Ofcom's fairness framework

Citizens Advice formal consultation response

citizens advice

Introduction

Citizens Advice gives people the knowledge and confidence they need to find their way forward - whoever they are, and whatever their problem. Our network of independent charities offers confidential advice online, over the phone, and in person, for free. Last year we helped 2.6 million people in person, by phone, email or webchat. Our advice website had over 25 million visits, with 34 million pages viewed.

Citizens Advice broadly welcomes Ofcom's new fairness framework. We also particularly welcome the recent work you have done to persuade most mobile phone companies to stop charging their customers an unfair loyalty penalty.

However, a fairness framework is only as good as Ofcom's ability to enact it. After Three refused to behave responsibly and fairly towards its loyal customers, Ofcom has seemingly lacked the necessary powers to compel it to do so. It seems likely this could restrict your ability to act where you would like to protect customers from unfair outcomes in other areas as well.

We recommend Ofcom is clear about this challenge, setting out:

- When it will be able to regulate for fair outcomes
- When it will need to rely on persuading companies to take voluntary action

Ofcom should also make the case for extending its powers if it is unable to protect customers in the way this framework demands.

In summary, our remaining recommendations for improving the draft framework are:

- Emphasise that promoting competition is only one tool among many for ensuring fair outcomes for consumers
- Ensure that the interests of low income consumers are weighted appropriately
- Provide further detail on the types of behavioural bias and ensure inertia is highlighted as the most prominent amongst them
- Explain that fair practice from providers goes beyond information provision
- Balance the considerations for intervention - including the benefits of intervention alongside the risks that are currently listed

- Set out the powers Ofcom has to intervene and how it will choose the most appropriate means of intervention.

The remainder of this response is structured as follows:

1. Positive aspects of Ofcom's fairness framework
2. Ofcom's existing powers and the use of voluntary agreements
3. Defining fair practice
4. Options for intervention and deciding when to use them
5. Appendix

1. Positive aspects of the framework

We particularly welcome three elements of this framework, which we discuss below.

Firstly, we welcome Ofcom's recognition that, alongside its duties as an economic regulator, it also has a responsibility to ensure fair outcomes for consumers. For example, we support your acknowledgement that competition alone can't always ensure fair outcomes are delivered for consumers and that regulatory intervention is necessary in certain circumstances. However, the framework heavily emphasises using existing powers *only* where promoting competition has failed to deliver the best outcomes - rather than exploring in more detail other means of delivering better outcomes for consumers. This risks consumers being harmed for longer than they need to be.

Secondly, we welcome your recognition that a well functioning market is one that works for all consumers, especially those on the lowest incomes. We understand the needs of low income consumers perhaps more than most: 8 in 10 people who visit a local Citizens Advice office are on a low income, and 1 in 5 people on low incomes interact with our service. This experience underlines the practical importance of the argument you set out in paragraph 3.20: an additional £1 goes far further for the people we tend to help than it will for a wealthier consumer. Ofcom should include this important insight in its framework and weight the interests of financially disadvantaged consumers appropriately when considering trade-offs between different market outcomes.

Thirdly, Citizens Advice are pleased to see Ofcom focusing on practices that disproportionately affect vulnerable consumers. We agree with the following prioritisation questions you set out in the framework:

- How do providers treat customers throughout the customer journey?
- Who is being harmed?
- What is the extent of the harm?
- How important is the service?

Yet we are concerned the framework may not go far enough to tackle exploitation across the market - nor place enough emphasis on regulatory interventions to provide additional consumer protection where needed.

With respect to how providers treat customers throughout the customer journey, we feel further detail must be provided on types of behavioural bias to ensure providers aren't unfairly exploiting these.

Ofcom should also emphasise that 'fair' practice goes beyond simple measures such as information provision, which have limited success in reaching disengaged customers. We touch upon this in more detail later in our response.

Finally, Ofcom should explain in greater detail how it will choose the most appropriate remedy when unfair practice is identified - rather than an overreliance on voluntary commitments. Ofcom should explicitly state the powers it will use to redress unfair practice when voluntary agreements fall short, and explore in more detail the consequences of not intervening.

