Tackling the loyalty penalty

Response to a super-complaint made by Citizens Advice on 28 September 2018

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CMA
Competition & Markets Authority

> "Customers rightly feel ripped off, let down and frustrated."

Executive summary

1. In some markets, longstanding customers can pay much more than new customers for the same services – this is known as the 'loyalty penalty'. This happens when suppliers charge higher prices to their existing customers, who they think are unlikely to switch to get a better deal. The result is that in many cases, people who stay with their supplier end up paying significantly more.

2. This is the basis of the super-complaint that Citizens Advice made to us. It highlighted concerns that not enough has been done to tackle loyalty penalty issues in 5 markets: mobile; broadband; cash savings; home insurance and mortgages.

3. Many services are paid for through automatically renewed or rolled over contracts. While this can be convenient for customers, it also increases the risk that customers who get rolled over year after year will pay a loyalty penalty. This super-complaint has given us the opportunity to look at this practice across markets, what has been tried in different markets over the years and consider what more can be done to prevent the loyalty penalty.

4. Overall, we have found that the loyalty penalty is significant and impacts many people, including those who can least afford it. Customers rightly feel ripped off, let down and frustrated. They should not have to be constantly 'on guard' or spend hours negotiating to get a good deal. This erodes people's trust in markets and the system as a whole.

5. Not enough has been done in the past by the CMA and regulators; there needs to be a step-change to tackle these problems more effectively. The focus should not only be on giving better support to consumers; but getting tough on harmful business practices and using targeted pricing interventions where needed to protect those who suffer most, particularly those who are vulnerable.

6. Our response sets out a significant package of reforms, both across markets and in the 5 markets, to address this issue and ensure that consumers can get better and fairer outcomes. The FCA and Ofcom are actively looking at this issue in the 5 markets. We welcome that work and make a number of recommendations in those markets.

How big is the problem?

7. There is a substantial loyalty penalty paid by consumers each year. Existing estimates suggest this penalty could be around £4 billion in total across the 5 markets we have looked at. The number of people who pay a penalty varies by market, with estimates ranging from under one million in mortgages to over 12 million in home insurance. This does not mean that prices are too high overall because some people are paying much lower prices, but some people are clearly paying too much.

8. These are the best estimates based on available data, but there are still gaps in the evidence base. Collecting and publishing information regularly on the size of the loyalty penalty and who pays it in key markets is important. This will improve understanding by regulators, raise public awareness and hold businesses accountable.

9. The loyalty penalty is not just a problem confined to the 5 markets. It is likely to be a much wider issue potentially arising in many other markets, for example in pay TV, roadside assistance, many other insurance markets, pensions and other subscription services such as online gaming, software and magazines.

Why does the loyalty penalty arise?

10. Many services are paid for through contracts which automatically renew or roll over, often on a higher rate. The result is that customers pay more for the same service unless they actively intervene:

- in some markets there is a sharp increase after the introductory price ('price jump') like in energy;
- in others there are successive price rises ('price walking') as in insurance; and
- elsewhere customers on older tariffs sometimes pay higher prices for similar services ('legacy pricing'), as in broadband.

11. In all cases longstanding customers can end up paying much more than new customers. There are many different reasons why customers remain with their supplier. They are not necessarily being actively 'loyal' to a particular brand or

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supplier. Some people wrongly believe that staying will pay off in the long term, do not know they could make significant savings or have other things to worry about, so do not even think about switching. It can also be confusing and time consuming to shop around, and suppliers can exacerbate these problems. In some cases, the saving is small and is not enough to be worth worrying about.

When is it most problematic?

12. Offering introductory deals is not necessarily harmful. It can encourage people to shop around and try out new services, as well as allowing new businesses a foot in the door by attracting new customers. The loyalty penalty raises particular concerns when:

- suppliers make it more difficult than it needs to be for customers to exercise choice, and then exploit those who do not switch;
- the price gap is large, with some paying very high prices, or it affects many people;
- it particularly harms those who may be vulnerable such as the elderly, those on low incomes, or with physical disabilities or poor mental health;
- it happens in 'essential' markets.

Who is hit hardest by the loyalty penalty?

