

**LLOYDS
BANKING
GROUP**



LLOYDS BANKING GROUP PLC
CMA DIGITAL COMPARISON TOOLS MARKET STUDY
Response to Statement of Scope

24 OCTOBER 2016

1. SUMMARY AND INTRODUCTION

DCTS HAVE DELIVERED HUGE BENEFITS TO CUSTOMERS

1. Since their creation, DCTs have rapidly increased in popularity among, and delivered significant benefits for, customers. Generally they have been a positive influence on customer engagement, and consequently competition between product providers across a range of markets. The number and reach of DCTs across many product markets means that customers can now, with little effort, research products and prices from a wide range of suppliers in the relevant product markets listed.
2. But within this positive overall assessment, there are some known issues in the DCT market as it matures and continues to grow. These are relatively well-understood and have been considered as part of recent competition and regulatory investigations by sector regulators and the CMA in market inquiries. DCTs do not represent a silver bullet solution to identified competition issues in all of the relevant product markets, but have an important role to play. For example, the CMA found that competition between private motor insurers was strong and that DCTs had increased competition;¹ and the CMA has concluded in markets such as personal current accounts that increasing the use of DCTs and the functionality they offer is critical for improving competition and comparison.²
3. Overall, we agree with the CMA's choice of four themes to be covered as part of this market study. But we believe it will be sensible for the CMA to put the main focus on competition between DCTs. This should include how DCTs compete on commission rates and any impact that customer awareness might have on the functioning of competition between DCTs. Secondly, where there are known issues regarding how DCTs affect competition between suppliers, those should be covered as part of the investigation. Beyond these areas, assessing and monitoring the impact of DCTs in the relevant product markets is best dealt with by the relevant sector regulators.

WE BELIEVE THE MARKET STUDY WILL BE MOST EFFECTIVE IF FOCUSED ON SIX KEY QUESTIONS

4. At this early stage of the DCT market study, the CMA has set out the likely areas of interest and focus for the study. These cover a relatively broad set of issues, and wide range of product markets. This response sets out what we believe will be the six key questions for the CMA to consider through the study. These specific questions go to the heart of the themes set out in the Statement of Scope, and we believe answering these questions will enable the CMA to deliver the biggest impact for customers through its investigation. The CMA's Statement of Scope also contains sixteen questions; we provide responses to the CMA's questions as an Annex to this document.

¹ CMA, Private motor insurance market investigation: Final report, September 2014.

² CMA, Retail banking market investigation: Final report, August 2016.

- (a) **Question 1: Does competition on DCTs' commission rates work as effectively as it could?** The ability of DCTs to introduce 'most favoured nation' (MFN) clauses in their commercial agreements with suppliers, could significantly impact competition between DCTs and between DCTs and other forms of distribution. The impact of MFN clauses on competition between DCTs has a long history in the competition and regulatory literature, and has been investigated by the CMA in the context of the private motor insurance market.³ We understand the justifications typically used to support the use of MFNs; specifically that these clauses can be used to support DCT business models in immature markets, or to support new entrants in more mature markets. Given MFNs constrain competition between competing distribution channels and restrict price differentiation, we do not consider these justifications outweigh the associated economic costs in mature 'retail' markets.⁴ MFNs should only be permitted where used by DCTs with a small share of total distribution. We believe that larger DCTs can survive without MFNs, by competing on price with direct channels or adopting other business models, such as "consumer subscription" or "supplier fixed fee" arrangements.
- (b) **Question 2: are customers aware of DCTs' commercial models, and what influence does this have on competition between DCTs, customer outcomes and decision-making?** DCTs started out as 'pure' comparison tools, covering the whole of the market, and operating as consumer advocates without commission. Today, the market has evolved such that DCTs operate much more like 'retailers': offering a narrower range of products, including exclusive promotional offers and supported by commercial relationships. DCTs do not always cover the entire market, contrary to promises in their advertising and branding, and customers are not always aware of these factors, or the differentiation between DCTs. This can have an important impact on customers' search behaviour. If customers expect little differentiation between DCTs (e.g. if they expect all DCTs to cover the whole market), they are less likely to shop around between DCTs, reducing competition between them.

The market study should investigate both the commercial relationships that exist between DCTs and product suppliers (such as commissions, decisions on listing and delisting of products and the impact on the available range of DCTs); as well as the degree of customer understanding of these issues and the scale of the potential resulting detriment to customers. Trialling the best way to increase the awareness of the DCT commercial models (e.g. through different ways of showing commissions and product ranges) would also mean valuable progress is made in this investigation.

- (c) **Question 3: how can the integrity of search results be maintained?** As 'retailers', any commercial arrangement has the potential to influence how products are presented or ranked within the DCT architecture. Behavioural research suggests these factors can have a significant influence on customer decision-making. Customers are unlikely to have the time (or inclination) to learn how different DCTs approach promotional listing across different suppliers and product markets. The CMA should therefore develop a standardised approach to the treatment of promotions, apply the common standards across all DCT markets, and set out a robust monitoring and enforcement strategy.

³ CMA, Private motor insurance market investigation: Final report, September 2014.

⁴ Retailers typically operate on the basis of margins earned on wholesale prices, which differs from DCTs' revenue model based on introduction and supplier commissions. However, we believe that the model that DCTs now offer to customers can be compared to those of retailers, offering a narrower range of products (rather than whole-of-market) and exclusive promotional offers.

