Loyalty penalty update: getting better and fairer deals

Progress in tackling the loyalty penalty

- Work by regulators is underway in the five markets to look in more detail at the problems and how they can best be tackled; key decisions are due shortly. While it is too soon to assess progress, we expect regulators to take firm action where problems are found.
- We have launched two enforcement cases investigating harmful business practices and we are progressing other cross-cutting areas of work.
- We have set out a framework which gives clarity to businesses about the difference between healthy competition and unacceptable practices, alongside proposals to strengthen consumer law.
- Work by regulators to look at publishing loyalty penalty metrics is underway; but more must be done to take this forward.
- Work on measures such as the use of Smart Data in key markets to tackle loyalty penalty issues is ongoing, and government is consulting on this.

Introduction

1. Last year we investigated concerns raised by Citizens Advice in a super-complaint about the loyalty penalty; this is when companies charge longstanding customers more than new customers or those who renegotiate their deal for the same goods or services. Our response to the super-complaint (Response) identified that there is a substantial penalty impacting millions of people across key markets critical to people’s lives: mobile; broadband; household insurance; cash savings; and mortgages.

2. We made significant recommendations to government and regulators, including: cracking down on harmful business practices which frustrate customers and trap them on poor deals; using targeted price caps where needed to protect those hardest hit; and publicly holding firms to account by

publishing the size of their loyalty penalty. We also made specific recommendations on the five markets.

3. The CMA has been working closely with government and regulators to take forward our cross-cutting recommendations; setting up a working group to oversee progress and giving updates to the Consumer Forum attended by government ministers and regulators.

4. We welcome the government's supportive response to our recommendations published yesterday. There must be continued commitment to do more to tackle the loyalty penalty and take bold action to intervene.

5. This update sets out the work and progress that has been made following our investigation.

Progress – work underway by regulators

6. Some progress has been made in taking forward our recommendations. The FCA and Ofcom have been investigating loyalty penalty issues further in the five markets which they regulate. Work in those markets is still ongoing and therefore it is too early to determine whether there has been sufficient progress by regulators. FCA[1] and Ofcom[2] are separately publishing updates on their progress in tackling these issues, and there will be key announcements by regulators on specific markets over the coming months.

7. Regulators need to recognise the scale of the loyalty penalty and its impact in their markets, and to design effective interventions that help those consumers who are most in need, particularly the vulnerable. We expect the FCA and Ofcom to take strong action in their markets where problems are found, including considering targeted price caps where necessary.

8. In telecommunications, Ofcom are currently considering pricing practices in mobile handsets and broadband.[3]

9. As set out in our response, in relation to mobile handsets, we do not consider that providers should continue to charge customers the same rate once they have effectively paid off their handsets. We understand that Ofcom is exploring this in further detail and its findings are expected to be published in

[1] FCA update on Citizens Advice super-complaint to the CMA, 19 June 2019.

[2] Ofcom's fairness update, 17 June 2019.

[3] We note that last month Ofcom announced new rules on end of contract notifications for customers including in mobile and broadband. These will come into effect from February 2020.

the summer.[4] We note Ofcom's recently published update which set out some initial findings indicating that some longstanding customers who stay beyond the end of their initial contract period are getting better deals than new customers.[5] Nonetheless we expect that in cases where customers do end up paying more than they should be, action should be taken to protect these consumers. We look forward to seeing the full results of its work and the actions it will be taking to protect consumers.

10. In broadband, Ofcom is still in the process of undertaking further work to explore the concerns raised and its interim findings are expected to be published in the autumn. We understand that its initial results indicate that where customers stay with their supplier but renegotiate, they get better deals than customers who are out of contract.[6] As recommended in our response, we consider that Ofcom should be considering a full range of interventions that reach all customers, including considering targeted safeguard caps for those who are vulnerable.

