

**EXTENDED WARRANTIES MONOPOLY INQUIRY:  
STATEMENT OF HYPOTHETICAL REMEDIES**

**Consultation on possible remedies**

The Competition Commission (CC) has today sent a letter to domestic electrical goods retailers and others concerned, to consult them on the final stage of its monopoly inquiry on extended warranties. The letter sets out the CC's provisional view that retailers who sell extended warranties at the point of sale of the electrical goods are doing so in a way which creates a "complex monopoly" situation in the supply of extended warranties. The CC is now considering whether this is against the public interest; and so it is consulting on a range of possible remedies. This "remedies letter" is attached. The letter has also been published on the CC's website.

All retailers who sell extended warranties at the point of sale of domestic electrical goods are identified as involved in the complex monopoly, including mail order and internet operations, together with the insurance and service companies involved in these transactions. Details are given at Annex 1 of the remedies letter.

Identifying those who are acting as a complex monopoly does not amount to an adverse finding. The CC also has to consider whether their conduct (described at Annex 3 to the letter) is against the public interest. In summary, the conduct identified has the effect of limiting the information and choice which consumers have when they consider buying an extended warranty. It may also involve higher prices for extended warranties than if there were more competition.

If the CC reaches the view that this conduct is against the public interest, it will recommend measures (technically "remedies" in the terms of the Fair Trading Act 1973) to address them. The CC is therefore consulting at the earliest opportunity on a range of possible remedies. In considering what remedies might be appropriate, the CC will look at what is practicable, proportionate and effective in addressing the problems identified. It will take account of variations in sales practices and of the practicability of applying remedies in the case of smaller retailers.

## **Consumers deserve choice, information, value**

The CC accepts that extended warranties provide a diverse range of services that are valued by a significant minority of DEG consumers; the question is whether consumers would get more choice and better value if competition to provide them were improved. The CC's current concerns are that consumers should have choice, and should have good information on the choices that are available; they should also have time and opportunity to consider what choice to make. The aim should be to encourage competition and empower consumers to get good value.

## **Remedies**

The possible measures on which the CC is now seeking comments include;

-Six aimed at ensuring that consumers have the information they need to make a considered choice (items 1 to 6 in Annex 2 of the letter); these include requirements on retailers to display the price of their own extended warranty, and of any manufacturers extended warranty; and to provide specified written information on their own extended warranties and those of other providers, and on the reliability of the type of appliance to which the extended warranty relates.

-Four aimed at giving consumers better opportunities and more time to consider the alternative extended warranty offerings, or to change their mind (items 7 to 10 in Annex 2); including requirements for extended periods during which consumers may cancel their extended warranty without cost; and for delayed notification, confirmation, or completion of an extended warranty purchase.

-Four aimed at promoting the offer of a wider choice of different extended warranties and greater competition amongst suppliers (items 11 to 14 in Annex 2); including requirements that suppliers should offer extended warranties that are annually renewable, and extended warranties that offer only core services; and that retailers should provide extended warranties on domestic electrical goods sold by other retailers.

-Three aimed at restraining selling practices that make some consumers feel unduly pressured (items 15 to 17 in Annex 2); including limits on incentives given to sales assistants and tighter controls on sales and discounting techniques.

-Two aimed at helping consumers to compare the quality and value of the cover offered by alternative extended warranties (items 18 and 19 in Annex 2); including establishing a standard benchmark extended warranty that would ease comparisons and a requirement to make clear the extent of insurance backing.

A number of these suggested remedies are alternatives, others are complements, to each other. Once the CC has received and considered responses to its suggestions (see paragraphs 11 to 13 below) it will make a decision on whether to recommend any remedies and, if so, which should be included in its final report.

## **Background**

The CC has reached the provisional views summarised above on the basis that when retailers sell extended warranties at the point of sale of the electrical goods they do so in a way which prevents, restricts or distorts competition, and that they are acting as a complex monopoly. The evidence shows that almost all extended warranties (excepting renewals) are purchased at the point of sale of the electrical good and that, at the point of sale,

- in virtually all cases, only one supplier's extended warranty is available;
  - there is generally no information available on alternative extended warranties or their suppliers;
- and that
- consumers generally have little information, and no systematic or easily available information, on the likely reliability, or repair costs, of the electrical goods for which they are purchasing an extended warranty.

So, generally, consumers are offered only one supplier's extended warranty and terms, and some may feel that they have to agree and pay for it before they can make an informed choice of the alternatives.

In its issues letter published in January the CC indicated that it considered that Dixons Group plc (Dixons) might have a "scale monopoly" in the market, because on information available at that stage it was estimated that Dixons had slightly more than 25% of the supply of extended warranties. Further analysis, taking account in particular of the supply of free warranties, has, however, suggested that Dixons' share is slightly below 25%. Assuming that this information is confirmed, the CC expects to conclude that there is no scale monopoly. This view does not affect the inclusion of Dixons in the complex monopoly.

## **Consultation Period**

The letter has been sent to the retailers, manufactures, and insurers listed at Annex 1 of the letter, and to others who participated in the inquiry, including the various representative bodies of consumers, retailers, manufacturers, insurers, etc. Comments and suggestions are invited by 6<sup>th</sup> June.

12. Hearings will be held in early June with parties most directly affected by the proposed remedies.
13. The CC has been asked to report by 1<sup>st</sup> July. In view of the need to consult fully on remedies, it is likely that a slightly longer period will be needed.