- (d) **Question 4: what can be put in place to enable DCTs to incorporate better non-price comparison in their rankings?** It is already in DCTs' interest to facilitate non-price comparisons, to help them differentiate their offer and provide richer information to their customers. However, customer behaviour and a lack of objective quality information limit the effectiveness of the propositions that have been developed to date. The CMA's retail banking remedies that will provide DCTs access to service metrics for PCAs are a step in the right direction. The CMA should consider what it can do to support non-price comparison in other sectors by requiring suppliers to provide objective quality data.
- (e) **Question 5: how will technology change comparison tools and business models?** DCTs are part of a rapidly changing eco-system of fintech firms that are always innovating. The CMA should ensure that it considers both the DCT business models in operation today, plus the models that are starting to emerge and can reasonably be expected to develop in the future, in particular in light of the forthcoming regulatory changes resulting from PSD II implementation. In this context, the CMA should consider whether and how the existing market is likely to evolve, and whether competition and market forces are likely to resolve any issues that may be observed today. This will help the CMA to understand where regulation is needed and the form it should take. Within this, one specific question is the extent to which Open Data implementation (APIs) needs to be consistent across all sectors.
- (f) **Question 6: could a standardised regulatory approach encourage competition, diversity and innovation?** It will be important to ensure that any regulations or other interventions following the DCT market study do not lead to unnecessary prescription and unintended consequences, stifling innovation. Where regulation is required, recent experience suggests the regulation would be better designed to be principles-based, rather than rules-based.
5. Further, the study is an important opportunity to bring regulatory consistency and clarity to DCTs. To date the regulatory approach to DCTs has been fragmented. The role that DCTs play in delivering competition has been explored by the CMA and sector regulators when this has been a relevant part of a specific product market investigation, and some sector regulators have themselves conducted thematic reviews. This has, perhaps inevitably, led to different interpretations and conclusions, and today the approach taken to DCTs across various product markets is inconsistent.
6. We believe the overarching aim of the market study should be to establish a set of principles governing how DCTs operate. These principles would then apply across all the relevant product markets, but rather than be prescriptive these would be flexible enough to allow operation in the different product markets to differ in practice, as determined by how competition operates, and how customers behave in those specific markets.

2. FURTHER COMMENTS ON THE QUESTIONS FOR THE CMA

7. At this very early stage of the market study, the potential scope of the investigation is very wide, in terms of both the themes and issues of interest and the potential product markets covered (each of which has its own regulatory history and set of live issues). We recognise that market study processes tend to start wide and narrow down relatively quickly. However in this case, given the particularly wide starting point and the volume of opinions and diversity of positions the CMA is likely to encounter (which will potentially go beyond those encountered in a study focusing on a single product market), there is a risk that this proves difficult to achieve in a logical manner.
8. This motivates our suggestion of focusing on a smaller number of key questions, and trying to achieve a unified set of principles rather than prescriptive rules and/or specific issues within any of the end-product markets, to the extent possible. We believe this will help to make the process more manageable, and that this is the best route to ensuring the CMA can deliver the most effective outcomes through its work.
9. We have product listings with all of the main DCTs in the markets in which LBG brands operate, and as such we have built working relationships with all the main DCTs over time. This means we have good insight into how the DCT business models operate today, and how the market could evolve in the near future.
10. We work in partnership with those DCTs offering our products, but we also serve customers through our direct channels, which act as a competing channel to DCTs. As both a partner and a competitor to DCTs, we are well placed to offer reasoned views on the DCT market, which we provide here and will continue to provide through the market study.

How competition between DCTs takes place

11. To aid the CMA and provide further context to our responses to the CMA's questions below, we set out a brief description of how we observe that competition between DCTs works today.
DCTs operate like 'retailers' as a 'pure' comparison tool is not economically sustainable
12. DCTs generally started out as 'pure' comparison tools, covering the whole of the market, and operating in the absence of commercial relationships with suppliers. This meant that DCTs could only generate revenue from general (i.e. not product related) advertising on their search pages.
13. DCTs have strong incentives to move away from this model because of the access they have to customers who are usually actively looking to purchase. Such customers are highly valuable to suppliers and there are significant costs for DCTs to attract these customers. DCTs will understandably seek to generate revenue from this access. This is similar to other third party distribution channels, such as brokers or financial intermediaries.
14. The market that has therefore emerged is one in which DCTs operate like 'retailers'. To generate revenues, DCTs enter into commercial arrangements with suppliers and generally earn a commission from each sale. A reliance on commercial agreements means that DCTs cannot offer whole-of-market coverage, but can sometimes offer exclusive promotional arrangements. The CMA's view in its energy market investigation was that "the role of PCWs

[is] effectively acting as brokers offering their customers good deals and facilitating switches rather than repositories of all available tariffs".⁵

Customer acquisition

15. The success of a DCT depends on its ability to attract customers. There are three main elements to how DCTs can do this:
 - a) the offer provided by the DCT to end customers. This includes the overall ease and functionality of the customer experience and customer service; the breadth of market coverage; and the specific comparison services and tools that are offered. DCTs make continued investments in their website and platform;
 - b) heavy investment in customer acquisition through marketing activity. This is focussed on advertising such as TV or newspaper advertising and paid internet search rankings. In 2014/15, Moneysupermarket spent 32% of its gross revenue on marketing, and DCTs in total spent £126m on TV and radio advertising.⁶ DCTs do not invest in physical assets to acquire customers, such as our branch network; and
 - c) the establishment of deeper relationships with customers across multiple product lines - a growing trend. For example, by agreeing with customers to provide information and options at product renewal time or when new prices or tariffs are launched.
16. Customer experience will also be determined by the price and range of products offered on the website. Price is generally set by the supplier of each product, reflecting DCTs' commission levels (which are currently very similar between the main DCTs) as well as the underlying costs of the products. Although some DCTs offer exclusive deals and promotions, it is largely through the range of products offered that DCTs would look to differentiate themselves today. However, DCTs have very similar ranges and disparities in range are very difficult to identify for customers. Only a truly diligent customer could identify gaps in coverage across different DCTs. This means that there is little to differentiate DCTs in terms of price or range from a customer's perspective.
17. As a result of successful customer acquisition by DCTs we observe that DCTs are now the dominant acquisition channel in some of the product markets. While not an issue per se, the CMA should consider whether in these markets the maturity (and penetration) of DCTs means that protections and regulation that were written in the past to support emerging DCT business models remain necessary and proportionate.
18. Further, in some product markets a single DCT supplier holds a large proportion of the relevant DCT market, and by extension a large proportion of the entire acquisition channel for that market. The standard competition concerns that arise in concentrated markets also apply in this case, and may exacerbate the concerns we raise in the rest of this document. Additionally, many customers tend to use one DCT, rather than shop around between them, which decreases the level of competition between DCTs. This is something we feel would be helpful for the CMA to consider explicitly as part of the market study.

