

**LLOYDS  
BANKING  
GROUP**



**LLOYDS BANKING GROUP PLC**  
**CMA DIGITAL COMPARISON TOOLS MARKET STUDY**  
**Response to Update Paper**

24 APRIL 2017

## LLOYDS BANKING GROUP PLC

### CMA DIGITAL COMPARISON TOOLS MARKET STUDY

#### 1. SUMMARY AND INTRODUCTION

1. DCTs have done a huge amount to transform customer engagement, and have driven significant customer benefits in a range of markets, for example motor and home insurance. They could have a similar impact in other markets particularly with the advent of open data initiatives. But as the DCT business model matures, there are some legitimate questions to consider. Most importantly: **is competition between DCTs driving up quality, increasing customer engagement and driving down the cost of the intermediation provided by DCTs?**
2. As the DCT market has grown and matured there are a number of reasons why DCT costs and commissions might be expected to fall dramatically including:
  - a) entry and expansion;
  - b) increased scale (many more customers) and increased scope (many more products);
  - c) reductions in digital operating costs, particularly significant given DCTs are entirely digital businesses;
  - d) reduced marketing cost per customer as satisfied customers use DCTs for more products and return annually; and
  - e) reduced marketing acquisition costs as advertising markets allow more targeted and effective advertising spend.
3. Instead commissions have increased over the past decade and now represent, for example, around [X] of the price a customer pays for a home insurance product.
4. The CMA should investigate whether competition between DCTs is simply driving up marketing and advertising spend without driving better outcomes for customers overall. Has competition between DCTs become a costly arms race to attract customers, without benefits in terms of overall cost reduction, quality improvements, or enhancement to the search experience?
5. The CMA has noted that in 2016 the Big 5 DCTs together spent £450 million on marketing, against total 2016 revenues for the same group of around £1 billion. This marketing expenditure was found to have grown by around 12% in each year since 2013.<sup>1</sup> Similarly [X] has stated that it spent 32% of its revenues on advertising and marketing to customers in 2014/15.<sup>2</sup> To put this in context, a company like Tesco earns gross profit of around £2

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<sup>1</sup> CMA Digital comparison tools market study update paper, 2017.

<sup>2</sup> [X]

billion and spends around £115 million (6%) on advertising.<sup>3</sup> It is unclear that the growth in DCT marketing spend is benefitting customers and delivering substantially higher engagement or higher switching benefits. By way of illustration, in 2016 around 15% of electricity and gas customers switched supplier, around the same proportions that switched in 2010.<sup>4</sup>

6. There are some encouraging signs that the market will tackle these issues. Some DCTs have entered the market with new subscription-based business models, and there are new data initiatives e.g. Open Data in banking, the CMA's energy remedies and smart metering data, that should provide new opportunities and competitive pressure. Importantly, barriers to entry in the DCT market are not large, as shown by the plethora of new entrants in recent years (albeit the new entrants have not yet achieved scale).
7. However, it is helpful to consider the most plausible reasons for the outcomes we see today, what the CMA can do through the investigation, and through any remedies it can apply to accelerate this progress.
8. The single biggest issue holding back competition is the continued use of **narrow MFN clauses** in markets where DCT penetration is high and where DCTs have become a critical route to market. In these circumstances narrow MFN clauses can restrict the ability of suppliers to provide a competitive constraint through their own direct sales channels, and **suppliers have limited negotiating power to seek the removal of these clauses**. Other problems include the **lack of sufficient quality indicators, hollowing out** in product markets where customers infrequently claim (mainly insurance), and the **integrity of rankings** displayed to customers.
9. The CMA can helpfully create a **set of customer-focused principles**, covering the things that a reasonably informed customer should know and understand about the market and reflecting the current competitive conditions. These principles can vary according to the maturity and concentration of DCTs within different markets – e.g., narrow MFNs could be permitted where DCTs are entering a market, but prohibited when DCTs have (individually or collectively) significant market share. The CMA can provide direction to sector regulators that they need to promote industry-wide objective quality measures, but where these do not emerge they should be required to enforce them and let them evolve through market processes. To reduce the costs and burdens of policing this, it will be important that the direction is provided in the form of principles, not detailed rules. The CMA's own objective service metrics remedy in Retail Banking is a good example on which to expand.

### **COULD THE DCT MARKET DELIVER THE SAME BENEFITS FOR CUSTOMERS AT A MUCH LOWER COST PER CUSTOMER?**

10. The DCT market today operates in a context where the major DCTs often have significant bargaining power over product suppliers. For example, in home insurance DCTs comprise

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<sup>3</sup> Gross margin is estimated for UK & ROI based on the latest preliminary results and proportion of retail sales in the UK. Advertising expenditure estimate is available at: <http://www.campaignlive.co.uk/article/top-100-uk-advertisers-bskyb-increases-lead-p-g-bt-unilever-reduce-adspend/1289560>.

<sup>4</sup> <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-switching-statistics>

[X] of all new product sales and in motor insurance they represent [X].<sup>5</sup> Within the DCT market overall, the market share between DCTs is highly concentrated with, for example, [X]. These levels of market concentration create the potential for DCTs to raise and maintain high commission levels.

11. While the interim report comments on competition within the DCT market, the CMA has not yet fully captured the reality of how DCTs compete with one another.
12. Customers in any market incur search costs to find the right product for their needs. In general, the normal competitive process will deliver reductions in these search costs where possible, and the presence of DCTs can improve economic efficiency by lowering search costs in relation to price, quality and range of service. DCTs also add value to customers by reducing uncertainty and the potential for regret: DCTs have an incentive to make sure customers get a good outcome, as this builds trust and leads to repeat business.
13. In this way, DCTs can deliver benefits by helping customers more easily find the best products for them, and increasing the level of engagement, search, and potentially switching that takes place. However, the relevant question to consider is whether these benefits could be delivered to customers at a lower cost per customer than current levels.
14. If, in the absence of MFNs, DCTs competed more aggressively on commissions, there would be a greater pressure for them to grow the market, innovate on quality, and secure repeat business. We would also expect to see them doing this by creating new products, and delivering this at a lower cost per customer.

#### **TO BUILD CUSTOMER UNDERSTANDING, CONFIDENCE AND TRUST, A SET OF CROSS-SECTOR PRINCIPLES SHOULD BE AGREED AND ADOPTED**

15. There is much to do to increase customer understanding, confidence and trust in the DCT market. We believe the best way to deliver this through cross-sector regulation would be for the CMA to outline a **set of customer-focused principles** covering the things that a reasonably informed customer should know and understand about the market. As a starting point, we suggest that customers should have a good understanding of:
  - a) the **quality** of the products being displayed, as well as the price. Quality matters where customers cannot or infrequently observe it (e.g. insurance claims), or where averages mask what matters (e.g. broadband speed). The CMA should apply the conclusions reached in relation to Open Banking in the retail banking investigation to other DCT product markets;
  - b) the **market coverage** of the results displayed;
  - c) the basis on which the **ranking** has been produced, including that the results are unbiased, there is crystal-clear separation between 'featured' or 'promoted' products

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<sup>5</sup> Statistics available from eBenchmarkers

and the rankings themselves, and the impact of any filtering or customer-decisions used to generate the results;<sup>6</sup> and

- d) the **commercial model and incentives** of the DCT, including how it is funded, and that the actions of a DCT (e.g. re-solicitation) may not necessarily be in their best interest.
16. Sector regulators should also clearly be required to lower barriers to entry and expansion by implementing Open Data through APIs for product, pricing, and usage data. This could be done through the existing UKRN group, adopting a similar working model to the Open Banking Implementation Entity as set up following the retail banking investigation.
17. It should be possible to agree the principles within the timescales available to the CMA for the current investigation. These principles should be uncontroversial. The CMA can provide direction to sector regulators that they need to promote industry-wide objective quality measures, but where these do not emerge they should be required to enforce them (as in retail banking), and then let them evolve through market processes. This would allow DCTs to innovate and find the best way to achieve the levels of customer understanding required.
18. To reduce the costs and burdens of policing this, it will be important that the direction is provided in the form of principles, not detailed rules. It should be left to DCTs themselves to show compliance through customer testing and showing they have achieved a reasonable level of customer understanding. Compliance checks could be undertaken by the CMA and sector regulators conducting periodic mystery shopping exercises and ethnographic studies. The DCTs would be free to self-report, and to publish results themselves, as a way to minimize the degree of direct regulatory involvement.
19. Meeting these principles would deliver significant benefits in terms of customer confidence and trust in DCTs, which the CMA identifies as necessary for the DCT market to deliver benefits for customers. It would also generate greater consistency on the transparency of pricing, range and the integrity of rankings, which would help customers to compare and differentiate across DCTs. In turn, these impacts could provide additional downward pressure on the total costs being incurred, and paid for by customers.