11. In financial services, FCA are undertaking further work in insurance, cash savings and mortgages.

12. In insurance, it appears that many longstanding customers are paying more than new customers with prices increasing year after year. We recommended that the FCA should closely investigate these types of pricing practices and consider interventions that limit this type of 'price walking'. We understand that the FCA is currently looking at these issues as part of its general insurance market study and we look forward to its interim findings expected later this year. We expect the FCA to look at all feasible options that provide an effective response to address the problems in this market.

13. In cash savings, the FCA is still actively considering introducing a 'Basic Savings Rate' which we welcome and will publish either a Consultation Paper or Feedback Statement in the second half of the year, setting out next steps on its proposals.

14. In mortgages, the FCA has been undertaking a market study and in March published its final report which set out a number of measures; including remedies to address problems for customers who cannot switch (known as 'mortgage prisoners') which we welcome. It is also undertaking further research to understand more about customers who can switch but don't.

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[4] Ofcom, Consultation: Helping consumers to get better deals in communications markets - mobile handsets.

[5] Ofcom, Fairness for customers update, 17 June 2019.

[6] Ofcom, Fairness for customers update, 17 June 2019

Once more is understood, we encourage the FCA to look at what other measures may be needed to help or protect these consumers.

Businesses must treat their customers fairly

15. As we made clear at the end of last year, as well as action by regulators and government, the onus must also be on businesses to look hard at their own practices. They must do what they can now to ensure their loyal customers are not unfairly penalised, and to support efforts to tackle this problem.

16. There have been early signs that some businesses are recognising these issues and re-evaluating how they treat their customers.[7]

17. However, there has not yet been a widespread shift and so we continue to urge businesses to treat their existing customers more fairly.

CMA enforcement - taking action against harmful business practices

18. Our super-complaint response identified harmful business practices across a wide range of markets which make it more difficult for customers to avoid paying a loyalty penalty, such as:

- Making it more difficult to leave a contract than to sign up;
- Rolling over customers onto new contracts without sufficient warning;
- Imposing ‘stealth’ increases in price on renewal year after year; and
- Requiring customers to sign up for auto-renewal when they buy a product or service.

19. As part of tackling these types of practices, the CMA now has enforcement cases underway in two sectors: anti-virus software and more recently online console video games. These are examining whether some of the business practices and terms and conditions of the companies involved are fair, in relation to auto-renewal, cancellations and refunds. A further update on these investigations will be published before the end of the year.

20. We have also been encouraging regulators to take their own enforcement action where these types of harmful practices are found in their regulated sectors.

[7] We note the recent comments in this regard made by Carolyn Fairbairn, Director General of the CBI, proposing that businesses should not only be alerting customers to better deals but also moving them onto better deals. We support efforts such as this to ensure better outcomes for customers.

Update on CMA’s anti-virus enforcement investigation

21. We are continuing to gather and review information to progress this investigation. It is currently focused on a number of areas associated with the automatic renewal of subscriptions, including: whether consumers expressly agree to be automatically renewed; if there is express agreement to pay a higher price when auto-renewed and if not whether businesses can charge a higher price; whether customers can easily prevent renewal; and whether they should be entitled to refunds if they no longer want or need the service.

22. We have written to a number of anti-virus firms following concerns that some of their practices and terms associated with the automatic renewal of subscriptions may breach consumer law, and we have required them to provide information to understand more about their practices. Once we have completed our analysis of this information and other evidence gathered we will consider what, if any, further action might be required.[8] At this stage, we have not reached a view about whether there have been any breaches of consumer law by the firms currently under investigation.

Update on CMA’s online video games enforcement investigation

23. On online video games, the CMA has opened cases against Nintendo Switch, Playstation and Xbox investigating a number of potential issues, including: whether the contract terms used by the companies are unfair; how easily consumers can cancel membership subscriptions, and obtain refunds; and the fairness of the automatic-renewal process. We are currently in the process of gathering evidence about the purchase and renewals processes and are reviewing information received from those businesses. Members of the public have also been asked to get in touch with their experiences, whether good or bad, and so far submissions from over 400 individuals have been received. At this stage, no view has been reached on whether any of the practices breach consumer law.

