The UK experience of market investigations

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Competition & Markets Authority

Introduction

Introduction

- Market investigation regime established in EA 2002
- Enable a holistic examination of markets
  - seek to identify features that **prevent**, **restrict** or **distort** competition
- Flexible approach allowed
- Broad range of order-making powers
  - Remedies tailored to AECs identified
  - Remedies are forward looking

Introduction

- 14 completed MIRs since 2002 (plus two ongoing)
  - 13 markets where AECs found & remedies designed / 1 clearance
- Wide range of industries investigated

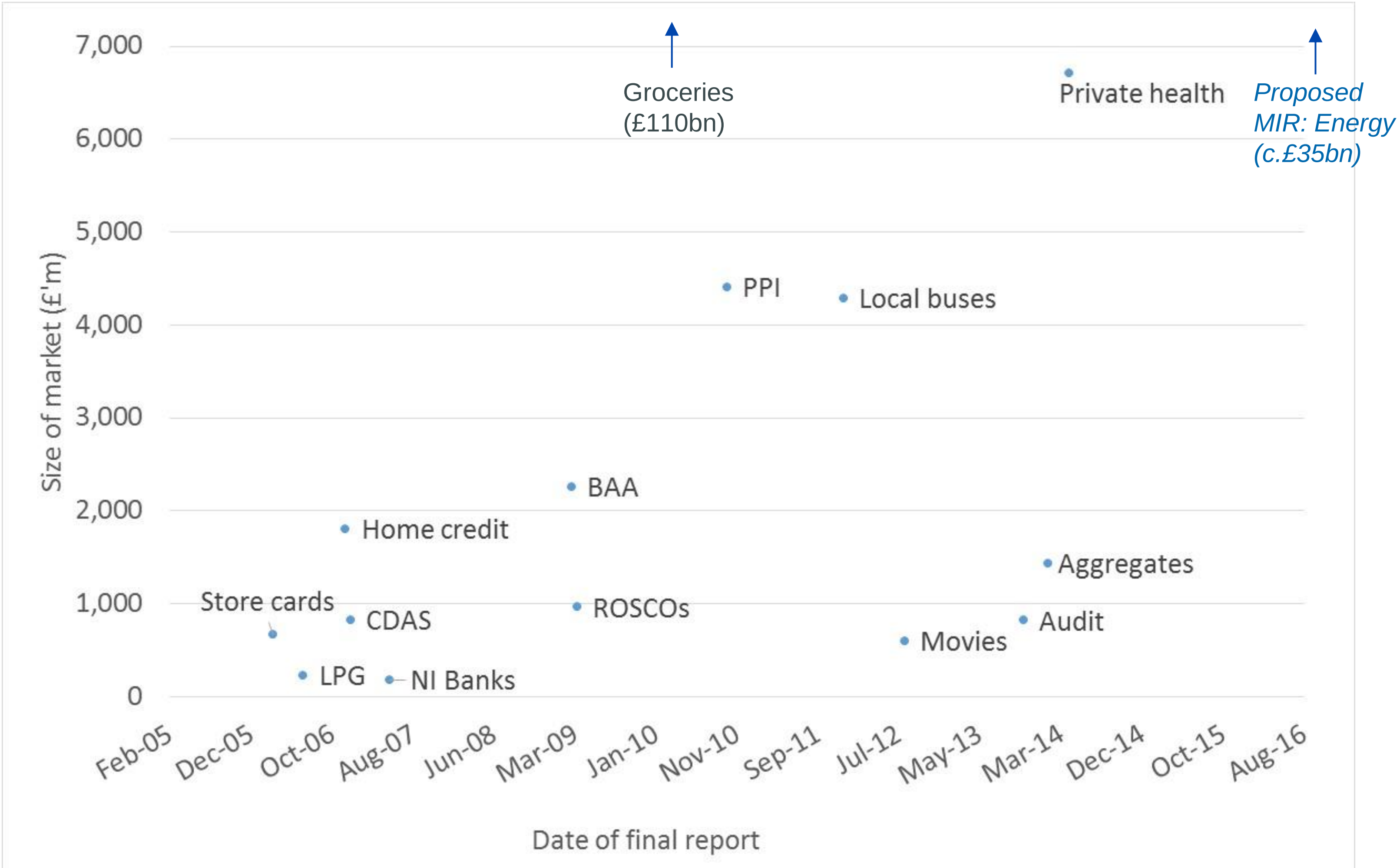
- Store cards
- Liquefied petroleum gas
- Home credit
- Classified directory advertising services (Yellow Pages)
- N. Irish banks (personal current accounts)
- Rolling stock leasing
- Groceries

