Extended Warranties on Domestic Electrical Goods

An OFT market study and notice of the OFT's intention to accept Undertakings in Lieu of a Market Investigation Reference

February 2012
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CONTENTS

Chapter                                               Page

1 Executive summary                                  4
2 Background and methodology                        15
3 Extended warranties                                24
4 Consumer purchasing of extended warranties         32
5 How well the EW market works                       44
6 Provisional decision on a market investigation reference 64
7 Other OFT action                                  83
A ANNEXE A: Consumer survey of extended warranties  85
B ANNEXE B: The proposed UIL                         88
C ANNEXE C: An illustrative example of the comparison website 89
D ANNEXE D: Terms of reference for an MIR           90

Note:
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1 EXECUTIVE SUMMARY

- The OFT has carried out a market study into extended warranties on domestic electrical goods.

- Whilst the market study has found that there have been some market improvements in recent years, several competition concerns remain. These include limited shopping around by consumers and a persisting retailer point of sale advantage which restricts competition.

- Several major extended warranty providers have offered undertakings which will help consumers to take a more informed purchasing decision and enable them to shop around more easily. The OFT is minded to accept these undertakings, but it invites comments from interested parties before it decides whether to do so.

Background

1.1 The OFT’s market study of extended warranties (EWs) on domestic electrical goods (DEGs) was launched on 14 April 2011. This followed an initial assessment of the market which indicated that there were credible concerns that competition for EWs was restricted and that EWs did not represent value for money.

1.2 The UK competition authorities have investigated EWs on several previous occasions, most notably the Competition Commission’s (CC) investigation into EWs which reported in 2003. The CC found that there were various practices which restricted for EWs. In particular, retailers had a competitive advantage over other providers through their ability to sell EWs at the point of sale (POS) of the associated DEG. This led to high EW prices and high profitability for the major POS providers.

1.3 The CC investigation resulted in the imposition of the Supply of Extended Warranties on Domestic Electrical Goods Order 2005 (EW Order) which was intended to encourage consumers to shop around by
providing better consumer information at POS and introducing statutory cancellation rights.

1.4 This market study sought to build on earlier work and focus upon the developments since the CC reported in certain key competition indicators such as pricing, shopping around and other value for money indicators.

Summary of findings

Some positive developments

1.5 The OFT has found that there have been several improvements in the market since the CC reported in 2003. In particular:

- New EW providers have entered the market.
- 25 per cent of consumers now shop around – a very significant increase from the four per cent who did so in 2002.
- About a third of EWs are now obtained from non-POS providers – a large increase from the 20 per cent of EWs which were obtained from non-POS providers in 2002.

1.6 There is also evidence that consumers are now getting a better deal when they purchase EWs than they did in 2002:

- Prices for fixed term EWs (those which provide a fixed term of cover, normally three or five years) at several of the major POS retailers have declined by around a third in real terms.
- The proportion of the supplier’s premium income (or income from the sales of EWs if the provider’s EW is not an insured product) paid out in claims (claims ratios) has more than doubled since 2002 (from around 20 per cent to 50 per cent) and profitability at the main EW providers appears to have declined.
- The quality of EWs offered has generally improved, through improvements in service quality and level of cover.
But some concerns remain

1.7 Despite these improvements, there remain some significant concerns that the EW market does not work as effectively as it could, ultimately resulting in consumers getting a poorer deal than they would get in a more competitive market. In particular:

POS providers still dominate the market

- Although non-POS providers have expanded, POS providers still dominate the market with around two-thirds of EW sales. One significant non-POS provider, which has attempted to expand its EW business in recent years, has emphasised that the POS advantage continues to restrict expansion by alternative providers.

Effective shopping around still relatively low

- Although 25 per cent of consumers are shopping around, OFT research shows that only 20 per cent of consumers obtain quotes from multiple providers and that only 18 per cent of consumers purchasing at POS shop around. These figures are low compared with shopping around for similar insurance type products. For example, 69 per cent of consumers say that they shop around for renewals of general insurance. The OFT considers that this relatively low rate of shopping around reflects the following:

  - It can be difficult and time consuming to compare EWs offered by different providers as they often have different terms, conditions and features (such as the extent of cover offered). Unlike similar insurance type products, there are no effective online comparison tools to enable consumers easily to compare the products available from various providers. These factors mean that even where shopping around occurs it may be less effective as consumers do not have access to readily comparable information about the EWs available from various providers.
- Around 40 per cent of EW consumers had not intended to purchase the EW before they purchased the associated DEG.

- Almost half of those EW consumers who did not shop around were unaware that they could purchase similar EW cover from an alternative provider to the retailer where they bought the DEG.

Information asymmetries exist

- There are information asymmetries between suppliers and consumers. Consumers generally have only limited access to information of the type that would help them to evaluate the value for money of different EWs. In particular, there is limited information about DEGs' reliability or likely repair costs.

1.8 These factors mean that providers' incentives to compete to obtain custom from well informed consumers are likely to be weaker than in a more competitive market. This is reflected in the OFT's findings on EW prices and profitability:

- That prices for some term EWs, at least at some providers, appear to have increased.

- That EW claims ratios, whilst significantly higher than they were in 2002, are still significantly lower than in similar insurance type markets. Claims ratios for general insurance, for example, are around 74 per cent.

1.9 The OFT has also considered the impact of the introduction of Pay As You Go (PAYG) EWs by some providers, where consumers purchase a rolling EW contract for which they make regular (often monthly) payments. Whilst PAYG EWs have certain benefits, particularly the greater ability of consumers to budget for the EW, the total price that consumers pay can be high. The OFT's analysis, for example, indicates that consumers of PAYG EWs can pay considerably more than the price of a comparable fixed term EW.
Decision on a market investigation reference

1.10 Section 131 (the Reference test) of the Enterprise Act 2002 (EA02) provides that where the OFT has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition it may make a market investigation reference to the CC (MIR). In the light of the OFT's findings above at paragraphs 1.7 to 1.9, it provisionally considers that it has reasonable grounds for suspecting that there are several features of the market which prevent, restrict or distort competition in the supply of EWs. These are:

- A persisting POS advantage which restricts competition between providers.
- Relatively limited, and ineffective, shopping around by consumers, which reduces provider incentives to compete effectively.
- Information asymmetries which mean that consumers are unable to readily evaluate the value for money of the EWs offered by various providers.

Leading to:

- Higher prices and relatively low claims ratios.

1.11 The OFT provisionally considers that it has reasonable grounds for suspecting that these features mean that consumers are detrimentally affected through higher prices and less choice in the provision of EWs.

1.12 Given that the OFT provisionally considers that the Reference test is met, the OFT has a discretion to decide whether to make an MIR.

1.13 The OFT’s guidance on MIRs sets out four criteria, all of which must be met before it can decide to make an MIR. The OFT’s assessment against the first three criteria is set out below:
• ** Appropriateness of a reference: the scale of the suspected problem is such that an MIR would be an appropriate response to it:**

  - The OFT notes that the EW market has a value of around £1bn per year. Whilst there have been some improvements, the features which give rise to competition concerns, such as limited shopping around, have effects across the market and are long standing.

  - The OFT therefore provisionally considers that an MIR would be an appropriate response to the competition concerns identified.

• ** Availability of remedies: there is a reasonable chance that remedies would be available:**

  - The OFT notes that there are several practicable remedies which would be available to the CC, including behavioural remedies (to improve consumer information) or structural remedies (to restrict the POS purchasing of EWs) to address the OFT’s competition concerns.

  - The OFT therefore provisionally considers that remedies would be available to address the OFT's competition concerns.

• ** Alternative powers: it would not be more suitable to deal with the competition issues identified by applying the Competition Act 1998 (CA98) or using other powers available to the OFT:**

  - The OFT has not found evidence of anti-competitive agreements or a provider abusing a dominant market position of the type which could be addressed by the CA98.

  - The OFT, and consumer organisations, have previously engaged in consumer education initiatives in relation to EWs. Whilst the OFT considers that these could have an impact on consumer purchasing behaviour, such action alone is highly unlikely to address the long standing features of competition concern.
The OFT therefore provisionally considers that it would not be more suitable to deal with the competition issues identified by applying the CA98 or using other powers available to the OFT.

Undertakings in lieu

1.14 The last criterion which the OFT considers before determining whether to exercise its discretion to make an MIR is whether there are appropriate undertakings in lieu of a reference (UIL) that could be used to address the problems identified. Under section 154 of EA02, UIL can only be taken where the OFT has the power to make an MIR and otherwise intends to make an MIR. In the light of the above analysis, the OFT provisionally considers that both the Reference test is met and that it would, absent the provision of acceptable UIL, otherwise make an MIR.

1.15 During the market study, the OFT has engaged with the key EW providers and, during summer 2011, shared its emerging findings with them. During this process, Dixons, Comet and Argos (the Undertaking parties), whilst disagreeing with the OFT’s analysis, offered UIL which they considered would be sufficient to address the OFT’s competition concerns.

1.16 Following discussions between the OFT and the Undertaking parties, the Undertaking parties have offered the following UIL:

- They will establish, maintain, publicise and participate in a website comparing EW prices and features from different EW providers in a neutral manner (EW Comparison website).

- This would enable consumers more easily to compare the EWs offered by different providers and facilitate more effective shopping around. The EW Comparison website will be open to POS and non-POS providers, thereby enabling consumers to compare more readily the EWs offered by a range of providers, thereby reducing the POS advantage. Domestic & General (D&G),
the largest non-POS provider, has also agreed to participate in this website.

- They will improve the prominence and accessibility of key information to consumers, such as information on the EW Comparison Website, the availability of alternative providers and information on consumers' statutory and cancellation rights, through the inclusion of a key points box on the Undertaking parties' in-store leaflets at POS and on their websites.

  - This will help to raise consumers' awareness of alternative providers to the retailer where they bought the DEG, making it more likely they will shop around and consider an EW from an alternative provider, thereby reducing the POS advantage.

- They will engage in regular mystery shopping exercises, conducted by an independent company, to monitor whether consumers are provided with accurate information by sales staff when they are considering whether to purchase an EW and report the results of these to the OFT.

  - This will help to ensure that consumers receive accurate information at POS, helping them to take a more informed decision about any EW purchases.

- They will improve the transparency of pricing of any PAYG EWs which they offer through including annual equivalent prices for PAYG EWs on the EW Comparison website and on in-store information, and by providing reminders to consumers who have held the PAYG EW for a significant time period.

  - This transparency will enable consumers to make a more accurate calculation of the longer term costs of such PAYG EWs.

1.17 The OFT has carefully considered the likely effectiveness of such UIL, taking full account of research about how consumers purchase EWs and the design of effective remedies. The OFT provisionally considers that the UIL, as a package, will enhance the ease and effectiveness of
shopping around by consumers, thereby leading to more shopping around and more consumers considering alternative, non-POS providers. Such behavioural change by consumers should increase the incentives for EW providers to compete more effectively by enhancing their EW offer and improving value for money.

The OFT is minded to consider, consistent with section 154 of the EA02, that the UIL offered by the Undertaking parties achieve as comprehensive a solution as is reasonable and practicable to the adverse effects on competition it has identified. It is therefore minded to accept the UIL and not to refer the supply of EWs to the CC.

**Invitation to comment**

1.18 Before taking a final decision on whether to accept the UIL and not to make an MIR, the OFT, consistent with section 155 of the EA02 and its practice on proposed decisions not to make MIRs, is inviting comments from consumers and interested parties. In particular, it would welcome comments from interested parties on the likely effectiveness of the UIL in addressing the OFT’s competition concerns. Any such representations should be provided to the OFT by 19:00 on **Wednesday 7 March 2012**. Please respond in writing to the following address or by email to degs@oft.gsi.gov.uk

The Extended Warranties Team
Goods and Consumer Group
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London
EC4Y 8JX

1.19 The OFT will consider any such representations before taking a final decision on the UIL and MIR. It expects that such a decision will be taken late in the Spring of 2012, although that is dependent on the
nature of the representations received during the consultation and whether any subsequent consultation is required.

1.20 The OFT recognises that the effectiveness of the UIL ultimately depends on behavioural change by consumers. Whilst the OFT has worked with parties to design effective UIL, and considers that the UIL should be effective in changing consumer behaviour, it can never be entirely certain that will be the case. If the OFT accepts the UIL, it will, subject to an assessment against its Prioritisation Principles, undertake an evaluation of the effectiveness of the UIL in improving outcomes for consumers at an appropriate point after their acceptance by the OFT. The OFT would also keep under review the carrying out of the UIL and consider any representations it receives in relation to varying or releasing the UIL, pursuant to its statutory duties.

Other action arising from the market study

1.21 In addition to the actions above, the OFT will take further action to address the competition concerns identified in the market study. In particular, it will ensure parties comply with their regulatory obligations and take action to improve consumers’ awareness of their options when purchasing an EW. This action includes:

- Continuing to monitor the EW Order, raising potential compliance concerns with parties as appropriate. If the UIL is accepted, the OFT would use the mystery shopping exercises to enhance further the effectiveness of this monitoring.

- Considering, subject to the application of its Prioritisation Principles, any complaints or evidence it receives indicating that EWs are being mis-sold such that enforcement action under the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) or other consumer law, would be appropriate.

- Continuing to work with partners, particularly consumer organisations, to ensure that the key messages arising from this market study, such as the importance of shopping around, are
communicated to consumers. The OFT has already incorporated key messages about EWs into the DEGs section of its ongoing 'Know your rights' campaign, which aims to increase consumers' awareness of their statutory rights when purchasing DEGs. This campaign will continue throughout the early part of this year.