## **THERE ARE A FURTHER SET OF SPECIFIC ISSUES THAT WOULD BENEFIT FROM FURTHER CMA ANALYSIS**

### **The impact of narrow MFNs**

20. Price competition between DCTs and direct channels provides one type of incentive to drive customer engagement across multiple DCTs. However, price competition is currently limited by narrow MFNs. As we described in our earlier submission, narrow MFNs in practice have the same impact as wide MFNs, thereby limiting the ability of direct channels to provide a competitive price constraint on DCTs, and inhibiting competition between DCTs.<sup>7</sup> Suppliers may be forced to set direct channel prices to cover the cost of distribution with a high-

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<sup>6</sup> This is an important issue given the CMA has found customers seldom reorder results that are first ranked by lowest price.

<sup>7</sup> Lloyds Banking Group Plc (10 January 2017), *CMA Digital Comparison Tools Market Study: Comments on Most Favoured Nations Clauses*

commission DCT because of a narrow MFN, and are unlikely to be willing to offer products on their direct site at prices above the level available through a DCT for reputational reasons.

21. Narrow MFNs also restrict the opportunity for different DCT business models to emerge, such as a new DCT that generates revenue from customer subscriptions, accessing product and pricing information directly from suppliers' direct channels (e.g. through Open Data).
22. With limited differentiation in range, quality or pricing it should not be surprising to see that some customers tend not to shop around with multiple DCTs. The CMA's evidence is mixed but data on actual behavior is more robust than the survey responses and the former suggests that the majority of customers do not in fact shop around between DCTs. For example, actual usage data suggests 90% of home insurance customers generated a quote using only one DCT. This is likely to be a more accurate assessment of how people are actually behaving given the tendency for survey respondents to both rationalise past behavior and be excessively optimistic about what they did and will do in future.
23. Narrow MFNs can have a place where markets are immature and DCTs are attempting to establish themselves. However, in markets where DCTs are well established, narrow MFNs are detrimental to competition and customers. Removal of these clauses, in mature DCT markets, is a crucial complement to the principles-based approach to regulation outlined above.
24. Even with the removal of narrow MFNs it is possible that the bargaining power accumulated by DCTs in some markets is sufficient for competition not to work effectively in the interests of customers. The CMA should be mindful of this possibility and seek to mitigate this risk by developing and deploying the customer-focused principles outlined above that will help stimulate customer engagement in the market.
25. If the CMA does not remove narrow MFNs in established markets, a minimum requirement should be to restrict narrow MFNs to customers that do not currently have an existing relationship with a provider's corporate group. This would ensure suppliers are able to offer their existing customers and employees better deals (reflecting lower costs of acquisition) as a reward for loyalty. Given the existing relationship between a supplier and a customer, it would make little economic sense for a narrow MFN clause with a DCT to influence the pricing that can be offered to existing customers in these circumstances. However, this is an outcome that could arise in the absence of such a restriction.

### **Commercial arrangements**

26. The CMA has identified some commercial agreements involving re-solicitation and brand bidding as an area of interest. We agree this is a topic that is worth considering further. Assessing these commercial agreements should be done through a customer lens. On this basis there is a balance to be struck: some restrictions or practices on bidding on brands and re-solicitation can be justified from a customer perspective (e.g. to avoid customer confusion, or to reduce the information burden placed on customers), but clearly there are limits beyond which such agreements would not act in the best interests of customers, given this could act to soften competition. (This may itself be one driver of the upward trend in advertising costs, given the alternative to marketing directly to customers is to acquire customers again through DCTs.)

27. A balance has been drawn in our current agreements. We note that in practice, we still see many customers using a DCT to shop around at renewal, [X].
28. We set out more detailed views in response to the CMA's specific qualitative questions on these issues.

**Integrity of rankings and hollowing out**

29. The FCA has recently changed the rules on the display of bundled insurance products. The intention was for fairer comparisons by improving the relevance and integrity of search results by ensuring more similar products were displayed. However, some DCTs initially implemented the rule in such a way that a customer who selects a feature will only be shown products that include the feature as part of the basic bundle. Products that have the feature as an add-on would not be shown.
30. This approach can lead to customers not finding the best product (or combination of products) for them, as it is possible that this may now be removed entirely from the search results shown. In this way, back-end DCT decisions around how they choose to filter results can have significant impacts, which may not be clear to customers.
31. Similarly, quality matters where customers cannot or infrequently observe outcomes (e.g. insurance claims). However, we see the hollowing out of products in these markets.
32. These are manifestations of the much wider issues described above in relation to DCT competition. As set out, the solution to these problems is for the CMA to provide direction to sector regulators that they need to promote industry-wide objective quality measures, but where these do not emerge they should be required to enforce them and then let them evolve through market processes.

## ANNEX – RESPONSES TO THE CMA’S QUESTIONS

### THEME 1: CONSUMERS

#### 1. Should we focus our attention on the consumer groups we identify in Chapter 5 and if not, what groups should we focus on?

1.1 Chapter 5 identifies four consumer groups of specific interest, where some customers may not be benefiting from DCTs as a result of their perceptions and behaviour. While these groups are helpful in describing some of the issues, the focus for the CMA should be on ensuring competition between DCTs is effective and benefits all customers, not only these groups. In addition to the four groups, we suggest one additional group to highlight some further issues. We discuss each of these groups below.

##### *Group A: non-internet users*

1.2 This group includes both consumers who may want but lack access to the internet and those who have made a conscious decision not to use it. We agree that the CMA should be interested in this group of customers.

1.3 In order to influence the behaviour of these customers, the most effective vehicle is likely to be an increase in non-digital contact with customers. A DCT salesforce using tablets and with access to open data could be available to help shoppers or customers at a range of retail locations including Post Offices, supermarkets, shopping centres etc. (or at customer properties) and use the tablet to engage customers by explaining the potential savings for them. The tablet could also be used to switch customers directly.

1.4 There is evidence that some customers value these types of interactions, and that this form of sales and customer engagement can be highly effective when guided by suitable principles. It is important that the benefit of these channels for this customer group are not lost through poor practice by some operators. The CMA should consider what it could do to facilitate these models and help to avoid any potential risks.

1.5 Further, the CMA can also consider how best to leverage the role of trusted third parties, which could include housing associations, advice charities, the ATM network etc. These trusted parties could also be highly effective at engaging non-internet customers, and thereby have an important role to play.

##### *Group B: internet users who do not shop around*

1.6 There are many reasons why customers do not shop around that are broader than the effectiveness of DCTs in the market. It should be for sector regulators to consider these issues including the materiality of such behaviour, potential impacts and any remedies. For example, the FCA has looked at these issues in the cash savings, cards and retirement income markets, and the CMA itself has investigated these issues in the PCA market.



- 1.7 In markets where DCTs are well established (such as in cards and insurance), the reasons why some customers do not shop around are likely to go beyond the role of DCTs. DCTs are widely used in these markets so any measures to encourage customers to shop around should focus on other areas in order to be most effective. Given issues we have highlighted about the nature of competition between DCTs and direct channels, there is even a risk that further increasing DCT usage within certain markets could cause customer harm in terms of higher prices and reduced choice. Within this group, it would therefore be more efficient for the CMA to focus on sectors where DCTs play a smaller role and there is scope for the increase in usage and usefulness of DCTs.
- 1.8 In other sectors where DCTs play a smaller or no role, more effective DCTs could potentially help to change customer behaviour and encourage shopping around. For example, in PCAs DCTs are not currently able to provide personalised comparisons, which may limit their usefulness for customers to a certain extent. While we understand DCTs do include PCAs in their product offering (sometimes irrespective of whether or not commission is being paid by the respective suppliers), there is potentially still scope to improve the usefulness and usage of DCTs for customers here. 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 these markets to grow further in future.

*Group C: internet users who shop around but do not use DCTs*

- 1.9 It is not necessarily the case that this type of behaviour should be a concern for the CMA. Specifically, this may not be an issue if customers are able to shop around effectively using other channels, for example, going directly to several suppliers.
- 1.10 The focus for the CMA should be where customers do not use DCTs as a result of concerns or perceptions about DCTs that inhibit their use. As identified by the CMA, lack of trust may be an issue here. Customers who lack trust in DCTs generally may not use them at all or use them more sparingly than would otherwise be the case. Generally, customers' behaviours and their use of DCTs suggest that they trust DCTs. The CMA consumer survey also indicated that customer trust in relation to a number of aspects of DCT operations is reasonably high.
- 1.11 However, as discussed in the CMA market study, there are some aspects that customers may be more concerned about. Some examples include how DCTs store and treat customers' personal information, the extent to which DCTs treat suppliers equally and lack of transparency in the rankings.
- 1.12 Transparency and customer understanding should be improved further to increase DCT usage for this group. Trialling and an empirical analysis of approaches that have been tried previously should be considered to identify the most effective measures to improve the way customers use DCTs and help increase DCT usage across markets.

*Group D: DCT users who tend to use only one DCT*

- 1.13 It is not necessary for a customer to use more than one DCT to benefit from competition. However, there needs to be a sufficient number of customers who do to ensure effective competition between DCTs. As previously noted, we believe the evidence from actual

customer behaviour suggests that the group of customers who tend to use only one DCT is large in many markets and may be of sufficient size to warrant concern around the effectiveness of competition.

- 1.14 The CMA should consider the reasons some customers do not shop around between DCTs, and the extent to which customers would be able to access and assess differences between DCTs even if they did so.

