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The Loyalty Penalty Super-Complaint: New Challenges for the CMA

Introduction

On 28 September, Citizens Advice lodged a "super-complaint" ("**Super-Complaint**") with the Competition and Markets Authority ("**CMA**") to ask the CMA to investigate *"[d]eep, structural price discrimination against disengaged and loyal consumers"*. Citizens Advice is concerned that loyal customers across five "essential" markets (i.e. mobile, broadband, home insurance, fixed rate mortgages, savings accounts) who stay with a provider of a certain product end up paying higher rates than new customers who accept more favourable offers (otherwise referred to as a "loyalty penalty"). Chief executive Gillian Guy has said: "*As a result of this super complaint, the CMA should come up with concrete measures to end this systematic scam.*"

Although the Super-Complaint will primarily be handled by the CMA, loyalty penalties have been on the radar of several regulators in the UK, in particular the Financial Conduct Authority ("**FCA**"). The FCA has confirmed that it will work closely with the CMA on the investigation and the Office of Communications ("**Ofcom**") will also be engaged by the CMA.

The Super-Complaint

So what does the Super-Complaint say ultimately? It explains that the loyalty penalty is described as the difference between the prices that are paid by loyal customers who stay with their provider (often on default or roll over contracts) and the prices paid by new customers for the same service. It also says that 8 out of 10 people responsible for household bills are paying the loyalty penalty in at least one of the five markets and that those experiencing the loyalty penalty in all five would be paying up to £877 more for those services per year – an overall loss to consumers of £4.1 billion per year. Citizens Advice has also found that more vulnerable consumer groups (including older people, and those with mental health issues, those on low incomes and those with lower levels of formal education) were disproportionately affected by the loyalty penalty.

And more specifically, in respect of the five markets identified and analysed in the Super-Complaint, it appears that:

- *Mobile (including handset)*: 34% of people are likely to be paying a loyalty penalty. This would result in an overpayment of £264 when people remain on a contract for a year after they have paid for the handset, if paying the average monthly penalty.
- *Broadband*: 43% of people are likely to be paying a loyalty penalty of £113 per year (that amount being the difference between the cheapest basic broadband contract and the price paid after the initial contract period ends).
- *Home insurance*: 47% of people are likely to be paying a loyalty penalty of £13 per year, increasing over time. This is the average difference between the initial price paid and the price offered on renewal after one year, based on the average cheapest combined premium.
- *Fixed rate mortgages*: 10% are likely to be paying a loyalty penalty, amounting to £439 per year (calculated as the difference between the amount that would be paid once a customer was moved to a standard variable rate after a 2 year fixed rate mortgage term ended, and the amount they would pay as a new customer with a fixed rate).
- *Savings accounts*: 37% are likely to be paying a loyalty penalty of £48 per year. Citizens Advice calculated this amount as the difference between interest paid on a one year fixed-rate cash ISA taken out in March 2016, and the interest earned when moved to a variable rate in March 2017.

However, the Super-Complaint also noted that these are not the only areas in which the loyalty penalty arises:

> *"Any market where customers are automatically placed on a standard rate upon expiry of an initial deal will be a candidate for this structural market failure."*

Citizens Advice has suggested ways in which the problem could be addressed in some markets, including ending the practice of charging for a mobile handset after expiry of the minimum contract term, considering whether a relative cap on mortgages might be appropriate, or assessing whether a basic savings rate could be strengthened. However, it considers that the CMA is best placed to evaluate the relative pros and cons of potential remedies, and propose a comprehensive solution.

What is a Super-Complaint?

By way of background, the Enterprise Act 2002 provides that a designated consumer body (so designated by order of the Secretary of State) may make a complaint (called a super-complaint) to the CMA that any feature, or combination of features, of a market in the United Kingdom for goods or services is or appears to be significantly harming the interests of consumers.[1] The CMA must, within 90 days after the day following receipt of the super-complaint, publish a response stating how it proposes to deal with the complaint (together with the underlying reasons). In particular, the CMA must decide: (a) whether to take any action, or to take no action, in response to the complaint, and (b) if it has decided to take action, what action it proposes to take.

Potential Outcomes

The CMA will engage with Ofcom and the FCA during its 90 day investigation of the Super-Complaint, and is currently seeking evidence and views from interested parties (by 14 October 2018), in particular on the following:

- The CMA would like their views on the existence, impact and root causes of a 'loyalty penalty' for consumers across mobile, broadband, savings accounts, home insurance and mortgages, and any others;
- Whether there are circumstances in which a 'loyalty penalty' is not problematic at all or where it is particularly problematic, and if so why?
- What specific additional challenges vulnerable consumers experience and whether there should be additional protections?
- What measures to tackle any 'loyalty penalty' should be considered, including those suggested by Citizens Advice and any others. Parties are asked to explain how the measures would effectively address the problem.[2]

Whilst Citizens Advice has stated that it believes that a market study will be necessary following the investigation, alternative (or in some instances additional) outcomes could include recommendations being made to government to change legislation; action being taken by Ofcom or the FCA; competition or consumer enforcement action being taken; or a decision that there is no action required.

