January 2020: Loyalty Penalty Update

Introduction

1. In September 2018, Citizens Advice submitted a super-complaint to the CMA about the loyalty penalty in five key markets: mobile; broadband; household insurance; cash savings; and mortgages. A loyalty penalty occurs when companies charge longstanding customers more than new customers or those who renegotiate their deal for the same goods or services.

2. Our response to the super-complaint (Response) in December 2018 identified a substantial loyalty penalty affecting millions of people across the five markets. We were clear that significant action was needed to assess the extent to which individuals are paying the loyalty penalty across markets and that action was needed to tackle it more effectively. We made specific recommendations to government and regulators to achieve this, as well as committing to take action ourselves.

3. This update sets out the progress that has been made in taking forward our recommendations by Ofcom and the FCA (regulators in the five key markets), the CMA, and the government.

Mobile and Broadband

4. Ofcom has been undertaking further work in mobile and broadband and has separately published an update on its progress in tackling the loyalty penalty.[1]

5. In mobile, in our Response, we recommended that:

   a) providers should move customers on bundled handset and airtime contracts onto a fairer tariff when their minimum contract period ends; and
   b) Ofcom should consider measures to increase consumer engagement and awareness; in particular, awareness and understanding of SIM-only deals.

6. Ofcom carried out a review of the market in 2018 and 2019, analysing prices paid by mobile customers who bundle their handset and airtime together in a single contract. It found that, out of 2 million bundled customers who are out-of-contract, around 1.4 million customers would save an average of £11 a

[1] Ofcom's fairness progress update, 9 January 2019.

month if they switched to a cheaper SIM-only deal. It also found that the remaining 600,000 would pay more (an average of £6 a month) if they switched to a similar SIM-only deal.[2]

7. Ofcom has progressed a number of targeted actions:

a) Ofcom has introduced new rules on end of contract notifications and annual best tariff notifications for customers in mobile (as well as broadband). These rules mean that customers will be told when their contract is coming to an end, and shown the best deals available, including SIM-only deals. These will come into effect from February 2020.

b) Ofcom secured voluntary commitments from all of the major mobile providers (except Three) to reduce bills for out-of-contract customers. Out-of-contract customers with Virgin Mobile or Tesco Mobile, and O2's direct customers, will see their bills reduce to the equivalent 30-day, or best available, airtime deal. EE and Vodafone's out-of-contract customers will get a 10% and £5 discount respectively, after they have been out-of-contract for more than three months. These measures will come into effect from February 2020.[3]

c) Ofcom launched a consumer information campaign in September 2019 to promote the benefits of switching telecom provider and highlight how recently-introduced changes have made it simpler to switch.

d) Ofcom has set out proposals on how it will implement a new EU framework which requires customers to be told the price at which they could buy the handset and airtime separately, before they sign up to a bundled contract.[4] As part of its implementation of that EU Framework, Ofcom has also proposed measures to address its concern that some split contracts (ie separate contracts for the handset and airtime)[5] can tie customers into excessively long contracts and deter them from switching. Ofcom plans to introduce these rules by December 2020.

8. We are encouraged that the commitments offered by Virgin Mobile, Tesco Mobile and O2 (for its direct customers only) appear to directly address the problem of customers remaining on excessive tariffs when they have

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[2] Ofcom: Helping consumers to get better deals in communications markets: mobile handsets, July 2019.

[3] Ofcom: New measures to increase fairness for mobile customers, July 2019.

[4] Ofcom: Fair treatment and easier switching for broadband and mobile customers – Proposals to implement the new European Electronic Communications Code, December 2019

[5] Split contracts offer an alternative way for customers to buy mobile handsets in instalments. Ofcom is concerned that longer split contracts (in some cases up to 36 months) could make it harder for customers to switch, if they have to pay off their handset first.

effectively paid off their handset. However, it is disappointing that not all providers have been willing to sign up to commitments that tackle this issue in full:

a) In particular, Three's lack of engagement in this process is a significant concern. We urge Three to reconsider its position. If Three does not sign up to commitments, we recommend that Ofcom considers further what it can do to ensure that Three's customers are not at a disadvantage.

b) We are also concerned that the commitments by EE and Vodafone fall short of switching customers to a comparable SIM-only tariff at the end of their minimum contract period. We urge these two firms to improve their commitments and overall approach to longstanding customers.

c) We expect O2 to move speedily to ensure that its commitments apply to its indirect customers (ie purchases via indirect channels/sales partners), that account for over 70% of O2's bundled contract customer base.

