation in the market.

105. The Legal services market study identified concerns regarding the sustainability and flexibility of the legal services regulatory model in England and Wales.

106. The majority of providers (such as solicitors and barristers) are subject to sector-specific regulations and are 'authorised' under the Legal Services Act 2007 to undertake a narrow set of six 'reserved' legal activities.[63] These authorised providers are currently regulated in respect of all of the legal activities they provide, not just those involving the provision of reserved legal activities. This is referred to as 'title-based regulation', in that all activities provided by an authorised provider, such as a solicitor or barristers, must comply with the professional rules governing the holders of that professional title.

107. The CMA found that the scope of the reserved legal activities has the potential to have a significant negative impact on competition in that unauthorised providers,[64] which may be lower cost providers, are restricted from competing to some extent in the legal areas to which the reserved legal activities relate.[65]

108. Arguments in favour of the current reservations are based on their importance in ensuring consumer protection or securing specific public interest benefits. While recognising these justifications, the CMA found that some of the current reserved legal activities are poorly aligned with the risks of providing legal services to consumers. In practice, the fact that only a very small proportion of consumers use unauthorised providers means that this poor alignment between risk and the scope of the reserved legal activities does not seem to be a major issue at the *current time*. However, the CMA was concerned that this misalignment may, *in time*, result in greater

[63] There are six reserved legal activities under the Legal Services Act 2007 which may only be provided by authorised providers. The six reserved legal activities are: the exercise of a right of audience; the conduct of litigation; reserved instrument activities (conveyancing); probate activities; notarial activities; and the administration of oaths.

[64] Unauthorised providers can provide all legal services except for the reserved legal activities and certain other legal activities that are subject to special regulation.

[65] However, there are a large number of providers in these legal areas and the scope of the reservations tends to be narrow which allows unauthorised providers to work around them.

consumer detriment as the proportion of unauthorised persons operating in the legal services sector increases.

109. Furthermore, in navigating the market, consumers often rely on regulated titles, such as 'solicitor' or 'barrister', as an important indicator of quality. However, they do so without a clear understanding of the significance of these titles in terms of regulatory protection they might provide. This means that consumers may avoid using unauthorised providers even in situations where they might benefit from using them. There are also restrictions on the ability of unauthorised firms to employ solicitors to deliver unreserved legal work. The CMA believed that this may reduce the ability of unauthorised firms to compete, given the importance of titles for consumer decision-making and trust. In addition, the restriction on solicitors working in unauthorised firms may unnecessarily reduce the availability of lower cost options for consumers.

CMA's recommendation

110. The CMA's main concern was that the current, title-based model is insufficiently flexible to apply proportionate, risk-based regulation which reflects differences across legal services areas and over time. The CMA therefore proposed that the government launch a review of the regulatory framework with the aim of making the regulatory regime more flexible and risk-based in the long term. The CMA considered that the review should be based on the following key principles:

(a) The regime needs to be more flexible – the current reserved legal activities would preferably be replaced (or supplemented) by an ability for the regulator to introduce or remove regulation directly in legal service areas which it considers pose the highest risk to consumers.

(b) Regulation should be proportionate and its costs justified on the basis of risk assessment. This means that when regulation is reviewed it is removed when there is insufficient evidence of risk.

(c) The scope of regulation should focus on activities and risks to consumers, with a shift away from regulation attaching solely to professional titles. An implication would be that some activities of currently unauthorised providers may fall within the regulatory net.

(d) Solicitors and other professionals should be less tightly regulated than they currently are for lower risk activities, reducing the costs of regulation and encouraging different approaches and business models.

111. In its response to the CMA's market study,[66] the government indicated that it could not commit to a formal review of the regulatory framework at the time, but agreed to continue to reflect on the potential need for such a review.

112. On 11 June 2020 Professor Mayson published his final report in an independent review of the legal services regulation.[67] This report stressed the need for regulatory reform and makes short and long term recommendations.

113. In light of COVID-19 Professor Mayson outlines that the legal services market has had to shift to remote and virtual working with greater reliance on technology. Professor Mayson adds that an increased use of unregulated providers and services at a time of personal, social and economic instability in the lives and circumstances of both consumers and regulated providers suggests a need for short-term reform to regulation. In the short term, the report recommends a 'parallel' structure that would leave the currently regulated providers untouched, but bring unregulated providers (including those who provide online services) within a short term version of registration and access to legal ombudsman investigation and redress. This is currently unavailable to unregulated providers and the consumers that use their services.

