

CMA STUDY INTO DIGITAL COMPARISON TOOLS – RESPONSE OF AA INSURANCE SERVICES LIMITED

Introduction

AA Insurance Services Limited (**AAISL**) welcomes the CMA's market study into digital comparison tools (**DCTs**) and its proposed scope and themes. We look forward to engaging with the CMA as its inquiry progresses.

At this preliminary stage, AAISL has the following over-arching comments, which are developed in response to the questions which the CMA identified in its scoping document:

- 1 First, it is important for the CMA to build on the previous work which has been undertaken in this area, including the UK Regulatory Network's (**UKRN**) report, in order to understand how digital comparison tools (**DCTs**) (and in particular price comparison websites (**PCWs**)) attract consumers and suppliers, given the two-sided nature of their business models, and how this affects their incentives to present data to consumers and to compete with each other.
- 2 Second, AAISL would encourage the CMA to undertake a detailed analysis of the entire consumer journey when using a PCW, from the initial selection of the PCW(s), through to data-entry, the use of filters to refine a search and scope the available policy features, the way in which search results are ranked and presented and the factors which drive decision-making (including the role of non-price factors). This analysis (and any related consumer research) should draw on the FCA's previous research on PCWs which identified a number of concerns regarding consumers' use of PCWs, including misconceptions which could lead to sub-optimal outcomes.¹ AAISL's experience of the private motor insurance (**PMI**) and home insurance (**HI**) markets is that the way in which results are ranked and the relationships between PCWs and suppliers (including commission fees and the impact of paid advertising on search results) are not well understood by consumers and often lead to "framing effects" which hinder the ability of consumers to access relevant information and assess whether a given product meets their needs. The increased reliance on PCWs has led consumers to focus almost exclusively on price to the exclusion of other factors, such as product features/cover and service quality, based on a misconception that all general insurance products are broadly equivalent.
- 3 Third, AAISL considers that this excessive focus on price has led to a "hollowing out" of the product (particularly PMI and HI) which, in turn, distorts competition between suppliers by incentivising them to focus entirely on securing the "buy box". This reduces incentives for suppliers to focus on improving service quality and breadth of coverage and to innovate by developing new product features. It also leads over time to a "winner's curse", in which the cheapest quoting brand is likely to be underpriced, which incentivises some insurers to recoup their margin by excluding common types of cover (for example, windscreen replacement cover in some instances) and/or by charging "hidden" administrative fees (as highlighted in an article published by Which? in September 2015²). AAISL is concerned that this is leading to an increasing erosion of trust in the market and leads to a very real risk that consumers do not select the product which best meets their needs.
- 4 Fourth, competition between PCWs remains weak (and significantly weaker than one would expect in a well-functioning market). This lack of competition exacerbates the concerns identified above in relation to framing effects and the impact on competition between suppliers. In particular:

¹ See <https://www.fca.org.uk/publication/research/price-comparison-website-consumer-research.pdf>, for example.

² See "Avoid the car cover rip-off", published by Which? in September 2015 and attached at **Annex 1**.