- Payment protection insurance
- BAA Airports
- Local buses
- Movies on Pay TV – cleared
- Statutory audit
- Cement/aggregates
- Private Healthcare

Remedies not yet implemented

- Payday lending (ongoing)
- Private motor insurance (ongoing)

Introduction



- Early MIRs covered relatively modest markets under the EA. However, the Groceries MIR (published in October 2009) ushered in a phase of larger, more complex inquiries

Introduction

	Customer information	Switching Remedies	Lower entry barriers	Recommend ations	Controlling outcomes	Structural remedies
Store cards	X	(X)				
LPG	X	X				
Home credit	X	X	X	(X)	X	
CDAS					X	
NI Banks	X	X				
Groceries				X		X
PPI	X	X		(X)		
BAA Airports			X	X		X
ROSCOS	X	X	X	X		
Buses	(X)		X	X		
Audit	(X)	X	X			
Aggregates	X					X
Private healthcare	X	(X)	X			X

- Remedies resulting from MIRs are quite varied, reflecting the variety of features found to affect competition

(X)=minor part of package

Introduction

- There are several means by which MIRs create benefits for customers:
  - Direct introduction of measures that address competition problems (ie remedies)
  - Affecting or influencing other regulations / regulators
  - Impact on the behavior of parties when the sector is being scrutinized

- Evaluating the effect of MIRs is not straightforward:
  - Difficulty of framing the counterfactual – what would have happened in the absence of the MIR measures?
  - Gathering relevant information for a formal ex post evaluation:
    - No formal information-gathering powers
    - Quality / service effects are often difficult to measure.
  - A reasonable period needs to elapse before impact is apparent

Introduction

- Quantifications of ‘detriment’ provide a limited measure of the harm to customers from AECs
  - Generally based on excess profitability analysis, ie only captures price detriment (& not necessarily all of that)
    - Groceries: £105m to £125m p.a.
    - BAA: £4m - £7m p.a. but substantial dynamic benefits anticipated
    - PPI: c.£1.5 billion (gross customer detriment p.a.)
    - Private Healthcare: c.£160m p.a.
  - Quality/choice/innovation detriment usually cannot be reliably estimated
- Remedies seek to provide as comprehensive a solution as possible to all AECs
- Impact needs to be assessed broadly

Types of Remedies

Types of remedies

- The CC imposed three basic types of remedy:
  - **Market opening measures** – aimed at lowering barriers to entry / expansion for competing suppliers
  - **Strengthening consumer response** – enabling consumers to be effective drivers of competition
  - **Divestitures** – changing the structure of the market
  - In addition, the CC has imposed several other remedies that do not fit neatly into these categories; notably remedies that control outcomes to mitigate the adverse effects of an AEC (discussed below)
  - In general, the CC has preferred to deal with the underlying problem(s) rather than just 'treat the symptoms', i.e., mitigate adverse effects.

Market opening remedies

LPG market

- Features leading to an AEC:
  - Suppliers retained ownership of gas tanks on customers' premises, which needed to be removed and replaced if the customer wished to switch
  - Customers faced charges from both incoming and outgoing suppliers to switch
  - Suppliers imposed contractual restrictions on switching, eg 3-month notice periods
- Remedies:
  - Tank transferred from existing to new supplier at regulated price
  - Maximum 42-day period to effect switch
  - Improved information to customers on the switching process

Market opening remedies

Home credit

- Features leading to an AEC:
  - Lenders did not share client data with credit reference agencies
    - Customers were unable to convey reliable information on their creditworthiness to lenders
  - Asymmetry of information about customers’ creditworthiness between incumbent and new lenders
  - Customers are insensitive to measures of price other than the level of weekly repayment

Market opening remedies

Home credit

- Remedies:
  - Lenders required to share data on payment records of customers through Credit Reference Agencies
  - Lenders required to give early settlement rebates at least as generous as those based on actuarial formula set out in The Consumer Credit (Early Settlement) Regulations 2004

Market opening remedies

Statutory audit

- Features leading to an AEC:
  - Significant barriers to switching auditors due to:
    - Opportunity costs in management time in selection/education of new auditor;
    - Loss of expertise/knowledge of incumbent auditor – reduced efficiency/increased risk of the audit in early years following a switch;
    - Difficulty in judging audit quality in advance – companies cannot calculate accurately the benefits of tendering / switching.