Greater clarity to businesses about harmful business practices and strengthening consumer law

24. As set out in our December 2018 response, the flexible and principles-based nature of the existing consumer law framework allows us and other enforcers wide scope for taking enforcement action to tackle these practices, as we are

[8] We have also written to 16 other anti-virus companies across the sector asking them to review their practices and terms and conditions to ensure that they are compliant with consumer law and put them on notice that they could also face an investigation if any consumer law concerns are identified.

doing in our enforcement cases. The clear message to businesses is that these sorts of practices will not be tolerated by us or by regulators.

25. But there may be areas where the law could be clarified or made more explicit to ensure these practices are stopped, and one of our recommendations was that the government should consider whether any changes to consumer law are needed to help tackle these practices effectively and quickly.

26. We consider that there is significant scope to strengthen consumer law to tackle unfair renewals and that this is an area worthwhile for the government to pursue. The White Paper provides a good opportunity to consider tackling harmful business practices and gather wider views, including from businesses, consumer groups and the legal community on this area. We welcome the government's commitment in their recent response to exploring this further.

27. The CMA has also already proposed wide ranging reforms to strengthen our consumer powers so that we can more effectively take action against firms on these and other types of issues, to protect consumers.[9] We welcome the government's announcement that it will be consulting on a key element of those reforms. We will continue to work with the government to take forward these reforms and potential changes to clarify laws around unfair renewals.

28. Our response also set out a number of principles to stop unacceptable business practices relating to unfair renewals, and we have continued to develop these alongside our enforcement work. We consider that the 'effective nudge' theories developed by Professor Richard Thaler,[10] a renowned behavioural economist, provide a useful high-level frame of reference for assessing whether business practices are harmful:

- All nudging should be transparent and never misleading;
- It should be as easy as possible to opt out of the nudge; preferably with as little as one mouse click; and
- There should be good reason to believe that the behaviour being encouraged will improve the welfare of those being nudged.

29. Healthy competition is where firms are competing to provide the best service, at the lowest prices to consumers. But that assumes that people are informed in making their decisions, and free to act on those decisions. With unhealthy

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[9] https://www.gov.uk/government/publications/letter-from-andrew-tyrie-to-the-secretary-of-state-for-business-energy-and-industrial-strategy

[10] A nudge is an influencing or behavioural strategy that firms should follow to generate good outcomes for customers. See, for example, *Nudge: Improving Decisions About Health, Wealth, and Happiness*, Richard H. Thaler and Cass R. Sunstein (2008), and *The Power of Nudges, for Good and Bad,* Thaler (2015).

competition, firms are effectively acting to disempower the consumer; reducing transparency (through hidden price rises) or making it harder for them to switch (lock ins, or keeping them waiting too long on the phone). Whilst the loyalty penalty may be a profitable model for firms, it is clearly not in the consumer's best interest and more fundamentally it reduces trust in businesses and markets as a whole. These sorts of harmful practices where the terms are not clear to consumers, where they cannot easily switch, and which do not result in consumers being on a good deal, are exploitative and show that competition is not working well.

30. The following new refined framework sets out the conditions for healthy competition and acceptable behaviour by firms. It provides six key principles which if followed will help prevent customers from being hit by the loyalty penalty.

Practices should be transparent and never misleading:

1. **Auto-renewal must be explicitly agreed to** by the consumer when signing up; not applied on a default basis and consumers should be able to take the contract without auto-renewal;
2. Consumers are **properly notified before** any renewal - in good time for them to take action;
3. **Changes to price, the product or other important terms must have the consumer's express agreement**.

It should be as easy as possible to opt out:

4. It should be at least **as easy to exit a contract as it was to sign up**, including being able to easily stop the renewal at any time, exit in the same way as it was signed up to and a cancellation right after renewal that is easy to exercise.

The behaviour being encouraged is in the consumer's best interest:

5. **Minimum terms are restrained and no longer than justified** and beyond that refunds are given if consumers cancel early;
6. **No auto-renewal onto a fresh fixed term**, unless it is clearly in consumers' interests, and exit fees should not be used after any initial minimum term.

