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Household retail competition and market liberalisation

CCWater

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Final Report

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Contents

Executive summary

This report considers lessons learned for the water and sewerage sectors in England from in other sectors, focusing on household customers

It is set in the context of the ongoing Ofwat study into the potential benefits of household retail competition, and the potential for future reforms to the household retail market

It addresses a number of questions CCWater asked us including what makes a successful household retail market, what risks and detriments have been experienced by domestic customers in other sectors, and what regulatory interventions have been made to address these detriments.

Many of the lessons from our previous report[1] are relevant both to the household and non-household markets. This is because many of the detriments experienced by non-households (especially small businesses) are also experienced by households. We have drawn out the key findings from our previous report where they are also relevant to households. This report focuses on recent developments in the GB energy and UK telecoms markets, and on the work of consumer bodies in the energy sector, considering the impacts on households.

[1]"Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform.

We identify six key success factors for a household retail market from a customer perspective

Success factor	Description
Price competition	Retailers compete on price for a given service level without making either abnormally high or abnormally low profits – there should be no evidence of oligopolistic or dominant behaviour from one or several players in the market, or leverage of dominance from other parts of the value chain for individual players. Customers can switch freely between suppliers who wish both to attract new customers and retain existing ones.
Customers receive value for money for the level of service offered	Customers are treated fairly. Retailers do not make use of customers' behavioural biases to apply differential charging for the same products or differential service for the same price. Information about price and service can be taken at face value.
Customers are engaged and active in the market	Customers do not face perceived or actual barriers to switching supplier. Switching supplier is straightforward, and customers are able to choose a level of complexity that suits their needs. Vulnerable customers are not excluded from the market, disengaged customers are not deterred by complexity.
Suppliers strive to provide better products and services	Retailers are incentivised to attract customers through improving their product and service offerings.
New suppliers can enter the market freely	New suppliers are not deterred from entering the market due to actual/perceived threat of a dominant supplier/ oligopoly, nor by overcomplicated regulatory barriers to entry.
Customers who need extra protection receive it	Where there is universal service and 'public good' qualities to the product there are likely to be customers who are vulnerable (and potentially also customers who are disengaged, or financially stretched). Appropriate protection needs to be put in place to help vulnerable and sensitive customers to participate in the market.

Sources: PwC analysis, NAO, Ofgem, CMA, Consumer Focus
Further supporting information is presented in Appendix 3

Engaged customers could save money, but savings are likely to be less than in energy

Electricity Market liberalisation has delivered long-term benefits for customers	
Electricity & gas prices[3,4]	One area where customers have made savings in energy is by switching to dual fuel. For example, we did a search on uSwitch for a property using £100/month electricity supplied by the incumbent E.ON and £100/month gas supplied by British Gas, and assuming the household has never switched. The top 10 results ranged from savings of £800-900 per year for fixed term dual fuel deals. However, in water and wastewater, the savings are likely to be significantly less because retail makes up a smaller part of the value chain, and there is likely to be less benefit from savings from upstream competition. In the 2015 Ofgem consumer tracking survey, 72% of customers receiving both gas and electricity and had a single supplier were on a dual fuel deal (around 35% of the total sample interviewed). Dual fuel supply became possible as a result of opening the supply market to competition. For water only (or sewerage only) customers, a dual water and sewerage retailer will become possible if there is a household market, and multi-utility (e.g. water, sewerage and energy) may also be viable.
Transparency[1]	Competition also improves transparency. Information adds value in its own right; in many cases, it can lead to more effective energy policy adjustments. Price transparency and ability to compare allows customers to switch suppliers.
Innovation[1]	Retail companies may develop innovative contracts and products (as a result of competitive pressure) that create added value from liberalisation'
Electricity & gas switching[2,3]	In the first year following opening of the electricity supply market, a MORI poll showed 89% customer awareness of the option to switch supplier. 5% actually switched. Subsequent survey results presented below suggest this level of awareness has declined over time. The 2015 Ofgem consumer tracker survey suggests around 50% of customers have now had some level of interaction in the market. Although this does not guarantee a benefit (customers can end up with a worse deal in a complex tariff environment), customers will tend to switch to get a benefit either to price or supply or service level: • 50% of customers surveyed had never switched and had not changed tariff or payment method • 6% had never switched but had changed payment method • 20% had switched before 2014, but had not switched in 2014/15, nor had they changed tariff/ payment terms in 2014/15 • 24% had either switched in 2014/15 or changed tariff/payment method, and had also switched prior to 2014/15.

Source: [1]OECD – Lessons from liberalised electricity markets https://www.iea.org/publications/freepublications/publication/LessonsNet.pdf
[2]CRI Regulatory Review 2000/2001, Millennium edition, chapter 2. Stephen Littlechild, Electricity Regulation.
[3]Ofgem 2015. Customer engagement with the energy sector – tracking survey 2015 (see; https://www.ofgem.gov.uk/publications-and-updates/consumer-research-datasets)
[4]USwitch (http://www.uswitch.com/gas-electricity/)

There are nine common detriments experienced by households in our case study markets

1. *Differential pricing or terms by companies with significant market share*
2. *Incumbents reduce service levels (e.g. to captive customers)*
3. *Risk of mis-selling and misleading information during 'dash for customers'*
4. *Companies or regulatory failures may frustrate market entry*
5. *Retailers or regulatory failures may frustrate switching*
6. *Poor data or processes can result in mistakes during switching*
7. *Complexity leading to customer confusion*
8. *Unfair and/ or hidden contract terms can confuse and disadvantage customers*
9. *Customers unaware of right to switch or are not incentivised to do so*

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Some key issues specific to household competition are…

The opening of the retail water market to household customers poses a unique set of issues which warrants careful consideration. Whilst the previously identified lessons learned from other retail market liberalisations remain relevant, there are a few extra dimensions which we've aimed to highlight in this report. These nuances broadly take the form of:

Customers

Market size would grow substantially – c. 23-24m customers compared with c. 1.3m in the Anglo-Scottish non-household market.

Households are a diverse group, varying in their willingness to switch, sophistication and vulnerability. Experience in other sectors suggests that we might expect larger numbers and proportions of the customer base to be disengaged (e.g. 50% have never switched or changed tariff in energy) and thus effective competition may be reduced for those customers.

The benefit from competition will also vary by customer groups and tariffs, with sophisticated customers buying better tariffs and less sophisticated customers remaining on historic and poor-value tariffs.

Competition

With a diverse customer base, retailers are given an incentive to 'cherry pick' and target high value customers who require low costs to serve.

This is potentially harmful for many vulnerable and low income customer groups. These groups may have more bespoke/ non-standard tariffs (e.g. social tariffs which are currently funded by the wholesaler in water). Vulnerable and low income customers may lack access to low cost to serve technologies (such as web based service or mobile apps). Hence, they may cost more to serve and thus may face higher tariffs.

Experience in the GB energy sector is that 'standards of conduct' regulation has been required to provide a means of protecting vulnerable and other customers who cannot access the best deals.

Regulation

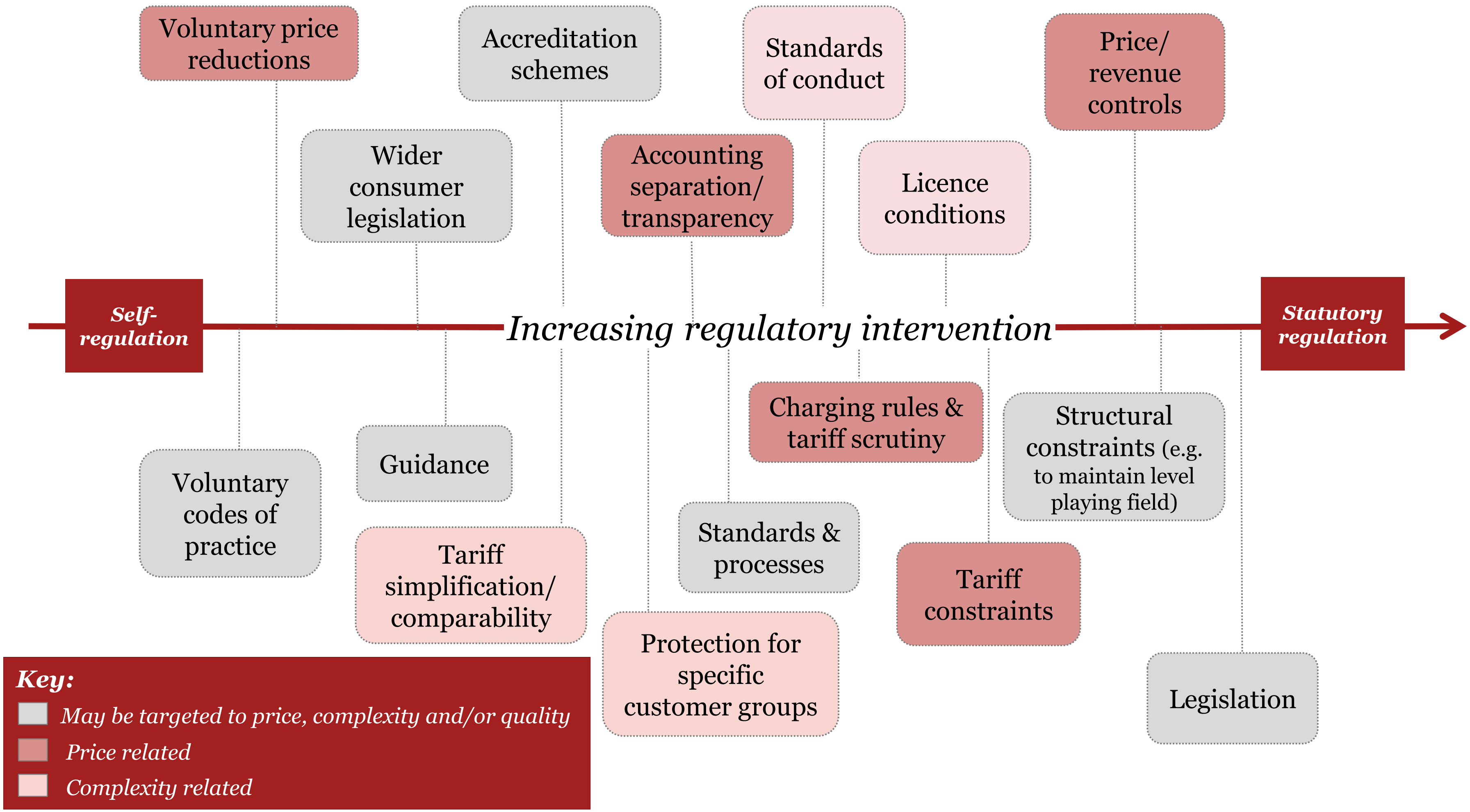
It appears to be difficult for regulators to intervene in markets quickly with targeted, proportionate and effective measures to remedy detriments. Careful consideration of the initial market design is needed given that it has proved difficult to make timely changes to market arrangements once the market is operational.

Regulators face difficulties partly because detriments are difficult to quantify. It may also be because more direct interventions, such as licence conditions are open to challenge from regulated companies and it is therefore more difficult to justify moving directly to the appropriate level of regulation.

Examples include Ofcom and Ofgem backing self-regulation solutions initially, and becoming more targeted if these are ineffective.

In the case of the energy, Ofgem has commenced the energy supply probe in 2008, and conducted its own Retail Market Review prior to referring the market to CMA.

The regulator will need to have specific tools to address likely detriments in a household market



Regulatory approaches need to be targeted and at an appropriate level of intervention to address potential detriment

Increasingly regulatory involvement

Model	***1. Industry self-regulation***	***2. Regulator signs off industry-governed code***	***3. Regulator signs off all major changes***	***4. Statutory regulation***
Examples	Banking code (historic)	Broadcasting code applied to TV advertising but administered by ASA	Electricity Balancing and Settlement Code (BSC) at wholesale market opening; Water retail in Scotland	Retail banking now is regulated through statutory instrument and FCA 'rulebooks'
Commentary	Ultimately resulted in more direct regulation in banking	May be appropriate for some issues (i.e. where the potential level of detriment is perceived to be less material) but not others	This is a model widely used in electricity and gas. There are central costs of the switching systems and of maintaining 'live' codes. In Scotland the regulator has more direct powers to shape and change codes.	The most interventionist form of regulation, where the regulator and sometimes Government have a direct role in setting 'rules'.