Relationship with suppliers

19. Commercial relationships between DCTs and product suppliers are based on commission rates. Commission rates are typically set at a certain £-level/product and paid for by product suppliers out of the margin suppliers generate on a product sale.

⁵ CMA, Energy Market Investigation: Final Report, paragraph 240.

⁶ Moneysupermarket Group, Preliminary Results, 1 March 2016.

20. Commission rates are set through negotiations between suppliers and DCTs. The outcome of these negotiations will depend on the relative strength of each party's bargaining position:
- a) **DCTs:** As commission is generally only paid on completed sales, a supplier with the best offer in the market for a customer either pays a commission to the DCT or will forgo the sale. [X]
 - b) **Suppliers:** Suppliers may have a stronger position in negotiations if they have a recognisable brand. DCTs want to cover a significant share of the market including products from recognisable suppliers, as this can help the DCT to attract customers, and increase the DCT's sales. However, there are many recognisable brands that could be included within a DCT's range [X].

Question 1 - Does competition on DCTs' commission rates work as effectively as it could?

21. MFNs have a role to play to support DCT business models in immature markets, or to support new entrants in more mature markets. However, we do not consider these justifications outweigh the associated economic costs in mature 'retail' markets, given MFNs constrain competition between competing distribution channels and restrict price differentiation between DCTs. We believe that the ability of DCTs to impose narrow MFN clauses on suppliers could significantly reduce the level of competition in the market.
22. The table below shows an illustrative example of how MFNs could affect prices offered to customers for a product that costs £200 before distribution. In the example, the costs of direct sales (£30) are below the DCT's commission rate (£60). In such a situation, suppliers would usually want to lower the price offered through the direct channel to reflect the lower cost and compete with the DCT channel. However, with an MFN arrangement in place, suppliers are not free to do so. The supplier must offer the product at a price of £260 in both channels if it wants to list it on the DCT.

Table 1: Indicative example of costs and prices offered to customers under MFN arrangement.

	Sale via DCT	Sale via supplier's direct channel
Cost of product	£200	£200
Cost of direct distribution	-	£30
DCT commission	£60	-
Total cost	£260	£230
Price offered to customer with MFN arrangement	£260	£260

23. In the absence of the MFN, customers could get a better price. In this case, the supplier could lower the price offered on the direct channel to £230. The DCT could then either accept the difference in price, and the likely reduction in sales as it becomes relatively less competitive to the direct channel; reduce their commission rate to the level of direct costs (£30); or offer its own discount paid from commission revenue. Customers would be offered the same price

through both channels; but the price paid by customers would be lower than in the scenario with a MFN arrangement in place.

24. There are therefore three main effects in which MFNs restrict competition:
- a) As illustrated above, MFN clauses restrict competition between distribution channels. With a narrow MFN in place, suppliers cannot offer lower prices through their direct sales channels than the price offered via a DCT. If a supplier has a cost advantage in its direct channel, it cannot use this either to constrain DCTs' commissions and therefore final prices, or reduce its prices offered to customers. This reduces the incentive for the DCT to compete on commission rate;
 - b) MFNs inhibit competition between DCTs. A supplier may be forced to set its direct channel price in order to cover the cost of distribution with a high-commission DCT because of an MFN agreement, as in the illustration above. [X] This further reduces the incentives for DCTs to compete on commission where there is unlikely to be price differentiation between DCTs.
 - c) MFNs restrict the opportunity for different DCT business models to emerge, such as a new DCT that wanted to generate revenue from customer subscriptions and accessed product and pricing information directly from providers' direct channels (e.g. through Open Data). If there is no differentiation between the direct channel price and DCT price, then this new DCT would not be able to offer a better deal than the DCT with an MFN and so would not be sustainable.
25. For the reasons outlined above, we believe that an increase in the use of MFNs across the market could significantly reduce competition. Additionally, these effects are likely to be more pronounced, the greater the relative size or market share of an individual DCT. [X]

Question 2 - Are customers aware of DCTs' commercial models, and what influence does this have on competition between DCTs, customer outcomes and decision-making?

26. As set out, in contrast to the models used at the inception of the market, DCTs now operate more like retailers, with limited ranges, promotional offers and earning revenue on sales. For clarity, we do not think it is necessary for DCTs to move back to a pure comparison model, or that the current models themselves necessarily create any competition concerns per se. Rather, our concerns relate to whether customers understand the implications of the current business models, and whether a lack of understanding has adverse impacts on competition between DCTs and risks customers making the wrong choices.
27. Competition can work well in a 'retailer' model with DCTs competing on price, quality, range and service as in other retail sectors. However, for this to work successfully in practice this would require:
- (a) DCTs that do not portray themselves as full comparison sites;
 - (b) customers who are aware that they are not being offered full market comparisons;
 - (c) DCTs that are able to differentiate themselves on price, quality, range and service between each other and other 'retailers' including direct channels; and
 - (d) customers who are able to assess and make active choices between the different attributes of DCTs.

