9 November 2015

Behavioural Insights Team response to Energy market investigation: Supplemental notice of possible remedies

This is the response from the Behavioural Insights Team to the *Competition and Markets Authority Energy market investigation, Supplemental notice of possible remedies.* For ease of reading we have bolded the relevant sections of the remedy and written our responses below each relevant query. We would welcome the opportunity to discuss our comments further, please contact felicity.algate@behaviouralinsights.co.uk.

(a) Would this remedy be effective in encouraging customers to engage more frequently in the market? Are there certain groups of customers who could not be covered by this remedy and, therefore, would not benefit, eg those on prepayment, DTS or other meters?

(i) To what extent is the higher level of engagement observed in response to end of fixed-term contract notifications the result of the type of customer who has chosen those products, rather than a response to the notification itself?

The CMA is right to highlight the problems of comparing customers who have chosen fixed-term contracts with those remain on the standard variable tariff. Scottish Power and Centrica report that domestic customers on fixed-term contracts tend to engage in significant numbers following the receipt of an end of contract notification and that this engagement is much greater than the engagement following an annual statement or price increase notification. We think it is important to highlight a flaw in this argument on the basis of selection bias. All customers on a fixed-term tariff have actively switched to such a tariff and, as such, are already engaged in the market whereas those on the standard variable tariff are not. The high levels of activity following a product end notification cannot be expected to be repeated if all contracts were fixed term.

(b) Would this remedy be effective in protecting those customers who failed to engage in the market, even after receiving prompts, from paying high prices? Would the extension of SLC 7, in the manner proposed by Centrica, provide such protection?

BIT does not believe that the proposed remedy would be sufficient to protect those customers who have never actively engaged with energy markets. However we do believe that there are potentially very significant customer benefits from the proposed approach. Prompting customers once a year can be expected to create a mechanism for customer engagement. Comparing across industries those markets characterised by limited term contracts such as mobile phones and car insurance tend to show higher levels of customer switching.[1] As noted in our previous submission the behavioural science literature suggests many ways communications can be made more effective at promoting customer engagement.[2] There is some suggestion that regular reminders can help increase customer engagement over time.[3] Even with regular prompts to compare tariffs there are still likely to be a group of consumers who will fail to engage, it may be that some of these are considered vulnerable and will require further action to protect them from severe detriment. It is important that tools are developed that make the market easier to navigate, whether that navigation is carried out by individuals themselves or with assistance from family, friends or other trusted organisations.

(c) Should this remedy apply to domestic customers only, or should it also be extended to microbusiness customers?

BIT believes this remedy should apply to both domestic customers and microbusiness customers.

(d) The wording of the end of fixed-term notifications appears to be critical to the effective functioning of this remedy. Should Ofgem take responsibility for developing and testing appropriate wording, or should the energy suppliers retain responsibility for this?

Developing effective wording for any communication is a very difficult task and effective approaches are likely to change over time, as such we would not recommend that Ofgem take responsibility for developing the wording. Instead we suggest that Ofgem and energy firms work together to test different approaches with clearly defined measures of a ‘successful’ communication. These outcome measures should be objective and measure real behavioural effects. The most obvious and appealing outcome measure would be switching rates. However, there is also scope for testing the level of customer understanding of notifications; for example a notification might be deemed ‘successful’ if 75% of customers understand the information included and are able to demonstrate a clear understanding of what steps they need to take to compare tariffs. These metrics could easily be tested through laboratory trials which are often cheaper and quicker to run than field trials.

---

[1] It is important to note that there are significant differences between the markets mentioned and energy in terms of heterogeneity of products and services.

[2] For example, messages highlighting social norms, calls to action, and reciprocity have been more effective at encouraging people to join the NHS organ donor registry compared to the control merely suggesting it. For more details on this example and other examples of using behavioural insights to improve communication see the Behavioural Insights Team Annual Update at http://38r8om2xjhhl25mw24492dir.wpengine.netdna-cdn.com/wp-content/uploads/2015/08/BIT_Update-Report-Final-2013-2015.pdf

[3] Karlan, D., McConnell, M., Mullainathan, S., & Zinman, J. (2010). Getting to the top of mind: How reminders increase saving (No. w16205). National Bureau of Economic Research.

