Finishing the job on the loyalty penalty

The mortgage and mobile handset markets

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The story so far

What is the loyalty penalty?

In 2018, Citizens Advice made a super-complaint to the Competition and Markets Authority (CMA), that customers who didn't switch at the end of their contract paid a 'loyalty penalty'. We estimated that **loyal customers were overpaying by £4bn** across five essential markets; insurance, mortgages, cash savings, broadband, and mobile handsets.[1]

Our research showed that **consumers can find markets complex and difficult to navigate.** It can be hard for them to know whether they are getting the best deal, and to make informed decisions. We also found that **older people, those on low incomes and people with mental health problems** were more likely to be stung by the loyalty penalty. They find it harder to shop around or switch providers to get a better deal.

Last year we found that

8 in 10

people are still paying the loyalty penalty in at least one market [2]

Why do we need to see action now?

The coronavirus pandemic has made it even harder for people to keep up with their bills. **Around 6 million people have fallen behind** on at least one household bill during the pandemic.[3]

Regulators should be doing all they can to prevent the **unfair and unnecessary cost of the loyalty penalty**, especially at a time when households are struggling.

The loyalty penalty in numbers [4]

In 2018, we estimated that the loyalty penalty was costing consumers

£4bn

For those on the lowest incomes, the loyalty penalty in all five markets could cost

8%

of their annual expenditure

Last year, we found that

40%

of out of contract customers in each market did not switch during the coronavirus lockdown

Progress has been patchy

Steps have been made in the right direction

Since the super-complaint, the CMA has asked regulators to develop and implement measures to tackle the loyalty penalty. While these are at different stages in different markets, **positive steps have been taken.**

The Financial Conduct Authority (FCA) have set the bar high in the insurance market, introducing proposals that effectively ban the loyalty penalty. We have also seen proposals put forward on cash savings, although these have been paused because low interest rates mean that the impact of the loyalty penalty is reduced.

Ofcom have secured voluntary commitments from telecoms providers in the broadband market, which will address around half of the loyalty penalty.

But in other markets, there is much more to do.

In the mobile market, **some providers continue to charge** bundled contract customers for handsets they have already paid off.

In the mortgage market, customers still face an increase in their bill when their initial contract ends, despite low interest rates. The FCA's plans for cash savings might be implemented when rates change, but **we have not seen any concrete proposals for the mortgage market.**

At a time when so many households are struggling, we need to see stronger action taken to **reduce customer bills in these markets as a priority.**

Ofcom estimated that
1.4 million
people are paying the mobile loyalty penalty

49%
of mortgage customers see their bills increase when their fixed rate ends

"You start to wonder, how far do we let [the payments increase] before we think, this is getting ridiculous."
- Tara*, mortgage customer

Voluntary measures in the mobile handset market leave some customers at risk

In the mobile handset market, people on bundled contracts (where the monthly price includes a handset and airtime) can be at risk of paying the loyalty penalty if they don't switch deals when their contract comes to an end. **Ofcom has estimated that 1.4 million people are paying the mobile loyalty penalty.**[5]

Our new research shows that almost 4 in 10 customers on bundled contracts have been eligible to switch since the first coronavirus lockdown in March 2020 - because their contract had either ended by then, or has ended since. However, **1 in 3 who could have switched didn't, putting them at risk of paying the loyalty penalty.**

Ofcom has reached voluntary agreements with some providers to reduce customer bills automatically once they reach the end of their contract. However, our analysis of Ofcom data found that the voluntary commitments will **only address £69 million of the £182 million overpayment in this market.**

Only three mobile providers have ended the loyalty penalty for all of their customers

Virgin Mobile and Tesco have committed to completely ending the loyalty penalty for all of their customers who are on bundled contracts. **O2 have also stopped charging their customers a loyalty penalty,** including indirect customers who had their initial contract with Carphone Warehouse, who are moved onto an O2 contract at the end of their fixed term, unless they opt out and switch provider.

Vodafone and EE apply a small discount (£5 and 10% respectively) once customers have been out of contract for three months.