Thank you

1.22 During this study the OFT has consulted a wide range of interested parties including retailers, manufacturers, and trade and consumer associations. We are grateful for their contributions and willingness to assist the OFT in its work.
2 BACKGROUND AND METHODOLOGY

2.1 The OFT’s market study of EWs was launched on 14 April 2011. This followed an initial assessment of the DEGs market which identified credible concerns that competition in the market for EWs was restricted and EWs did not represent value for money for consumers.1

2.2 Concerns about how the EW market operates have been longstanding and have prompted various investigations by the UK competition authorities. This chapter summarises the key findings of those previous investigations, before considering the OFT’s reasons for, and its approach to, this market study.

Recent history of regulatory intervention into EWs

OFT market study in 2001

2.3 The OFT launched a market study in 2001, which examined both consumer and competition issues in the EW market.2 That study identified concerns about a lack of effective competition between providers and also inadequate consumer protection. As a result, the then Director General of Fair Trading referred the EW market to the CC for further investigation in July 2002.3

1 The OFT’s press release announcing the market study can be found at: www.oft.gov.uk/news-and-updates/press/2011/55-11

2 The OFT also investigated the EW market in 1994 under the Fair Trading Act 1973. This investigation was restricted to non-competition issues.

3 This reference was made under the Fair Trading Act 1973.
CC Investigation in 2003

2.4 In July 2003, following a detailed investigation, the CC found that there was relatively little competition between EW providers, noting that:

- Prices set by retailers at POS appeared to be set at levels that consumers would bear rather than a result of competition.
- Prices did not appear to reflect variations in underlying costs or risks.
- Larger EW retailers’ return on capital persistently and substantially exceeded their cost of capital, indicating that EW prices were generally higher than necessary to cover costs and generate an adequate return. Indeed if EW profits for the five largest EW retailers had been in line with their cost of capital over the five years to 2002 prices of EWs would have been on average up to one-third lower.

2.5 The CC also found that EW providers at POS had a competitive advantage over those who did not have access to consumers at POS. In particular:

- few consumers sought information on EWs prior to their purchase.
- consumers had little opportunity at POS to consider alternatives to the EW on offer.

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4 The Competition Commission’s report (hereafter CC (2003)) is available on the CC website at: www.competition-commission.org.uk/inquiries/completed/2003/warranty/index.htm

5 CC (2003), paragraph 2.359.

6 CC (2003), paragraph 2.308.
2.6 To address these concerns, the EW Order was made. This required retailers to provide better pricing and other information for consumers at POS in-store, on websites and in certain advertisements. In addition, consumers were provided with statutory cancellation rights. These measures were collectively intended to help consumers to shop around and make a more informed choice when considering EW purchases.

The impact evaluation of the EW Order (the OFT impact evaluation) in 2008

2.7 The OFT commissioned an independent evaluation of the EW Order in October 2007 by LECG, an economic consultancy. The OFT impact evaluation, which reported in October 2008, found that:

- There had been some changes in consumer shopping patterns, with more consumers purchasing EWs away from POS, although 68 per cent of consumers still purchased EWs at POS.

- The proportion of consumers shopping around had increased from four per cent in 2002 to 15 per cent in 2008.

- There was evidence that some stores were not fully complying with the EW Order, with some sales staff provided consumers with inaccurate information concerning their rights under the EW Order.

- The EW Order was addressing, based upon a conservative estimate, £18.6m per year of the £366m annual detriment arising from

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8 A summary of the key features of the EW Order can be found in the OFT’s guidance to retailers on selling EWs. This can be found at: [www.of.t.gov.uk/business-advice/treating-customers-fairly/sellingextendedwarranties/](http://www.of.t.gov.uk/business-advice/treating-customers-fairly/sellingextendedwarranties/)

9 OFT 1024 (2008), Evaluating the impact of the Supply of Extended Warranties on Domestic Electrical Goods Order 2005, prepared for the OFT by LECG.
restrictions in competition.\textsuperscript{10} This figure was subject to a number of assumptions and even relatively small changes would increase the size of the consumer benefit significantly. The OFT impact evaluation also considered that it was possible that the full impact of the EW Order had not yet materialised.\textsuperscript{11}

2.8 Following the OFT impact evaluation, the OFT worked with various parties, particularly retailers, to improve compliance with the EW Order. Amongst other things, the OFT has:

- Monitored retailer websites and raised compliance concerns with parties.
- Required major retailers to provide details of their approach to complying with the EW Order.
- Periodically reminded the major retailers of their obligations under the EW Order.
- Produced guidance to retailers to help them to fully understand the obligations created by the EW Order.\textsuperscript{12}

Reasons for this market study

2.9 The OFT launched a market review of the DEGs sector on 24 November 2010. This was comprised of:

- A review of the Restriction on Agreements and Conduct (Specified Domestic Electrical Goods) Order 1998 (DEGs Order), and associated

\textsuperscript{10} Although some of the remaining consumer detriment was being addressed by wider market factors.

\textsuperscript{11} OFT impact evaluation (2008), paragraph 6.51.

\textsuperscript{12} Referred to in footnote 8.
undertakings (the Remedy Review). This review focused on competition for DEGs.\textsuperscript{13}

- An invitation to comment on a possible market study of aftermarkets for DEGs, including competition in the markets for the repairs of DEGs and the supply of EWs.

2.10 The OFT received comments from across the DEGs sector. Following careful consideration of these comments the OFT considered that there was insufficient evidence of harm to competition and consumers to justify prioritising a market study into the repairs of DEGs.

2.11 However, the OFT received credible evidence of on-going competition concerns about the supply of EWs. In particular, concerns were raised that competition continued to be restricted by the retailer POS advantage. The OFT also received more general concerns that EWs did not represent value for money given the high levels of reliability of most DEGs. As a result of this information, the OFT decided that a tightly focused market study to consider the effectiveness of competition was a priority for the OFT.\textsuperscript{14}

**Scope of the market study**

2.12 To facilitate efficient delivery, the OFT has ensured that the market study has been tightly scoped in the following ways:

- the number of products considered

\textsuperscript{13} On 24 June 2011, the OFT announced that it had advised the CC that the DEGs Order and associated undertakings should be removed. The CC announced on 1 February 2012 that it agreed with the OFT’s advice and removed the DEGs Order and undertakings.

\textsuperscript{14} For further details on the OFT’s conclusions following the invitation to comment see chapter 3 of OFT 1230 (2011), Aftermarkets for Domestic Electrical Goods - Findings on aftermarkets and the launch of a short market study into extended warranties (hereafter OFT 1230).
• the range of issues addressed.\textsuperscript{15}

\textbf{The number of products considered}

2.13 This market study included EWs for all DEGs, which are all goods that are designed to be connected to an electricity supply or powered by batteries and used for domestic purposes.\textsuperscript{16} This included EWs on televisions and audio-visual devices (brown goods), household appliances (white goods), computers (grey goods), small domestic appliances (such as kettles), communications and photographic equipment. However, to enable the market study to be delivered efficiently, the OFT focused its information gathering and analysis on DEGs upon which EWs are most frequently purchased:

• televisions
• washing machines
• personal computers.

2.14 The selection of these DEGs meant that the OFT was able to consider EWs across each of the major types of DEGs (white goods, brown goods and grey goods). The OFT has therefore not considered EWs on other products, such as small domestic appliances or communications equipment, in significant detail. However, it notes that these products are often sold in a similar manner to the DEGs which are the focus of this market study.

\textsuperscript{15} The OFT has received some concerns about how aspects of the operation of the EW market impact on competition between independent repairers. However, consistent with the historic concerns about the operation of the market, the OFT has focused upon the direct impact that the market has on consumers.

\textsuperscript{16} Excluding watches, jewellery or fixed installations (other than integrated appliances). This was the definition of a DEG used in the EW Order. Further details of the full scope of the market study can be found at chapter 3 of OFT 1230.
The range of issues considered

2.15 The market study has focused on what the OFT considers to be the key competition indicators in the EW market:

- the structure and operation of the EW market, particularly the extent to which the POS advantage persists
- consumer behaviour, particularly the extent to which consumers shop around and the availability of information to consumers.

And their impact upon:

- the pricing of EWs, particularly trends in EW prices over time
- the profitability of EWs, particularly focusing upon claims ratios as an indicator.

Approach and methodology

2.16 This market study was carried out under the OFT’s function in section 5 of the EA02 of 'obtaining, compiling and keeping under review information about matters relating to the carrying out of its functions'. The OFT has not conducted a review of the EW Order under section 88(5) of the Fair Trading Act 1973, and has therefore not specifically considered whether the EW Order remains appropriate. This was because during the invitation to comment, the OFT did not receive any representations that there had been a ‘change of circumstances’ since the EW Order was implemented which meant that it should be varied, revoked or superseded. The EW Order will therefore remain in place.

2.17 In conducting the market study, the OFT also considered that there was already considerable information on the operation of the EW market in the public domain. This included the OFT’s market study report from 2002, the CC's report in 2003 and the report of the OFT impact evaluation in 2008.
2.18 Both as a result of the invitation to comment and during the market study, the OFT received and considered evidence from a wide range of parties including insurers, repairers, manufacturers, retailers and associations representing businesses and consumers. In particular, the OFT has considered information and evidence from:

- A wide range of EW providers. Although the OFT focused its detailed information gathering on the largest providers of EWs in order to limit the burdens on business of providing information, it has also considered information from providers with lower levels of EW sales.

- A wide range of published market reports.

- Several academic papers about EWs, particularly papers which consider consumer purchasing behaviour.

2.19 The OFT also engaged GfK NOP to carry out an omnibus consumer survey (OFT/GfK survey), focusing upon whether and, if so, how consumers shop around for EWs (the results of this can be found at Annexe A).

2.20 Conducting the market study alongside the Remedy Review has enabled the OFT to obtain a more complete understanding of the context in which the EW market operates.

17 The OFT also attended a meeting of the Association of Manufacturers of Domestic Electrical Appliances to discuss issues regarding EWs.

Structure of the report

2.21 The structure of the remainder of this report is as follows:

- Chapter 3 provides an overview of EWs.
- Chapter 4 sets out the OFT’s findings about consumer purchasing of EWs.
- Chapter 5 sets out the OFT’s findings on the structure of the EW market and how well it is working for consumers.
- Chapter 6 sets out the OFT’s provisional decision on an MIR and the OFT’s provisional decision on UIL.
- The annexes include the results of the OFT’s consumer survey and further information about the proposed UIL.
3 EXTENDED WARRANTIES

Introduction

3.1 DEGs are normally sold with a manufacturer’s guarantee, which usually covers the breakdown of the DEG in the first year after purchase. EWs (sometimes known as service contracts) are contracts which extend the cover provided by the manufacturer’s guarantee. They typically provide cover for either a period of three or five years from the date of purchase, although some EWs are rolling contracts, sometimes known as PAYG EWs, which continue until they are cancelled by the consumer. Most EWs cover a specific DEG, some cover several different DEGs.

3.2 EWs are purchased with around one fifth of DEGs purchased.\textsuperscript{19} Estimates of the annual value of the market vary considerably, from around £800m to £1.2bn,\textsuperscript{20} largely depending on which specific DEGs are included in the definition. Based on information provided by parties during the market study, the OFT estimates that the annual market value is in the region of £1bn.

3.3 EWs at different providers vary in a number of ways, both with respect to their features and coverage, and the way that they are sold.

3.4 As regards coverage, in addition to covering the risk of breakdown, some EWs can provide other features, including:

- cover for accidental damage
- support with installing the DEG
- ongoing helpline support
- regular servicing.

\textsuperscript{19} See Annexe A.

\textsuperscript{20} Mintel (2006) and Datamonitor (2010).
• guaranteed maximum repair times

• ready access to a nationwide repair network meaning the consumer does not incur the costs associated with finding a reputable repairer

• arranging the collection of the DEG from the consumer

• protection for the DEG when it is taken outside of the UK.

3.5 The level of cover provided also varies between EWs. For example:

• whether the EW terminates if a replacement is made

• the circumstances under which the EW does not provide cover, known as 'exclusions'

• whether a faulty DEG can be replaced with a new DEG (new for old cover) and whether the value of the potential replacement DEG depreciates over time

• whether an excess is payable and whether a charge is levied where no fault is found.

3.6 EWs are sold in a number of different ways, by the various different providers, including:

• by retailers at POS when the consumer is purchasing the DEG

• by manufacturers, where the manufacturer places the details of the EW in the DEGs' packaging for the consumer to respond to

• by retailers and manufacturers, in mailings to customers, including renewal mailings to consumers toward the end of EW cover periods

21 It is important to note that in some cases an EW bought from a retailer at POS is in fact provided by a separate insurer, upon whose behalf the retailer is acting.
(or toward the end of the period covered by the manufacturer guarantee)

- by insurers and other providers, through websites and over the telephone
- as part of another product, such as a packaged bank account
- as a free product at some manufacturers, such as Miele, and retailers, such as John Lewis.

