

NHBC structural warranties undertakings review

Final decision

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The Competition and Markets Authority has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

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1. Summary

Background to this review

- 1.1 The National House Building Council (NHBC) provides structural warranties for over 1.6 million homes in the UK. It sets technical standards for house builders who are registered with it, and it monitors compliance with these standards through inspections. NHBC estimates that it provides warranty schemes covering around 80% of new homes.¹
- 1.2 This review is of Undertakings given by NHBC to the Secretary of State for Trade and Industry in 1995, following a Monopolies and Mergers Commission (MMC) investigation which had concluded that a monopoly position existed in favour of NHBC and that aspects of its rules for house builders operated against the public interest, in particular by preventing NHBC's members (currently referred to by NHBC as Registered Builders) from dual sourcing or switching to other warranties without financial penalty.
- 1.3 In line with the MMC's recommendations, NHBC's rules² were changed to facilitate dual sourcing and switching by its members to other warranties. In addition, and in line with the MMC's recommendations that warranties that were dual sourced should be of a standard broadly comparable to NHBC's product, NHBC's amended rules included a definition of 'Other Home Warranty schemes'. This resulted in NHBC becoming a 'quasi-regulator' of new home warranty products.
- 1.4 The Undertakings given by the NHBC relate to its Rules as amended and are as follows:

'(1) The NHBC shall not make any amendments or addition to the Rules of Membership to which this paragraph applies unless the Director General of Fair Trading has previously given his consent thereto in writing.

(2) This paragraph applies to any amendment or addition to the Rules of Membership that has or may have the result that the NHBC ceases to comply with, or complies to a lesser extent with, the MMC recommendations.'³

¹ See [NHBC website](#).

² See [NHBC rules for builders and developers registered under the NHBC scheme](#).

³ The MMC recommendations can be found from paragraphs 8.90 to 8.102 of [A report on the existence or possible existence of a monopoly situation in relation to the supply within the United Kingdom of structural warranty services in relation to new homes](#).

1.5 In 2015, the NHBC undertakings were part of a CMA invitation to comment on a number of market remedies.⁴ NHBC requested a review of its Undertakings and the CMA began this review on 21 March 2017.

Final decision

1.6 In deciding whether to retain, vary or release the Undertakings, the CMA considers whether there has been a change of circumstances that means that the Undertakings are no longer appropriate. If there has been such a change, the CMA considers what action should be taken as a consequence.

1.7 On 29 June 2017, we published our provisional findings and a provisional decision that the Undertakings should be varied. We ran a consultation on this and we received three responses: one from NHBC, one from another warranty provider and one from a mortgage lender. In reaching our final decision, we have considered matters raised in these responses, with a focus on any new evidence provided.

1.8 Having taken account of responses to our provisional decision, we remain of the same substantive view which is that the following changes have taken place since 1995:

- There have been changes in the market for structural warranties for new homes, including material changes in the regulatory requirements for these products and the number and range of structural warranties available.
- The Undertakings and amended rules have had the intended effect that other providers have entered the market for structural warranties. However, market expansion by those who have entered has been limited to date. Only two other providers have more than a very small share of the market. NHBC retains a very high market share and the market remains highly concentrated.
- The Undertakings and amended rules have also had the intended effect that some builders do now dual-source warranties and smaller builders may switch from NHBC to another provider. However, both dual-sourcing and switching appear to be at low levels, as evidenced by NHBC's high market share.

1.9 Based on our assessment of these changes, we conclude that, by reason of a change of circumstances, certain aspects of the Undertakings are no longer

⁴ See [CMA: Review of monopoly remedies put in place before 1 January 2005](#).

appropriate, in particular, in so far as these have resulted in NHBC having a 'quasi-regulatory' role in relation to other structural warranty providers.

- 1.10 However, we conclude that some of the concerns identified by the MMC remain, albeit that they have been ameliorated to some extent as a result of the effect of the Undertakings and rules. In particular, although NHBC's Registered Builders are now free to dual source and switch, they have, to date, only done so to a limited extent, so that NHBC's market share remains very large.
- 1.11 Accordingly, our view remains that it is not appropriate to release the Undertakings. However, we conclude that the Undertakings should not be retained in their current form and should be superseded. The CMA has now received from NHBC amended Undertakings that we consider are better suited to the changed circumstances.
- 1.12 Specifically, we are proposing Undertakings that would remove any expectation that NHBC should continue to play a 'quasi-regulatory role' in relation to other structural warranty providers who are NHBC's competitors.
- 1.13 However, in light of the fact that the extent of dual sourcing and switching to date remains very limited and that NHBC continues to enjoy a very strong position in the market for structural warranties, we are minded to accept superseding Undertakings from NHBC which continue to ensure that NHBC's rules for house builders 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.
- 1.14 As part of the change, we will amend the role of the CMA in relation to the Undertakings. NHBC has previously been required to submit any changes to its Rules to the CMA for prior approval. The CMA will now oversee the implementation of NHBC's initial proposed changes to its rules. Thereafter, we will not require NHBC to notify us of any future rule changes prior to their introduction but will require them to notify us of any such changes. We will place greater weight on NHBC's self-assessment and third party complaints in monitoring whether subsequent rule changes comply with the revised Undertakings.
- 1.15 The duration of the Undertakings has been set at 15 years.

Superseded Undertakings

- 1.16 The proposed Superseded Undertakings are set out in Annex 1 to this report. At their core, the Undertakings state:

'NHBC undertakes:

that it shall not make any amendments or additions to the Rules of Membership which have the object or effect of preventing or discouraging Registered Builders from dual sourcing from or switching to Structural Warranties provided by Alternative Providers.'

Consultation

1.17 We are now consulting on the Superseded Undertakings. The consultation closes on 1 November. Please submit responses to:

Praful Depala
Structural Warranties Review
Competition and Markets Authority
Victoria House
37 Southampton Row
London WC1B 4AD

Email: structural.warranties@cma.gsi.gov.uk

1.18 Following this consultation, the CMA will consider the responses received and the evidence and views presented. The CMA will assess the impact of these responses on the proposed Undertakings before reaching a final decision.

2. Introduction and background

2.1 In this section, we set out the CMA's statutory duty in relation to this review of the Undertakings. We outline the MMC's recommendations following its report in 1990 and how these recommendations led both to changes to NHBC's rules and to the Undertakings. We say how we have reached the decision to conduct this review and the approach that we have taken to the review.

CMA legal duty

2.2 The CMA has a statutory duty by virtue of Schedule 24 to the Enterprise Act 2002, as amended by the Enterprise and Regulatory Reform Act 2013, to keep under review undertakings, such as the NHBC undertakings, that were made under section 88 of the Fair Trading Act 1973. From time to time, the CMA must consider whether, by reason of any change of circumstances:

- (a) undertakings are no longer appropriate and need to be varied, superseded or released; or
- (b) an order is no longer appropriate and needs to be varied or revoked.

MMC recommendations and NHBC Undertakings

2.3 In 1990 the MMC investigated the supply of structural warranty services for new homes in the United Kingdom.⁵ The MMC concluded that a monopoly situation existed in favour of NHBC. At that time the NHBC supplied over 90% of structural warranty services and had only one competitor.

2.4 The MMC further concluded that certain NHBC rules and some omissions from those rules⁶ had the effect of restricting competition because they were acting as barriers to entry for NHBC's potential competitors by making it more costly for them to offer alternative warranty schemes of a comparable standard.

2.5 The MMC found that the effect of NHBC's rule 12 (rule 8 in NHBC's current rules) was broadly to require its members to pre-notify to it all the homes they proposed to build and thus trigger the process of inspection, insurance and payment of associated fees. If an NHBC member wished to submit new homes to another warranty scheme, then this would result in a virtual doubling of its unit warranty costs as these would be incurred in both schemes. The MMC found that Rule 12 operated against the public interest because it

⁵ See [MMC report](#).

⁶ See [NHBC rules for builders and developers registered under the NHBC scheme](#).

prevented house builders, without incurring a financial penalty, from dual sourcing and sampling alternative schemes and that, as such, it restricted competition.