Three have opted not to apply any discount whatsoever.

	Average monthly loyalty penalty **before** voluntary commitments	Average monthly loyalty penalty **after** voluntary commitments
Vodafone	£14.50	**£9.50**
O2	£11.50	£0
EE	£8	**£4.98**
Three	£11.50	**£11.50**
Virgin	£8	£0
Tesco	£1.50	£0

Measures to improve engagement are not enough

Customers don't always know they're overpaying
One reason the mobile loyalty penalty is particularly unfair is that the price doesn't increase at the end of the contract. Instead, bundled handset contracts obscure extra costs. **The price remains the same when it should reduce** to reflect the fact that the handset has been paid off at the end of the minimum contract period. This makes it even more difficult for customers to see that they are being overcharged than in other markets.

To try and tackle this, in February 2020 Ofcom started to require providers to send notifications when customers reach the end of their contract. However, around **one third of people whose contract ended since March 2020 told us they did not receive a notification.** Either customers aren't receiving the notifications, they don't notice them, or the messages are unclear. We've previously recommended that Ofcom uses Randomised Control Trials (RCTs) to determine the most effective notification content and timing, and make this mandatory.

1 in 4

customers on bundled contracts find the prospect of shopping around for a new deal confusing, stressful or overwhelming

1 in 5

customers are put off by switching, because it's too difficult or time consuming [6]

Even the most effective measures to improve engagement will leave many consumers overpaying. This is why these demand-side remedies must sit alongside supply-side interventions - such as automatically reducing the monthly price that out-of-contract customers pay. **Three, Vodafone and EE should ensure that none of their customers face the loyalty penalty, by reducing the monthly price to the equivalent SIM-only price.**

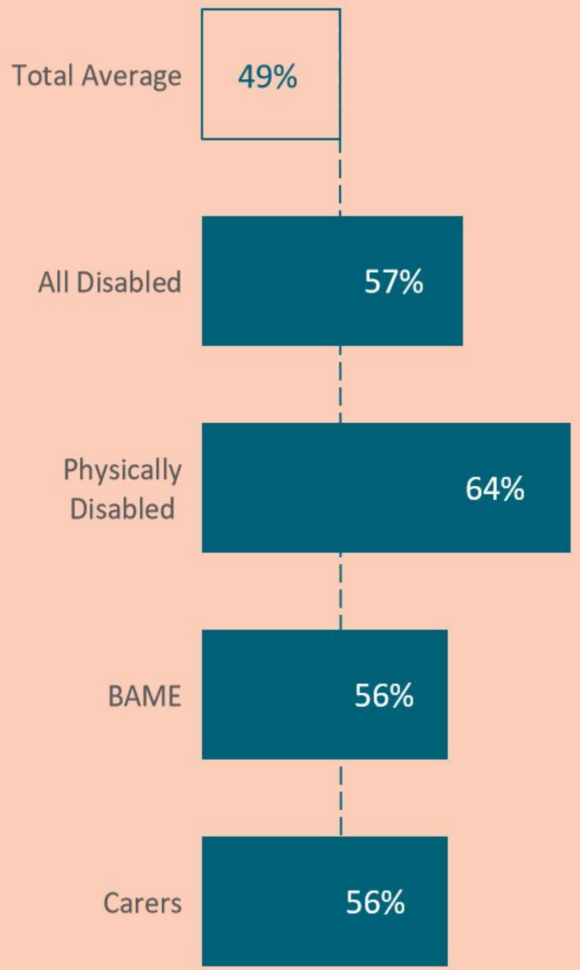
Mortgage customers are still facing price hikes

The mortgage loyalty penalty costs customers £1,000 per year on average.

In the mortgage market, customers typically agree to a fixed rate of payment for a period of 2, 3, 5 or 10 years. When this initial period ends, customers are moved onto a **Standard Variable Rate (SVR).** This SVR is usually between 2-5% higher than the Bank of England base rate, and changes with this base rate. Payments on the SVR are typically more expensive than those on a fixed rate contract.

