

## COMPETITIONS AND MARKETS AUTHORITY (CMA) INVITATION TO COMMENT: 'LOYALTY PENALTY' SUPER-COMPLAINT

OCTOBER 2018

### **1. INTRODUCTION**

- 1.1. Fair By Design welcomes the Competition and Market Authority's invitation to comment on the Citizens Advice's 'loyalty penalty' super-complaint.
- 1.2. Please note that we consent to public disclosure of this response.
- 1.3. For more invitation about this response please contact Lucie Russell, [l.russell@barrowcadbury.org.uk](mailto:l.russell@barrowcadbury.org.uk) Tel: 020 7632 9070.

### **2. ABOUT FAIR BY DESIGN**

- 2.1. Fair by Design is a movement dedicated to reshaping essential services, like energy, finance and insurance, so they don't cost more if you're poor.
- 2.2. People in poverty pay more for a range of products including expensive energy tariffs for pre-payment meters, high cost loans, rent to own products such as kitchen appliances, and insurance in poorer postcodes. This is known as the Poverty Premium.
- 2.3. We collaborate with industry, government, and regulators to design out the Poverty Premium, and raise awareness amongst the public to bring about change.
- 2.4. Our venture fund provides capital to help grow new and scalable ventures to innovate the market.
- 2.5. Fair by Design was conceived by the Joseph Rowntree Foundation and Big Society Capital and is being led by the Barrow Cadbury Trust.

## **RESPONSE TO CMA INVITATION TO COMMENT: 'LOYALTY PENALTY' SUPER-COMPLAINT**

### **3. WHAT ARE YOUR VIEWS ON THE EXISTENCE, IMPACT AND ROOT CAUSES OF A 'LOYALTY PENALTY' FOR CONSUMERS ACROSS MARKETS; INCLUDING THE FIVE IDENTIFIED BY CITIZENS ADVICE (MOBILE, BROADBAND, SAVINGS ACCOUNTS, HOME INSURANCE AND MORTGAGES) AND ANY OTHERS?**

We have sectioned our responses below into existence, impact and root causes. We have focused on the energy and insurance markets which are two of the three areas being covered by the Fair By Design campaign.

**3.1 Existence;** we welcome the focus by the CMA on the Poverty Premium, of which the loyalty penalty is a key driver.

#### **3.1.1. Energy:**

3.1.1.1. In one of his first policy interventions since becoming chair of the Competition and Markets Authority, Andrew Tyrie vowed to tackle the "Poverty Premium" through more vigorous enforcement of the law and market wide interventions. He also said that if necessary the CMA would seek new legislative powers.<sup>1</sup>

3.1.0.1. The CMA's energy market investigation found that customers on low incomes, disabilities, and limited levels of education are less likely to use Price Comparison Websites (PCWs)<sup>2</sup>, leaving them more likely to be exploited by price rises and penalties for loyalty that companies regularly impose. Additionally, 39 percent of customers living in low income households (earning less than £16,000) have never switched supplier.<sup>3</sup>

3.1.0.2. The Conservative manifesto also highlights the loyalty penalty, and its impact on certain groups of consumers: "We will pay immediate attention to the retail energy market. Customers trust established brands and mistakenly assume their loyalty is rewarded. Energy suppliers have long operated a two-tier market, where those constantly checking for the best deal can do well but others are punished for inactivity with higher prices. Those hit worst are households with lower incomes, people with lower qualifications, people who rent their home and the elderly."<sup>4</sup>

3.1.0.3. This was reiterated in the Department for BEIS' consumer green paper 'Modernizing consumer markets': "In energy...and financial services, firms charge increasingly higher prices to customers who have not recently switched provider...and it is often the vulnerable who suffer disproportionately...huge choice...can be complex and difficult for consumers to compare."<sup>5</sup>

3.1.0.4. The existence of the loyalty penalty in energy and other sectors was also acknowledged by Theresa May in a Guardian comment piece:

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1 <https://www.ft.com/content/80a97128-8f2c-11e8-b639-7680cedcc421>

2 Competition and Markets Authority, 2016, 'Energy Market Investigation - Summary of Final Report'

3 Ibid

4 <https://s3.eu-west-2.amazonaws.com/conservative-party-manifestos/Forward+Together+-+Our+Plan+for+a+Stronger+Britain+and+a+More+Prosperous....pdf>