- (a) There are strong "network effects" in the PMI and HI markets, in particular, where the "big four" PCWs continue to account for a very high share of the third party intermediary channel and of all policies sold. PCWs therefore exercise considerable market power and are unavoidable trading partners for suppliers (particularly for PMI and HI where they account for approximately []% and []% respectively of all policies sold). Their cost per acquisition (**CPA**) fees remain high and there is no evidence that these fees are subject to any meaningful competitive pressure. Moreover, there has been no significant PCW entry of scale in recent years;
- (b) AAISL is aware that the CMA has, in the context of the PMI market, prohibited the use of "wide" most favoured nation (**MFN**) clauses in an effort to increase competition between PCWs. However, this has not had the impact which the CMA envisaged: it remains the case that there is little incentive on the part of the major PCWs to compete on price (i.e. by reducing CPA fees and by engaging in promotional activity). This is because relatively few customers shop on multiple PCWs. Further, PCWs focus on maximising "click-to-sale" conversion rates, which blunts their incentives to compete with each other. As a result, competition takes place almost exclusively on the basis of high profile and expensive marketing campaigns which are designed to attract more consumers to their sites and which do not drive optimal consumer outcomes;
- (c) AAISL's ability to compete on price and innovate through its own website has been significantly constrained since the CMA's final report and Order in the PMI market investigation were published. This is due to the following factors:
- (i) AAISL was in many cases successful in resisting narrow MFNs in its agreements with PCWs prior to the CMA's final report. However, since these were approved by the CMA, they have now proliferated across a number of general insurance markets including PMI and HI. These narrow MFNs lead to perverse incentives since they require AAISL to ensure that its direct price is no cheaper than the most expensive price for the equivalent product on *any* PCW even if its cost of acquisition is lower, meaning that AAISL's direct customers cross-subsidise those who use PCWs. In other words, narrow MFNs are having a similar effect in practice to wide MFNs and are preventing AAISL from providing better value products to its customers, many of whom hold multiple AA-branded products and do not wish to purchase via a PCW. This insulates PCWs from the threat of price competition and prevents AAISL from fully meeting the needs of its customers.
- (ii) This adverse effect on price competition is magnified because the definition of "PMI Product" in the Order is interpreted broadly by PCWs. This means that, in order to price a PMI product more cheaply on its own website, an insurer needs to ensure that the features of the product are substantially different to any products which are listed on a PCW. In AAISL's view, this further reduces incentives for insurers to compete on price via the direct channel and artificially distorts competition.
- (iii) The lack of an effective constraint from the direct channel weakens the incentives for suppliers (including AAISL) to innovate and invest in new product development. The "hollowing out" of the products offered on PCWs, coupled with the ineffectiveness of the direct channel, means that policies which offer broader coverage or a higher service quality are not being efficiently distributed either via indirect channels (PCWs) or direct channels. As a result, insurers have substantially less incentive to develop and invest in

higher quality products since they are unlikely to generate an adequate return. This is not consistent with the existence of a well-functioning competitive market and means that there is a very real risk that consumers will not benefit from adequate insurance coverage.

AAISL would therefore welcome a full review of the impact (and spread) of narrow MFNs, which it does not believe are essential for the PCW business model.

- 5 Fifth, as a result of the market power of the PCWs and the features of the market referred to above, there is a significant imbalance in bargaining power between PCWs and suppliers (including AAISL). This leads to practices one would not expect to see in a well-functioning market including, for example:
 - (a) The fact that CPAs are effectively dictated by the PCWs["];
 - (b) Instances where PCWs have sought to transfer risk/liability ["];
 - (c) Some instances where PCWs have threatened to switch off suppliers if they do not agree to PCW demands.
- 6 Finally, AAISL notes that there is currently a "patchwork" approach to the way in which PCWs are regulated across different sectors as a result of recent market investigations. We would encourage the CMA to adopt a uniform approach so as to ensure that consumers are able to access the information they need and to assess this information so that they can make informed choices and select the products which best suit their needs. This might constitute a binding code of conduct for DCTs which would apply on a cross-sector basis, drawing on some of the features of the Ofgem Consumer Confidence Code, the FCA's recent work in the high-cost short-term credit market and forthcoming changes to the FCA Handbook, which will require greater transparency from insurers and customer prompts on searching for a better deal. Similar principles could be applied to DCTs/PCWs to increase competition and improve outcomes for consumers.³

COMMENTS ON THE THEMES IDENTIFIED BY THE CMA

Theme 1: Consumers' perceptions, use and experience of DCTs

1. **When and why do consumers use DCTs? To what extent do they trust them?**
2. **How do consumers choose which and how many DCTs to use?**
3. **What are consumers' expectations of DCTs – for instance in terms of market coverage and the relationships between DCTs and the suppliers they list?**
4. **What are consumers' experiences of using DCTs? Do they benefit from using them and, if so, how? What works well and what could be improved?**