Market opening remedies

Statutory audit

- Mid Tier audit firms face experience/reputational hurdles which they may lack incentives to overcome given infrequency/ unpredictability of tendering
- Information asymmetry between shareholders and audit firms – shareholders have little information regarding work carried out by the auditor

- Remedies:
  - FTSE 350 companies required to retender for audit services at least once every ten years
  - Strengthen role of audit committee relative to management

Market opening remedies

Payment Protection Insurance

- Features leading to an AEC
  - Suppliers fail to seek to win customers actively by using the price or quality of their PPI policies as a competitive variable.
  - Product complexity (variations in pricing structures and in T&Cs, the way information is presented to customers); the perception that taking PPI would increase their chances of being given credit; the bundling of PPI with credit; and the limited scale of stand-alone provision act as barriers to search for all types of PPI policies.
  - The sale of PPI at the point of sale restricts the extent to which other PPI providers can compete effectively.

Market opening remedies

Payment Protection Insurance

- Remedies:
  - A prohibition on selling PPI at the credit point of sale
    - Seven days must elapse between credit sale and lender seeking to sell PPI to the customer
    - A limited exception: PPI may be sold over the Internet or telephone 24 hours after conclusion of the credit sale period provided that the consumer has initiated the transaction.

Strengthening consumer response

Store cards

- Features leading to an AEC:
  - Little competitive pressure on pricing: APRs, late payment fees, bundled insurance products
  - Lack of information provided to consumers on statements leading consumers to take credit or insurance on terms which are not clear to them
- Remedy:
  - Better information on cost of credit on statements, including applicable APR, ‘wealth warning’ (minimum repayments) and statement regarding availability of cheaper credit (if APR >25%)
  - Provision and prominent display of facility pay by direct debit

Strengthening consumer response

Home credit

- Features leading to an AEC (information shortfalls):
  - The lack of data sharing;
  - The inability of agents not already known to a customer to convey their reliability to that customer; and
  - The regulatory prohibition on door-to-door canvassing of cash loans.
- Remedies:
  - Lenders required to publish information on prices and other terms of their loans on an independent website
  - Recommendation that the Consumer Credit Act 2006 require home credit statements to include total cost of credit among other information

Divestitures

BAA

- Features leading to an AEC:
    - Common ownership of Edinburgh and Glasgow airports which prevents competition between them
    - Common ownership of the three BAA London airports (and Southampton):
        - prevents, restricts or distorts competition between them in terms of (i) price and (ii) capacity development (to alleviate constraints)
        - exacerbates the inadequacies of the regulatory system, reducing the benefits of regulation & distorting competition between airlines
    - Aspects of the planning system restrict and/or distort competition by acting as a barrier to entry of new airports and expansion of existing ones.

Divestitures

BAA

- Remedies:
  - Disposal of both Gatwick and Stansted to separate purchasers
  - Disposal of either Edinburgh or Glasgow airports
  - Recommendations to improve the regulation of Heathrow and Aberdeen airports

The main benefits from the divestitures were expected to result from the dynamic aspects of competition, as Gatwick and Stansted were already subject to regulated price control.

The CC expected improvements in the way in which the London airports delivered capacity, as well as in a range of service/quality aspects of airports' offering.

Others – controlling outcomes

Classified Directory Advertising Services (Yellow Pages)

- Features leading to an AEC:
  - High levels of concentration, with Yell holding a 75% market share, which have persisted over an extended period of time; and
  - High barriers to entry and expansion, including the network effect and the need to establish a strong brand identity. These gave Yell a significant incumbency advantage
- Remedies:
  - Yellow Pages adverts to be subject to a price control of RPI–6 per cent until March 2008; RPI thereafter
  - Volume discounts permitted provided they are published and available to all advertisers

Effectiveness of Remedies

Effectiveness of remedies

Market-opening measures

- **LPG:**
  - Important to combine market-opening measure with enhanced information to customers to facilitate switching
  - Rates of switching by individual customers has increased from 0.5% prior to the MIR to 4.0% in 2013
  - For metered estates, rates of switching have also increased but to a more limited extent – from 0.5% to 1.2% (in 2013)
    - In these cases, large groups of customers need to agree to switch