114. Professor Mayson makes a number of long-term recommendations aimed at creating a level playing field for legal services and enhancing consumer protection through targeted and proportionate regulation. This includes the recommendation that the primary objective for the regulation of legal services should be promoting and protecting the public interest. All 'providers' of legal services, whether qualified or not, should be subject to registration and regulation on a risk-based before-, during- and after the event-basis. Furthermore, Professor Mayson recommends that regulation should be targeted and proportionate, and should take account of risk, burden and cost. Professor Mayson also recommends that there should be an independent, single, sector-wide regulator of legal services. [68]

115. The CMA will reassess the case for reform of the regulatory framework (factoring in Professor Mayson's findings) as part of the review that it

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66 Government response to findings and recommendations, December 2017

67 See the following for full list of arguments and recommendations: Reforming legal services: regulation beyond the echo chambers

68 For a full list of long term recommendations see page 16-22 of : Reforming legal services: regulation beyond the echo chambers

committed to undertake in the market study final report that is due to take place during the second half of 2020.[69]

Airline slot allocation process: barriers to entry and the importance of regulation keeping up to date

116. The CMA has offered advice on government aviation strategy in a number of publications.[70] In particular it has advised on the competition impacts of the current airport slot allocation mechanism.[71]

117. The CMA considered that the current regulation raises barriers to entry and protects incumbents from competition. The effect of this is to limit and distort competition in the downstream market (i.e. airline to passenger market). The inefficiencies stem from the current EU regulations which underpin the aviation sector in Europe and the slot allocation process. These regulations were drafted in 1993 and have not been updated to reflect the wide-ranging market developments that have taken place in the last 25 years.

118. In particular, the current 'grandfathering' rule under the administrative system give airlines an indefinite right to an airport slot, as long as they use it at least 80% of the time. This is known as the 'use-it-or-lose-it' rule. Even when new slots become available, which is very rare at the busiest airports, only half of these are reserved for 'new entrants'. Very few airlines meet the strict definition of a new entrant, which requires the airline to hold fewer than five slots at the airport on the day a new slot is allocated.[72]

119. Furthermore, airlines may hold onto slots they do not necessarily need or are not able to use efficiently, simply to prevent other airlines from using them. Although the 'use-it-or-lose-it' rule is in place, it does not require an airline to use a slot in the most efficient way. For example, the airline with the slot may use a smaller aircraft whereas a new entrant might have an incentive to maximise the capacity the slot offers. The current rules also restrict the ability of new and/or smaller airlines to enter and expand their offerings. These factors potentially limit choice of airlines, routes and flight

[69] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/873689/Annual_Plan_2020-21.pdf

[70] For example in In June 2019 the CMA responded to the government's Green Paper on its new aviation strategy, 'Aviation 2050 – the future of UK Aviation' (the Green Paper). See Aviation 2050, Response from the CMA for further detail

[71] A slot is the right for an airline to take-off or land at a particular airport, at a particular time

[72] See WSG guidelines

times for passengers, and could lead to worse outcomes in terms of the routes and frequency of services, and higher air fares.

120. The CMA has advocated changing the current regulations and to move from an administrative allocation system to a market-based approach (such as auctioning). Short of that, the CMA has suggested that the administrative rules should be changed to move from a perpetual license to a time-limited allocation, allowing for new airlines to enter and expand services at busy airports.

121. The CMA considered that an auction mechanism would promote competition between airlines and generate benefits for passengers, businesses, airports and the wider economy and alleviate many of the inherent problems of the administrative system. A well-designed auction would compel airlines to support their investment decisions by paying an upfront fee. All of the information that an administrator would have to assess would be captured in a price that would truly reflect the value that an airline places on the slot.[73] The auction would then extract and use information otherwise unavailable to an administrator. The introduction of a formal price mechanism means that airlines would face a direct cash cost of holding a slot, which will create the right incentives to use slots efficiently or exchange or sell slots to airlines that may use the slots more efficiently. This is likely to lead to potential improvements in efficiency which could, among other things, result in: increase in the use of larger aeroplanes, carrying a greater number of passengers in total; an increase in the number of routes with a higher proportion of connecting passengers at hub airports.[74]

122. At the time of writing, the 'use it or lose it' rule has been temporarily suspended during the COVID-19 crisis.[75] As noted above, under this rule, airlines were required to utilise 80% of their slots to allow them to keep the slot in the following season. Prior to the suspension, airlines were operating 'ghost flights' (flights taking place without passengers) to avoid losing their slots. This provides further tangible evidence of the potential inefficiencies and inflexibility of the current system of slot allocation. The CMA recognises

[73] However, the price may reflect market power, meaning that price information may not be very informative for the administrator.