Whilst PCWs enable consumers to access pricing information on a range of providers, AAISL considers there are a number of issues with the way in which PCWs operate which prevent customers from realising full value from their use. In addition to the points made in the introduction above, AAISL would highlight the following:

³ FCA, *Policy Statement PS16/21*, August 2016

- First, PCWs focus on price to the exclusion of other factors such as product features and quality. As a result, PCWs do not sufficiently support consumers to make decisions based on the overall value of the product and whether it adequately meets their needs. This is a particular concern in general insurance markets, where constraints on consumers' ability to choose insurance products based on value has been a concern expressed in FCA studies.⁴
- Second, the focus on "headline" price by PCWs reduces transparency for consumers in terms of add-on costs. This is supported by findings in the FCA's market study on general insurance add-ons, which found that sufficient information to allow consumers to make a decision is not always presented in a timely manner by PCWs, that competition between bundles (a package of primary product and add-ons) is not effective and that this ultimately can result in poor value for consumers.⁵ ["].
- Third, the way in which PCWs currently operate means that consumers are not always clear about the features of the product they are purchasing. The FCA report suggests that PCWs do not always take sufficient care to ensure that consumers have the appropriate information to allow them to make educated choices.⁶ By contrast, direct purchasers on AAISL's website are able to easily access frequently asked questions which explain in plain language the key features of the product.
- Fourth, there is a lack of transparency for consumers over how results are displayed by PCWs. Consumers are not always aware of how DCTs are funded or the impact this may have on which results are shown by DCTs⁷. Many PCWs do not offer a whole market view and only feature brands that have paid commissions, or alternatively give significantly greater prominence to sponsored results (e.g., requiring click throughs to non-sponsored results). The FCA's Cash Savings Market study, for example, found that the factors which determine the default order in which products are displayed by PCWs are not always clear and that some PCWs gave prominence to those products which had been sponsored.⁸ Other FCA studies suggest that this lack of transparency can have an impact on consumer decision-making and outcomes, reducing their ability to select the appropriate product for them.⁹ The risk to consumers is exacerbated by studies that have found that consumers have an expectation that PCWs would vet and check the providers that they include.¹⁰

AAISL encourages the CMA to undertake an analysis of the whole customer journey, across the sectors which it is proposing to analyse as part of its case studies.

Theme 2: Impact of DCTs on competition between suppliers of the services they compare

5. What factors influence suppliers' use and choice of DCTs, and why?

AAISL's experience is that DCTs are an unavoidable trading partner for customer acquisition across multiple insurance products. This has a real impact on how AAISL engages with its existing customers and targets new customers.

⁴ FCA, *General Insurance Add-Ons: Final Report – Confirmed Findings of the Market Study*, July 2014

⁵ FCA, *General Insurance Add-Ons: Final Report – Confirmed Findings of the Market Study*, July 2014

⁶ FCA, *Thematic review of price comparison websites in the general insurance sector*, July 2014

⁷ UKRN, *Price comparison websites*, September 2016

⁸ FCA, *Cash Savings Market Study*, January 2015

⁹ FCA, *Price comparison website: Consumer market research*, June 2014

¹⁰ FCA, *Price comparison website: Consumer market research*, June 2014

For PMI, AAISL needs to engage with all four of the main PCWs in order to ensure its policies get are marketed to a broad target audience. There is no viable alternative to using the main PCWs. The only alternatives would be a massive direct mail/email programme (which would be very costly) and/or committing significant investment in driving business direct (also incredibly costly).

6. To what extent do DCTs make it easier for suppliers to enter the market, attract more consumers and engage more effectively with them?

Whilst DCTs/PCWs play an important role in enabling suppliers to market to a broad range of consumers, AAISL's experience is that the time and resources needed to develop the required contractual relationships with multiple DCTs, and develop IT systems to support the collation of data, can act as a barrier to suppliers becoming listed on DCTs. Similarly, ["] DCTs are not willing to undertake the development work required to list new products unless there are significant and proven commercial benefits to them.

7. How have DCTs affected competition between suppliers? What impact has this had on the price, quality and range of products offered by suppliers?