#### *NEW Group E: High churn DCT users*

- 1.15 An additional group to consider is DCT users that switch providers when it is not in their interests. Broadly speaking, it is important that those customers that do not switch regularly are prompted to consider their product and ensure they are still getting a suitable product and good value. While DCTs have an incentive to prompt customers to switch and are helpful here to a certain extent, the way commissions are paid also means they have an incentive to encourage customers to switch even if the customer is likely to switch anyway or if switching is not necessarily in the customer's interest. By resoliciting and marketing to customers before the end of a natural contract period, DCTs may be encouraging customers to switch in instances when it is not in their interest to do so.
- 1.16 For example, in the energy market, there have been concerns that some comparison and switching sites could be misleading customers over which deals provide the best value, leading them to switch to deals which may not be in the customer's best interest. Due to the way in which commissions are paid, comparison sites have an incentive to get customers to switch to providers where they earn commissions, and not to providers who have not agreed to pay commissions even if they may have a more suitable deal. They also have an incentive to get customers to switch more often, even where it could be in customers' best interest to stay with their current provider. This could inflate customers' energy bills as they may not always be getting the most suitable product at the best value when they switch.
- 1.17 Even where customers do not switch, DCTs that attempt to re-solicit customers too frequently may still create costs for customers. This can take the form of increased suspicion and eroded trust in DCTs with reduced effectiveness of DCT marketing and the behavioural nudge to engage with a market.
- 1.18 There is therefore a balance needed between re-solicitation of customers that do not switch, and avoiding over-soliciting customers about a product purchase.

## 2. In which sectors do DCTs not currently play a major role but could in principle offer substantial benefits to consumers? Why have they not become established in these sectors?

2.1 Across the financial services sector, DCTs make up a significant share of total and LBG sales in credit cards, home and motor insurance. However, in other markets, customers tend not to use DCTs.

### Table 1: [X]

2.2 DCTs play a smaller role in some product markets where customers do not currently use DCTs or use DCTs to a smaller extent compared to other markets. Financial service product markets with relatively lower DCT usage include loans, PCAs and Cash ISAs. While we understand DCTs may choose to include some of these products in their product offering (sometimes irrespective of whether or not commission is being paid by the respective suppliers), there is potentially scope to improve the usefulness and usage of DCTs for customers in these markets. Reasons for relatively low usage may lie both on the demand and supply side of the market.

- a) **Demand side.** The benefits to customers of using DCTs may be relatively limited for certain types of products for a number of reasons:
- i) **Straightforward products with easily comparable prices.** Some products (e.g. loans) are relatively straightforward with easily comparable prices so the advantages of using DCTs over other sources of comparison may be limited.
  - ii) **Products with universal prices.** For some products (e.g. Cash ISAs), prices are the same for all customers and do not depend on individual behaviour or risk. For these products, there may be relatively less value in using a DCT, rather than using other sources of comparison.
  - iii) **Products where there is good availability of alternative channels.** Broad coverage of certain markets is easily available through various channels (online, media, marketing information). For example, information on Cash ISAs is widely available (e.g. through best buy tables) across a broad range of channels. DCTs add less value here compared to markets where DCTs are a key channel and consolidated information on options is harder to find elsewhere (e.g. insurance).
- b) **Supply side.** The usage of DCTs might be limited by factors on the supply side to some extent, including decisions made by both the suppliers and DCTs:
- i) **Low lifetime values.** Suppliers may find the value of paying DCTs commissions to drive higher volumes is relatively limited for certain products. There may be several reasons for this:
    - in markets where typical customer expenditure is relatively low (e.g. Cash ISAs), there are potentially lower gains to be made from switching;
    - overall frequency of switching in a market or average length of a product contract also play a role in determining the potential value to be gained by the supplier; and

- smaller expected customer lifetimes in certain markets and resulting lower value could also be a factor limiting suppliers' incentives to pay commissions for certain products.
- ii) **Alternative channel preferences.** In the current low interest rate environment, it may not make commercial sense for suppliers to pay for DCT driven traffic in some markets if they are driving sufficient traffic through other channels. We note that some DCTs may still choose to include certain products like PCAs and Cash ISAs in their product offering, irrespective of whether or not commission is being paid by the respective suppliers. The overall impact on usage/availability of these products on DCTs will depend on DCTs' willingness to offer these products even when commissions are not being paid.
- iii) **Limited availability of DCTs offering effective comparisons:** DCTs may not (yet) have the tools needed in certain markets to give customers accurate personalised comparisons of either price or quality. This may limit the number of DCTs operating in certain markets where comparisons across suppliers are less straightforward. For example, PCA prices depend 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. With comparison of price and quality made quick and easy through the use of Open Data, we expect DCT usage in such markets to grow in future.

2.3 Table 2 below compares the reasons why each of these products may have relatively low usage of DCTs. For PCAs and loans, there is the potential to grow DCT usage but this will depend on delivering effective comparison for these products.

**Table 2: Factors limiting DCT usage in Cash ISAs, PCAs and Loans**

<b>Factors limiting DCT usage</b>	<b>Cash ISA</b>	<b>PCA</b>	<b>Loan</b>
<b>Demand side</b>			
Straightforward products with easily comparable prices	✓		✓
Products with universal prices	✓		
Products where there is good availability of alternative channels	✓		✓
<b>Supply side</b>			
Low lifetime values	✓	✓	
Alternative channel preferences	✓	✓	
Limited availability of DCTs offering effective comparisons		✓	✓

**3. How has the growing use of DCTs affected suppliers' offers to consumers who do not use DCTs in our case study sectors and more broadly? What impact have DCTs had on suppliers' ability to discriminate between active and inactive consumers? What are the implications for vulnerable consumers?**

*3a) How has the growing use of DCTs affected suppliers' offers to consumers who do not use DCTs in our case study sectors and more broadly?*

- 3.1 All of our products available through DCTs are also available through direct channels. While there is no difference in availability through DCTs or direct channels, there may be differences in the mix of products sold between the two channels in some markets. For example, the take up rate for our Premium tier insurance products is [x] through direct channels, compared to [x] through DCTs.

*3b) What impact have DCTs had on suppliers' ability to discriminate between active and inactive consumers?*

- 3.2 While we offer the same range of products to all our customers, differences in behaviour may lead to differences in the level of benefits gained by "active" and "inactive" customers. Specifically, across any relationship product, introductory pricing is used to encourage customers to switch providers across a broad range of markets. By definition, more "active" customers are more likely to take advantage of these offers across our markets while "inactive" customers are less likely to do so.
- 3.3 When a customer applies for a product through direct channels or through a DCT, we cannot tell with certainty whether the customer will be "active" or "inactive". However, on average, suppliers are aware that those customers acquired through DCTs are more likely to switch.
- 3.4 The presence of DCTs in a market increases the likelihood of customers switching more often. Competition in many of these markets is focussed on introductory offers. The presence of DCTs implies more customers are able to take advantage of these introductory offers. An increased level of switching in a market creates an environment where customers are likely to stay with a single supplier for a shorter period. This constrains suppliers' ability to offer introductory discounts and increases the competitive pressure on prices after the introductory period (as customers are more likely to switch). The FCA investigation in cash savings also describes the positive impact of DCTs on competition.
- 3.5 To the extent that the FCA acts to protect those customers that do not switch (as it has in relation to transparency and engagement for GI renewals, for example), this will also reduce the importance of defining 'active' and 'inactive' customers, and considering interventions aimed at these groups.

*3c) What are the implications for vulnerable consumers?*

- 3.6 Broadly speaking, the implications for vulnerable customers are likely to be the same as those for all other customers. However, to the extent that vulnerable customers overlap with "inactive" customers, this may increase the magnitude of the impacts described, compared to other groups. Specifically, as described in previous sections, by definition "inactive" customers may receive lower benefits compared to more active ones in markets with introductory pricing. Therefore if vulnerable customers tend to be "inactive", they are likely to receive lower benefits compared to "active" customers. Equally, actions by the CMA to reduce the costs of DCTs and re-focus DCT competition on engaging new (inactive) customers to expand the DCT market, will particularly benefit inactive customers.

- 3.7 To further understand any implications, it would first be helpful to understand the definition of vulnerability the CMA proposes to use. According to the CMA study, vulnerability may be linked to factors like age, socio-economic status, physical and/or mental disabilities. However, no clear definition is provided. In principle, the precise definition of vulnerability adopted is likely to have a significant impact on the answer to this question.
- 3.8 We would also note that broad definitions linked to demographic differences are simplistic, and may be unhelpful for considering how best to support particular subsets of customers within the market e.g. older customers may include savvy older customers who still fall within a simplistic age-based definition. Instead, focussing on the specific behaviours of interest is likely to be a more fruitful avenue for the CMA to pursue and lead to more effective interventions, where appropriate.
- 3.9 The CMA survey noted non-users of DCTs are more likely to be oldest (but also youngest) consumers, those not in employment and those on lower incomes. Across our markets, all customers benefit irrespective of whether they come through direct channels or are acquired through DCTs since we offer the same products and pricing across all channels. In addition, we have policies in place to help protect certain customer groups [X].
- 3.10 In general, the presence of DCTs in a market makes shopping around and comparing prices easier for all customers. The presence of DCTs constrains suppliers' ability to offer introductory discounts so introductory prices are likely to be smaller and there is more competition across the market. As noted above, by definition, customers who do not switch or switch less often will benefit less from introductory pricing. However, this is no different to other markets where DCTs are not present.