31. We will continue to work with government to take this area forward alongside potential changes to strengthen consumer law.

Publicising the loyalty penalty and better understanding who is impacted

32. As set out in our response, measures that shine a light on these problems can put reputational pressure on businesses to reduce large price differences between new and existing customers. We therefore recommended that regulators publish metrics on the size of the loyalty penalty in key markets and for each supplier. This recommendation has been welcomed by the government in its response.

33. The UK Regulators Network (UKRN) is now undertaking work looking at publishing loyalty penalty metrics alongside a broader set of key market metrics, as part of the ‘performance scorecard’ proposal set out in the government’s Consumer Green Paper last year.[11] Although we recognise the challenges of this exercise, we believe these metrics would be a very powerful reputational incentive for firms to improve their treatment of existing customers, and this is important for healthy competition to flourish.

34. An update by UKRN on their work will be published shortly. Whilst some progress has been made, we consider that further commitment is needed by regulators on loyalty penalty metrics to take this forward more quickly. We would expect to see metrics on the size of the loyalty penalty paid in key markets on a supplier level, where feasible published by the end of the year.

35. In addition to publicising data, it is important to ensure regulators have sufficient and high-quality data on and an understanding of, who is paying the loyalty penalty and by how much, particularly for consumer groups who may be vulnerable. Our investigation found that while there is some evidence to indicate that certain groups of consumers may be more at risk of paying a loyalty penalty - such as the elderly, or those on low incomes - there are a number of gaps and limitations in the existing evidence base which prevent regulators from fully understanding the extent of the problems. Crucially, it is not possible to understand whether the same groups of individuals are worse off across markets.

36. We have now completed a feasibility study into how this evidence gap could be filled by linking data directly from firms to a large high-quality survey on consumer characteristics, to produce a more comprehensive and high-quality dataset. Although challenging, we think this exercise is feasible in a number of

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[11] As reflected in the government response, the Green Paper set out expectations that regulators, through the UKRN, would develop performance scorecards which provide a set of comparable data on consumer outcomes for each company, including the loyalty penalty.

key markets[12] and would be very valuable. It would provide key insights into the extent of the problem and who it is impacting across markets, to inform the need for targeted action.

37. We have therefore made a new recommendation that regulators take this forward to pilot this work in key markets, utilising their data gathering powers. If these powers are not found to be sufficient, government should strengthen them.

Protecting consumers through targeted interventions and more active support in getting better deals

38. We recommended that greater consideration should be given to targeted pricing regulations in cases where there is clear harm and particularly to protect vulnerable consumers. We also recommended that regulators closely consider the need for these type of measures in the markets currently under review.

39. We look forward to the results of the regulators' further work. Where we find these problems in our markets work, we will also closely consider the case for targeted interventions.

40. We also welcome the continued impetus behind Smart Data initiatives such as Open Banking and the recently published Smart Data government consultation. In particular we welcome the draft government steer for this to be prioritised in telecommunications, where we believe it will have a significant impact and could transform these markets. We will continue to offer support in taking this forward.

41. We are also pleased to see that there are signs of further and continued growth of alternative and innovative models to support consumers such as automatic switching services. However, we accept that these types of initiatives are not going to reach all consumers. Some consumers will continue to need more active support; that is why we considered it was vitally important to look at different ways in giving more active face to face support to consumers. We welcome the government's support for considering this further in conjunction with consumer groups such as Citizens Advice.

[12] Energy, broadband, cash savings, mortgages and potentially insurance.

Next steps

42. Six months on from our report, the loyalty penalty continues to be an issue of great concern and we remain committed to working with regulators and government in tackling this exploitative problem.

43. We will continue to look at whether sufficient progress has been made in taking forward our recommendations over the following six months and will publish a further update on progress at the end of the year. This will reconsider what next steps, including further action by us or the regulators, is needed.