The figure above shows four potential models in a continuum. At the left hand side of the diagram, the regulator allows the market to set up its own codes for switching, sales practices and other areas where there is a risk of consumer detriment. At the right hand side, regulation is prescriptive and set in statute. The higher the risk of detriment, the greater regulatory involvement could be justified. However, regulation should also be targeted. For example, if risk of detriment only applies to certain customer groups, regulation should only be targeted at those groups.

There is a trade-off between the price paid (by customers) to finance the central regulatory and structural arrangements (e.g. a market operator) the flexibility to innovate conferred by the regulatory model, and the benefit of the regulatory protection. This needs to be balanced against the likely cost to customers/ society of the detriments experienced in the absence of any regulatory intervention.

Introduction

- ***Background***
- ***The non-household lessons learned are relevant to households too***

CCWater commissioned this report to improve its understanding of issues that could arise in a household retail market

This report considers lessons learned for the water and sewerage sectors in England from in other sectors, focusing on household customers. It is set in the context of the ongoing Ofwat study into the potential cost and benefits of household retail competition, and the potential for future reforms to the household retail market. It addresses a number of questions CCWater asked us, which were:

- What are the regulatory or legislative arrangements for household retail competitions in other sectors?
- What specific potential consumer detriments could be addressed through specific terms or codes?
- How could they be met – legislation, governmental guidance, regulation, codes of practice?
- Examples of customer protection measures introduced in other household retail utility markets that should be adopted in water, particularly in respect of vulnerable customers?
- Are there any policy or protection measures that are needed in household water/wastewater retail that are unique to this sector?
- Are there more general lessons/solutions from other sectors that:
  - Could be adopted/adapted by water?
  - Should have been picked up before the market was liberalised in other sectors?
  - Proved insurmountable (and still bedevil that sector (actually or perceptually))?
- Have any solutions in other sectors actually led to another problem?
- To what extent has household retail competition delivered benefits to customers either through better service, price or customer satisfaction?
- What evidence is there that shows whether customers' expectations of these markets have been met, or benefits have been achieved (compared to the cost of establishing such markets)?
- What tests are used to establish whether a household retail competition has proven successful?
- Are there any regulatory or customer service risks if traditional appointees were to exit from the household and non-household retail market (i.e. essentially creating wholesale-only companies).
- Are there any scenarios or models of a household retail market that might not be in water customer interests? And why?

The report is designed to be read alongside our previous report "Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform." This is because many of the issues experienced by non-households (especially SMEs) are also experienced by households. We have not sought to replicate any of the analysis in the previous report, but have, instead focused on recent developments in the GB energy and UK telecoms markets considering the impacts on households.

Introduction

- ***Background***
- ***The non-household lessons learned are relevant to households too***

Consumer detriments may be caused by market failure, regulatory failure and/or behavioural bias

Market failure

Market power

Firms are able to use dominance in one business unit to raise prices (profitably) above the competitive benchmark in contestable areas such as retail.

Imperfect information

Customers cannot make informed choices between products or services because the information firms provide is incomplete.

Innovation disrupters

Reducing market concentration could reduce innovation. Customers could suffer welfare loss if markets are not designed to take this into account.

Public goods

Free-rider effects may cause the costs or the provision of the good to be allocated unevenly between customers.

Regulatory failure

Poorly designed regulation

Policies that fail to target the cause of the problem and/ or create further distortions to the market.

Changes through time

Policies that were appropriate when first introduced, but circumstances have changed meaning that they are no longer appropriate or effective.

Acts of omission

The regulator fails to act when market failures occur.

Regulatory barriers to entry

Examples include unduly onerous licensing regimes, high administrative costs (such as onerous data reporting requirements), exit barriers, and entry inspection costs.

Behavioural biases

Anomalous preferences

Firms exploit consumers' preferences, where they run counter-intuitive to the rational economic choice. Examples include bias towards the *status quo* or bias towards the default option.

Cognitive errors

Consumers may make sub-optimal decisions due to failure to predict the future consequences, or because the problem is structured (framed) in an unhelpful way.

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

There are nine common detriments experienced by households in our case study markets

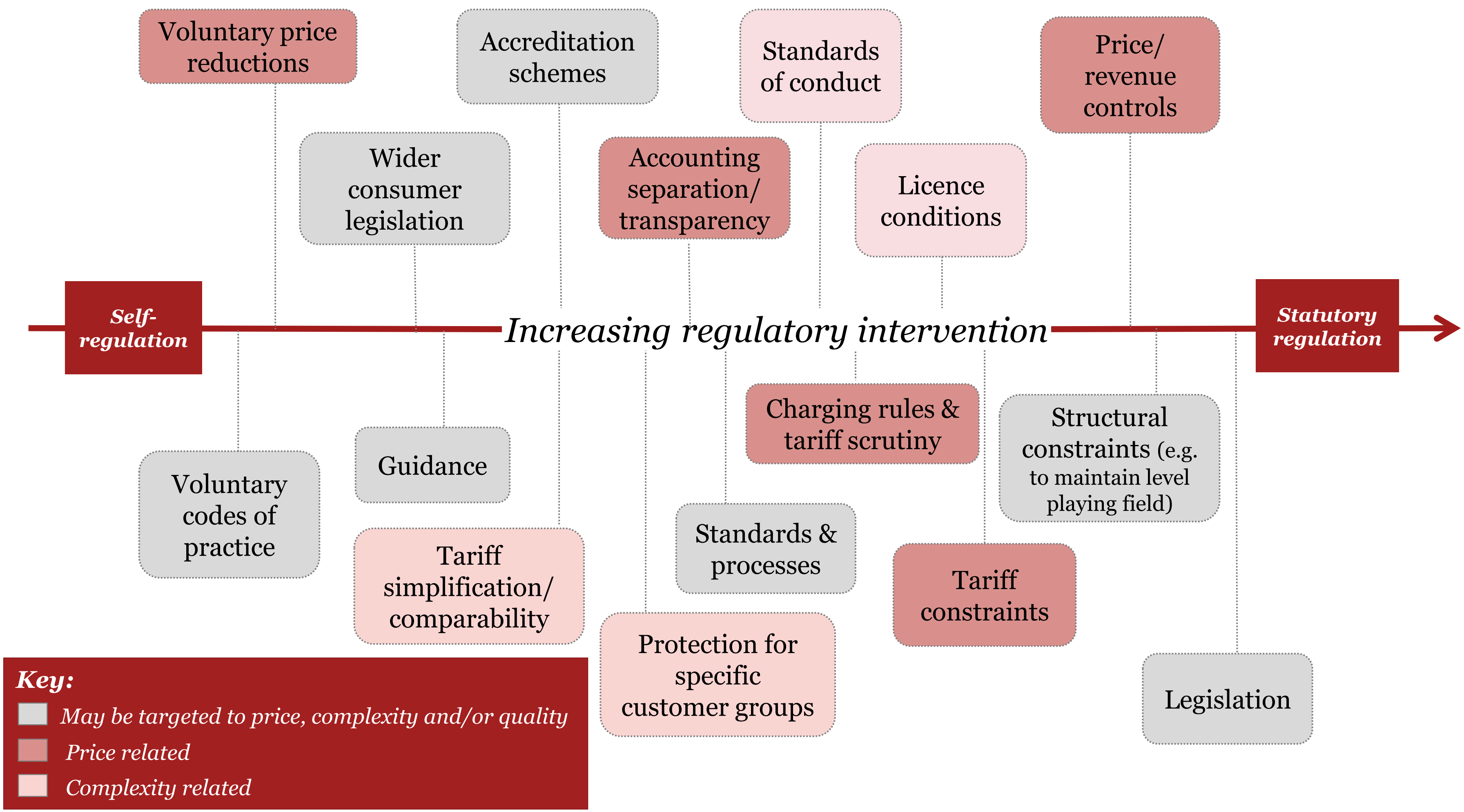
Our research into detriments experienced in the regulated markets we looked at for non-households indicated that there are nine common specific detriments experienced by customers in regulated markets. These also apply to households and are listed below:

1. *Differential pricing or terms by companies with significant market share*
2. *Incumbents reduce service levels (e.g. to captive customers)*
3. *Risk of mis-selling and misleading information during 'dash for customers'*
4. *Companies or regulatory failures may frustrate market entry*
5. *Retailers or regulatory failures may frustrate switching*
6. *Poor data or processes can result in mistakes during switching*
7. *Complexity leading to customer confusion*
8. *Unfair and/ or hidden contract terms can confuse and disadvantage customers*
9. *Customers unaware of right to switch or are not incentivised to do so*

The nine common detriments are discussed in more detail in Appendix 1.

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Regulators can use specific tools to target detriments or issues arising in markets



Will customers benefit from liberalisation?

- ***What will a successful outcome look like?***
- ***What will a well functioning market look like?***
- ***What should we expect given other market liberalisation?***

This section explores how existing success criteria for water market reform could apply to household competition

A number of success criteria exist for the non-household retail market, which will open in April 2017. This section explores the extent to which these criteria can be applied to the possible introduction of household competition. We consider the criteria for success published by:

- Open Water
- MOSL
- CCWater

It should be recognised that the primary concern of MOSL and to some extent Open Water is not necessarily consumer protection, although these parties are putting in place market arrangements that are likely to protect consumers.

Most of the success criteria for the non-household market are applicable to a household market too. This should be expected, given that the main detriments that central market arrangements are designed to protect against are also experienced by households in other sectors.

We also comment on additional success criteria that could be relevant to a household market.

What does success look like to Open Water? Is this also relevant to household competition?

Open Water's first four success criteria appear to relevant to both household and non-household competition. However, our view is that criterion 3 may need to be expanded if there were household competition to cover the protection of vulnerable groups. Criterion 5 is relevant if the reference to 'non-households' is deleted. Other success criteria that may be relevant include minimising barriers to switching.

01 The new competitive markets are fair, transparent and efficient.

02 The market encourages diversity of entry and minimises barriers to entry

03 Outcomes are cost-beneficial for the majority of customers.

04 The market incentivises innovation in services by both existing and new market participants

05 All non-household customers have a choice and are aware of how they can exercise that choice. They are in a position to negotiate better targeted, more efficient and more cost-effective services.

Not likely to be relevant to the household market

06 The market delivers a seamless customer experience in England and Scotland.

Source: Open Water

What does success look like to MOSL? Is this also relevant to household competition?

MOSL's first seven success criteria appear to relevant to both household and non-household competition. Given that the market operator is performing an exchange function and is somewhat removed from customers, its seventh criterion is the only truly customer-focused one.

01 That the new market opens on time and within budget

02 Participants have been able to execute their strategies relating to market opening

03 The new market functions efficiently, effectively and reliably

04 'No surprises' for partners or participants during the pre-launch phase

05 Retailers are able to enter and exit the market freely

06 Reputations across the stakeholder community are maintained and enhanced through the introduction of competition.

07 Customers are satisfied with their experience of the new market (i.e. switching process)

Not likely to be relevant to the household market

08 A seamless, coordinated market across the UK (England-Scotland initially) for customers.

Source: MOSL

What does success look like to CCWater? Is this also relevant to household competition?

CCWater's first success criteria1, 2, 4, 5, 6 and 7 appear to relevant to both household and non-household competition (deleting all references to 'eligible'). However, our view is that criterion 4 may need to be expanded to cover the protection of vulnerable groups. Criterion 3 may not be relevant as currently drafted (e.g. there may be disengaged customers but they would still be able to participate). However, this depends (for example) on the extent to which debt blocking could be used to lock customers out of a household market. Other success criteria that may be relevant include minimising barriers to switching.

01 Market reforms deliver benefits for customers in the competitive and non-contestable retail markets and the benefits are recognised by customers.

02 Satisfaction with service and value for money amongst eligible customers is consistently higher than before the reforms were introduced.

04 Protection mechanisms are embedded and are appropriate for all groups of eligible customers

05 Eligible customers can easily navigate the contestable retail market and easily procure appropriate products and services.

06 The contestable retail and upstream markets are efficiently and effectively operated

07 Arrangements for the contestable retail and upstream markets allow all types of market participants to deliver the levels of service that customers expect.

Possibly less relevant to the household market

03 Customers that cannot choose retailer do not experience detriment.

Source: CCWater

Will customers benefit from liberalisation?

- *What will a successful outcome look like?*
- *What will a well functioning market look like?*
- *What should we expect given other market liberalisation?*

This section presents our analysis of the main factors that define a well functioning market

We reviewed sources from NAO, Ofgem, CMA, the Financial Services Authority (now FCA) and Consumer Focus. These sources covered

- Whether a market is successful
- How competitiveness could be measured in a market (noting that this is difficult to do)
- The sources of competitive harm in markets (to identify pitfalls that should be avoided in a successful market)
- Regulatory effectiveness in regulated markets
- What effective regulation in a market could look like to a consumer

Further supporting information is presented in Appendix 2.