#### **4. What factors, if any, have we missed that may be holding back consumers from using DCTs?**

- 4.1 The factors listed by the CMA broadly cover all the key issues that we consider may be holding back consumers from using DCTs. These include:
- a) possible lack of trust in DCTs;
  - b) uncertainty around how DCTs store and treat customers' personal information;
  - c) the extent to which DCTs treat suppliers equally; and
  - d) lack of transparency in the rankings.
- 4.2 Many of these issues are likely to be particularly relevant for Group B (internet users who do not shop around) and Group C (internet users who do shop around but do not use DCTs). Both these groups include users who have easy access to DCTs but consciously choose not to use them.
- 4.3 We have discussed some of these issues and possible actions that could help in the response to Question 1. In particular, transparency and customer understanding should be improved further to increase DCT usage and address these issues. Trialling and an empirical analysis of approaches that have been tried previously should be considered to identify the most effective measures to improve the way customers use DCTs and help increase DCT usage across markets.

- 4.4 More generally, as set out in the introduction we believe defining a set of customer principles, and addressing the use of narrow MFNs in mature markets, will refocus DCT competition towards expanding the DCT market. This would help reduce any existing barriers to using DCTs, and the competitive process would help identify and deliver the most effective ways of doing this.

## 5. What, if anything, should be done about consumers' concerns about data sharing and the extent to which they feel in control?

- 5.1 The CMA study identifies some concerns on the part of some DCT users about how comparison sites use their data and the extent to which consumers may feel in control of this. The CMA review suggests room for improvement in how DCTs explain this to consumers and offer control over how their data is shared.
- 5.2 We broadly agree with the CMA's assessment. It is important for DCTs (and other companies more generally) to be transparent with customers about how they use data and what benefits customers will get from it, and to ensure they give customers clear information to allow them to make informed choices.
- 5.3 To ensure this is done on a consistent basis it is helpful to set out customer-focused cross-sector principles that consider the areas that a reasonably informed customer should know and understand about the market. These principles, which we have outlined below, broadly align with many of the themes that the CMA has already outlined including transparency, relevance and accessibility. Specifically, a customer's understanding of the market should include:
- a) the **quality** of the products being displayed, as well as the price. Quality matters where customers cannot or infrequently observe (e.g. insurance claims), or where averages mask what matters (e.g. broadband speed). The CMA should apply the conclusions reached in relation to Open Banking in the retail banking investigation to other DCT product markets;
  - b) the **market coverage** of the results displayed;
  - c) the basis on which the **ranking** has been produced, including that the results are unbiased, there is crystal-clear separation between 'featured' or 'promoted' products and the rankings themselves, and the impact of any filtering or customer-decisions used to generate the results;<sup>8</sup> and
  - d) the **commercial model and incentives** of the DCT, including how it is funded, and that the actions of a DCT (e.g. re-solicitation) may not necessarily be in their best interests.
- 5.4 Sector regulators should also clearly be required to lower barriers to entry and expansion by implementing open data through APIs for product and pricing data and usage data. This could be done through the existing UKRN group, adopting a similar working model to the Open Banking Implementation Entity as set up following the retail banking investigation.
- 5.5 We note that the issue of concerns around data sharing is particularly relevant for two groups of non-DCT users identified by the CMA: Group B (internet users who do not shop around) and Group C (internet users who do shop around but do not use DCTs). Both these groups include users who have easy access to DCTs but consciously choose not to use them.

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<sup>8</sup> This is an important issue given the CMA has found customers seldom reorder results that are first ranked by lowest price.



- 5.6 While DCTs do appear to provide customers with at least some information on how their data is handled, increasing transparency further is a critical step to help address any customer concerns around data sharing.
- 5.7 This is particularly important in the personal current account market environment. The introduction of Open Data could lead to increased customer concerns on data sharing and the extent to which they feel in control of their data. While Open Data is seen as a solution in several areas, e.g. by making price and quality data more accessible and improving the effectiveness of DCTs, this likely to be accompanied by significant customer concerns around the use of their data which need to be addressed.
- 5.8 To address customer concerns in this area, DCTs will need to build reputation and trust among customers about how they handle their data. Building reputation and trust among consumers (through increasing transparency and customer understanding) will help DCTs address both consumer concerns about data sharing, as well as other concerns that may be inhibiting the use of DCTs.

## **6. What actions, if any, are needed to improve the way consumers use DCTs – including multi-homing and using DCTs’ functionalities such as filtering and ranking?**

- 6.1 At present, customers cannot access consistent and comparable information about how search results are generated and are therefore unable to assess how DCTs differ. For example, key information customers may not have complete access to might include market coverage, relative prices, the filters applied (e.g. bundled products only), the filters available, ranking methodology, and the availability of alternative rankings to price e.g. based on metrics like quality.
- 6.2 This may lead to customers not getting the most suitable and best value products available. As comparison is difficult, and consumers themselves may not understand the importance of these factors, this allows competition to focus away from the products themselves and instead on to other dimensions like advertising.
- 6.3 To ensure customers are getting the most suitable and best value products available, the basis on which search results are presented should be made clear to customers. All DCTs should provide this information in a more transparent and consistent way to improve customer decision-making and encourage more differentiation between DCTs on the key dimensions of price, quality and range.
- 6.4 The CMA can provide direction to sector regulators that they need to promote industry-wide objective quality measures, but where these do not emerge they should be required to enforce them and let them evolve through market processes. To reduce the costs and burdens of policing this, it will be important that the direction is provided in the form of principles, not detailed rules.
- 6.5 A particular example is that of bundled and unbundled prices. As a result of the add-ons market study, the FCA required DCTs to show both bundled and unbundled prices for insurance. However, instead of making the necessary changes to achieve this, we have seen one DCT respond initially by changing its customer journey so that once a customer has expressed an interest in an add-on, only those providers who include that add-on within the core product price were shown. Other suppliers who allow customers flexibility about whether or not to take the add-on from them do not even appear as options to the customer. This type of behaviour reduces effectiveness of DCTs for customers and runs contrary to FCA’s intention of improving choice and transparency for all customers.
- 6.6 A further example of the control that DCTs have over the presentation of information is in the personal current account market. Some Halifax personal current accounts pay a monthly reward, rather than credit interest. While for a customer these may have very similar financial impacts, DCTs can choose not to include Halifax in their results for ‘high interest paying accounts’ on the basis that technically no credit interest is paid.
- 6.7 Increasing transparency will help customers understand how DCTs differ and any benefits of using more than one DCT, i.e. multi-homing. While, it is not necessary for a customer to use more than one DCT to benefit from competition, there does need to be a sufficient number of customers who do to ensure effective competition between DCTs. The CMA has presented two pieces of evidence on the number of users using only a single DCT:

- a) the CMA customer survey suggests that only 36% of recent users used only one DCT; and
  - b) the CMA's analysis of DCT data for home insurance found that almost 90% of consumers generated a quote using only one DCT.
- 6.8 We would caution that the reliability of the survey results may be biased by behavioural issues given the context in which the survey questions will have been asked, framing and other issues. Actual behavioural data tends to be more reliable than self-reported behaviour, which is vulnerable to post-rationalisation and over-optimism biases. To understand the extent to which customers are only using a single DCT, we therefore believe the focus should be on results generated from actual customer data to provide a more accurate picture.
- 6.9 However, we accept that the results from the actual data may not provide a complete picture of the market due to possible over-estimation due to data issues, and the focus of the analysis on the home insurance market, (where levels of single DCT usage may be higher than other markets given the need for more customer information to generate an insurance quote).
- 6.10 The CMA should consider the reasons some customers do not shop around between DCTs, and the extent to which customers would be able to access and assess differences between DCTs even if they did so.
- 6.11 For consumers to be able to access and assess differences between DCTs, any improvement in comparability and consistency will need to be achieved on a cross-sectoral basis and with the support of all the DCTs so that customers can compare and build familiarity across sectors. This should be done quickly with the presentation and language of key elements of comparability, including market coverage, filtering and ranking approaches, made more consistent across all DCTs.
- 6.12 These measures should then be developed further to identify which ones are most effective to improve the way customers use DCTs. Trialling and an empirical analysis of approaches that have been tried previously should be considered, however this should not delay the adoption of a more consistent approach.
- 6.13 Customers themselves may have limited interest in information on how search results are generated and the differences between DCTs, and be relatively unaware of the impacts. Designing trials and experiments to show customers the importance of these factors (and the impact of missing out) could also be helpful.
- 6.14 The use of Open Data has the potential to simplify "multi-homing" by reducing the data entry burden for complex products. If data entry can be simplified, and data "ported" across providers, then competition between DCTs and between DCTs and direct channels should be enhanced.