- 2.6 NHBC amended its rules and rule 8 (formerly rule 12) allows builders registered with NHBC to purchase cover from an 'Other Home Warranty Scheme' as defined in the rules (see paragraph 4.74 for the definition).
- 2.7 NHBC's former rule 38 dealt with cancellation of registration of membership in the event of bankruptcy or by the NHBC for reason of member conduct, etc. Rule 41 imposed on a member whose registration had been cancelled a requirement to indemnify NHBC for undertaking any of the former member's obligations.
- 2.8 The two omissions in the NHBC rules highlighted by the MMC were the absence of any provision for cancellation of membership at the option of a member and the absence of a provision protecting the premium rating of a member of NHBC who, having cancelled their membership, subsequently sought to resume it. (Premium rating can significantly impact the price at which a member can purchase NHBC structural warranty cover.)
- 2.9 Following the report, NHBC introduced changes to its rules to address the MMC's concerns. In particular, new rules 41-43, replaced rules 38-41 and made provision for voluntary cancellation of membership and clarified the member's obligations thereafter.
- 2.10 To address the identified omissions, a new rule 44 provided a cancelling NHBC member with the right to request that NHBC 'buy out' the member's obligations to homeowners following cancellation. This aimed to address the MMC's concern that, absent such provision, a builder might not wish to cancel its membership, if it was unclear whether the builder would be able to count on NHBC cover for homes which, although notified to NHBC, had not yet been sold at the time of cancellation.
- 2.11 A second new rule, rule 46, dealt with reinstatement of registration and included provision for protection of member rights acquired as a result of a previous period of registration as a member. The governing principle is that a reregistering member should be able to do so on terms no less favourable than those that would have pertained had the member remained at NHBC. This has the effect of protecting the premium rating of a reregistering member.
- 2.12 Following the MMC's Report, NHBC amended its rules in line with the MMC's recommendations and gave the following undertakings to the Secretary of State under section 88 of the Fair Trading Act 1973:

'Changes to the NHBC's Rules of Membership

(1) "The NHBC shall not make any amendments or addition to the Rules of Membership to which this paragraph applies unless the Director General of Fair Trading has previously given his consent thereto in writing.

(2) This paragraph applies to any amendment or addition to the Rules of Membership that has or may have the result that the NHBC ceases to comply with, or complies to a lesser extent with, the MMC recommendations⁷."

Interpretation

In these undertakings:

"the MMC recommendations" means the recommendations set out in paragraphs 8.90 to 8.102 of a report by the Monopolies and Mergers Commission entitled "A report on the existence or possible existence of a monopoly situation in relation to the supply within the United Kingdom of structural warranty services in relation to new homes." (CM 1439);

The NHBC means the National House-Building Council;
and

"the 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.'

Decision to undertake this review

2.13 In 2015, the NHBC Undertakings were part of a CMA invitation to comment on 13 sets of market remedies.⁸ In response to this exercise, NHBC requested a review of its Undertakings.

2.14 Having considered the case for doing so against its published prioritisation principles and having concluded that there was a realistic prospect of finding a change of circumstances, the CMA began this review on 21 March 2017.

⁷ The MMC recommendations can be found in paragraphs 8.90 to 8.102 of its [report](#).

⁸ See [CMA: Review of monopoly remedies put in place before 1 January 2005](#).

2.15 At the start of the review, we stated that it would focus on how the market for new home structural warranties operates in order to see if there has been a change in circumstances which would justify the removal or variation of the Undertakings. While we are aware that buying a new home is one of the largest financial decisions consumers make, we were clear that the CMA would not be considering wider issues relating to new home buying, including the quality of new build homes, as part of this review. As such, we have not sought to reach conclusions on any issues outside the remit of the review.

Our approach to this review

2.16 To launch the review, the CMA published a decision document⁹ on 21 March 2017 in which it outlined the reasons for the review and sought the views of a range of stakeholders including providers of structural warranties, house builders, mortgage lenders and bodies representing these sectors. The CMA set a response date of 20 April 2017. Questionnaires were sent to a wide range of these stakeholders.

2.17 The CMA received 27 responses to its questionnaires: nine from other warranty providers, six from builders, ten from mortgage lenders and a response from each of the Council of Mortgage Lenders and the Consumer Code for New Homes. We held meetings and telephone interviews with eleven stakeholders.

2.18 We published our provisional decision to vary the Undertakings on 29 June 2017 and asked for responses to this by 20 July. We received three responses to our consultation: one from NHBC, one from another structural warranty provider and one from a mortgage lender. We published these on 6 September, taking account of the confidentiality concerns of respondents where appropriate. We considered matters raised in these responses, with a focus on any new evidence provided to us, in forming our final decision.

⁹ See [CMA case page](#).

3. Overview of NHBC and structural warranties

- 3.1 A structural warranty provides cover for the buyer of a newly built home, typically for a ten-year period. It covers major faults in design or construction such as subsidence, drainage or rain penetration; however, it does not cover every type of fault that may occur. It may also be known as latent defects insurance. Cover is typically wider in the first two years when the builder will normally be responsible for handling claims in that period that it has failed to comply with the warranty provider's building standards (with the warranty provider stepping in if the builder fails to remedy the problem). The warranty provider takes over the role of handling claims for the following years three to ten.
- 3.2 The buyer of a new home will usually need to demonstrate to a mortgage lender that the home has a structural warranty in order to agree a mortgage.
- 3.3 The NHBC was the first provider of structural warranties. It was created in 1936 as the National House Builders Registration Council (NHBRC). The house building industry founded it in response to government pressure and potential legislation in the 1930s when there was concern over poor building standards.
- 3.4 The NHBRC developed a set of building standards and carried out assessments of the work by its members to ensure compliance with these standards.
- 3.5 A two-year warranty by the builder was created by the NHBRC and in 1965 this became a ten-year 'Buildmark' warranty which is similar to the product offered today. The current format of the warranty was launched in the late 1980s.
- 3.6 In 1973 the organisation was renamed National House-Building Council (NHBC) and became independent of government. In 1978 NHBC became an insurance company.
- 3.7 Since 1985, NHBC has been a major private sector supplier of 'Approved Inspectors' who can monitor compliance with building regulations alongside those working for local authorities.
- 3.8 In addition to warranties, NHBC also provides other products and services in the new home building sector, including training and health and safety services; additionally, in collaboration with the Home Builders Federation it carries out research into customer satisfaction with new homes and builders and provides other data collection and analyses. NHBC funds research through the NHBC Foundation and provides guidance to the house-building

industry on technical construction matters. It also has awards for site managers to recognise the role they play in delivering high standards in house building.

- 3.9 While operating as an insurance company, NHBC's corporate form is that of an independent, non-profit distributing company limited by guarantee. It is run by a board of directors who are accountable to a Council of members comprising representatives from mortgage lenders, law societies, consumer groups, architects, surveyors and house builders. As a non-profit making company, any surpluses generated are re-invested in the business or returned to its Registered Builders under the premium refund scheme (see paragraphs 4.58 to 4.68 for an explanation of this).¹⁰
- 3.10 NHBC is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority.

¹⁰ This section has been sourced partly from NHBC's submission to the CMA and partly from secondary sources.

4. Our consideration of changes of circumstances

Introduction

- 4.1 In deciding whether to retain, vary, release or supersede Undertakings, the CMA considers whether there has been a change of circumstances that means the undertakings are no longer appropriate, or are no longer appropriate in their current form. If there has been such a change, the CMA considers what action should be taken as a consequence.¹¹
- 4.2 In this decision, we have taken the following approach:
- (a) We considered the circumstances that led the MMC to conclude that Undertakings were required. These are in three areas:
 - (i) Competition in the structural warranty market: market entry and expansion of other providers;
 - (ii) NHBC's Registered Builders' ability to dual source or switch warranty provider; and
 - (iii) NHBC's role in setting standards in the structural warranty market and in defining 'Other Home Warranties Schemes'.
 - (b) We considered whether there has been any change in circumstance since 1995, in each of the three areas, as a result of which, the Undertakings would no longer be appropriate.
- 4.3 In the rest of this section, we set out the evidence we have found in each of these three areas and our conclusions in each.

Evolution of competition in the structural warranty market since the MMC report

- 4.4 In this section, we set out briefly how the structural warranty market has evolved since the MMC report in 1990. This is the context for our examination of the relevant change of circumstances.

¹¹ See [CMA 11: Guidance on the CMA's approach to the variation and termination of merger, monopoly and market undertakings and orders](#).

Evolution of market entry and expansion

- 4.5 The MMC undertook its investigation of the structural warranty market for new homes, following a complaint from Municipal Mutual Insurance (MMI). MMI was one of the first companies to seek to supply structural warranties for new homes, as an alternative to NHBC's product.
- 4.6 Since the MMC review in 1990, there have been a larger number of new entrants in the market for structural warranties for new homes. We set out below the timeline for these developments.
- (a) In 1993, insurance firm Zurich bought MMI's assets and launched its own range of ten year warranties for the private sector, the public sector, commercial developments and self-build projects.
 - (b) In the early 1990s Housing Associations Property Mutual (HAPM) launched a warranty purely for social housing projects with cover of up to 35 years. The pressure on cost reduction in the social housing sector meant that this product became unaffordable. HAPM left the market after a few years.
 - (c) In 1997 an insurance broker, MD Insurance Services launched Premier Guarantee, a ten year structural warranty in a similar format to that of NHBC. In 2007 it acquired and relaunched a second structural warranty product under the LABC brand.
 - (d) In 1999 Building Life Plans (BLP) launched insurance policies, similar to a new home warranty and in 2003, Buildzone launched a warranty.
 - (e) In 2009, with a downturn in the new homes market following the financial crisis, Zurich exited the structural warranty market.
 - (f) Since 2009, many more warranty providers have entered the market and today we believe that there are up to 15 providers alongside NHBC. These include: Aedis (launched 2009); Checkmate (launched 2010); Q Assure, Global and CRL (all launched in 2011); FMB Insurance (launched in 2012); Advantage HCI (launched in 2013); Protek (launched in 2015) and ARK (launched in 2016). Two more providers, ICW and Capital, have entered the market although we do not know in which year.