The table on the next page sets out our analysis of the key factors that determine a well functioning market, based on analysis of the common themes from sources that cover related topics.

We have identified six key factors for a successful market from a customer perspective

Key factor	Description
Price competition	Retailers compete on price for a given service level without making either abnormally high or abnormally low profits – there is no evidence of oligopolistic or dominant behaviour from one or several players in the market, or leverage of dominance from other parts of the value chain for individual players. Customers can switch freely between suppliers who wish both to attract new customers and retain existing ones
Customers receive value for money for the level of service offered	Customers are treated fairly. Retailers do not make use of customers' behavioural biases to apply differential charging for the same products or differential service for the same price. Information about price and service can be taken at face value.
Customers are engaged and active in the market	Customers do not face perceived or actual barriers to switching supplier. Switching supplier is straightforward, and customers are able to choose a level of complexity that suits their needs. Vulnerable customers are not excluded from the market, disengaged customers are not deterred by complexity.
Suppliers strive to provide better products and services	Retailers are incentivised to attract customers through improving their product and service offerings.
New suppliers can enter the market freely	New suppliers are not deterred from entering the market due to actual/perceived threat of a dominant supplier/ oligopoly, nor by overcomplicated regulatory barriers to entry.
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Sources: PwC analysis, NAO, Ofgem, CMA, Consumer Focus

Will customers benefit from liberalisation?

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This section presents evidence from the GB energy market experience

We reviewed data from several sources relating to the experience in GB energy around the time the domestic retail market was opened, and more recent experience in the market.

Electricity and gas consumers who are engaged in the market and have switched can secure significant savings. However, around half the households in the market have never switched (either to a different tariff with their existing supplier or to an alternative retailer)[1]. This shows that there is significant disengagement with the market. Disengaged customers are not seeing the benefits of competition.

It is expected that the saving available for a water and sewerage household retail market would not be as significant as those that have been secured by engaged customers in the GB energy market. This is partly because a longer time has elapsed since privatisation than was the case when the energy markets opened to households, as retail forms a smaller proportion of the value chain than in energy, and because there are likely to be fewer benefits flowing from upstream competition than were experienced in energy.

The CMA recently published (alongside their provisional decisions on the Energy Market Investigation) analysis of the potential gains from switching[2]. CMA estimated that the range of potential savings available per customer was £40-73 annually (in scenarios where exit fees were included, equating to 4-6% of the total energy bill) and £143-164 per customer where exit fees were excluded (11-14% of the total energy bill). The CMA's scenarios considered internal switching (where the customer switches to a different tariff with the same retailer) and external switching (i.e. switching to a different supplier).

Customers in the GB energy market have also experienced some level of detriment and competition issues that are ongoing. Historically, these detriments may have been linked to the structure of the GB energy market, with six large vertically integrated firms dominating the market for the majority of its history. Ofgem has been introducing regulatory measures to deal with these detriments and risks since the market opened to domestic consumers (e.g. early consultation papers on ease of switching, and issues with contract terms in the early 2000s). More recently, the CMA has identified significant levels of consumer detriment, driven predominately by low levels of customer engagement.

The CMA review had its origins in the Ofgem 'Supply Probe' in 2008, where Ofgem first sought to bring the issues in the energy supply market together in one place. The Supply Probe was followed by the Ofgem Retail Market Review (RMR), launched in late 2010, and concluding in 2013. At each stage, Ofgem has introduced further measures designed to address specific issues and detriments in the market. Ofgem also sought the CMA market review following the RMR.

Sources: [1]Ofgem 2015. Customer engagement with the energy sector – tracking survey 2015 (https://www.ofgem.gov.uk/publications-and-updates/consumer-research-datasets)
[2]CMA 2016. Analysis of the potential gains from switching
(https://assets.publishing.service.gov.uk/media/576bcbca40f0b66bda0000b0/appendix-9-2-analysis-of-the-potential-gains-from-switching-fr.pdf)

Engaged customers are likely to save money, but savings are likely to be less than in energy…

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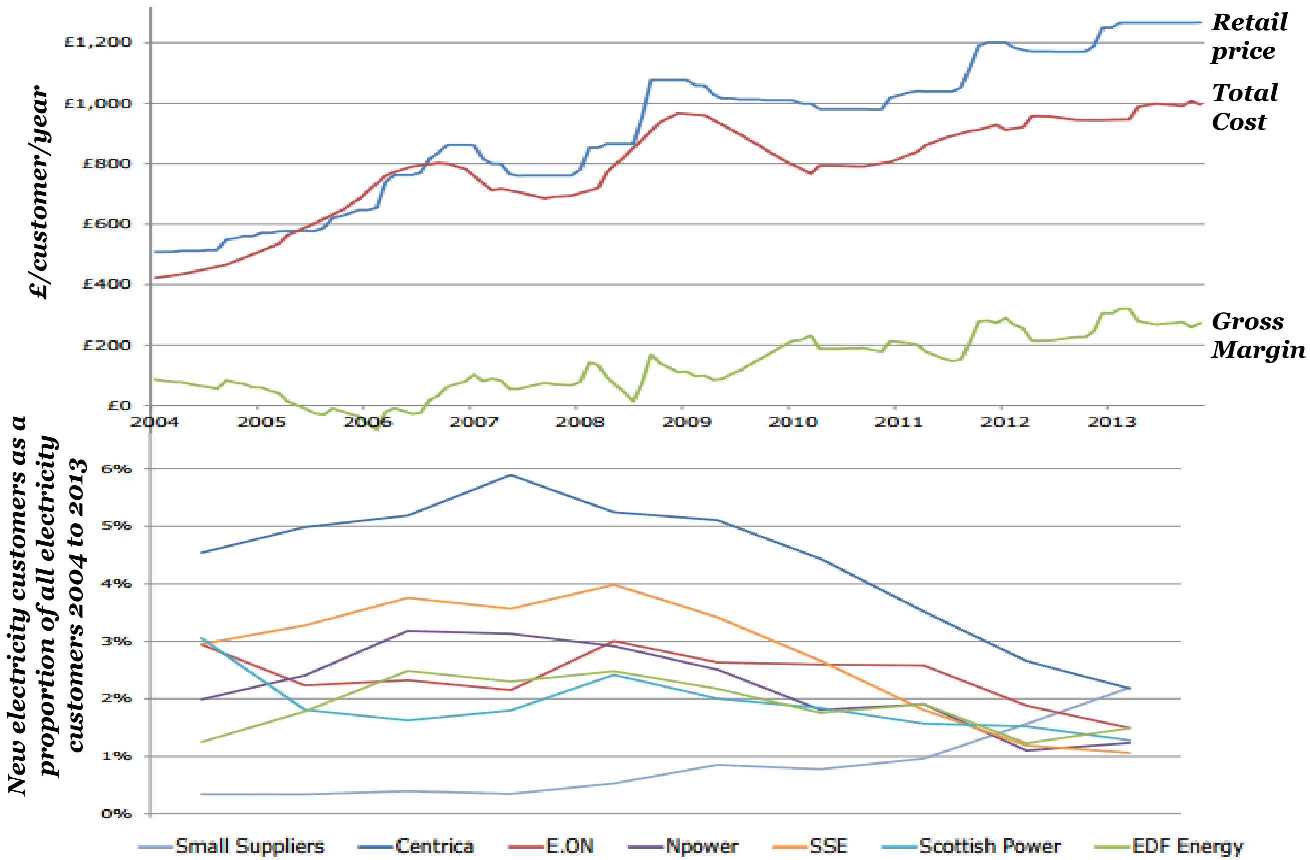
[2]CRI Regulatory Review 2000/2001, Millennium edition, chapter 2. Stephen Littlechild, Electricity Regulation.
[3]Ofgem 2015. Customer engagement with the energy sector – tracking survey 2015 (https://www.ofgem.gov.uk/publications-and-updates/consumer-research-datasets)
[4]USwitch (http://www.uswitch.com/gas-electricity/)
[5]Ipsos MORI for Ofgem, 2015, pages 5-6 (https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/customerengagementreport2015_final_for_publication.pdf)

Has the total benefit been curtailed by anti-competitive practices?

UK average nominal prices of the biggest six suppliers', mapped against the proportion of customers who have switched to a new supplier, between January 2004 and December 2013.



Source: Ofgem – State of the market assessment (2014)

Using the case study of the British energy retail market, gross margins for the biggest energy suppliers have increased in inverse proportion to the switching displayed by customers.

This suggests that whilst the threat of switching should by itself reduce prices and margins for retailers, in practice customers do not switch often enough to make this threat credible.

In energy, there is an upstream competitive generation market. The 'Big 6' energy suppliers tend to have vertically integrated supply and generation functions giving them an 'upstream hedge'.

As a result, vertically integrated companies can make margins in both the upstream and downstream parts of their businesses.

Have regulators responded appropriately?

Have some customers been left behind?

Customers whose needs differ from that of the standard customer often end up having to pay disproportionately more, which is of particular concern where customer groups have vulnerable characteristics. In a 2011 paper setting out the likely future consumer representation needs in regulated markets, Consumer Focus (CF) notes that "Firms may lack an incentive to address the needs of [these types of] consumers … if this will cost them more than their standard product or service… we consider that all regulators have a responsibility to intervene in order to protect consumers in a position of vulnerability from detriment."

Does self-regulation work?

Regulators may not make effective interventions when consumers face problems in the market, and often do not intervene quickly or decisively enough when self-regulation is failing. Relevant stakeholders often consider that regulators have a misplaced confidence in the ability of market mechanisms to change company behaviour (in particular consumers switching between providers).

This feeds a perception that regulators are slow to intervene, sometimes only doing so following significant public pressure. This feature of regulatory behaviour is likely to have the largest impact on vulnerable consumers who, due to their personal circumstances or the actions of providers, are less able to fend for themselves. Examples of specific areas where the issue and action to address it have had a long duration include doorstep selling, contract rollovers, recalibration of prepayment meters and green tariffs.

Regulators are required to be proportionate, and regulation should not place undue burden on companies, which can make it difficult to move quickly to a more direct intervention without first demonstrating that a less burdensome approach has been tried.

For example, the Financial Services Authority's handling of firms selling payment protection insurance (PPI) containing unfair clauses, made several attempts to get the industry to act before taking enforcement action.

What other tools could be employed?

Other low burden regulatory tools include reputational regulation, were the regulator 'names and shames' companies that are not treating their customers fairly. However, when the regulator names a company, it needs to have solid evidence to support its conclusions, which it should in many cases be addressing through enforcement action.

Reputational regulation and enforcement action are *ex post* regulatory tools that are applied after a breach has happened.

Information can also be used to empower disengaged consumers who are falling foul of complexity or lack of transparency from regulated markets.

CF found a mixed picture on how, and how effectively, regulators measured the outcomes of their interventions on the customer detriment the intervention was designed to address.

Sources: Consumer Focus, March 2011. "Regulated industries and consumers."
Consumer Focus, 2009. "Rating regulators
Consumer Focus, 2009. "Streetwise: real people, real issues."
Further supporting information is presented in Appendix 3

Policy risks and lessons learned from other sectors

This section sets out developments since the non-household lessons learned report was published, focusing on the Competition and Markets Authority market investigation into the GB energy market.

It is structured around the key themes we identified where there are specific issues for household customers:

- ***Customers***
- ***Competition***
- ***Regulation***

This section considers the policy risks and lessons learned from other sectors

The following sections consider risks from the energy market, drawing mainly on the CMA market investigation provisional decisions and suggested remedies. At time of writing, the CMA investigation has yet to conclude (it published its final decisions on 24th June 2016). It also considers some risks from other sectors, and some risks and issues that are specific to the water and sewerage sector in England.

It is interesting that the CMA proposes to unwind some of the Retail Market Review reforms (such as simpler tariffs) in its decisions on remedies. This shows that putting in place targeted measures to address issues and risk of detriment in markets is a complex undertaking where regulators need to consider carefully the effectiveness of the measures they put in place.

This report draws on new information published since we issued the non-household 'lessons learned' report and seeks to answer the specific questions CCWater raised on potential risks that could arise as a result of household competition.

The subsections link to the three main theme areas that we identify on p7 (customers, competition and regulation).

