Positive Impact 12/13

Consumer benefits from the OFT's work

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1 EXECUTIVE SUMMARY

1.1 As part of CSR10, the OFT committed to meeting a set of impact indicators including publishing an estimation of direct savings to consumers from the OFT’s activities and an associated benefit to cost ratio.\(^1\) This document presents the estimates of impact of OFT’s work, on average, over the previous three financial years (2010/11 to 2012/13).

1.2 We estimate that the OFT has saved consumers at least £422m per year on average over the period April 2010 to March 2013. Table 1 compares the estimated consumer savings to the average annual OFT spend of £48m\(^2\) over the same period, giving us a benefit to cost ratio of around 8.7:1.

1.3 Although necessarily relying in part on assumptions,\(^3\) we regard our estimates as a conservative assessment of the total impact of the OFT’s work. The reported benefits reflect only our estimates of the direct financial benefit to consumers of the OFT’s work on competition enforcement, consumer enforcement, merger control, and market studies and reviews. The estimates do not include the wider benefits of the OFT’s interventions, such as any impact on productivity, innovation or consumer confidence, or the deterrence effect of either the OFT’s work or the wider competition and consumer enforcement regime.

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\(^2\) This is total OFT costs (actual spend) minus costs of Anti Money Laundering and Consumer Credit Licensing. We use a three-year moving average for costs to make it consistent with the way in which we estimate benefits.

\(^3\) Impact estimations are conducted immediately after cases are completed and are therefore based only on information available during the case and on assumptions regarding the expected impact of our interventions. On this basis the estimates are considered to be ‘ex ante’ evaluations.
1.4 In general we would expect these wider effects to be substantial relative to the direct impact of our work. Whilst these wider benefits are difficult to quantify for individual cases with any precision, research carried out by the OFT in 2011 estimated that the deterrence effect of our competition enforcement work (abuse of dominance, cartels and other anti-competitive agreements) could be between 12 and 40 times the direct effect. Taking deterrence into account would therefore significantly increase the overall impact of the OFT’s work.

1.5 We also conducted two detailed (‘ex-post’) evaluations of the longer term impact of our interventions this year.

- Firstly we assessed the impact of the 2008 OFT market study and UTCCR test case into personal current accounts. We estimated total annual consumer benefits from a reduction in unauthorised overdraft charges as a result of our intervention at between £259 million and £619 million.

- Secondly we assessed the impact of our intervention against anti-competitive information exchanges by public schools. We estimated that the intervention had generated savings of at least £85m to consumers since 2004/05, equating to average savings of £495 per boarder per annum.

1.6 The ex-post evaluations have not been included in this year’s positive impact figures either as the direct financial impacts were considered at the time the projects were completed or because difference in methodology mean that the estimates are inconsistent with our published approach to impact estimation.

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Table 1: Estimated annual consumer savings and OFT costs for 2010-13

<table>
<thead>
<tr>
<th>Estimated average annual consumer savings 2010-13</th>
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<tr>
<td>Competition enforcement</td>
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<tr>
<td>Consumer protection enforcement</td>
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<tr>
<td>Merger control(^5)</td>
</tr>
<tr>
<td>Market studies, reviews of orders and undertaking, and market investigation references</td>
</tr>
<tr>
<td><strong>Total benefits</strong></td>
</tr>
<tr>
<td><strong>Total OFT costs (averaged over 2010-12)</strong></td>
</tr>
<tr>
<td>Benefit/ Total OFT costs</td>
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</tbody>
</table>

Structure of the document

1.7 Section 2 presents an overview of our methodology. Section 3 presents estimates of consumer savings from specific areas of our work. In section 4, we discuss findings from our recent detailed long-term evaluations. Section 5 presents the total costs, and section 6 summarises the overall results.

\(^5\) The OFT has a duty to investigate mergers that legally qualify for scrutiny. This means that OFT merger control work is demand-led and not discretionary, unlike other areas of the OFT’s work. Given that the number of qualifying mergers can vary considerably from year-to-year (because of fluctuations in the economic cycle for example), the consumer benefits of the OFT’s merger control work can also vary significantly from year-to-year.

\(^6\) This is total OFT costs (actual spend) minus costs of Anti Money Laundering and Consumer Credit Licensing, which do not form part of the requirement for impact estimation under CSR10.
2 OVERVIEW OF OUR METHODOLOGY

2.1 Below we briefly describe our overall approach to impact estimation. For a detailed explanation of our methodology, please see 'A guide to OFT’s Impact Estimation methods’ available on our website.7

2.2 The OFT’s goal is to make markets work well for consumers and the impact estimations included within this report focus on the direct financial benefits to consumers of the OFT’s work. The direct financial benefits to consumers may include, for example, the direct reduction in prices to consumers or the value to consumers of improvements in quality, service or information provision following an intervention.