3.7 Table 3.1, taken from Mintel consumer research, shows an estimate of the share of EWs supplied by various providers. This shows the electrical retailers, Dixons, Comet and Argos, to be the largest EW providers, followed by smaller electrical retailers and insurers.\(^{22}\)

Table 3.1: Share of EWs supplied by the various providers

<table>
<thead>
<tr>
<th>Provider</th>
<th>Share of supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dixons Retail</td>
<td>32</td>
</tr>
<tr>
<td>Argos</td>
<td>14</td>
</tr>
<tr>
<td>Comet</td>
<td>10</td>
</tr>
<tr>
<td>D&amp;G</td>
<td>6</td>
</tr>
<tr>
<td>John Lewis</td>
<td>6</td>
</tr>
<tr>
<td>Warranty Direct</td>
<td>2</td>
</tr>
</tbody>
</table>

\(^{22}\) The OFT notes that there are limitations with using consumer research data for this information, most particularly that it relies on the accuracy of consumer recall. It also may understate the importance of renewals. However, the OFT has not received sufficient information from parties to prepare market share information based upon sales values or volumes.
Any product manufacturer  |  5  
Any supermarket  |  4  
Any utility provider  |  1  
Other  |  15  
Don’t know  |  7  

Source: Mintel (2011)

**Types of EWs**

3.8 There are two main types of EWs offered to consumers:

- **Insured EWs**: where the consumer is directly insured by the EW provider against the cost of repair or replacement.
- **Service-backed EWs**: where the consumer is provided with a repair or replacement service, without the EW purporting to be an insurance product.²³

From a consumer’s perspective these types of EWs are essentially the same. Indeed, it seems unlikely that consumers, in general, are aware of the distinctions between these types of EW.

3.9 The distinction, however, becomes significant when considering the level of financial protection that consumers can expect in the event that the EW provider goes out of business. Insured EWs are covered by the

²³ The providers of these often have a ring fenced fund within their business to meet the EW liabilities.
Financial Services Compensation Scheme, and thereby provide greater consumer protection, whereas service-backed EWs are not.24

Relationship with statutory rights

3.10 The Sale of Goods Act 1979 (as amended) (SOGA), and associated regulations, establish consumers' legal rights when purchasing goods, such as DEGs. Under SOGA an item is considered faulty if it is:

- not of satisfactory quality
- not fit for purpose
- does not match the retailer’s description.

3.11 If an item is faulty when bought, a consumer may be entitled to a refund, a repair or a replacement.

3.12 During the market study, it has been put to the OFT that these statutory rights mean that an EW is an essentially 'useless' product. However, the OFT, consistent with the CC's view when it investigated the market, considers that EWs do offer benefits which go above and beyond consumers' statutory rights. These include, amongst other things, the features referred to in paragraphs 3.4 and 3.5, such as accidental damage cover and specific service standards. Moreover, under SOGA, the onus is on the consumer to demonstrate that the DEG was faulty at the time of purchase from six months after the purchase of the DEG. This could involve an independent inspection of the product or, in the event of a dispute between the retailer and the consumer, litigation, all of which may lead to some cost and inconvenience to consumers. This is not required for claims under an EW.

24 General guidance publications on whether an EW constitutes a contract of insurance is available from the Financial Services Authority.
3.13 The OFT is concerned that many consumers may not be fully aware of their statutory rights when purchasing a DEG and that lack of awareness may influence their decision on whether to purchase an EW.\(^{25}\) The OFT is currently running a 'Know your rights' campaign during 2011 to 2012, which is intended to raise consumers awareness of their rights under SOGA.\(^{26}\) One of the particular areas of focus in this campaign is DEGs. The campaign includes:

- a consumer leaflet
- website videos, including a specific video focusing upon consumer rights when purchasing DEGs
- targeted engagement with key interested parties to raise awareness of consumers' rights.

This campaign will continue into 2012 and will be evaluated to assess its effectiveness in delivering key messages to consumers.

The relationship with the DEGs market

3.14 It is important to understand that prices of EWs are, at least partially, constrained by competition in the DEGs market. This is because there are clear and obvious links between the EW and the DEG for which it is bought. In particular, consumer research indicates that a key factor relating to the purchase of an EW is the type of the DEG itself.

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\(^{25}\) This is consistent with a consumer survey conducted by TNS for BIS in 2008 (details at: [http://webarchive.nationalarchives.gov.uk](http://webarchive.nationalarchives.gov.uk) and [www.berr.gov.uk/whatwedo/consumers/page51180.html](http://www.berr.gov.uk/whatwedo/consumers/page51180.html)) which demonstrated that many consumers were unaware of their statutory rights when purchasing goods. For example, only just over a quarter of consumers surveyed considered that all shops would have to legally refund, compensate, repair or replace a faulty item where proof of purchase was no longer available.

\(^{26}\) See [www.oft.gov.uk/OFTwork/consumer-protection/campaign11-12/kycr](http://www.oft.gov.uk/OFTwork/consumer-protection/campaign11-12/kycr)
According to Datamonitor, consumers are more likely to buy EWs for white goods (specifically for large household appliances such as washing machines, fridges and dishwashers) as these are important appliances upon which consumers rely.

In addition, the pricing of an EW is usually linked to the price of the associated DEG (EW prices are often based on price bands, and Richer Sounds has a policy of pricing the EW at 10 per cent of the accompanying DEG). Consumer research indicates that a key factor in consumers' decisions to purchase EWs is the price of the related DEG. Indeed, Mintel research found that 49 per cent of EW purchasers said that they would purchase an EW if the cost of cover was reasonable in relation to the cost of the item. Changes in the price of a DEG are therefore highly likely to have some impact on the price of an associated EW.

The OFT concluded during the review of the DEGs Order and associated undertakings that competition in DEGs retailing had significantly improved since the implementation of the DEGs Order in 1998, due to:

- vigorous competition in DEGs retailing, particularly through the entry and expansion of non-specialist retailers (such as catalogue stores and multiple grocers) and online retailers, which tend to have a strongly price focused proposition to consumers
- changes in consumer behaviour, particularly consumers taking advantage of greater price transparency, as a result of increased


28 Except for low value DEGs.


30 The review of the DEGs Order focused on competition in the retailing of DEGs. It therefore did not consider, in detail, the effect of competition between manufacturers and improved manufacturing processes on the price of DEGs.
internet use to shop around for DEGs. Indeed, survey evidence provided to the OFT suggests that up to 80 per cent of consumers purchasing DEGs look at the internet when deciding which DEGs to buy.

3.17 These changes have contributed to significant deflation in DEGs prices. Certainly, evidence from Verdict indicates that there has been a significant decline in the retail prices of DEGs over time, with retail prices declining, in nominal terms, by over eight per cent on average each year between 2000 and 2009.\textsuperscript{31} Given the direct linkage between the price of the DEG and the EW, the OFT would expect this price deflation to mean that a consumer buying the same DEG would be likely to pay a lower price on the associated EW than they would have in the past. However, falling DEGs prices are only likely to impose an overall ceiling on EW prices, as although consumers may be unwilling to purchase an EW which appears expensive when compared with the price of the DEG, that does not, in itself, ensure that EWs are sold at a competitive price.

Conclusion

3.18 A competitive DEGs market, leading to competitively priced DEGs is therefore not, in itself, sufficient to ensure that EWs are sold at a competitive price. This point was recognised by the CC which found that, notwithstanding falling DEGs prices prior to its report in 2003, EWs were not being sold at a competitive price.

\textsuperscript{31} Verdict (2011), UK Electricals 2011, page 36. This excludes information for 2010 and 2011 which are based upon estimates. The OFT notes that the information for these years also shows significant price declines.
4 CONSUMER PURCHASING OF EXTENDED WARRANTIES

4.1 This chapter focuses upon consumer purchasing behaviour for EWs, particularly considering whether that behaviour has changed since the CC reported. In particular, the chapter covers:

- the availability of information to consumers
- the factors influencing consumer choice of EWs
- the extent of consumers' shopping around
- the extent to which consumers are aware of alternative providers
- selling practices for EWs.

Availability of information to consumers

4.2 It is important that consumers are able to readily access reliable, useful sources of information on prices and product features to enable them to shop around for EWs, thereby driving competition between suppliers who compete to provide the best deal.

4.3 Since the CC reported, there have been some improvements in the information available to consumers regarding EWs:

- The EW Order requires all EW providers to display information on an applicable price of the EW alongside the DEG to which it relates, as well as 'further relevant information', such as the consumer's cancellation rights and statutory rights, in in-store leaflets. However, as explained in chapter 2, the OFT impact evaluation revealed that there is some historic evidence of a lack of compliance with the EW Order. The OFT also notes that, from checks conducted during this market study, some of the further relevant information may not be as readily accessible as it could be, sometimes being several clicks away from the webpage on which the DEG is displayed, or otherwise not being as prominently displayed in in-store leaflets as it could be.
• Online sources of product information have grown, making it easier for consumers to compare EWs online. Some parties noted that online forums and message boards are becoming more influential, such that feedback posted by consumers can impact on consumer perceptions of EWs and influence their EW purchasing decision.

4.4 Despite these improvements, the OFT has received evidence that information asymmetries continue to exist which mean that consumers do not have access to all of the information they may need to help them to take fully informed decisions:

• About the likelihood that a DEG will need to be repaired and likely repair costs. Whilst Which? subscribers have access to some information on these points, most consumers do not. This makes it difficult for them to assess value for money and to make an informed purchasing decision.

• Those arranging cover may not fully appreciate whether the EW is an insurance-backed or service backed product (see chapter 3).

• Some consumers are not fully aware of their statutory rights when purchasing a DEG (see chapter 3). Moreover, there is historic evidence that some consumers are not fully aware of their rights under the EW Order, including their cancellation rights.

The factors influencing consumer choice of EWs

4.5 A consumer’s decision as to whether to purchase an EW is likely to depend on a number of factors, including evaluating the following benefits which an EW may bring:

32 The CC made a similar finding in 2003, noting that the lack of information on reliability and costs of repairs would mean consumers would find it difficult to assess value for money of a particular EW product.

33 Which? (December 2008), Shops get your rights wrong.
• **Peace of mind:** this is often cited by consumers as a reason for purchasing an EW. For example, the OFT has seen consumer research which reported that the large majority of consumers (80 per cent) who had purchased an EW believed it provided peace of mind.\(^{34}\) Consumers may get peace of mind from an easier repair process and the time saved by not having to search for a suitable, reputable repairer.

• **Protecting against risk:** consumers may be risk averse and value the certainty\(^{35}\) an EW affords that they are protected from product failure.

• **Perceptions of likelihood of breakdown:**
  - Consumers who view the DEG as more likely to break down are more likely to purchase an EW. For example, 51 per cent of consumers purchasing EWs state that they are worried about their electrical goods breaking down, compared with 26 per cent of those not purchasing an EW.\(^{36}\)
  - However, consumers may make errors in assessing probabilities. For example, consumers may over-estimate the risk of product failure\(^{37}\) because anecdotes or memories of breakdown are easy

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\(^{34}\) Mintel (2011), page 9.

\(^{35}\) Subject to policy exclusions or excesses.

\(^{36}\) Mintel (2011), page 9. This may reflect the fact that the risk of product failure depends partly on the consumer and their intended use for it. For example, a washing machine being intensively used by a large family is more likely to need repair than one in a single person household.

to call to mind for the consumer and they tend to believe that events that are easily recalled are more likely. As consumers value certainty, they often pay much more to go from very small risks to none at all, than for similar risk reductions that still leave some uncertainty. As a result they may be susceptible to sales techniques that emphasise certainty and 'peace of mind'.

- **Cost or significance of the DEG:** Consumers are more likely to seek cover for expensive items or items they regard as important or essential.

- **Easing liquidity constraints of those consumers who lack ready access to cash:** a consumer’s preference not to face unexpected risks can be strengthened where they face liquidity constraints. For example, consumers with limited access to finance may prefer to purchase an EW as they would be unable to afford to pay potentially unanticipated, and perhaps significant, repair or replacement costs for their electrical products. However, most survey evidence (and information supplied by one EW provider) fails to indicate that there are significant differences in propensity to purchase an EW between consumers in different income ranges or socio-economic groups.

38 Indeed, those that have previously claimed on an EW policy will tend to provide larger estimates of the likelihood of product failure: Chen, T., Kalra, A., and Sun, B. (2009), Why do consumers buy extended service contracts?, Journal of Consumer Research, 36, 611–623.


41 Survey evidence includes: Mintel (2011) by socio-economic group (page 95) and by gross annual household income (page 96), Mintel (2006) by household income (page 63) and Finaccord (2011) by income (page 13). The OFT’s survey conducted by GfK did find a statistically significant difference in propensity to purchase an EW by socio-economic group: only 12 per cent of those from A and B socioeconomic groups (based on 362 respondents) purchased an EW compared to 25 per cent of Ds and Es (264 respondents). However, this was the only research we saw to do so.
4.6 However, many consumers purchasing an EW had not planned to purchase an EW and thus do not take much time to consider their EW purchase decision. For example, Mintel reported that only around two fifths (39 per cent) of EW holders agreed that they had intended to take out an EW before they purchased the DEG. Behavioural economics offers an explanation for this: consumers may be 'desensitised' to making a secondary purchase after purchasing a relatively more expensive main item.

The extent of consumers’ shopping around

4.7 When consumers shop around to find the best deal they can drive effective competition between providers. The OFT survey indicates that the proportion of consumers shopping around for EWs has increased since the CC reported, though overall numbers remain relatively low. For example, in 2002 shopping around was rare (with only four per cent of consumers shopping around). This figure had increased to 15 per cent by 2008, and that upwards trend has continued with 25 per cent of

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42 When consumers do not foresee their need to purchase an EW, the equilibrium pricing strategy of firms may be to compete purely on the price of a base good (the DEG) and to suppress information about add-on prices (the EW), enabling them to charge above marginal cost for the add-on good. This was shown by Gabaix, X. and Laibson, D. (2006), Shrouded attributes, consumer myopia, and information suppression in competitive markets, Quarterly Journal of Economics.