It is set out in tabular form, stating what the risk or detriment to customers is, its cause and the regulatory action that could be adopted to address the risk.

Policy risks and lessons learned from other sectors

- ***Customers***
- ***Competition***
- ***Regulation***

Mis-selling is an ongoing issue in energy

Risk/ Detriment	*Cause*	*(Potential) Regulatory/ Mitigating Actions*	*Comments*
Mis-selling to customers by retailers	• Failure to train and monitor own staff, or staff employed by agencies • Provision of incorrect information to customers on the doorstep and phone • Management failure to prevent the mis-selling of contracts • Insufficient attention to energy sales rules • Poor auditing mechanisms • Failure to provide key terms of a contract before it was signed or provided incomplete terms	In October 2009, Ofgem introduced tougher obligations to prevent misselling targeted specifically at domestic customers. These included the following: • “Hotline” set up for consumers to provide any evidence of mis-selling • Suppliers need to be proactive in preventing mis-selling to customers both face to face and over the phone • Suppliers selling contracts face-to-face were also required to provide customers with an estimate before any sales were concluded • Customers to receive comparison of supplier's offer versus their current deal	

Price comparison websites can be part of the mis-selling issue

Risk/ Detriment	Cause	(Potential) Regulatory/ Mitigating Actions	Comments
Mis-selling to customers through price comparison websites (PCWs) and other third party intermediaries	In the past there have been claims that PCWs could have done a better job. Respondents to the Retail Market Review consultation in 2011 cited the following: • Misrepresentation of information • Lack of transparency about commission charges • Poor quality of customer service • Inconsistent advice The price comparison websites' funding models may include commission from the energy supply companies whose tariffs they advertise, which creates a risk that the organisations that pay commission could get preferential coverage for the PCW. Recent media on issues with the Age UK branded tariff for pensioners not being necessarily the cheapest option or in customers best interests (though a caveat here that this is still under investigation by Ofgem), highlight that PCWs are not the only type of intermediary that have the ability or incentive to mis-sell to customers.	Since November 2013, Ofgem has new powers to act against brokers and price comparison websites that are marketing energy products or services in a misleading way. Even if Ofwat were unable to draw on these same powers, the CMA retains the power to ensure that marketing and comparison of products/ tariffs to customers is not done in a misleading manner.	PCWs play a crucial role in empowering consumers to engage with the market. Appropriate standards, either regulatory or voluntary, are required for PCWs. Ofgem took over management of the Confidence Code for domestic PCWs from Consumer Focus in 2013. One of the requirements of the Code is for PCWs to make available whole of market comparisons, where PCWs must endeavour to provide information on all available domestic tariffs, for all available payment types. This requirement is now at risk of removal, as a result of a recommendation from the CMA's market investigation[1].

[1] https://www.ofgem.gov.uk/information-consumers/domestic-consumers/switching-your-energy-supplier/confidence-code

Confusion can arise when customers are sold between retailers

Risk/ Detriment	Cause	(Potential) Regulatory/ Mitigating Actions	Comments
Customers being sold between retailers, without their consent, resulting in customer confusion and distrust of the market, as well as potentially poor customer outcomes	• Customers are sold between companies, especially by incumbents to new entrants, for example Npower sold 770,000 of their customers to Utility Warehouse in November 2013 • Customers end up with a retailer they may be unfamiliar with, and potentially customer service levels (and future tariffs) that are different to what they originally signed up for • This is problematic if a retailer with a reputation for delivering high quality service (and is able to charge a premium) sells their customers on to a retailer with a poorer service level. These customers may end up paying above the market rate for service levels below the standard they previously enjoyed • It should be noted that this is a potential risk and not a common recent complaint in the energy sector	• The regulatory framework (e.g. the licence) has to be strict enough to prevent retailers that do not offer appropriate levels of service from entering/ remaining in the market • The regulator (or Government via statute) can set minimum service standards • The regulatory framework could potentially also make restrictions on how the transactions can take place, for example controls around either the maintenance of historic customer experience when customers are sold on or constraints on tariff cost reflectivity (or service reflectivity). Customers sold to retailers with worse customer service, may not be result in an acceptable outcome for those customers	In the water and wastewater market, retail exit (and retailer insolvency where a buyer is found) may create issues with significant numbers of customers being sold from one retailer to another when the customers did not explicitly choose it. In a household competition context, this could involve disengaged and vulnerable customers who are inactive in the market and may need different protections or assistance than disengaged non-households.

Tariff complexity can create customer confusion

Risk/ Detriment	*Cause*	*(Potential) Regulatory/ Mitigating Actions*	*Comments*
Customer confusion due to complexity	• High number of tariffs. A consistent message from Ofgem's consumer research over recent years is that people find or perceive there are too many (and too complex) tariffs to allow them to assess their options properly. • Complex structure of tariffs. A lack of standardisation in the presentation of tariffs and tariff information is a cause of confusion. Consumers are unable to establish whether they are comparing "like with like", and are generally confused by the range of technical terms used. • High number of components of energy tariffs. Customer representatives state that many customers are confused by the number of components of energy tariffs such as standing charges, tiers, unit rates, discounts, cash back, termination fees, loyalty bonuses and bundled products.	**Retail market review (RMR) 2013 (for domestic customers).** As part of the RMR, new rules on tariff choices were implemented through standard conditions of the electricity supply licence and gas supply licence. **Stripping away tariff complexity (for domestic customers).** Suppliers have been required to eradicate complex and confusing multi-tier retail tariffs for domestic users. They were limited to no more than four tariffs for each product offered e.g. variable electricity, fixed electricity, fixed dual fuel (although this will be reversed by the CMA energy market review). New tariffs must allow simple comparison and must include both a standing charge and a per kWh rate. **Arming customers with better, more relevant information.** Suppliers must now make sure customers are well informed about their tariff choices and understand the details of invoices. They are required to present all their tariffs using the Ofgem 'tariff comparison rate' tool that helps customers compare tariffs across various suppliers. They must provide regular information on bills and annual statements to their customers on what the cheapest tariff could be based on current consumption.	Some customers benefit from complexity whereas others will suffer. There may need to be simple tariffs and of limited numbers for vulnerable (and disengaged) customers. Ofwat could benchmark these against other tariffs and regulate using a backstop tariff approach (similar in form to the CMA's remedy to cap prepayment customer tariffs).

Customers can find it difficult to engage in regulated markets

Risk/ Detriment	Cause	(Potential) Regulatory/ Mitigating Actions	Comments
Weak customer response and lack of engagement	• Disengaged customers may be unaware of gains from switching • Customers with low incomes, low qualifications, living in rented accommodation, or over 65s are less likely to be engaged with the domestic retail energy markets • Barriers to engagement may exist, for example conventional meters are not necessarily visible or immediately informative to customers	• Increased communication of the likely gains • Reducing the burden of switching suppliers • Using price comparison websites (PCW's) can significantly reduce search and switching costs for domestic customers by providing an easy means to gain personalised quotes, on a comparable basis, from a range of different suppliers. However, there are potential risks that must be managed as discussed previously • Fully roll-out of smart meters (at a room/ device specific level) linked to periodic reminders that switching is available • Smart meters can also be a useful tool in reducing energy usage (and therefore saving money on bills)	There need to be appropriate safeguards around PCW's. As note previously, they may not offer the best deal (e.g. because they are middle men and will need an additional margin, either from commission or directly). Hence, PCWs may fail to identify the best deal.

Source: CMA - Energy market investigation Summary of provisional findings report

There are water and wastewater-specific issues and risks for certain household customer groups

Risk/ Detriment	Cause/ Examples	(Potential) Regulatory/ Mitigating Actions	Comments
Policy or protection measures that are needed in household water/ wastewater retail that are unique to this sector.	• Certain types of customer have a definitive need for a continuous and reliable supply of water (normally for health reasons)	• The legal definition of vulnerable customers in water includes 'chronically sick', for example customers who use dialysis machines and therefore need to use large amounts of water every day for health reasons • Any regulation aimed at vulnerable groups would also apply to these customers	
	• Customers served by 'last mile' infrastructure and retail companies (under the New Appointments and Variations regime – termed NAVs)	• The NAV regime is a form of 'franchise competition' where a third party, often appointed by a developer takes over the last mile infrastructure and retail service to a group of customers exceeding a given volume threshold • There may need to be specific provision for customers served by NAVs that switch supplier (e.g. bill consolidation arrangements) given that there is an additional party involved (i.e. the NAV responsible for local pipework) as well as the wholesaler and retailer	

Policy risks and lessons learned from other sectors

- ***Customers***
- ***Competition***
- ***Regulation***

Lack of transparency can cause confusion and lack of engagement

Risk/ Detriment	Cause	(Potential) Regulatory/ Mitigating Actions	Comments
Lack of price transparency (or lack of transparency of terms)	• Tariffs may be poorly communicated to customers, or communicated in a way that does not engage them • Tariff complexity may cause customer confusion, which hinders their ability to manage their tariff and usage • There may be many contract issues that further prevent effective competition. Examples include contract rollover, out of contract rates, and hidden or unfair contract terms • Actual meter readings may not be sufficiently granular for customers to manage their usage and respond to price changes (e.g. there is often only one actual read per year, when consumption information would need to be much more frequent, e.g. daily, hourly or even twice hourly to manage demand)	• Recent regulatory interventions include requiring energy companies to be more transparent about the tariff and usage on energy bills to facilitate customer engagement with the market (including indicating on the bill the cheapest tariff they offer given each customer's usage profile, and showing annual consumption) • Information needs to be provided in simple language and in an accessible way • Smart metering (and therefore greater visibility and accessibility of daily consumption) may help, although other measures are also likely to be needed • Greater signposting and visibility of changes in price are likely to be needed delivered in a way that makes it easier for customers to respond (e.g. via text messages or apps)	Electricity and gas bills are often based on estimates with only one actual read per year. This does not provide appropriate incentives either to suppliers to help customers reduce consumption, or to customers.

Source: CMA - Energy market investigation Summary of provisional findings report

Suppliers may have capacity to leverage market power or tacitly co-ordinate to keep prices higher

Risk/ Detriment	Cause	(Potential) Regulatory/ Mitigating Actions	Comments

Supplier behaviour	• The CMA has found that the use of differential pricing practices by suppliers is resulting in significant customer detriment. Energy companies have also argued in the past for deemed tariffs significantly above the rate available for customers on contracts through claims that they need to purchase power on the spot markets at higher costs
	• There have been claims in the past that suppliers may have been tacitly coordinating through the public price announcements they make
		• Competition law can be used to address examples of poor supplier behaviour, including individual competition cases and market investigation. However, this is an *ex post* mechanism and may not be effective if the evidence is incomplete or unclear. Competition cases can take significant amounts of time to conclude, and while the competition authority or regulator is investigating the competition case, the detriment to customers may continue to occur
		• Ex ante mechanisms include:
		  • Structural remedies such as requirements for separation between wholesale and retail parts of the business
		  • Transparency remedies such as accounting separation or other information requirements
		  • Closer regulation of tariffs, including requiring evidence of cost-reflectivity	

Source: CMA - Energy market investigation Summary of provisional findings report

Disengaged and vulnerable customers are at risk of being transferred onto high tariffs

Risk/ Detriment	Cause	(Potential) Regulatory/ Mitigating Actions	Comments
Disengaged customers may lose out financially They may find themselves stuck on deemed tariffs and contracts that are at rates far higher than the market rate	• High deemed rates • The regulatory requirement that rates should not be ‘unduly onerous’ has been open to interpretation, and it may be difficult for regulators to prove that the rates are not cost reflective • The contract rollover process may be used by suppliers to put customers onto high deemed rates (and behavioural bias issues around contract renewal notices) • Objections to transfer, especially debt blocking (which may occur even where it is expressly disallowed) may make it seem too difficult to switch away • Applying ‘standing charge only’ deemed contracts where there is no consumption • Rolling insolvent customers or customers struggling to pay their bills onto deemed contracts (and therefore higher rates) • Abuse of credit checking and delays to contract negotiation allowing suppliers to charge higher deemed rates in the meantime • Lack of clarity over when a deemed contract applies	Having regulated deemed contract terms that are understood could offer greater protection against consumer detriment than having no terms at all. It is also likely to make dispute resolution quicker if terms are in place (e.g. ‘out of contract’ rates are likely to be even higher than deemed rates in GB energy, and any disputes must be settled through the courts). What is included in deemed terms and how deemed rates are calculated is clearly important if the detriments experienced in other sectors are to be minimised. Use of ‘default’ or backstop tariffs is one option available. The CMA suggested that measures to prompt customers on default tariffs to engage in the market could help and proposed that a price control should apply to pre-payment customers only.	

