CMA DIGITAL COMPARISON TOOLS MARKET STUDY

RESPONSE OF SAGA TO THE STATEMENT OF SCOPE

I. EXECUTIVE SUMMARY

1 Saga is grateful for the opportunity to respond to the CMA's Statement of Scope and looks forward to engaging with the CMA as the Market Study progresses.

2 Saga supports the CMA's suggested approach, scope and themes. This response, however, focuses on those issues, raised by the CMA's paper, with which Saga has direct experience and which it perceives give rise to genuine competition concerns.

3 Saga interacts with DCTs in two main sectors: insurance and personal finance. Because, in both of these sectors, many of Saga's customers are accessible through only one of the big four DCTs, it considers each of those DCTs to be an unavoidable trading partner with unilateral market power. Against that background, Saga has particular concerns in the following areas:

(a) The proliferation of Wide MFNs (described in more detail below) for products which fall outside the scope of The Private Motor Insurance Market Investigation Order 2015 (the **Order**), particularly when those products are sold through the same distribution channels as private motor insurance (**PMI**). In its recent market investigation, the CMA found such Wide MFNs had led to a lack of competition between DCTs for PMI;

(b) The Order has effectively also "blessed" Narrow MFNs (again, described further below), leading to their proliferation on both PMI and non-PMI products. Amongst other things, the collective impact of multiple narrow MFNs is hampering the ability of suppliers to compete through the direct channel. Outside PMI, where DCTs now also view Wide MFNs as acceptable, the proliferation of Narrow MFNs is being felt particularly keenly;

(c) The focus of the DCTs on price leads insurance and other financial services providers to compete on price, to the exclusion of all other factors, encouraging suppliers to strip out additional features that are not presented to the customer by the DCT. This reduces the choice available and can inhibit customers' ability to find the right product, forcing them to select on price where they might otherwise prefer to weigh non-price features more heavily (and where, ultimately, the headline price may not be available to them). In turn, this has reduced competition for more bespoke or more sophisticated products;

(d) As this market power has become more established, DCTs have sought to transfer more excessive risks to suppliers. Saga has serious concerns over these risks, as they are both potentially extremely large and entirely outside of its control; and

(e) Saga has some more general concerns about the way in which DCTs are regulated, because of the lack of a level playing field which is distorting competition .

II. KEY SECTORS IN WHICH SAGA TRANSACTS WITH DCTS

4 In insurance, Saga deals with DCTs on the following lines, through its broking divisions (Saga Services, Bennetts (a motor bike specialist) and Direct Choice), as well as an underwriter (Acromas Insurance Company Limited):

(a) PMI, bike and van insurance;

(b) Home insurance; and

(c) Travel insurance.

5 For personal finance, Saga deals with DCTs through Acromas Financial Services:

(a) Credit cards;

(b) Savings;

(c) Annuities; and

(d) [CONFIDENTIAL]

III. KEY ISSUES

The proliferation of Most Favoured Nation clauses (Themes 2 and 3)

6 Since the entry into force of the Order, Saga has experienced two tangible distortionary effects in the markets in which it operates:

(a) An assumption by DCTs that Wide MFNs outside the scope of the Order (i.e. non-PMI) are enforceable under competition law. Saga considers this falls under Theme 3, as it gives rise to a distortion in competition between DCTs. Wide MFNs restrict the ability of a supplier to offer a given product more cheaply on different DCTs, thereby limiting the extent to which those DCTs compete with each other and setting a price floor across the market. They also ensure that when one DCT increases its cost-per-acquisition (**CPA**), Saga has to replicate the resulting premium increase for other DCTs which have not increased their own CPAs; and

(b) Attempts by DCTs to introduce Narrow MFNs across Saga's various business lines. Saga considers this falls under Theme 2, as it gives rise to a distortion in competition between suppliers. Narrow MFNs restrict the ability of a supplier to offer a given product more cheaply through its direct channels.