Potential barriers to entry and expansion

- 4.7 We asked other warranty providers about their experience of entering the market and have identified a number of potential barriers to entry and expansion.

4.8 We note that, in commenting on our provisional decision, NHBC stated that it regards these factors as “anecdotal market observations” and unconnected to the Undertakings. It also commented that they do not represent credible barriers for a profit-making company with sufficient funding. We remain of the view that an assessment of factors relating to the ease of market entry and expansion is relevant to this review as the underlying purpose of the Undertakings was to facilitate the development of a more competitive market. We consider the factors listed below which were given to us by third parties as potentially valid.

Mortgage lender approval

4.9 Most other warranty providers told us that, in order to enter the structural warranty market, they needed to gain approval by mortgage lenders. Mortgage lenders will generally not provide a mortgage on a newly built home without it having cover from a structural warranty from a provider on its ‘approved list’. This means that house builders are reluctant to purchase a warranty from a provider that does not have approval from a substantial proportion of mortgage lenders because selling the house could become more difficult if a prospective purchaser was limited to a small number of mortgage lenders.

4.10 Warranty providers told us that having to approach each lender individually for approval and meet each lender’s individual requirements was time consuming and expensive.

4.11 The Council of Mortgage Lenders (CML) is clear that it cannot endorse individual warranties. However, it does set out considerations for lenders although it is clear that these points do not constitute lenders’ requirements.¹² The points are set out as follows:

‘Warranty and indemnity schemes - lender considerations’¹³

NB: this is for general information only. Each lender will have their own individual requirements and additional considerations.

Lenders consider:

- The length of the cover period (the industry standard is currently 10 years)

¹² On 1 July 2017, the Council of Mortgage Lenders became part of UK Finance. The handbook is now the UK Finance handbook for mortgage lenders.

¹³ Source: [Council of Mortgage Lenders website](#).

- The process to ensure build quality and compliance with building regulations, such as the inspection regime
- The financial limits of the cover
- The consistency of cover of the period (often an initial period is covered by the builder, after which it reverts to the warranty provider alone - lenders would want to ensure a consistent level of protection)
- What elements of cover are included (for example, builder's insolvency; temporary accommodation costs, etc.)
- Information which provides evidence of financial stability
- Confirmation that the warranty provider (and broker, if relevant) have evidence of FCA authorisation
- Any evidence of claims experience.'

4.12 Our analysis of information given in the CML's handbook for mortgage lenders shows that, in addition to NHBC, five structural warranty providers (Buildzone, Checkmate, CRL, Global and MDIS) are approved by nearly all of the major lenders and a further 11 warranty providers (Advantage, Aedis, Ark, BLP, Bopas, Buildassure, Buildcare, Capital, ICW, Protek, Q Assure) are approved by at least ten of the major lenders.

4.13 However, the process for gaining approval appears to be potentially lengthy and complex. Factors noted by other warranty providers were that:

- (a) Some lenders showed a lack of understanding of the structural warranty product and a tendency to regard NHBC's Buildmark policy as a 'gold standard' and to compare any new warranty with NHBC's. One provider¹⁴ told us that it had originally set out to develop a product that was different to NHBC's, but had been forced to provide a similar (albeit not identical) product because of lender lack of awareness of what should be required of a warranty.
- (b) A few lenders had taken the view that they already had sufficient warranty providers on their 'approved list' and were not interested in considering any new providers. There is no requirement on mortgage lenders to consider new warranties for approval.

¹⁴ [redacted].

- 4.14 Some warranty providers provided us with estimates of the time it had taken them to obtain approval from a sufficient number of lenders for them to be credible with developers: these time periods varied between twelve months and six years.
- 4.15 Another supplier of structural warranties noted that NHBC's Board and Council include people from mortgage lenders and house builders and suggested that this could represent a conflict of interest if they represent the interests of those employers rather than those of consumers and the building industry more broadly. We have not considered NHBC's governance as we did not find it relevant to our review of the Undertakings. We have therefore not reached a conclusion in this area.

Consumer code membership

- 4.16 Many warranty providers mentioned that Lloyds Banking Group (Lloyds), one of the UK's biggest mortgage lenders, changed its requirements for warranty approval in 2014 so that, in place of the previous criteria, it asked only that warranty providers should be designated 'code users' of the Consumer Code for Home Builders (CCHB). It did this in the face of an increase in the number of warranty providers seeking approval.
- 4.17 The CCHB was launched in 2010 following a market study by the OFT on House Building¹⁵ which concluded that greater consumer protection was needed for new home buyers. It was intended to be a pan-industry code, but during its development, one warranty provider left the group and it was finally launched by a group including just two warranty providers, NHBC and MDIS, together with some other building industry bodies and consumer groups.
- 4.18 A number of warranty providers told us that they had applied to CCHB to become code users but, after several months (two years, in one case¹⁶) of what they described to us as changing requirements, they gave up. The CCHB told us that it did accept one other warranty provider¹⁷ as a code user, but that this provider decided to set up its own code instead. It told us that other applicants for code user status had been turned down as they failed to meet the qualifying criteria set out in its application guidelines.
- 4.19 Lloyds now accepts warranty providers which are users of any consumer code approved by the Chartered Trading Standards Institute (CTSI) as an alternative to the CCHB. We are aware of five CTSI-approved codes, of which

¹⁵ See [OFT UK House Building Study](#).

¹⁶ [redacted].

¹⁷ [redacted].

one (Consumer Code for New Homes) currently has four warranty providers as code users. Applications from other home warranty providers to sponsor four further codes are currently pending at CTSI.

- 4.20 While only Lloyds sets a criterion of ‘Code User status’ as a requirement for approval, its status as one of the biggest lenders means that, in effect, code membership is now a requirement for full entry into the warranty market. Some of those running consumer codes told us that they had annual running costs of approximately £300,000.¹⁸
- 4.21 In its response to our provisional decision, NHBC stated that the CCHB is a wider issue, highlighting in particular that it is constituted not by NHBC alone but through a joint venture between NHBC and another warranty provider and it disagreed with its inclusion in this review. Being a ‘user’ of a consumer code was cited by many organisations as a necessity for market entry and so we retain it as a factor relating to market entry within our final report.
- 4.22 In response to our provisional decision, a mortgage lender noted that, if NHBC no longer plays a quasi-regulatory role (see paragraphs 4.83- 4.94), then the consumer code will play a more important role in maintaining the standard of new build homes. For this reason, the lender proposed a review of the code(s) to ensure that there is sufficient impartial oversight of new build standards. Issues relating to quality standards are not relevant to our review of the Undertakings. We note that a lender’s requirements for structural warranty providers can play a role in shaping the market for structural warranties.

Awareness and recognition

- 4.23 Several warranty providers told us that market entry and expansion had been challenging because of very high level of awareness amongst builders, banks and others of NHBC and the lack of awareness that there were alternatives to NHBC. One provider¹⁹ told us that lenders, developers and in some circumstances even government perceived NHBC to be a quasi-governmental body and the only viable provider of structural warranties. Other warranty providers told us that changing these perceptions was a requirement for their growth.

¹⁸ [REDACTED].

¹⁹ [REDACTED].

Geographic coverage

- 4.24 Two other warranty providers²⁰ mentioned that they needed to have sufficient inspector capacity to conduct site inspections in all appropriate locations to meet large builders' requirements. Several large builders²¹ confirmed this. We are only aware of one other warranty provider that has equivalent geographic coverage to NHBC and a similar ability to serve the needs of builders working across the whole of the UK.
- 4.25 In response to our provisional decision, another provider of structural warranties suggested that having a UK-wide inspector capacity is only a factor affecting market entry and expansion if large builders expect to work with a single warranty provider. We consider that it is appropriate for builders to have a choice of purchasing from one or many providers and so maintain that UK-wide coverage might be a de facto barrier to entry.
- 4.26 Another warranty provider queried whether NHBC's role as a major supplier of approved inspectors who monitor compliance with building regulations represented a conflict of interest with its role as a provider of structural warranties that are dependent on this compliance. It stated that inspections should be carried out by third parties. It has not been necessary to take a view on this issue as it is not relevant to our review of the Undertakings.

Insurance capacity

- 4.27 Two warranty providers mentioned insurance capacity as a barrier to entry. One said²² that securing backing from a reputable, 'A' rated insurer and the other²³ that sourcing an insurer willing to take ten-year risk had not been easy. If business expands, providers would also need to secure an increase in capacity from their insurers who would have to meet the associated solvency requirements.