43 Similarly, in 2003 the CC noted that pre-planning to purchase an EW was generally low (36 per cent of those purchasing an EW from the same retailer as sold them the electrical product on average), CC (2003), paragraph 9.22.


45 Indeed, the CC identified inertia from EW purchasers as a key feature of the market which impaired consumers’ ability to make an informed choice of product.

46 OFT impact evaluation. paragraph 1.16.
consumers in 2011 reporting that they compared the EW they purchased with those of other suppliers of EWs.47

4.8 The form that shopping around takes varies between consumers. For example, some consumers carried out research before making their purchase: around a quarter (26 per cent) of EW holders who are also internet users agreed that they used the internet to arrange or research their EW cover.48 About a third (35 per cent) of consumers compared the features of multiple products offered by the same supplier, but only a fifth (20 per cent) of consumers obtained quotes for an EW from multiple suppliers.49

4.9 How consumers carry out their research appears to influence purchase decisions. Those that had researched online showed a higher propensity to purchase their EW from providers other than the retailer selling the goods.50 Similarly, our survey showed strong evidence of a statistically significant association between sales channel and comparing EWs. Only 18 per cent of customers purchasing from the retailer stated that they had shopped around, compared with 39 per cent purchasing elsewhere.51

4.10 Although shopping around for EWs is much higher than historic rates for some similar insurance type products, such as Payment Protection Insurance (PPI) (where only 12 per cent of consumers shopped around in

47 See Annexe A, Table A 3. This is slightly lower than the 32 per cent reported by Mintel (2011). However, Mintel’s figure may over-state the extent of shopping around as the survey used an online panel (and online users are more likely to have been sophisticated shoppers).


49 See Annexe A, Tables A 5 and A 7.


51 OFT calculations based upon the OFT/GfK survey.
2006),\textsuperscript{52} it is lower than for many other similar insurance type products according to consumer surveys. For example, 69 per cent of general insurance customers surveyed say they shopped around last time they renewed their product.\textsuperscript{53} This may, at least partially, be explained by EWs generally being lower priced than similar insurance type products.\textsuperscript{54}

4.11 In addition, the OFT considers that shopping around is made more difficult, and therefore less effective, by the:

- complexity of EWs
- absence of EW comparison tools
- limited consumer awareness of alternatives.

**Product complexity and comparison tools**

4.12 The CC noted that the complexity of EWs and the wide disparities in terms and conditions offered between products made it difficult for the consumer to judge value for money and to compare products, even away from POS.\textsuperscript{55} The OFT’s research supports this as it found product features vary substantially between providers. For example, they vary in whether the EW has an excess, whether accidental damage is covered, and whether the policy provides new for old replacement (see chapter 3).

\textsuperscript{52} OFT 869, Payment Protection Insurance, Report on the market study and proposed decision to make a market investigation reference, October 2006 (hereafter OFT 869), paragraph 6.22.

\textsuperscript{53} Mintel (2011), Consumers and General Insurance – UK, page 91. The OFT recognises that these figures relate to renewals of existing policies rather than the purchase of a new product so the comparison with EWs is not exact.

\textsuperscript{54} Consumers may be less likely to shop around when the product is lower-priced, as they perceive that there would be only limited financial savings to be obtained from shopping around.

\textsuperscript{55} CC (2003), paragraph 13.19.
Moreover, the absence of choice tools (such as price comparison websites, which include high level information on product features)\textsuperscript{56} makes it more difficult for consumers to shop around as it may be more time consuming to understand and evaluate the range of different EWs on offer.

One concern arising from product complexity is that consumer expectations about the anticipated coverage level diverge from the actual coverage in practice. For example, the Financial Ombudsman Service has reported that around a half of the complaints it received about EWs were in relation to policy terms\textsuperscript{57} and a sample of complaints to the Consumer Direct service found that 40 per cent\textsuperscript{58} of complaints about EWs were about disputes over the extent of coverage and interpretation of coverage terms. Another area where expectations diverge is in relation to the standard of repair services under warranty.\textsuperscript{59}

Awareness of alternatives

Awareness of alternative EW providers to those at POS is still limited. For example, Mintel found that half (49 per cent) of EW purchasers who

\textsuperscript{56} By way of example, for a home insurance policy moneysupermarket.com provides information on product features such as the sum insured, total excess, whether it is a new for old policy and whether replacement locks cover, home emergency cover and legal cover are included.

\textsuperscript{57} Financial Ombudsman Service, closed Warranty cases for period of 1 April 2010 to 28 February 2011 (this also includes information about car warranties as it was not possible to exclude that information). Similarly, Manning Gottlieb OMD for Espares, reported that 91 per cent of UK adults that purchased an extended warranty expect that all repairs will be covered.

\textsuperscript{58} Sample of complaints to Consumer Direct during 2010. The most common area of dispute was the replacement value of the item, and the second most common was the interpretation and/or exclusion of accidental damage claims.

\textsuperscript{59} This accounted for 35 per cent of complaints to Consumer Direct (these were generally related to slow servicing and the quality of the repair service).
had not shopped around for their EW were unaware of the existence of alternative providers offering similar products.\footnote{Mintel (2011), page 66. This is consistent with the findings of the OFT’s market study in 2001. The OFT impact evaluation also found that a quarter of consumers believed that the only time to buy an EW is at POS.}

4.16 One party asserted that consumers are aware of alternative ways to protect themselves from product breakdown and submitted data on cancellations as evidence supporting this. It noted that consumers can and do cancel and switch to different methods of cover:

- **Cancellation:**\footnote{The CC reported that only 10 per cent of purchasers had considered cancelling their EW.} Around [ ] per cent of consumers cancelled their term EWs within the first year of purchase (with most of those cancelling within the first 45 days). Cancellation rates for PAYG EWs are higher: nearly [ ] are cancelled within the first year, although a significant minority of consumers retain the PAYG EW for more than four years.

- **Switching:** Survey evidence provided to the OFT indicates that amongst those who had cancelled an EW, around a quarter (27 per cent) indicated that this was so that they could take up an alternative product, although only [ ] switched because they could buy a cheaper product from a competitor.\footnote{[ ]} Combining the cancellation and switching figures implies that very few consumers overall (less than five per cent) switched specifically because they could buy a cheaper EW from an alternative provider.

**Sales practices**

4.17 Sales staff are likely to be an important influence on a consumer’s purchasing decision. This is demonstrated by the OFT’s consumer survey...
which indicates that 44 per cent of EW purchasers discussed the suitability of the EW with a member of the provider’s sales staff.\(^{63}\)

4.18 Historically, various concerns have been expressed that sales staff engage in either aggressive sales tactics or misleading behaviour to sell EWs to consumers. The CC noted that selling practices which made consumers feel under pressure to purchase an EW did exist to some extent.\(^{64}\) The OFT has considered the evidence it has received on this issue below.

- **Aggressive selling:** Mintel research suggests that some 28 per cent of EW purchasers felt pressure from sales staff to take out an EW.\(^{65}\) However, the nature of such pressure is unclear from the survey. In particular, it is unclear whether it represented the sales staff offering an EW to a consumer, and setting out its advantages, or whether it represented inappropriate sales behaviour. The OFT also notes that Consumer Direct has recently received very few complaints about aggressive selling practices.

- **Misleading actions or omissions:** During the market study, the BBC’s Watchdog programme conducted a mystery shopper survey of a small number of Comet stores. This suggested that Comet staff at several stores provided consumers with incorrect information concerning the terms and conditions of its EWs, most particularly the extent of any exclusions. The OFT notes that this alone does not provide conclusive evidence of systematic mis-selling of EWs, given the small sample of stores and the fact that some of the questions asked of Comet staff by the mystery shopper may not be typical of the questions generally asked by consumers.\(^{66}\)

\(^{63}\) See Annexe A, Table A 8.

\(^{64}\) CC (2003), paragraph 2.349.

\(^{65}\) Mintel (2011), page 63.

\(^{66}\) In particular, the mystery shopper asked whether the policy covered damage caused by vermin. Comet has indicated that this question was not typically asked by consumers and
Comet has subsequently rolled out a 'comprehensive refresher training programme for all staff'.

- **Sales Commissions**: Sales commissions may provide incentives for sales staff to engage in inappropriate behaviour in order to sell EWs.\(^{67}\) The OFT welcomes the action taken by the major POS EW providers in eliminating, or otherwise substantially reducing, direct sales commissions to staff for the sale of EWs. However, it notes that some retailers still use limited commission payments to incentivise sales of EWs.

4.19 The OFT has not received sufficient evidence during the market study to indicate that EW providers are engaging in unfair commercial practices to sell EWs. However, following the market study the OFT will consider any complaints, and accompanying evidence, which it receives on this issue with a view to taking enforcement action under the CPRs or other consumer law, if justified by the evidence received and following an assessment under the OFT’s Prioritisation Principles.

**Conclusion**

4.20 The OFT notes that there have been some important changes in consumer behaviour since the CC reported, most particularly that more consumers now shop around for EWs. Moreover, consumer information has improved, partly due to the EW Order and partly due to the expansion of online sources of information.

therefore has not been part of its general staff training. It has emphasised that no claims have ever been refused by Comet on the basis of damage caused by vermin in recent years. Moreover, Comet has also been able to provide the OFT with explanations with respect to some of the other examples used during the programme which would tend to suggest that consumers were not misled.

\(^{67}\) Indeed, the CC concluded that the presence of sales commissions was one of the selling practices that contributed to the pressure consumers felt to purchase EWs at the POS, CC (2003), paragraph 1.16.
4.21 However, despite these improvements, some significant concerns remain. Consumers still lack important information which would allow them to take a more informed decision about which EW to buy, particularly information which would enable them effectively to evaluate value for money. The incidence of shopping around remains limited compared to similar products and its effectiveness may be limited through the complexity of the EW products and the absence of comparison tools. Finally, some consumers are not aware of alternative providers when purchasing EWs.
5 HOW WELL THE EW MARKET WORKS

5.1 This chapter considers competition in the EW market, focusing particularly on whether a POS advantage persists and continues to restrict competition. It then goes on to consider how well the market works for consumers, focusing upon certain key indicators, such as

- EW prices
- the quality of EWs
- the profitability of EW providers
- other competition indicators.

Sales at POS

CC findings

5.2 The CC found that retailers of DEGs had a POS advantage arising from their position as the retailer of the DEG. This was due to:

- The convenience associated with purchasing an EW at the same time as buying the DEG.
- The fact that the retailer has the opportunity to explain the benefits of the EW.
- The fact that the retailer may have the first opportunity to try to sell an EW to a consumer before any other supplier unless the consumer has actively researched the EW market in advance.

5.3 The CC then found that although it was relatively easy for a potential new entrant (that was not selling DEGs) to acquire the capabilities needed to enter the EW market (such as access to a repair network) the major difficulty would be accessing customers at the point at which they wish to purchase an EW. The CC therefore concluded that the POS
advantage made it hard for potential new entrants to compete effectively with POS providers, thereby restricting competition.

OFT findings

5.4 The OFT notes that the factors which the CC considered led to a POS advantage continue to persist.

- It remains convenient for consumers to purchase an EW at the same time as purchasing the DEG, a point made to the OFT by the major DEGs retailers during the market study.

- The POS provider continues to have the opportunity to explain the benefits of the EW. Indeed, the OFT’s survey found that, of those who purchased EWs, 44 per cent of them discussed the suitability of the EW with a member of the provider’s sales staff.68

- That, because shopping around remains relatively limited (see chapter 4), particularly amongst those consumers who obtained their EW at POS, retailers generally retain the first opportunity to sell an EW to a consumer.

5.5 This POS advantage is likely to be reflected in the fact that although the proportion of EW consumers purchasing at POS has declined since 2002, the majority continue to purchase at POS. This is demonstrated in Table 5.1 which, based upon a variety of consumer surveys, suggests that around two-thirds of EW consumers obtained their EW at POS.

68 See Annexe A, Table A 8.
Table 5.1: Percentage of consumers obtaining EWs from POS providers

<table>
<thead>
<tr>
<th>Source</th>
<th>Percentage obtaining the EW from POS retailer</th>
</tr>
</thead>
<tbody>
<tr>
<td>LECG (2008)⁶⁹</td>
<td>68</td>
</tr>
<tr>
<td>Mintel (2011)⁷⁰</td>
<td>64</td>
</tr>
<tr>
<td>Finaccord (2011)⁷¹</td>
<td>62</td>
</tr>
<tr>
<td>GfK NOP for OFT (2011)⁷²</td>
<td>69</td>
</tr>
</tbody>
</table>

5.6 To assess whether such a POS advantage is likely to restrict competition, the OFT has considered developments in the non-POS supply of EWs and whether they indicate that non-POS EW providers are better able to compete effectively with POS providers.

Non-POS provision and new entry

5.7 Since 2003, the number and importance of non-POS EW providers has increased as a result of entry into the market by internet providers (for example, Gadgetcover.com) and further expansion in the market by retail banks, credit card providers and utility companies (such as British Gas). The main source of the growth in the non-POS market has been from manufacturer-provided EWs, which now account for between 12 to 15 per cent of the market by volume.⁷³ However, it is worth noting, as the OFT impact evaluation found, that a significant proportion of this growth reflects the increasing practice of some manufacturers (such as Miele


⁷¹ Finaccord (2011), page 27.