9. Considering the market more generally, while the voluntary commitments are a pragmatic step in the right direction, we are concerned that the variation in providers' offerings may be confusing to consumers and, as a result, the overall (or aggregate) result might fail to tackle the loyalty penalty effectively. Firms should also not be allowed to seize an unfair advantage by adopting commitments that are weaker and less effective than those of their competitors. Ofcom plans to monitor how these commitments affect consumer outcomes going forward and we look forward to the findings of this review.

10. In broadband, in our Response, we recommended that Ofcom consider a number of possible interventions including:

a) tackling legacy pricing;
b) targeted safeguard caps to protect vulnerable consumers; and
c) measures to increase consumer engagement.

11. Ofcom published an in-depth review of broadband pricing practices in September 2019.[6] It found that:

a) there are around 8.8 million out-of-contract broadband customers in the UK (41% of all broadband customers), of which 1.5 million are potentially vulnerable customers and pay higher prices as a result;

b) while vulnerable customers are not disproportionately out-of-contract compared to the general population, vulnerable customers are more likely

[6] Ofcom: A review of pricing practices in fixed broadband, September 2019.

to have re-contracted and less likely to be new customers, which suggests that barriers to switching provider may be higher for vulnerable customers (or they have a lower propensity to switch provider); and

c) the headline figure masked variation between individuals and sub-groups, e.g. customers over 65 are more likely to be out-of-contract and less likely to be new customers.

12. However, Ofcom also recognised that these conclusions are to be treated with caution, due to limitations of the data held by providers. Only three providers hold information on the age of their customers, and the proportion of customers identified as vulnerable for reasons other than age was significantly lower than expected (e.g. 1% identified as disabled by providers vs 21% self-reporting in the 2017/18 Family Resources Survey).

13. Following the review, Ofcom secured voluntary commitments, of varying nature, from the UK's biggest broadband providers, to protect customers who are out-of-contract and/or face barriers getting better deals. Most of these will come into effect by March 2020.[7]

14. In addition, Ofcom:

a) is exploring the case for a special tariff to protect broadband customers on low incomes;

b) is considering requiring providers to take part in a collective switch trial to help the least engaged customers, including vulnerable consumers; and

c) has consulted on a proposed guide for providers on treating vulnerable consumers fairly[8], with the final guide to be published later in 2020.

15. Looking forward, Ofcom has committed to publish an update on the commitments made by broadband providers in the spring. In the longer term, it will monitor consumer outcomes in retail broadband closely as these measures come into effect. Ofcom will also monitor and report on a range of metrics, including the proportion of customers who are new, re-contracted and out-of-contract, and the proportion in each group who are vulnerable.

16. While the voluntary commitments in broadband are a welcome step, as with mobile, we are concerned that their varying nature could confuse customers and have differing levels of impact on tackling the loyalty penalty. Ofcom's

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[7] Ofcom: Fairer prices for broadband customers, September 2019.

[8] Ofcom Consultation: Proposed guide for treating vulnerable consumers fairly, September 2019.

monitoring of the impact of these commitments is therefore of vital importance.

17. As already required by Ofcom, we expect providers to improve the data available to assess the impact of the loyalty penalty on vulnerable consumers. This will allow Ofcom to make a more accurate judgement of the impact of the loyalty penalty, and of the commitments that providers have made to tackle it, on this group. We also expect Ofcom to move to implement a social tariff to protect vulnerable households, should the evidence support the case for this.

Financial Services: Insurance, Cash Savings and Mortgages

18. The FCA has been undertaking further work in insurance, cash savings and mortgages and has separately published an update on its progress in tackling the loyalty penalty.[9]

19. In insurance, in our Response, we welcomed the FCA's general insurance market study and recommended that it should consider:

    a) targeted pricing interventions and restrictions that limit price walking; and
    b) how intermediaries can continue to benefit the home insurance market.