It is difficult to predict what the outcome will be at this stage and we will need to wait and see what next steps the CMA takes in this respect. However, although this is the first super-complaint submitted by Citizens Advice for seven years, its previous super-complaints have successfully prompted changes in the relevant markets as a result of the concerns raised. For instance:

- *Cold-calling and upfront fees (2011)*: in response the (then) Office of Fair Trading (**"OFT"**) announced targeted enforcement action, including the revocation of consumer credit licences where appropriate. It also published two new pieces of guidance, and asked the Government to consider whether new legislation was needed.[3]
- *Payment Protection Insurance (2005)*: the complaint prompted the OFT to open a market study, which resulted in a market investigation reference to the (then) Competition Commission in 2007.[4]
- *Doorstep Selling (2002)*: the complaint prompted the OFT to launch a market study which completed in 2004 and made a number of recommendations for action by Government and resulted in a consumer education campaign run by the OFT.[5]

Consumer Focus (which was integrated into Citizens Advice and Citizens Advice Scotland in 2014) also brought a super-complaint in 2011 relating to cash ISAs. Although the OFT decided not to make a market investigation reference following its investigation, the industry agreed to adopt various measures to address concerns relating to transparency.[6]

[1] Enterprise Act 2002, Part I, section 11(1)
[2] https://www.gov.uk/cma-cases/loyalty-penalty-super-complaint

[3] OFT press release *"OFT announces package of measures to address concerns over credit practices"*, 62/11, 1 June 2011
[4] OFT press release *"OFT refers the PPI market to the Competition Commission"*, 15/07, 7 February 2007
[5] OFT press release *"Doorstep selling laws inadequate, OFT identifies six hard-sell tactics"*, 83/04, 12 May 2004
[6] OFT press release "OFT secures improvements for cash ISA customers following super-complaint", 69/10, 29 June 2010

Other Relevant Investigations

Is this the first time that the issue of loyalty penalties has arisen? As referenced in the Super-Complaint, this issue has been considered in the context of various investigations conducted by the CMA, Ofcom and the FCA. Of these, ongoing (and anticipated) studies and consultations include:

- *Ofcom research*: A research document published by Ofcom[7] notes that broadband customers outside their minimum contract term typically pay a non-discounted price. Ofcom started work in July 2017 to try to better understand difficulties engaging in communications markets, and to help to identify and implement solutions. Ofcom is focusing initially on end-of-contract notifications, and published a series of pieces of quantitative research in April – July 2018.[8] Proposals may be published shortly.[9]
- *Ofcom Consultation*: On 26 September 2018 Ofcom published a consultation document[10] seeking views on potential solutions to the issue that many mobile customers on bundled handset and airtime contracts continue to pay the same price after the end of their minimum contract period. Potential solutions include achieving greater transparency beyond end-of-contract notifications, the introduction of fairer default tariffs that would apply at the end of the minimum contract period, and/or requiring separate contracts for handsets and airtime, where the handset payments stop at the end of a fixed period. Comments are requested by 7 November 2018.
- *FCA Insurance Market Study*: In a statement responding to the submission of the Super-Complaint,[11] the FCA noted the announcement in its 2018/2019 Business Plan that it was looking at the pricing practices of general insurance firms. As part of that work it will be launching a market study looking at how general insurance firms charge their customers for home and motor insurance. The terms of reference for this market study will be published in a few weeks' time.

  Moreover, the Director General of the Association of British Insurers, Huw Evans, has said in relation to long-standing customers losing out: *"The insurance industry recognises this is a problem and earlier this year became the first and only sector to take voluntary, industry-wide action to tackle it. This includes commitments from firms to review premiums charged to customers who have been with them for five years, and the industry publishing a report on progress within two years."*
- *FCA Mortgages Market Study*: the FCA considered the level of switching in the market, including why consumers do not switch products when they would benefit from doing so. The interim report (published in May 2018) acknowledges that there is more that can be done to help these consumers[12] and the FCA is consulting on potential ways in which it could be made easier for less active consumers who have been on a reversion rate for an extended period of time to switch products with their existing lender, if it is in their interests to do so.[13] The FCA's final report is expected in Winter 2018.
- *FCA Cash Savings Market Study*: the FCA's final report (published in January 2015[14]) confirmed that the cash savings market was not working well for many consumers. This referred *inter alia* to providers having significant savings balances in accounts opened more than five years ago paying lower interest rates than those opened recently, and perceived switching difficulties. Various remedies were proposed to address the issues, and studies conducted into their impact[15]. The FCA recently published a Discussion Paper on price discrimination in the cash savings market, noting their concern that competition is not working well - particularly for longstanding customers – and inviting comments by 25 October 2018 on options to address it, including the introduction of a basic savings rate.[16]