Source: PwC - Research into use of deemed contracts in comparator industries for CCWater

Policy risks and lessons learned from other sectors

- ***Customers***
- ***Competition***
- ***Regulation***

The regulatory framework may not incentivise a transparent and competitive market

Risk/ Detriment	*Cause/ Example*	*(Potential) Regulatory/ Mitigating Actions*	*Comments*
Regulatory framework	• CMA's view was that Ofgem's statutory objectives may, in certain circumstances, constrain its ability to promote effective competition • CMA noted that the regulatory accounting framework did not provide sufficient transparency concerning costs incurred, and visibility of profitability in the generation and retail segments • Communication of the impact of regulatory policies on energy prices and customers' bills • No formal process for regulators and Government to come to a common policy position	• Modification of the regulator's statutory objectives to increase emphasis on promoting competition • Improve the regulatory framework for financial reporting, so that the retail and generation segments are reported on as standalone businesses • Ofgem to adopt an ongoing programme of identification, testing, and trialling of potential regulatory measures designed to promote customer engagement • Maintain the exemptions regime for smaller suppliers to increase competition • CMA recommended that Ofgem publish an annual 'state of the market' report • Greater transparency of the interactions between Ofgem and DECC	• CMA considered that aspects of the Retail Market Review (RMR) reforms limited the ability of suppliers to innovate and provide (to a maximum of four) products which may be beneficial to customers and competition • Four tariff rule limited discounting and reduced competition benefit

Source: CMA - Energy market investigation Summary of provisional findings report

Retail exit may lead to problems with resolving operational issues

Risk/ Detriment	Cause/ Example	(Potential) Regulatory/ Mitigating Actions	Comments
Failures in operational service following retail exit	• In energy, customers contact the distribution company directly if there is a power cut. This can lead to confusion as the supplier needs to publish two sets of contact details on the bill. • In the non-household water and wastewater retail market in Scotland, a single point of contact was established with the retailer. The retailer contacts Scottish Water to resolve operational issues raised by the customer. • In Scotland, there is some anecdotal evidence from complaints of occasional breakdown of communication between Business Stream and Scottish Water in relation to operational work on the network leading to issues with complaints handling[1]. • In either case, it is possible that the network operator could become less incentivised to fix operational problems because it is removed from the customer.	• Consider whether customers' interests are better served by a single point of contact or multiple contact points • In both markets there are guaranteed standards for fixing operational network issues with financial penalties for failure • In its price controls, Ofgem requires networks to engage with customers and includes incentives linked to customer experience	

Sources: CMA - Energy market investigation Summary of provisional findings report, SPSO complaints decision papers
[1]For example, see the following Scottish Public Setrvices Ombudsman (SPSO) decisions:
http://www.spso.org.uk/decision-reports/2014/may/decision-report-201304731-201304731
In this example, SPSO needed to intervene to arrange a 3 way meeting between Business Stream, Scottish Water and the customer:
http://www.spso.org.uk/decision-reports/2013/december/decision-report-201201727-201201727

Regulators can introduce incentives to help customers reduce consumption and therefore bills

Risk/ Detriment	*Cause*	*(Potential) Regulatory/ Mitigating Actions*	*Comments*
Energy (Water) Efficiency is potentially **part** of the solution to help customers. However, it needs to be combined with appropriate protections against the detriments and risks that customers are facing	Poor incentives to help the customer reduce consumption or adopt 'green energy' options. In the absence of incentives, the retailer or wholesaler are less/ unlikely to assist customers to reduce their demand – where energy is charged on a per unit basis revenue and profit will increase as more units are sold.	In energy, energy saving initiatives involving cross-subsidy (the ECO and previously CERT/ CESP schemes) were introduced with binding statutory targets. This suggests that incentives on suppliers to promote energy efficiency are not strong. It has proved difficult for energy suppliers to meet the targets set in CERT/CESP– and several energy suppliers have been fined for failure to meet them. In the Scottish non-household water and sewerage market, one of services retailers commonly offer is helping customers reduce water and wastewater bills and sharing the benefits in some way. However, the evidence is more limited on whether this is actually occurring in the market (as opposed to being one of the services advertised on retailers' websites). It may be that non-households receiving these services have high consumption and the bill saving justifies the effort/ specialist skills needed to achieve savings. In energy, 'Green' micro-generation is incentivised via 'feed in tariffs', and green energy may be incentivised through 'contracts for difference'.	• This is not necessarily fully competition or liberalisation-related – where consumption is measured suppliers are unlikely to be incentivised to sell less product • As the energy cost of heating/pumping water and water usage are linked - there are questions about the potential synergies between retailing water and energy together • Water efficiency has sometimes been suggested as a means of fighting 'water poverty' to be used alongside social tariffs. The CESP scheme was also targeted towards lower income households

Source: CMA - Energy market investigation Summary of provisional findings report

Regulatory arrangements in other sectors

- ***Alternative regulatory models***
- ***GB Banking Sector & Codes***
- ***GB Telecoms - Making Switching Easier***

Regulatory tools range from self-regulation to statutory controls on companies

Increasingly regulatory involvement

Model	1. Industry self-regulation	2. Regulator signs off industry-governed code	3. Regulator signs off all major changes	4. Statutory regulation
Examples	Banking code (historic)	Broadcasting code applied to TV advertising but administered by ASA	Electricity Balancing and Settlement Code (BSC) at wholesale market opening; Water retail in Scotland	Retail banking now is regulated through statutory instrument and FCA 'rulebooks'
Commentary	Ultimately resulted in more direct regulation in banking	May be appropriate for some issues (i.e. where the potential level of detriment is perceived to be less material) but not others	This is a model widely used in electricity and gas. There are central costs of the switching systems and of maintaining 'live' codes. In Scotland the regulator has more direct powers to shape and change codes.	The most interventionist form of regulation, where the regulator and sometimes Government have a direct role in setting 'rules'.

The figure above shows four potential models in a continuum. At the left hand side of the diagram, the regulator allows the market to set up its own codes for switching, sales practices and other areas where there is a risk of consumer detriment. At the right hand side, regulation is prescriptive and set in statute. The higher the risk of detriment, the greater regulatory involvement could be justified. However, regulation should also be targeted. For example, if risk of detriment only applies to certain customer groups, regulation should only be targeted at those groups.

There is a trade-off between the price paid (by customers) to finance the central regulatory and structural arrangements (e.g. a market operator) the flexibility to innovate conferred by the regulatory model, and the benefit of the regulatory protection. This needs to be balanced against the likely cost to customers/ society of the detriments experienced in the absence of any regulatory intervention.

Alternative regulatory models have different implications for customers (2 of 2)

The following sections discuss selected case studies from other sectors. The regulator's ability to put measures in place after initial market design (put in place during the initial market opening) appears to be dependent on Government commitment to protect consumers. This will be related to Government perception of the seriousness of the detriment risk in a given market. An overview is presented below.

In the past in retail banking, the banks signed up to a voluntary banking code. However, it became clear that the self-regulation approach was not offering sufficient customer protection, and the market ultimately moved to a very high level of regulatory intervention. This involved placing the rules previously provided for in the banking code into secondary legislation. Hence, the compliance burden increased from a voluntary basis for code signatories only to a mandatory statutory compliance requirement.

The telecoms and energy markets have both had similar issues with switching (e.g. erroneous transfers, transfer blocking, contract rollover). However, the two sectors have taken different regulatory approaches to the issues.

In telecoms, there was historically no market operator. Ofcom considered introducing a 'market operator' for telecoms switching in a mature telecoms market, but ultimately decided against it, preferring to put less costly protections instead. These included a formal process for switching where the roles and responsibilities of the 'gaining provider' and 'losing provider' were more clearly defined, and licence conditions designed to provide additional protections against the illegal practice of 'slamming' where customers are unknowingly switched (against their will).

Source: [1]Offer 1998 (https://www.ofgem.gov.uk/ofgem-publications/79067/review-electricity-trading-arrangements.pdf)

In energy the market operator was introduced through an Offer review of market governance in the electricity pool (which concluded in 1998[1]). This included measures to bring trading in line with commodity trading markets elsewhere. Governance reforms included recognition of the need to bring in alternative approach where responsibility for management of the mandatory and natural monopoly elements of the market should rest with an independently established organisation, the 'Independent Market Organisation'.

This became the 'Market Operator' Elexon and the Balancing Settlement Code was also introduced as part of the New Electricity Trading Arrangements.

The difference between energy and telecoms appears to be that in energy, Government was heavily involved in support for the reforms (including legislation where necessary). A DTI review of utility regulation took place in parallel with the Offer review. This review ultimately gave rise to the Utilities Act 2000, which enabled a number of reforms, and developments in consumer protection in energy.

These examples also show the difficulty of changing the regulatory framework after the initial market design. In banking, the move was a radical one from self-regulation to placing the rules on statute – this may have been necessary due to the perceived seriousness of the issue and also that statute is an undisputable way of putting hard rules in place.

Where there is resistance from companies with putting specific measures in place (e.g. in the licence), regulators may struggle to change the existing arrangements or to justify any significant interventions that they want to make unless they have good evidence of the detriment and backing from Government or from developments in EU/ international competition policy.

Regulatory arrangements in other sectors

- ***Alternative regulatory models***
- ***GB Banking Sector & Codes***
- ***GB Telecoms - Making Switching Easier***

Case study: GB Retail Banking Sector (Banking Code)

The following case study, which discusses the Banking Code and how it evolved within the existing retail banking market, has relevance as it explores the use of standards and codes in personal/household consumer markets, as well as how such an industry responds to an increasing regulatory scope.

The Banking Code sits in model 1 (self-regulation) in our continuum on p47. It represents an industry led code setting out the retail banking service customers can expect from banks that signed up to the code.

The Banking Code was the (now superseded) set of good practice standards that UK financial institutions could choose to sign up to when dealing with personal customers and was first introduced in 1991. There were separate versions of the code for personal and business banking. The last version of the code was published in 2008 accompanied by a set of banking code rules that subscribers were required to abide by . It covered current accounts, savings, cards and loans.

An independent organisation, the Banking Code Standards Board (BCSB) administered and enforced the codes and there were independent code reviews every three years. The BCSB could make amendments to the codes (if the 'sponsor organisations' agreed), and part of its remit was to identify gaps in the code.

Three industry associations ('sponsor organisations') owned the codes and were responsible for preparing code amendments. Neither the independent code reviewer nor the independent regulator (FSA) could amend the code without industry agreement. FSA had no formal role in the development or governance of the banking code.

The BCSB had the right, from time to time, to pass on information to FSA regarding certain parts of the code relating to obligations in the FSA Handbook and other regulations.