2.3 Many of the beneficial outcomes of the OFT’s work are not easily quantifiable and are not included in the total benefits shown in Table 1. For example, these figures do not attempt to measure the impact on consumers of any psychological detriment averted by our actions, the deterrence effect of our competition and consumer enforcement work, or the impact of increased competition on innovation, productivity or economic growth. Each of these can be significant. In addition, it does not comprise the full extent of the OFT’s work.8

2.4 We consider that by focussing on the direct financial benefits of our interventions and ensuring that estimate for individual case use robust and conservative assumptions, in line with our published guidance, the overall consumer savings identified are a conservative estimate of the total impact of the OFT’s work.


8 The estimate of benefits does not include activities such as, support provided to Trading Standards Services, OFT work on consumer credit, competition advocacy, and consumer codes.
2.5 The OFT conducts both impact estimates (ex-ante evaluations) and detailed long-term evaluations (ex-post evaluations) to estimate the impact of our work. Ex-ante estimates of impact are based on the best information available at the time of estimation – which is typically when the decision or recommendations have been made or implemented but the full impact is not yet observable. Ex-post evaluations are more robust and are based on information gathered after the OFT recommendations have been implemented and the resulting impact realised. Ex-post evaluations are only conducted for a small subset of cases – typically one or two a year. As they are not usually conducted within the same year as the intervention, the majority of the figures included in this report are ex-ante estimates.

2.6 The OFT and the Competition Commission (CC) together operate the merger and market investigations regimes and the consumer savings for these areas are jointly considered. We have agreed an 80-20 rule to split impact estimates with the CC where the majority of impact would go to the 'main actor' organisation.9 In the merger regime, for example, the OFT would be the 'main' organisation where undertakings are accepted in lieu of reference to the CC, whereas the CC would be the 'main' organisation if the merger was referred and the CC either imposed a remedy or prohibited the merger.10

2.7 We use the Consumer Price Index to take account of inflation. All figures for the ex-ante estimates are presented in February 2012 prices, and rounded to the nearest one million pounds.11

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9 The specific percentages applied in the apportionment (80-20) are broadly based on costs incurred by the organisations on the mergers and market investigations.

10 For each intervention, the primary agency estimates its benefits according to the methodology it considers most appropriate. The estimates are then adopted by the other agency.

11 In line with Central Government techniques for discounting future accruals of benefits or costs, we discount future consumer savings by the HMT endorsed Social Time Preference Rate (3.5 per cent). See ‘The Green Book: Appraisal and Evaluation in Central Government’, HMT. Available from: www.hm-treasury.gov.uk/d/green_book_complete.pdf.
3 CONSUMER SAVINGS BY AREA

Introduction

3.1 This section presents estimates of the impact of our work for each of the following areas: enforcement of competition law, enforcement of consumer protection legislation, merger control and markets work. The specific methodologies used to estimate impact in each of these areas have been explained in, 'A guide to OFT’s Impact Estimation methods' published on the OFT website.

3.2 For mergers and market investigations, the OFT is the first stage authority in a two stage process (referring cases where there are competition concerns for further investigation to the CC, the second stage authority). Our estimates of consumer savings from mergers and market investigations therefore include the OFT’s ‘share’ of the CC’s impact estimates.

3.3 In line with our published methodology we do not publish impact estimations for individual cases. Case estimates are independently reviewed by Professor Stephen Davies\textsuperscript{12} to ensure that our methodology is followed and in particular to ensure that any assumptions we use are both robust and conservative.

Competition enforcement

3.4 The OFT engages in a range of activities to promote compliance with the Competition Act (CA98), including formally investigating and taking enforcement action against anti-competitive practices and providing guidance\textsuperscript{13}. Under the Enterprise Act 2002 (EA02) we can also

\textsuperscript{12} Stephen Davies is Professor of Economics at the University of East Anglia.

\textsuperscript{13} More information on compliance and guidance can be found on the OFT’s website. www.oft.gov.uk/OFTwork/competition-act-and-cartels/competition-law-compliance.
investigate and prosecute individuals who have dishonestly been involved in cartel activity.

3.5 We estimate conservatively that the OFT’s interventions saved consumers at least £409m in aggregate between the financial years 2010 and 2013 resulting in annual average consumer savings of £136m. We consider this to be a lower bound estimate as it is based on conservative assumptions on specific cases with regard to price overcharge and duration. In addition, it does not include the significant deterrent effect of our competition enforcement actions.

