July 2020: Loyalty Penalty Update

Introduction

1. In September 2018 Citizens Advice submitted a super-complaint to the CMA raising concerns about the loyalty penalty[1] in five markets (mobile, broadband, cash savings, mortgages and insurance). In our super-complaint response, we found that this is a significant issue and that action was needed to effectively tackle the loyalty penalty. We set out a package of recommendations to the regulators of the five markets - Ofcom and the FCA - as well as cross-cutting recommendations to Government and regulators more generally.

2. We have continued to engage with regulators and Government on this important issue. This update considers progress since our last update in January 2020 which has been impacted significantly by Coronavirus (COVID-19).

Recent developments - impact of COVID-19

3. Since our last update, the COVID-19 pandemic has been having a significant impact across all aspects of the economy, affecting consumers and businesses. Many consumers are under increasing financial pressures, with levels of problem debt reportedly rising.[2] Businesses are also facing major challenges and ongoing uncertainties; for many the focus has been on building resilience and ensuring continuity of service.

4. COVID-19 has also affected all five markets we looked at. These markets provide essential services and therefore their effective operation and resilience is critical, particularly at this time. For example:

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[1] 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] For example, research by the debt advice charity StepChange estimated that as of late May 2020, 6 million people negatively affected had accumulated £6.1 billion of arrears and debt, averaging £1,076 in arrears and £997 in debt per adult affected. https://www.stepchange.org/policy-and-research/debt-research/post-covid-personal-debt.aspx

(a) in broadband, usage has significantly increased as people work and learn from home following government lockdown measures; some broadband providers have reported an increase between 35% and 60% in weekday daytime traffic;[3] and

(b) in mortgages, over 1.8 million mortgage payment holidays were taken up when the scheme was first announced in March,[4] as many consumers are facing financial difficulties.

5. It has also had an effect on the work of the CMA and sector regulators; in particular, on the timeframe for the FCA and Ofcom's ongoing work on tackling the loyalty penalty in the five markets they regulate.

6. Nevertheless, it remains important, now more than ever, that people staying with their provider are not paying more than they need to, and that they are not being unfairly misled into paying a loyalty penalty. Businesses must act fairly and transparently to ensure that they do not exploit their longstanding customers and undermine trust in markets.

7. People are facing additional pressures as a result of COVID-19 that require their attention and focus. They should not also continually have to be 'on their guard' to ensure they are not being ripped off as contracts come up for renewal. Businesses need to give their customers clear accessible information about the prices they are paying as well as sufficient warning when contracts are ending, to enable customers to switch easily or renegotiate.

8. While it is too early to understand the longer-term implications of COVID-19 for markets and consumer interactions relevant to the loyalty penalty, it is clear that in the short term at least there are some important considerations. For example, many businesses have had to change or adapt their operations due to reduced staff availability. We recognise that this has put pressure on firms. However, it may also make it harder for customers to switch or to renegotiate a better deal with their existing provider. Some consumers may also generally be more cautious about changing providers at this time. It's therefore imperative that businesses do what they can to support their customers and ensure it is as easy as possible for them to access good deals.

9. This is particularly important for vulnerable consumers. Our super-complaint response found that the elderly, those with physical disabilities or mental

[3] Since the start of lockdown on 23 March 2020 to mid-May 2020. https://www.ofcom.org.uk/about-ofcom/latest/features-and-news/broadband-networks-stand-firm-during-pandemic

[4] https://www.gov.uk/government/news/help-with-mortgages-to-continue-for-homeowners-affected-by-coronavirus

health problems, those on a low income or those who struggle to use or access online services, were in general more likely to experience difficulties switching or renegotiating to get a better deal. When combined with the impacts of COVID-19, these groups may be even more at risk of experiencing harm from the loyalty penalty. Businesses should take into account that some customers may require additional support during this difficult time.