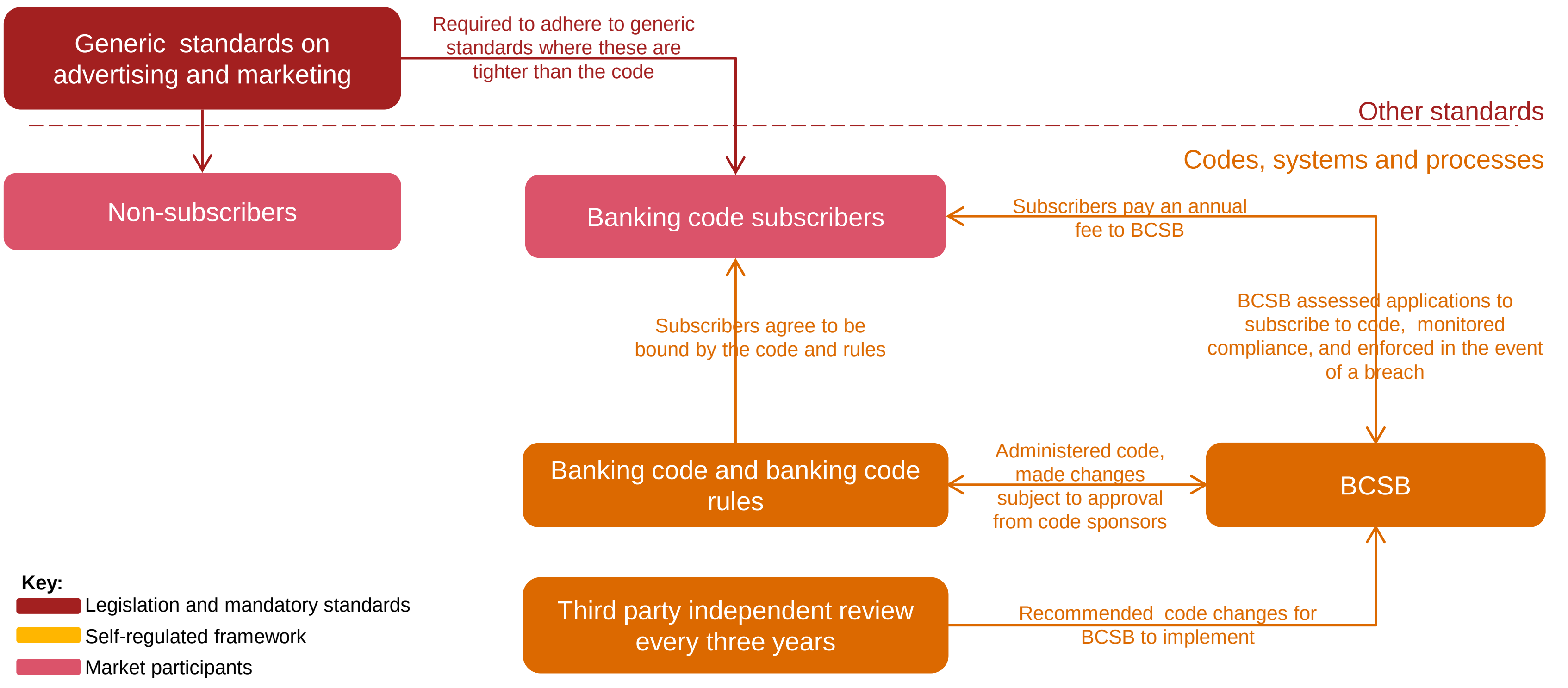
BCSB monitored code compliance, including undertaking mystery shopper exercises, site inspections and other tests of compliance. It could enforce compliance through suspending or cancelling subscriptions; naming the subscriber in breach; Recommending redress (including redress for customers affected by a breach); or Issuing warnings or reprimand. BCSB did not have powers to fine companies for breaches. Parties found to be breaching the code had a right of appeal.

BCSB also had a process for handling complaints from subscribers or members of the public, including arrangements for arbitration if resolution could not be reached.

Once registered, their entire business had to adhere to the minimum standards in Code, provide an annual statement of compliance, and provide BCSB with information it reasonably required to assess compliance.

A schematic of the arrangements under the former banking code is included on the next page, focusing on codes, agreements, systems and processes that were in place prior to the transfer of responsibility for parts of the code to FSA.

GB Banking Sector - Arrangements under the Banking Code prior to 2009



The Banking code was superseded in 2009 by a statutory instrument and a code, each with different governance structures.

The areas subject to self-regulation have reduced over time, so that only loans are now covered by a voluntary code.

GB Banking Sector – Ongoing Evolution

The areas subject to self-regulation have decreased over time in the banking sector, with parts of the banking code being directly regulated by the FSA from 2009, driven partly by EU legislation.

In 2009, responsibilities for the conduct of business regulation for deposit and payment products were transferred from the banking code to be regulated directly by the FSA. The remaining services that were covered by the banking code became the Lending Code, which remains a self-regulated code. Government transposed new EC law on Payment services into national law (the Payment Services Regulations 2009) [1] . The aim was to create an EC-wide market operating under common rules and regulations . The FSA stated that the reasons for changing the method of regulation were because [2]:

- "it is increasingly anomalous that the FSA does not regulate retail consumers' core financial services relationship especially now that we are to regulate payments services;
- this anomaly potentially restricts our regulatory effectiveness because we are unable to look comprehensively across all risks affecting firms' retail market activities within our scope;
- there may be scope for consumer detriment because in this key sector we are not enforcing Principle 6 (a firm must pay due regard to the interests of its customers and treat them fairly), the cornerstone of our regulatory approach; and
- our risk-based approach has affected the cost benefit case for voluntary self-regulation of retail banking services."

The FSA identified an increase in signs of market failure indicated by customers choosing less appropriate services, poor after-purchase service and increases in the number of complaints to both the firms and the Financial Ombudsman Service [3].

1 - http://www.hm-treasury.gov.uk/d/si_payment_services_regulations100209.pdf
2 - http://www.fsa.gov.uk/pubs/cp/cp08_19.pdf
3 - See annex 2 of the FSA consultation document

Regulatory arrangements in other sectors

- ***Alternative regulatory models***
- ***GB Banking Sector & Codes***
- ***GB Telecoms - Making Switching Easier***

Case study: Ofcom Making Switching Easier

The following case study provides an example of customer protection measures introduced in other household retail markets that could be adopted in water. Again, it was implemented into a mature market by a regulator, so shows the potential issues a regulator might face when implementing after market opening (as opposed to during the initial market design phase prior to a market opening). This case study does not fit neatly in the continuum on p47 - the regulator has defined a simple framework for switching that the industry must follow without putting a formal code in place. Although the regulator sets the rules and framework, this model could be considered lighter touch – perhaps more in line with model 2 in terms of level of regulatory intervention.

Ofcom, the UK's Communications watchdog, decided to look into the whole process of switching landline and broadband services in order to reduce the hassle that people face when changing providers. Ofcom launched a consultation in 2012 because it wanted to make sure that[1]:

- "Switching those services is easy and hassle-free;
- The switching processes don't stop providers competing with each other to deliver lower prices, greater choice, innovation and good value; and
- Consumers are protected from being switched against their will."

The table below highlights the significant problems faced by consumers when it comes to switching:

Significant problems faced by consumers when it comes to switching

Multiple processes	The existence of multiple processes creates confusion and lack of clarity
Difficulty and unnecessary costs	Losing providers have no incentive to make it simple for customers to switch away, which can result in delays, increased costs and unwanted pressure on the customer to change their mind
Lack of information	Lack of full and unbiased information on the implications of making a switch
Insufficient customer consent	There are still concerns over customers being switched against their will
Erroneous transfers	Switches where the wrong line is inadvertently switched account for a large proportion (46%) of the switches that happen without consent
Loss of service	A significant minority of consumers (20%) suffer some loss of service when switching
System problems	Customers are unable to use industry-agreed switching processes when switching between some providers. Customers also face difficulties when switching between different networks that provide fixed voice and broadband services
"Reactive save"	Losing providers may offer "reactive save" inducements to keep a consumer from switching away

Source - http://stakeholders.ofcom.org.uk/binaries/consultations/consumer-switching-review/annexes/switching-plain-english.pdf

Case study: Ofcom Making Switching Easier

Ofcom considered three broad group of options[1]:

- retaining the existing processes and making incremental improvements to them
- moving all processes to a harmonised GPL (gaining provider-led system) process
- or focusing on a new LPL (losing provider-led system) process

Ofcom's assessment of each option supported the adoption of the GPL process as this option is likely to be the less disruptive option for consumers, industry and competition. Ofcom considers that implementing the first stage of the GPL process will promote the interests of consumers by:

- ending the confusion and difficulties that come with multiple processes
- ending the LPL system, which will make sure that the switching process works in consumers' interests, and that if they wish to switch they can do so easily
- improving information to put consumers fully in the picture about the implications of a switch
- strengthening Ofcom's ability to act against providers who deliberately switch consumers without their consent
- reducing the number of wrong lines being switched
- addressing the loss of service suffered during switching, particularly for bundles of fixed voice and broadband services

The second stage of the GPL process will involve considering whether further changes are needed to address key issues. Ofcom's aim is to make switching work more quickly, cheaply and easily for consumers and, in so doing, make competition work more effectively, for single and bundled services.

Source - http://stakeholders.ofcom.org.uk/binaries/consultations/consumer-switching-review/annexes/switching-plain-english.pdf

Appendices

- ➢ *Key lessons from other sectors*
- ➢ *Supporting information for what makes a successful market*
- ➢ *Supporting information for 'have regulators responded appropriately*

Appendix 1 – nine key lessons learned from other sectors

Areas where detriment commonly occurs in regulated markets

1. Incumbents may apply differential pricing or terms in dominant parts of their business
2. Incumbents may reduce service levels (e.g. to captive and high cost to serve customers)
3. Mis-selling and misleading information is a risk during the 'dash for customers'
4. Incumbent actions or regulatory failures may frustrate market entry
5. Retailers or regulatory failures may frustrate switching
6. Poor data or processes can result in mistakes during switching
7. Complexity leading to customer confusion
8. Unfair and/ or hidden contract terms can confuse and disadvantage customers, especially the fringe customers (e.g. time poor)
9. Customers may be unaware of their right to switch or disincentivised to do so due to behavioural biases

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Regulatory tools commonly used to manage areas of detriment

Regulators may seek to set rules around areas of potential customer detriment to prevent it from occurring. The strength of these rules depends on the seriousness of the failure, the range of measures experienced in our comparator sectors being:

- Voluntary codes of practice
- Regulatory guidance
- Regulatory or market standards and processes (e.g. market code)
- SLAs
- Licence conditions
- Accreditation schemes for unregulated third parties
- Level playing field requirements
- Primary and secondary legislation
- Wider consumer legislation

Where the detriment potentially leads to higher prices than would otherwise be experienced the regulator may:

- Seek voluntary price reductions
- Set charging rules and scrutinise proposed tariffs
- Set licence conditions (e.g. no undue preference or discrimination)
- Apply tariff constraints such as differentials or default tariffs
- Apply price or revenue controls where market power exists

Similarly, regulators may seek to reduce complexity where it exacerbates behavioural biases by, for example:

- Standards of conduct
- Tariff simplification or comparability requirements
- Protection for specific customer groups
- Specific guidance on transparency and clarity of information

Appendix 1 – nine key lessons learned

Lesson learned	Examples	Driver(s)	Ex ante regulatory tools*
1. *Incumbents may apply differential pricing or terms in dominant parts of their business*	• Energy 'in area' and 'out of area' price differentials (not explained by cost-reflectivity). • Energy 'in area' and 'out of area' variations in payment methods. • Business Stream has re-negotiated tariffs with 60% of its customers, and around 5% have switched, which leaves c.35% of customers on the default tariff. • Peak and off peak pricing in rail (although this is potentially valid if it spreads load on the network).	• Market power	• 'In area' retail price controls. • Default tariffs (as used in Scotland) to limit price differentials. • Tariff regulation through licence (e.g. no undue discrimination, cost reflectivity). • Tariff simplification or comparability requirements (although their use may stifle innovation). • Tariff differentials (e.g. fare flex in rail).
2. *Incumbents may reduce service levels (e.g. to captive and high cost to serve customers)*	• Increasing focus on high-value customers in energy . • Initial criticism of retail service levels to businesses after market opening for water and sewerage in Scotland. • Energy complaints handling (although not clear how far this relates to market power and competition versus general poor service).	• Market power • Poorly designed regulation	• Recognition that micro-businesses require protection in energy. • Consumer Complaints Handling Regulations prescribe binding complaints handling standards. • Codes and licence conditions setting out minimum levels of service to customers. • Standards of conduct. • Self regulation (e.g. voluntary back-billing code for micro-businesses).

*We focus on *ex-ante* regulation because *ex post* measures are generic to all lessons learned. While they are useful safeguards, they can also be ineffective because they detect detriment after the event, with a time lag during which customer detriment continues. Examples of *ex* post measures include:

- Reporting requirements and regulatory monitoring, including complaints monitoring
- Licence or statutory enforcement (including generic consumer and competition legislation), code enforcement, fines and redress
- Special administration and licence revocation

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Appendix 1 – nine key lessons learned

Lesson learned	Examples	Driver(s)	Ex ante regulatory tools*
3. *Mis-selling and misleading information is a risk during the 'dash for customers'*	• Illegal practice of switching without consent in telecoms. • Customers pressurised into switching in energy and telecoms. • Misleading, incomplete or incorrect information in energy and telecoms. • Misleading information on broadband speeds (although Ofcom considers this to be a complex area). • Misinformation and mis-selling caused either directly by a retailer or by unregulated TPIs, subcontractors etc. • Mis-selling can include unfair or unclear product bundling or tying as seen in PPI mis-selling cases in the Financial Services sector.	• Imperfect information	• Transparency of offer to customers . • Standards of conduct. • Voluntary code for broadband speed claims. • Regulatory guidance on broadband speed claims. • Use of wider consumer legislation. • Voluntary regulation of TPIs through accreditation scheme. • Regulation of TPIs through retailers' licences. • Changes in secondary legislation (e.g. PPI mis-selling).