3.6 In 2011 the OFT published deterrence ratios for our competition enforcement work, produced by London Economics. The research estimated that for each cartel case investigated by the OFT, 28 others were deterred. For investigations into abuse of dominance and other commercial agreements, the figures were 12 and 40 cases deterred respectively. The overall magnitude of the OFT’s impact is therefore expected to be significantly higher than the estimated £136m direct annual benefits.

Consumer protection enforcement

3.7 The OFT’s consumer protection enforcement work seeks to change trader behaviour that contravene consumer protection legislation using a range of interventions such as issuing informal warnings, accepting undertakings under the Enterprise Act, or obtaining Court Orders. All interventions are aimed at protecting consumers, particularly vulnerable

14 See ‘The impact of competition interventions on compliance and deterence’ OFT1391. The research identifies and quantifies the wider benefits and costs associated with deterrence resulting from enforcement activities undertaken by the OFT.

15 Trading Standards are also responsible for consumer protection enforcement and tackling unfair trading practices. This section only considers the consumer savings resulting from OFT enforcement action. An evaluation of the impact of the fair trading work of local authority Trading Standards Services in the UK, June 2009, OFT1085 can be found at: www.oft.gov.uk/shared_oft/about_oft/of1085.pdf.
consumers, from rogue trading, unfair commercial practices and other breaches of consumer protection legislation.

3.8 In contrast to the evaluations of our competition enforcement work there are no set rules of thumb for assessing the impact of consumer enforcement cases. Our approach and methodology for assessing these cases continues to develop and reflects the OFT’s knowledge of specific cases and markets. We use conservative assumptions to estimate the impact of our work and, where possible, monitor changes in the market to gather evidence on the assumptions underlying these estimates.

3.9 For the period 2010 to 2013, the total consumer benefits from our consumer enforcement work are estimated at an average of £77m per year.

3.10 We note that these figures only cover our consumer enforcement work which is a sub set of our wider consumer protection work. We do not include, for example, any benefits from our consumer education and awareness work or other non-enforcement activities. We do not have an estimate for the deterrence impact of our consumer enforcement work, but would expect it to be substantial, particularly where the work sets a precedent.

**Merger control**

3.11 The OFT is the first stage of a two stage merger regime. Under the Enterprise Act 2002, it has the duty to review merger situations and refer to the CC any cases where there is a realistic prospect of a substantial lessening of competition (SLC) in a UK market. The OFT has the power to accept Undertakings in Lieu (of reference to the CC) (UiL) from the merging parties, if these are deemed to address potential concerns identified in the course of its investigations.

3.12 Our estimates of consumer savings in this area include mergers amended by the OFT through UiLs, mergers that are abandoned on
referral to the CC (abandoned mergers), and mergers amended or prohibited by the CC.\textsuperscript{16}

3.13 Table 2 presents the average annual estimates of consumer savings from the merger regime for the years 2010 to 2013. The estimates for abandoned mergers andUiLs have been scaled down by the CC 'SLC rate'.\textsuperscript{17} The SLC rate is the proportion of the last 30 mergers examined by the CC where an SLC finding was made; it is currently 33 per cent. The application of this scaling down factor is to account for the uncertainty of the outcome of a CC reference.\textsuperscript{18}

\begin{table}[h]
\centering
\begin{tabular}{l c}
\hline
\textbf{Estimated average annual consumer savings} & \\
\hline
UiLs & £13m \\
Abandoned mergers & £1m \\
CC merger decisions & £11m \\
\hline
\textbf{Total – joint merger regime} & £25m \\
\textbf{Benefits apportioned to the OFT} & £13m \\
\hline
\end{tabular}
\caption{Average annual consumer savings from the merger regime, 2010-13}
\end{table}

3.14 During the past three financial years (2010 to 2013), the merger regime has saved consumers £25m per year on average, of which £13m per year is apportioned to the OFT.

\textsuperscript{16} We have agreed an 80:20 rule to split impact estimates with the CC so that the OFT is credited with 80 per cent of the benefits fromUiLsand abandoned mergers (with 20 per cent going to the CC) and 20 per cent of the benefits from the CC’s merger decisions (with 80 per cent going to the CC).

\textsuperscript{17} In the published guide to OFT’s impact estimation methods, the ‘SLC rate’ is referred to as the ‘hit rate’.

\textsuperscript{18} We have assumed that the percentage ofUiLsand abandoned mergers which would have been judged to involve an SLC is equal to the proportion of mergers actually examined by the CC for which it made an SLC finding (taken over the last 30 cases). Whilst this is arguably a conservative assumption it is consistent with our overall approach to ex-ante impact estimation.
3.15 The benefits from the merger regime are dependent on the cases that come to the OFT for assessment and are therefore driven, in part, by the economic climate and can vary significantly from year to year.