20. The FCA published its interim findings report in October 2019. The report found that the insurance markets are not working well for consumers and identified a range of practices (as well as complex pricing practices) employed by firms that make it difficult for consumers to get better deals. In particular, the report found that insurers often sell policies at a discount to new customers and increase premiums when customers renew, targeting increases at those less likely to switch. It also found that longstanding customers pay more on average, although loyalty is not the only reason customers paid higher prices. Overall, 6 million policy holders paid high prices in 2018 and could have saved £1.2 billion (if they paid the average premium for their risk).

21. The report discusses a range of potential remedies to address these practices, which take into account the CMA's principles for healthy competition and acceptable behaviour by firms (set out in our June 2019 update). The potential remedies include: banning or restricting practices such as raising prices for consumers who renew year-on-year, or requiring firms to automatically move consumers to cheaper equivalent deals. It also raised the

[9] FCA update on Citizens Advice super complaint to the CMA, 9 January 2019.

prospect of compelling insurers to publish information about price differentials between customers and previews a future strategy on Open Finance.[10]

22. We welcome the candidate list of remedies which represent a good range of potential responses to the problems identified. We look forward to seeing a final set of remedies that are effective at addressing the scale of consumer detriment in this sector.

23. In cash savings, in our Response, we welcomed the FCA's work to consider introducing a 'Basic Savings Rate' (BSR) and recommended that the FCA:

    a) if it implements a BSR, evaluate whether it has had the intended impact and if not, consider further pricing interventions such as a targeted absolute price floor in cash savings; and
    b) consider whether collective switching could be applied in this market.

24. The FCA has published a Consultation Paper which sets out proposals for: (a) a Single Easy Access Rate (SEAR), which will operate in a similar way to the previously proposed BSR; and (b) a requirement on firms to publish data on their SEARs.[11]

25. We welcome the progress towards the introduction of a SEAR and, in particular, the proposal to specify a common format for the publication of data on SEARs. We are also pleased that a clear timetable has been set out to: (a) publish next steps and, if FCA decide to make rules, a final instrument in the second half of 2020; (b) implement any new rules to take effect in April 2021; and (c) carry out an ex-post evaluation of the interventions three years after their introduction. As part of any ex-post evaluation, we expect the FCA to have regard to our recommendations set out in paragraph 23 above.

26. In mortgages, in our Response, we welcomed the FCA's market study to help those customers who cannot switch in this market ('mortgage prisoners') move onto better deals, where feasible. We also recommended that the FCA look at what measures may be needed to help or protect the 10% of long-standing customers who could switch and make significant savings but do not.

27. The FCA has been undertaking further research to understand more about these customers and the reasons why they are not switching. This research has now been completed and the FCA is currently considering the case for potential remedies. This is an issue that cuts to the core of the loyalty penalty

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[10] Call for Input: Open finance, published 17 December 2019.

[11] FCA Consultation Paper, 9 January 2019. Firms would publish their SEARs, the proportion of the balances held in easy access accounts that are receiving SEARs, and the highest (introductory) interest rate offered on an easy access cash savings account and an easy access cash ISA.

in this market. We therefore encourage the FCA to set out a timetable (similar to the timetable for cash savings) for this work and for implementing remedies that help or protect these consumers, if needed.

Enforcing Consumer Protection Law

28. Our super-complaint response identified harmful business practices across a number of other sectors beyond the five markets which make it more difficult for customers to avoid paying a loyalty penalty, such as: continual 'stealth' price increases, not giving customers enough warning before being rolled over or making it more difficult to leave than it is to sign up.

29. As part of tackling these types of practices, the CMA launched enforcement cases in two sectors: anti-virus software and online console video gaming. We 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. We will publish a further update on these cases in the first quarter of 2020.

30. Effective enforcement of consumer law is an essential element of maintaining trust in markets and protecting consumers and new powers are needed to strengthen the system of consumer law enforcement.