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Appendix 1 – nine key lessons learned

Lesson learned	Examples	Driver(s)	Ex ante regulatory tools*
4. Incumbent actions or regulatory failures may frustrate market entry	• Retailer payment in advance for wholesale water and sewerage services in Scotland may have frustrated entry as working capital management was difficult for start ups. Business Stream negotiating tariff reductions with customers putting their supply out to tender may have exacerbated this. • Initial lack of new entrant retailers in the water and sewerage market in Scotland. • The 'Big 6' energy companies have a significant inactive customer base not enjoyed by entrants, which gives them scale economies and potentially stabler cashflows. • The availability and allocation by the regulator of spectrum limits the number of players in mobile telephony. • The Big 6 supply companies are able to 'hedge' through vertical integration with generation making market entry difficult due to difficulties around access to the commodity. .	• Market power • Regulatory failure	• Revised licence application process designed to reduce barriers to entry in Scotland (while strengthening arrangements for licence enforcement). • Measures to facilitate different payment terms for water and sewerage wholesale services in Scotland (e.g. option to use escrow account, letters of credit). • Measures to improve market participation through improved retailer behaviour (e.g. Standards of Conduct in energy) and customer empowerment (e.g. annual statement of usage and rates charged). • Measures to ensure greater upstream market liquidity (e.g. REMIT in energy).

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Appendix 1 – nine key lessons learned

Lesson learned	Examples	Driver(s)	Ex ante regulatory tools*
5. Retailers or regulatory failures may frustrate switching	• Objections to transfer in energy and telecoms. • Poor data and incompatible systems/ data leading to slow transfer times in energy. • Lack of a common process led to switching complexity in telecoms.	• Market power • Regulatory failure	• Licence prohibition on objections in energy, included in the prohibition on mis-selling in telecoms. • Requirement to keep proof of a switch in telecoms (the market operator would do this in energy and water/ sewerage in Scotland). • Self-regulation/ industry codes of practice. • Standards of conduct regulation (energy and FS). • Market operator data standards. • Switching SLAs, regulated market codes. • Central switching agencies in energy, common process in telecoms.
6. Poor data or processes can result in mistakes during switching	• Erroneous line transfers in telecoms (where the wrong property is accidentally targeted for a switch or house move).		• Introduction of a standard switching process in telecoms. • Use of a market operator to hold data centrally and verify switches in energy and water/ sewerage in Scotland means erroneous transfers appear less problematic in these sectors.

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Appendix 1 – nine key lessons learned

Lesson learned	Examples	Driver(s)	Ex ante regulatory tools*
7. ***Complexity leading to customer confusion***	• Complex tariff structures, large number of tariffs in energy. • Poor information around tariffs in energy. • Multiple customer points of contact across a disaggregated value chain(e.g. supplier and distribution company in energy). • Confusion over responsibility for meters in the Scottish water and sewerage market. • Confusion over fare complexity in rail, and poor information to customers at point of sale.	• Behavioural bias	• Standards of conduct. • Requirements to simplify tariff numbers and structures (e.g. energy). • Rules on discounts and bundling (e.g. Ofgem). • Requirements around clarity and relevance of information (e.g. Code of Practice on ticket information). • Requirements to standardise/ make comparable tariff information (energy, note this potentially reduces scope for bespoke customer service through tariffs). • Single point of contact with the retailer for all customer contacts relating to water and sewerage in Scotland. • Inevitably, there may be issues or areas of the market where unbundling proceeds more slowly leading to market evolution (e.g. metering). Signposting the direction of travel in an accessible way and attempts to reflect this direction of travel in regulatory requirements for customer service. • Performance reporting and publishing customer research (e.g. rail).

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Appendix 1 – nine key lessons learned

Lesson learned	Examples	Driver(s)	Ex ante regulatory tools*
8. Unfair and/ or hidden contract terms can confuse and disadvantage customers, especially the fringe customers (e.g. time poor)	• Energy contracts agreed over the telephone without full information to the customer (e.g. on duration, fixed vs variable price). • Automatic contract rollover (on less favourable terms) in energy. • Mid-contract mobile phone price rises. • Early termination charges and rules around termination in energy and telecoms. • No 'get-out clause' in energy.	• Behavioural bias	• Unfair Terms in Consumer Contracts Regulations (1999). • Licence conditions in energy (e.g. contracts and communication must be in plain intelligible language) and in telecoms (requirement to offer contracts with minimum terms). • Regulatory guidance (e.g. Ofcom guidance on fairness in fixed term contracts). • Shortening the maximum termination notice period in energy and information requirements for renewal letters. • Standards of Conduct. • Response to regulatory scrutiny/ pressure to change approach (e.g. Ofcom early termination charges resulted in voluntary reductions).
9. Customers may be unaware of their right to switch or disincentivised to do so due to behavioural biases	• Non-households in Scotland were found to lack incentive to switch, or be unaware of their right to switch supplier following opening of the water and sewerage retail market. • Differential pricing 'in area' and out of area by energy suppliers is possible in part because certain price inelastic, high cost to serve and potentially vulnerable customers are not aware or not incentivised to switch.	• Behavioural bias	• Awareness raising by consumer bodies and regulators. • A regulatory framework that encourages active participation by entrants, while protecting vulnerable customers from mis-selling.

Source: PwC, 2014. Lessons Learned: A cross-sectoral study of issues that have been detrimental or a risk to customers through the introduction of market reform

Appendices

- *Key lessons from other sectors*
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Appendix 2 - How can we measure if a market is successful?

Prices	Comparative pricing data can be used to help assess whether competition is resulting in lower prices to consumers. However, there may be barriers. For example, interpretation may be complicated by volatile input prices (e.g. in the energy sector), the variety of product specifications, or by bundling of services.
Quality of service	Quality of service can be tracked by using data such as the level of complaints. However complaints may increase due to improved processes for complaints and a belief by consumers that complaining will make a difference rather than reflecting deterioration in service levels.
Market share	Market share data can indicate the level of competition that has developed in a sector and relative market power. The 'Herfindahl-Hirschman' index is often used to determine the levels of concentration of companies in a particular sector, and therefore the levels of competitiveness in the sector as a whole.
Profitability	A profitability analysis can indicate where firms are making excess profits and therefore the areas where competition is not working effectively. However, this data is often commercially confidential and difficult to interpret. Profitability data can also be difficult to interpret and depends on an understanding of factors such as how the company has allocated its costs.
Switching	Switching data gives an indication of how active consumers have become in the market. Interpretation is difficult as a low level of switching could indicate consumer apathy, or a high level of satisfaction. A high level of switching could indicate that consumers are actively participating in the market and thereby helping to drive prices lower, or a high level of consumer dissatisfaction.
Innovation & technological development	Innovation and technological development can indicate that competition is working effectively and that companies are responding to consumer needs. However, measuring innovation and understanding what level of innovation and development is necessary is complex.

Source: NAO - Protecting consumers? Removing retail price controls (2008)

Appendix 2 - How do other sectors measure competitiveness?

Ofgem's view on indicators of competitive intensity:

"An effective and vibrant competitive market is one where firms strive to outperform each other on ***price, quality and innovation to attract and retain customers****. Where a firm is fighting hard to win new customers, we might expect this to* ***show up in its switching statistics and its margins****. So an aggressive growth strategy might result in lower margins as a result of low prices and high switching rates as the low prices attract more new customers. In this context,* ***the rates of switching and margin information can indicate a firm's competitive strategy relative to its rivals****."*

Source: Ofgem – State of the market assessment (2014)

Source: Ofgem – State of the market assessment (2014)

Appendix 2 - How do other sectors measure competitiveness?

The CMA's view of sources of competitive harm:

"Competitive harm can flow from five main sources:

(a) unilateral market power (including market concentration);

(b) barriers to entry and expansion;

(c) coordinated conduct;

(d) vertical relationships; and

(e) weak customer response.

The five sources are not mutually exclusive. Individual features identified in a market investigation have been associated with more than one of them. Some may have mutually reinforcing effects. Barriers to entry and expansion, in particular, have been found to be features, sometimes in combination with other features, in many investigations."

Source: Competition Commission –
Guidelines for market investigations (2013)

Source: Competition Commission – Guidelines for market investigations: their role, procedures, assessment and remedies. (2013)

Appendix 2 - How do other sectors measure regulatory effectiveness?

The FSA set high-level customer outcomes which they reviewed regularly to ensure regulation remained relevant and effective:

Strategic Aim	*Outcome Number*	*Definition*
Help retail consumers achieve a fair deal	1	Consumers receive and use clear, simple and relevant information from the industry and from us
	2	Consumers are capable and confident in exercising responsibility when dealing with the financial services industry
	3	Firms treat their customers fairly and so help them to meet their needs
Promote efficient, orderly and fair markets	4	Firms are financially sound and well managed
	5	Firms and other stakeholders understand their respective responsibilities and mitigate risks arising from market conduct
	6	Markets are efficient, resilient and internationally attractive
Improve our business capability and effectiveness	7	The regulator is professional, fair, efficient and easy to do business with
	8	The regulator is effective in identifying and managing risks to our statutory objectives
	9	The costs and benefits of regulation are proportionate

Source: [1]Consumer Focus, 2009. "Rating regulators."
(http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2011/01/Rating-Regulators.pdf)

Appendix 2 - In a follow up to 'Rating Regulators' Consumer Focus set out a proposed framework…

Legal framework

- statutory objectives and duties enable the regulator to adequately promote the interests of all consumers
- responsibilities between different actors are clearly defined, without gaps or overlaps
- structures are sensitive to devolved contexts
- the right tools for the job

Culture and accountability

- translates statutory objectives into consumer focused priorities and values
- embeds a consumer focus across all levels of the organisation
- transparent about its activities
- accessible to the general public, including disabled users
- works effectively in a devolved setting

Impact and learning

- defines and measures its impact on consumers in terms of outcomes
- evaluates its work and embeds learning

State of readiness

- identifies likely sources of consumer detriment, both now and in the future, which shapes work priorities
- uses effective mechanisms to understand the consumer perspective and translate this insight into sound decisions
- works effectively with others, including with consumer organisations
- influences the wider regulatory agenda

State of action

- empowers consumers to help achieve regulatory outcomes
- has effective incentives to encourage compliance with its rules
- chooses the appropriate regulatory approach in the circumstances, and intervenes in a timely fashion when needed
- gives priority to, and intervenes effectively on behalf of, consumers who are vulnerable
- uses enforcement tools when necessary to protect consumers

Source: [1]Consumer Focus, 2010. "Regulating in the consumer interest." (http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2010/10/Fresh-thinking-Regulation.pdf)

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Appendix 3 - Consumer Focus views the issues in all regulated and liberalised markets as similar

In a 2011 paper setting out the likely future consumer representation needs in regulated markets, Consumer Focus (CF) stated that "Representing consumer interests in these complex markets requires discrete skills and expertise including high level consumer policy and research, an understanding of behavioural economics, an ability to understand complex technical issues, an understanding of how markets work and regulatory trade-offs, and consumer information and engagement expertise[2]."

"A number of consumer issues are common across the sectors concerned:

- "access in remote rural areas
- "affordability, particularly for vulnerable consumers
- "complexity of tariffs and charges
- "affordability and access for small business consumers
- "privacy and the use of customer data
- "customer service standards and redress when things go wrong
- "clarity and comprehensibility of customer information
- "switching and choice
- "the fair allocation of costs and charges to different customer segments"

CF notes a number of areas the energy, water, passenger transport and communications sectors have in common, including:

- "All demonstrate complexities in both product and service offering and in pricing models, making it difficult for consumers to make informed choices and exercise market power"
- "All are relatively heavily regulated in whole or in part because it is not possible, for various reasons, for normal competitive markets to function properly across all of the sectors in question."

"The consumer issues in these sectors often show close parallels. These include the treatment of vulnerability and disadvantage, privacy and the use of customer data, redress, access and charging terms for SMEs, the interests of rural consumers, the effect of the digital revolution on both company and consumer behaviour, the promotion of sustainable consumption, cost reflectivity in charging structures, switching, and what constitutes effective competition and choice."