Volume builders' loyalty to NHBC

- 4.28 Other warranty providers told us that it is difficult for them to expand in the market as they cannot persuade larger builders to switch warranty provider from NHBC due to NHBC's practice of paying premium refunds to larger builders. We examine this further in paragraphs 4.66 to 4.81.

²⁰ [redacted], [redacted].

²¹ [redacted], [redacted], [redacted], [redacted].

²² [redacted].

²³ [redacted].

Market shares of NHBC and other structural warranty providers

- 4.29 We next consider the evolution of market structure since the undertakings were put in place.
- 4.30 In 1990, the MMC estimated that NHBC had 90% of the market for structural warranties in the UK and it concluded that a monopoly situation existed.
- 4.31 There are no official figures on the structural warranty market and there is no single source of market shares or market size. We have therefore gathered data to enable us to estimate NHBC's current market share.
- 4.32 NHBC claims publicly that it accounts for 80% of the UK market for structural warranties for new homes. We have examined how NHBC calculates this figure and aimed to calculate it ourselves using the source data. We have also produced an alternative estimate of market share based on data we have gathered on sales of structural warranties by NHBC and other providers.
- 4.33 Each method gives a different outcome: using NHBC's approach, our estimate is that it has around 90% market share; using warranty sales across providers, we estimate it to be around 70%. We set out each approach below.

Market share based on DCLG data on new build 'starts'

- 4.34 NHBC calculates its market share using data from the Department for Communities and Local Governments (DCLG) on the number of starts of new build dwellings. While the data is dependent on the quality of information returned to DCLG by the house building industry, it represents the most reliable measure of new build activity in the UK.
- 4.35 Using DCLG data on new build 'starts' and NHBC data on volume sales of warranties, we have calculated its market share at around 91% in 2016, up from 85% the previous year. The data shows some volatility in market share of NHBC in recent years, with a previous high of 91% in 2007 and a low point of 73% in 2009.

Table 1: NHBC structural warranty sales as % of new home starts

Structural warranty sales (volume) % of new house starts

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
NHBC	80%	91%	90%	73%	85%	86%	83%	84%	85%	91%

Notes:

1. Data on new house starts are taken from the Department for Communities and Local Government.
2. Data on the number of policies sold submitted by NHBC.

- 4.36 Discrepancies between our estimate and NHBC's estimates may be due to revisions of the DCLG data or other factors. We also note that the DCLG data

excludes new homes created through conversions and change of use.²⁴ NHBC has provided warranties for these types of homes, although it now has [redacted] for this segment of the market. The DCLG data gives a smaller total size of the new homes market and may give NHBC a higher market share in it in recent years than it would have across the whole market.²⁵

- 4.37 Our second approach was to aggregate data on the number and value of warranties sold each year by each warranty provider, in order to obtain an estimate of market shares. In addition to NHBC, we were given sales data by eight other providers. The data we collected on the value of warranties sold related to a greater number of years, and so we have used this as our main measure, although it does have the risk that sales figures are not only for new home warranties and so may not be strictly comparable. In their responses to our provisional decision, two organisations queried whether it was valid to measure market share based on value, rather than volume, of warranties sold: one organisation pointed out that the MMC had calculated market share using volume of warranties sold and the other queried whether, if warranties were sold at different prices, our estimate was valid. We have considered these comments and we accept that each method (calculating market shares by value or volume) has its caveats. Our estimate of market share based on volume was in fact the same as that based on value, but we had data on the volume of sales by each company for fewer years. We are confident that using market shares based on value of warranties sold does not materially affect the accuracy of the results.
- 4.38 The main finding of our analysis is that NHBC's market share [redacted] and was around 70% in 2016. If we were able to include data from all other warranty providers, NHBC's share could be [redacted], although not by much, as we think that we have included data from the main competitors by size. Equally, if the sales data from other providers includes sales of other products, then NHBC's market share might be higher.
- 4.39 The data does not show growth of market share across a range of other providers; rather, several have remained at a steady level over the past five years, while one provider has grown its share significantly. The data shows that only two other providers have a market share of around or above [redacted].

²⁴ Data on new house starts are taken from [DCLG live table 208](#).

²⁵ We considered using DCLG data on the number of completions of new homes instead as this included conversions and change of use, but we were aware that, while this data would match some providers' sales of retrospective warranties, it would give less accurate market shares for NHBC.

Table 2: Structural warranty market shares based on sales values

Structural warranty sales (value)
% aggregated market

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
[X]											[X]
[X]							[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]							[X]	[X]	[X]	[X]	[X]
[X]						[X]	[X]	[X]	[X]	[X]	[X]
[X]					[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]										[X]	[X]
[X]					[X]	[X]	[X]	[X]	[X]	[X]	[X]

Notes:

1. Data on the value of policies sold submitted by structural warranty providers.
2. [X] has not been able to provide a breakdown of the total value of the policies sold. Their submission therefore includes commercial and warehouse covers; therefore, their respective share is likely to be inflated.
3. [X] has responded to our questionnaire but is not willing to provide the data requested.
4. [X] has only provided data for 2011 and 2016/7. We have filled in the remaining years assuming a constant annual growth rate.

4.40 While the different methods produce different outcomes, both place NHBC’s market share within a range of 70% to 90%, broadly consistent with NHBC’s own estimate. While NHBC’s market share has declined in recent years, as would be expected given that there has been some new entry, it continues to be very high and is [X], the second largest provider. We conclude that the market remains, by any standard, highly concentrated.²⁶

4.41 In its response to our provisional decision, NHBC stated that the new home warranty is a long tail insurance product spanning over 15 years and some competitors have only recently entered the market. They stated that it is expected that as competitors become more established, then their market share will continue to decline. NHBC also pointed out that it has no share of the self-build market and a very small share of two other segments of the

²⁶ The Herfindahl–Hirschman Index is 5,352 in terms of volume and 5,210 in terms of value which is well above the threshold for which we would consider a market to be highly concentrated.

market. We accept that most other providers of warranties have only entered the market since 2009, but our market share figures are based on warranty sales in the most recent year for which data was available (rather than on historical, cumulative figures) and the method based on value of sales covers warranties sold across all market segments, so it is as accurate as we can achieve. We are unable to judge with any certainty how market shares might change in the future.

Conclusions on the evolution of competition since 1995

- 4.42 Facilitated by the changes to NHBC's Rules and by the Undertakings, NHBC now faces more competition than at the time of the MMC report. Entry into the structural warranties market is possible, as shown by the growth in the number of warranty providers since 2009. However, several factors remain which have the potential to serve as barriers to entry or expansion. The market remains highly concentrated and NHBC retains a very high market share.

House builders' ability to dual source or switch warranty provider

Introduction

- 4.43 The focus of the MMC's report was its finding that NHBC's rules for its Registered Builders did not allow them to dual source or switch to other warranties without financial penalty. Following undertakings given by NHBC to the Secretary of State and amendments to its rules, it has become possible for builders to do so. In this review, we have sought evidence of whether house builders do in fact dual source or switch warranty providers and the reasons for their behaviour in these areas.
- 4.44 For both dual sourcing and switching, we have noted major differences between small and large builders. These are important to note as, while builders of all sizes operate in the new homes market, according to government statistics, the market has become increasingly weighted towards large builders so their behaviour is important to the overall outcome in the structural warranty market.
- 4.45 According to DCLG data, volume builders (those completing over 2,000 units a year) now constitute 59% of the new build homes market, increased from 31% in 2008. Meanwhile medium sized builders (101-2,000 units) and small builders (1-100 units) market shares have dropped from 40% to 29% and 28% to 12% respectively.

Dual sourcing of warranties by housebuilders

NHBC's submission on dual sourcing

4.46 In its submission to the CMA,²⁷ NHBC told us that builders now had the ability and the incentive to dual source. It said that the decision to do so could be driven by considerations of quality or of price. NHBC stated that it was now standard practice for the majority of builders to dual source new home warranties from a range of providers.

Evidence from housebuilders

4.47 We have gathered data from five of the UK's large house builders and examined the extent to which they dual source warranties in both volume and value terms. According to DCLG data, we believe that these builders account for just over 30% of the UK's new homes market.²⁸

4.48 The data showed that three out of the five large builders are dual sourcing warranties, albeit to a very limited extent. For those that dual source, NHBC still represents nearly [redacted] of their structural warranty purchases.

Table 3: Dual sourcing: NHBC share of large builders' warranty purchases (volume)

Share of structural warranties purchased from NHBC (in terms of volume)

Builder	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Notes

1. CMA calculations based on data submitted by construction companies.

2. Shares calculated as the ratio of the number of policies purchased from [redacted] over the total number of policies purchased by the construction company.

²⁷ See pages 23-24 of NHBC submission on [CMA case page](#).

²⁸ Data source DCLG [live table 209](#).