### **Earlier stages in the Inquiry**

The CC was asked on 2<sup>nd</sup> July of last year to undertake an inquiry into the supply of Extended Warranties on domestic electrical appliances under the Fair Trading Act 1973. The terms of reference require the CC to investigate and report on whether one or more companies is involved in a monopoly in the market; on whether there are any practices which exploit or maintain this monopoly; and on whether they may operate against the public interest.

Following initial investigations the CC published on 28<sup>th</sup> February an “issues letter” setting out the issues that they had identified for further consideration, in order to give interested parties an opportunity to put to the CC any points they wished to raise. The CC then held hearings with number of the main parties, followed by an open hearing on 25<sup>th</sup> April.

### **Notes to Editors**

1. The reference was made by the Director General of Fair Trading under s.2 of the Fair Trading Act 1973 on 2 July 2002 (see Press Release 34/02). The CC has been asked to report by 1 July 2003.
2. The inquiry is being carried out by a group of five CC members led by Sir Derek Morris, the CC Chairman. The other four members are Christopher Clarke, Dr Diane Coyle, Peter Hazell and Dr Elizabeth Monck.
3. Further information can be found on the CC website: [www.competition-commission.org.uk/inquiries/warranty.htm](http://www.competition-commission.org.uk/inquiries/warranty.htm)

Enquiries should be directed to: Francis Royle, Press Officer, tel.: 020-7271 0242

## **COMPETITION COMMISSION**

### **EXTENDED WARRANTIES INQUIRY – POSSIBLE REMEDIES**

**20 May 2003**

Provisional view on the monopoly situation

1. Following the issues letter dated 28 February 2003 and having taken further evidence, the Commission's provisional view is that a complex monopoly situation exists in the supply of extended warranties (EWs) on domestic electrical goods (DEGs) in the UK. We have taken account of arguments and evidence put to us to date in response to the issues letter.
2. In reaching provisional views on the complex monopoly situation, we have considered the evidence that retailers of DEGs who provide paid EWs at the point of sale (POS) of the relevant DEGs are members of a group which supply at least one quarter of EWs and conduct their affairs in a way which has the effect of preventing, restricting or distorting competition to provide EWs. The conduct that we have provisionally identified as having this effect is summarised in Annex 3 to this letter, and was further described in the issues letter. We will continue to assess any further evidence relating to this. We note that not all members of the group engage in all the practices identified. However our provisional view is that, overall, this group engages in the courses of conduct identified and that there is therefore a complex monopoly situation.
3. Those whom we have provisionally identified as members of this group are listed in Annex 1. We also believe they may benefit from the complex monopoly situation. For the reasons more fully explained in the issues letter, insurance and service companies that are involved in the provision of EWs through retailers at POS are identified as members of the group. (This is because in many cases the consumer who purchases an EW at POS contracts with the insurance company or service company rather than with the retailer, and the retailer is acting as the agent for the insurer; they are thus all parties involved in the supply of that particular EW.) It should be emphasised that identifying a monopoly situation does not in itself imply an adverse finding, i.e. that those concerned are acting against the public interest.
4. In the issues letter we indicated that on the basis of initial evidence, the Dixons Group (Dixons) might supply at least a quarter of the reference services. However, further information received and further examination of the data have suggested that when free EWs are included in the supply, our best

estimate is that Dixons' share of supply is below 25%. This is the case whether shares are calculated on the numbers of EWs or on their value (assigning a notional value to free EWs). Assuming that this information is confirmed, we expect to conclude that there is no scale monopoly. This view does not affect the inclusion of Dixons in the complex monopoly.

#### Courses of conduct

5. Our provisional view of the market is that there is a separately identifiable market for EWs, distinct from the DEG market. Reasons for this include the facts that only a minority of purchasers of DEG also purchase an EW, and that EWs and DEGs are priced separately and on the basis of different pricing policies.

6. Central to our provisional view that a complex monopoly operates in relation to extended warranties are four overlapping characteristics of market behaviour. We base this view on evidence from the parties and from consumer surveys. The characteristics are:

- (i) almost all EWs (excepting renewals) are purchased at the point of sale of the DEG to which the EW attaches; and consumers generally engage in little, if any, research or comparison as between alternative EW offers. In our view this is likely to reflect convenience to the consumer, lack of availability of price information and a tendency for consumers to think about purchasing an EW mainly or only at the point when they are focused on the DEG purchase;
- (ii) in virtually all cases, only one supplier's EW is available at POS. This will typically be the EW provided by the retailer though in most cases that EW is actually supplied by a third party which is the sole supplier of EWs to the retailer.
- (iii) at POS, there is generally no information available on alternative suppliers. Many consumers are aware of alternative sources, for example manufacturers, but evidence suggests that very few will have found out or will have had provided to them at POS any information about specific suppliers, their terms or conditions;
- (iv) consumers generally have little information, and no systematic or easily available information on the likely reliability of DEGs, likely repair costs or, where relevant, the probability of theft or accidental damage, all of which are needed to assess the value of an EW.

7. The CC regards none of these characteristics as surprising nor, taken individually, as necessarily distorting, preventing or restricting competition. The behaviour of consumers when purchasing an EW is understandable and rational; there are significant difficulties in identifying or conveying robust data on future reliability of DEGs or repair costs of individual models, and it is normal commercial practice that a retailer selling its own EW will generally choose not to offer a competitor's EW or provide information about alternative sources. We are, nonetheless, currently of the view that these courses of conduct, taken together and in the context described, act to distort or restrict competition.