⁷² See Annexe A, Table A 9.

⁷³ 12 per cent, OFT/GfK survey, Annexe A, Table A 9: 15 per cent, Mintel (2011), page 47.
and Dyson) of offering free EWs on their DEGs, rather than consumers actively shopping around to get the best deal and choosing a non-POS provider. Indeed, the OFT impact evaluation indicated that around three quarters of paid for EWs continued to be purchased at POS.  

5.8 Moreover, the non-POS providers (with the exception of D&G, discussed at paragraph 5.9) have relatively small market shares. Indeed, Mintel research indicates that Warranty Direct, the largest named non-POS provider (except D&G) had a market share of only two per cent in 2011. Moreover, one significant non-POS EW provider which has been looking to expand has informed the OFT that competition has not improved 'either for the consumer...or potential suppliers of EWs seeking entry and expansion in the market'. It notes that this reflects the competitive advantage enjoyed by many of the incumbent providers, most particularly the POS advantage enjoyed by retailers. One significant POS provider also noted that 'competition has not increased measurably' since the introduction of the EW Order.

5.9 Several EW providers have referred to the growth of D&G, the largest non-POS provider, as indicating that non-POS providers are able to expand effectively in the market. However, it is important to note that [ ] of EWs sold by D&G are [ ], which may not directly compete fully with EWs sold at POS. Moreover, D&G also benefits from a wide range of well established relationships with manufacturers which provides direct access to consumers who have purchased DEGs produced by those manufacturers. D&G’s website states that D&G works with 'most of the UK’s major manufacturers', a point confirmed by Finaccord research, which highlights that over 90 per cent of white goods manufacturers

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74 The OFT impact evaluation (page 9) estimated that in 2008, around two-thirds of the decline in the proportion of EWs sold at POS had been due to free EWs offered by manufacturers.

75 See table 3.1.

76 D&G obtains these relationships through successfully winning tenders to provide EW services for those manufacturers.
(including most of the major UK manufacturers) which run an EW scheme using a partnership with an insurer, sell EWs sourced from D&G.\textsuperscript{77} This provides D&G with an effective route to access customers, from which other providers do not benefit. The POS advantage enjoyed by the retailers, in any event, appears to be considerably more successful in securing sales than the sales channels enjoyed by D&G: whereas the overall EW penetration rate on DEGs is around 18 per cent, D&G only sells EWs on [ ] of the DEGs about which it receives consumer information. This provides a vivid illustration of the extent of the retailer POS advantage, even over the better established non-POS providers.\textsuperscript{78}

5.10 The OFT is aware that Applecare, an EW offered on Apple products only, is available at POS in Dixons, Argos and Comet, alongside the EWs provided by those retailers. Whilst the OFT welcomes this development, it currently applies to only one manufacturer’s products, and that manufacturer has a very limited role in the provision of white and brown DEGs suggesting the overall effect is limited.

Conclusion

5.11 The evidence obtained by the OFT during the market study indicates that retailers continue to benefit from a POS advantage, and that such an advantage restricts the ability of alternative providers to compete effectively for customers.

\textsuperscript{77} Finaccord,(2011) page 12.

\textsuperscript{78} However, the OFT notes that EWs provided by D&G are more likely to be on older DEGs. This will tend to mean that these EWs are more expensive which may explain some of the consumers’ reluctance to purchase these EWs.
Market outcomes for consumers

EW Prices

5.12 In 2003, the CC concluded that EW prices were significantly higher than they would have been if the market was more competitive. The OFT’s impact evaluation, based on an analysis of published EW price lists, concluded that EW prices, overall, had remained static in nominal terms and were therefore likely to have fallen in real terms.79

5.13 The OFT is mindful that price changes need to be interpreted in the context of:

- **repair costs:**80 for example, increasing repair costs may mean that EW prices have become closer to the cost of providing the EW product over time

- **the DEGs price:** lower replacement costs imply it is cheaper to replace than purchase an EW. One way this may be expressed is by looking at the ratio of EW price to DEGs price – a fall in EW prices does not necessarily imply increased competition for EWs if prices have not fallen relative to the DEGs price.

Prices for term warranties at POS

5.14 According to some EW price lists for the major EW providers, whereas prices for most EWs have declined since 2002/2003, EW prices on

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79 OFT impact evaluation, paragraph 9.1.

80 Parties have reported to us that repair costs have increased in recent years. For example, the ONS labour cost index and repair cost index have both grown by about 20 per cent since 2003. However, figures on reliability of electrical products are less widely available.
higher value DEGs have often remained broadly stable or otherwise increased in real terms.\textsuperscript{81}

5.15 As the price list information was inconclusive, the OFT requested data on price changes from the major EW providers which looked at the prices that consumers actually pay for an average EW. The results\textsuperscript{82} varied substantially depending in particular on the type of DEG for which the EW is purchased and the length of the EW. Table 5.2 presents summary results of average price changes\textsuperscript{83} in the average term EWs bought by consumers for the major EW providers since 2003.

Table 5.2: Price changes in average term EWs for major POS providers in real terms between 2003 and 2011

<table>
<thead>
<tr>
<th>Retailer</th>
<th>TVs</th>
<th>Laundry Products</th>
<th>PCs and Laptops</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provider A</td>
<td>[50-60]% decline</td>
<td>[30-40]% decline</td>
<td>[50-60]% decline</td>
</tr>
<tr>
<td>Provider B</td>
<td>[30-40]% decline</td>
<td>[20-30]% decline</td>
<td>[20-30]% decline</td>
</tr>
<tr>
<td>Provider C</td>
<td>[40-50]% increase</td>
<td>[0-10]% decline</td>
<td>n/a\textsuperscript{84}</td>
</tr>
</tbody>
</table>

\textsuperscript{81} This is based upon a high level analysis which considered EW price lists for televisions, fridge freezers and washing machines at several major EW providers.

\textsuperscript{82} The OFT notes that caution must be taken in considering these results, as there are several issues with the data: mix of DEGs purchased and types of EWs (especially length of term) may differ over time, which would manifest themselves as price changes even if there had been no change in underlying price levels. Changes to service levels and EW quality may occur so that there is a change in the overall consumer value for money from purchasing an EW that is not captured by simply looking at prices.

\textsuperscript{83} Price changes are shown in real terms, with CPI having been used as a deflator.

\textsuperscript{84} [ ].
This evidence would tend to suggest that average EW prices, at least for most term EWs, have declined in real terms at the major providers. This is similar to evidence provided by smaller retailers of term EWs, which submitted that prices had fallen in real terms or were static in the context of increasing repair costs (so prices were becoming closer to actual repair costs). However, it is important to note that, at least at one major EW provider, average EW prices have remained static or otherwise significantly increased.

The OFT notes that the evidence received on the ratio of the EW price to the DEGs price is somewhat mixed. One significant POS EW provider reported that the ratio of EW to DEGs prices had halved for its term EWs. However, another major POS provider also provided information on its EWs, which revealed that falls in EW prices have not kept pace with the falls in DEG prices such that the ratio of EW to DEG prices has increased: The OFT notes that recent research by Which? also reports ratios of EW to DEGs prices of a similar magnitude, for example, between 43 per cent to 57 per cent for washing machines, and 31 per cent to 38 per cent for televisions. The OFT would expect such ratios to have consistently declined if there was evidence that competition in EWs, rather than falling DEGs prices, was leading to lower priced EWs. These mixed results suggest that competition for EWs is not the sole factor in declining term EW prices.

Prices for PAYG EWs at POS

PAYG EWs are of increasing importance as a source of EW sales. This is particularly the case for Dixons, the main POS provider of EWs, where

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85 However, the OFT notes that this figure is based on all DEGs’ prices, and not only prices of DEGs on which an EW was sold.

86 Which?, 14 December 2011, Warranty warning.
PAYG EWs, which were introduced in 2005, now account for around [ ] per cent of all EWs which it sells.87

5.19 The OFT analysed Dixons’ PAYG prices and drew the following conclusions:

- Average real prices per month for PAYG warranties have been stable or falling since their introduction in 2005. For example, prices for EWs on televisions and washing machines fell by [ ] per cent and [ ] per cent respectively.

- However, the PAYG EW is generally significantly more expensive than its term equivalent for the same period of cover. It has been put to the OFT that few consumers hold the PAYG product for an equivalent time to that for which they would hold the term product, meaning that they pay less overall by buying a PAYG EW. Whilst the OFT recognises that this is indeed the case for many consumers, the higher PAYG prices may mean that consumers pay significantly more for an equivalent period of cover. For example, a consumer who purchased a PAYG product on a £299 television88 and cancelled it after 12 months would have made payments totalling £48, equating to some £4 per month. If they had purchased a three-year term EW, and cancelled it after one year, they would have paid £26.33, equating to only £2.19 per month.89 In fact, a consumer paying for the PAYG EW would have paid an amount equal to the price of a three-year term EW after just 20 months.

- Moreover, the OFT notes that PAYG EWs are significantly more expensive than the comparable term EW price was in 2004. For

87 For the avoidance of doubt, Argos and Comet do not currently offer PAYG EWs.

88 A very typical price for a TV according to one provider.

89 Moreover, the OFT notes that Dixons’ PAYG EW can cost more than the cost of the associated DEG if the warranty is held long enough. For example, a warranty on a £500 washing machine would exceed the original product cost if held beyond four years and eight months.
example, the average monthly cost of a three-year term EW for a washing machine was [ ] in 2004, compared to an average of [ ] for a PAYG EW in 2010.

- The OFT has found that consumers tend to hold PAYG EWs for less time than term EWs last. Our calculations suggest that an average PAYG EW is held for [ ] although there is variation in the retention rates. Although consumer cancellation in early years is relatively high (and higher than for term products), a substantial minority of consumers continue to hold a PAYG EW beyond four years [ ].

5.20 It has been put to the OFT that PAYG EWs, with their relatively low monthly prices, enable consumers to budget more effectively, and provide consumers with greater flexibility to cancel the EW when they no longer want to keep it. Although the OFT accepts this to some extent, it notes that consumers are apparently paying a significantly higher price for any such advantages. Moreover, the cancellation rights provided by the EW Order mean that all EW products, including term EWs, are flexible products, with consumers having a right to cancel and obtain either a full or a pro-rata refund.

5.21 Furthermore, the OFT notes that there are alternative means that EW providers could use to help consumers to budget to pay for the EW, particularly providing instalment payment plans. Indeed, the OFT notes that Comet provides the opportunity for consumers to make EW payments by instalments at no additional cost. Similarly, Dixons' Mastercare EW, offered to consumers following the expiry of the manufacturer guarantee period, offers consumers the ability to pay by instalments, also at no additional cost.

90 However, the OFT notes that it would expect, given the greater likelihood of the DEG to break down later in its life, that consumers who hold the EW for longer may obtain greater value from the EW in the later years.

91 The right to a pro-rata refund applies if the warranty is cancelled after 45 days.
5.22 Dixons has submitted that there are additional costs associated with the provision of the PAYG EW. However, the OFT has not received evidence that any such additional costs would be large enough to justify the significantly greater prices of the PAYG EW.

5.23 The OFT considers that consumers' willingness to pay these higher prices for PAYG EWs may reflect the fact that the monthly price of the PAYG EW appears low, particularly when compared to the price of the DEG, which as described in chapter 3 is a key determinant as to whether a consumer purchases an EW.92

**Comparison of level of POS and non-POS prices**

5.24 The OFT’s impact evaluation suggested that EW prices at non-POS providers could be assumed to act as a proxy for the competitive price for EWs.93 The OFT notes that there is only a limited disparity between EW POS prices and those of D&G. However, as noted in paragraph 5.9, D&G’s business model appears to be significantly different from those of other providers, given its greater focus on [ ] and EWs sold pursuant to manufacturer relationships which may directly impact upon the nature of its competition with POS retailers.

5.25 However, the OFT notes that smaller non-POS providers often have lower prices than the major POS retailers,94 for example:

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92 The relatively low monthly price may also mean that consumers may be less likely to shop around, as they perceive that there would be only limited financial savings to be obtained from shopping around.

93 OFT impact evaluation, paragraph 1.26.

94 The OFT recognises that some of these differences could be partially accounted for by differences in service levels offered by those providers. However, to come to a final view on whether these differences in price were justified would require detailed cost information from each of the providers, splitting out the costs associated with providing different elements of the EW cover. The OFT has not had access to such information during the market study.
• Warranty Care’s term EWs for TVs are between 34 and 55 per cent less expensive than the comparable term EW offered by Dixons, Comet or Argos and between 21 and 65 per cent less expensive for washing machines. \(^{95}\)

• GadgetCover’s EW for laptops is offered on an annual basis, and can be up to 41 per cent cheaper than the annual equivalent price of a term EW provided by Dixons or Comet, although Dixons’ EW prices are less expensive than GadgetCover’s price for lower priced laptops (those priced below £250). \(^{96}\)

• SquareTrade’s EW on an iPad 2 is between 44 per cent and 59 per cent cheaper for three years of cover than those offered by other providers. \(^{97}\)

Conclusion on prices

5.26 Overall, the pricing evidence seen by the OFT remains somewhat mixed. There have been some significant price declines in average prices for many term EWs, but if consumers are purchasing a PAYG EW they may be paying more than they would have been in 2003 and more than for a term EW. Moreover, the fact that some non-POS prices are generally at a lower level than POS prices, at least in relation to some EW providers, could suggest that prices, overall, are not at the levels they would be in a more competitive market.