Table 4: Dual sourcing: NHBC share of large builders' warranty purchases (value)

Share of structural warranties purchased from NHBC (in terms of value)

Builder	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Notes

1. CMA calculations based on data submitted by construction companies.
2. Shares calculated as the ratio of the value of policies purchased from [REDACTED] over the total value of policies purchased by the construction company.
3. [REDACTED] has only submitted volume data.
4. [REDACTED] has only submitted data regarding its purchases from [REDACTED]. In its submission, however [REDACTED] told us that it sources a growing part of its warranty requirements from [REDACTED] aiming to [REDACTED].

4.49 In its response to our provisional decision, NHBC objected to us drawing conclusions about the overall extent of dual sourcing from a sample of just five large builders as it believed that this distorted the representation of the extent of dual sourcing. However, we have seen no evidence that any other large builder is dual sourcing more of its warranties than those in our sample and so we conclude that our findings are valid as an indicator of large builders' behaviour more broadly.

4.50 We have discussed the reasons why NHBC's Registered Builders may or may not choose to dual source warranties with builders themselves as well as with trade associations and with NHBC and the other warranty providers.

4.51 We examine each of the factors below:

- (a) *Scale*: the Home Builders Federation (HBF), the trade body for the home building industry, told us that a key reason why many large builders only sourced from NHBC was that, while there were other warranty providers who operated nationally, NHBC had set itself up so that their structure mirrored that of the larger builders and this assisted the large builders in their work with NHBC. This point was also made by some large builders, both those who dual source²⁹ and those who currently do not.³⁰

Two large builders told us that that they would prefer not to be dependent on NHBC and would dual source more if there was an alternative warranty provider that was capable of meeting their needs on large developments; one of these told us that it was actively working with another warranty provider to establish a viable alternative to NHBC.

²⁹ [REDACTED], [REDACTED], [REDACTED].

³⁰ [REDACTED], [REDACTED].

However, one large builder told us that there were alternatives to NHBC with sufficient scale to serve their needs across the UK. Two small builders³¹ and a number of the warranty providers³² told us that NHBC's service was geared to large builders and did not meet the needs of smaller builders: one small builder³³ told us that that NHBC's product is best suited to a development where there are a large number of similar properties; another told us that small builders were not eligible for NHBC's premium refund scheme and that, while NHBC's training was good, it focussed on the needs of large builders, and was expensive and so beyond the means of small builders³⁴.

In its response to our provisional decision, NHBC stated that it disagrees with the CMA's approach of linking the volume of new homes being built to a Registered Builder's strategy to dual source as these are separate issues. We agree that there is not a simple link, but we accept third parties' views that scale is a potential factor.

- (b) *Quality of service*: the HBF told us that larger builders often valued NHBC's quality of service and the positive impact of its other activities such as awards for building site managers which are aimed at driving high quality standards in building. Two of the large builders³⁵ confirmed this and said that the quality and robustness of NHBC's inspection regime, and additional support such as its training, were also important.
- (c) *Price* was mentioned by all builders as a factor when choosing a warranty provider. One large builder³⁶ said that NHBC pricing remained competitive and the fact that some builders were dual sourcing had helped in this regard. Another large builder³⁷ said that other providers were generally cheaper than NHBC. A third³⁸ said that it was able to source warranties more cheaply from another provider and make significant savings as NHBC's prices had risen each year. The HBF and two large builders³⁹ told us that price negotiation was possible when seeking a warranty for bespoke buildings and builders would therefore look for value in this area. In its response to our provisional decision, NHBC clarified that it does not negotiate price with its registered builders for bespoke developments.

³¹ [redacted], [redacted].

³² [redacted].

³³ [redacted].

³⁴ [redacted].

³⁵ [redacted] and [redacted].

³⁶ [redacted].

³⁷ [redacted].

³⁸ [redacted].

³⁹ [redacted] and [redacted].

We did not examine warranty prices across different providers, but three of the warranty providers⁴⁰ said that their cover was no cheaper than NHBC's. However, several warranty providers mentioned that there were lower cost warranties available in the market.

- (d) *Type of development*: NHBC's warranties appear well suited to large volume developments of similar properties as it can offer 'type' approval (ie approval of the house design which can then be repeated across different projects). However, according to many parties, NHBC warranties are less well suited to developments which use bespoke or more innovative construction methods. NHBC told us that changes in the housing market had led to its competitors establishing themselves in sectors such as social housing, mixed use developments, conversions and self-build. NHBC said that its focus was on providing [redacted] and on [redacted] and that it had withdrawn from the self-build sector. NHBC told us that its competitors had the majority market share in two other sectors, the [redacted] sectors.
- (e) *NHBC premium rating scheme*: one warranty provider⁴¹ considered that NHBC's rating scheme for builders (in which builders with one of the three top premium ratings awarded on the basis of their historical claims record, pay less for cover) was a barrier to NHBC Registered Builders' dual sourcing warranties. Large builders did not mention this as a factor.

In its response to our provisional decision, NHBC stated that it does not accept that its premium rating scheme is a barrier to dual sourcing. Although this was only mentioned by one other warranty provider, we consider it a valid potential factor to mention.

- (f) *Premium refunds*: two other warranty providers⁴² suggested that NHBC's system of premium refund (explained in paragraphs 4.66 to 4.81), restricted its Registered Builders' incentive to dual source. We have confirmed with NHBC that, if a builder remains on its register and has sourced a sufficient volume and value of warranties from NHBC, then dual-sourcing will not prevent it from being eligible for a premium refund, although, in due course, a lower level of warranties purchased from NHBC would result in a smaller potential refund. In its response to our provisional decision, NHBC stated that it does not think premium refunds reduce a builder's ability to dual source. We do not consider they are

⁴⁰ [redacted], [redacted], and [redacted].

⁴¹ [redacted].

⁴² [redacted] and [redacted].

likely to be a major factor, but we consider that they may affect a builder's incentives to a small degree alongside other factors.

- (g) *Switching as an alternative to dual sourcing*: while NHBC's annual registration fee is a small sum for a medium or large sized builder, for smaller builders it is an unnecessary expense if they are not planning to buy NHBC's products. Two small builders⁴³ also told us that they were more likely to switch than to dual source to avoid the cost of paying a registration fee.

Switching between warranty providers

The MMC's concerns

- 4.52 The MMC found that two of the NHBC's rules and some omissions from the rules, operated against the public interest and could restrict competition by discouraging builders from voluntarily seeking cancellation of their membership of NHBC in order to transfer to another scheme.
- 4.53 NHBC's former rule 38 dealt with cancellation of registration of membership in the event of bankruptcy or by the NHBC for cause (member conduct etc.). Rule 41 imposed on a member whose registration had been cancelled a requirement to indemnify NHBC for undertaking any of the ex-member's obligations. The two omissions in the NHBC rules highlighted by the MMC were the absence of any provision for cancellation of membership at the option of a member and the absence of a provision protecting the premium rating of a member of NHBC who, having cancelled their membership, subsequently sought to resume it. Premium rating can significantly impact the price at which a member can purchase NHBC structural warranty cover.

Rule amendments to address the MMC's concerns

- 4.54 Following the report, NHBC introduced changes to its rules to address the MMC's concerns. In particular, new rules 41-43 replaced rules 38-41 and made provision for voluntary cancellation of membership and clarified the member's obligations thereafter.
- 4.55 To address the identified omissions, a new rule 44 provided a cancelling NHBC member with the right to request that NHBC 'buy out' the member's obligations to homeowners following cancellation. This aimed to address the MMC's concern that, absent such provision, a builder might not wish to cancel

⁴³ [redacted] and [redacted].

its membership, if it was unclear whether the builder would be able to count on NHBC cover for homes which, although notified to NHBC, had not yet been sold at the time of cancellation.

- 4.56 A second new rule, rule 46, dealt with reinstatement of registration and included provision for protection of member rights acquired as a result of a previous period of registration as a member. The governing principle is that a reregistering member should be able to do so on terms no less favourable than those that would have pertained had the member remained at NHBC. This has the effect of protecting the premium rating of a reregistering member.

Switching warranty provider

- 4.57 As shown in the sections on market shares and dual sourcing, some builders now purchase structural warranties from providers other than NHBC. It is not straightforward to identify the extent to which those buying cover from other warranty providers have switched from NHBC as distinct from those who are new builder entrants to the market or builders who dual source.
- 4.58 While we did not receive submissions from all large UK house builders, of those we did hear from, only one was considering switching from NHBC to another warranty provider in the future. We did not hear from any who had already done so. We have also not heard from any other warranty provider that any large builders are expected to switch.
- 4.59 One warranty provider,⁴⁴ which estimated that it had a market share of between 3-5%, told us that it thought that its builder customers were almost exclusively new entrants to the new homes market who had not worked with NHBC.
- 4.60 NHBC has only recently begun to collect data on why a builder has left its register. For the period June 2016 to April 2017, it said that of 50 builders who had cancelled membership in this period, 10 of them (20%) had left to join another scheme.

Switching by smaller builders

- 4.61 Two small builders⁴⁵ told us in interviews that they had switched from NHBC. One had done so following an experience of poor service from NHBC around inspections.⁴⁶ Both builders told us that they felt that NHBC's service was

⁴⁴ [redacted].