5 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/699937/modernising-consumer-markets-green-paper.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/699937/modernising-consumer-markets-green-paper.pdf)

“From this winter, our energy price cap will stop loyal customers paying unfair prices. Where other companies are charging their customers a “loyalty penalty”, we will take action.”<sup>6</sup>

3.1.0.5. Ofgem estimated that 64 percent of accounts with the ‘Big Six’ energy suppliers were on a Standard Variable Tariff (SVT)<sup>7</sup> These tariffs offer the poorest value for consumers, and furthermore the high percentage indicates that switching to cheapest deals is not occurring.

3.1.0.6. Morgan Wild from Citizens Advice giving testimony at an APPG on Poverty said: “Clients are five times more likely to be in poverty. Citizens Advice sees the coalface issues with people experiencing high costs as a result of the Poverty Premium. Markets are often not servicing consumers’ needs and need to be better regulated to take action to reduce the premium. One of the biggest ways in which markets fail poorer consumers is through the loyalty penalty: poorer consumers are disproportionately less likely to be on the best deals – especially for energy. They are 30% more likely to be paying a loyalty penalty for energy, 20% more likely for insurance and 100% for broadband. The loyalty penalty amounts to a cost of £1,000 per annum across six essential markets. The lowest income consumers may lack access to online deals, may not be thinking as a consumer and therefore may not be aware that there is an option to switch provider, and so pay a loyalty penalty.”<sup>8</sup>

### 3.1.1. Insurance:

3.1.1.1. The Association of British Insurers Chairman Andy Briggs said: “Insurers do a great job for their customers, providing peace of mind and financial help when they most need it, but the renewal market simply doesn’t work where loyal customers get charged much more than new customers. “Given many consumers expect to get cheaper insurance when they shop around, there is no easy solution. These new Guiding Principles and Action Points are a positive initiative by the ABI and BIBA members to demonstrate that the whole industry recognise this is an important issue that needs to be addressed.”<sup>9</sup>

3.1.1.2. “The insurance loyalty penalty’ report produced by Citizens Advice found that:

- Across the UK, 12.9m households are paying a loyalty penalty - 63% of the home insurance market.
- 1 in 3 customers purchased their policy over 5 years ago. These people could be paying up to 70% more for a policy than a new customer.
- Since new regulations came into force, people are more likely to notice price increases (24% vs 19%). However, 32% of consumers still renewed their policy without checking for better deals first. And a number of firms did not fully comply with the regulations.

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<sup>6</sup> <https://www.theguardian.com/commentisfree/2018/oct/06/theresa-may-labour-voters-look-again-tory-party>

<sup>7</sup> Social Market Foundation, Eliminating the Poverty Premium in energy (2018)

<sup>8</sup> <http://www.appgpoverty.org.uk/wp-content/uploads/2018/05/Minutes-APPG-on-Poverty-18-April-2018.pdf>

<sup>9</sup> <https://www.abi.org.uk/news/news-articles/2018/05/insurance-industry-takes-action-on-excessive-differences-between-new-customer-premiums-and-renewals/>

- Insurance markets are very complex. Among those who identified an unexplained increase in their premium, only 7% renewed without shopping around. But just 53% of insurance customers are confident they could identify unfair charges - so many are unlikely to act.<sup>10</sup>

3.1.1.3. The Financial Ombudsman in its 'ombudsman news' highlighted that "From the complaints we see, it's clear insurance is an area where people may feel they've been penalized for staying put. In particular, people who've stuck with their insurer for a number of years are telling us they've discovered they're paying far more than new customers – or more than they'd pay for similar cover elsewhere."<sup>11</sup>

## 3.2. Impact

### 3.2.0. Energy:

3.2.0.1. Data from Ofgem shows that the price difference between the average SVT from the 'Big Six' and the cheapest tariff in the market was £308<sup>12</sup>

3.2.0.2. Citizens Advice found that people face a 'loyalty penalty' of up to £110<sup>13</sup>

### 3.2.1. Insurance:

3.2.1.1. Someone with the average cheapest combined policy would pay an extra £13 after 1 year and £110 after 5 years.<sup>14</sup>

3.2.2. These above figures compelling illustrate that the loyalty penalty is a compounder of the Poverty Premium as they actively impact on people's resources and living costs.