[74] A market-based approach is not without risks. The CMA identified several of these in its written advice to the DfT. Designing a market-based approach is complex but many of these same difficulties are faced by an administrator who is also faced with the inherent shortcomings of the administrative system. To the extent there are any risks specific to a market-based approach, we understand these can be addressed in auction design.

[75] The suspension was applied under the current circumstances as a means of providing financial relief to airlines facing bankruptcy while they face this sharp downturn in demand

that COVID-19 has had a significant impact on the airline industry[76] and government will need to consider any changes to slot allocation alongside any broader policy interventions arising from changes to patterns of demand.

Potential scope for ongoing reform of banking regulation

123. The identification of areas for regulatory reform requires a robust evidenced-based evaluation of the effectiveness of regulation in achieving its desired purpose. This should be conducted based on consultations with businesses (both large and small) and wider stakeholders and should include an assessment of its impact on competition, innovation and consumer welfare more broadly.

124. While changes to banking regulation may not be suitable in the short to medium term in the current economic climate, the CMA is mindful that COVID-19 and the associated economic contraction may have a negative impact on competition in various banking markets. In addition, it is important to ensure that schemes that have been established to provide vital short-term financial support to SMEs – for example, the Coronavirus Business Interruption Loan Scheme and the Bounce Back Loans scheme do not over the longer-term entrench the position of the largest banks, at the expense of challengers and new entrants. Therefore, a regulatory focus on competition is likely to be especially important over the coming years. We set out below two areas where policy attention may need to focus.

Capital requirements and the impact on smaller players

125. An important regulatory issue affecting the scope for entry and expansion into banking markets is the interaction between prudential regulation and competition. Smaller banks have argued for some time that they are disadvantaged in Pillar 1[77] (blanket) Capital Requirements Regulation (CRR) because they are required to use standardised risk weighting for their lending. In contrast, larger firms can use internal models via the Internal Ratings Based (IRB) approach,[78] which allows for lower risk weightings. The

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[76] COVID 19 has had a significant impact on aviation industry due to travel restrictions as well as a vast reduction in demand among travellers. This has resulted in cancellation of flights and reduced revenue for airlines, forcing many airlines to declare bankruptcy.

[77] A firm's capital requirements for credit risk are determined in accordance with Pillar 1 of the Capital Requirements Regulation (CRR).

[78] The internal ratings based (IRB) approach - Banks calculate their own risk weights based on their own internal risk models and data. The IRB approach is much more granular and is intended to better reflect the actual risks held by the bank. It requires a bank to have sophisticated risk models and good quality data on its own past

result is that smaller banks must hold more capital for the same lending, potentially making them less competitive, especially in mortgages.[79] PRA, BoE and HMT have been actively considering these issues, including the proportionality of banking regulation, the extent of the capital differentials between IRB and SA banks[80] and the regulatory burden on smaller banks.

126. The CMA notes that progress has been made in the area of increasing banks access to the IRB approach. For instance, the PRA finalised a review of its approach to IRB credit risk model applications for smaller banks and building societies in March 2019 to facilitate access to IRB models for these firms. Since launching the review, PRA have approved IRB permissions for three additional firms, increasing the total number of IRB permissions to 19.[81]

127. More broadly, the CMA considers that the UK's departure from the EU may allow the further development of policy on the competition effects of differential capital requirements once the UK is able to depart from the Capital Requirements Directive[82] (CRD) framework. In this regard the CMA welcomes the proposal by government that it will implement targeted deviations from the EU regimes where they are necessary to reflect, firstly, the number, size and nature of investment firms and credit institutions within the UK; and secondly, the structure of the UK market and how it operates.[83]

Regulatory burdens on smaller, non-systemic banks

128. The FCA[84] and PRA have indicated that barriers to entry in banking have reduced but barriers to expansion are still significant. In the Retail banking market investigation, the CMA found that the proportion of a bank's cost in compliance with regulations will be greater for smaller firms than larger firms and that disproportionate regulation can be an impediment to effective competition.[85] The Retail banking market investigation focused on aspects of

lending. Banks approved to use the IRB approach, for example for mortgages, are required to use the IRB approach across all mortgage classes to avoid 'cherry picking' by banks.

79 Paragraph 49, Retail banking market investigation, Barriers to entry and expansion: capital requirements, IT and payment systems

80 Standardised Approach (SA) - Risk weights set internationally by the BCBS, are based on data supplied from credit reference agencies (CRAs), and are transposed into UK law through the CRD IV.38 The SA applies one risk weight to each asset class based on the broad type and credit quality of the counterparty (eg sovereign, commercial bank, corporate, retail).