Effectiveness of remedies

Market-opening measures

- **Home credit:**
  - Mixed results in terms of suppliers' use of CRA data
  - Where lenders have chosen to use the data, the information advantages of the incumbents have been reduced
  - Impact in terms of encouraging mainstream lenders to compete with home credit providers limited by economic downturn
  - Decline in bad debts partly due to remedy and partly due to more stringent lending criteria (as a result of the recession)
  - Changes to early settlement rebates resulted in transfer from lenders to customers of c.£35 million per year (approximately half the detriment identified in 2006)

Effectiveness of remedies

Market opening measures

- **Payment Protection Insurance:**
  - Impact of the MIR was to ‘shine a light’ on the various respects in which the market was working poorly for consumers
  - Evidence of very high profitability of PPI highlighted incentive to mis-sell PPI
  - FSA worked closely with CC
    - moved to ban single-premium products following PFs
  - Fall-out from the mis-selling scandal has been a significant reduction in the size of the market from £4.4bn in 2006 to c.£1.2bn in 2011
    - UK banks so far provided €27 billion for compensation to customers

Effectiveness of remedies

Strengthening consumer response

- **Store cards:**
  - Number of store cards in issue, number of transactions and total outstanding credit balances continued to decline from 2006 onwards, albeit at a slower pace then in 2004-2005
  - Average APR declined from 24.7% to 23.9% between 2005 and 2008
  - Proportion of card issuers charging less than 25% APR (warning level) increased from 30% in 2005 to 57% in 2008
- Most of the changes took place during the MIR, rather than following remedies implementation

Effectiveness of remedies

Divestitures – BAA (Gatwick Airport)

- Improved customer service:
  - Several initiatives, such as new check-in products and the introduction of long-haul incentive programme (to attract long-haul flights)
  - Ratio of complaints to compliments reduced from 17:1 (2009) to 5:1 (summer 2010)
  - Significantly improved performance in meeting security queue targets
- Capital expenditure efficiency savings:
  - Extended Pier 6 rather than investing in Pier 7 – close to the same outputs for £150m investment (rather than £400m budgeted by BAA)
  - Alternative capital proposal for improvement to baggage system, c.£70m cost, compared with £120m under BAA proposal

Effectiveness of remedies

Divestitures

- Several beneficial effects in terms of regulatory framework:
  - Separate ownership of airports allows CAA to benchmark performance via ‘comparative competition’
  - CAA determined that Stansted no longer needs to be regulated
  - Gatwick regulation lighter touch – licence-backed commitments rather than RAB
- London airports now competing for new capacity

Effectiveness of remedies

Others

- **Yellow Pages**
  - Change of circumstances: spend on Internet classified advertising increased from £1.5bn to £4bn between 2006 & 2012
  - Evidence that Internet had overtaken *Yellow Pages* as consumers' first choice of media for searching for goods/services
  - hibu's (Yell) UK CDAS business' revenues declined by >60% since 2006; digital revenues higher than CDAS revenues
  - hibu priced below its price cap in all classifications
  - Price control lifted in March 2013

Effectiveness of remedies

- A number of MIRs have had an impact via other regulators (as well as directly):

  - **PPI**: MIR provided in-depth view of market, used by FSA
  - **Statutory Audit:** CC emphasis on strengthening the role of audit committees – influential on EU measures
  - **ROSCOs:** CC recommendation for extended franchise terms for train operating companies was initially resisted but later implemented by the in-coming coalition government

Learning from regulators

- Sector regulators (eg Ofcom, FCA, Ofgem) working extensively on switching and demand-side interventions
- FCA in particular working on behavioural remedies in the financial sector
- All sector regulators working on access remedies (price caps, non-price access remedies)

Work with sector regulators

- Worked with Ofgem on competition in the energy market in early 2014. Possible market investigation in energy later this year.
- Currently working with FCA on market studies focussing on competition in SME banking and personal current accounts.

Conclusions

- Remedies have generally focussed on promoting competition & making markets work better, rather than regulatory approach of controlling outcomes
- Remedies are flexible to the specific issues identified in the MIR
- Difficulty of assessing outcomes – often too early to tell or there have been other changes in the market
- However, remedies have had substantial early impact in certain markets, (eg BAA and PPI) and significant impact in other markets (e.g. home credit, store cards, LPG)
- Working closely with regulators and learning from remedies in regulated sectors

References

- CC Review of Store Cards Remedies (2011)
- CC Review of Home Credit Remedies (2013)
- CC Consideration of possible material change in circumstances, BAA market investigation:
- Review of the Competition Commission's approach to remedies in market investigations: recommendations and proposed action:
- Review of Undertakings (Yell)