8. In consequence, we currently consider that competitive forces in the market for EWs may be constrained by consumers' lack of opportunity to consider alternatives at POS, and also by the lack of appropriate information, either on the terms and prices of the EW on offer in comparison with any alternatives, or on DEG reliability and repair costs. It is notable that there is little current competition between retailers in providing EWs. EWs seldom appear in price promotions and retailers rarely provide EWs on DEGs supplied by other retailers. In consequence, consumers appear significantly less able to make an informed decision when considering their purchase than they are when they purchase the DEGs themselves.

9. Furthermore in this context, limiting the choice of cover and time periods may also act to restrict and distort competition. An additional factor is that consumers generally pay for EWs at POS, even though many of the benefits of the EW are not delivered until the initial guarantee expires.

10. In these circumstances, competitive pressure on the provision of EWs is in our view likely to be weakened. Other possible courses of conduct that may also have the effect of preventing, restricting or distorting competition are still being considered. In the situation described above, retailers may be able to set prices that do not reflect the underlying and associated costs, and as a result, may be above those necessary adequately to finance the business. Where this happens, this can act further to distort competition by sending misleading information to consumers as to the resource costs of EWs. It may also distort incentives for consumers in deciding on purchasing an EW. This could reduce demand below the level that fully competitive conditions would generate. In this context it may be significant that only a minority of consumers purchase EWs.

11. We are still considering whether these effects may be further reinforced by certain selling practices and whether they may also provide an opportunity, in some cases, for unfair terms to be specified.

12. In addition, there is widespread use of uninsured service agreements, principally for tax reasons. This raises the question whether such arrangements may provide less protection than insured schemes. (A note on insured and uninsured EWs is attached at Annex 4.)

#### The public interest

13. We estimate that about 16.5 million EWs were provided in 2001 (including about 3.7 million free EWs). EWs clearly satisfy a genuine demand from many consumers, who want to cover themselves against relevant risks, and who may also require customer support services for the DEG they have purchased. The main public interest issue for us is whether that demand would be satisfied better and more cheaply if the practices we have identified were not distorting or restricting competition.

14. We are still considering, in the light of the submissions we have received, whether these practices are against the public interest. Our current concerns are that the way in which EWs are sold at POS may have the effect of limiting consumer information and choice, and may result in consumers paying higher prices than otherwise for EWs. In addition, in some cases, EWs may be provided on terms that are less favourable or provide less protection than in a fully competitive market, and some selling practices may also operate against the public interest. It does not currently appear to us that the practices that may result in such adverse effects are an essential condition for delivering the convenience of buying EWs at POS. We would also need to consider whether any such adverse effects would be offset by any lowering of prices of DEGs that may result from the relevant practices. For example, it may be against the public interest if competitive prices do not prevail in each market. It might also be against the public interest if a minority of consumers were buying expensive EWs and thereby in part subsidising the majority who buy only the DEGs.

#### Remedies

15. Given our provisional view on the complex monopoly situation and the possibility that this may result in effects adverse to the public interest, we are now consulting those who may be affected on a range of possible remedies that may address any adverse effects on the public interest that we identify. This letter is the first stage in that consultation process. We welcome proposals from interested parties regarding other possible remedies.

16. We set out in the attached Annex 2 the range of possible remedies that might wholly or partially, singly or jointly, address an adverse public interest finding. We will focus on remedies that, separately or taken together, would remove barriers to competition at POS, encourage the development of a more competitive market and improve informed choice for consumers. This in turn could provide scope for lower prices. The list in Annex 2 also notes certain remedies that we have considered but are not currently minded to pursue as options. In considering which remedies should be the basis for consultation, we have also taken account of the views about possible remedies expressed by consumers in our survey.

17. The remedies are essentially aimed at practices by retailers of DEGs providing paid EWs at POS (including some manufacturers selling direct to the public). To this extent, although insurers and others are included in the list of those provisionally identified as part of the complex monopoly group, the remedies addressing those practices may not directly affect them. They may be affected indirectly, in so far as the remedies affect the market for EWs and commercial practices. Practices among retailers also vary and not all the adverse findings (and thus remedies) would necessarily apply to them in all cases. Also, remedies that may be appropriate or feasible to address conduct by large DEG specialist retailers may not always be so in the case of other retailers, such as smaller retailers, on-line retailers and catalogue retailers. We do not propose that remedies would apply to the provision of free EWs.

18. Some of the remedies concentrate on improving information. We will need to consider whether such remedies would be effective on their own, or whether they would need to be combined with remedies that increase opportunities for consumers to consider such information before final commitment to an EW purchase. The remedies are shown in groups, covering improving information, changing the conditions of supply and amending selling practices. Some of those shown in each group may be alternatives. The remedies are described in general terms and may contain several options for implementation. Variations in the detail of these remedies may eventually be proposed. In deciding on any recommendations which may be necessary we will have regard, in particular, to whether remedies are relevant and proportionate to any adverse effect on the public interest, and are likely to be practicable and cost-effective.

#### Next steps

19. Comments and further or alternative suggestions are invited. Please reply to the Inquiry Secretary (Tom Muir) by 6 June.

## MEMBERS OF COMPLEX MONOPOLY GROUP

## ANNEX 1

This is a provisional identification of the complex monopoly group, which consists of all retailers and manufacturers<sup>1</sup> of DEGs who provide paid EWs at POS, together with insurers and service companies involved in such provision. Not separately named in the list below, but included in the provisional identification, are approximately 3,000 smaller retailers of DEGs. Also not separately named are some retailers, manufacturers and insurers who account for small shares of supply of paid EWs at POS. In some cases EWs are provided at POS through service companies; these are also not separately named but included in the provisional identification.