## 3.3. Root causes

We view the root causes as having demand and supply-side factors:

### 3.3.0. Demand-side factors

3.3.0.1.1. OFCOM found that low income consumers have less access to the internet: "The proportion of adults in DE6 households who do not go online is almost double the UK average (22% vs. 12%)."<sup>15</sup>

3.3.0.1.2. Lower access rates among low income consumers – in addition to simply not owning a computer or internet-enabled device because of the associate cost – may be down to a lack of the ability to use the internet and online services; or confidence: a fear of crime, lack of trust or not knowing where to start online.

3.3.0.1.3. Additionally, low income consumers are worried about their financial situation and have less capacity (literal and cognitive) to

<sup>10</sup> <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20openalty.pdf>

<sup>11</sup> <https://www.financial-ombudsman.org.uk/publications/ombudsman-news/144/144-insurance-pricing.html>

<sup>12</sup> Social Market Foundation, *Eliminating the Poverty Premium in energy* (2018)

<sup>13</sup> Citizens Advice, *The Cost of Loyalty* 2018

<sup>14</sup> <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20openalty.pdf>

<sup>15</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0011/113222/Adults-Media-Use-and-Attitudes-Report-2018.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0011/113222/Adults-Media-Use-and-Attitudes-Report-2018.pdf)

devote time to managing their utility suppliers.<sup>16</sup> This is known as a 'scarcity mindset'.

### **3.3.0.2. Energy:**

3.3.0.2.1. The University of Bristol found that reasons for low income consumers not switching energy supplier included risk aversion and the need to retain tight budgeting control.<sup>17</sup>

3.3.0.2.2. Low-income consumers may be less ready to take the risk of switching their energy supplier, as the impact of overlapping payments; unexpected charges; or being locked into tariffs that end up being expensive, is perceived to outweigh the benefits.<sup>18</sup>

### **3.3.0.3. Insurance:**

3.3.0.3.1. In cases where premiums had risen year on year, eventually reaching levels that customers – or their relatives considered unfair – the Financial Ombudsman found that people had been counting on businesses to do the right thing.<sup>19</sup>

## **3.3.1. Supply-side factors:**

### **3.3.1.1. Energy:**

3.3.1.1.1. Consumer risk aversion is underpinned by the complex tariff structures within the energy market.<sup>20</sup>

3.3.1.1.2. Use of the word 'Standard' implies the Standard Variable Tariff is the 'normal' price.

### **3.3.1.2. Insurance**

3.3.1.2.1. Citizens Advice found that just 53% of insurance customers are confident they could identify unfair charges<sup>21</sup> – so many are unlikely to act. This is likely the case for all consumers; they simply do not have the capacity to interrogate their policy wording.

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<sup>16</sup> Citizens Advice, [The Cost of Loyalty](#) 2018

<sup>17</sup> Sara Davies *et al*, [Paying to be poor](#) (University of Bristol, 2016)

<sup>18</sup> Social Market Foundation, [Eliminating the Poverty Premium in energy](#) (2018)

<sup>19</sup> [Financial Ombudsman Annual Review 2018](#)

<sup>20</sup> Sara Davies *et al*, [Paying to be poor](#) (University of Bristol, 2016)

<sup>21</sup> <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20penalty.pdf>

**4. ARE THERE CIRCUMSTANCES IN WHICH YOU THINK A ‘LOYALTY PENALTY’ IS NOT PROBLEMATIC AT ALL OR WHERE IT IS PARTICULARLY PROBLEMATIC, AND IF SO WHY?**

- 4.1. The loyalty penalty is particularly problematic because, along with the Poverty Premium, it is part of what we term the ‘unfair costs of living’ where many essential services are priced in a way that end up penalizing certain groups.
- 4.2. People in poverty, older people and those who are vulnerable often face a double whammy of both poverty premiums and loyalty penalties, as these two issues often intersect with one another. This has a range of knock-on effects on their financial resilience, health and wellbeing.

