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**NHBC's response to the CMA's Provisional Decision dated 29 June 2017 to vary the 1995 undertakings given by NHBC ("Undertakings")**

1. NHBC welcomes many of the CMA's conclusions about the changes in circumstances in the new home warranty market and its recognition that the Undertakings are no longer appropriate as currently worded.
2. However, NHBC maintain that the Undertakings can be released completely, rather than varied, based on analysis of the evidence of the extent of the change of circumstances. Further, and independently of any analysis of the change of circumstances, NHBC believe that a complete release would achieve a more appropriate outcome overall and relieve both the CMA and NHBC of the administrative burden of an undertaking. The reasoning on both points is explained in **Appendix 1**.
3. In **Appendix 2** is NHBC's proposed Undertaking wording, if the CMA remains minded to vary rather than completely release.
4. In **Appendix 3** are comments NHBC wishes make on certain issues covered in the Provisional Decision.

**Alistair Hodder**

**Head of Legal, NHBC**

**Thursday, 20 July 2017**

## Appendix 1 - Complete release or variation

### Introduction

1. In its Provisional Decision (paragraph 1.10), the CMA states “...*it would not be appropriate to release the Undertakings completely, we provisionally conclude that the Undertakings should not be retained in their current form and should be varied...*” NHBC disagrees with this approach.
  - a. The Undertakings can be released completely, rather than varied, based on analysis of the evidence of the extent of the change of circumstances.
  - b. Further, and independently of any analysis of the change of circumstances, a complete release would achieve a more appropriate outcome overall and relieve both the CMA and NHBC of the administrative burden of an undertaking.

### Analysis of the change in circumstances

2. In NHBC’s view, based on an analysis of the change of circumstances the CMA can conclude that the concerns articulated by the MMC in its report no longer apply, at all. The MMC’s concerns centered on the behaviour of NHBC at the time, in restricting Registered Builders’ access to competitor products.
3. NHBC has not restricted Registered Builders’ access to competitor products since 1995. This is despite the fact that NHBC could have done so to a significant extent through enforcement of the NHBC Rules by which the Undertakings were put into effect. As acknowledged in the Provisional Decision, other providers are able to, and have, entered the market for structural warranties.
4. The MMC’s concerns relating to barriers to entry are now redundant given there are 15 active competitors to NHBC. The CMA has concluded that NHBC’s Registered Builders are free to dual source and switch, which was the focus of the MMC’s concerns and the CMA has recognised that NHBC’s market share has declined.
5. Whilst some NHBC competitors complained about barriers to entry, this was anecdotal evidence and NHBC believe that there are no barriers to entry attributable to NHBC’s behaviour. Any barriers competitors do face are part of normal market conditions when setting up a new business which would be overcome in time through normal resources and funding. For example, the need to comply with regulatory requirements and the challenge all new market entrants face, getting known to potential customers. NHBC invite the CMA to

place no weight on the anecdotal evidence of NHBC's competitors concerning barriers to entry. For more on this, see paragraphs 9 to 12 in Appendix 3.

6. NHBC provided clear evidence of major builders dual sourcing to a very significant extent and in some cases not doing business with NHBC at all. NHBC invite the CMA to place more weight on the factual evidence submitted by NHBC and correspondingly less weight on the responses of just six Registered Builders, upon which it appears that the provisional conclusion that “...*the extent of dual sourcing and switching remains very limited...*” (Paragraph 1.12) was based. For more on this, see paragraphs 13 to 17 in Appendix 3.

### **Overall outcome**

7. The aims of proposed varied undertakings are for NHBC to comply with competition law. NHBC is committed to doing this, as reflected by its behaviour and as articulated in its own internal competition compliance policies. There is no need for this to be formalised in a varied undertaking.
8. Regarding paragraph 6 (a) of the Notice of Intention to Vary, the role as a “quasi-regulator” of structural warranties only exists today because of the continued existence of the Undertakings. Complete removal of the Undertakings would mean that NHBC must abolish this “quasi-regulator” role in order to comply with competition law and its own internal policies. This is an outcome NHBC has been asking for since the review commenced. There is simply no need for this to be formalised in an undertaking.
9. Regarding paragraph 6 (b) of the Notice of Intention to Vary, the same analysis applies. If released from the Undertakings, competition law requires that the NHBC Rules do not have the object or the effect of discouraging its Registered Builders from dual sourcing from, or switching to, other providers of structural warranties.
10. The net effect of varied Undertakings will be to say, NHBC undertakes to comply with competition law. This is something NHBC has demonstrated a firm commitment to since 1995 (arguably before then too, as recognised by the MMC), especially given that it has not taken any advantage of the opportunity to enforce the Rules that give effect to the Undertakings and restrict its competitors' activities. On the contrary, NHBC has embedded a commitment to comply with competition law in its own internal controls framework through its competition law policy and has requested the release of the Undertakings; a strongly pro-competitive stance.
11. Regarding the CMA's role in relation to the Undertakings, this role came about because of the need to police the particular circumstances of the Undertakings in 1995. However, this role will become redundant. The Rules are in the public domain as they are published online. There is no need to have formal



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monitoring arrangements, whereby NHBC submits a copy of the Rules to the CMA following any amendment, to ensure NHBC continues to comply with competition law.