Quality of EWs

5.27 Considering price levels in isolation will not reveal whether the value for money of EWs to consumers has increased, as any improvements in the

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\(^{95}\) Price lists accessed in June 2011.

\(^{96}\) Price lists accessed in June 2011.

\(^{97}\) Price lists accessed in January 2012.
level of competition may have resulted in improvements in EW quality, as well as a change in price levels. In order to assess this, the OFT has considered the quality of the typical EW bought by consumers in terms of service levels offered.

5.28 The evidence indicates that there have been some improvements in the quality of EW products offered, particularly enhanced coverage and better quality standards. For example, coverage for accidental damage is becoming more widespread, many policies offer installation support, and higher service standards (such as new for old replacement). Moreover, as a result of the EW Order, cancellation rights have improved. Specific examples of improvements since 2003 include:

- Dixons has reduced maximum service times (a replacement can be requested if a product cannot be repaired within 21 days,\(^{98}\) compared with six weeks in 2003) and introduced a premier EW option offering a higher level of support (including faster repair times and additional services, such as a remote fixing facility for PCs).

- Comet has introduced a payment plan, which allows consumers to pay for the EW in four equal payments over 10 months at no extra cost, has enhanced its software support services for its multimedia EWs and introduced an annual appliance ‘health check’.

5.29 Overall, the OFT considers that there have been some improvements in the quality of the EW product offering. Although these have generally been limited and have not changed the fundamental nature of the EW product, they have apparently enhanced the service which is provided to consumers.

\(^{98}\) Twenty-one days is the maximum repair time for the Whatever Happens warranty. The maximum repair time for Whatever Happens Premier warranty is seven days.
Profitability

5.30 Profitability can be an indicator of whether competition is effective. Consistent with the narrow focus of the market study, the OFT has not completed a detailed assessment of the profitability of various EW providers' businesses. It has instead primarily considered changes in claims ratios as an indicator of likely profitability.\(^9^9\) This is consistent with the OFT’s approach in other similar markets.\(^1^0^0\)

5.31 The OFT has defined 'claims ratio' as the cost of claims as a percentage of net EW revenue (or premium income) in a given year.\(^1^0^1\) A low claims ratio could be indicative of high profitability in that the provider does not make significant payments relative to the payments it has received. Table 5.3 summarises our findings. The data received by the OFT indicates the average claims ratio is around 50 per cent, up from around 20 per cent in 2002/3.\(^1^0^2\)

\(^9^9\) The OFT recognises that there are limitations associated with looking at claims ratios as a proxy for profitability, including that all relevant costs (such staff costs, service centres, retail premises costs and advertising) may not be included and that claims in a given year do not generally relate to sales in that year so the ratio will be affected by volume growth and product mix.

\(^1^0^0\) Such as in PPI and in Private Motor Insurance - call for evidence.

\(^1^0^1\) The OFT notes that there were differences in the way parties put together the claims ratio information in their responses to our information request, particularly in relation to which costs were included and excluded from the calculation. As a full breakdown of these costs was not provided, it has not therefore been possible for the OFT to calculate claims ratios that are on an identical basis.

\(^1^0^2\) This estimate is weighted by the size of the providers’ EW businesses using revenue estimates which they provided.
Table 5.3: Claims ratios for extended warranties for major providers

<table>
<thead>
<tr>
<th>Retailer</th>
<th>2002/03</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dixons</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Comet</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Argos</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>D&amp;G</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

Source: Information provided by EW providers

Moreover, the average claims ratio of ABI members, participating in an ABI study, increased from 54 per cent to 64 per cent from 2002 to 2009. The OFT notes that this data may contain some overlap with the major providers and it includes both at POS and non-POS providers. It is also worth noting that EW claims ratios are considerably higher than the 20 per cent mean claims ratio which the OFT found during its market study of PPI.103

However, despite these improvements, the claims ratios for the major EW providers appear to be lower than those for similar insurance type products. For example, Mintel reports a claims ratio of 74 per cent for general insurance, including 62 per cent for property insurance.104 Although the OFT recognises that there are limitations in undertaking comparisons of EWs with other financial products which may be distributed in a different way to EWs, the significant divergences between claims ratios for EWs at most providers and general insurance claims ratios supports the view that claims ratios for EWs appear relatively low.

103 OFT 869, paragraph 6.49.
5.34 Some EW providers also provided information on the underlying profitability of their EW business, indicating that profitability has significantly declined in recent years:

- Dixons estimated that its return on capital employed (ROCE) figure was [ ] for EWs, which is significantly lower than the [ ] in 2002. However, Dixons also noted that its operating margin on EWs was around [ ] its operating margin on DEGs.

- Comet estimated that its EW profits (net of allocated costs) have fallen by [ ] per cent since 2002/3. Comet’s return on sales and return on capital employed have fallen during the same period from [ ] respectively.

5.35 A detailed analysis of this profitability information, including scrutiny of the cost allocation methodology employed, was beyond the scope of this market study. Moreover, given the consistent evidence which the OFT has received regarding claims ratios, the OFT considers that such an analysis would be unnecessary to provide indicative information of the type which this market study has focused on.

5.36 The evidence suggests that profitability of EWs has declined. However, EW claims ratios appear to be significantly lower than those of similar insurance type products. This suggests that consumers may not be obtaining maximum value for money when they purchase EWs.

**Other Competition Indicators**

5.37 In addition to the indicators regarding price, quality and profitability, the OFT has also considered the frequency of changes in EW prices, EW price dispersion and the level of advertising for EW products as other indicators of competition.

5.38 The OFT has been informed by several EW providers that they actively monitor the EW prices of their competitors. If competition were vigorous, the OFT might expect there to have been frequent changes to EW prices as providers attempt to match, or beat, their competitors' prices. In this regard, the OFT notes that retailers very vigorously
monitor DEGs prices, sometimes changing them on a daily basis in response to competitors’ prices.\textsuperscript{105} By contrast, the OFT notes that changes to EW prices are relatively infrequent. Dixons, for example, has only changed its EW prices on five occasions between February 2003 and summer 2011,\textsuperscript{106} which is not suggestive of vigorous price competition.

5.39 The OFT has also looked at the dispersion in EW prices across seven\textsuperscript{107} different POS providers. If price competition were intense the OFT may expect the variation in EW prices to be limited as prices cluster around a competitive level. However, it is clear from figure 5.4 that EW prices vary dramatically across retailers.\textsuperscript{108} In fact, in some cases consumers can pay up to four times more by purchasing from the most expensive as opposed to the cheapest provider.\textsuperscript{109}

\textsuperscript{105} See paragraph 3.48 of the Remedy Review.

\textsuperscript{106} Based on information provided by Dixons in relation to five-year term EWs.

\textsuperscript{107} Six providers for washing machines, as Richer Sounds do not supply this product.

\textsuperscript{108} Although the differentiated nature of the EW product (considered in chapter 3), with different EWs providing different levels of cover, may explain at least some of these differences.

\textsuperscript{109} For TVs, the cheapest provider was Richer Sounds, which caps its EW prices at 10 per cent of the DEGs price, and the most expensive was Shop Direct. For washing machines, the cheapest warranties were SquareTrade being sold by Amazon, and Dixons was the most expensive provider.
Figure 5.4: Price comparison of three-year term extended warranties for TVs and washing machines\textsuperscript{110}

![Price comparison chart]

Source: OFT analysis of public domain pricing information

5.40 In addition, the OFT notes the significant disparity in changes in prices over time as shown in table 5.2. The OFT would expect that were the providers competing effectively, they could sustain differences in price related to differences in quality, but it would expect the price movements to be similar, maintaining the disparity. This does not appear to be the case from the information the OFT has received.

5.41 Moreover, if providers were vigorously competing to acquire custom from one another, the OFT might expect that they would devote resources to advertising their EW product. In 2010 advertising spend on EWs was approximately £8.8m.\textsuperscript{111} This is equivalent to 0.88 per cent of the total value of EW market. However, advertising spend on EWs is low

\textsuperscript{110} These prices have not been adjusted to account for differences in the quality of the EW offered.

\textsuperscript{111} Mintel (2011), page 50.
compared to similar insurance type products. For example, advertising spend in 2009 was equivalent to 1.6 per cent of the value of the household insurance market.\textsuperscript{112} Moreover, in the EW market D&G and Dixons accounted for the vast majority of spending on advertising, with many providers not recorded as spending anything on advertising at all. Furthermore, almost all of the spend on advertising was focused on direct mail. This suggests that unless a provider has access to information on consumers that have purchased DEGs, either at POS or through a manufacturer relationship, it may consider that advertising is likely to be ineffective as a cost-efficient means of acquiring customers.

5.42 The OFT considers that these indicators are consistent with limited competition between EW providers.

The existence of a potential waterbed effect

5.43 The OFT is aware that there is the potential for a waterbed effect to occur in the market for EWs. This would imply that any excess profits resulting from high prices in the market for EWs are competed away in the market for DEGs retailing\textsuperscript{113} and passed onto consumers in the form of lower prices for DEGs.

5.44 Establishing the size of any such effect would require a comprehensive assessment of the extent to which excess profits are competed away. In this market study, a full analysis of the extent of the waterbed is not necessary as, even if the waterbed was complete (that is all excess EW profits were competed away in the competitive DEGs retailing market), there is an allocative inefficiency\textsuperscript{114} in the market for EWs. This is

\textsuperscript{112} Based on advertising spend of £120.5m in a market worth £7.5bn in 2009. Source: Datamonitor (2010), UK Household Insurance 2010, pages 26 and 65.

\textsuperscript{113} The size of the effect depends on the intensity of competition in the DEGs market.

\textsuperscript{114} Allocative inefficiency occurs because consumers are not making the correct trade off between how much they value a good, and how much it costs to produce. This could lead them to over- or under-consume a given product, relative to the efficient allocation.
because some consumers who would purchase the EW at a competitive price, are not purchasing one because EW prices are too high. There is also a distributional impact as the 20 per cent of consumers that purchase an EW are cross-subsidising the other 80 per cent of consumers who purchase only a DEG but not an EW. These factors imply that, notwithstanding any waterbed effect, there is still consumer harm in the market for extended warranties, which could be substantial.\textsuperscript{115}

\textbf{Conclusion on how well this market works for consumers}

5.45 The OFT considers that the POS advantage, although diminished, continues to restrict competition between EW providers.

5.46 The OFT notes that there appear to have been several significant market improvements. In particular, there is evidence that prices for term EWs have declined and that EW quality has improved.

5.47 However, the evidence suggests that the market could work more effectively. Higher claims ratios than those of other similar products suggest that prices may be higher than the competitive level and other indicators, such as the lack of price changes and advertising, may suggest competition is less effective than it might be. Moreover, PAYG EWs, which can cost considerably more than a comparable term EW, are increasingly important, suggesting consumers may not be getting good value for money.

\textsuperscript{115} The OFT’s impact evaluation found that the allocative inefficiency arising from some consumers not buying EWs at all due to high prices was some £122m in 2002.
6 PROVISIONAL DECISION ON A MARKET INVESTIGATION

REFERENCE

6.1 During the market study the OFT has considered whether it should refer the market for EWs to the CC. This chapter sets out the OFT’s proposed decision on an MIR.

The Reference test under section 131 EA02

6.2 In order to make an MIR, the OFT must have reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods and services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK. Where this threshold is met, the OFT has a discretion as to whether to make an MIR.

6.3 For the purposes of the Reference test, the relevant market features can be either structural in nature or can relate to the conduct of suppliers or customers. In practice there may not be a clear divide between structural features and those relating to conduct.

6.4 Based upon the analysis conducted during the market study, and set out in chapters 4 and 5, the OFT is minded to decide that there are reasonable grounds for suspecting that the following features of the EW market prevent, restrict or distort competition:

- The persisting POS advantage enjoyed by retailers, which gives them a competitive advantage over other providers. This ultimately limits competition by restricting expansion by other providers and limits consumer choice (see chapter 5).

- Shopping around remains limited, with no more than a quarter of consumers doing so. Many consumers are still unaware of the existence of alternative providers. Moreover, the complexity of the EW product restricts the effectiveness of shopping around by making it more difficult for consumers to make effective comparisons between EWs available at different providers. This ultimately
diminishes the incentives of suppliers to compete effectively in order to win custom (see chapter 4).

- **Information asymmetries** between suppliers and consumers mean that consumers are unable to evaluate effectively the costs and benefits of EWs offered by different providers, and are less able to assess whether the EWs offered are value for money (see chapter 4).

6.5 These features ultimately lead to consumer choice being restricted and mean that consumers are likely to be paying higher prices than they otherwise would in a more competitive market.

**Exercise of discretion**

6.6 The OFT has a discretion, rather than a duty, to make an MIR where the Reference test is met. The OFT’s guidance on MIRs\(^{116}\) sets out four criteria, all of which must be met before the OFT decides to make an MIR.

- Appropriateness of an MIR: the scale of the suspected problem, in terms of its adverse effect on competition, is such that an MIR would be an appropriate response to it.
- Availability of remedies: there is a reasonable chance that appropriate remedies will be available.
- Undertakings in lieu: it would not be more appropriate to address the problem identified by means of UIL.
- Alternative powers: it would not be more suitable to deal with the competition issues identified by applying the CA98 or using other powers available to the OFT.