The impact of the Order on Wide MFNs

7 Saga is concerned that DCTs have interpreted the Order as effectively "blessing" Wide MFNs on non-PMI insurance lines, as well as beyond insurance. For example:

(a) [CONFIDENTIAL]

8 Further, [CONFIDENTIAL]

9 The competition harm that the CMA identified as caused by Wide MFNs in PMI is equally relevant to other products. The issues identified by the CMA in the PMI market investigation stemmed from the nature of the distribution channel, as opposed to the products themselves. This is best summarised by the extracts from the CMA's own summary, set out in the text box, below.

10 In Saga's view, the same distribution channel characteristics are also present in respect of the other products which it sells through DCTs (set out in Section II, above). Further, in an insurance context, although they are different consumer products, from a supply-side perspective there is little difference between PMI and other lines, such as home, van or bike insurance.

CMA Private Motor Insurance Market Investigation, Final Report 24 September 2014

56. *We found that there were four large PCWs; which appeared to enjoy a significant degree of market power against PMI providers because a proportion of the customers of each PCW did not shop on other PCWs. Therefore, these consumers were accessible online to PMI providers only through each specific PCW. We found that unilateral market power allowed the PCWs to negotiate effective MFN clauses. We found that entry and expansion appeared to offer a limited threat to the four large incumbent PCWs, and was made harder by MFNs."*

58. We found that wide MFN clauses soften price competition between PCWs in relation to PMI. With a wide MFN clause in place, a PCW does not face the possibility that a retail customer will find the same PMI policy more cheaply on a competing PCW. There is little incentive for a PCW facing a competitor with a wide MFN clause to seek better PMI prices for their retail consumers from insurers because that better price would be passed on to the competitor also. There is, therefore, little reward for commission fee reductions and less disincentive against raising fees.

59. We found that the softening of price competition between PCWs regarding their services to PMI providers due to wide MFN clauses was likely to lead to less entry, less innovation and higher commission fees, all leading to higher PMI premiums. We found that:

> *(a) The common strategy for an entrant seeking to gain a foothold in a market by offering a cheaper product was precluded by wide MFNs. We found evidence that entry had been deterred because of the difficulty of offering a differentiated product.*
>
> *(b) Innovation by PCWs, to the extent that it reduces the expected cost of supplying PMI (eg through better fraud prevention), would not be incentivised as much in the presence of wide MFNs because the lower cost of PMI provision would not be reflected in lower PMI premiums.*
>
> *(c) PMI premiums are higher with wide MFNs because it is not possible for competing PCWs to offer lower prices to gain market share. We found evidence of price reductions and commission reductions being offered by PCWs but being turned down by PMI providers because of the presence of wide MFNs in contracts with other PCWs.*

The impact of the Order on Narrow MFNs

11 Similarly, the exclusion of narrow MFNs from the Order [CONFIDENTIAL]

12 Saga has serious concerns about the impact of this change to the competitive environment. In particular, as they proliferate:

(a) The collective impact of multiple narrow MFNs is eroding the direct channel as a competitive constraint and (outside PMI), exacerbating the impact of Wide MFNs (which restrict competition between DCTs). A PMI provider is removed from being a constraint on the market as a whole as soon as it enters into its first narrow MFN with a single DCT. As a result, every DCT benefits from each Narrow MFN that is entered into across the market, regardless of whether or not it is a party to that MFN. As such, each of those Narrow MFNs blunts the constraint that the supplier can provide on the market as a whole (i.e. by preventing it from pricing below a "floor price");

(b) Narrow MFNs prevent providers from offering lower prices on their own websites (such as would allow them to reflect differences in the costs and risk profile of customers acquired through direct channels). This is a particular concern for Saga because:

(i) Its specialist providers, such as Bennetts, typically undertake a more sophisticated risk profiling exercise for new customers than a DCT. For example, understanding the performance of a customer's previous bike (whether through an existing customer relationship or enhanced due diligence) could result in a [CONFIDENTIAL]% discount on a premium, which would have to be re-inflated to comply with a Narrow MFN clause;

(ii) Saga offers a "lifetime customer journey", gathering information on its members through a variety of product offerings. This additional data allows it to price risk more efficiently directly than through DCTs; and

(iii) [CONFIDENTIAL].