2. Existing powers

Paragraph 3.2 outlines that Ofcom has powers to directly address unfair market outcomes - but they are usually used when promoting competition alone hasn't adequately protected customers from harm. The framework over-emphasises promoting competition first and foremost, only re-assessing when this has led to consumers losing out. This is prevalent from an early stage as paragraph 2.1 says 'where appropriate, by promoting competition,' but competition then features as the first of Ofcom's 3 goals in paragraph 2.2.

This distinction is unhelpful and we would like to see the regulator pursue a more active approach to using its existing powers - which may involve competition, but not always - to tackle consumer harm. For example, Ofcom recently came to voluntary agreements with most mobile phone providers to reduce bills for out-of-contract customers as they believe new European laws don't give the regulator powers to act to stop harming customers in this way.[1] These voluntary commitments also feature in paragraph 3.15.

Yet, it's unclear from the framework where the regulator does have power to act in instances of consumer harm, what the repercussions are for providers - such as Three - who have signed up to the Fairness for Customers commitments, but are acting unfairly to their customers by continuing to charge a loyalty penalty. While voluntary agreements are explored in more detail later on in our response, we would like the regulator to set out clearly where it does have the power to act and provide an indication of what this could look like.

[1] Ofcom, 'Making communications markets work well for customers', June 2019

3. Defining fair practice

Price discrimination can be beneficial to the average consumer in certain circumstances, especially when it brings consumers into a market who otherwise wouldn't be able to afford the service. For that reason, we agree that price discrimination on its own does not constitute unfair practice in all circumstances. However, we should be concerned when price discrimination results from the exploitation of behavioural biases and/or hurts vulnerable customers.

Ofcom should clarify what it means by 'behavioural bias'.

Ofcom's fairness framework should be clearer about the meaning of 'behavioural bias'. Currently the framework does not adequately explain different types of behavioural bias, nor does it offer any examples of how these biases present themselves.

Ofcom should offer examples of the key forms of behavioural bias in the framework, whether they are displayed by a small group of vulnerable consumers or a large proportion of consumers more generally. This will clarify what it means for a provider to exploit a behavioural bias.

Paragraph 3.26 states:

'We recognise that not all disengaged customers are vulnerable, and that disengagement may sometimes be a deliberate choice. We will take this into account where we apply the framework. Provided there is no procedural unfairness and firms' practices do not exploit behavioural biases or encourage disengagement, so that customers can easily access the information they need in order to engage in the market and act on it, we will usually be less concerned about purely distributive fairness between non-vulnerable customers.'

Ofcom should make explicit that consumer inertia is a behavioural bias. Research conducted by The Behavioural Insights Team highlights that inertia is one of the strongest forces in consumer behaviour.[2]

All essential service markets have consumer inertia 'baked in' through long-lasting, automatically renewing contracts that allow price increases at the end of a contract. The way choices are designed - in this case, making the status quo contract renewal with a higher price - has a significant impact on behaviour, even if the economic incentives for switching providers are clear. For example,

[2] The Behavioural Insights Team - Applying behavioural insights to regulated markets - 2016

our research found that loyal customers are being stung in broadband, home insurance, cash savings & mortgage markets - by billions each year; though Ofcom's efforts to secure voluntary agreements should see the penalty decrease substantially in the mobile market. [3] The ability of providers to exploit this behaviour is the principal reason why the loyalty penalty is so widespread and persistent. And regulators haven't acted quickly enough - across the board - to stop this behaviour from occurring.[4]

Failing to recognise consumer inertia as a behavioural bias risks providers labelling it as an *active* choice by consumers to disengage. Under the framework set out by Ofcom, providers in this situation could continue to exploit this key behavioural bias but claim it to be 'fair practice'.

Because of this widespread behavioural bias, even where consumers have full access to information, a lack of consumer engagement can't simply be labelled as an active choice to disengage. The assumption has been for too long that if people were better informed they would switch and competition would ultimately make the market work better. But this approach has not worked enough so far, and it isn't the silver bullet to solving the loyalty penalty.