6.7 The OFT’s detailed assessment against the four criteria is presented below.

\(^{116}\) OFT 511 (2006), Market Investigation References.
Appropriateness of an MIR

6.8 A critical factor in assessing whether an MIR is appropriate is whether it is proportionate to the scale of the competition concerns identified. The OFT guidance on MIRs notes that an MIR will only be made when the OFT has reasonable grounds to suspect that the adverse effects on competition of features of a market are significant. The following three criteria are relevant to whether adverse effects on competition are significant, and thus whether an MIR may be appropriate:

- the size of the market
- the proportion of the market affected by the features that prevent, restrict and distort competition, and
- the persistence of the features identified as adversely affecting competition.

6.9 Overall, the OFT considers that the features it has identified are likely to have a significant detrimental effect on consumers through higher prices for EWs and less choice than might be expected in a more competitive market.

6.10 In relation to the particular factors in the guidance, firstly, the OFT notes that the EW market is large, with sales of around £1bn a year. A relatively small reduction in any of the adverse effects which the CC may find would offset the costs of an MIR and would have a beneficial impact for large numbers of consumers.

6.11 Secondly, a significant proportion of the market is affected by the features which give rise to the OFT’s competition concerns. For example, the limited frequency and effectiveness of shopping around has effects across the EW market. In addition, the inability of consumers to evaluate value for money effectively affects all consumers, so that they generally find it difficult to make the purchasing choices which best meet their needs.
6.12 Thirdly, the features identified as adversely affecting competition are unlikely to be of short duration. Whilst there is evidence that there have been recent market improvements, these improvements are occurring at a relatively slow rate. For example, if the current trends in shopping around continue it would take over 12 years for the proportion of consumers shopping around to be of a similar magnitude to the proportion of consumers shopping around for general insurance. Moreover, many features of the market such as the POS advantage, complexity of EWs and consumer difficulties in assessing value for money are long standing. Indeed, some of these were explicitly considered during previous investigations by the competition authorities.

6.13 The OFT’s guidance also indicates that where the OFT is confident that there are offsetting customer benefits arising from the market features that adversely effect competition, it will not make an MIR. Whilst the OFT recognises that purchasing at POS does give rise to some level of convenience for consumers, it has not had access to sufficient information during this market study to assess the extent of such a benefit (indeed no party has sought to specifically quantify this benefit). The OFT can not therefore be confident that any offsetting customer benefits outweigh the likely detriment arising from the adverse effect on competition.

Availability of remedies

6.14 It is not for the OFT in a market study to determine which remedies would or would not be appropriate. In the context of a market study, the OFT is required to assess whether there is a reasonable chance that remedies would be available to the CC if it finds one or more adverse effects on competition following a detailed investigation. In the case of EWs, the OFT envisages several potential remedies could be implemented by the CC to address the competition concerns which it has raised if the CC decided that they had an adverse effect on competition. These could include:

- **Behavioural remedies**: Such as improving information to consumers at POS and through improving the ability of consumers to make
effective comparisons between the EWs offered by different providers.

- **Structural remedies:** Such as prohibiting retailers from being permitted to supply EWs at the POS of the accompanying DEG, along the lines of the Payment Protection Insurance Market Investigation Order 2011, which was implemented following the CC’s market investigation of PPI. However, as reflected in chapters 4 and 5, there was evidence of much lower rates of shopping around and lower claims ratios for PPI than the OFT has found for EWs during this market study.

6.15 The OFT notes that, in addition to the specific remedies referred to above, the CC also considered a wide range of other potential remedies to address the adverse public interest findings which it identified during its investigation in 2003 and which were not implemented through the EW Order. In principle, many of these potential remedies would still be available to the CC should it conclude that there was an adverse effect on competition.\(^{117}\)

**Alternative powers**

6.16 The OFT has considered whether it would be more appropriate for the OFT to use alternative powers to deal with the features of the market which give rise to the OFT’s competition concerns. However, the OFT does not consider that alternative powers could address these market features in an effective and efficient manner. The OFT has not received evidence of an agreement between undertakings, decisions by associations of undertakings or concerted practices which have as their object or effect the prevention, restriction or distortion of competition of the type which the OFT could address under the Chapter I prohibition of the CA98 and/or Article 101 of the Treaty on the Functioning of the

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\(^{117}\) A full list of these potential remedies can be found at CC (2003), paragraphs 2.382 to 2.417. They include delayed purchase of the EW, requiring POS providers to offer their EWs for sale on DEGs bought from other retailers and requiring EWs to be annually renewable.
European Union (TFEU). Furthermore, the OFT has not received evidence of conduct on the part of one or more undertakings which amounts to the abuse of a dominant position of the type which the OFT could address under the Chapter II prohibition of the CA98 and/or Article 102 of the TFEU.

6.17 The OFT, and consumer organisations such as Which?, have also previously engaged in various consumer education initiatives in relation to EWs. Whilst the OFT considers that these could have an impact on consumer purchasing behaviour (a point explored further in chapter 7), such action alone is highly unlikely to address the long standing features of competition concern in this market.

**Undertakings in Lieu**

**Background**

6.18 Under section 154 of the EA02, the OFT has the power to accept UIL if it considers that it has the power to make an MIR under section 131 and otherwise intends to do so. In accepting UIL, the OFT must have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned and any detrimental effects on consumers so far as resulting from the adverse effect on competition.

6.19 During summer 2011, in line with its commitment to transparency, the OFT shared its emerging thinking about the market study with the major UK providers of EWs. Following those discussions, Dixons, Comet and Argos (the Undertaking parties), whilst disagreeing with the OFT’s analysis, offered UIL which they considered would be sufficient to address the OFT’s competition concerns.

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118 This section constitutes the relevant notice of the proposed UIL in accordance with sections 155(1) and 155(2) of the EA02.
6.20 The OFT’s guidance indicates that UIL are unlikely to be common because:

- In many cases, the OFT will not have done a sufficiently detailed investigation of the competition problem, prior to making an MIR, to be able to judge with any certainty whether particular UIL will achieve as comprehensive a solution as is reasonable and practicable.

- Trying to negotiate undertakings with several parties, in circumstances in which possible adverse effects on competition have not been comprehensively analysed, is likely to pose serious practical difficulties. By contrast, where an adverse effect on competition arises from the conduct of a very few firms there may be more scope for accepting UIL, provided that the OFT is confident that they will achieve a comprehensive solution.

6.21 The OFT considers that these issues do not arise in relation to EWs. Firstly, in addition to this market study, the EW market has been considered in depth by the competition authorities (see chapter 2). These previous investigations have enabled the OFT to have a sufficiently detailed understanding of market dynamics to assess whether the UIL offered will achieve as comprehensive a solution as reasonable and practicable. Secondly, it is possible to achieve UIL which have wide market coverage from the three major POS providers, which together account for around two thirds of the POS market. The OFT has also obtained a voluntary agreement from D&G, the largest non-POS EW provider, that it will display pricing information in relation to certain EW products on the EW Comparison Website which will be established if the UIL are accepted. Finally, the EW Comparison website will be open to all providers who meet certain, limited minimum standards. This

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119 Based on OFT calculations of market shares in Mintel (2011).

120 Those EWs available at POS and 45 days after the purchase of the DEG.
means that it could include a wide range of providers from across the EW market.

The UIL

6.22 Following discussions between the OFT and the Undertaking parties, the Undertaking parties have offered UIL to:

- Establish, maintain and participate in an EW Comparison website. This would enable consumers more easily to compare the EWs offered by different providers. The EW Comparison website will be open\textsuperscript{121} to POS and non-POS providers and will present information on the various EWs available in a neutral manner. This would enable consumers more readily to compare the EWs offered by a range of providers (an illustrative example as to how such an EW Comparison website might look is included at Annexe C).\textsuperscript{122}

- Publicise the hyperlink to the EW Comparison website, in a specified, prominent position on their websites and in-store leaflets and establish a marketing fund which will be used to achieve the visibility of the EW Price Comparison Website on the first page of a Google search result when certain relevant terms are searched.

- Improve the prominence and accessibility of key information to consumers, such as the availability of alternative providers and information on consumers' statutory and cancellation rights, through the inclusion of a key points box in the Undertaking parties' in-store leaflets at POS and on their websites.

- Engage in regular mystery shopping exercises, conducted by an independent organisation, to monitor whether consumers are

\textsuperscript{121} Subject to certain, limited, minimum requirements.

\textsuperscript{122} This was provided to the OFT by one Undertaking party only. It may therefore not accurately reflect the final content or design of the EW Comparison website. It is included in this report for illustrative reasons only.
provided with accurate information by sales staff when they are considering whether to purchase an EW and report the results of these to the OFT.

- To provide specified value for money information to the OFT (such as information which would enable the OFT to calculate claims ratios) to enable it to monitor, as appropriate, the value for money of the EWs provided by the Undertaking parties. This could be used for the OFT to determine whether and, if so, what further interventions in the market may be appropriate.

- To improve the transparency of PAYG pricing through including annual equivalent prices for PAYG EWs on the EW Comparison website and on in-store information, and reminding consumers who have held the PAYG EW for a significant period of time that they have done so.

OFT Assessment

6.23 The OFT’s assessment of the various elements of the UIL, considering the situation which the UIL is attempting to address, and the purpose and effect of the UIL is considered in table 6.1.

Table 6.1: Assessment of the UIL

<table>
<thead>
<tr>
<th>Undertaking¹²³</th>
<th>Situation it is attempting to address</th>
<th>Purpose and effect of the undertaking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establish and maintain the EW Comparison website</td>
<td>The persisting retailer POS advantage, which restricts competition between providers and restricts consumer</td>
<td>The EW Comparison website is intended to provide an effective and accessible means for consumers to compare EWs at POS to those offered by alternative providers.</td>
</tr>
</tbody>
</table>

¹²³ See Annexe B for full details of the relevant section of the Undertaking.
| (Undertaking 2 and 3) | choice. The limited incidence and effectiveness of shopping around, complicated by the complexity of the EW product. Information asymmetries, which limit consumers' ability to assess value for money. | The OFT considers that this is likely to be of relevance to a wide range of consumers, not simply those purchasing DEGs online, as some 80 per cent of consumers shop around online for DEGs, who therefore may also consult the EW Comparison Website before making an EW purchase. This should help to facilitate more effective shopping around, encourage consumers to consider a wider range of EW providers and provide a mechanism which alternative providers can use to enter and expand in the EW market. The comparative information on EW product features enables consumers more effectively to evaluate the value for money of particular EWs, assisting them in taking a better informed purchasing decision. Moreover, the enhanced competition for EWs arising from the price comparison website may help to ensure that EW prices more accurately reflect the costs of providing them without the consumer having to undertake an assessment of the value of the EW. To establish appropriate governance arrangements for the website to ensure it is sustainable and is capable of addressing the adverse effects on competition identified by the OFT. |
| Publicity for the EW Price Comparison website (Undertaking 4) | The persisting retailer POS advantage, which restricts competition between providers and restricts consumer choice.  
The limited incidence and effectiveness of shopping around.  
The inability of consumers to assess effectively the value for money provided by different EW providers. | To ensure that sufficient consumers become aware of, and use the EW Price Comparison website, such that it has the effects specified above.  
In particular, this is intended to enable the 80 per cent of consumers shopping around online for DEGs to become aware of the EW Price Comparison Website so they might use it to compare the EWs offered by various providers. |
|---|---|---|
| Mystery shopping (Undertaking 5) | The persisting retailer POS advantage, which restricts competition between providers and restricts consumer choice.  
The limited incidence and effectiveness of shopping around.  
The inability of consumers to assess effectively the value for money provided by different EW providers. | To help ensure that EW sales staff at the major EW providers provide accurate information to consumers about the nature of the EW to enable consumers to take a more informed decision as to the value for money of the EW they are considering purchasing.  
To the extent that consumers are aware of alternative providers and ask EW sales staff about those alternative providers, this should help ensure that EW providers provide consumers with accurate information about the availability of alternative providers. This should help, albeit to a lesser extent than other elements of the UIL package, to facilitate more effective shopping around and to encourage consumers to consider a wider |
<p>| Key points information at POS (Undertaking 6) | The persisting retailer POS advantage, which restricts competition between providers and restricts consumer choice. The limited incidence and effectiveness of shopping around. | The key points box, accessible in varying formats and displayed in a prominent manner is intended to make consumers more aware of their options when purchasing EWs. This includes the existence of alternative providers and cancellation rights which enable a consumer to shop around following purchasing an EW at POS. This should help facilitate more effective shopping around, encourage consumers to consider a wider range of EW providers and provide a mechanism which alternative providers can use to enter and expand in the EW market. |
| Information on PAYG EWs (Undertaking 6) | Higher priced PAYG EWs | The enhanced transparency of PAYG EW prices, through the publication of annual equivalent information on in-store materials is intended to ensure that consumers are able to take a better informed decision as to the longer term costs involved in purchasing and continuing to hold a PAYG EW and to enable them more effectively to evaluate the value for money of the EW. |
| Provision of value for money information to the OFT (Undertaking 7) | The inability of consumers to assess effectively the value for money provided by different EW providers. | To enable the OFT to evaluate effectively whether the EWs offered by various providers represent value for money. This provides the OFT with a sufficient evidence base to raise concerns about this issue with retailers in the future should that be necessary. The OFT considers that the provision of such detailed information to consumers directly is unlikely to be useful absent an appropriate comparator. There is also a potential risk that such information, unless provided in an appropriate format, could ultimately mislead consumers. |</p>
<table>
<thead>
<tr>
<th>Compliance with, and effectiveness of the undertakings (Undertakings 9 and 10)</th>
<th>The persisting retailer POS advantage, which restricts competition between providers and restricts consumer choice. The limited incidence and effectiveness of shopping around. The inability of consumers to assess effectively the value for money provided by different EW providers. Higher priced PAYG EWs.</th>
<th>To assist the OFT in ensuring that the UIL are complied with, which is a precondition to enabling the UIL to address the adverse affects on competition identified by the OFT. To assist the OFT assessing whether the UIL have been effective in addressing the adverse effects of competition identified by the OFT.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procedural points to assist the operation of the UIL (Remaining Undertakings)</td>
<td></td>
<td>To ensure the effective operation of the undertakings by clarifying arrangements with respect to confidentiality, the continuation and termination of the UIL, the effective date of the UIL and the definitions used in the UIL.</td>
</tr>
</tbody>
</table>

6.24 In the light of the foregoing, the OFT considers that the UIL, as a package, will enhance the ease and effectiveness of shopping around by consumers, thereby leading to more shopping around and more consumers considering alternative, non-POS providers. Such behavioural change by consumers should enhance the incentives for EW providers to compete more effectively by enhancing their EW offer and improving their value for money.
6.25 The OFT therefore is minded to consider, consistent with section 154 of the EA02, that the UIL offered by parties achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned. On balance, and taking into account all relevant factors in the round, the OFT is therefore minded to accept the UIL and is therefore not minded to refer the supply of EWs to the CC.