## Appendix 2 – Draft varied undertaking

### *DRAFT*

## NHBC Structural Warranties 1995 Undertakings Review

### 2017 Undertakings given by NHBC to the CMA

#### Introduction

1. These new Undertakings (“**the 2017 Undertakings**”) constitute a variation to the 1995 Undertakings (“**the 1995 Undertakings**”) given by NHBC to the Secretary of State for Trade and Industry on 7 December 1995, following a MMC investigation which concluded that a monopoly position existed in favour of NHBC and that certain aspects of its Rules of Membership for Registered Builders operated against the public interest, in particular, by preventing NHBC’s Registered Builders from dual sourcing or switching to Alternative Providers without financial penalty.
2. NHBC commits to give the 2017 Undertakings, on condition that they are accepted by the CMA as a variation of the 1995 Undertakings in a Final Decision.
3. The 2017 Undertakings are being offered by NHBC under section 92(2) (ii) of the EA02 to conclude the CMA’s review into the 1995 Undertakings.
4. The giving of these 2017 Undertakings by NHBC does not constitute any admission of wrongdoing by NHBC. In particular, NHBC has not been the subject of any CMA infringement decision or statement of objections.

#### Further Definitions

1. For the purpose of these 2017 Undertakings the following definitions apply:

**Alternative Providers** means any company providing a structural warranty product for new homes;

**EA02** means the Enterprise Act 2002;

**CMA** means the Competition and Markets Authority;

**Effective Date** means the date on which NHBC receives formal notification of a Final Decision;

**Final Decision** means the CMA’s final decision in its review of the MMC Undertakings;

**MMC** means the Monopolies and Mergers Commission;



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**NHBC** means the National House Building Council;

**Registered Builders** means builders or developers of new homes listed on NHBC's register;

**Rules of Membership** means the rules as laid down from time to time by the NHBC for builders and developers of new homes registered with the NHBC;

**Structural Warranty** means insurance cover for the buyer of a newly built home, covering major faults in design or construction such as (but not limited to) subsidence, drainage, or rain penetration.

**Working Day** means any day other than a Saturday, Sunday or any other day that is a public holiday in England.

## The Undertakings

1. NHBC undertakes:
  - (a) not to introduce any amendments to the Rules of Membership which have the object or the effect of preventing or discouraging Registered Builders from dual sourcing from, or switching to, Structural Warranties provided by Alternative Providers;
2. To give effect to the Undertakings, NHBC will:
  - (b) Within [20] Working Days starting from the first Working Day after the Effective Date, place an announcement on NHBC's website confirming that all Registered Builders are entirely free to dual source from, or switch to, Alternative Providers.

## Duration

3. The 2017 Undertakings will continue to apply [for 10 years or] such shorter period if the CMA considers there has been a change of circumstances that means the 2017 Undertakings are no longer appropriate, or are no longer appropriate in their current form. At the end of the [10 year] period the 2017 Undertakings shall expire.

## Compliance

3. NHBC will maintain a policy on competition law compliance, to ensure that NHBC complies with competition law and supports free and open competition in all markets in which NHBC operate.



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Executed by:

Signed for and on behalf of NHBC

[SIGNATURE]

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Steve WOOD, CEO

On: [DATE]

At: NHBC House, Davy Avenue, Knowlhill, Milton Keynes, Bucks, MK5 8FP

## Appendix 3 – Comments on the provisional decision

### Introduction

1. NHBC wishes to comment on the following issues covered in the Provisional Decision, as follows.

### Consumer Code

2. The CMA stated in the press release following the decision to carry out the review of the Undertakings that *“The review will look at how the market for new home structural warranties currently operates to protect home buyers to see if there has been a change in circumstances which would justify the removal or variation of the undertakings. The CMA will not be considering wider issues relating to the NHBC as part of this review”*.
3. NHBC maintains that the Consumer Code is a wider issue and disagrees with the CMA’s approach to include it as part of the review. The review of the Undertakings concerns only specific issues, and only relates to NHBC. However, the Consumer Code is a joint venture between NHBC and MD Insurance Services Limited. The actions of MD Insurance Services Limited should not be included in the review of the Undertakings and the subject matter of the Consumer Code does not overlap with the subject matter of the Undertakings.
4. NHBC invites the CMA to remove paragraphs 4.14 to 4.18 from the Final Decision.

