‘Loyalty penalty’ super-complaint

A response by the Building Societies Association to the CMA’s initial call for evidence

Restricted
14 October 2018

Building Societies Association

Introduction

The Competition and Markets Authority (the CMA) posed four questions surrounding "loyalty penalties" in mobile phone contracts, broadband, home insurance, mortgages and savings, following a super-complaint by Citizens Advice (the CA) on 28 September 2018.

We restrict our comments to the two product areas in the CA's list that are relevant to our members; namely, savings and mortgages.

An overall observation is that, in a competitive market, prices and charges will inevitably vary from product-to-product and firm-to-firm. There is a limit to how far regulators or government should intervene in pricing practices within industries that are competitive, well-regulated and have a strong ombudsman service – and where firms have provided customers with all relevant information and there are no unfair barriers to changing products.

There is also a significant issue concerning personal choice and responsibility and whether it is appropriate for government or regulators, in effect, to regulate consumers through the medium of firms. Price is not always the key determining factor for a consumer, with service, trust and ethos among the various other relevant factors. We need to exercise great caution in moving too far down a command and control path as we simply do not have enough insight into a customer's affairs to definitively understand why people may make certain choices.

However, we fully acknowledge that a different set of considerations applies where firms have not complied with regulatory requirements or where the customers in question are vulnerable. In the former case, it is very important that the relevant regulator supervises and enforces effectively. In the latter case, it is crucial that firms have fair and flexible policies and practices for assisting and supporting vulnerable customers.

Though not always perfect, customer-owned mutuals, such as building societies and credit unions, do tend to demonstrate a track record of better customer treatment, as evidenced by better interest rates, higher service scores, and considerably fewer cases of misconduct. We ascribe this to the ownership structure, and the organisational culture that flows from it: customers are much more central to the organisation's purpose, and the needs of shareholders and customers do not conflict as they might do at quoted companies. Regulation that effectively pushes towards homogenisation risks reducing the effective competition that different approaches bring to bear.

1. **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?**

General

We believe that the CA's conclusions are too sweeping and, in particular, do not sufficiently take into account the varying customer experiences and differences from industry-to-industry in key matters such as regulation, supervision and complaint-handling.

Both savings and mortgages are closely regulated by the Financial Conduct Authority (FCA) and consumers of financial services have the benefit of the Financial Ombudsman Service, the largest ombudsman scheme in the world. In recent years, a wide range of significant protections have been introduced for borrowers and savers; including the following –

- FCA Banking Conduct of Business Rules (BCOBS) in 2009
- FCA competition powers since 2015
- Strengthening of the FCA Mortgage Rules (MCOB) following the Mortgage Market Review (MMR) and the Mortgage Credit Directive (MCD) in 2016
- the Senior Managers' and Certification Regime for deposit-takers since 2016 (which focuses on individual, as well as firm, responsibilities)
- the Payment Services Regulations 2017.

These are in addition numerous 'horizontal' consumer protection measures that apply to financial services and other industries, eg the Consumer Protection from Unfair Trading Regulations 2008, the Consumer Rights Act 2015 etc. It should also be borne in mind that, in addition to the numerous enhancements set out above, the FCA has recently undertaken, or is in the process of undertaking, a wide range other exercises designed to improve competition, conduct and fair treatment of customers; for example –

- the Financial Advice Market Review,
- the Cash Savings Market Study,
- the Mortgage Market Study,
- the Retail Banking Business Models Review,
- work on vulnerable customers, etc.

All of these are still work in progress, are under review and/or have triggered further initiatives.

Therefore, as the CA's super-complaint acknowledges, different factors apply in each of the five industries it identifies. Indeed, customers' experiences will vary sector-by-sector or firm-by-firm, within each industry. In addition, the effectiveness of regulation and complaint handling is by no means homogenous across the industries in question. Accordingly, there can be no 'one-size-fits-all' solution to the suggested problems.

In the light of the FCA's considerable past and continuing work regarding savings and mortgages, it may be counter-productive for the CMA to establish parallel workstreams. We therefore strongly urge the CMA to recommend that the FCA continue its work in relation to these areas.

Savings

Evidence shows that building societies generally pay higher savings interest rates than the big banks, including on savings accounts held for a long time.

Price comparison service Savings Champion research has shown that a significant percentage more building society accounts (73%) paid a higher rate than the base rate, compared to banks (54%). This includes accounts closed to new business, and continues the trend that was evident over the last six years, and which has remained the case throughout the first half of 2018.