Any other facts which the OFT considers justifies the acceptance of the undertakings

6.26 Before concluding that the UIL provide as comprehensive a solution as reasonable and practicable to the OFT's concerns, the OFT carefully considered the likelihood that such undertakings would be effective in remedying the adverse findings identified during the market study. In doing so, the OFT has paid particular regard to the following sources and following findings:

- The OFT's impact evaluation, which found that the main reasons why those consumers who shopped around for EWs did so was the provision of relevant information, including pricing information, sales staff saying that there were other providers and leaflets saying that there were other suppliers. The OFT considers that this indicates that the provision of further relevant information to consumers in an appropriate and accessible format is likely to have a sufficient effect in changing consumer behaviour. Moreover, the mystery shopper should enhance the OFT’s ability to monitor compliance with the EW Order, which could help to ensure that the full effect of the EW Order is realised.

- The OFT has consulted previous guidance prepared by the OFT on consumer remedies, the FSA and the European Commission on the effective design of price comparison websites.\(^{124}\) It has reflected the key points of this guidance in the proposed EW Comparison website.

The OFT has taken account of the effectiveness of price comparison websites in stimulating competition in other sectors.

The OFT has considered various empirical research regarding the sale and provision of EWs, including academic papers (such as those referred to in chapter 4) and focus group information.\textsuperscript{126}

6.27 The OFT also recognises that the UIL will impose a burden on industry parties, particularly to set up and maintain the EW Comparison website. The OFT has obtained information on the estimated cost of the key aspects of the UIL from parties. It considers that the proposed UIL provide a proportionate means of effectively addressing the adverse effects, without imposing significant financial burdens on the Undertaking parties.

6.28 The OFT has considered the potential that the proposed UIL could have a negative effect, most particularly by the EW Comparison website facilitating co-ordination between EW providers. The OFT notes that, pursuant to the EW Order, there is already significant information regarding retail pricing for EWs in the public domain. The UIL merely make it easier for consumers more readily to access this information. Moreover, no information of a confidential nature (such as future retail price intentions) will be exchanged between EW providers as a result of this website. The different business models of the various EW providers (for example, POS as against non-POS) and the different characteristics of the EWs supplied by different providers also make it less likely that co-ordination would be sustainable. The OFT has also considered whether the EW Comparison website could be used as a signalling mechanism, whereby an EW provider (or providers) could credibly convey information about itself (for example, its intention to increase


prices) to another EW provider. The OFT will consider whether there is any evidence of such behaviour, in the form of frequent increases in EW prices. If so, it will consider whether any further action would be appropriate.

Conclusion

6.29 In conclusion, the OFT is minded to decide that, although the reference test is met, the balance of evidence and the resulting assessment points in favour of the OFT exercising its discretion not to refer the market for EWs to the CC. This is because the OFT is minded to accept UIL which it considers will achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned.

Consultation

6.30 Before taking a final decision on the appropriateness of an MIR and UIL, the OFT will consult key interested parties on the following closely interlinked decisions:

- its provisional decision not to make an MIR
- its provisional decision to accept UIL.

6.31 Such a consultation is consistent with section 155 of the EA02 and the OFT’s practice on proposed decisions not to make MIRs.126

6.32 During the consultation, the OFT would welcome comments from interested parties and consumers on the features which it considers give rise to competition concerns and which it provisionally considers meet the reference test and the exercise of the OFT’s discretion in relation to this decision.

Moreover the OFT would welcome comments from interested parties and consumers on the UIL which it proposes to accept. In particular the OFT would welcome comments on:

- Whether the UIL, as a package, are sufficient to change consumer behaviour, particularly to facilitate increasing shopping around.

- Whether the UIL will enable non-POS providers to compete more effectively with those retailers with a POS advantage. In this regard, the OFT would be particularly grateful for comments from non-POS providers as to whether they would wish to join the EW Comparison website and whether they consider that appropriate mechanisms are in place to ensure that the EW Comparison website provides a neutral means to facilitate competition between EW providers.

- Whether the governance arrangements (for example, the Steering Group) are appropriate.

- Any appropriate modifications to the UIL.

Any such representations on the OFT’s proposed decisions not to make an MIR and to accept UIL should be provided to the OFT by 19:00 on Wednesday 7 March 2012. Please respond in writing to the following address or by email to degs@oft.gsi.gov.uk

The Extended Warranties Team
Goods and Consumer Group
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London, EC4Y 8JX

Next steps following the consultation

Once the consultation period has concluded the OFT will consider the representations it receives (and not withdrawn), with a view to taking a final decision on the UIL and MIR later in the Spring of this year. In the event of any modifications to the proposed UIL, following the
consultation, the OFT, pursuant to section 155(4), will undertake another consultation on the UIL, lasting no fewer than seven days, before deciding whether to accept the UIL.

6.36 If the OFT accepts the UIL it will engage in appropriate steps to publicise the UIL, particularly through working with interested parties, such as consumer organisations, to help consumers become aware of the key aspects of the UIL. It will then monitor parties’ compliance with the UIL. Moreover, subject to an assessment against its Prioritisation Principles, it will undertake an evaluation of the effectiveness of the UIL in improving outcomes for consumers at an appropriate point after their acceptance by the OFT.

6.37 The UIL will remain in place until, consistent with section 154(6) of EA02, they are varied or superseded by another UIL or released by the OFT. The OFT will, as soon as reasonably practicable, consider any representations received by it in relation to varying or releasing the UIL. Potential grounds for variation, supersession or release by the OFT could be market developments\(^\text{127}\) which may mean that the undertakings, or any part of them, are no longer appropriate or that the UIL do not effectively address the adverse effects identified by the OFT during the market study.

\(^{127}\) For example, in the event that developments in website design and technology make the commitments with respect to the publicity for the website impractical or ineffective for an undertaking Retailer to deliver.
7 OTHER OFT ACTION

7.1 The market study has identified several concerns about the operation of the EW market. As a complement to accepting the UIL (or otherwise to making an MIR if the UIL are not accepted), the OFT considers that there is further action that could quickly be taken to help make the market work better for consumers.

7.2 The OFT has already assisted the ABI with the preparation of guidance to help EW consumers take an informed decision when considering EW purchases.\textsuperscript{128} The OFT will work with partners (such as consumer organisations), which provide information directly to consumers, to ensure that the information they provide (on websites, for example) reflects the key points from this market study, particularly the importance of consumers shopping around to secure the best deal.

7.3 The OFT considers that consumers are more able to make informed purchasing decisions when they understand their statutory rights. As part of the OFT’s ‘know your rights’ campaign (see chapter 3), the OFT has produced a video guide for DEGs consumers. This includes key information about consumers’ rights under SOGA,\textsuperscript{129} in addition to encouraging consumers to shop around when purchasing EWs. This will shortly be supplemented by a consumer leaflet which will be distributed by Trading Standards Service officers. This campaign will continue throughout this year.\textsuperscript{130}

7.4 In addition, the OFT will:

\textsuperscript{128} Available at: \url{www.abi.org.uk/Publications/ABI_Publications_Consumer_Guide_to_Extended_Warranties_2e9.aspx}

\textsuperscript{129} Available at: \url{www.youtube.com/watch?v=7rqlQ_2l2cY}

\textsuperscript{130} Available at: \url{www.of.t.gov.uk/business-advice/treating-customers-fairly/sogahome/}
• Continue to monitor the EW Order, raising potential compliance concerns with parties as appropriate. If the UIL are accepted, the OFT would use the mystery shopping to further enhance the effectiveness of this monitoring.

• Consider, subject to the application of its Prioritisation Principles, any complaints or evidence it receives indicating that EWs are being mis-sold such that enforcement action under the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) or other consumer law, would be appropriate.
## A ANNEXE A: CONSUMER SURVEY OF EXTENDED WARRANTIES\(^{131}\)

Table A 1: In the last 12 months have you bought any electrical product for home use?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>3003</td>
<td>45%</td>
<td>55%</td>
<td>Less than 1%</td>
</tr>
</tbody>
</table>

Base: all adults 16 +

Table A 2: You have said that you purchased at least one electrical product for home use in the last 12 months. Did you buy an EW for any of those electrical products?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>1344</td>
<td>18%</td>
<td>81%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Base: all adults 16 + who have bought a DEG in the last 12 months

Table A 3: Thinking about your most recent purchase of an EW, did you compare the EW which you purchased with those of other suppliers of EWs?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>240</td>
<td>25%</td>
<td>75%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Base: all adults 16 + who have bought an EW

\(^{131}\) Completed by GfK-NOP for the OFT. Based on a sample survey of 3,003 consumers, of whom 240 had purchased an extended warranty in the last year. Fieldwork dates: 20–22 May, 27–29 May, 10–12 June 2011. Percentage totals may not add to 100 per cent due to rounding. Percentages have been weighted to be representative of the UK adult population.
Table A 4: Thinking about your most recent purchase of an EW, did you do any of the following: gathered general information about EWs by searching online or visiting or telephoning suppliers?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>240</td>
<td>25%</td>
<td>74%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Base: all adults 16+ who have bought an EW

Table A 5: Thinking about your most recent purchase of an EW, did you do any of the following: compared features of different extended warranties offered by one supplier?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>240</td>
<td>35%</td>
<td>63%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Base: all adults 16+ who have bought an EW

Table A 6: Thinking about your most recent purchase of an EW, did you do any of the following: compared features of different EWs offered by different suppliers?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>240</td>
<td>23%</td>
<td>76%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Base: all adults 16+ who have bought an EW

Table A 7: Thinking about your most recent purchase of an EW, did you do any of the following: obtained quotes from more than one supplier?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>240</td>
<td>20%</td>
<td>79%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Base: all adults 16+ who have bought an EW
Table A 8: Thinking about your most recent purchase of an EW, did you do any of the following: discussed suitability of EW with supplier or their representative (for example, sales assistant)?

<table>
<thead>
<tr>
<th>Total</th>
<th>Yes</th>
<th>No</th>
<th>Don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td>240</td>
<td>44%</td>
<td>54%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Base: all adults 16+ who have bought an EW

Table A 9: From where did you obtain the most recent EW which you purchased?

<table>
<thead>
<tr>
<th>Total 240</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>The retailer/shop I purchased the electrical product from</td>
<td>69%</td>
</tr>
<tr>
<td>The product manufacturer</td>
<td>12%</td>
</tr>
<tr>
<td>An insurance company</td>
<td>5%</td>
</tr>
<tr>
<td>Through my bank</td>
<td>4%</td>
</tr>
<tr>
<td>Through my credit card</td>
<td>2%</td>
</tr>
<tr>
<td>Another retailer</td>
<td>4%</td>
</tr>
<tr>
<td>Other</td>
<td>2%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>2%</td>
</tr>
</tbody>
</table>

Base: all adults 16+ who have bought an EW
ANNEXE B: THE PROPOSED UIL\textsuperscript{132}


\textsuperscript{132} Any person wishing to inspect or obtain a non-electronic version of the proposed UIL can do so by visiting the OFT’s offices during working hours and asking for a member of the OFT’s EW team in the Goods and Consumer Group.
ANNEXE C: AN ILLUSTRATIVE EXAMPLE OF THE COMPARISON WEBSITE

D ANNEXE D: TERMS OF REFERENCE FOR AN MIR

D1. The Office of Fair Trading in exercise of its power under sections 131 and 133 of the Enterprise Act 2002 hereby makes a reference to the Competition Commission for an investigation of the supply of extended warranties on domestic electrical goods in the United Kingdom.

D2. The OFT has reasonable grounds for suspecting that a feature or a combination of features of the market for the supply of extended warranties on domestic electrical goods in the United Kingdom prevents, restricts or distorts competition.

D3. For the purposes of this reference:

'extended warranty' means a contract, whether backed by insurance or otherwise, which at least provides cover against the cost of repairing or replacing a domestic electrical good in the event of a breakdown and which may also provide additional cover against eventualities such as accidental damage, loss or theft and assistance in setting up and operating a domestic electrical good.

'domestic electrical goods' means products designed to be connected to an electricity supply or powered by batteries and used for domestic purposes, but does not include watches, jewellery or fixed installations (other than integrated appliances).