There are many reasons why consumer inertia occurs, even where clear information about price rises is provided to consumers:

- **Consumers are time-poor.**
  Consumers who shop around will always be a (good) feature of a well-functioning market. But people lead complex, busy lives, often juggling work and caring commitments and making a huge number of choices each day. In order to make well-informed decisions in essential service markets, consumers would need to almost double the amount of time they spend shopping around. But even among those who would like to spend more time shopping around for essential services, only 1 in 6 say they have the time (16% of consumers overall).[5] Even simply recognising higher bills relies on consumers reading and understanding their bills on a regular basis. But evidence gathered from the Citizens Advice network and consumer service shows that many people are surprised by tariff

[3] Citizens Advice, Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority, September 2018
[4] Q371, Dermot Nolan, Oral evidence to the Business, Energy and Industrial Strategy Select Committee inquiry on pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill, January 2018
[5] Citizens Advice - Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority - 2018

rises, or never notice them at all.

- **The way choices are designed can have a big impact on consumer behaviour, even when the economic incentives for a consumer are clear.** Particularly in the face of complexity, or 'choice overload', people either resort to inaccurate 'rules of thumb', or they stick with the default option.

- **Fear of things going wrong also puts people off switching.** When people do invest time in shopping around to get a good deal, they can often come upon further obstacles when they're trying to make a switch. Fear, or experience, of switches going wrong can put consumers off in future. This isn't necessarily an irrational fear: for many vulnerable and low income consumers, the impact of something going wrong can be considerably worse than for the average consumer. This in turn can cause financial problems when consumers remain in a contract that's not suitable for them.

While some nudge remedies have led to better outcomes for some consumers, they haven't overcome these problems.[6] The explanations above demonstrate that for many consumers inertia isn't a deliberate choice not to engage, but a behavioural bias that prevents them from engaging fully.

While we whole-heartedly agree with prioritising the needs of vulnerable consumers, your framework appears to place the blame on consumers for not engaging, rather than recognising the behavioural biases that drive lack of engagement and the active decisions of providers to exploit this behaviour. For example, paragraph 3.41 states:

'In communications markets, we are likely to be most concerned when poor outcomes are experienced by customers in vulnerable circumstances. On the other hand, it is likely that we would be less concerned where customers paying higher prices have actively chosen to do so, for example, where they are aware that better deals are available but have decided that the amount they would save does not justify the effort of shopping around.'

Ofcom should highlight consumer inertia as one of the strongest and most widespread behavioural biases, hence making it unfair for providers to exploit it.

[6] See table 1: Effect of measurable switching remedies, Appendix

Ofcom should emphasise that 'fair' practice goes beyond simple measures such as information provision

Paragraph 3.34 outlines the type of behaviour that Ofcom expects to see from providers that treat customers fairly. These include:

a) Giving customers clear, easy to understand and timely information before, during and at the end of their contract
b) Supporting customers in making well-informed decisions; and
c) Responding promptly to fix problems when things go wrong

While these are certainly features of a well functioning market, the nature of consumer inertia means that information provision alone is not enough to ensure a fair outcome. As outlined above, consumers can be fully aware that it is economically advantageous to switch, but lack the time to shop around, or fear encountering a problem when switching.

This has long been understood, and it is unfair for providers to continually raise prices in the knowledge that many customers won't take action because of a behavioural bias.

Rather than exploiting inertia, we would expect 'fair practice' from providers to involve recognising the limits of information nudges and putting measures in place to ensure customers - especially vulnerable customers - are on a deal appropriate to their needs.

For example, providers could implement an opt-out scheme where consumers are automatically switched onto the best available deal when their contract comes to an end.

4. Options for intervention and deciding when to use them

It is positive to see all the major telecoms providers signed up to the Fairness for Customers commitments set out in paragraph 3.15. However, we are concerned that the voluntary nature of these commitments may mean providers are not sufficiently incentivised to stick to them.