<b>RETAILERS</b>	<b>MANUFACTURERS (PROVIDING EWs at POS)</b>	<b>INSURERS (PROVIDING EWs THROUGH RETAILERS AT POS)</b>
Allders Departments Stores Ltd	Apple Computer (UK) Limited	Allianz Cornhill Insurance plc
Apollo 2000 Limited	Dell Computer Corporation Limited	AON Warranty Group Limited
Argos Retail Group	Hewlett-Packard Limited	AXA Insurance UK plc
Bennetts (Retail) Limited	Sony (UK) Limited	Domestic & General Group plc
Box Clever Technology Limited	Time Technology Group Limited	Hitachi Credit Insurance Corp Ltd
Carphone Warehouse Group plc		Landmark Insurance Company Limited
Comet Group plc		Pinnacle Insurance plc
Co-operative Group Limited		Retra Insurance Services Ltd
Dabs.com plc		Royal & Sun Alliance Insurance plc
Dixons Group plc		
Grattan plc & Freemans plc		
Jessops Limited		
John Lewis plc		
Littlewoods Retail Limited		
MFI UK Limited		
Miller Brothers Group Limited		
Orange Retail Limited		
Phones 4u Limited		
Powerhouse Retail Limited		
Redcats (UK) plc		
Richer Sounds plc		
SSE Retail Limited		
Vodafone Limited		

<sup>1</sup> Most DEG manufacturers who sell EWs do so through insurance companies, not at POS. Those listed here sell EWs together with DEGs which they sell directly to the public at POS.

## **EXTENDED WARRANTIES - POSSIBLE REMEDIES**

(Abbreviations used:

EWs - extended warranties

DEGs – domestic electrical goods

POS – point of sale of DEGs)

### **List of possible remedies**

#### A Informed decisions

1. Display price of retailer's EW
2. Display price of manufacturer's EW
3. Provide written information to consumers
4. Information on alternative providers
5. Tables of comparative information
6. Publish information on EW profitability

#### B Opportunity to compare

7. Written quotes
8. Longer cancellation periods
9. Written confirmation of the right to cancel
10. Delayed completion of sale
11. Requirement to provide EWs on DEGs sold by other retailers
12. Require annually renewable policies to be offered
13. Requirement to unbundle different elements of EWs
14. Provision of customer lists to manufacturers and other providers of EWs

#### C Selling practices

15. Discounting policy
16. Limits to sales incentives
17. Controls on sales processes

#### D Reasonable cover for risks

18. Financial protection
19. Introduce benchmark product

**A. The primary objective of the first group of possible remedies, below, is to help ensure that the consumer has the knowledge necessary to make an informed decision regarding the purchase of an EW.**

### **1. Display price of retailer's EW**

A retailer would be required to display the price of its EW alongside the price of the DEG. This would be designed to make it easier for consumers to compare total prices (i.e. including the EW) of DEGs between stores. Issues to be considered include:

- Whether this requirement would apply only to the price that is displayed next to the DEG in-store, or to a wider range of in-store price lists and advertising;
- Whether there should be a requirement for the EW price to have equal prominence to the DEG price; and/or whether the EW price should be displayed according to defined standards (for example, the 1999 Price Marking Order states that certain charges should be easy to identify, easy to read and such as not to confuse the consumer); and
- Which EW price should be displayed in the case of a retailer that offers various EW options (for example, 3 year or 5 year protection); or whether both should be displayed; or if only one, where the prices of other options would be available in-store.

### **2. Display price of manufacturer's EW**

Retailers would be required to display the price of the manufacturer's EW alongside the price of the DEG. This would be designed to make it easier for consumers to compare the price of the in-store EW to that of the manufacturer. Issues to be considered include:

- Whether there should be a requirement for the EW price to have equal prominence to the DEG price; and/or whether the EW price should be displayed according to defined standards;
- Whether manufacturers would wish to compete in this way with the retailers on whom they rely for sales;
- Any disadvantage to other potential competitors;
- What other information might be needed by consumers to allow them to understand what the price of the manufacturer's EW represents; and
- How retailers would be expected to respond to consumer queries on the manufacturer's EW.

### **3. Provide written information to consumers**

Retailers would be required to make available written information that would be designed to help consumers to make an informed decision about the purchase of an EW. Issues to be considered include:

- The stage in the EW purchasing process at which the consumer should be provided with the information (options might include when the EW is first mentioned, or any time before payment);
- The types of information about EWs that should be provided and the detail of this information, with options including:
  - A comparison of the protection offered by the EW, statutory rights, manufacturers' guarantees, household insurance;
  - The availability of EWs from alternative sources including the main categories of EW providers;
  - Key features of the terms and conditions of EWs, including the risks covered and whether cover stops following a claim; and
  - What would happen in the event of the provider failing.
- Whether the information would be standardised across all retailers, and the process by which it could be prepared and agreed; and
- Other types of information that might be provided, including information about DEG reliability and repair costs for a particular category of DEG e.g. front loading washing machines.