28. We do not believe that these conditions are yet met and so more needs to be done by DCTs and regulators to help customers get the full benefits of the retailer business model currently in operation.
29. A lack of customer understanding of DCTs' models, is also likely to affect competition between DCTs. If consumers are not aware of the model (and for example believe all DCTs cover whole-of-market and offer similar levels of service) that is likely to reduce consumers shopping around between DCTs and, consequently, the level of competition between them.
30. Customers can also constrain commission rates, and ultimately the price of the product, if they choose between DCTs on the basis of price or commission.⁷ Currently, customers do not do this and there is no incentive for DCTs to lower prices to gain more customers. This is the case for two reasons. First, customers do not know what the relative commission rates are and so do not know if they are getting a good deal from a DCT. Second, even if customers did know, the differential between commission rates is unlikely to be sufficient to materially impact the total price to the customer.
31. To address these issues and improve customer awareness and understanding, the CMA should consider as part of the market study how the following could help:
 - (a) clearer advertising, marketing and branding of DCTs and the services they provide, and do not provide, to help change customer perceptions of the sector; and
 - (b) clearer signalling of the range offered and how DCTs make money, including the commission rates earned from suppliers.
32. It is not possible to say what the best way of delivering these changes is as they will depend on what works for customers – this could be by revealing commission rates, notifications on websites, or through advertising. These changes should therefore be tested and trialled so that any intervention is effective and helps customers assess what is on offer. And as we noted throughout the CMA's retail banking investigation, where customer behaviour needs to be better understood this process needs to start early in the diagnosis phase of the work. Further, the customer research cannot only involve asking customers through surveys or other traditional market research methods, but must also involve behavioural research.
33. Finally, we observe that there is a trend in the DCT market towards DCTs seeking to establish deeper relationships with customers across multiple product lines. While this can be helpful for customers, there are two issues to consider:
 - (a) behavioural insights suggests that customer brand perception, and the context in which decisions are made have an important influence on customer decision-making. If DCTs are successful in creating these wider customer relationships, the risks associated with the issues set out will be magnified; and
 - (b) in particular, one objective for creating these wider customer relationships may be to serve customers in multiple product markets, or to otherwise expand the services offered beyond the product market that initiated the customer relationship. The CMA may therefore also wish to consider the role that cross-sales may play an increasing part in DCT business models, and what principles should govern DCT activity.

⁷ For example, in the private motor insurance investigation, the CMA found that 'multi-homing rates could be higher if it were generally known that shopping around on different PCWs yielded lower prices'. CMA, Private motor insurance market investigation: Final report, September 2014.

Question 3 - How can the integrity of search results be maintained?

34. One of the main services that customers want from DCTs is the ability to find the best deal. However, there is always a potential tension for a comparison tool or retailer to offer the most profitable product, rather than what is best for the customer. In DCTs and other search engines, there are well known problems of promoting certain results because they are advertisements, paid-for listings or carry higher margins or commissions. It is important if results are promoted that this is clearly signalled, that customers are clear about this, and critically that behavioural insights are not used to make the distinction ambiguous, which would be against the spirit of the existing rules and requirements placed on DCTs.
35. Customers are unlikely to have the time to learn how different DCTs indicate these promotional listings across different product markets, and this is therefore an area where the CMA (and sector regulators) can help to ensure there are standard rules and guidance for how promotional listings are shown alongside objective search results.
36. In addition to promotional listings themselves and the degree to which customers understand and can rely on these, there are two related issues that the CMA can helpfully consider.
37. First, DCT sites are structured around particular products that a customer must pre-select, and within this there are often particular behavioural profiles that a customer must opt into e.g. the size of loan required, or whether they want a credit card primarily to make a balance transfer or to receive rewards on their spending. It is not clear that customers fully understand the impact that these choices have on the search results they observe, or that their resulting behaviour once the product is taken out can influence which products would have been the best ones for them ex-post.
38. Second, hidden assumptions are made by DCTs in order to create the rankings shown. This can impact customer decisions and ultimately customer outcomes. In addition, there are important indirect effects that shape how competition works in the market, given suppliers are more likely to compete across the dimensions that maximise their chances of reaching the top rankings based on the default assumptions. For example:
 - (a) credit card balance transfer products typically assume a £3,200 balance being transferred and repaid at £100 per month. This may create a priming effect that influences how customers choose and interact with their card;
 - (b) search results can be tailored to create rankings based on different criteria, and will involve a default ranking. On some DCT sites for credit cards the default is based on length of balance transfer offer. This has created competition over the length of balance transfers on offer, which may not be optimal for customers; and
 - (c) some DCTs offer the ability to rank based on the chances of passing a supplier's eligibility requirements. There are different interpretations of affordability in credit decisions or appetite for risk, which may mean offers may not be presented on a level playing field (i.e. the eligibility score may not be consistent with reality if all information was collected and used). Again, this may not be in a customer's best interests.

Question 4 - What can be put in place to enable DCTs to incorporate better non-price comparison in their rankings?

39. The focus of the CMA's work should largely be on competition between DCTs. However, the CMA should look at how it can assist non-price factors and avoid the 'hollowing out' of

products. We believe it is already in DCTs' interests to facilitate non-price comparisons, but we recognise that this is not easy.

40. Customer behaviour and a lack of objective quality information are particular problems. For example, DCTs do increasingly display non-price factors, such as quality metrics. However, they are not used consistently across DCTs or products within a single DCT, and could be improved to increase consumer understanding and trust in them. For example, where and how quality metrics are shown varies (e.g. [x] displays quality metrics in rankings for home insurance but not for car insurance).

The CMA's remedies to give access to service metrics for PCAs and SME banking are a step in the right direction. The CMA should consider what it can do support non-price comparison in other sectors. For example, this could include information on general quality of service and the level of complaints across products; and for insurance products in particular could include better information for customers on exclusions and payout times.