We strongly suggest conducting randomised control trials in the field to test appropriate wording, and not just relying on focus groups or internal testing.

(i) If suppliers design these prompts, how can they be incentivised to maximise their effectiveness?

As set out in our answer to the previous question BIT believes the key to this is to define objective measures of successful customer engagement. In theory it is possible that the notifications may be as effective as possible but that people decide not to switch supplier for a whole range of reasons, including convenience. As such it is important that switching rates are not the sole measure of consumer engagement. It is also important to point out that notifications are a small component of the wider energy market so sufficient attention should be paid to the overall customer journey. For example, once someone receives a notification, it is crucial that it is easy for them to compare different tariffs and generate useful and accurate results from their searches. The most effective way to incentivise suppliers is likely to be changing the licensing conditions to include certain requirements relating to customer engagement (along with a robust way of evaluating these measures).

(e) Should the default tariff be fixed price as well as fixed term, or should suppliers be allowed to roll customers onto a variable price tariff?

BIT does not have a strong view on whether the price should be fixed or variable however we would note that uncertainty or ambiguity aversion suggests that when an outcome is unknown people tend to prefer to choose certain probabilities (that is a fixed price) over uncertain probabilities (the chance of an unexpectedly higher bill). [4] It seems reasonable to think that similar behaviour might occur in energy markets with people choosing the certainty of fixed price tariffs rather than variable rate.

(i) If the default tariff were variable price, should energy suppliers be required to roll all customers who did not take action onto the same tariff, such that in effect there was only a single variable price default tariff per supplier?

BIT does not have a strong view on this proposal however we would note the need for a market which is easy for the consumer to navigate, probably with the help of intermediaries.

(ii) If the default tariff were fixed price, should energy suppliers be required to roll all customers who did not take action within a given period, eg one month, onto the same default tariff? Is there a risk that the existence of multiple default tariffs (eg one for every month) would reduce the pressure on SVT pricing that currently results from media attention on changes to SVTs?

---

[4] Viole, F., & Nawrocki, D. N. (2012). Puzzles and Paradoxes: The Consistent Role of Ambiguity Aversion. *Available at SSRN 1984695.*

Again BIT does not have a strong view on this proposal however we would note that if the fixed term tariffs are variable price then we would still expect media reporting of any changes to variable energy prices, as currently happens. If this were the case it would mean consumers would receive two prompts: one personalised at the end of their tariff and the other through means of media reporting of changing prices.

(f) How should this remedy be implemented in order to ensure it is effective and proportionate?

BIT does not have a strong view on the implementation of the remedy, in our view the crucial component of the proposal is the design and delivery of the end of tariff notifications. In terms of market wide implementation BIT would suggest the CMA/Ofgem should select a certain date by which all suppliers must ensure that all of their customers are on a fixed term tariff. Having a fixed date for all suppliers can help create a market-wide focus which can be used by suppliers, intermediaries and other organisations as a means for trying to encourage more consumers to compare, and perhaps, switch supplier.

(i) How long should energy suppliers be given to phase existing customers off their SVTs?

N/A

(ii) Should the remedy be phased in starting with customers who have been on the SVT longest? Alternatively, should it be organised geographically in order to facilitate marketing by competitors and support from consumer groups in later years? For example, energy suppliers might be required to move all SVT customers in a region to the default tariff in the same month, such that the following year energy suppliers, PCWs and other TPIs would know that a large number of customers in that region might be looking to move in that month.

BIT does not have a strong view on the introduction of the proposed remedy however we would make the following points:

- Having a common start date would be likely to create an opportunity for firms (and PCWs and TPIs) to compete to get new customers a year later when that fixed term ends. If there is no exit fee for the fixed-term default tariffs (and we think there should not be exit fees), then coordinating the exact starting month is not as important.
- Having different regions starting at different times may still have the advantage of creating a local ‘switching day’ and may have the additional benefit of allowing a stepped wedge design to evaluate the effectiveness of this fixed-term default tariff.