#### **4. Information on alternative providers**

Retailers would be required to display information about alternative providers of EWs. This remedy would be designed to increase consumer awareness of the availability of EWs from manufacturers and other providers. Some DEG retailers already notify consumers that EWs can also be purchased from other sources. Issues to be considered include:

- How many alternative EWs should be included in the information and how these would be selected (for example, whether the manufacturer's EW should be given priority, as is the case in the British Retail Consortium Code of Practice, section 2.2);
- The type of information that would be displayed and how this would be prepared and agreed (for example, whether a retailer would be required to display sales literature that was prepared by a competing firm);
- The effect that in-store sales staff may have on how consumers interpret this information; and
- Any effects on potential new providers of EWs.

#### **5. Tables of comparative information**

Tables comparing prices and terms and conditions of many of the EWs available in the market would be published by an independent organisation. The tables might help consumers to find the best prices for different levels of cover. Issues to be considered include:

- How this information would be made available to consumers, for example it might be displayed in-store or could be requested by post and published on the internet (for example, the consumer body Energywatch publishes comparative tables on electricity and gas prices that are available by post and on the internet);
- The optimum level of detail in the tables that would balance ease of understanding and usefulness to consumers; and
- Which organisations would prepare and approve the tables.

## **6. Publish information on EW profitability**

Retailers would be required to publish information on their overall EW profitability. With the involvement of consumer organisations, this may help to provide consumers with the information they need to make an informed decision about the value for money of the EWs of different providers. Issues to be considered include:

- Finding a definition of profitability that would be relatively straightforward to prepare and would be meaningful;
- Where best this information may be made available (for example, annual accounts);
- Independent verification of this data; and
- The level of detail, presentational format and frequency with which this information would be published.

**B. The primary objective of the second group of remedies, below, is to provide consumers with greater opportunity to compare the EW that is offered in-store with alternatives and to assess their need for an EW on a considered basis.**

## **7. Written quotes**

Retailers would be required to offer all consumers interested in purchasing EWs the option of taking away a written quote and applying later. This remedy would help ensure that consumers have time to read the information about the product they are buying before making their purchase. This is similar to a requirement in the GISC Code of Practice to provide written quotes if requested, including all the information needed to make an informed decision, and confirming how long the consumer has to take up the insurance on these terms. Issues to be considered include:

- How the consumer would be informed of this option (for example, verbally by the salesperson, or displayed on the EW literature and application form);
- Verification of the offer to provide written quotes (for example by means of requiring the consumer to confirm that the offer had been made during the EW purchase process); and
- The period that the consumer would be given to consider the quotation and apply for the EW.

## **8. Longer cancellation periods**

The cancellation period for EWs during which the EW could be cancelled without penalty would be set at a minimum period, which could be up to a year. This would allow time for the consumer to investigate other options, and for manufacturers to offer their EWs to consumers who return product registration cards. Issues to be considered include:

- The extent to which this would increase the risk of providers of in-store EWs, in that consumers could effectively obtain fully refunded EW coverage for the duration of the cancellation period by cancelling; and
- The optimum length of the cancellation period.
- Whether part of the amount paid by the consumer could be retained by the retailer to cover the cost of insurance cover that was in effect up to the time of cancellation.

## **9. Written confirmation of the right to cancel**

Retailers would be required to write to purchasers of EWs to confirm that they have the right to cancel during the cancellation period. A simple form would be enclosed to allow the policy to be cancelled by post. This would help ensure that consumers are made aware of their cancellation rights and are in no way worried about having to return to the store to cancel the EW. Issues to be considered include

- The date on which the cancellation period would start, for example the day that the letter was sent to the consumer or the day of purchase of the EW (the former applies to a similar requirement for life assurance).

## **10. Delayed completion of sale**

Consumers would be able to apply to purchase a retailer's EW either at the POS of the DEG or for a limited period after (the "application period") but the transaction would not be finalised until the end of that period. Finalising the transaction would involve confirmation by the customer and payment. The aim of this remedy would be to help ensure that the consumer has a reasonable opportunity to compare the EW that is offered in-store with alternatives. We recognise that there may be some customers who would prefer to finalise the transaction at the POS of the DEG, but this would need to be set against the

advantages of this remedy. It is envisaged that the following elements, which include parts of remedies 6, 7 and 8, would be included:

- The retailer would give consumers application forms for EWs in-store but would be prohibited from taking payment for an EW until the end of the application period;
- Consumers could complete the application form in store or at any time during the option period;
- Before the end of the application period, the retailer would be required to write to the consumer reminding them of what was needed to complete the purchase. The consumer would be asked to confirm acceptance of the EW by signing and returning a freepost card and either making or authorising payment. Only on receipt of this confirmation and at the end of the application period would the retailer be permitted to take payment for the EW.

Issues to be considered include:

- Whether retailers would provide some or all of the EW cover during the application period, before receiving payment; or alternatively, whether EW cover would only begin once payment had been received; and how cover for categories such as theft, accident and helpline services would be dealt with;
- In the case that consumers had free EW coverage during the application period, whether this would increase the risk to providers of EWs and the cost of EWs;
- Whether provision of free EW coverage during the application period would have the effect of discouraging consumers from seeking alternatives;
- The effect on consumer choice and convenience of not allowing payment to be made in store; how understandable this purchasing process would be to consumers;
- The length of the application period, taking into account the time needed for consumers to investigate alternative EWs and the issues raised above of any risks to consumers and costs to providers during this period;
- How straightforward administrative arrangements could be made; and
- Whether this process would apply to all EWs or only those of higher value (for example, EWs over £50).