31. In June 2019, the Government announced that it will consult on giving the CMA new powers to fine businesses who have broken consumer law directly (ie without the need to go through a court). It also announced that it will legislate to give regulators, such as Ofcom and the FCA new powers to stop longstanding customers being taken advantage of if their existing powers are insufficient.[12] In addition, the CMA has also proposed wide-ranging reforms to strengthen our consumer enforcement and our market study/investigation powers so that we can more effectively investigate and take action against firms on these and other types of issues.[13] We will continue to work with the new Government to take forward these reforms and potential changes to clarify laws around unfair renewals.

Loyalty Penalty Metrics

32. We recommended that the regulators should publish the size of the loyalty penalty in key markets and for each supplier, through for example an annual

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[12] https://www.gov.uk/government/news/new-powers-to-fine-firms-that-exploit-consumer-loyalty
[13] https://www.gov.uk/government/publications/letter-from-andrew-tyrie-to-the-secretary-of-state-for-business-energy-and-industrial-strategy

joint loyalty penalty report. UKRN was identified as a possible vehicle for this work as part of its work on performance scorecards.

33. UKRN, and some regulators have recently published their work on performance scorecards.[14] This work identifies a range of metrics that will help to identify where consumers are being well-served by firms and where performance need to improve. These metrics are in relation to: customer satisfaction, service quality, value for money and complaints. We note that the only price differential metrics provided in this exercise were for the energy sector, which was not part of the super-complaint. We would therefore continue to encourage UKRN, Ofcom and the FCA to consider whether future iterations of the performance scorecards could provide an appropriate vehicle to publicise these metrics.

34. Ofcom has separately published information on price differentials for mobile[15] and broadband[16] in published reports, as well as provided a simple guide on the 'Boost your Broadband' website.[17] We welcome Ofcom's publication of this data which provides useful information for consumers. However, we encourage Ofcom to consider whether data on the loyalty penalty could be deployed and presented in a way that provides a reputational incentive for firms to improve their treatment of existing customers.

35. The FCA has not yet published data meeting our recommendation, but is considering options to do so as part of its work in the insurance and cash savings markets. For cash savings, the proposed "sunlight" remedy in paragraph 23 would provide comprehensive information on price differentials if brought into effect. In insurance, requiring firms to publish information on rate differentials is one of the remedies being considered as part of the Market Study. For mortgages, there is no public information at present on rate differentials at the supplier level. We therefore urge FCA to publish relevant data as soon as practicable, while recognising the complexity of the analysis required in these sectors and the procedural steps required in the various markets.

36. We also recommended that regulators 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. In June 2019, we reported that we had completed a feasibility study into how data from firms could be linked

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[14] UKRN Performance Scorecards, 9 January 2020.

[15] Ofcom: Helping consumers to get better deals in communications markets: mobile handsets, July 2019.

[16] Ofcom: A review of pricing practices in fixed broadband, September 2019.

[17] https://www.boostyourbroadband.com/

to a large high-quality survey on consumer characteristics to produce a comprehensive dataset. Ofcom plans to trial the matching of customer records held by providers to new survey evidence on vulnerable customers (being gathered later this year) to help further strengthen evidence on the outcomes of vulnerable consumers in the telecoms market. While we recognise the difficulties involved in data-matching, we encourage regulators to keep seeking means to achieve this, bringing data together in powerful ways that can serve consumers better.

Next Steps

37. Over 12 months on from our report, there has been some good progress by regulators and we recognise the detailed and in-depth analysis of the issues in the various markets over the last 12 months. However, this work remains far from complete and the focus of the regulators must now be on putting in place sufficiently strong remedies to address those problems. We recognise that the process of investigating markets and designing, testing and implementing effective remedies takes time. That said, it is important to remember that consumer detriment is on-going in the five markets.

38. We also welcome the Government's previous commitment to legislate for civil fines to be available where companies break the law. We look forward to working with Government on how to achieve a direct enforcement model, where the CMA (and potentially other enforcers who wish it) are empowered to decide whether consumer protection law has been broken and to impose fines directly.

39. The CMA remains committed to making sure the issues which have been identified in the super-complaint are effectively tackled in the five markets and across the whole economy. We will publish a further update in July 2020, at which point a number of the pieces of work underway will have reached significant milestones. This will allow us to make a fuller assessment of the extent to which the actions taken will effectively tackle the loyalty penalty in the five markets and give a clearer view of where it may be necessary to go further, in the five markets and the wider economy.