3.16 The two phase process means that consumer benefits from referred mergers, in which the CC subsequently find an SLC, are only estimated after the CC’s investigation is finalised and are therefore unlikely to be included until the year after the OFT’s decision. We note that this year the OFT reference rate was 14 per cent, slightly above the recent trend rate.\textsuperscript{19}

3.17 Benefit figures for mergers do not include the wider benefits, such as deterrence, of our mergers work and the wider merger regime, which we would expect to be significant. In 2007 the OFT published deterrence ratios for our mergers work, produced by Deloitte.\textsuperscript{20} The survey suggested that at least five proposed mergers were abandoned or modified on competition grounds before the OFT became aware of them for each one merger blocked or modified following intervention by the UK competition authorities. Taking deterrence into account would therefore significantly increase the overall impact of the OFT’s merger work.

\textsuperscript{19} The relatively high figure partly reflects the difficult economic backdrop, where mergers of close rivals are more frequent. Other factors include the work of the Mergers Intelligence Unit in catching more cases and the OFT’s new role in hospital mergers.

\textsuperscript{20} See ‘The deterrent effect of competition enforcement by the OFT’, www.oft.gov.uk/OFTwork/publications/publication-categories/reports/Evaluating/of963. Note that this analysis is not directly comparable with the more recent deterrence work conducted for the OFT by London Economics (published December 2011).
Market studies, reviews of orders and undertakings, and market investigation references (MIRs)

3.18 Typically, OFT market studies are examinations into the causes of why particular markets are not working well for consumers, leading to proposals as to how they might be made to work better. They take an overview of regulatory and other economic drivers in a market and patterns of consumer and business behaviour.

3.19 The OFT may refer markets to the CC for further investigation where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK is preventing, restricting, or distorting competition. In estimating consumer savings therefore, we consider the impact of the market investigations regime as a whole and include a proportion of the impact of investigations carried out by the CC.\(^{21}\)

3.20 Where the market study or review has led to action by other government departments or industry stakeholders following our recommendations, we only attribute a proportion of the impact to the OFT. For example, where OFT recommendations from a market study are implemented by a different government department, the impact estimates would be apportioned between the OFT and the relevant government department.

3.21 We estimate conservatively that the savings from the market investigation regime are at least £437m per annum between the

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\(^{21}\) For market investigations carried out by the CC following a reference by the OFT, 20 per cent of impact is apportioned to the OFT and 80 per cent to the CC. The OFT does not claim any impact from referrals to the CC by other regulators. For the OFT market studies and reviews of undertakings and orders that could involve a reference to the CC, but where this is not the outcome, 80 per cent of the impact is apportioned to the OFT and 20 per cent to the CC. For market studies where referral to the CC is not considered as a possible option, the OFT is attributed with 100 per cent of the impact.
financial years 2010 and 2013, of which £195m per annum is apportioned to the OFT.
4 WIDER BENEFITS

Introduction

4.1 In addition to assessing the direct impact of our interventions, the OFT conducts in depth ex-post evaluations of the long-term impact of our past interventions, in order to gain a better understanding of the overall impact of our interventions and improve our impact in the future.

4.2 This year the OFT has conducted two ex-post evaluations, the findings of which are summarised below. These estimates of consumer savings have not been included in this year’s positive impact figures either as the direct financial impacts were considered at the time the projects were completed or because difference in methodology mean that the estimates are inconsistent with our published approach to impact estimation.

4.3 Both of these evaluations were conducted by OFT economists and independently reviewed by Professor Stephen Davies.

Evaluating the impact of the 2008 OFT market study and UTCCR test case into personal current accounts (PCA)

4.4 In January 2013, the OFT published an ex-post evaluation of the impact of the 2008 OFT market study and UTCCR\textsuperscript{22} test case into personal current accounts.\textsuperscript{23} The evaluation focused on the impact of the OFT’s recommendations on switching, transparency and unarranged overdraft charges (‘UOCs’) following the market study. It also considered the impact of the OFT’s investigation into the fairness of PCA unarranged overdraft charging terms under the UTCCRs (the 'Test Case').

\textsuperscript{22} Unfair Terms in Consumer Contract Regulations 1999

\textsuperscript{23} An evaluation into the impact of the OFT’s intervention into the Personal Current Accounts market (pdf 1.8Mb).
4.5 Overall, the evaluation found that the success of the OFT’s recommendations in the PCA market is mixed so far. The OFT’s work appears to have had a very substantial impact in lowering unarranged overdraft charges, resulting in significant estimated consumer benefits. On the other hand, the recommendations on switching and transparency appear to have had less impact to date.