While savings interest rates in general are lower than they were six years ago (due to a combination of the continuing very low Bank Rate and other policy measures such as the Funding for Lending Scheme and Term Finance Scheme), the average variable rate paid by banks has dropped by 6% more than the average rate paid by building societies in that time. In fact, over the 12 months to end June 2018 the average variable interest rate paid by building societies was 33% higher than that paid by the banks, showing a clear gap between the two groups.

In 2017, BSA analysis showed that people saving with building societies earned £775 million in additional interest on their savings last year than if they had earned the average interest rates paid by large monetary financial institutions, a group mainly comprising the big banks. This figure was £460 million for the first half of 2018.

In addressing the question of savers with long-standing balances being disadvantaged, we suggest the CMA pay full regard to remedies already put in place by the Financial Conduct Authority. For example, following its 2015 Cash Savings Market Study, the FCA required:

- enhanced disclosure of the current interest applying to an account in statements and relevant web pages;
- a new summary box for key product features, aiding pre-purchase comparisons of cash savings accounts;
- standardised pre-notification to customers of the ending of fixed rate and bonus periods;
- speedier internal switching between products offered by a customer's existing provider and faster cash-ISA transfers between providers – this has been enhanced by a voluntary cross-industry commitment to faster cash-ISA transfers; ie 85% to be completed within 7 working days, (*cf* the HMRC requirement of 15 working days);
- advance customer notifications of any interest rate cut (subject to a *de minimis* of £100 balance) no later than 14 days in advance of the rate reduction.

The FCA is now considering, in Discussion Paper 18/6, supply-side remedies to address the continuing problems it perceives with consumer inertia and front book versus back book pricing. Its favoured approach is a new basic savings rate, possibly linked to a new 'sunlight' remedy. We are participating fully in the FCA's consultation and will be responding by their 25 October deadline. We will be pleased to share with the CMA our response to the FCA.

Mortgages

Standard Variable Rates or Reversion rates are clearly explained to customers on the European Standardised Information Sheet (ESIS) or Key Facts Information documents that every customer taking a mortgage product receives before entering a mortgage contract. These documents outline clearly how much the existing payments would increase to if the variable rate applied at the date of production of the document, as well as including a figure illustrating how much payments could go up to in a stressed situation.

Earlier this year the FCA, as part of its interim market study into competition in the mortgage market, identified that there were a number of borrowers stuck on SVR as they no longer met the affordability criteria changed by the regulator in 2014.

Industry has worked with the FCA since the report and 65 lenders representing 93% of the market have signed up to a voluntary agreement to ensure there are no barriers for existing customers to switch their product from a reversion rate to a core product. In terms of customers trapped with inactive lenders or unregulated entities, there are regulatory barriers to helping these customers, such as the Mortgage Credit Directive (MCD) affordability rules. The BSA is working closely with the FCA and other key stakeholders to explore a solution for this cohort of customers.

The Mortgage Report issued by CA acknowledged, as recently as 2017, that the majority of mortgage holders did not default onto an SVR. Indeed, the vast majority of customers move to a new mortgage deal when their fixed rate contract ends. Building societies actively prompt their customers to refinance, and will continue, through the annual mortgage statement and associated communications, to remind any customers that do move onto the SVR.

Virtually all (97%) mortgage customers receive professional advice before entering into a mortgage contract. Of these, approximately three quarters receive independent advice from an intermediary (ie a financial adviser or mortgage broker). At the heart of this advice process is an assessment of the customer's ongoing ability to afford the mortgage, including if they were to revert to paying three percentage points above their reversion rate, usually the SVR, within the next five years.

The FCA's recently published Strategic Review of Retail Banking Business Models Progress Report shows the proportion of customers on SVR has halved from 35% in 2013 to 17% in 2018. This is evidence of lenders having positive contact strategies to ensure customers are aware of their options when an existing deal expires. In addition, intermediaries clearly have a vested interest in ensuring their customers are contacted at the end of an existing deal to explore the option of switching internally or moving lender via a re-mortgage.

All our members have contact strategies where they write to customers prior to the mortgage deal expiring, many then follow up with phone calls and further letters. There are numerous examples of good practice such as offering discounted Standard Variable Rates (SVR). Moreover, a lender's SVR forms part of its broader strategy for retaining borrowers, so that there are various valid approaches across the market. For example, the SVR is not always higher than the initial rate.

We should not forget many customers are actively making the decision to remain on a reversion rate, such as an SVR, because of the flexibility it offers, for example because they plan to move or redeem the mortgage in the near future. A significant number might have small mortgage balances outstanding, or value the ability to pay off large lump sums.