Stopping harmful business practices

10. Tackling the types of unfair business practices that make it more difficult to avoid paying a loyalty penalty is key to restoring consumer trust in markets. These include practices like 'stealth' price rises, rolling customers over without warning or making it more difficult to leave than signing up. Building people's trust in markets can also play an important part in helping to restore our economy and help businesses to thrive. Our super-complaint response set out recommendations to help stop these harmful practices including through enforcing consumer law and by strengthening consumer protection law. We launched consumer law enforcement cases in the anti-virus software sector and the online video gaming sector, which are continuing to be progressed. We expect to say more over the coming months.

11. We have also seen other types of harmful business practices that exploit consumers emerging in the context of COVID-19 - such as 'price gouging', unjustifiably increasing prices of certain products like hand sanitiser, and consumers struggling to get refunds for services that have been cancelled during lockdown.

12. In normal times the CMA would not necessarily be concerned with price rises in markets, as a response to changes in demand and/or supply, as this makes the market readjust to a competitive position. However, COVID-19 has led to markets functioning in unusual ways, with short term spikes in demand and disruptions to supply. We've received complaints that a small minority of businesses have been exploiting this to drive up prices to levels that cannot be justified by cost increases. This is concerning, particularly as the price rises relate to products seen as essential and exploit the restrictions on movement put in place as part of government 'lockdown' measures, which has meant that consumers cannot shop around as much and have had to shop more locally. These high price rises take advantage of the vulnerable position of consumers and their short-term market power arising from these unusual circumstances, rather than signalling the need for increased supply. The TaskForce's July update considers these issues in more detail. Much like the loyalty penalty, these types of behaviour are based on businesses' ability

to exploit consumers, particularly vulnerable people like the elderly who may have restricted mobility and others who cannot shop around as easily.

13. Through this TaskForce the CMA has been investigating these exploitative practices in more detail. We have been taking action using our powers to their fullest extent, including issuing guidance to businesses and consumers, writing to trade and industry bodies. We have also launched investigations into suspected charging of excessive and unfair prices for hand sanitiser, written a joint statement with several trade associations condemning price gouging and launched investigations looking at cancellation/refund issues in wedding and private events, holiday accommodation and package holidays, and nurseries and childcare provision. While these types of practices have generally been seen amongst a minority of businesses, they are still unacceptable. Although businesses are facing difficulties, consumers must still be treated fairly.

14. The CMA will continue to use its powers to protect consumers. However, as we set out in our super-complaint response, there is scope for consumer law and the CMA's powers to be strengthened to enable us to more effectively tackle different types of harmful pricing practices like loyalty penalties. We welcome the Government's support for giving the CMA new powers to fine businesses for breaking consumer law.[5] We have also advised Government on legislative changes that would enable a faster and more robust response to the types of unjustifiable price rises seen during the COVID-19. We will continue to work with the government to ensure our powers and consumer law are sufficient to protect consumers.

15. The CMA will continue to monitor business practices, particularly in the context of COVID-19 and take action where needed.

Ongoing work by regulators on the loyalty penalty

16. Regulators have a key role in protecting consumers and supporting businesses in the markets they regulate during this difficult time. Ofcom and the FCA, among others, have been working with businesses to ensure that services in their markets are continuing to operate and that consumers are getting sufficient support, particularly vulnerable consumers and those facing financial hardship at this current time.[6] Responding to the current challenges

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[5] 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, without the need to go through a court.

[6] For example, on 1 April Ofcom published a statement on how broadband and mobile firms are servicing consumers, and in May the FCA has issued statements setting out proposals to support consumers in mortgages and insurance who may be in financial difficulty due to COVID-19, including revised actions for firms where appropriate.

and the wider implications arising from this crisis, has rightly been a key priority over the past few months.

17. Both Ofcom and the FCA have also made progress in their work on the loyalty penalty since our last update. However work has in most cases understandably been delayed as the regulators focus on the impacts of COVID-19 in their markets.