4.6 The evaluation estimated that total annual consumer benefits from a reduction in UOCs are in the range between £388 million to £928 million (in 2011 prices), and more likely towards the upper end of this range. The work of the FSA and media pressure created by consumer groups are considered to have also contributed to the decline in unarranged overdraft charges and the evaluation therefore attributed only two-thirds of the estimated annual consumer benefits to the OFT. This results in benefits attributable to the OFT of between £259 million and £619 million.

4.7 Evidence from the OFT indicates that the total direct cost of the OFT of undertaking the Market Study, Test Case and follow up work was in the order of £3.8 million between 2007 and 2011 (in 2011 prices).

An evaluation of the impact of the OFT’s intervention against information exchange by public schools – independent fee-paying schools

4.8 In May 2012, the OFT published an ex-post evaluation of the impact of its 2006 intervention addressing the anti-competitive conduct of 50 independent fee-paying schools,\textsuperscript{24} which shared information concerning the setting of fees during academic years 2001/02 to 2003/04.\textsuperscript{25} The

\textsuperscript{24} Decision of the Office of Fair Trading, (No. CA98/05/2006), Exchange of information on future fees by certain independent, fee–paying schools, 20 November 2006, (Case CE/2890-03).

\textsuperscript{25} Evaluation of an OFT intervention - Independent fee-paying schools (pdf 1.4Mb).
evaluation focused predominately on the impact of the OFT’s investigation on prices (‘fees’).

4.9 The evidence (econometric analysis) concluded that there had been a significant decrease in boarding fees since the intervention – boarding fees were on average 1.6 per cent lower and day fees 1.5 per cent lower, than they would have expected to be in the absence of the intervention. The total discounted savings to consumers were estimated at £105m (£85m in boarding fees and £20m in day fees).

4.10 Given the high degree of confidence placed on the findings in relation to boarding fees, the analysis suggested that the OFT’s intervention generated savings of at least £85m to consumers in the post-intervention period 2004/05 to the present, equating to average savings of £495 per boarder per annum.

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26 The boarding fees findings are statistically significant at the 95 per cent level (meaning there is less than a five per cent probability that there was no effect). The day fees findings are only statistically significant at the 90 per cent level, and unlike the boarding fees results are not robust to sensitivity tests.

27 These figures are in 2012 prices.
5 COSTS

5.1 Cost figures may fluctuate from year to year and as such will impact on the benefit to cost ratios reported in the Positive Impact reports. To smooth out any such fluctuations, we use a three year moving average for total costs. This is consistent with the way in which we report estimated benefits.

5.2 For the purposes of calculating the benefit to cost ratio, the total costs of the OFT excludes Consumer Credit Licensing and Anti Money Laundering, for which the OFT is not required to conduct impact estimation.

5.3 On this basis, the average annual OFT costs over the financial years 2010-13 is estimated at £48m.\textsuperscript{28}

\textsuperscript{28} Figure in February 2012 prices.
6 SUMMARY

6.1 Table 3 presents estimates of consumer savings and OFT costs for the period 2010-13. The benefit to cost ratio for the period is 8.7:1.

Table 3: Estimated consumer savings and OFT costs for 2010-13

<table>
<thead>
<tr>
<th>Estimated annual consumer savings (averaged over 2010-13)</th>
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<tbody>
<tr>
<td>Competition enforcement £136m</td>
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<tr>
<td>Consumer protection enforcement £77m</td>
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<td>Merger control £13m</td>
</tr>
<tr>
<td>Market studies, reviews of orders and undertakings, and market investigation references £195m</td>
</tr>
<tr>
<td><strong>Total benefits</strong> £422m</td>
</tr>
<tr>
<td><strong>Total OFT costs (averaged over 2010-13)</strong> £48m (^{29})</td>
</tr>
<tr>
<td><strong>Benefit/ Total OFT costs</strong> 8.7:1</td>
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</tbody>
</table>

6.2 Benefits are based on conservative estimates of the direct financial benefits of the OFT’s work on enforcing competition and consumer law, merger control and market studies and reviews only. It does not include estimates of the deterrent effect of our work which is likely to be significant. In addition, many of the wider benefits of the OFT’s work, such as the impacts on consumer confidence or productivity, are not easily quantifiable and have therefore been excluded. The total impact of the OFT’s work is therefore expected to be higher.

\(^{29}\) This is total OFT costs minus costs of Anti Money Laundering and Consumer Credit Licensing.