The FCA have previously reported as many as **800,000 customers** (around **10%** of mortgage holders) pay the loyalty penalty in the mortgage market, with savings of £1,000 per year to be made when moved off the SVR.[7] Our latest loyalty penalty research shows that **49% of those who were able to switch but didn't saw a price increase as a result.**

In 2020, mortgage customers with protected characteristics who did not switch were more likely to pay the loyalty penalty:



42% of mortgage consumers who were able to switch during lockdown didn't.

The FCA has suggested that better communication of the possibility and benefits of switching is an effective way to combat the loyalty penalty. Our 2018 super-complaint outlined how **consumers found it difficult to switch, with vulnerable consumers more likely to struggle.**[8] Our most recent research shows this picture has not changed.

"It's a hassle... do I pay [the SVR] or do I stress myself out having to make all these calls and appointments getting alternative quotes. It's frustrating." - Tara*

During lockdown, customers still faced barriers to switching - **21%** of mortgage customers that didn't switch said the process was **too time consuming or difficult**, and **16% said they didn't have the time to switch.**

An uncertain future for mortgage customers

Mortgage customers are feeling the financial hit of the pandemic

The FCA has not yet announced or taken specific action in the mortgage market to address the loyalty penalty. Research into switching was paused due to the coronavirus pandemic, and the reduction in interest rates may have been seen as a route to reduce harm. However, despite low interest rates, our research shows **some mortgage customers are actually now more vulnerable to the harm caused by the loyalty penalty, because of the pandemic.**

> **"I'm working, I have a schedule... I'm trying to help [the kids] with school at the same time. I think the pandemic, when you're trying to change services, is very challenging. The branches are open less and there's less appointments because of social distancing."** - Tara*

Our Coronavirus Harms research shows **8% of mortgagors are behind on their payments,** an increase of 3 percentage points from before the pandemic. Additionally, 15% of customers have accepted a mortgage holiday or other help with their mortgage payments during the pandemic. However, some customers have had to access savings to make payments and **some anticipate continuing financial losses due to the recession.**

Customers are still being penalised

Despite the reduction of the base rate, our research shows customers whose contract ended during lockdown **still saw their price increase.**

Customers we spoke to also commented on how it has become more difficult to contact their provider due to pandemic restrictions and call demand.

Helping to protect mortgage customers in the future

Although the FCA have successfully introduced pandemic protections to protect mortgage customers from some immediate financial impacts of the pandemic, **many customers will be facing long-term financial difficulty in the months and years to come.**

They should not face the harm caused by the loyalty penalty on top of this. We know that it is possible to intervene successfully to reduce the harm caused by the loyalty penalty, as demonstrated in other markets.

The FCA need to make interventions in the mortgage market as soon as possible, to prevent struggling mortgage customers from facing future financial penalties.

Tara's* story

Tara is self employed, and works in recruitment. She lives with her partner and her 2 children.
Tara bought her home in 2010, and was on a fixed rate contract for 5 years.

At the end of the initial period, Tara received **a single letter, 2-3 weeks before the rate change** to tell her that she was being moved onto the SVR.

Tara found the letter frustrating. As a full time worker and parent, she felt she was not given enough time to be able to take any action to prevent being moved to the SVR.
She also said **alternative options were not made clear to her in the letter**, making her feel as if the expectation was that she would just stay on the SVR.

"[The letter] comes across as, 'if you need to switch you need to do it now', and with customer service- you ring up and you can't get through to anybody, and they say '[advice] is by appointment only and we haven't got any appointments for 3 weeks', by which time you're on the variable rate."

Tara has now been paying the Loyalty Penalty on her mortgage for **almost 6 years.**

Tara described how the SVR, as well as costing more, makes it harder for her to budget because of the changing SVR payments and her unfixed income.

Last year, Tara visited a mortgage adviser from another provider. **She was given limited information and they did not follow up with quotes and information promised.** As a result, she didn't switch.

Tara has lost income during the pandemic, losing 80% of work from some clients. Though some costs decreased during the lockdown and her family put off less important costs, **Tara still had to access savings to pay her bills.**
Tara is worried that work will continue to be scarce, and is aware that **time to claim support during the pandemic is running out.**

* Names of interview participants have been changed to protect anonymity.