ANNEX – RESPONSES TO THE CMA’S QUESTIONS

THEME 1: CONSUMERS’ PERCEPTIONS, USE AND EXPERIENCE OF DCTS

1. When and why do consumers use DCTs? To what extent do they trust them?

- 1.1 DCTs have generated huge benefits to customers from being able to access and assess products and prices from a wide range of suppliers more quickly and with less hassle. Consumers have free access to the comparison tools as well as broader information on products that DCTs cover (for example guides and discussion forums). They offer a time efficient way to search for products and generally provide an easy and consumer friendly user experience.
- 1.2 In financial services, customers tend to use DCTs in those markets where these benefits are greater:
 - a) Home and motor insurance have high levels of DCT usage. Customers need to input a relatively large amount of information to access a quote. Using a DCT, they only need do this once to access quotes from many suppliers. They can then purchase from their chosen supplier without needing to re-enter the information. As repeat purchase products, customers have learned to use DCTs over the last 15 years and usage has grown.
 - b) Credit cards also have high levels of DCT usage for slightly different reasons. There are a range of different features to the product (e.g. balance transfer periods, cashback, interest rates) that may be of interest to different groups of customers. These can also change regularly with new product launches. Customers can quickly get an overview of the market and the best offers available depending on what they are looking for.
 - c) PCAs have low levels of DCT usage. This is because DCTs are unable to give customers accurate comparisons of either price or quality. Price depends on the exact pattern of customer usage and the different multi-price tariffs offered by suppliers. Quality depends on attributes of the product and service that are difficult to measure. This is why providing DCTs, and other third parties, with this information was a central remedy in the CMA’s retail banking investigation. With comparison of price and quality made quick and easy through the use of Open Data, we expect DCT usage in the PCA market to grow in future.
- 1.3 Consumers’ behaviours and their use of DCTs suggest that they trust DCTs. Consumers routinely provide their personal data and information to DCTs, use DCTs’ results and rankings to inform their choice and act on the comparison results, either through purchasing through a DCT or through buying products directly with suppliers informed by the DCTs’ search results.
- 1.4 A certain level of customer trust is critical for the functioning of the market. However, there is also a risk that customers’ perception of DCTs does not accurately reflect the DCTs’ business models, which rely on generating revenue from suppliers, and that customers do not fully understand those tools when using them.
- 1.5 Examples of where transparency and consumer understanding should be improved are described in our answer to question 4.

2. How do consumers choose which and how many DCTs to use?

- 2.1 We have described how customers choose which DCTs to use in paragraphs 15 to 16 and repeat these points below.
- 2.2 The success of a DCT depends on its ability to attract customers. There are three main elements to how DCTs attract customers:
- a) the offer provided by the DCT to end customers. This includes the overall ease and functionality of the customer experience and customer service; the breadth of market coverage; and the specific comparison services and tools that are offered. DCTs make continued investments in their website and platform;
 - b) DCTs also invest heavily in customer acquisition through marketing activity. This is focussed on advertising such as TV or newspaper advertising and paid internet search rankings. In 2014/15, Moneysupermarket spent 32% of its gross revenue on marketing, and DCTs in total spent £126m on TV and radio advertising.⁸ DCTs do not invest in physical assets to acquire customers, such as our branch network; and
 - c) there is also a trend in the DCT market towards DCTs seeking to establish deeper relationships with customers across multiple product lines. For example, by agreeing with customers to provide information and options at product renewal time or when new prices or tariffs are launched.
- 2.3 Customer experience will also be determined by the price and range of products offered on the website. Price is generally set by the supplier of each product, although some DCTs also offer exclusive deals and promotions. It is largely through the range of products offered that DCTs would look to differentiate themselves. However, DCTs have very similar ranges. This means that there is little to differentiate DCTs in terms of price or range from a customer's perspective.

3. What are consumers' expectations of DCTs – for instance in terms of market coverage and the relationships between DCTs and the suppliers they list?

- 3.1 DCTs have evolved from 'pure' comparison tools to a 'retailer' model. As 'pure' comparison tools, DCTs would offer whole-of-market coverage without commercial arrangements with suppliers. In a 'retailer' model, DCTs have commercial arrangements, and offer limited market coverage, and exclusive deals and promotions.
- 3.2 This type of 'retailer' model is something that customers experience in a range of markets, both online and in physical stores. Customers have learned how to make decisions based on incomplete market coverage and awareness of commercial relationships. Some customers have also learned that this is how DCTs operate.
- 3.3 However, in contrast to other types of retailers, many customers may believe that DCTs are still 'pure' comparison tools because of both how these businesses evolved and how they are still marketed today, including the names of some DCT companies. This means that some customers are not always fully aware of DCTs' models, or differentiation between DCTs. For example:
- d) DCTs do not always make the extent of their market coverage clear to customers. In some cases, explanations of market coverage can be difficult to find and descriptions can be ambiguous, such as messaging around finding the 'cheapest' or 'best' deal. Customers could, understandably, make assumptions that DCTs cover the whole market

⁸ Moneysupermarket Group, Preliminary Results, 1 March 2016.

of products. This could deter customers from searching more widely and may mean they purchase a product that is not fully appropriate.

- e) Similarly, DCTs' commercial arrangements are not always clearly described and in some cases can be difficult for customers to find. As above, this could skew consumers' choices. For example, consumers may choose a product portrayed at the top of a screen, failing to understand that it is not part of the results ranking but an advertisement.

3.4 The CMA should investigate the degree of customer understanding of DCTs' commercial models. If, as we expect, some customers are not clear on this, the CMA should investigate how to change customer's perceptions and behaviour, as we outline in our executive summary to this response.

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?

4.1 There are significant benefits to customers from using DCTs, as they provide a user friendly and time effective way to access and assess products from a large range of product suppliers.

4.2 However, as set out in section 2, the CMA should consider the following to improve how customers can benefit from using DCTs:

- a) To increase customers' awareness of DCT's commercial model and how to differentiate between DCTs, the CMA should to consider as part of the market study how the following could help:
 - i) clearer advertising, marketing and branding of DCTs and the services they provide, and do not provide, to help change customer perceptions of the sector; and
 - ii) clearer signalling of the range offered and how DCTs make money, including the commission rates earned from suppliers.

It is not possible to say what the best way of delivering these changes as they will depend on what works for customers – this could be by revealing commission rates, notifications on websites, or through advertising. These changes should therefore be tested and trialled so that any intervention is effective and helps customers assess what is on offer.

- b) To ensure there are standard rules and guidance to maintain the integrity of search results. This should consider:
 - i) guidance for how promotional listings are shown alongside objective search results;
 - ii) whether customers fully understand the impact that search choices or defaults (e.g. size of loan or balance transfer period) have on the results they observe, or that their resulting behaviour once the product is taken out can influence which products would have been the best ones for them ex-post.
 - iii) the impact that the use of hidden assumptions made by DCTs (e.g. credit repayment profiles, or eligibility algorithms) have on product selection and suppliers.
- c) To help DCTs with the provision of standardised objective quality data that can be used to provide personalised quality comparison, as the CMA has done in its remedies for PCAs and SME banking.

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?