⁴⁵ [redacted]; [redacted].

⁴⁶ [redacted].

geared to the needs of large builders and did not meet their needs as smaller firms.⁴⁷ One warranty provider⁴⁸ claimed that builders had switched to it due to their dissatisfaction with NHBC.

4.62 We were told by the HBF⁴⁹ that small builders found NHBC's rules and requirements more difficult to meet than did large builders. While the HBF could not confirm the extent to which its Registered Builders had switched from NHBC, they were aware that switching had happened. They were also aware of firms who switched from NHBC but then returned at a later date.

4.63 NHBC warranties are only available at the outset of a new home's development, while other warranty providers also offer retrospective warranties which can be purchased when a development is complete. A small builder explained to us how it might be preferable to buy a more expensive retrospective warranty upon completion of a development, as they are then close to realising revenue from its sale, rather than buying a lower cost warranty, such as those provided by NHBC, at an earlier stage in construction.

Switching by larger builders

4.64 Many of the factors identified above which affect dual sourcing by large builders (scope and scale, quality of service and price) are equally relevant to switching behaviour. Two factors have particular relevance in the context of switching and we explore these below.

NHBC scope and scale

4.65 Some large builders appeared keen to reduce their dependence on NHBC and be able to source warranties from a competitive market. Only one large builder told us that they might well switch away from NHBC completely after sampling other warranties. Other large builders⁵⁰ all told us that, even if they began using an alternative provider on volume developments, they were unlikely to switch away from NHBC. The reason for remaining with NHBC was to mitigate a perceived risk that the new provider might not remain in the market or that they might not sustain the same quality of provision over time. The annual cost of remaining on the NHBC register is low in relative terms for a large building firm.

⁴⁷ Similar points were made by a number of warranty providers including [REDACTED] and [REDACTED].

⁴⁸ [REDACTED]

⁴⁹ Telephone interview with HBF.

⁵⁰ [REDACTED], [REDACTED], [REDACTED], [REDACTED], [REDACTED].

NHBC premium refunds

- 4.66 NHBC's practice of paying its larger Registered Builders a premium refund was mentioned by many other warranty providers as a reason why these builders would not switch away from it to other providers.
- 4.67 NHBC has confirmed that, although it is not common for larger builders to leave its register, if any builder who would otherwise be eligible for a refund leaves its register (as it might do if it switched all of its new business to another warranty provider), then it is no longer eligible for any further premium refunds. However, NHBC stated that premium refunds were not considered by them to be loyalty factors or payments.
- 4.68 NHBC told us that in the 10 years from 2007-2016, the number of builders who had received premium refunds was as follows:

Table 5: NHBC Premium Refunds – the total number of builders who received a refund in each year from 2007-2016 are as follows

<i>Scheme</i>	<i>Year Paid</i>	<i>No. of builders who received a refund</i>
23 (1991/92)	2007	230
24 (1992/93)	2008	267
25 (1993/94)	2009	234
26 (1994/95)	2010	224
27 (1995/96)	2011	196
28 (1996/97)	2012	197
29 (1997/98)	2013	194
30 (1998/99)	2014	170
31 (1999/00)	2015	157
32 (2000/01)	2016	157

- 4.69 Data given to us by NHBC showed the 20 builders who had received the largest amount of annual refunds over the past five years. The data showed that the refunds to any builder can vary considerably in size each year and can range from zero, due to poor claims history, to substantial amounts – the highest, made in 2012, was £2.7 million, although in 2016, the largest payment was just over £747,000.
- 4.70 NHBC has explained to us that, as a non-profit distributing organisation, it is appropriate to refund any surplus to builders. It states that the aim of this is to raise the standard of construction, by rewarding builders who have a good claims history on closed policies.
- 4.71 NHBC's Registered Builders are eligible for a premium refund if, over the past 20 years, they have paid at least £100,000 in premiums (at current prices); have registered at least 750 homes with NHBC and they currently have one of NHBC's highest premium ratings (either A1S, A1L or A1*). The refund calculation is made on the portion of a builder's insurance premiums which

remains after a deduction has been made representing the cost, calculated on a per policy basis, of the reinsurance premium paid by NHBC on behalf of all builders; it is then split between a 'bankruptcy' pool from which NHBC can pay claims for builders who are no longer in business and a balance which is available for distribution in the form of refunds.

- 4.72 These eligibility criteria mean that it is mainly medium or large sized builders who obtain a greater proportion of NHBC's premium refunds. NHBC has explained that this is because builders with a cumulative premium contribution of less than £100,000 during a 20 year period will not have any balance remaining after appropriate allocations have been made into a bankruptcy pool so there will be nothing available for refund. The proportion of money allocated to the bankruptcy pool steadily reduces, and the proportion available for refunds increases, as the level of cumulative contribution rises.
- 4.73 In order to assess the importance to builders of the premium refund and whether it could constitute a significant barrier to switching, we compared data on the size of refund received with the amount paid by a builder that year in premiums to NHBC.
- 4.74 We found that, in some cases, the amount of refund paid to builders can represent a significant proportion of their premium spend. In fact, in some cases, it exceeds the premium paid that year. We queried with one builder whose refund had exceeded their premium, whether this was possible and why it might be and it was confirmed that it was correct, but that, generally, the company would expect the value of the refunds to be around half that of the amount of fees it pays each year to NHBC.
- 4.75 No large builder told us that their entitlement to future refunds would influence their decision to switch from NHBC: two builders⁵¹ said that it had no impact on the choice of warranty provider; two more⁵² said that it would impact choice but only when the builder was considering the overall cost of warranties and one builder⁵³ said it considered the refund incentivised it to focus on build quality.
- 4.76 NHBC has offered to publish a summary of its procedures relating to the calculation and payment of premium refunds. We consider that greater transparency in this area of NHBC's business model would be desirable.
- 4.77 In its response to our provisional decision, another provider of structural warranties stated that it believes NHBC's premium refunds have the greatest

⁵¹ [redacted], [redacted].

⁵² [redacted], [redacted].

⁵³ [redacted].

influence on a builder's purchasing decision and that they are "loyalty inducing".

- 4.78 NHBC told us that it sometimes writes off sums owed by builders to NHBC and occasionally NHBC has made a one-off payment to builders for commercial reasons. For instance to resolve disagreements over claims costs and to mitigate legal and commercial risks.⁵⁴ It does not treat these as premium refunds. In its response to our provisional decision, another warranty provider queried whether the purpose of one-off payments is to be similarly loyalty-inducing.

Conclusions on dual sourcing and switching

- 4.79 The Undertakings and NHBC's rule changes that followed the MMC's report have made it possible for builders registered with NHBC to dual source from other warranty providers and to switch providers.
- 4.80 Overall, our assessment is that dual sourcing and switching by NHBC's Registered Builders has only happened to a limited extent and that NHBC's current market share remains large. Evidence from builders and from other warranty providers has supported this:
- Some large builders do now dual source warranties, although the extent of this remains very limited. A few large builders have plans to dual source a higher proportion of their warranties in the future. We have found no evidence that any large builder has switched away from NHBC entirely, and we have only found one which states that it might do so in the future.
 - Small builders may be more likely to switch provider than to dual source to avoid the cost of paying a registration fee to more than one provider. Small and medium sized builders appear to switch providers, although we have not been able to quantify the scale of this behaviour.
- 4.81 NHBC's premium refunds may play some role in disincentivising switching, even if they are not designed to do so, as the payments to larger house builders in particular can be substantial. However, given that refunds are only due 15 years after the premiums are paid and are dependent on claims levels on warranties during that period, the link between the upfront choice of warranty provider and a possible future premium refund is indirect and uncertain. NHBC has offered to take steps to address the lack of transparency

⁵⁴ A respondent to the consultation also brought the issue of non-refund payments to our attention.

in relation to the operation of the premium refund scheme. We consider such increased transparency highly desirable.

- 4.82 Overall, we provisionally conclude that the MMC's remedies have had a positive impact on enabling greater switching and multi-sourcing, but the extent to which this occurs in practice remains limited.

NHBC's role in setting standards in the structural warranty market

NHBC undertakings: rules concerning a definition of other home warranty

- 4.83 The MMC was keen to ensure that, should builders dual source or switch to other warranties, then they should only use those which were of 'broadly comparable standard' to NHBC's. This was due to the MMC's belief that the format of NHBC's warranty, which included registration, published technical standards and other features, was important in ensuring that warranties helped maintain build quality and so protect the interests of consumers.

- 4.84 For this reason, in line with the MMC's recommendations,⁵⁵ NHBC amended its rules and rule 8 allows builders registered with NHBC to purchase cover from an 'Other Home Warranty Scheme.'⁵⁶

Rule 8a states: 'You must ensure that any home, newly built or to be built or sold by you, or on your behalf, to which these Rules apply is registered and accepted for cover either by NHBC or by an Other Home Warranty Scheme.'