## THEME 2: INPUTS TO DCTS

### **7. Have we captured the range of issues that might prevent DCTs from operating effectively?**

- 7.1 For the purposes of the response to this question, we have taken “operating effectively” to mean that DCTs have sufficient information available to them so that they can compete against one another in a way that benefits customers. More generally, we believe it is an important principle that DCTs have the right information to help customers make the best decisions for themselves.
- 7.2 The CMA has outlined several potential issues in relation to credit cards and insurance markets which we discuss in further detail in our response to Question 8. Our view is that while the issues highlighted by the CMA do exist and can lead to unhelpful customer experiences, they are not the key issue. Instead the lack of access to the right service quality information is a much more important information gap that creates potentially significant detriment to customers, especially in markets such as insurance.
- 7.3 In insurance, DCTs provide customers with little or no service quality information, which is very important for how customers will experience the product. One of the biggest drivers of customer satisfaction in the market is the level of service at the point a customer makes a claim. While making a claim is a relatively uncommon experience for most customers they are generally doing so in a period of significant stress. The harm from poor service in such circumstances can as such be particularly severe. This kind of service quality information is generally unavailable and has encouraged a hollowing-out by some providers and commoditisation of the insurance market. This is one example where greater availability of non-price comparison should be encouraged.
- 7.4 The CMA’s Retail Banking investigation has remedies that seek to address the issue in the personal and business current account markets by providing customers’ perceptions of service quality as well as objective metrics of quality. The CMA should focus its attention on how it, and other sector regulators, can ensure that similar initiatives can be put in place in the other markets covered by DCTs, and particularly in those markets where non-price factors are more important.

## **8. Do the issues identified materially affect DCTs' ability to operate effectively and deliver good consumer outcomes?**

- 8.1 The CMA has identified several potential issues in relation to the information that DCTs have access to in credit cards and insurance. For insurance these include:
- a) DCT listings not reflecting a uniform policy excess and/or minimum coverage level;
  - b) no easy interface to allow DCTs to access a customers' existing policy terms to do a like-for-like comparison; and
  - c) DCTs mapping customers' responses to different suppliers systems with customers potentially ending up with different products or pricing depending on the DCT.
- 8.2 For credit cards the CMA raises several issues around customers not being able to get definitive eligibility and pricing information via DCTs.
- 8.3 We discuss these issues in more detail below. In general though and as we noted in our submission in response to the CMA's Statement of Scope, the information required for DCTs to make effective comparisons is already relatively easily accessible. We do not think any of the issues that have been highlighted by the CMA in relation to financial products are a material barrier to DCTs competing against one another.
- 8.4 That said, and as the CMA has identified, some of the gaps in information availability do have an impact on customer experience. We believe that there are challenges to resolving many of these issues that will require careful consideration. Moreover, as noted in the response to Question 7 we believe that the most significant issues for information availability are not in relation to the issues highlighted but instead centre on the lack of service quality information and the resulting pressure to hollow-out competition.

### *Credit card eligibility checks*

- 8.5 As identified by the CMA, there are currently limitations in the way that eligibility checking is done which means that customers may not get a definitive answer when searching for a new credit card. Providing definitive eligibility and pricing is clearly a benefit to customers but there are challenges to doing so that the CMA should consider as part of any response.
- 8.6 At the moment eligibility checking is often done via third parties between a DCT and a supplier. These third parties will receive a request for an eligibility check from a DCT. The third party will receive data from a credit bureau and will apply this to score cards that it has for a supplier. There are two main issues with the current system:
- a) Third parties will not normally have each supplier's score card. Instead, a third party will hold a proxy score card that is similar to but not identical. In addition, the credit bureau providing information to the third party may not be the same as the one used by a supplier. The implication is that the third party is generally only able to proxy the eligibility check of a supplier and so often cannot give a definitive answer as to whether a customer will be accepted.

- b) Each eligibility check requires data from a credit bureau and this data incurs a fee that the supplier must pay. This means that a customer searching for a product (not selecting one) incurs a cost for a supplier who wants to be listed under searches that incorporate eligibility checks.
- 8.7 The system is a mechanism that goes some way towards providing full eligibility checks, but it has drawbacks for both customers and suppliers. As we noted in our previous submission, there are different interpretations of affordability in credit decisions or appetite for risk, which may mean offers are not be presented on a level playing field. For example, the eligibility score may not be consistent with reality if all the relevant information was collected and used. That means that rankings on eligibility score may not always be in the customer's best interest.
- 8.8 Any solution to try and bring forward changes will need careful consideration. For example, mandating full eligibility checks under the current system could create a significant barrier to entry for smaller providers. They would need to pay a fee for each search by a customer which could quickly become a substantial burden. Such unintended consequences would need to be carefully thought through.

### *Insurance*

- 8.9 The CMA has identified issues around how DCTs currently capture information from customers and how this is transposed onto insurers' systems. The CMA has framed this issue as one where insurers' request slightly different information. While this is true the issue is more general – both DCTs and insurers have variation in how they categorise customers' information.
- 8.10 This is a problem not only because customers may receive a product that is not suitable for their needs but because it can also act to inhibit competition between DCTs. Even if a DCT has better range or pricing, this may not always be visible to a customer and the incentive for DCTs to compete may be diminished.
- 8.11 One solution would be to mandate standardisation across the industry. This may help to some extent, but there are risks that such an approach acts to inhibit innovation in the market and further commoditises insurance products. A supplier wanting to offer a new product or a new innovative supplier entering the market would be constrained by the standardised questions asked of customers. To avoid this it would be important that any standardisation defines a core set of questions or open data common to customers while allowing for some flexibility to layer on additional questions or information for the needs of specific DCTs or insurers.
- 8.12 More generally, and as noted in our response to Question 7, we believe the more fundamental issue in the market at the moment is around the absence of service quality information. This is a crucial aspect of the product that is being largely ignored and has a much larger impact on the outcomes customers currently receive in the market.
- 8.13 The CMA should look at how more could be done to generate the right service quality information, looking to the Retail Banking remedies and other market interventions. That

said, we would note that there are several areas where DCTs do already have non-price information that is not being used as effectively as it could be to help drive the best customer outcomes. This includes the issue of listings not accounting for minimum coverage levels which DCTs have the information to display. It also includes the way DCTs currently focus on the upfront price and neglect additional charges that a customer may incur for things such as paying by credit card or debit card and for changing or cancelling a policy.

## **9. Are current or planned initiatives sufficient to address the issues found?**

- 9.1 In terms of making information more readily available we are currently working on improving the customer experience on eligibility checks for our credit card customers. We are working to give definitive eligibility results and also expand coverage of where our eligibility checks are listed. We have, for example, recently listed on [X]. But as already outlined in the response to Question 8, providing definitive eligibility is challenging.
- 9.2 One of the issues we face is having timely data on a customer's current credit score. We may have, for example, customer data that allows us to give an eligibility result. But if this customer data is even slightly out of date there will be instances where a customer has, for example, recently become bankrupt. When a full eligibility check is then done and the most up to date data is taken from a credit bureau that customer will then be rejected.
- 9.3 More generally, as outlined in the response to Question 8, providing eligibility checks is not straightforward to do in a commercially viable way. Incurring costs to just to be listed on search results is a challenging proposition that is only worthwhile where we think there is a good chance we can convert a search result into a sale.
- 9.4 Given these types of issues we expect the work we and others are doing to improve eligibility and pricing but not to fully resolve them in the short-term so that customers always have definitive eligibility and pricing.
- 9.5 In insurance we have no specific initiatives to address the information issues the CMA has outlined. We believe the most material problem for customers is the lack of service quality information and the potential for hollowing-out by some providers that follows. That said, the solution to this issue requires an industry-wide solution so that there are ways to effectively compare quality across suppliers.



### THEME 3: COMPETITION

#### 10. What explains the strong position of a specific DCT in each of our case study sectors? What do DCTs do to grow their business in sectors where they appear to be relatively small compared to the leading DCT of the sector?

- 10.1 Given our focus on financial services, we have provided comments based on our knowledge and experience in the credit card and insurance 'case study sectors'. Within financial services, DCTs tend to offer a broad range of financial services products, including both insurance products and credit cards.
- 10.2 The relative position of DCTs in each case study sector depends on their ability to attract customers, and there are two main elements that determine their ability to do this:
- a) The primary factor is **investment in marketing** which attracts customers and creates a recognisable brand in the market. This is focussed on advertising, mainly on television but also including newspaper and paid internet search rankings. DCTs spend a significant share of their revenue on marketing. For example, for [X] this accounted for 32% of its gross revenue in 2014/15.<sup>9</sup>
  - b) The establishment of **deeper relationships with customers** across multiple product lines - a growing trend. DCTs which operate across multiple sectors can encourage customers to use their website for a wider range of sectors, for example by offering offers on additional products. This can also include contacting customers to provide information and options at product renewal time or when new prices or tariffs are launched.
- 10.3 In principle the offer provided by the DCTs to end-customers could matter. Customer experience could be affected by the price and range of products on the website. DCTs could also differentiate themselves through factors like ease and functionality of the customer experience. In practice we think these features do not play a strong role in competition between DCTs. DCTs ability to expand their market share or enter into new markets is much more strongly dependent on investment in marketing and relationships with customers.
- 10.4 Beyond financial services, we observe that DCTs tend to focus on one sector, or a grouping of similar sectors like travel and hotels. This would be consistent with competition, whereby each DCT attempts to differentiate itself from other players by targeting specific market segments. This is not an uncommon strategy and can be observed in many other markets and sectors. This could also be driven by differing regulatory regimes across sectors which make it easier to focus operations on one particular sector. It could also be linked to the important role played by marketing. If the key driver to attract customers is marketing expenditure and building a recognisable brand, then targeting a specific customer segment by building a sector-specific brand could be one possible approach. This could be the case if it were easier to build a brand around a narrower expertise and within smaller customer segments.
- 10.5 The CMA is right to consider this question, and will be best placed to form a judgement based on the information it collects through the investigation.