In general, the limited ability of customers using DCTs to rank results by factors other than price (or to assess factors of competition other than price) means that:

- A "framing effect" is created whereby it is difficult for consumers to assess whether those products with certain features at that price point are appropriate for them or to evaluate products based on their features.
- Across the market there is a reduction in incentives for suppliers to innovate in the development of new product features, or focus on quality, ultimately impacting on the value customers receive. This has resulted over time in a "hollowing out" of PMI and HI products, in particular, so that there is an excessive focus on price to the detriment of non-price factors (such as quality of service, breadth of cover and other product features).
- As the highest ranked providers are most likely to 'win' customers, this has encouraged tighter claims control across the insurance industry as these providers will be the best placed to be ranked first on price.
- This leads to the emergence of a "winner's curse", in which the cheapest quoting brand is likely to be underpriced, leading to insurer losses and subsequent increases to insurance premiums.¹¹

As noted in the introduction, AAISL is concerned that this is contributing towards a significant erosion of trust in the general insurance sector (and financial services more broadly) and would be happy to share the research which it has commissioned on this topic.

8. What are the barriers, if any, to DCTs increasing competition between suppliers; and how can these be overcome?

As noted above, DCTs do not sufficiently support consumers to select products based on value or the most appropriate product features for them. If DCTs were encouraged to provide further information on products or support consumers to be able to rank on a basis which

¹¹ Institute and Faculty of Actuaries, Winner's Cures, The Unmodelled Impact of Competition: <https://www.actuaries.org.uk/documents/winners-curse-unmodelled-impact-competition-report-winners-curse-giro-working-party-0>

included other factors, this would support consumers and promote competition between suppliers.

9. In what ways, if any, have DCTs changed suppliers' approach to consumers – for instance in terms of whether they treat consumers who use DCTs differently to those who do not?

The widespread use of "narrow" MFNs, which have spread in the aftermath of the PMI market investigation, prevents suppliers from offering greater value to existing customers or those customers who approach them through direct channels. In effect, the need to price products the same whether consumers approach direct or through a PCW (which requires AAISL to incur a CPA fee) means that direct customers cross-subsidise those who use PCWs. This prevents AAISL from passing on the benefit of lower prices to direct customers who have a strong affinity to the AA brand, are typically lower risk and who have a lower cost of acquisition.

Theme 3: Competition between DCTs

10. In what ways do DCTs compete with each other – for instance in terms of coverage, the savings consumers can make, the services they provide, their ease of use, transparency and how they protect consumers' data?

As noted in the introduction, AAISL's experience is that competition between PCWs is limited. The existence of "network effects" means there is little incentive on the part of the big four to compete with each other on price (i.e. CPA fees and promotional activity, which would lead to lower prices for consumers). Instead competition takes place predominately on the basis of high profile/costly marketing campaigns to attract consumers to their sites, leading to excess advertising expenditure.

AAISL welcomed the PMI Order prohibiting the use of 'wide' MFN clauses which were identified by the CMA as a barrier to competition by reducing incentives for PCWs to lower commission rates and engage in promotional activity in order to attract providers. However, the PMI Order only applies to the PMI market and does not cover other products, such as HI. Moreover:

- AAISL's experience is that the prohibition on wide MFNs has not in itself driven greater competition between PCWs (including on CPA fees). In fact, AAISL has seen a continuing increase in the CPA fees charged by PCWs (and, in some cases, are above £["] – particularly for more specialist cover);
- At the same time, AAISL has seen the use of 'narrow' MFNs increase substantially (which AAISL previously sought to resist). This leads to perverse incentives as AAISL is required to ensure that its direct price is no cheaper than the most expensive price for the equivalent product on any PCW even if its cost of acquisition is lower, meaning that AAISL's direct customers cross-subsidise those who use PCWs. It also reduces AAISL's incentives (and that of other suppliers) to invest in and develop its own direct channel, in order to compete with the PCW channel. AAISL would therefore welcome a full review of the impact (and spread) of narrow MFNs, which it does not believe are essential for the PCW business model and which contribute towards the lack of competition between PCWs and a lack of intra-brand competition (on both price and non-price factors) between suppliers and PCWs.