(c) This has the additional consequence of chilling price competition through the DCT channel, with less incentive for suppliers to make price reductions on DCTs, because of the need to offer the same prices direct; and

(d) Narrow MFNs also have an impact on entry and innovation. Had the major insurance brokers had narrow MFNs in place with underwriters in the 1980s and 1990s, it is unlikely that DCTs would have been able to enter the market. In the same way, the existence of narrow MFNs today may be hampering the emergence or expansion of alternative channels, such as social media.

"Hollowing out" (Themes 1, 2 and 3)

13 The UKRN Report acknowledges the fact that certain products are "hollowed out" to the detriment of other factors such as quality (paragraph 6.4). It also highlights consumer frustration with their inability to personalise searches, the absence of a range of ranking options and insufficiently clear rankings (paragraph 3.11). Saga recognises and agrees with all of these concerns.

14 The European Commission's recent Preliminary Report in its e-commerce sector inquiry also recently recognised this issue, noting that it: "*may be detrimental for specialised retailers with brick and mortar shops (but also specialised online retailers) which have higher cost structures because of the additional services they provide. While price comparison tools may therefore increase sales in the short term, they may reduce incentives of specialised retailers to invest in quality and services and lead to a reduced number of retailers in the long run".* (paragraph 496)

15 As suggested by the European Commission, Saga considers there is a genuine, competition based, theory of harm to be explored here, as follows:

(a) The focus of the DCTs on price leads insurance and other financial services providers to compete on price, to the exclusion of all other factors;

(b) This has led to a progressive unbundling of products, with suppliers offering the minimum viable product, in order to ensure they can price as close as possible to the top of the listings;

(c) In turn, this has led suppliers to cease competing on non-price factors, leading to a reduction in competition for more bespoke or more sophisticated products; and

(d) Ultimately, this leads to an adverse effect on competition for "non-core" customers (i.e. those not whose requirements are not well served by the lowest-price).

16 [CONFIDENTIAL]

17 When combined with MFNs (whether Wide or Narrow), this outcome is particularly egregious. Not only are [CONFIDENTIAL]% of customers unable to secure the advertised rate on a DCT, those providers that do focus on such customers will be constrained in their pricing by any equivalent products they choose to offer on the DCT.

The excessive transfer of risk by DCTs to suppliers (Theme 4)

18 Each of the main DCTs is an unavoidable trading partner for Saga's insurance and personal finance products. A large proportion of Saga's customers only look at one DCT before purchasing a product. Indeed, as can be seen from the text box above, the CMA itself recognised that (market-wide) "*a proportion of the customers of each PCW did not shop on other PCWs. Therefore, these consumers were accessible online to PMI providers only through each specific PCW*", giving those PCWs "*unilateral market power.*"

19 As this market power has become more established, DCTs have sought to transfer more excessive risks to suppliers. Saga has serious concerns over these risks, as they are both potentially extremely large and entirely outside of its control. Such a dynamic should not occur in a well functioning market, where liability for risks should be borne by those that have control over the likelihood of them occurring (as is the case, for example, in a broker/underwriter relationship).

Regulation of DCTs more generally (Theme 4)

20 Saga supports the CMA's proposal to consider the regulatory environment in which DCTs operate. In particular:

(a) As the role of the DCT in the supply chain begins to more closely resemble that of a traditional broker, it has become more apparent that DCTs are not regulated in the same way as brokers. Accordingly, Saga encourages the CMA to consider whether the applicable regulatory landscape still represents a level playing field. In particular, given the unilateral market power held by each of the large DCTs, Saga considers they should be subject to clearer regulatory obligations and oversight in respect of customer ownership and marketing rights;

(b) Saga recognises many of the "common consumer problems" identified in paragraph 3.11 of the UKRN Report. Some of these are discussed above, in the context of hollowing out. Some, however, have regulatory implications, such as the fact that consumers rarely understand how DCTs work or generate revenue;

(c) Customers frequently assume that DCTs cover the whole of market, when in fact the number of brands shown can be very small for some categories. There is, however, no requirement on DCTs to disclose the level of market coverage in place for a product; and

(d) The current regulatory structure is insufficiently prescriptive when it comes to how a DCT should define a particular product line, for the purposes of comparison. For example, peer-to-peer lending is often included within "savings" by DCTs, despite having a very different risk profile (e.g. no capital protection or Financial Services Protection Scheme cover etc.).

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