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<sup>9</sup> [X]

**11. What are the barriers, if any, for DCTs to enter or expand into sectors where they currently do not provide comparison services or where they are currently relatively small?**

- 11.1 At a high level, developing a DCT business requires access to IT and the algorithms required to build the search engine and site, sourcing pricing information from the relevant suppliers in the markets covered, agreeing commission levels with suppliers, and driving customers to the site – primarily through paid advertising. There are no barriers to the majority of these factors. However, at scale there may be barriers to accessing the paid television advertising required to compete with the largest incumbent DCTs.
- 11.2 Partnerships with white label providers are readily available, allowing easy access to the relevant IT technology and skills needed to build or expand an existing DCT. The ability to access screen scraping software is easily accessible, which would be access pricing and other information, which is generally public. Most suppliers (with some notable exceptions) are ready and willing to be listed on DCTs, and would be open to listing on new DCTs providing that this provides a cost-effective route to market. The more significant challenge for a new or small DCT would be the ability to build a recognisable brand, and drive traffic towards their site. In the DCT market, paid television advertising appears to be particularly important.
- 11.3 In principle, there are no barriers to accessing paid television advertising, or advertising through other channels, and advertising space is a highly competitive market. Accordingly, in principle there are no barriers to a DCT developing a brand and or expanding the traffic to its site. However, a small number of the largest DCTs represent the majority of DCT television advertising, and they have developed particularly strong brands. There is a limit to the volume of prime time television advertising available, which may be required in this market and appears to be a key part of the marketing strategies of all the largest DCTs.
- 11.4 It may therefore be the case that there are some significant advertising barriers that any DCT would need to overcome in order to compete effectively with the largest established DCT businesses. In addition, there are some other potential barriers that are worth considering. First, there is scope to improve a range of elements of DCT business models, including the transparency of their offers, and the integrity of rankings and search results. The current lack of transparency makes it difficult for customers to differentiate between DCTs (other than through brand), which limits competition and the ability of new entrants to compete and grow.
- 11.5 Second, the presence of narrow MFNs (and the reputational damage that would come from having a higher direct price) constrains suppliers' ability to negotiate lower prices with DCTs and pass this through to the customer. This again weakens competition, making it more difficult for new entrants to compete and grow.
- 11.6 Finally, one consequence of these factors is the low level of multi-homing among customers, which the CMA itself has observed in the data collected on this subject. This means customers are unlikely to spot new DCTs with better offers, should they exist. Equally, the fact that established DCTs are able to establish a deeper relationship across multiple products, and have personal details and information on when the existing products are going to expire for those customers that used their services is likely to give these established

businesses a significant advantage when these customers come to renew their products, and potentially enter the DCT market again.

## 12. What has been the impact of the removal of wide MFNs in the private motor insurance sector?

- 12.1 The CMA's market investigation into private motor insurance found adverse effects of wide MFNs on competition. Wide MFNs were consequently prohibited with the expectation that this would increase the level of competition in the sector. However, in our experience this has not had the anticipated effect as wide MFNs were commonly replaced by narrow MFNs, which largely replicate the negative impact on competition (and moreover, we have seen efforts by DCTs to remove limited carve-outs that we had previously been able to negotiate to allow us to offer lower prices direct to existing Group employees and customers).
- 12.2 Following the removal of wide MFNs, we have not seen any significant impact on the level of price competition in the general insurance sector. In particular, the levels of commissions charged by DCTs have largely been unaffected, and our pricing has not changed. The CMA itself has identified a number of conditions under which narrow MFNs may harm competition, and these conditions are met in the motor insurance sector (and the same would be true for home insurance too). In particular:
- a) **In the absence of MFNs, the direct channel is a strong competitive constraint on DCTs.** We believe this condition to hold in most financial services sectors, including the motor insurance industry. Customers perceive the direct and DCT channels as close substitutes, meaning the direct and DCT channels compete with one another. This means that the price differences across the two channels are important to customers overall.
  - b) **There is a weak competitive constraint from other DCTs.** If suppliers are unable to set lower prices on their direct websites, they are unlikely to set lower prices on other DCTs. Suppliers may not want to gain a reputation for offering higher prices in direct channels than through DCTs for the exact same products, and may also be concerned with how this may be viewed by regulators. This means providers typically offer a unique price for their product across all channels (albeit sometimes with short-term promotional offers).
  - c) **Suppliers have weak negotiating power vis-à-vis DCTs.** This is reflected in their inability to push back on narrow MFNs and commission rates which are increasing over time, or unexpected and detrimental changes to customer journeys (e.g. as referred to in the response to Question 20). This is because DCTs are an important acquisition channel for private motor insurance, accounting for around [ ] of LBG sales.
  - d) **There is a weaker negotiating constraint from suppliers that do not have narrow MFN clauses.** As we do not have insights into the commercial contracts of other suppliers, we are unable to assess whether this condition holds in the motor insurance sector.

**13. What has been the impact of narrow MFNs in the sectors where we have observed them (home insurance, private motor insurance, credit cards, broadband and flights)?**

- 13.1 We welcome the CMA's consideration of the points we raised in relation to narrow MFNs in our previous submissions. The analysis undertaken by the CMA is a good summary of the conditions under which narrow MFNs may harm competition, as well as of the potential benefits of MFNs. However, we find that the CMA is unclear in its conclusion on narrow MFNs. The conclusion needs to be made firmly and be adopted as a principle of cross-sector regulation.
- 13.2 In a mature market without narrow MFNs, suppliers would offer prices through each DCT and direct channels that reflect the underlying cost of the product and the cost of distribution. Lower commissions would be passed to customers in lower prices as suppliers seek to appear higher in price comparison rankings.
- 13.3 Instead, with narrow MFNs in place, little or no price differentiation takes place between DCTs and across channels:
- a) The ability to set lower prices on our **direct channel** is restricted directly by the narrow MFN. While the CMA presented evidence that acquisition costs for suppliers tend to be higher via direct channel in general, this is not the case for our products. For example, the cost of direct acquisition in home insurance is significantly lower than the commission rates paid to DCTs. This was shown in our earlier response to the CMA's information request on home insurance. We are left unable to pass these savings on to customers and the competitive constraint that could be imposed on DCT commissions is removed.
  - b) Narrow MFNs also indirectly restrict price differentiation on **other DCTs**. First, the reduced competitive pressure from direct channel decreases incentives for DCTs to compete over commission rates. Second, suppliers may not want to set lower prices on DCTs compared to their direct channels for reputational reasons, and not to affect the competitiveness of their direct channel.
- 13.4 In markets where DCTs are well-established, suppliers may be in a weak negotiating position with regard to the removal of these clauses. Consequently, we believe that removing narrow MFNs in established DCT sectors would introduce more competition and help to constrain commissions and marketing expenditure. This would result in lower prices and more benefits for customers.
- 13.5 Where DCTs are still developing a foothold in a market, it would be reasonable for the CMA or sector regulators to conclude that the overall benefits of DCT entry could justify the effect of the narrow MFNs, and also that DCTs in such a market would be unlikely to have especially strong negotiating power over suppliers to maintain the MFNs.
- 13.6 Narrow MFNs pose another risk with substantial distributional and fairness concerns, if narrow MFNs restrict pricing for existing Group customers and employees. The ability and incentive for suppliers to invest in price, quality and service for existing customers can be as much a feature of a healthy market as a high level of DCT-enabled switching. [✂]
- 13.7 While we believe that narrow MFNs should be prohibited in mature markets altogether, at the very least the CMA should restrict DCTs' ability to impose narrow MFNs on suppliers' existing Group customers and employees.