Telecoms - broadband and mobile

18. In **broadband**, Ofcom has undertaken further work on pricing following its September 2019 report which will be published later this month, as part of their ongoing work to consider loyalty penalty concerns in the sector. This will look at the price differential faced by consumers who are out-of-contract, as well as assessing the impact of providers' actions to help their customers - especially those in vulnerable circumstances. We welcome this further work by Ofcom to understand the issues in broadband and which consumers are most affected. It is important to have a consistent approach to data collection in order to develop an understanding of the issues that vulnerable consumers face across the market, to ensure they are not unfairly disadvantaged, as well as to enable more accurate comparisons across providers.

19. We also encourage Ofcom to consider ways to ensure that the support by providers to vulnerable consumers is consistent across the sector. We remain concerned that different changes from different providers (most of which will come into effect by the end of the year) will not be as equally effective at tackling the loyalty penalty and may also confuse consumers. Ofcom's forthcoming new guidance for providers on treating vulnerable consumers fairly will help with this to some extent, though progress by providers should be carefully monitored.

20. It is vital to understand the effectiveness of past interventions, to inform the development of further remedies where needed such as special tariffs to protect customers on low incomes and exploring the benefits of collective switching.[7] We therefore welcome Ofcom's ongoing work to monitor consumer outcomes, as set out in its 2020/21 workplan, and encourage Ofcom to report on its findings when appropriate. We recognise that it is important to ensure people across all parts of the UK have access to broadband and that there is sufficient business investment in the

[7] Collective switching typically entails a third party negotiating a better 'group' deal and offering this to consumers. It may involve an intermediary signing up customers and then approaching suppliers to negotiate special deals. In its simplest form, a collective switch provider would then offer each member of the group the same single offer on an opt in or opt out basis. More complex forms include offering more than one deal for customers to choose between.

infrastructure to enable the roll out of gigabit capable networks such as 5G. This is clearly a priority, now more than ever. Alongside this, it is also important that customers are treated fairly and not exploited, which means that sufficient protections must be in place, particularly for those who are more vulnerable.

21. **In broadband and mobile,** rules introduced by Ofcom came into effect in February 2020 for providers to notify customers when their contracts are coming to an end and tell them if they have any better deals available. It is too early to say how successful these end of contract notifications have been in tackling the loyalty penalty in these markets. The notifications are a welcome step, although it is possible that some consumers will remain on much poorer deals. We therefore welcome Ofcom's plans to monitor and report on the impact of these new requirements on the loyalty penalty. We urge Ofcom to ensure that providers are fulfilling their obligations to consumers, and to take further steps if needed.

22. **In mobile**, earlier this year voluntary commitments from a number of major mobile service providers excluding Three came into effect. O2 has since extended its commitment to customers who purchased their contract through Carphone Warehouse, which is a welcome step toward protecting more consumers. We expect Ofcom to monitor the outcomes of these commitments, and to take further action against providers where necessary. However, we continue to be significantly concerned that Three has not engaged with the process. We urge Ofcom to consider what more can be done to ensure Three's customers are not being unfairly disadvantaged. As in broadband, we encourage Ofcom to consider whether further measures need to be taken across the market to ensure the loyalty penalty is tackled equally effectively across the different providers.

23. Ofcom is also undertaking work on the affordability of telecoms services, which it is due to publish later this year. This work is particularly important given the financial pressures on consumers arising from COVID-19. As we set out in January, as part of this work we expect Ofcom to consider appropriate interventions, including direct interventions like social tariffs to protect consumers - particularly those who may be considered vulnerable - in their markets.