"Expert consumer policy work typically encompasses work on market structures, barriers to entry, price controls and other regulatory tools, product design, charging structures, the relationship between input costs and retail prices, sales and marketing practices, billing, sustainability, treatment of disadvantaged consumers, withdrawal of service and debt recovery practices, customer service and redress, consumer information and empowerment, and consumer education. Many of these issues run across sectors…"

Source: [1]Consumer Focus, March 2011. "Regulated industries and consumers."
(http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2011/03/Regulated-industries-and-consumers.pdf)

Appendix 3 - Consumer bodies' perception is that regulators may adopt 'self-regulation' first

In a paper discussing regulators and issues with regulated markets[1], CF stated the following:

"Of most concern, and the area where stakeholders expressed the greatest frustration, relates to the regulators' decisions to intervene or not when consumers face problems in the market. There are two main elements to this. First, stakeholders consider that regulators have a misplaced confidence about the ability of market mechanisms, in particular consumers switching between providers, to change company behaviour. This tendency feeds a perception that regulators are slow to intervene, sometimes doing so only following significant public pressure. This feature of regulatory behaviour is likely to impact most severely on consumers in a position of vulnerability who, due to their personal circumstances or the actions of providers, are less able to fend for themselves."

"The second main element of concern with respect to regulatory approach is regulators' use of self-regulatory solutions as the default approach to changing company behaviour. Self-regulation enjoys advantages over more interventionist models and, indeed, has achieved notable successes in the markets we examined. However, our concern is that regulators follow a pattern, from which they rarely depart, of encouraging self-regulatory solutions from industry even when the odds for success are very slim. The consequence is that consumers continue to suffer problems longer than is necessary and, again, this style of working contributes to a perception that regulators are overly-timid in the face of strong industry pressure. Ofcom has recently published a set of principles setting out the circumstances when different types of regulatory approach are likely to be suitable, including that direct intervention from the outset will sometimes be necessary. We encourage other regulators to publish similar statements."

"…affordability of lifeline services is a key public policy concern given the large numbers of households are classified as experiencing fuel poverty or water poverty."

CF notes that the legislative categorisation of specific groups of vulnerable customers that regulators must 'have regard to' is potentially unhelpful in the sense that it does not place a strong responsibility towards those groups; and that there may be other groups who suffer detriment as a result of the regulated market who are not formally classed as 'vulnerable'.

CF stated that regulators should undertake direct consumer research in the markets they address as a matter of good practice so that detriment can be identified, quantified and addressed. Accessing and understanding 'hard to reach groups', especially where the customers are vulnerable is important.

"Ofcom produces an annual report entitled The Consumer Experience, which lists the full results of its research programme aimed at measuring how well consumers have fared over the year in relation to telecoms, the internet and digital broadcasting. In parallel with this it also produces a policy evaluation based on the research."

Source: [1]Consumer Focus, 2009. "Rating regulators."
(http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2011/01/Rating-Regulators.pdf)

Appendix 3 - Consumer bodies' perception is that regulators may adopt 'self-regulation' first

CF felt that regulators tended to use judgement rather than a policy framework to make policy decisions/ decisions to intervene in markets based on customer research results[1]. It stated that this may lead to inconsistent policy decisions and approaches.

"It is important that regulators base their decisions on how consumers actually behave in markets rather than rely solely on models which view consumers as rational economic actors. The National Audit Office has recommended that regulators build an understanding of behavioural economics, which can provide insights into consumer participation in markets that cannot be explained by traditional economic theory."

CF, unsurprisingly, viewed the relationship between regulators and consumer representatives as key – a close and co-operative relationship with consultation on key matters affecting consumer policy was seen as important in getting the best outcome for customers.

Self regulation can create issues in regulated markets

CF notes that: "…not all firms will cooperate and the interests of consumers who are vulnerable can often be neglected if it is not commercially advantageous for firms to address their needs. Regulators need to be mindful of when self-regulation is likely to work or not, and they must be ready to intervene quickly and decisively when self-regulation is failing."

"Ofgem was particularly singled out [by commentators and stakeholders] for criticism in this respect, for example on the issues of doorstep selling, recalibration of prepayment meters and green tariffs. There characteristic appears to feed another perception that regulators are slow to intervene, sometimes doing so only following significant public pressure – the launch of Ofgem's energy market probe last year being the most notable example."

On self-regulation as the first line of regulatory intervention:

"One example given to us is the Financial Services Authority's handling of firms selling payment protection insurance (PPI) containing unfair clauses, when it gave the industry numerous chances to put its house in order before taking enforcement action."

"Another example put forward by stakeholders was Ofcom's response to slamming (a form of mis-selling, where fixed-line telephone customers are switched from one company to another without their express knowledge and consent)."

Source: [1]Consumer Focus, 2009. "Rating regulators." (http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2011/01/Rating-Regulators.pdf)

Appendix 3 - Regulatory protection for vulnerable customers was also seen as a key issue

Vulnerable customers

"Consumer Focus defines vulnerability more widely as relating to consumers whose needs are not ordinarily provided for in the market concerned."

"Firms may lack an incentive to address the needs of consumers whose needs differ from those of the average consumer, if this will cost them more than their standard product or service. Alternatively, firms may provide a tailored solution but charge consumers disproportionately more for it. Where consumers lack the ability to fend for themselves, we consider that all regulators have a responsibility to intervene in order to protect consumers in a position of vulnerability from detriment."

Other potentially under-used tools

Other potentially under-used regulatory tools include reputational regulation, were the regulator 'names and shames' companies that are not treating their customers fairly.

Information can also be used to empower disengaged consumers who are falling foul of complexity or lack of transparency from regulated markets.

CF found a mixed picture on how, and how effectively, regulators measured the outcomes of their interventions on the customer detriment the intervention was designed to address.

Source: [1]Consumer Focus, 2009. "Rating regulators." (http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2011/01/Rating-Regulators.pdf)

Appendix 3 - Qualitative research points to issues householders raise with regulated markets

Consumer Focus* provides the following commentary in opinion based research it commissioned following its creation in 2009[1]:

Energy:

“Consumer Focus has established an Extra Help Unit to work with vulnerable consumers – people facing disconnection, for example – and to intervene on their behalf. Vulnerable consumers can be referred to the Extra Help Unit by Consumer Direct, their MP, Member of the Scottish Parliament or Member of the Welsh Assembly.

“The last few months have seen a worrying increase in the number of people facing problems with energy suppliers. There is strong and growing anecdotal evidence that consumers are struggling to pay bills and, compared to last year, there has been an increase in disconnections and in final demands being sent.

“Consumer Focus will use all of its power and influence to ensure that energy suppliers treat customers fairly. We have legal powers to gather information from energy companies to ensure they provide a fair deal and, in particular, that they stick to the ‘disconnection safety net’.”

“I ended up with my energy company through switching. When I moved into my flat, I went on uSwitch …my supplier came out as the cheapest. The website was really easy to use and it was clear they offered us the best deal.

“I had been paying my direct debits at the quoted cost for a year when the supplier asked me for a meter reading. They then said we owed them twice as much per month as they had quoted – even though they had asked for information about my flat before quoting – and sent me a bill for £400. I’m lucky and can pay this – but this would be a massive problem for a lot of people. When I phoned the supplier, they told me that my original direct debit – the price quoted on uSwitch – was for half the average energy usage for a flat my size. They must have known this when they gave me the original quote. They put me in this situation and now my bill is double what I expected. If they looked after you properly they would keep you informed about how much you owe more regularly, or contact you when the figures in your direct debit change. They wouldn’t wait a year to tell you and then charge you all at once. They came out as the cheapest on uSwitch but they may well not be, now that we’ve had to pay double.”

*Consumer Focus was the consumer champion operating across the economy, arising from the merger of energywatch Postwatch, and the National Consumer Council. It was re-branded Consumer Futures’ in May 2013, and then merged with Citizens Advice from April 2014.

Source: [1]Consumer Focus, 2009. “Streetwise: real people, real issues.” (http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2011/01/Streetwise-Report-web-PDF.pdf)

Appendix 3 - Qualitative research points to issues householders raise with regulated markets

Telecoms:

"The marketplace has structural problems, particularly with the difficulties for consumers in switching providers. Tariffs are often complicated and difficult to compare, contract terms can be too complex and not sufficiently transparent and there is some evidence that insurance packages may be mis-sold.

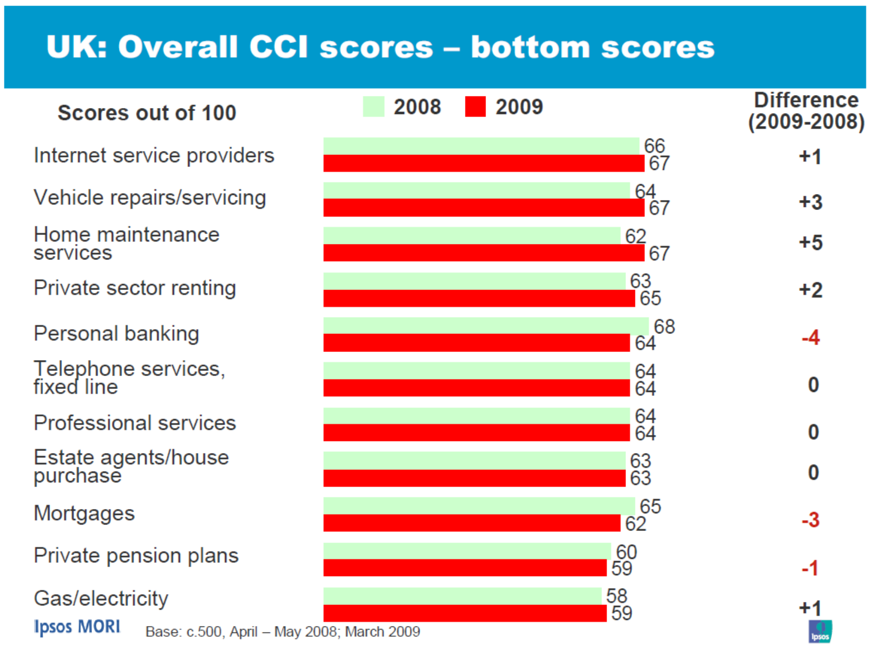
"Consumer Focus is particularly concerned by charges that may not be noticed by individual consumers but, when added up, represent a significant income for the companies. It will be examining charges including the rounding-up of calls and the cost of dialling 'free' and national-rate numbers, as well as the significant disparity in costs for pay-as-you-go users and contract customers."

"Most people in the Somali Community have a mobile and a land line. We use our mobiles the most and we call each other a lot.
"Almost everyone is on pay-as-you-go…"
"People gradually stopped using contracts because they didn't trust them. They thought the point of the contract was that you paid one fixed price, always the same – and now they were getting different bills every month. People don't like the idea of not knowing when they're allowed to ring without being charged; they want to know how much money they're using…"
"Contracts need to be clearer so people know how much their calls are going to cost them and what their obligation is. Then the people I know might go back to using contract phones and not paying extra for pay-as-you-go [1]"

"For lots of people around here it's not possible to get a better deal on services like energy or banking, or even to research the deal they're getting.
"If you don't speak the language and you don't want to get in trouble you pay the bill, whatever the figure. You can't even tell whether the amount you're paying is the final total or just an estimate. Unless it's massively more than you were expecting you just pay it without even thinking about it. [1] "

Source: [1]Consumer Focus, 2009. "Streetwise: real people, real issues." (http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2011/01/Streetwise-Report-web-PDF.pdf)

Appendix 3 - Regulated markets are rated lower by customers than sectors with no natural monopoly element



In the another survey, the gas and electricity sector received one of the lowest scores of any industry on customer perception of protecting consumer rights.

Regulated sectors, including banking, telecoms and energy were also in the top 10 for cause for complaint, and actual complaints made, whereas more fully competitive sectors (regulated by OFT/CMA through general competition and consumer protection methods) tended to have lower levels of complaints.

Customers were asked if they felt at a disadvantage in the market, with higher proportions saying they felt disadvantaged in the gas and electricity market. This suggests the issues may arise due to the natural monopoly elements of the markets, and that consumer protection is important. Ipsos MORI stated that:

"In general and in the above markets, those feeling they are at a disadvantage are relatively more likely to: be female; have a disability; be in the 16-34 age group; be from an ethnic minority; have a low household income (up to £12k gross pa); use Internet but purchase over the phone; have made a complaint or felt they had cause to complain."

"In addition, among disadvantaged consumers the satisfaction score for their overall experience of the markets they are asked about is 68, significantly lower than the whole sample's score on the same measure (75)."

Source: [1]Ipsos MORI, 2009. "Report on the 2009 Consumer Conditions Survey." (http://webarchive.nationalarchives.gov.uk/20110218162432/http://www.consumerfocus.org.uk/files/2010/12/Consumer-Conditions-Survey-2009.pdf)