**14. What is the commercial rationale for the non-brand bidding and negative matching agreements we have observed (in all of our case study sectors) and what is their commercial and competitive impact?**

14.1 [X]

14.2 [X]

14.3 [X]

14.4 [X]

14.5 [X]

14.6 We do not have negative matching agreements in any of our markets.

**15. What is the commercial rationale for the non-resolicitation agreements we have observed (in home insurance and energy) and what is their commercial and competitive impact?**

- 15.1 Customer experience is a key factor in determining the overall value of a product for a customer. While key metrics like price and quality of service play an important role, it is also important to ensure customer preferences are met. From our own customer data, we are aware that a large proportion of our customers opt out of marketing materials, so limiting the level of contact about new offers/information is clearly important to many customers. These customer preferences need to be carefully balanced against competition and helping customers choose the most suitable deals. It is therefore important to ensure the right level of customer solicitation is in place to improve the overall customer experience and build confidence and trust in DCTs.
- 15.2 In addition, acquiring customers through DCTs may be more expensive for suppliers compared to those acquiring customers through direct channels, based on our understanding that DCT commissions outweigh direct acquisition costs. These customers are also relatively low value customers, as they are more likely to switch on a regular basis compared to those acquired through direct channels. For example, home insurance customers acquired through internet banking have retention rate of around [%], compared to [%] for those acquired through DCTs.
- 15.3 To ensure all customers are getting the most suitable product and at the best value, it is important that those customers that do not switch regularly are prompted to consider their product and whether they can increase the value received by switching. While DCTs have an incentive to prompt customers to switch and are helpful to a certain extent, they also have an incentive to encourage customers to switch even if the customer is likely to switch in any case, or if switching is not necessarily in the customer's interest. There is therefore a balance needed between re-solicitation of customers that do not switch, and avoiding over-soliciting customers about a product purchase.
- 15.4 Where we have contracts in place with DCTs on non-resolicitation, this seeks to draw an appropriate balance, with non-resolicitation agreed for [%]
- 15.5 Further, as the retention figures in the above example show, this does not have the effect of deterring switching (indeed, the insurance renewals letters themselves contain switching prompts based on the customer trials we carried out with the FCA), but is about delivering on customer experience expectations. Nor does it prevent DCTs from carrying out general marketing, multi-product offers (including the last product purchased) or suggesting to customers that they should visit the DCT again to renew their reward/incentive (e.g. cinema tickets) – all of which we see happening in practice.
- 15.6 In the absence of these clauses, either because these were prohibited by the CMA or we did not agree them with DCTs, there would likely be a negative impact on price and quality of service to customers. The higher cost of increased customer resolicitation by DCTs might ultimately lead to higher prices for customers. Further, the increased customer resolicitation in the absence of these clauses might have a detrimental impact on the overall customer experience and is unlikely to be in customers' interests.
- 15.7 We note that the contracts we have in place vary across DCTs. [%]

**16. In which other sectors, if any, are (i) wide or narrow MFNs; (ii) non-brand bidding or negative matching; or (iii) non-resolicitation agreements in place? What impacts do they have in these sectors?**

16.1 Please see the responses to Questions 13 and 14 for agreements in place in our markets and their impact.



**17. Are there any other agreements in place that may affect the effectiveness of DCTs and/or the effectiveness of competition between DCTs (and competition between DCTs and other sales channels)?**

- 17.1 The agreements discussed under previous questions broadly cover the key agreements we currently have in place with DCTs. There are no additional agreements we have in place with DCTs across any of our markets that are relevant here.

**18. How has the growth of DCTs affected product features and/or the product mix in our case study sectors over time? What specific evidence/examples indicate these changes?**

- 18.1 The growth of DCTs has not affected our *offering* in terms of quality products; we continue to offer a range of products with different levels of quality. For example, we offer credit cards with different reward schemes, as well as insurance products with a range of covers and premiums.
- 18.2 However, product *choice* in the DCT channel tends towards lower cost products. This is reflected, for example, in [X]. Another example can be seen in [X]. So while there is no difference in the range of products we offer, we have seen a significant change in the product mix being chosen. It is not clear this is in customer interests.
- 18.3 Customers will have different preferences over the mix of price and quality for any given type of product. A possible justification for the increasing share of lower price and quality products sold through DCTs could be that these preferences have changed over time – which we do not believe to be the case. The CMA should investigate if this is indeed the case. In some markets, like insurance, customers may not need to make a claim for many years, which means it may take time for customers to discover and understand the trade-off between price and quality they have made, and whether this is appropriate for them.
- 18.4 The increasing focus on price (and equivalent reduction in the focus on quality) triggered by the growth of DCTs puts pressure on suppliers, as excessive emphasis on ranking by price gives very little visibility to providers who do not make it to the top of the ranking. The price has become the most important design feature, which reduces the efforts across the market to develop better quality products. Further, we also observe a tendency in the market towards pricing structure which lowers the headline price but introduces hidden, or add-on charges. For example, an insurance product can be designed in a way where premium is low, but there are fees for a variety of product features such as setting up a direct debit, or cancelling the policy.
- 18.5 DCTs do not currently provide tools that would help customers make effective choices between different levels of quality, and the associated trade-offs to price. The transparency around the pricing is also limited, which can easily confuse customers about the full cost of the products. Cross-sector principles on quality metrics, transparency and rankings could help to mitigate these issues, as we describe in the introduction.

**19. How widespread is the use of product reviews and ratings on DCTs and what has been the impact, if any, of the use of these tools?**

- 19.1 Effective product reviews and ratings are important to ensure customers purchase products which are best suited to their needs. DCTs have tried to use product reviews and ratings to help customers make choices about quality. However, this has not been very successful at mitigating excessive focus on price and ensuring a better match to customers' needs. The rating tools have a large potential to benefit customers but the tools which are currently used could be designed in a way which is more helpful to customers. As it is, we do not see any clear evidence that the current tools are particularly valuable to customers.
- 19.2 The CMA should set out cross-sector principles with respect to consistency on transparency and fairness in how quality and rankings are shown to allow customers comparing and differentiating products. Customers should also have the ability to tailor the quality information better to their needs. A single dimension of customer satisfaction does not allow this, as different features may be more important to different customers.
- 19.3 Developing a successful approach to quality metrics could benefit from trialling and empirical analysis. In particular, the CMA should seek to understand customer engagement with product reviews and rankings, which includes:
- a) understanding how customers use them, and what type and format of information is most engaging and informative; and
  - b) understanding how using the ratings affects customer purchasing behaviours. For example, are they more likely to shop around more and pay less attention to price? Would this result in buying different products?
- 19.4 Understanding of the above issues requires further behavioural analysis. The CMA can provide direction to sector regulators that they need to promote industry-wide objective quality measures, but where these do not emerge they should be required to enforce them (as in retail banking), and then let them evolve through market processes. This would allow DCTs to innovate and find the best way to achieve the levels of customer understanding required. To reduce the costs and burdens of policing this, it will be important that the direction is provided in the form of principles, not detailed rules.
- 19.5 If the CMA is minded to undertake research itself, there are two main ways to undertake this type of research. First, customers could be tested in labs, where their behaviour and eye movement can be tracked. Alternatively, real tracking data from DCTs can be analysed. The key questions which the CMA should seek to answer include:
- a) Which customers use reviews and ratings?
  - b) How does this information affect sales relative to customers that do not use them?
  - c) Which sites perform better at engaging customers on quality?
- 19.6 The FCA's ongoing work on PCA and SME banking service metrics also has the potential to result in ratings which help customers make informed choices on quality of products. We also see a potential role for Open Banking and PSD2. Improved access to customer data could be used by DCTs to display reviews and ratings focusing on features that might be particularly relevant to customers or written by product users with similar characteristics.

**20. What needs to be in place to prevent or mitigate any harmful impact of product unbundling or hollowing out and what can DCTs do about it?**

- 20.1 In order for customers to get the most suitable and best value products for them, they need to engage in comparison on the basis of both price and non-price factors. We believe it is already in DCTs' interests to facilitate non-price comparisons, but we recognise that this is not easy. Customer behaviour and a lack of objective quality information are particular problems.
- 20.2 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. For example, [X] displays quality metrics in rankings for home insurance but not for car insurance. The metrics could be improved to increase consumer understanding and trust in them.
- 20.3 Facilitating non-price comparison cannot be achieved through intervention in products or search results. As noted in the response to Question 19 and in the introduction, further research is needed to understand customer behaviour in relation to rating and review tools, and the CMA can provide direction to sector regulators that they need to promote industry-wide objective quality measures.
- 20.4 There may be a role for giving customers more tools to make these better comparisons. This may require inputs on non-price factors that are standardised, objective and independent. The FCA's ongoing work on PCA and SME banking service metrics could provide some solutions.
- 20.5 There should be consistency in how product features and quality are presented to customers for different products and across different DCTs. DCTs need to change how they explain the search results they present. This should include whether non-price factors are accounted for, or whether such factors are available. Any quality information should be displayed in a transparent and engaging way. Customer research could be used to test which approaches are most successful at engaging customer attention.
- 20.6 DCTs should also be more transparent about how the pricing is communicated to customers. Customer attention should not be driven towards headline price alone. Instead, more transparent information on the full cost of the product should be included in the ranking, or at least clearly communicated. We discuss this in more detail in the response to Question 6.
- 20.7 However, the CMA needs to be mindful of unintended consequences that may arise from remedies which are not designed well. One example is the FCA's intervention on insurance add-ons which instead of helping customers has reduced transparency and consistency. There is evidence of DCTs at least initially short-cutting the FCA requirement to show bundled and unbundled prices for insurance by including only certain types of products in rankings. Such exclusions of products which might be better suited to customer needs runs contrary to the FCA's intention of improving choice and transparency for the customer.

## THEME 4: REGULATION AND FUTURE OF DCTS

### 21. What are your views on the issues we list in in Table 8.1 and at paragraphs 8.13 to 8.42 of Chapter 8 and how could they be addressed?