81 PRA, Annual Report 1 March 2019–29 February 2020

82 EU legislative package covering prudential rules for banks, building societies and investment firms

83 HM Treasury, Prudential standards in the Financial Services Bill: June update, Policy statement, June 2020

84 FCA, An evaluation of reducing barriers to entry into the UK banking sector, December 2018

85 Paragraph 9.114 Retail banking market investigation.

regulation that may have the potential to give rise to barriers to entry and or expansion such as bank authorisation and capital requirements.[86]

129. Both the PRA and FCA have mooted the possibility of a simpler regime for small firms post-Brexit, drawing on insights around size thresholds for firms and size and complexity of the rulebooks.[87]

130. The CMA considers that there may be scope for a closer look at the regulatory approach, post-Brexit, with a view to reassessing whether the balance is correctly struck between enhancing competition, and achieving other regulatory objectives. For example, banking regulations currently apply size-based criteria[88] and banks are often subject to more stringent regulation once they exceed a certain threshold. Post-Brexit there may be an opportunity to avoid using 'cliff edge' thresholds in areas such as balance sheet size with a move to broader thresholds that facilitate the growth and expansion of smaller banks.

Competition impact assessment guidelines

131. As well as making the case for the removal or creation of regulation as part of the CMA's markets and advocacy functions, the CMA has also developed the Competition impact assessment: guidelines for policy makers .[89] The guidelines aim to encourage policymakers to assess the impact of their proposals on competition during the start of regulatory design and regulatory review. The guidelines should also be closely considered by the government as part of its RRI and inform the design of regulation to ensure regulation promotes competition for the benefit of consumers. As noted in the CMA's recent paper*:* Regulation and competition: a review of the evidence*,* the CMA encourages policy makers to apply the guidelines and incorporate the considerations below into their practices and processes.

132. The initial screening stage of the guidelines asks whether a proposal affects a market where products or services are supplied by the private or public sector. Should a market be affected by the proposal, policymakers should move to the next stage in the initial screening and apply the four questions

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[86] It also looked at aspects of bank tax regime but this did not cover the regulatory regime as a whole.

[87] FCA, Christopher Woodlard, Regulation in a changing world, October 2019 and PRA, Sam Woods, Seven awkward questions, Speech given at roundtable to mark the fith anniversary of the PRA's Secondary Competition Objective, January 2019

[88] Such as with respect to balance sheet size.

[89] https://www.gov.uk/government/publications/competition-impact-assessment-guidelines-for-policymakers.

which form the competition checklist. These four considerations and their impact on competition are summarised below:

(a) **Does the measure directly or indirectly limit the number or range of suppliers?** Regulation that reduces competition directly (by placing limits on who can participate in a market) or indirectly (by raising costs and resulting in firms leaving the market or by reducing entry) may enhance the market power of the firms that remain and lead to price increases or a reduction in choice for consumers.

(b) **Does the measure limit the ability of suppliers to compete?** Regulation that restricts the means by which suppliers compete can inhibit competition between those suppliers to the detriment of consumers. Regulations may also prevent suppliers from developing new products.

(c) **Does the measure limit suppliers' incentives to compete vigorously**? The benefits of competition stem from suppliers competing vigorously by lowering prices or increasing quality to win customers and market shares. Sometimes, suppliers might decide, implicitly or explicitly, not to compete, through agreeing a common price or not to undercut each other. Alternatively, suppliers might agree not to compete for certain customers or in certain product areas. Regulation can make it more or less likely that suppliers will enter into such anti-competitive agreements.

(d) **Does the measure limit the choices and information available to consumers?** Sufficiently engaged customers who can access, assess, and act on information to select goods or services have an important role to play in stimulating rivalry between suppliers. This takes place where customers make informed decisions which reward those firms that best meet their preferences. Regulation can have an impact on the ability of consumers to decide where they purchase or change the information available to consumers, influencing the ability of consumers to make informed decisions. Furthermore, regulation may reduce switching by increasing the cost of changing suppliers.

133. If the answer to any of these questions is 'yes', a competition concern may arise, and policymakers should therefore move to undertake an in-depth assessment of the likely impact.[90]

[90] See Competition impact assessment guidelines Part 2.

134. Where a policy is likely to adversely affect competition in a market, policymakers should consider whether there are alternative proposals that will achieve the same policy objective but with less adverse effects.[91]

[91] Competition impact assessment guidelines 2.10.