What next?

This report has shown just how much work is left to do to tackle the loyalty penalty. Regulators have made good progress in some areas, **but we need to see stronger action across the board.** The coronavirus pandemic has also changed the context for consumers. Many have faced income shocks and relied on support from government and regulators to get by. On top of this, our new research has show that **consumers are still being penalised for loyalty.**

No-one should be paying for a handset they already own

Our new research in the mobile handset market shows that measures to boost engagement and demand-side remedies are **not sufficient to prevent customers overpaying.** This is particularly important in the bundled handset loyalty penalty, where the price does not increase at the end of the contract, obscuring the overpayment.

Providers need to make sure that no-one is charged for a handset they've already paid off. Ofcom should take stronger action to ensure prices are automatically reduced for all out-of-contract bundled customers, backed up by government action if needed.

Mortgage customers can't be left behind

Despite the expectation that low interest rates would reduce SVR payments, our new research suggests that the pandemic has worsened barriers to switching. We've also seen that those who are newly financially vulnerable **risk significant harm from the loyalty penalty** in the short and long-term.

The FCA has researched barriers to switching in the mortgage market, but the consultation with proposed changes has been delayed due to the pandemic. They are also yet to make any recommendations on supply-side interventions, which are needed to reduce the harm for customers when they are unable to switch.

Stronger action is needed now

The coronavirus pandemic has had a devastating impact on household finances. While the economy as a whole starts to recover, many people will struggle with the long-term impact of lost income and debts built up over the last year.

As government and regulator support schemes come to an end, tackling the loyalty penalty is one way that consumers can be protected from unfair and unnecessary costs. We want mobile providers and the FCA to prioritise **concrete and enforceable plans to reduce customer bills now**, to finish the job on the loyalty penalty. If regulators are unable to eradicate the loyalty penalty, government must step in.

Methodology

1. Mobile handset market

Citizens Advice commissioned ICM Unlimited to survey 4,140 UK adults (18+) about their mobile phone contract and their experience of switching during the Covid-19 pandemic. Fieldwork took place online, between 3rd and 8th February 2021.

All survey statistics referring to the mobile handset market are from this polling, unless otherwise stated.

2. Mortgages market

Citizens Advice commissioned Opinium to survey 3,454 UK adults (18+) on the topic of the loyalty penalty. This survey took place online between 14th - 27th August 2020. Additional fieldwork was carried out with 949 respondents who indicated that they had a mortgage contract between 15th and 21st September 2020.

All survey statistics referring to the mortgage market are from this polling, unless otherwise stated.

Citizens Advice conducted 3 qualitative phone interviews with participants from the Opinium research between 29th January and February 18th 2021.

3. Coronavirus Harms

Citizens Advice commissioned ICM Unlimited to survey a nationally representative sample of 6,004 UK adults (18+).

Fieldwork was conducted via an online survey between 12th and 25th November 2020.

The survey covered people's experiences of the coronavirus pandemic, and the impact of the crisis and lockdown on their work, finances, and access to services.

References

1. Citizens Advice, Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority, 2018.
2. Citizens Advice, The loyalty penalty in essential markets: two years since the super-complaint, 2020.
3. Citizens Advice, Excess debts: who has fallen behind on their household bills due to coronavirus?, 2020.
4. Citizens Advice, Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority, 2018.
5. Ofcom, Helping consumers to get better deals in communications markets: mobile handsets, 2019. Ofcom estimated that 1.4 million people could save if they switched to a cheaper SIM-only deal at the end of their bundled contract.
6. Of respondents who said they were discouraged from switching, 5% said it was too difficult, 10% too time consuming, 11% they hadn't had time to look, and 2% didn't want to pay an exit fee.
7. Financial Conduct Authority, Mortgages Market Study Final Report, 2019.
8. Citizens Advice, Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority, 2018.

*** Names of interview participants have been changed to protect anonymity.**

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Published April 2021.