(iii) Should energy suppliers be required to provide contact details for all SVT customers or a subset of SVT customers (eg those who have been on the default tariff for several years in a row, eg three or five years) to Ofgem, which could then seek to contact them with further prompts? Alternatively, should suppliers be required to place the contact details of these customers on a shared database, available to all licensed energy suppliers, in order to allow targeted marketing to these customers? We note that GDF has been required to share such information on those of its customers who remain on the regulated tariff in France.

As set out in our response to Remedy 10, part (f), BIT believes making rival energy providers aware of which customers remain on default tariffs requires careful consideration, as those more likely to stick to defaults are, in this context, 'vulnerable customers'. These customers may be enticed to switch by suppliers who know they can then rely on those customers staying with them after the tariff comes to an end. In other words, suppliers might set up tariffs which are very attractive in the short term, but which increase dramatically in price at some point in the future, and then target these 'non-switchers' specifically with these offers. Giving suppliers' information on which customers don't tend to switch, could be risky in this regard. Third party intermediaries might be a better option, for example consumer groups such as Which?.

BIT supports Ofgem contacting these households, guiding them through the tariff switching process or directing them to an Ofgem meta-PCW (our support for which is explained in our previous response to remedy 6(d)) or a transactional PCW.

(g) What should the default tariff be called? Should it be the 'emergency' tariff to further prompt engagement or would some other wording be more appropriate? Is there a risk that certain customers will be concerned that their energy supply will be cut off if they do not engage following an end of contract prompt?

BIT supports calling the tariff an "emergency tariff" as it will encourage consumers to take action, indeed we suggested it as part of our submission to the proposed remedies. We appreciate there is a danger that "emergency" tariff may create worry for some customers but in terms of possible negative consumer consequences BIT believes this is an empirical question and suggests some testing to see the behavioural impact of changing the name. BIT would suggest CMA/Ofgem hold a small number of focus groups with vulnerable groups to understand what reaction the name "emergency" might create. Another option might be to send a small sample of consumers a letter in advance of rolling them onto the "emergency" tariff telling them what will happen and providing easy to follow information about what steps they need to take to move off the tariff. This letter could include a designated phone number/website for them to visit which CMA/Ofgem/suppliers monitor to see what response rates are. After the letter has been sent a survey could be used to find out how people have reacted.

If “emergency tariff” cannot be used, BIT suggests calling the default a “temporary” or “short-term” tariff, rather than the “safeguard” tariff to encourage higher levels of action by consumers by highlighting the unusual nature of the tariff. As stated in BIT’s response to Remedy 11, section (m)(1), the phrase “safeguard tariff” may imply to the consumer that they are “safe” and do not need to take action.

(i) How should the CMA assess the costs of such potential distress to customers?

N/A

(ii) Are there means by which this distress could be avoided or mitigated?

While BIT appreciates the concerns about calling any tariff an “emergency” tariff we would suggest this distress could be avoided or mitigated by making it clear in the notification letters the simple steps a person can take to move off the emergency tariff; this would include making clear that consumers will not be cut off if they fail to take action. It may be that for consumers who are transferred onto the “emergency” tariff there are additional requirements placed on suppliers to try and prompt customer engagement; for example a series of reminders starting with letters and perhaps escalating to phone calls or even passing customer details onto a trusted intermediary (such as a consumer organisation) to prompt action.

(h) Should Ofgem monitor the proportion of customers on default tariffs, their average tenure and/or the pricing of default tariffs (eg with a view to publishing summary information)?

Making more information available does not automatically improve consumer outcomes, indeed ‘information overload’ can lead to consumer inertia.[5] The key to any information is how easy it is for an individual/business to understand and use the information in their decisions. As such BIT would urge the CMA/Ofgem to think carefully about when, and how, the proposed information can be shared in such as way as to be available when a consumer decision is being made. Just publishing the information and expecting consumers to spend time looking for it is unrealistic and instead it may be more effective to share the information with third parties, such as price comparison sites, who can then make it available to consumers as part of a wider measure of customer satisfaction/quality of service for different suppliers.

[5] Iyengar, S. S., & Lepper, M. R. (2000). When choice is demotivating: Can one desire too much of a good thing?. *Journal of personality and social psychology*,*79*(6), 995.

(i) Should all energy suppliers be subject to the prohibition on evergreen tariffs?