13. The loyalty penalty affects many consumers across different markets and at different points in time. The exploitative practices used by some suppliers can cause serious problems for all consumers, who do not have the time or are not able to take the steps necessary to avoid paying a penalty.

14. The most vulnerable in our society can have even greater challenges engaging in markets, such as those on low incomes, people who struggle to use online services, or people with poor mental health who may avoid or fear change. This means they may be more at risk of paying the loyalty penalty and may be least able to afford it. It is therefore important that the needs and capabilities of vulnerable consumers be taken into account when looking at tackling the loyalty penalty.

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> Suppliers must stop taking advantage of their existing customers by charging higher prices, misleading people about offers and making it more difficult for customers to get good deals.

15. Protecting the interests of vulnerable consumers is a priority area for the CMA. We have an ongoing programme of work underway to better understand the challenges vulnerable consumers can face in markets, and how we can help to address them.

What role do businesses play in this?

16. Suppliers can also be a big part of the problem, as well as being a key part of the solution to enable customers to get better deals. Businesses across a wide range of markets can make it much more difficult for existing customers to engage and penalise them if they are not constantly checking the deals they are getting. We have identified a range of practices, which we consider to be unacceptable. These include:

- making it more difficult to leave a contract than it is to sign up;
- rolling over customers onto new contracts without sufficient warning;
- imposing 'stealth' increases in price on renewal year after year, which can lead to very significant price increases without customers being aware of it; and
- requiring customers to auto-renew or get rolled over when they take up a service or buy a product; in most markets there should be a choice.

17. We recognise that auto-renewal can benefit consumers, particularly when there are harmful consequences from not renewing. However, suppliers must stop taking advantage of their existing customers by charging much higher prices, misleading people about their offers and making it much more difficult for customers to get good deals than it needs to be. These practices are likely to impose a significant cost on the economy, both in terms of the time consumers spend trying to get better deals and because they can end up paying much more. This makes people feel that markets are working against their interests and undermines trust.

18. Action has been taken by regulators and the CMA to try to tackle these problems. However, the prevalence of these issues across many markets shows that there is much more for us to do to stop these types of practices by businesses.

19. We are taking enforcement action in the anti-virus software market, and this is a first step in a wider programme of enforcement. We will also be considering whether existing law should be changed to ensure these practices are stopped.

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What more should be done to tackle the loyalty penalty?

20. The CMA, regulators and government must together tackle these problems head on. While there have been efforts to do so, these have not had sufficient impact. In the past too much has been asked and expected from consumers, and not enough from businesses. Although we have become better at designing more effective interventions, more can be done, particularly to protect vulnerable consumers.

21. Suppliers should do all they reasonably can to support their customers in getting the best deal, rather than exploiting any perceived weaknesses or biases. We encourage businesses to work together with regulators to achieve this, rather than frustrating or delaying attempts to fix these issues.

22. There is also a strong case for considering more direct intervention such as price controls, targeted to protect those who are worse off. These have been used before by the CMA and regulators in some cases, particularly to protect vulnerable consumers. And they should be considered in other markets. We make a number of recommendations where such interventions should be considered by regulators, alongside other measures, in the 5 markets highlighted by Citizens Advice.

23. It is also important that customers are given greater support and the tools they need to make active and informed choices. This ensures that businesses are put under continued and greater competitive pressure. There are newer and bolder ways to do this which could transform some markets and make it much easier for consumers to get better deals.

24. Based on our review we consider that the best ways to achieve change are:

- providing genuine support to consumers through the use of 'smart data' (data-driven technologies and services to help consumers), using intermediaries (including price comparison websites, automatic switching services, or local face-to-face advisory services) and 'collective switching' which offers exclusive tailored deals;
- enforcement against businesses to tackle harmful and unacceptable practices; and

- considering targeted direct pricing interventions either to limit price differences, such as restricting price walking, or price caps, where there is clear harm, in particular to vulnerable consumers.

Our package of reforms across markets

25. We are recommending **8 key reforms** to address the problems related to the loyalty penalty.

Stopping harmful business practices

26. The CMA and regulators should continue to take action against suppliers whose business models are harmful to consumers. This means using our existing consumer enforcement powers and the powers regulators have to intervene directly, and strengthening these powers where needed.