There is a nonetheless a small minority of customers who fail to engage even following numerous attempts by their lender.

Our members strongly support financial education in the community and put a lot of time and investment into this. The building society sector looks forward to the creation of the Single Financial Guidance Body (SFGB) and engaging with the SFGB to offer our continued support for financial education.

We would refer the CMA to the FCA Mortgage Market Study, which tackles the concerns raised in the CA complaint. The FCA recently issued an interim report, providing a readout of its findings to date and the industry is working closely with the FCA to address the issues it has raised.

2. **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?**

Clearly, what the CA describes as a 'loyalty penalty' is likely to be less problematic, or not a problem at all, in certain circumstances or combination of circumstances; for example where –

- the customer places greatest value on non-price factors; eg the flexibility of a SVR, service standards, affinity with the corporate ethos, etc

- the firm has been transparent, rule-compliant and there are no bars to customer switching
- the so-called 'penalty' is a very small amount
- the customer is well-informed and not subject to a recognised vulnerability.

As the CA Mortgage Report in 2017 recognised, customers with a short term remaining on their mortgage, or who are on a low variable rate, may have good reasons to stay on their current contract. The FCA Mortgage Market Study Interim Report found "high levels of consumer engagement; currently over three quarters of consumers switch to a new mortgage deal within 6 months of moving onto a reversion rate."

The FCA has carried out work on price discrimination and on issues concerning distributive fairness; see eg its July 2018 research note *Price Discrimination.*

Where the FCA has identified serious issues it has intervened on pricing in a number of areas, such as payday lending, and there are other restrictions on certain pricing elements, such as various mortgage charges (under FCA MCOB 12) and at common law regarding contractual penalties etc.

Furthermore, the continuing work on mortgage SVR 'prisoners' shows that good progress can be made by industry initiatives in problem areas.

3. **What specific additional challenges do vulnerable consumers experience and should there be additional protections?**

Depending on the background of the customer, there can be additional challenges for individuals who are not in a position to spend time shopping around for best product deals and instead rely on an existing provider to keep their products competitive.

- example 1 – individuals who have difficulty making decisions because of mental health issues are not likely to shop around
- example 2 – individuals who have low literacy and/or numeracy skills or do not have English as a first language are less likely to shop around. This is a particular challenge for individuals who do not have internet access, as most switching services are only provided online
- example 3 – individuals whose time is absorbed looking after themselves or another person due to long term illness etc naturally have less time to spend on managing their finances anyway and even less time to shop around
- example 4– "rogue" salespeople targeting the above groups deliberately to pressure them into staying with their provider or to switch to a more expensive option

Additional protections may include the following -

i. firms could consider persistent loyalty as a possible indicator of in individual in vulnerable circumstances
ii. clear and simple product comparison literature available on paper as well as online – and in other languages
iii. switching advice available via face-to-face / telephone, as well as online
iv. partnerships with vulnerability support organisations to allow switching discussions within patient or carer support groups
v. greater civil powers for Trading Standards to investigate and close down firms where targeting vulnerable groups is part of sales policy or practice.

The possibility of a customer being vulnerable is one that spans many different product areas and a range of potential circumstances. There is a wide spectrum of potential vulnerabilities and they can have different effects. Problems can range from vulnerable people falling prey to criminals to the difficulties that vulnerable customers might experience in being able to understand, compare or switch products.

The FCA and firms are already pursuing many initiatives. For example, among other things, our sector has done a great deal of work on third party support. The FCA plans a major further consultation on vulnerable customers next year.

Therefore we believe that, as far as savings and mortgages are concerned, this aspect of alleged loyalty 'penalties' can be left to the FCA and the relevant sectors.

4. **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.**

As described above, many of the regulatory changes implemented in recent years seek to achieve similar goals to the CA's suggestions. Moreover, the FCA is currently considering various remedies in both the mortgage and savings markets, which the CMA will also want to factor into its consideration of the super-complaint. The BSA is engaging constructively with the FCA on these proposals.

As the CA recognises, ongoing digital developments should also make it easier to compare and move providers, with many developments relating to financial services. The regulators and industry are working to ensure that consumers benefit from the opportunities that the new technologies present such as wider choice, more timely communication, reduced search costs, more efficient processes and better prices.

It is important that any measures do not result in unintended consequences that are ultimately detrimental to consumers. For example, any measures that inadvertently diminish the diversity of provision in financial services could have negative consequences on the effectiveness of competition, the breadth of consumer choice and financial stability.

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BSA EU Transparency Register No: 924933110421-64