For example, and as touched upon earlier, it is encouraging to see a number of major providers committing to switching their customers onto the best equivalent sim only deal when they come to the end of their mobile handset inclusive contract. This is in recognition of the unfair nature of the mobile handset loyalty penalty. However, Three have refused to apply any discount for customers outside of their contract and are, therefore, not meeting their commitments to fairness. It's not clear under this voluntary framework whether Three will face any kind of intervention from Ofcom in response to breaching the fairness commitments.

This highlights the key limitation of voluntary agreements - providers may sign up to fairness commitments but in reality have few incentives to stick to them. Combined with - as paragraph 3.2 would suggest - a lack of regulatory power to compel firms to act, we are concerned that the framework does not go far enough to set out how the regulator will tackle consumer harm.

In paragraph 3.24, the regulator states it will operate with a bias *against* intervention, and paragraph 3.47 discusses the consequences of intervention and the precautions that must be taken when considering the case for intervention. However, in order to fully respond to concerns around unfair practice, equal regard should be given to the benefits of intervening and consequences and risks for consumers of not intervening. For example, the government intervened positively in the energy market to protect vulnerable customers by introducing the Warm Home Discount and Ofgem later extended the prepayment meter cap to include this group of consumers.[7] We would like to see Ofcom add a paragraph following 3.47 on considering the benefits of intervening, and the consequences of not.

While we agree that investment in new services to benefit customers is to be encouraged and will need a reasonable return on investment, there is a balance to be struck. In the past, regulators have been too concerned about the necessary rate of return for investors, leading to consumer bills that were higher than they otherwise needed to be. For example, in *Monopoly Money,*[8] our analysis found that consumers had overpaid by £100 million because Ofcom over-estimated the cost of borrowing and investment. We would like to see the regulator balance these needs carefully in the future.

Further, paragraph 3.25 demonstrates an over-reliance on Ofcom acting only when complaints are received, or when market monitoring raises concerns. The loyalty penalty is a good example of how the status quo has led to bad outcomes for consumers. While price discrimination *can* be good for some customers, it shouldn't be the case that regulators assume practices are fair unless consumers and consumer bodies, such as Citizens Advice, provide evidence to

[7] Ofgem, Decision to extend the PPM safeguard tariff to those consumers in receipt of Warm Home Discount, 2017
[8] Citizens Advice, Monopoly Money - How consumers overpaid by billions, 2019

the contrary. We would like to see Ofcom putting consumers at the heart of this framework by coming from the assumption that unfair pricing *is* an ongoing concern of theirs unless market monitoring demonstrates that it is leading to better outcomes.

Paragraphs 3.48-3.49 explain the range of remedies Ofcom are likely to consider, however there is insufficient explanation of how Ofcom will choose the most appropriate remedy. It is not enough for the framework to set out what will be considered as fair and unfair practice, it must also outline how the most appropriate remedy will be determined. For example, why Ofcom might choose to work with providers on a voluntary basis as opposed to modifying regulatory conditions.

Finally, it would be helpful for Ofcom to outline the processes it will put in place to actively ensure providers' practices are monitored and unfair practice is spotted.

5. Appendix

Table 1: Effect of measurable switching remedies

Market	Intervention description	Effect on switching
Energy[9]	Ofgem requires that energy companies provide a cheaper tariff message on all bills since late 2013.	Previous tracking surveys have indicated that some consumers took some form of action by switching tariff or supplier in response to these prompts on their bills. No ongoing evidence is available about how this translated to increased switching or increased value for money.
Cash ISAs[10]	The OFT secured agreement from banks to show interest rates on ISA statements in 2010. Following a further market study, the FCA put in place new rules requiring that these be placed prominently.	The OFT's review of the original intervention found that awareness of interest rates **lowered** during this period (plausibly because the Bank of England interest rate was lowered over the same time period).
Savings[11]	Cash savings disclosure remedies This trial tested the effectiveness of three different types of information provision interventions: • Information about comparable higher-rate-paying products • A pre-filled return form that enabled simplified switching • A reminder about the rate decrease	Overall, all the interventions increased switching within internal providers, but not to higher-paying products from other firms. • Front-page information about available higher rates led to an increase in switching from **3%** to **6%** of consumers. Non-front-page disclosures had **no effect.** • A pre-filled return form increased switching from a baseline of **3%** to **12%**. • Optimal timing of reminders to switch prompted an increase in switching from **4.7%** to **8.2%**.