It is important that any remedy relating to fixed term tariffs is applied equally across all suppliers to avoid further consumer confusion.

(j) Would any energy suppliers have the ability to circumvent the remedy? If so, how could they do this?

The biggest risk to the remedy working effectively is that the tariff end notifications may difficult to understand and confusing. Consumers may avoid taking action because they are unsure and concerned about making a poor decision and they overestimate the regret they will feel if they do not make a good choice, in the behavioural literature this is sometimes known as anticipated regret.[6] Making the options more difficult to understand is likely to result in more people making the wrong choice which may lead to more anticipated regret which in turn may lead to higher consumer inertia as people seek to avoid making the wrong choice. Harvard academic, Lauren E. Willis notes that there is evidence that "firms exacerbate judgment and decision biases intentionally... they increase the difficulty of decisions to foster procrastination, thereby encouraging use of the default."[7]

(k) Could this remedy give rise to unintended consequences and, if so, what these might be and how they might be prevented or mitigated?

As noted above BIT believes that the biggest risk from the proposal is that by creating fixed term tariffs you are adding another complication to the market, for example there may be twelve 'standard variable fixed term' tariffs, one for each month, whereas there was one before. As noted elsewhere in this response and in our response to the other proposed remedies all the steps in the customer journey, from the wording of the letters to the layout of suppliers websites, can have significant effects on consumer behaviour. As such, all deserve close attention to make sure they are as easy to negotiate as possible so that the market functions as well as possible.

(l) Are there any relevant customer benefits to which we should have regard as being affected by the proposed remedy?

---

[6] Gilbert, D.T. et al (2004) Looking Forward to Looking Backward The Misprediction of Regret Psychological Science May 2004 vol. 15 no. 5 346-350 http://pss.sagepub.com/content/15/5/346

[7] Willis, L.E. (2013) When nudges fail: Slippery defaults. The University of Chicago Law Review, 1155-1229 https://dash.harvard.edu/bitstream/handle/1/11215415/04_Willis%20FINAL%20print.pdf?sequence=1

BIT notes two possible customer benefits from the current standard variable tariff structure:

1. Consumers can choose the 'hassle-free' option of the standard variable tariff (this takes account of the standard economic argument of utility maximisation whereby an individual compares the value of the time required to switch against the possible savings and takes whichever course of action delivers highest utility). It has been widely demonstrated that individuals' frequently act is a way which directly contradicts rational choice theory[8] so BIT does not believe that this argument holds. Even if fixed term tariffs are introduced then an individual will be free to take no action which will result in them being automatically rolled over to a new fixed term tariff (in much the way happens in car insurance markets).
2. The evergreen nature of the standard variable tariff means that an individual is free to switch at any point without needing to wait until the end of their fixed term tariff. Again BIT believes that while this is theoretically true, research by the CMA and other organisations suggests that consumer awareness of the ability to switch remains low. On balance BIT believes that the introduction of fixed term tariffs (with no exit fees) will help create clear consumer contact points which can be used, and refined, to promote greater customer engagement.

The consumer research conducted by the CMA suggests that neither of these arguments hold in this case: 34% of respondents said they had never considered switching supplier; 36% of respondents either did not think it was possible or did not know if it was possible to change one (or more) of the following: tariff, payment method and supplier; 56% of respondents said they had never switched supplier, did not know it was possible or did not know if they had done so; and 72% said they had never switched tariff with an existing supplier, did not know it was possible, or did not know if they had done so.

(m) What are the relevant costs and benefits that we should take into account when considering the proportionality of this remedy?

N/A

(n) Are there any alternative remedies that would be as effective as the proposed remedy in addressing the provisional AEC and that would be less costly and/or intrusive?

N/A

---

[8] Kahneman, D. (2011). *Thinking, fast and slow*. Macmillan.

(o) Should the CMA seek to implement this remedy itself via an order (eg to make a licence modification), or whether it should make a recommendation that another body, such as Ofgem or DECC, implement the remedy?

BIT does not have a strong view on the mechanism for implementing the proposed remedy. The key thing is that the introduction is done across the market within a reasonable time frame and in as simple a manner as possible to help make it easy for consumers to understand the new structure of the market.