The definitions and interpretations within its rules include the following definition for Other Home Warranty Schemes:

'Any home warranty scheme that incorporates:

A register of builders and developers on which applicants may be entered provided they can show a good standard of building ability and sound building knowledge, as applicable; and

A set of published technical standards with which Registered Builders and developers must comply and which include reasonable standards of design, quality of materials, workmanship and durability; and

⁵⁵ See paragraph 8.94 of the [MMC report](#).

⁵⁶ At the time of the MMC report, this was rule 12. NHBC's current rules are available on its [website](#).

A system of inspecting new homes during construction so as to ensure that they are built in accordance with the published technical standards; and

Transferable warranties providing the owners of the homes covered by the scheme with a right, for at least 10 years from the date of completion of construction of the home, to have repairs carried out, or to be indemnified against the cost of repairs, at least against damage resulting from defects in the structure of such homes.'

NHBC submission

- 4.85 NHBC's submission to the CMA sets out its view that, while it was appropriate at the time of the MMC investigation for NHBC's warranty to be considered a benchmark for others, it has resulted in NHBC becoming a 'quasi regulator' of new home warranty products. It states that this role is now obsolete as warranty products are now regulated by the Financial Conduct Authority and there is now a range of warranties in the market which do not have the same features as NHBC's Buildmark: for example, some warranty providers may not operate a register of builders and they may not publish technical standards. In its response to our provisional decision, NHBC commented that financial services regulation, such as the Insurance Distribution Directive, issued since 1990 has focussed much more on fair outcomes for consumers and that this makes NHBC's quasi-regulator role redundant.
- 4.86 NHBC has also explained to us how building regulations and the system of building control inspections that monitor and enforce compliance with building regulations have developed since 1995 and form a sufficient basis for basic build quality. This allows some warranty providers to avoid developing and publishing their own technical standards and to rely instead on the standards set by building regulations when designing their products.
- 4.87 NHBC has also stated that, in practice, since 1995, it has not checked whether its Registered Builders use another warranty which fits the definition. It has stated that other structural warranty providers do not always treat NHBC's warranty as a model for their own products.
- 4.88 NHBC has made these points to the CMA as part of its request to have the undertakings released, so that it might make changes to its rules without approval from the CMA. It wishes to remove this definition and the effect of rule 8 from its rules as it considers it obsolete.

Views of third parties

- 4.89 NHBC's views on this rule are very largely borne out by the responses we received from other parties. Most said that they were unaware that NHBC had such a role⁵⁷ although one warranty provider believed that builders expected NHBC to recognise other warranties.⁵⁸ Two other warranty providers said that the perception within the industry that NHBC had this role was contributing to its continuing dominance.⁵⁹
- 4.90 Among lenders, only one believed that NHBC continued to play a useful role in defining other structural warranties.⁶⁰ However some lenders said that they continued to consider the NHBC as a standard setter more generally and/or look to NHBC's warranty as a benchmark when deciding whether or not to recognise other warranty providers for inclusion on their lending list.⁶¹ As we described in paragraphs 4.9 to 4.15, lender approval of a warranty is the main pre-condition for market entry and NHBC's role in assessing it was not mentioned.
- 4.91 Among house builders, we found no evidence that this rule played any part in their consideration of which warranty to purchase.⁶²
- 4.92 In its response to our provisional decision, a mortgage lender gave its view that warranty providers must be subject to stringent qualifying criteria given the potential impact on customers if new build quality slips or they are left without protection in the case of builder default. It notes that this is necessary for a lender's internal risk mitigation requirements. We fully agree that measures to ensure new build quality are important and that lenders can play a role in setting proportionate requirements for structural warranty providers which help ensure build quality.

Conclusion on NHBC's role in setting standards for warranty providers

- 4.93 We agree with NHBC that, given the regulatory and other changes identified since 1995, NHBC's rule 8 is no longer necessary nor appropriate. We also agree that NHBC should not be expected to play a 'quasi-regulatory' role in assessing the warranties offered by its competitors and note that it wishes to remove rule 8 as soon as practicable.

⁵⁷ [REDACTED], [REDACTED], [REDACTED], [REDACTED], [REDACTED], [REDACTED].

⁵⁸ [REDACTED].

⁵⁹ [REDACTED], [REDACTED]

⁶⁰ [REDACTED]

⁶¹ [REDACTED]; [REDACTED]; [REDACTED].

⁶² [REDACTED], [REDACTED], [REDACTED], [REDACTED].

4.94 We find that the concerns expressed by the MMC in its report, which led to this rule being put in place, are no longer valid and that this is a change of circumstance from the time when the Undertakings were given.

5. Final decision

5.1 Our view on the change of circumstances which underlies our final decision and the proposed revision to the Undertakings is summarised below. While taking full account of responses to our provisional decision – as set out in this document - we have not changed our substantive view on the change of circumstances or the need to seek revised Undertakings.

- There have been changes in the market for structural warranties for new homes, including material changes in the regulatory requirements for these products and the number and range of structural warranties available. On this basis, we conclude that there is no longer any need for NHBC to ensure that other warranty providers comply with its definition or the format of its own product. NHBC's role as a 'quasi-regulator' of warranties is no longer appropriate.
- The Undertakings and amended rules have had the intended effect that other providers have entered the market for structural warranties. However, market expansion by those who have entered has been limited to date. Only two other providers have more than a very small share of the market. NHBC retains a very high market share and the market remains highly concentrated.
- The Undertakings and amended rules have also had the intended effect that some builders do now dual source warranties and smaller builders may switch from NHBC to another provider. However, both dual-sourcing and switching appear to be at low levels, as evidenced by NHBC's high market share.

5.2 All of the responses to our provisional decision welcomed the review and both third parties welcomed the decision to vary the Undertakings. NHBC maintained that they can be released entirely based on the extent of the change of circumstances. NHBC also stated that a release would achieve a more appropriate outcome overall as the aim is for NHBC to comply with competition law, to which it is committed and that this does not need to be formalised in varied Undertakings.

5.3 Based on our analysis of these changes, and having taken full account of responses to our provisional decision, we confirm our provisional conclusion that by reason of a change of circumstances the concerns articulated by the MMC in its report no longer apply in full. As a result, the Undertakings are no longer appropriate as currently worded. However, it is clear that certain of the concerns identified by the MMC remain, albeit that they have been ameliorated to some extent as a result of the effect of the Undertakings.

Accordingly, whilst our conclusion is that it would not be appropriate to release the Undertakings completely, we consider that the Undertakings should not be retained in their current form and we have sought revised Undertakings from NHBC in order to make the Undertakings better suited to the changed circumstances.

Superseded Undertakings

- 5.4 NHBC has proposed revised Undertakings that will supersede the Undertakings previously given by NHBC. These are set out in full in Annex I to this document.
- 5.5 The key provisions of the proposed Undertakings are that:
- NHBC undertakes that it shall not make any amendments or additions to the Rules of Membership which have the object or effect of preventing or discouraging Registered Builders from dual sourcing from or switching to Structural Warranties provided by Alternative Providers.
 - NHBC undertakes to notify the CMA of any amendments or additions to the Rules of Membership at the same time as notification of such amendments or additions is made to Registered Builders.
 - NHBC undertakes that it shall within 10 Working Days starting from the first Working Day after the Commencement 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.
- 5.6 In advance of the revised Undertakings coming into force, we expect that NHBC will make changes to its rules and that these will remove NHBC's role as a 'quasi-regulator' of structural warranties, in that NHBC will no longer be expected to ensure that its Registered Builders only use other warranties that comply with a definition set by NHBC of 'Other Home Warranty Schemes'.
- 5.7 As part of the revision, we will change the role of the CMA in relation to the Undertakings. NHBC has previously been required to submit any changes to its Rules to the CMA for prior approval. The CMA will now oversee the implementation of NHBC's initial proposed changes to its rules. Thereafter, we will not require NHBC to notify us of any future rule changes prior to their introduction, but we will require them to notify us of any such changes. We will place greater weight on NHBC's self-assessment and third party complaints in monitoring whether subsequent rule changes comply with the revised Undertakings.