[9] Professor Amelia Fletcher, The role of demand side remedies in driving effective competition: A Review for Which?, November 2016.
[10] Professor Amelia Fletcher, The role of demand side remedies in driving effective competition: A Review for Which?, November 2016.
[11] FCA, Attention, Search and Switching: Evidence on Mandated Disclosure from the Savings Market, July 2016.

Home and motor insurance [12]	Encouraging customers to act at renewal This trial measured the impact of different types of renewal notices for customers switching/negotiating their insurance policy at renewal. It tested four types of disclosures: ● Including last year's premium next to this year's premium in renewal notices ● Sending a leaflet with renewal notices e.g. a guide to shopping around ● Simplifying renewal notices by using bullet points and simpler language ● Sending reminders two weeks after renewal notices	Putting the previous year's premium on renewal notices caused a **3.2%** increase in consumers switching or negotiating their home insurance policy. There was little evidence of price increases at renewal found for customers at the two motor insurers, and including last year's premium has **no effect**. Other changes to renewal notices, such as simplifying them, sending information leaflets and reminders had **little or no impact** on consumer behaviour.
Current accounts	The Current Account Switching Service (CASS) was launched to reduce frictions switching for Personal Current Accounts, Charities and Business Current Accounts. The Current Account [13] Switch Guarantee now ensures that banks take care of closing the old account, moving balances and switching payments.	Switching rates in 2017 increased to **1.8%** a year.[14]
Energy[15]	Cheaper Market Offers Letter trial. Randomly allocated 150,000	Letters increased switching from a baseline of **1%** to an average of **2.9%**

[12] Financial Conduct Authority, Occasional Paper No.12 Encouraging consumers to act at renewal: Evidence from field trials in the home and motor insurance markets, December 2015. Data from three home insurance companies, not market wide.
[13] Behavioural Insights Team for Citizens Advice, 'Applying behavioural insights to regulated markets', May 2016.
[14] 931,956 switches were conducted in 2017, compared to an estimated number of banked adults of 50.6m. ONS number of adults. 1.5m (number of unbanked adults). Source: BACS, Current Account Switch Service Dashboard, 2018; Financial Inclusion Commission.
[15] The Behavioural Insights Team, One letter that triples switching, February 2018

	default tariff customers to receive either: • No letter (control group) • An Ofgem-branded letter showing personalised cheaper deals from rival suppliers • A supplier-branded letter showing personalised cheaper deals from rival suppliers The test observed the switching rates for each group for thirty days after the letters were sent.	
Energy[16]	CMA database remedy Tested 2,400 customers who had been on a default tariff for 3+ years, and randomly allocated them to receive either: • No letter (control group) • An Ofgem-branded letter showing personalised cheaper deals (best offer letter) • Up to six marketing letters from rival suppliers (simulating the CMA remedy)	*Customers were sent a letter from their supplier advising them that they could opt out of being sent energy deal offers.* After 28 days, those who didn't opt out then received either the cheaper deals letter or marketing material. The CMA database remedy resulted in switching from **6.8%** to **13.4%** (CMA remedy) or **12.1%** (Ofgem best offer letter).
Energy[17]	Active choice collective switch trial Using the disengaged customer database, Ofgem identified 50,000 customers who had been on the same deal for 3 years or more. Consumers could opt into a collective switch run by a price comparison website (PCW), as well as opt out of further communication. The following data was shared with the PCW running the collective switch:	**22.4%** of customers in the trial switched overall, compared to a baseline of 2.6% in the control group. Customers who switched saved around £300. Vulnerable consumers were as likely to switch as the remainder of the intervention group.

[16] Ofgem, Small Scale Database trial, November 2017.
[17] Ofgem, Open letter: Active choice collective switch trial - early findings, August 2018.

	name, address, current tariff and historic consumption data. All of this data was shared without consumers' consent.	

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