### Market position

5. In the Provisional Decision, the CMA makes various statements about the lack of significant change in NHBC’s market position. The MMC concluded that NHBC’s market share in 1990 was approximately 90%<sup>1</sup> however it has slowly declined throughout the years due to the emergence of new competitors. The new home warranty is a long-tail insurance product spanning over 15 years and some competitors have only recently entered the market. It is expected that as competitors become more established then NHBC’s market share will continue to decline.
6. There are no official figures confirming the market shares for the new home warranty market. The CMA has referred to NHBC’s own estimated data which is based on the volume of newly built homes.
7. The CMA’s alternative method to estimate NHBC’s market share was based on the financial value of the sales of new home structural warranties sold by NHBC

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<sup>1</sup> Paragraph 5.12 MMC Report



and the other providers. We note that this methodology of market share calculation is different to the approach taken by the MMC<sup>2</sup>.

8. The structural warranty market is highly segmented. NHBC has a zero share of the self-build market and a very small share of the newly converted or change of use market. They are increasingly significant segments. However, the CMA has not considered the market shares of such segmentations.

### **Potential barriers to entry and expansion**

9. The CMA has described some difficulties which other warranty providers report that they have encountered when they approached lenders to seek approval for their structural warranty products (paragraphs 4.7 to 4.13). In addition, the CMA described the endorsement process of the Council of Mortgage Lenders. NHBC notes these are market observations and unconnected to NHBC and the Undertakings.
10. In the Provisional Decision, the CMA states there is a high level of awareness amongst builders, banks and others about NHBC and that it was difficult for competitors to change these perceptions (paragraph 4.19). This is outside NHBC's control and unconnected to the subject matter of the Undertakings.
11. Equally the anecdotal evidence from other warranty providers regarding NHBC's geographical coverage and insurance capacity is also outside NHBC's control and unconnected to the subject matter of the Undertakings.
12. NHBC does not consider that the potential barriers to entry and expansion referred to at paragraphs 4.7 to 4.13 are credible barriers for a profit-making company with sufficient funding to establish itself as a new home warranty insurer and/or broker.

### **Dual sourcing or switching**

13. The CMA gathered evidence from five of NHBC's Registered Builders (paragraph 4.41) and has concluded they are dual sourcing but to a "...very limited extent". While the CMA suggests that such Registered Builders accounts for approximately 30% of the UK's newly built homes, NHBC maintains this has distorted the representation of the extent of dual sourcing.
14. NHBC disagrees with the CMA linking the volume of new homes being built to a Registered Builder's strategy to dual source. These are separate issues and NHBC consider they should be treated as such.
15. NHBC has attempted to meet the needs of its Registered Builders which means that it is structured to operate nationally and welcomes the fact that Registered

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<sup>2</sup> Paragraph 5.12 MMC Report

Builders are dual sourcing. In the Provisional Decision, an NHBC Registered Builder is noted to have acknowledged there were alternatives to NHBC with sufficient scale to serve their needs across the UK (paragraph 4.43). This demonstrates a competitive new home warranty market.

16. With regards to paragraph 4.43 (c) in relation to pricing, NHBC uses a standard metric to calculate price. If there is a bespoke development, the price will be matched to the risks being underwritten using NHBC's standard method for calculating premiums. The pricing will be bespoke for the development but it is not negotiated by the Registered Builder.
17. NHBC does not accept that its premium rating scheme is a barrier to NHBC's Registered Builders dual sourcing as suggested by one warranty provider. NHBC note this anecdotal feedback has been only raised by one warranty provider only and not raised by any Registered Builders.

### **Premium refunds**

18. NHBC does not accept that the payment of refunds restricts a Registered Builder's ability to dual source as suggested at paragraphs 4.43 (f) and 4.58 to 4.68. This has been suggested by other warranty providers based on anecdotal evidence which is entirely contradicted by what the Registered Builders say at paragraph 4.66 namely "*No large builder told us that their entitlement to future refunds would influence their decision to switch from NHBC...*".
19. NHBC welcomes the comment from one Registered Builder at paragraph 4.66 stating that the "*...refund incentivized it to focus on build quality.*", which is precisely the purpose of the refunds and NHBC's overall ethos to raise the standard of construction.
20. To increase transparency concerning the premium refund eligibility, NHBC will publish a summary of the premium refund rules on its website. NHBC proposes to do this before the end of the 2017/2018 financial year.

### **Other issues raised in the Provisional Decision**

21. The CMA has given little weight to the impact of the Financial Services legislation and the Insurance Distribution Directive. This has an important role to play in ensuring fair outcomes for consumers and makes the "quasi-regulator" role redundant.
22. NHBC also wish to correct the CMA in relation to paragraph 4.10. NHBC is authorised by the PRA and regulated by the FCA and the PRA.