**5. WHAT SPECIFIC ADDITIONAL CHALLENGES DO VULNERABLE CONSUMERS EXPERIENCE AND SHOULD THERE BE ADDITIONAL PROTECTIONS?**

5.1. The FCA’s Financial Lives survey, published in October 2017, suggests that half of UK adults have characteristics of potential vulnerability in relation to their financial resilience and capability.<sup>22</sup> Potential vulnerability covers those who may suffer disproportionately if things go wrong; the reasons for this can vary from suffering a recent life event (such as redundancy, bereavement or divorce) to low financial capability i.e. managing money or knowledge about financial matters. The reason may also be a health-related problem.

**5.2. Mental health:**

5.2.0. Money and Mental Health Policy Institute’s survey found that 82 per cent of people with mental health problems said the thought alone of switching and shopping around was exhausting. Nonetheless, more than two thirds (69 per cent) recognized that switching suppliers is the key to getting the best deal on essential services<sup>23</sup>

**5.3. Elderly consumers:**

5.3.0. Low income: In 2016/17, 16 per cent of pensioners in the UK – 1.9 million – were on low incomes (less than 60 per cent median household income) after housing costs.<sup>24</sup>

5.3.1. Digital exclusion: Age UK’s research found that nearly of quarter 65-74 year olds have not been online recently, defined as within the last three months.<sup>25</sup>

5.3.2. People in vulnerable states are particularly likely to be penalised. 32% of those paying the loyalty penalty are over 65, compared with 23% of the wider population. And those on low incomes or who are disabled are less likely to actively engage in the market when an insurance policy renews.<sup>26</sup>

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<sup>22</sup> <https://www.fca.org.uk/publication/research/financial-lives-consumers-across-uk.pdf>

<sup>23</sup> Money and Mental Health Policy Institute, [Levelling the playing field](#). 2017

<sup>24</sup> Age UK, [Poverty in later life](#), 2018

<sup>25</sup> Age UK, [Everything is online nowadays](#), 2018

<sup>26</sup> <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20penalty.pdf>

5.3.3. The above data illustrates the range of challenges vulnerable consumers' experience. Protections must be provided through targeted and appropriate service design. Vulnerable consumers should not be expected to purely protect themselves by making the right choices about the right products in the context of them having to navigate complex markets, which are often highly challenging for them.

6. WHAT MEASURES TO TACKLE ANY 'LOYALTY PENALTY' SHOULD BE CONSIDERED, INCLUDING THOSE SUGGESTED BY CITIZENS ADVICE AND ANY OTHERS? PLEASE EXPLAIN HOW THESE MEASURES WOULD EFFECTIVELY ADDRESS THE PROBLEM.

6.1. 'Being poor shouldn't cost more' – Fair By Design's roadmap for tackling the Poverty Premium<sup>27</sup> – recommends that the Competition and Markets Authority (CMA), which has been a leader in looking at the Poverty Premium, should lead on a partnership between all relevant regulators to reduce and ultimately remove the Poverty Premium in all its forms. It could start with the higher prices low income consumers pay for essential services, including the extra cost of customer loyalty, learning from good practice in each of their respective sectors. Where they are unable to act they should publicly hand over these problem areas to the Government to take remedial action. By responding to the Citizens Advice Super Complaint by taking concerted action they will be making headway into not only dismantling the loyalty penalty but also impacting the Poverty Premium itself.

6.2. **Energy:**

6.2.0. Market regulation is needed that prevents energy companies from leaving low income and vulnerable customers on expensive standard tariffs when much cheaper tariffs are available. This should be achieved through automatic switching when a fixed term deal expires.

6.2.1. Energy companies should work with social landlords to ensure low income and vulnerable consumers are defaulted onto the cheapest energy tariffs and this is maintained when the property is vacant to prepare for the next tenant.

6.3. **Insurance:**

6.3.0. Regulators need to ensure that Insurance providers supply a comparison with the previous year's price, to help consumers understand how much more they are paying when they renew products.

6.3.1. Companies need to develop lower-premium insurance products specifically for low income and vulnerable consumers, to mitigate against the loyalty penalty. These need to be created using the principals of service user- centred design. Creating these products which will work for low income and vulnerable consumers will thus ensure their auto renewals remain cheaper than generic products.

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<sup>27</sup> <http://fairbydesign.com/wp-content/uploads/2018/09/FbD-Roadmap-Artwork-Web-with-revision.pdf>