- 21.1 The CMA has listed a range of potential issues in relation to existing regulatory regimes including the potential for excessive barriers to entry, inconsistency, too much prescription, a lack of clarity on which regulations apply for a product, insufficient enforcement, and distortions from requirements to list the entire market.
- 21.2 DCTs will be best placed to articulate the challenges they currently face in operating within multiple regulatory regimes. While a requirement for whole of market coverage may undermine commercial viability of DCTs current business models, it means that the rest of the regulatory regime must be effective to ensure partial market coverage does not lead to customer harm.
- 21.3 More broadly, we agree with the CMA that additional prescriptive regulations are not the answer and that a principles-based approach is the way forward. From a customer's perspective it is likely that most DCTs, no matter the industry, are used and viewed in a similar manner. That suggests that there should be a set of consistent cross-industry principles.
- 21.4 We believe the CMA should outline a **set of customer-focused principles** covering the things that a reasonably informed customer should know and understand about the market. As a starting point, we suggest that customers should have a good understanding of:
- a) the **quality** of the products being displayed, as well as the price. Quality matters where customers cannot or infrequently observe (e.g. insurance claims), or where averages mask what matters (e.g. broadband speed). The CMA should apply the conclusions reached in relation to Open Banking in the retail banking investigation to other DCT product markets;
  - b) the **market coverage** of the results displayed;
  - c) the basis on which the **ranking** has been produced, including that the results are unbiased, there is crystal-clear separation between 'featured' or 'promoted' products and the rankings themselves, and the impact of any filtering or customer-decisions used to generate the results;<sup>10</sup> and
  - d) the **commercial model and incentives** of the DCT, including how it is funded, and that the actions of a DCT (e.g. re-solicitation) may not necessarily be in their best interests.
- 21.5 Sector regulators should also clearly be required to lower barriers to entry and expansion by implementing open data through APIs for product and pricing data and usage data. This could be done through the existing UKRN group, adopting a similar working model to the Open Banking Implementation Entity as set up following the retail banking investigation.
- 21.6 Most of these principles are covered by the themes outlined by the CMA including transparency, relevance and accessibility. We have placed clearer emphasis on the quality of

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<sup>10</sup> This is an important issue given the CMA has found customers seldom reorder results that are first ranked by lowest price.

products being displayed wherever possible – an important principle to try and work toward avoiding a hollowing-out of product markets.

- 21.7 This principles-based approach would also help to resolve many of the issues raised including inconsistent regulation, regulation that is too prescriptive, and boundary issues where DCTs struggle to navigate different regulations for different activities.
- 21.8 It should be possible to agree the principles within the timescales available to the CMA for the current investigation. These principles should be uncontroversial. The CMA can provide direction to sector regulators that they need to promote industry-wide objective quality measures, but where these do not emerge they should be required to enforce them (as in retail banking), and then let them evolve through market processes. This would allow DCTs to innovate and find the best way to achieve the levels of customer understanding required.
- 21.9 To reduce the costs and burdens of policing this, it will be important that the direction is provided in the form of principles, not detailed rules. It should be left to DCTs themselves to show compliance through customer testing and showing they have achieved a reasonable level of customer understanding. Compliance checks could be undertaken by the CMA and sector regulators conducting periodic mystery shopping exercises and ethnographic studies. The DCTs would be free to self-report, and to publish results themselves, as a way to minimize the degree of direct regulatory involvement.

**22. What is the balance between potential benefits and risks in introducing a cross-sector approach? What would be the most effective approach(es), and why?**

22.1 As outlined in the response to Question 21, we believe a principles-based approach is appropriate across all sectors. We believe that the benefits to customers from this type of approach would far outweigh any potential risks.

22.2 Voluntary accreditation would not be the right approach. As the CMA notes, awareness of existing accreditation schemes is low as customers expect regulation to be in place. Leaving these principles as voluntary undermines their centrality to a well-functioning market that enables customers to meaningfully engage. Whatever course the CMA chooses it should ensure that regulators are sufficiently empowered to apply the principles in a consistent way and that DCTs are either required or very strongly incentivised to engage with the principles. The outcome should be one where all DCTs are effectively covered and abide by the principles.

### **23. How could a cross-sector approach interact with existing regulatory frameworks?**

- 23.1 The CMA should work with sector regulators to develop and finalise a cross-sector principles-based approach. Such an approach is important to achieving consensus across sectors but also to facilitate integration with existing regulatory frameworks.
- 23.2 There are likely to be good reasons for some sector-specific regulations and it is the sector regulator that should pick up these issues. The CMA should be providing oversight with the principles it creates and work with the sector regulators to identify the best way of managing them with any existing sector regulations. A truly principles-based approach should provide the sector regulators with sufficient flexibility to manage any sector-specific issues they face.



**24. What future developments outlined in Chapter 9 are likely to have the greatest impact in driving engagement? If there are any important developments we have missed, what are they and why are they important?**

- 24.1 The market for DCTs is likely to evolve due to a number of expected changes. This includes new regulations, increasing use of mobile devices and API technology. A combination of these factors creates opportunities for new DCT products and new business models, including those that do not rely on supplier commission to fund their activities.
- 24.2 We have considered the list of digital technology trends provided by the CMA, and we agree that all of them are likely to affect the way comparison services are offered. However, some are likely to have a greater impact on customer engagement than others. In particular, alternative interfaces and increasing personalisation should improve user experience, but their impact on increased customer use is likely to be incremental.
- 24.3 In contrast, automated advice/decision-making and richer customer data have the potential to transform customer engagement and use of comparison services. These changes will increase the ease of using comparison tools by minimising the effort required from customers in several ways. Less effort will be required to input data and access information.
- 24.4 The access to better data will allow the new technologies to more easily match products to customers' actual needs, and will therefore eliminate the effort required to make a decision on which product is best. The new technologies might even complete the switch automatically. It will be easier for customers to use multiple DCTs, to shop between multiple providers directly, and to compare DCT and direct prices. This is why contractual arrangements that restrict competition between these channels require such careful consideration.
- 24.5 In particular, access to better customer data is an important enabler for DCT growth in some markets, like PCAs, where more information is required from customers and currently more effort may be required to select the best suited product. It could also help in markets such as loans where, as noted in the response to Question 8, there are challenges around telling a customer whether they will be approved for a product or not.
- 24.6 While the new services may bring large potential benefits to customers, they also present some challenges. These challenges include how to introduce and communicate the new services to customers in a way which is not confusing or potentially off-putting. The underlying complexity and need to allow access to very detailed personal data may deter some customers. This is particularly relevant in the context of GDPR which will require explicit customer consents for any use of their personal data. Customers need to be approached about these services in a transparent and comprehensive manner, and the potential benefits need to be clearly communicated.
- 24.7 Technology and data aside, the CMA should consider the evolving market share of DCTs, both individually and collectively. LBG is a large counterparty to the DCTs with which we do business, but (as we have outlined) they hold a strong negotiating hand due to share in their particular part of the value chain. If that share continues to grow, the effect of (for example) narrow MFNs could become greater, and more detrimental to customers, even as the suppliers' ability to negotiate away these clauses recedes yet further.

## **25. What future DCT-related technologies might affect or assist vulnerable consumers?**

- 25.1 As discussed in the response to Question 3, to the extent that vulnerable customers overlap with “inactive” customers, there may be some implications from future DCT-related technologies. Any concerns around customer “inactivity” are particularly strong for vulnerable customers, as they could benefit from better and cheaper products relatively more than other customers.
- 25.2 In this context, new DCT-related technologies may help if they target the reasons why vulnerable customers are “inactive”. New technologies are likely to involve automated advice/decision-making using richer customer data. The reasons why these services may be beneficial to customers include reduced effort and better matching to needs, discussed in more depth in the response to Question 24. As such, if the barriers to DCT use among vulnerable customers are around the perceived complexity and required effort, new technologies might increase their engagement with DCTs. In particular, increased personalisation and better eligibility matching under PSD2 and Open Banking are likely to be especially beneficial to customers in financial difficulty.
- 25.3 Issues relating to trust, transparency etc. should also be considered with a view to the expansion of DCTs into these vulnerable/inactive segments. DCT rankings, incentives and coverage should not just be understandable, but presented so that they cannot be misunderstood. The CMA may also consider whether vulnerable customers are likely to “multi-home” or tend to accept the first offer – and consider related recommendations around MFNs and coverage accordingly.
- 25.4 If the barriers to engagement with DCTs are around lack of digital engagement or access to technology, the new technologies are unlikely to help vulnerable customers directly. However, new technologies and upcoming market developments have the potential to also generate wider, indirect benefits from increased switching and competition in the market. This is likely to result in lower prices and better quality products, and may have a positive impact on vulnerable customers whether or not they use DCTs.
- 25.5 However, in general we would recommend the CMA to focus on the particular behaviours of interest and to segment customer groups based on these behavioural patterns or profiles, rather than use broad and simplistic definitions of customer vulnerability. The definitions used are likely to have a significant impact on the needs of particular customer groups, and the ability for DCT-related technologies to affect or assist them. As we have suggested, the answer to engaging certain customer groups may lie in lower-technology solutions such as face-to-face interactions in a range of shopping locations.