## **11. Requirement to provide EWs on DEGs sold by other retailers**

Providers of EW at POS would be required to offer their EWs on the same terms and conditions to consumers who had purchased DEGs from other retailers. This could help encourage price competition for EWs at the retail store level. Issues to be considered include:

- The range of DEGs on which retailers would be required to provide EWs; whether, for example it could be any DEG brand and model that was also stocked by the retailer providing the EW;

- For how long the consumer would have the option to purchase the EW; whether for example the consumer might be offered the EW at any time during the first year after purchase of the DEG; and
- How the retailer would be expected to provide information and promote the availability of EWs on DEGs purchased from its rivals.

## **12. Require annually renewable policies to be offered**

Retailers would be required to offer annual renewal of their EWs as an option. The aim of this remedy would be to increase competition for renewals. Many other types of general insurance are renewed on an annual basis. We recognise that some consumers would prefer to purchase cover for longer periods, hence retailers would be free to offer longer EW policies alongside the annual option. Issues to be considered include:

- The appropriate level of coverage if a policy were to be sold for the first year of ownership of a DEG, given that the scope would be reduced due to statutory rights and the manufacturer's guarantee;
- The extra risks and costs involved incurred by providers in offering annual renewals and whether these would lead to higher prices;
- Cancellation rights (for example, providing a pro-rata refund at any time during the period of cover);
- Whether the current "typical" 1+2 and 1+4 year durations of EWs provide sufficient choice: and
- How the options could be presented to consumers without causing confusion.

## **13. Requirement to unbundle different elements of EWs**

Retailers would be required to offer consumers the option of purchasing different elements of EW cover separately (for example, breakdown repair, helpline, accidental damage and frozen food cover). The aims would be to help consumers to compare different EWs on a "like for like" basis and to compare the costs and benefits of different elements of cover. Issues to be considered include:

- The feasibility of identifying whether a claim was caused by accidental damage or a fault;
- Any extra administration costs involved and whether these could lead to higher prices; and
- How the options could be clearly presented to consumers.

## **14. Provision of customer lists to manufacturers and other providers of EWs**

DEG retailers would be required to make lists of customers purchasing DEGs or EWs available to manufacturers and other providers of EWs. This could lead to greater awareness of alternative EWs by consumers. Issues to be considered are:

- Whether manufacturers, as the producers of the DEGs and the providers of the guarantee which the EW either extends or augments should be treated any differently from other providers of EWs;
- The availability of lists of DEG or EW customers;
- Data privacy principles and law;
- Whether the information should be provided free of charge and if not, how the price might be determined;
- Whether providing this information could cause a loss of future DEG sales for a retailer; and
- Whether there would be a requirement to provide data to any firm that requested it on an equal basis.

**C. The primary objective of the third group of remedies, below, is to restrain any selling practices found to operate against consumers' interests.**

### **15. Discounting policy**

In order to avoid pressure to buy “on the spot” or targeting of certain consumer groups, any discounts offered to customers purchasing an EW in-store would be required to be made available:

- For later purchase of an EW (i.e. if a customer decides to purchase the DEG in-store but to take away a quotation for the EW, the total price of the DEG and EW would be the same as would apply if the EW had been purchased in the same transaction as the DEG); and
- To all customers (i.e. the same discount on the combined DEG / EW should be offered to all customers).

Issues to be considered include:

- How to cover discounts offered in the form of favourable financing arrangements; and
- How retailers could administer such an arrangement.

### **16. Limits to sales incentives**

Incentives to salespeople to sell EWs at POS, including commission payments, sales targets and other bonus payments would be limited to a level that would not be disproportionate to incentives paid on other sales. This may help to reduce the instance of pressure selling, as in some cases we understand that total incentives paid on EW are proportionally higher than those paid on other sales. Options might include:

- Limiting incentives to a certain percentage of sales value;

- Limiting incentives to a certain percentage of profit contribution; or
- Requiring retailers to ensure that incentives on EWs are proportionate to those paid on other sales based on either sales value or profit contribution.

Issues to be considered include:

- Measuring total incentives, given that there can be significant other payments such as bonuses and competition rewards; and
- Whether any single level of incentive could be appropriate to all retailers.

## **17. Controls on sales processes**

Retailers would be required to follow a code of conduct for selling of EWs and to put in place industry-wide controls to monitor sales practices. Issues to be considered include:

- The content of the code of conduct. This could be based on the existing BRC code, with further requirements. Examples of possible further requirements that may deal with the main categories of “pressure selling” complaints (see Annex 3, paragraph 5) include:
  - A requirement to stop the EW selling process immediately if the consumer indicates that they do not want to buy an EW or that the selling process is unwelcome or inappropriate (this is based on the Association of Energy Suppliers’ Code of Practice for the face-to-face marketing of energy supply)
  - A requirement to avoid the use of more than one salesperson to sell the EW to a single customer; and
  - A requirement to avoid making selective comparisons to other providers’ warranties.
- How controls could be strengthened to ensure full compliance with the Code. This could involve the use of a research firm to carry out mystery shopping under the auspices of an independent compliance board that could impose penalties for non-compliance, or the OFT. This arrangement would be similar to the Mortgage Code Compliance Board procedures or those currently being implemented by the Association of Energy Suppliers; and
- The possible role of such a compliance board in monitoring other remedies in this document.

**D. The primary objective of the fourth group of remedies, below, is to help ensure that the consumers who purchase EWs have reasonable cover for the risks of ownership of DEG equipment.**

## **18. Financial protection**

Retailers would be required to make clear to consumers whether or not the policy was insured and covered by the Financial Service Compensation Scheme. The aim of this measure would be to ensure that

consumers could consider the risk, however small, of a non-insured provider failing. It would be for the Treasury and the FSA to take account of the CC's findings in considering relevant taxation and regulatory issues (see Annex 4) Issues to be considered include:

- How this information could be communicated to consumers in a clear way.