Recommendation 1

Bolder use of existing enforcement and regulatory powers to tackle harmful business practices. We are launching investigations in the anti-virus software market. **This is a recommendation to regulators and action by the CMA.**

Recommendation 2

Legislative and/or regulatory change may also be needed to effectively tackle these practices and we will be exploring this further, alongside new **powers for the CMA to seek substantial fines where law** is breached. **This is a recommendation to government.**

- We have developed a set of core principles for business to follow across markets and we will be building on these, alongside considering whether these should be explicitly covered in existing law. These include:
  - **exit/entry equivalence**: people must be able to exit a contract at least as easily as they can enter it;
  - **auto-renewal should generally be on an 'opt in'** basis upfront, and include a clear and prominent option without auto-renewal in most markets;
  - **exit fees should not be used after any initial minimum/fixed term;**

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- **auto-renewal onto a fresh fixed term** should not generally be used;
- **customers must be sufficiently informed** about the renewal and any price changes (through sufficient notifications) in good time; and
- **switching should generally be managed by the gaining supplier** so that customers do not have to contact their existing supplier if they want to move.

Publicising the loyalty penalty to hold suppliers to account

27. Reputational measures designed to put pressure on businesses can have a real impact in markets. In this case, data on the scale and size of the loyalty penalty, and which suppliers have the highest price differences, can put pressure on them to reduce this gap.

Recommendation 3

Publish the size of the loyalty penalty in key markets and for each supplier, through for example an annual joint loyalty penalty report. **This is a recommendation to regulators.**

Giving people more help in getting better deals

28. The CMA and regulators have relied too heavily on 'information remedies' to help consumers, which have had limited impact. In recent years we have got better at developing and testing more intelligent 'nudges', and these can make a difference for some customers. But they are not always sufficient, particularly for the hardest to reach consumers. Many people need even more support.

Recommendation 4

Empower intermediaries to support switching for example, giving a greater role to local consumer-facing advisory organisations, such as Citizens Advice, who could more actively support switching for vulnerable consumers. **This is a recommendation to government.**

Recommendation 5

Press ahead with the Smart Data Review and rolling this out in those markets such as telecoms, where it has the greatest potential to transform markets. **This is a recommendation to government and regulators.**

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Recommendation 6

Capture and share best practice on 'nudge' remedies that have been tested and shown to work or not. Some remedies (such as requiring suppliers to give last year's price on renewal) could be rolled out across markets and potentially strengthened. This is a recommendation to regulators and the UK Competition Network.

Protecting consumers from harm, particularly vulnerable consumers

29. Regulators have in the past been reticent to introduce price caps because these can distort markets. But where people who are unable or find it very difficult to switch are paying significantly higher prices, the case for targeted intervention is stronger.

Recommendation 7

Consider targeted pricing regulations such as limiting price differentials or price caps, alongside other measures where there is clear harm, particularly to protect vulnerable consumers. We also make recommendations about potential pricing interventions to be considered as part of ongoing work in the 5 markets. **This is a recommendation to regulators and the CMA.**

Better understanding of the loyalty penalty across markets

30. It is also important to have more robust data on the extent of the loyalty penalty across a number of key markets, and who is paying it. This is currently assessed on an ad hoc basis through specific market studies. But this approach does not enable comparisons across markets, nor, crucially, does it allow regulators to identify whether the same individuals are worse off across markets and over time.

Recommendation 8

Assess the feasibility of matching price data to a recurring, large scale UK survey to improve our understanding of who pays the loyalty penalty across markets, and whether vulnerable consumers are particularly adversely affected. **This is a recommendation to regulators.**

Our recommendations in the 5 markets

31. Alongside these cross-cutting recommendations, we have also looked at each of the 5 markets highlighted by Citizens Advice. We have considered what actions have previously been taken, what can be learnt from our review and what more can be done to tackle the loyalty penalty in these markets. We have worked with the regulators to understand these markets.

32. Based on our review, we also make recommendations to the FCA and Ofcom on measures to tackle the loyalty penalty in the 5 markets, which should be considered as part of their current work in these markets, alongside any other potential remedies.

Mobile

33. We do not consider that providers should continue to charge customers the same rate once they have effectively paid off their handsets at the end of the minimum contract period. This is unfair and must be stopped. We welcome Ofcom's recent consultation on this.