5.1 Customers will purchase financial services products in their preferred channel. We compete through our direct channels to offer customers a full range of financial services products. However, in some product markets a large number of customers prefer to use DCTs. [X]

Ensuring quality of service and brand reputation

5.2 We will only choose to work with a DCT if they offer a high level of customer service and have a good reputation. The DCT is responsible for the first contact we have with a new customer and it is important that this experience reflects our own standards and brand. This means that we expect it to maintain the integrity of search results and to avoid misleading customers about their product choice.

Opportunity to increase sales volumes

5.3 [X]

Table 2: Share of sales through DCTs

Product	Share of digital sales	Share of total market	Share of LBG sales
Motor insurance	[X]	[X]	[X]
Home insurance	[X]	[X]	[X]
Credit cards	[X]	[X]	[X]
Loans	[X]	[X]	[X]
PCA	[X]	[X]	[X]
Cash ISA	[X]	[X]	[X]

Source: [x]

5.4 [X] DCTs are popular with customers, such as cards, home and motor. We are not aware of any suppliers that are not present on DCTs in these markets, even if they use different brands in their direct and DCT channels.

5.5 [X] This includes Money Supermarket, Compare the Market, Uswitch and Confused in motor and home insurance, and Money Supermarket in credit cards. These DCTs have achieved this scale by developing a strong brand, and by regularly demonstrating to customers that they will save time and money in an efficient manner. There are three core elements to achieve this:

- a) a large marketing budget to drive traffic to the DCT;
- b) continued investment in the website and platform; and
- c) commercials in place with many suppliers to ensure tables are representative of the market.

5.6 [X]

Profitable commercial terms

- 5.7 DCTs can be an efficient and profitable distribution channel. Customers to DCTs are usually actively looking to purchase a specific product. Search tools mean that customers for whom we offer the best value can identify our products more quickly. And the nature of the commercial arrangements means that the cost to a supplier is based on actual sales. This compares with other acquisition investments (such as marketing direct channels) which may not be targeted at the right customers and where there is no direct link between the investment and sales volumes.
- 5.8 Despite these features, the attractiveness of a DCT will depend on the commercial terms that can be agreed. The commission per sale must be recovered in the price we charge and so will either result in a higher, less competitive price or a lower return per sale. This is what we would expect in a normal commercial arrangement.
- 5.9 However, we are concerned with the use of 'narrow' MFNs. As explained in our introduction, competition over commission levels negotiated with end-suppliers is weak and the continued existence of (and regulatory support for) MFN clauses in commercial contracts means suppliers cannot compete with DCTs on price through their direct channels. This ultimately weakens competition overall, and acts as a disincentive to investment in direct distribution channels – the costs of which are ultimately borne by customers.

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

- 6.1 DCTs have had a hugely beneficial impact for customers in some product markets by reducing the time and hassle to access and compare different offers, as explained in the response to Question 4. DCTs have also clearly changed how suppliers enter and expand in a market and engage with customers. However, it is not clear if DCTs have actually made it easier to enter, expand or engage. To answer these questions would require extensive evidence over time and across sectors looking at relative costs of acquisition, cost of entry, and modelling alternative scenarios in which DCTs do not exist. We do not believe that the CMA should use its limited resources in this investigation to try to answer these questions and should instead focus on looking at competition between DCTs and at the known issues.
- 6.2 In the absence of DCTs, suppliers would instead invest in alternative distribution channels and marketing, such as TV or newspaper advertising, paid or unpaid internet search rankings or through a retail network (such as Swinton). DCTs may have both a lower average cost than these other channels and allow suppliers to 'pay-per-acquisition' making any acquisition investment more scalable. If this is the case, then it may mean DCTs make it easier:
- a) to enter by reducing the minimum efficient scale to operate in a product market; and
 - b) to attract more customers for a given level of investment.
- 6.3 However, the significance of any impact on entry and expansion will depend on how much higher acquisition costs would be in the absence of DCTs. These factors may also be different in each product market. This is something that the CMA would need to investigate by looking at relative acquisition costs and other costs of entry for suppliers in each of the product markets.

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

- 7.1 Competition in the in-scope financial services markets is strong. This has been enhanced by DCTs that make it easier and quicker for customers to find the products and prices of different suppliers in each product market. Customers are able to compare more suppliers and can compare suppliers that they may not otherwise have come across. This has intensified competition in each of the product markets where DCTs are used extensively as is widely recognised.
- 7.2 The extent of any impacts on price, quality and range will depend on each product market and would require a full investigation of how competition takes place in those markets. We do not believe the CMA should use its limited resources to conduct such an investigation. Instead, it should look at competition between DCTs and seek to address known issues, as set out in the six questions in our introduction.
- 7.3 We believe there are specific issues in relation to the 'hollowing-out' of offers i.e. an increased price focus, to the detriment of quality, and in ensuring the integrity of search results is not compromised by the existence of commercial offers. These issues should be investigated as part of the market study.

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

- 8.1 We do not believe there is a need for DCTs to increase competition between suppliers further, or any barriers to doing so where DCTs are already extensively used. More generally, we think

the scope of the market study will be most effective if restricted to concentrating on how competition works in the DCT market (i.e. between DCTs), as opposed to how competition works in each of the product markets where products are listed on DCTs. These are markets with sector regulators, who in many cases are currently, or have recently, investigated how competition is working in these markets.

8.2 In relation to the role of DCTs within product markets, there are a number of actions that can be taken to help the development of DCTs in other product areas. DCTs generally have a positive impact for customers, and furthering the use of DCTs in new areas will be helpful.