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[7] *"Pricing trends for communications services in the UK"*, 17 May 2018

[8] Including *"Consumer Engagement with Communication Services, a Qualitative Research Study, Final Report"*, April 2018; Ofcom Kantar Media consumer research January 2018, published May 2018; *"End-of-contract notifications, Attitudes to and understanding of alternative content options Research Findings"* July 2018

[9] Ofcom indicated that it expected to publish proposals in July 2018, supported by detailed analysis and research

[10] *"Helping consumers to get better deals in communications markets: mobile handsets"*, 26 September 2018

[11] "*Financial Conduct Authority FCA statement on Citizens Advice super complaint*", RNS Number: 2943C, 28 September 2018

[12] Mortgages Market Study, Interim report - Market Study MS16/2.2, May 2018, paragraph 6.41

[13] Interim report paragraphs 9.34-9.38

[14] Cash savings market study report: Part I: Final findings, Part II: Proposed remedies, January 2015, Market Study MS14/2.3

[15] For example, *"Attention, Search and Switching: Evidence on Mandated Disclosure from the Savings Market"* July 2016, Occasional Paper 19

[16] *"Price discrimination in the cash savings market"*, Discussion Paper DP18/6, July 2018

Finally, the submission of the Super-Complaint to the CMA coincided with the launch by the Government of its Smart Data Review,[17] which considers how the development and use of new data-driven technologies and services can be accelerated to improve consumer outcomes in regulated markets. It notes that consumers that do not switch or engage often pay considerably more, and that new technologies – including automatic switching services and utility management services – could potentially address some of these issues.

Comment

The Super-Complaint appears to pose some new challenges for the CMA, in particular in relation to the possible breadth of its scope (potentially extending to any market where customers are automatically placed on a standard rate upon expiry of an initial deal) and its interaction with the ongoing investigations and consultations outlined above, as well as recently announced initiatives. The "fast-track" 90 day period of investigation does not leave the CMA with much time to analyse a market and reach a view on the concerns raised, as well as consider potential remedies to address issues identified. The impact of the timing constraint will only be exacerbated with the potential scope of the Super-Complaint.

The fact that the loyalty penalty – and underlying consumer disengagement – have already been identified as a current problem in the markets covered in the Super-Complaint may well be helpful, as well as the detailed analysis that has already been conducted by sectoral regulators and the proposed solutions being discussed in some areas (though without a specific focus on the vulnerable consumers highlighted by Citizens Advice as being the most adversely impacted). However, the various market study and consultation timetables do not as we say correspond with the 90 day statutory deadline for responding to the Super-Complaint, which may be problematic, notwithstanding the FCA's statement that they will *"work closely with the CMA as they investigate [it]"*.[18] It is also likely to be too early to properly assess the impact of the action voluntarily taken by the insurance industry, and the insurance market study has only just been announced by the FCA.

Another more general hurdle will likely be presented by the lack of a "one size fits all" solution across the various markets. Instead, different solutions are likely to be appropriate depending on the individual market structure and level of regulation. Against this background, it will be interesting to see how the CMA will engage with the FCA and Ofcom to address the matters raised in the Super-Complaint within the 90 day period, and how it will ultimately choose to respond.

In the meantime, we would anticipate that the CMA may receive a large number of responses from interested parties in response to the questions posed. Such parties are likely to include not only other consumer organisations and charities with first-hand experience of the impact of the loyalty penalty (particularly those representing the vulnerable consumers identified in the Super-Complaint), but also price comparison and switching platforms, financial advisers and industry bodies.[19] Stakeholders involved in the FCA's market studies, or responding to Ofcom's consultations, may also consider submitting their views to the CMA within its initial investigation phase to make the CMA aware of recent industry action taken or upcoming initiatives, notwithstanding the differing timetables and phases of enquiry.

Contact us

If you would like any further information, or if a brief discussion on any of the issues arising in this briefing would be helpful, please do not hesitate to get in touch.

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[17] The terms of reference were published on 28 September 2018

[18] "*Financial Conduct Authority FCA statement on Citizens Advice super complaint*", RNS Number: 2943C, 28 September 2018

[19] Indeed, the Internet Services Providers' Association has already commented publicly on the Super-Complaint: *"With a consultation ongoing, we feel that Citizen Advice is jumping the gun in relation to the broadband market"*