### **19. Introduce benchmark product**

A benchmark standard for EWs would be established. This could help consumers to compare prices of EWs offered by different providers with the confidence of knowing that the protection offered was broadly similar. Issues to be considered include:

- What the criteria for the benchmark standard would be. For example, possible elements might include the length of cover, risks covered, terms and conditions such as whether the EW lapses if the equipment needs to be replaced, and the financial arrangements supporting the scheme;
- Whether retailers would be expected to offer the benchmark standard product or whether its use would be optional;
- Whether this would have the effect of forcing EW providers to “unbundle” features such as accidental damage from a basic repair coverage product, and the associated advantages and disadvantages to consumers; and
- How the benchmark standard would be communicated to consumers.

### **Other remedies considered**

In addition to the possible remedies listed above, the CC has also considered those on the following list but is not currently minded to pursue them as they seem likely to be impractical, ineffective or disproportionate:

- Prohibiting a retailer from selling its own EW;
- Requiring retailers to have a separate area within the store for EW sales;
- Requiring retailers to sell EWs from alternative providers;
- A price or profit control on EW business;
- Preventing retailers from removing manufacturers' publicity from display equipment in-store (but see remedy 4);
- Requiring longer initial DEG guarantees; and
- Providing detailed model-by-model DEG reliability information.

## ANNEX 3

### **POSSIBLE UNCOMPETITIVE PRACTICES**

#### **1      *Restricting choice***

At POS, consumers are typically offered only one provider's particular combination of cover and related terms on EWs. Where this happens, given the advantage of buying at POS, it restricts their choice of supplier and/or cover. It may also mean, to some extent, that they take elements of cover they might not otherwise have bought.

#### **2      *Restricting information about alternatives***

Information available to consumers at POS about alternative EW offerings is restricted. Information is generally available at POS about the main features of the range of DEGs available and their price. It appears that, in contrast, there is very little, if any, information provided to consumers at POS to enable them to evaluate the retailer's EW and compare it with the EWs of other providers. There may be very limited scope for such alternative providers to obtain or challenge a POS advantage. There are then distortions or restrictions on competition if consumers cannot make a reasoned and informed choice about which EW to buy (or whether to buy one at all) because information on alternative EWs is not made available, particularly at POS. This can be exacerbated by lack of information on reliability and repair costs of DEGs. Consumers' awareness of statutory rights may also be low.

#### **3      *Contracting in advance***

Consumers are usually required to contract and pay for EWs substantially in advance of the date when the main component of the service provided comes into effect. This is because repair services (and in some cases other elements of the EW) are already provided during the first year (and occasionally longer) under the manufacturer's initial guarantee. (This issue may not be so relevant in the case of those EWs on PCs

where helpline services are provided.) The effect of contracting in advance may also be to foreclose competition.

#### **4      *Setting prices above competitive levels***

Where there is a lack of effective competition at POS, this may mean that consumers are paying more than they would otherwise. Also, higher prices may deter some consumers from buying EWs. If there is scope to make profits in excess of competitive levels on EWs, the issue arises as to the broader impact. If the result is lower prices than otherwise in other competitive areas of business such as DEG retailing, then this may cause further distortions or restrictions on competition in these other areas.

#### **5      *Selling practices***

Retailers have an interest in ensuring that sales practices do not deter consumers. Nevertheless, incentives to staff and broader performance targets may encourage selling practices which amount to a distortion of competition. Three examples we are currently looking at are

- continued attempts to sell EWs to consumers who have indicated that they do not want to buy an EW, including the introduction of a second salesperson (so called “double hitting”;
- the use of discounts and other selling methods designed to persuade consumers to buy “on the spot” rather than taking time to consider their decision;
- the provision of selective information on repair costs and breakdown probability.

#### **6      *Unfair terms***

EWs may include terms or conditions that are not fair to consumers and would not be sustainable in fully competitive conditions. Possible examples are: the termination of EW cover following a claim; disproportionately small repayment on cancellation in relation to the cost of the EWs (or no facility to cancel); and applying depreciation rates, or using reconditioned products for replacement in a way which was not sufficiently highlighted and therefore not anticipated by some consumers. A further practice, which we understand may have been largely discontinued, has been to offer cash back to consumers for

making no claim during the life of the EW, but with conditions that mean many consumers in practice fail to qualify for a cash repayment.

## 7 *Uninsured cover*

EWs may be offered in the form of uninsured service agreements rather than in the form of insurance contracts; amongst other things this enables suppliers to obtain preferential tax treatment. Such agreements may provide consumers with a lower level of protection in the event of insolvency. Many EW providers have established ring-fenced trust funds that are intended to offset this risk. We are considering the extent to which, if at all, these arrangements fall short of providing in practice the degree of protection afforded by insured schemes.