8.3 The CMA's approach to DCTs in the retail banking markets is an example of how a regulator can support the emergence of DCTs where they do not currently exist:

- a) In both PCA and BCA markets, it is very difficult for customers to obtain the information required from the customer about their account usage. This is one of the reasons why usage of DCTs in this market is so low. The CMA has therefore introduced a remedy by which suppliers must make available customers' transaction histories as Open Data. Using APIs, DCTs will for the first time be able to give customers a complete and personalised price comparison based on actual data with minimal hassle for the customer.
- b) The CMA has supported a 'challenge prize' launched by the independent charity Nesta to identify possible solutions to the problem of limited access by SMEs to information on banking services. The CMA believed this remedy was likely to facilitate innovative and commercially sustainable solutions to help with customer comparison in SME banking and should encourage new suppliers to enter the market, without precluding an ongoing role for existing providers of comparison services. This approach will stimulate the development of comparison services and other advisory services for SME banking.
- c) The CMA is requiring suppliers to cooperate in the production of publicly available and standardised customer satisfaction metrics. It will also require PCA providers to make publicly available information on service quality metrics. It is also requiring providers to make available tariff features and other information, such as branch locations via Open Data. These metrics will then be available for DCTs to develop non-price comparison tools for customers.

8.4 However, while this is a helpful reference point, the CMA will recognise that reaching the specific conclusions referenced above in the PCA and BCA markets followed an extensive investigation spanning a number of years. The solutions in one product market are not necessarily the right solutions for another. Instead, the competition between suppliers should be investigated in the context of each particular product market, with solutions (involving DCTs or otherwise) developed accordingly on a case by case basis. This again supports the position that the CMA's role in this market study can helpfully come up with principles for DCT regulation, but should avoid developing a prescriptive set of rules to apply across multiple product markets.

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?

9.1 We aim to be the best bank for customers, regardless of the route through which customers take out our products. Naturally, there will be differences in the customer experience whether customers use a DCT or a direct channel. For example, the customer journey through DCTs

would be similar to the journey through our direct digital channel, customers using branch or telephony channels will have a different experience.

- 9.2 Importantly, we do not engage in any activity to 'hollow-out' product features or service to offer a lower price specifically for the DCT channel.
- 9.3 We have not changed our approach to customers because of the creation of the DCT market.

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?

- 10.1 We have set out in section 1 and 2 our views on how existing DCT business models operate, and how competition at the DCT-level works in practice. DCTs must attract customers to their site, typically through marketing spend, add value to customers by providing meaningful search results, and ultimately convince customers to switch or purchase products through their site. Equally, DCTs must maintain arrangements with suppliers to ensure they offer good market coverage, and have the confidence of customers.
- 10.2 DCTs will compete with one another across all of these areas, competing to:
 - a) create the most recognisable brand (often through TV advertising) to drive traffic to their site;
 - b) offer the best market coverage, the most intuitive customer-interfaces, the most tailored search results, other useful services (e.g. soft credit search) etc.;
 - c) maximise customer click-through, and more generally there will be commercial incentives to deliver revenue. This could be achieved for example through customers choosing paid-advertising, or suppliers that pay the highest rate of commission (although there are relevant protections for customers in the form of regulations and consumer protection legislation); and
 - d) more generally achieve the most favourable commissions with suppliers. This can involve exclusive promotional offers.
- 10.3 DCTs do not generally compete on product prices offered to the end customers. Prices are generally set by the supplier of each product, reflecting DCTs' commission levels (which are currently very similar between the main DCTs as well as the costs of the products. Although some DCTs offer exclusive deals and promotions, it is largely through the range of products offered that DCTs would look to differentiate themselves today.
- 10.4 In practice, we observe differentiation in the offer that DCTs provide to customers:
 - a) market coverage differs across DCTs in terms of the specific suppliers and the share of available products covered;
 - b) most DCTs offer a broad coverage of products. However, some have a stronger focus on specific product areas in their branding, and some of the larger DCTs tend to have particularly large focus and market share in specific product markets;
 - c) the service provided differs across DCTs. For example availability of certain comparison features (e.g. credit score check); additional search tools such as side-by-side

comparison of offers selected by consumers; and availability and details of non-price metrics vary between DCTs; and

- d) the user experience differs on how customer service is offered (e.g. online chat vs. helpline), how clearly the website is laid out and how easy it is to find information.

10.5 One key aspect where competition between DCTs does not appear to be working effectively is commission rates. We observe high commission rates and high volume of advertising by DCTs (including TV advertising and paid search). The CMA should test if marketing spend (as part of DCTs' revenue is excessive and if customers are getting sufficient benefit.

11. What factors influence how effectively DCTs can compete – for example, whether they can secure the necessary consumer data, supplier information or other data?

11.1 Within the context of a competition investigation, we have interpreted this question as asking whether there are any significant barriers to entry or expansion in the DCT market.

11.2 The key activities a DCT must undertake are to attract customers to their site, ensure a good range of products to choose from, and manage their site to ensure accurate comparisons can be created and tailored to customers. Attracting customers can be done primarily through advertising, which is a competitive market with no significant barriers to competition. Equally, access to the skills and assets required to develop and run a comparison site are not subject to significant barriers to entry or expansion.

11.3 In relation to access to customer information, the information required for DCTs to make effective comparisons is already relatively easily accessible and unlikely to be a barrier to competition between DCTs.

11.4 DCTs are able to access information about supplier offers and prices through public channels. Customer data is either manually inputted by the customers as part of the search activity, or in relation to credit scores is easily available to DCTs from credit score suppliers.

11.5 For financial products, there is certain information that DCTs do not have access to, for example detail on the eligibility criteria used by suppliers to make final lending decisions. However, this does not materially impact competition between DCTs as no DCT has exclusive access to such internal eligibility decision models, and nor is this necessary.

11.6 'Open Data' changes will improve access to both suppliers' and consumers' transaction data, reducing this issue in future. DCTs with the technical capability in place to access API-based information will be able to use this information to improve accuracy and personalisation of comparisons.

11.7 However, as set out in the response to Question 12, we believe there may be an issue to address in the way commercial relationships currently operate between DCTs and suppliers, which affects how DCTs can compete.

12. If there are barriers to competition between DCTs, how significant are these and how can they be overcome?

12.1 The only significant barrier to competition between DCTs we observe relates to the possibility of DCTs introducing MFN clauses in their commercial arrangements with suppliers. The arguments for and against narrow MFNs are well known in the competition literature. There is a balance between restricting competition between the direct channel and DCT, and avoiding

the potential problems of suppliers free-riding on the advertising and comparison tools offered by DCTs. We think this balance points towards allowing MFNs for DCT entrants and in product markets with low DCT shares.