Financial services - mortgages, insurance and cash savings

24. Following the CMA's recommendation, in March the FCA published research in **mortgages** looking into the 10% of longstanding consumers who do not switch even though they could. The FCA found that overall these customers are not generally vulnerable, though those who did not switch were more

likely to be older than those who did. The three main reasons customers gave for not switching were: they are content with their deal and many are loyal to their lender; thinking that it is too difficult; or underestimating the benefits of switching. The FCA's mortgages market study estimated that these individuals miss out on an average saving of £1,000 per year over the first two years of switching, and £100 a year thereafter. The FCA plans to publish a consultation paper setting out proposed rule changes to help this group of consumers, which has been delayed until later this year. We encourage the FCA to look at ways to reach these consumers to encourage them to switch where they can get better deals elsewhere, particularly given the potential savings that could be made.

25. Earlier this year, the FCA also published research on 'mortgage prisoners' - consumers who for various reasons cannot switch providers. Last year the FCA announced modified affordability criteria intended to make it easier for some of these consumers to switch providers. However, COVID-19 has meant that many lenders have been unable to offer new means of helping mortgage prisoners. Given this, administrators now have until 1 December 2020 to contact relevant customers about switching options by which point it is anticipated that new products will be in place. The FCA is keeping the market under review and working with industry to get new switching options in place. However there remains a substantial proportion of mortgage prisoners that won't benefit from these changes as lenders may not consider them to be commercially suitable.

26. Many mortgage customers, including mortgage prisoners, are under significant financial pressure due to COVID-19 and are in need of additional support at this time. We welcome the action taken by FCA in response to COVID-19 to introduce broader market-wide interventions such as mortgage payment deferrals and stopping repossession activity, which are beneficial to all consumers (including mortgage prisoners). We understand that the FCA is keeping the need for these interventions, which currently last until 31 October 2021, under review. The FCA has also committed to continue to look at what further steps it can take to support mortgage borrowers affected by COVID-19. We share concerns about the challenges faced by many given the current situation, including mortgage prisoners.

27. In **cash savings**, consultation on a Single Easy Access Rate (SEAR), which will operate in a similar way to the previously proposed Basic Savings Rate, has been extended to October due to COVID-19. We welcome the FCA's proposals and look forward to the outcome of the consultation.

28. In **insurance**, the FCA's final report on its general insurance pricing practices market study, which will importantly set out remedies, has also been

postponed. In its interim findings published in October 2019, the FCA found that six million policy holders paid high prices in 2018 and could have saved £1.2 billion (if they paid the average premium for their risk). While the insurance sector, like many others, is facing a number of challenges as a result of COVID-19, we consider that an effective set of remedies are nevertheless needed in this market to address the scale of the problems the FCA provisionally found. We strongly support taking this work forward and the need for sufficient remedies to tackle the loyalty penalty in this sector.

Next steps

29. COVID-19 has had a significant effect on consumers and on businesses in the five markets, as well as on the work being undertaken by the regulators. It has also further highlighted the essential nature of these services and the potential for unfair exploitative business practices. Tackling the loyalty penalty continues to be important, alongside tackling other practices that have arisen during COVID-19 such as price gouging. While businesses are clearly facing difficulties, there is no justification for misleading consumers or treating them unfairly. Businesses can build confidence and trust with their customers by supporting them through this difficult time.

30. We are continuing to engage with regulators and Government on their work in this area. While progress continues to be made, work in this area is still ongoing and some has necessarily been postponed due to COVID-19. Given the importance of protecting consumers now more than ever, where possible we encourage regulators to continue to progress their work and ensure that effective interventions to address the problems are put in place.

31. The CMA remains committed to making sure the issues which were identified in the super-complaint are effectively tackled in the five markets and across the economy. We've commissioned research - a comprehensive assessment of the existing relevant economic literature - to build on our understanding and evaluation of the economic impacts of loyalty penalties in markets. This will also help to inform thinking about the effectiveness of different types of interventions to address loyalty penalty issues. We will be publishing this research later in the year and will consider the findings and its implications for tackling the loyalty penalty.

32. We will continue to review progress and provide a further update at the end of this year/early next, which will mark two years on from our super-complaint response.