- 5.8 In its response to the provisional decision, NHBC proposed that any Undertakings should be subject to a sunset clause, so that they would cease to have effect automatically after 10 years. In a subsequent submission to the CMA, NHBC explained its view on the appropriateness of a sunset clause. It stated that it had been subject to the previous Undertakings since 1995 and had not breached them. The Undertakings required it not to amend its Rules to restrict switching or dual sourcing by its members. It stated that, after a further period of 10 years, in which revised Undertakings were in force, it would be clear that, absent the Undertakings, NHBC would not seek to re-impose such restrictions on its members; its members' expectations and NHBC's own culture of competition compliance would prevent this. Without a sunset clause, a further review would be required before the Undertakings could be lifted. In NHBC's view this would impose an unnecessary cost burden on NHBC.
- 5.9 We considered NHBC's proposal for a sunset clause carefully. While, as noted above, there had been a significant number of recent entrants to the market, competition remained limited so that NHBC's market share remained very high. Given this ongoing concern, we considered that it was right that revised Undertakings should be given a full opportunity to encourage competition in the market. The new Undertakings are more focused and targeted than the 1995 Undertakings and include provision for the main elements to be drawn to the attention of members through a notice on the NHBC website. As a result, we would expect awareness of the ability to dual source and/or to switch to increase. We noted that the nature of the revised remedy was such that any ongoing burden on NHBC was likely to be modest. We were nonetheless mindful of the need to ensure that the overall period of the remedy was not unreasonable and that it did not impose unnecessary burdens, including in relation to the cost of future reviews.
- 5.10 Having balanced these factors, we have decided that the proposed new Undertakings should be subject to a sunset clause of 15 years. In considering the appropriate limit to duration, we noted NHBC's evidence⁶³ that that the new home warranty is a long tail insurance product spanning over 15 years. As a result, we could expect companies that are considering their options regarding structural warranties to do so within that period. In light of this, we consider 15 years is a period long enough for us to believe that the changes capable of being brought about in the market by the Undertakings should have manifested themselves within that period and accordingly it is appropriate for the new Undertakings to cease to have effect after 15 years.

⁶³ See paragraph 4.41 above.

5.11 Our guidance⁶⁴ indicates that where a sunset period substantially longer than 10 years is in place, the CMA would normally assess the continued need for the remedy within 10 years. In this instance, the CMA does not envisage prioritising a further review of the new Undertakings within the 10 year period. However, the Undertakings will be subject to CMA monitoring, and, if necessary, the CMA will be able to take action before the sunset clause takes effect, either by way of a review of the Undertakings or using its other tools.

⁶⁴ Market Studies and Market Investigations: Supplemental guidance on the CMA's approach, CMA3, paragraph 4.25.

ANNEX 1: NHBC STRUCTURAL WARRANTIES REMEDIES REVIEW

Undertakings given by NHBC to the Competition and Markets Authority pursuant to paragraph 16 of schedule 24 to the Enterprise Act 2002

1. Background

- 1.1. On 7 December 1995, the Secretary of State for Trade and Industry accepted the 1995 Undertakings, following a MMC investigation, which had 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.
- 1.2. In July 2015, the Competition and Markets Authority (CMA) published an invitation to comment on its proposal to conduct reviews on whether some or all of 13 sets of monopoly remedies put in place before 1 January 2015, which included the 1995 Undertakings, had experienced a change of circumstances relevant to the remedy in place and whether these remedies may no longer be appropriate and need to be varied, superseded or removed.
- 1.3. In response to this consultation, NHBC requested a review of the 1995 Undertakings and on 21 March 2017, the CMA commenced this review.
- 1.4. On 18 October 2017, the CMA published its Remedies Review Report concluding that the 1995 Undertakings were no longer appropriate and should be superseded.
- 1.5. Now NHBC hereby gives to the CMA the following Undertakings pursuant to paragraph 16 of Schedule 24 to the Act, which shall supersede the 1995 Undertakings.

2. Interpretation

- 2.1. The purpose of these Undertakings is to give effect to the CMA's Remedies Review Report and they shall be construed accordingly.
- 2.2. Any word or expression used in these Undertakings or the recitals to these Undertakings shall, unless otherwise defined herein and/or the context otherwise requires, have the same meaning as in the Act or the Remedies Review Report (as appropriate).

- 2.3. In these Undertakings the word ‘including’ shall mean including without limitation or prejudice to the generality of any description, definition, term or phrase preceding that word, and the word ‘include’ and its derivatives shall be construed accordingly.
- 2.4. The headings used in these Undertakings are for convenience and shall have no legal effect.
- 2.5. References to any statute or statutory provision shall be construed as references to that statute or statutory provision as amended, re-enacted or modified whether by statute or otherwise stated.
- 2.6. References to recitals, paragraphs, subparagraphs, annexes and schedules are references to the recitals to, paragraphs and subparagraphs of, annexes and schedules to, these Undertakings unless otherwise stated.
- 2.7. Unless the context requires otherwise, the singular shall include the plural and vice versa and references to persons includes bodies of persons whether corporate or incorporate.
- 2.8. The Interpretation Act 1978 shall apply to these Undertakings as it does to Acts of Parliament.
- 2.9. Further, in these Undertakings:

‘the 1995 Undertakings’ means the undertakings given by NHBC under section 88 of the Fair Trading Act 1973 to the Secretary of State for Trade and Industry following the MMC Report;

‘the Act’ means the Enterprise Act 2002;

‘Alternative Providers’ means any company providing a Structural Warranty product for new homes other than NHBC;

‘the CMA’ means the Competition and Markets Authority;

‘Commencement Date’ means the date on which these Undertakings are accepted by the CMA in accordance with paragraph 16 of Schedule 24 to the Act;

‘MMC’ means the Monopolies and Mergers Commission;

‘MMC Report’ means the report of the MMC dated 14 December 1990 entitled *A report on the existence or possible existence of a monopoly situation in relation to the supply within the United Kingdom of structural warranty services in relation to new homes*

‘NHBC’ means the National House Building Council;

‘Registered Builders’ means builders or developers of new homes listed on NHBC’s register;

‘Remedies Review Report’, means the CMA’s report dated 18 October 2017 entitled *NHBC structural warranties undertakings review: Final decision*;

‘the Rules of Membership’ means the rules as laid down from time to time by 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;

‘Termination Date’ means the day that is 15 years from the Commencement Date and which corresponds to the same day of the month as the Commencement Date.

‘Undertakings’ means these undertakings as given by NHBC and accepted by the CMA;

‘Working Day’ means a day other than a Saturday or Sunday or a public holiday in England, Wales or Scotland, and any reference in these Undertakings to ‘days’ means calendar days.

3. Commencement

- 3.1. These Undertakings will come into force on the Commencement Date.
- 3.2. The 1995 Undertakings will cease to have effect from the Commencement Date.

4. Undertakings

- 4.1. NHBC undertakes that it shall not make any amendments or additions to the Rules of Membership which have the object or effect of preventing or discouraging Registered Builders from dual sourcing from or switching to Structural Warranties provided by Alternative Providers.
- 4.2. NHBC undertakes to notify the CMA of any amendments or additions to the Rules of Membership at the same time as notification of such amendments or additions is made to Registered Builders.
- 4.3. NHBC undertakes that it shall within 10 Working Days starting from the first Working Day after the Commencement 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.

5. Procedure for notification

- 5.1. NHBC undertakes that any notification by it shall make full disclosure of every material fact and matter that it reasonably believes is relevant to the CMA's assessment of whether the notified amendment or addition complies with these Undertakings.
- 5.2. In the event that NHBC discovers that a notification has been made without full disclosure to the CMA in accordance with paragraph 5.1, NHBC undertakes to:
 - 5.2.1. inform the CMA in writing identifying the information that it omitted to include in the notification within two Working Days of becoming aware that the relevant information is misleading or incomplete; and
 - 5.2.2. at the same time or not later than two Working Days starting with the date on which it has informed the CMA of the omission in accordance with paragraph 5.2.1 above, provide to the CMA a notification that includes the missing information.

6. General obligation to provide information to the CMA

- 6.1. NHBC undertakes that it shall promptly provide to the CMA such information as the CMA may reasonably require for the purpose of performing its functions under the Undertakings or under the Act.
- 6.2. NHBC undertakes that should it at any time be in breach of any provision of the Undertakings, it will notify the CMA within two Working Days starting with the date it becomes aware of the breach to advise the CMA that there has been a breach and of all the circumstances of that breach.

7. Acceptance of Service

- 7.1. NHBC hereby authorises [] to accept on its behalf service of all documents, orders, requests, notifications or other communications connected with the Undertakings (including any such document which falls to be served on or sent to NHBC in connection with proceedings in court in the United Kingdom).
- 7.2. Unless NHBC informs the CMA that [] has ceased to have authority and has informed the CMA of an alternative to accept and acknowledge service on its behalf, any document, order, request, notification or other communication connected with the Undertakings shall be deemed to have been validly

served on NHBC if it is served on [], and service or receipt shall be deemed to be acknowledged by NHBC if it is acknowledged by email from [] to the CMA.

8. Effect of invalidity

8.1. NHBC undertakes that should any provision of the Undertakings be contrary to law or invalid for any reason, NHBC shall continue to observe the remaining provisions.

9. Governing law

9.1. These Undertakings shall be governed by and construed in all respects in accordance with English law.

9.2. Disputes arising concerning these Undertakings shall be subject to the jurisdiction of the courts of England and Wales.

10. Termination and release

10.1. The variation, release or supersession of these Undertakings shall not affect the validity and enforceability of any rights or obligations that arose prior to such variation, release or supersession.

10.2. The Undertakings shall cease to have effect at 17.00 on the Termination Date.

FOR AND ON BEHALF OF NHBC

.....	Signature	Signature
.....	Name	Name
.....	Title	Title
.....	Date	Date