## INSURED AND UNINSURED WARRANTIES

### EW characteristics

1. EWs may be offered in insured or uninsured form: the latter are normally marketed under descriptions such as service plans or service-backed warranties. These account for well over half of the total market. The two types of cover largely take the following basic forms.
2. With an insured EW offered at point of sale (POS), the customer buys the cover through an agent, usually a retailer, but contracts with an authorised insurer who underwrites the risk. Even if the insurer wholly or partly reinsures its exposure, it remains liable to the EW customer in the event of the reinsurer being unable to meet its obligations under the reinsurance contract.
3. With an uninsured EW at POS, the customer, through an agent in the same way as for the insured cover, contracts with a third party. The third party is not an authorised insurer but a company set up for the purpose of providing the EW. The provider is typically domiciled in an offshore jurisdiction and not connected to the agent. The provider normally does not undertake the detailed management of the EWs but uses part of the receipts from the customer to buy the claims administration and repair services, often in part from the retail agent.
4. Until 1997, most or all EWs were of the insured type. Insurance Premium Tax (IPT) at 4% on the premium charged for insured schemes as against 17.5% VAT on the charge for an uninsured scheme favoured the former, despite the facility to reclaim input VAT on repair costs. A substantial switch to the uninsured variant followed changes in indirect taxation which made the insured EWs sold at POS subject to Insurance Premium Tax (IPT) also at the rate of 17.5% : this switch reflected the fact that under IPT the VAT on repair costs is not refundable, thus favouring the uninsured schemes. (EWs sold directly by insurers untied to the purchase transaction for the DEGs are subject to IPT at 5%). Insurers also face the costs of regulation which may be higher in the UK than in other jurisdictions.
5. Some points of definition need to be noted within this broad analysis. First, in many cases a small part, usually less than 10%, of the uninsured EW charge is used by the provider to include within the contract cover bought from an authorised insurer for risks not included within the EW breakdown/repair

cover: frozen food loss or accidental damage are commonly among these additional risks. Second, it is a normal part of the arrangements for the service EW provider to insure his financial exposure with a captive insurance subsidiary of the retail agent established in an offshore financial centre such as the Isle of Man or Guernsey. That insurance contract is between the service provider and the captive insurer. The assets corresponding to the captive insurer's liabilities are usually held within a ring-fenced trust fund managed by a third party trustee, usually an offshore branch or subsidiary of a major UK bank.

6. A consequence of these complex practices is that service-type EWs, though uninsured in the sense of not being the subject of a contract between the customer and an authorised insurer, have some of the characteristics of insurance. There is also evidence that many customers for these EWs do not realise they have not bought an insured EW. These are not necessarily just technical distinctions. In the event of an insurer authorised by the FSA being unable to pay claims under an insured EW, the protection offered by the Financial Services Compensation Scheme (FSCS) under the Financial Services and Markets Act 2001 could be called upon to provide compensation. But comparable arrangements for compensation of EW customers are not generally available in offshore financial centres, no matter how rigorous the standards of regulating locally-authorised insurers may be. There are two implications; the insurance protection outside the UK may be less beneficial than in the UK because of the absence of the FSCS, and in the case of uninsured schemes with trust fund arrangements it may be more difficult for the consumer to obtain the benefit of the underlying assets in the event of a liquidation or equivalent failure.

#### *Possible public interest issues*

7. Two public interest issues may arise from the situation described above.

(a) First, whether the absence in an uninsured EW of compensation arrangements comparable with the FSCS is detrimental to the interests of buyers of such EWs. The financial position of any particular retailer-owned captive insurer, including the holding of its assets within a ring-fenced trust, may in practice be strong. But if there is no safety net comparable to the FSCS then the UK customer has no guarantee of protection should the captive's financial position deteriorate. There have been cases (e.g. Tempo) where UK retailers sold such EWs for which the financial backing proved to be inadequate when the retailer became insolvent.

(b) Second, if buyers are unaware of the differences between EWs from authorised insurers and service providers then there may be inadequate information provided about the nature of the

uninsured EW. If so, there could also be an adverse effect on competition between the providers of the two categories of EW.

8. Two developments in train could be relevant. The FSA is consulting on draft guidance (its CP 150 of August 2002) on the identification of insurance contracts, including the question whether the characteristics of any service-type EWs are such that they constitute insurance contracts and should be treated as such. If the FSA consultation were to result in any significant number of such EWs being accepted as insurance contracts that might have a material effect on the level of protection of EW customers. Second, the selling of general insurance is to be brought within FSA regulation from January 2005: this is partly in response to the UK's obligation to implement the EU Insurance Mediation Directive (IMD) of September 2002. The extent to which UK rules may apply to the selling of EWs is uncertain. The IMD only applies to contracts of insurance and most EWs, even where they are insurance contracts, are excluded from its scope. These EWs will be excluded from the UK's implementing legislation in the first place. The Treasury has also said in its public consultation on the IMD that it will await the CC report before deciding on the extent to which EWs on domestic electrical goods that are identified as insurance contracts should be subject to regulation, having regard to whatever guidance the FSA may issue resulting from its consultation.

9. Public interest issues for the CC are whether the purchasers of service-backed EWs are sufficiently protected against the providers being unable to meet their liabilities to them and whether the purchasers of EWs should benefit from the protection against such default offered by the FSCS. The FSA consultation on identifying insurance contracts may have a bearing on these questions. But the answer to them depends primarily on whether the captive insurer/trust fund arrangements described above are sufficiently secure. That may be the case in general but there is no obvious current mechanism for ensuring it remains so. The question is whether some such mechanism is needed and whether consumers are sufficiently aware of the differing degrees of protection offered by the two types of EW.

10. The effect of changes in IPT in contributing to the increase in the provision of uninsured EWs is also relevant. The consultations referred to in paragraph 8 do not include taxation questions. The interaction of the VAT and IPT structures as they affect the provision of different types of EW may, however, be a matter to be taken into account in the light of our findings.