11. **What factors influence how effectively DCTs can compete – for example, whether they can secure the necessary consumer data, supplier information or other data?**
12. **If there are barriers to competition between DCTs, how significant are these and how can they be overcome?**

There are significant barriers to competition between DCTs, including:

- the significant marketing investment required to become one of the 'top 4' PCWs;
- regulatory consents and approvals;
- the need to agree a significant number of contractual relationships with suppliers; and
- the significant investment required to develop the required IT systems.

These barriers to entry hinder innovative DCTs (particularly PCWs) entering the market which may offer a greater range of results or provide more information on product features, quality or value.

Theme 4: The regulatory environment

13. **Are there any areas of regulation or self-regulation applying to DCTs that lack clarity, certainty, consistency, or enforcement?**

As the UKRN report into PCWs shows, there is currently a 'patchwork' of regulation of DCTs by different sector regulators. For example, Ofcom and Ofgem run separate voluntary code/accreditation schemes for PCWs in their respective sectors. AAISL notes that Ofgem's code in particular provides good levels of transparency for consumers, and in particular:

- where consumers search by price, rankings must be presented as best price;
- whilst commissions can be taken from suppliers, this must not influence the information to consumers and PCWs must clearly identify suppliers with whom a commission arrangement is in place; and
- supplier advertising must not be on the home page or comparison pages.

AAISL believes that a uniform approach (for example, through a mandatory code of conduct with accreditation for PCWs) would help to increase transparency, trust and consumer outcomes when using DCTs.

The FCA has recently published rules and guidance for PCWs in the high-cost short-term credit market and AAISL believes that similar principles could assist with PCWs operating in other areas of financial services. In the area of insurance add-ons, it is also evident in the market that there has been inconsistent application by DCTs of the guidance provided on insurance add-ons from the FCA's market study.

Changes to the FCA Handbook will shortly require greater transparency from insurers and customer prompts on searching for a better deal.¹² These principles could be equally applied to DCTs to improve outcomes for consumers. Where DCTs do not show the whole market or

¹² FCA, *Policy Statement PS16/21*, August 2016

the best deal, a similar prompt for consumers in these circumstances would increase consumer understanding of the service actually being provided by DCTs and help them to access better deals.

14. Do there appear to be any areas where DCTs may not be meeting competition or consumer protection requirements?

As noted above, AAISL considers that narrow MFNs have an adverse effect on competition and we would encourage the CMA to undertake a more detailed analysis as part of its study.

["].

There are also other examples of practices which AAISL would not expect to see in a well-functioning market (caused by a significant imbalance in bargaining power between PCWs and suppliers). In addition to the examples cited in the Introduction (including the transfer of risk/liability and threats to delist), AAISL is aware that some PCWs charge for "click-throughs" even if no product is purchased from a consumer, and some PCWs pre-populate customers' data in order to increase quote completion rates, and when such pre-populated data is incorrect it could invalidate a claim. We would encourage the CMA to consider this as part of its study.

15. Do any aspects of regulatory approaches to DCTs need to change and, if so, why?

We would encourage the CMA to consider a cross-sector approach to developing a code for DCTs which would address the issues above. To maximise consumer benefit, a binding code could focus on (amongst other things) improving:

- transparency for consumers on whether a PCW is offering a "whole market view";
- transparency for consumers on how PCWs' results are ranked or displayed;
- clarity for consumers on how individual PCWs are funded; and
- information on product features allowing customers to select appropriate products for their needs and secure best value; and

In addition, AAISL believes that the CMA should consider reviewing:

- the operation of wide MFNs outside of the PMI market; and
- the effect of the proliferation of narrow MFNs in the PMI and HI markets on competition.

ANNEX 1

"AVOID THE CAR COVER RIP-OFF" PUBLISHED BY WHICH? IN SEPTEMBER 2015