- 12.2 MFNs reduce the incentive for DCTs to compete on commission rates, especially for large DCTs with more negotiation power. With such arrangements in place, DCTs have a reduced incentive to compete on commission rates, as explained in paragraph 24. This means that MFNs could ultimately increase prices that consumers pay for the products they buy either via the DCT channel or directly through product suppliers.
- 12.3 In product markets where DCTs are the largest distribution channel, and where individual DCTs have high market shares, there is no justification for MFNs. This is even more so if DCTs are not operating as 'comparison tools' but as 'retailers' with limited ranges and earning sales commissions. Such retailers should be able to compete with other channels by offering the lowest cost distribution and between each other by negotiating commercial deals with suppliers free from pricing constraints.
- 12.4 In addition, a lack of consumer understanding of DCTs' models, as outlined in our response to Questions 3 and 4, could also affect competition between DCTs. If consumers are not aware of the model (and for example believe all DCTs cover whole-of-market and offer similar levels of service) that is likely to reduce consumers shopping around between DCTs and, consequently, the level of competition between them.
- 12.5 Finally, forthcoming regulatory changes such as PSD II implementation will shortly increase the volume of information available to DCTs. However, care should be taken when interpreting this impact this will have on DCT competition. While access to increased data will arguably allow DCTs to develop new functionality and more accurate/bespoke search results, this will not increase the level of competition that takes place. There are no barriers to the information available to DCTs today, and there are unlikely to be barriers to accessing the relevant information in future.

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?

- 13.1 DCTs are subject to a wide range of rules and regulations, including sector-specific regulatory rules, and voluntary codes and schemes. To date sector regulators have taken different approaches to DCTs, and as a result the current regulatory environment is both complex and disjointed. A helpful role for the CMA to undertake as part of the market study will be to provide an overarching set of principles by which DCTs in all product markets can be regulated.
- 13.2 Our overarching submission covers the main areas of concern, which include the degree to which DCTs offer whole-of-market coverage, the prevalence (and merits of) exclusive promotional offers, and the use of advertising and behavioural designs within DCT architecture that threaten the integrity of search results and rankings.
- 13.3 The CMA should ensure that any review of existing regulations, or process through which new regulations are created, does not lead to unnecessary prescription. The competition issues in each of the product markets will be different, and these markets (and DCT roles within them) will evolve in different ways. These issues will be picked up on an ongoing basis by the relevant sector regulators. As set out above, it is important that the CMA provide oversight and create a set of principles that can apply to DCTs in general. But equally, it is important that the sector

regulators have sufficient flexibility to manage the specific issues they face (consistent with the principles).

- 13.4 Another important aim will be to avoid regulations that cause unintended consequences or stifle innovation. The recent experience in the creation of simple tariffs in the energy sector is a good example of where poorly designed regulations can have the opposite impact to that intended. This points towards involving industry participants properly in the market study process, and to behavioural testing of any potential remedies to understand what the impacts will be in practice.
- 13.5 Finally, the CMA should ensure that it not only considers DCT business models that have existed in the recent past, or exist today. Rather, the recommendations from the market study should look towards the future, ensuring the principles remain robust to new market structures and business models. To do this, the CMA should consider how the market is likely to evolve: this will help inform if regulation will be required, and if so what type of regulation is most appropriate. We set out further thoughts about how regulation may evolve in the response to Question 16.

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

- 14.1 Competition and consumer protection law cover a wide range of requirements. This specifically includes prohibitions on *'unfair commercial practices'*, and *'misleading and aggressive practices'*. When applied specifically to DCTs, this requires DCTs to clearly explain the ranking methodologies they use, the market coverage they provide, and any claims that are likely to *'cause the average consumer to take a different transactional decision'*.
- 14.2 In our view, there is insufficient transparency and low levels of consumer awareness and understanding about DCTs' business models and market coverage that would be relevant under the requirements set out above. The level of transparency and information provided varies across DCTs, and the CMA should consider if consumers could benefit from a more standardised approach. While there are existing rules and requirements, the differences in practice suggest that more could be done to monitor and enforce these requirements. For example, as the different approaches are designed to influence customer behaviour, using behavioural research and insights may be a productive area to explore.
- 14.3 Specifically, the CMA should consider if the ways in which search results are displayed by DCTs could skew consumers' decisions, and whether clearer explanations or consistent rules could help improve consumer decision making. As part of the market study, the CMA should explore if:
- a) the way DCTs rank and present search results is influencing consumer choice. For example, default settings of rankings vary across DCTs. Some DCTs use 'popularity' metrics to rank results. It is well known in the behavioural science literature that such forms of 'social proof' can have a strong influence on people's decisions, even if popularity is unlikely to be an appropriate indicator for a product choice that meets a consumer's individual needs; and
 - b) methods used by DCTs to attract attention to specific offers or promotions skew consumers choice. For example, some DCTs offer special offers or 'price cuts' without providing further information (e.g. on how long the offer lasts or the size of the discount).

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

15.1 We set out our thoughts on the regulatory approach to DCTs in the response to Question 13.

16. Finally and in relation to all the issues above, what likely developments over the next three years should we take into account and why?

16.1 DCTs are part of a rapidly changing eco-system of fintech firms that have innovated quickly to create the DCT market over recent years, and who continue to innovate at a rapid pace. The CMA should ensure that it considers both the DCT business models in operation today, plus the models that are starting to emerge and can reasonably be expected to develop in the future. These new models include those that do not rely on supplier commission to fund their activities.

16.2 In particular, in light of the forthcoming regulatory changes resulting from PSD2 implementation, the CMA should consider whether and how the existing market is likely to evolve in a world in which access to customer data is easier, the scope of the information available has increased, customer trust and engagement with digital services has increased further beyond the levels seen today, and whether this is likely to resolve any issues that may be observed. This will help the CMA to understand where regulation is needed and the form it should take. Within this, specific questions include the extent to which Open Data implementation (i.e. the approach to APIs) needs to be consistent across all sectors.