- **We support a requirement on mobile providers to move customers on bundled handset and airtime contracts onto a fairer tariff** when their minimum contract period ends. **This is a recommendation to Ofcom**.
- In addition, Ofcom should seek to increase the engagement and awareness of consumers by pushing forward with implementing smart data, supporting the development of innovative intermediaries, and tackling low levels of awareness of SIM-only deals. **This is a recommendation to Ofcom**.

Broadband

34. Loyalty penalty problems in this market must be thoroughly investigated and we welcome the review recently launched by Ofcom. As part of its review we recommend that:

- Ofcom consider a number of possible pricing interventions including **tackling broadband legacy pricing and targeted safeguard caps to protect vulnerable consumers, alongside measures to increase engagement such as the use of smart data and exploring the feasibility of collective switching. This is a recommendation to Ofcom.**

Cash savings

35. The FCA has recognised that interventions to date have had limited impact on addressing the harm to longstanding customers, and it is currently considering a 'Basic Savings Rate' among other potential interventions. We welcome this further work and recommend that:

- If the FCA **implement the Basic Savings Rate, it evaluates whether this has had the intended impact and if not, consider further pricing interventions** such as a targeted absolute price floor in cash savings. The FCA should also consider whether collective switching can be applied. **This is a recommendation to the FCA.**

Insurance

36. Evidence suggests that many longstanding customers are paying much more than newer customers, with businesses repeatedly increasing prices year on year. Therefore, we welcome the FCA's current market study and as part of this study we recommend that it:

- Investigate **insurance pricing practices and consider pricing interventions that limit price walking**, for example rules to restrict this practice. This is a recommendation to the FCA.
- Explore how intermediaries can continue to benefit the home insurance market (for example where 'semi-smart' solutions can improve the existing infrastructure of price comparison websites). **This is a recommendation to the FCA.**

Mortgages

37. In mortgages, the FCA is currently undertaking a market study. It is taking immediate action to tackle those who cannot switch in this market (ie 'mortgage prisoners') by helping these customers move onto better tariffs, where feasible. We strongly support that work, but there are still 10% of longstanding customers who could switch and make significant savings but do not. We recommend that:

- **The FCA find out more about mortgage customers who could switch but do not**

and look at what measures can be taken to help or protect them if needed. This is a recommendation to the FCA.

What next?

38. We believe a step-change in approach is needed to effectively tackle these issues. We have set out a package of reforms, both across markets and specifically in relation to the 5 markets identified by Citizens Advice. We believe these will achieve real changes and help existing customers get a fair deal.

39. A number of the market-specific recommendations can now be taken forward by regulators through their existing studies or ongoing work in each of these markets. Some of the recommendations require further consideration and oversight by the CMA and others such as government and regulators.

40. The CMA will be undertaking further work on the loyalty penalty, working closely alongside regulators, government, business and organisations such as Citizens Advice. This project will take forward in particular:

- recommendation 1, where we are launching enforcement cases;
- recommendation 2, a review of the case for changing consumer law in addressing the loyalty penalty; and
- recommendation 8, exploring the feasibility of matching price and survey data.

41. We will provide an update on our progress to the newly established joint government-regulator Consumer Forum, led by the Minister for Consumer Affairs, in 6 months. An update will also be published on our website. The FCA and Ofcom will also provide an update on their progress in the 5 markets.

42. The Consumer Forum provides an important opportunity for us to work more closely together. We support its development and continued oversight on key consumer issues such as tackling the loyalty penalty across key markets and addressing the challenges faced by vulnerable consumers.

43. We have considered Citizens Advice's request that we undertake a market study into the loyalty penalty across the 5 markets. We do not believe this is the right

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approach at present, given the work we have already done and the project we will be undertaking to take forward our cross-cutting recommendations. In relation to the 5 markets, our recommendations to regulators can be taken forward now in their ongoing work without the need for a market study. We consider this is the most efficient way to achieve results quickly.

44. We will look at whether sufficient progress has been made in taking forward our recommendations over the next 12 months. At that stage we will reconsider what next steps are necessary, such as whether a market study is needed. The CMA is committed to continuing to drive this work forward to maintain momentum and ensure changes are achieved.