

# Helping consumers to get better deals in communications markets: mobile handsets

Citizens Advice response to Ofcom's  
consultation



November 2018

## Summary

Citizens Advice welcomes the opportunity to comment on the proposals set out in Ofcom's consultation. The mobile handset loyalty penalty is unacceptable: no consumer should continue to be charged for a product they have already paid off. Ofcom must ensure that providers selling bundled contracts are clear about the respective costs of the airtime and handset elements and automatically apply a handset discount to their customers' bills at the end of their minimum term.

- Consumers face an average handset loyalty penalty of £22 per month, rising to £38 per month for smartphones. We estimate that 4 million people overpaid a total of £490 million on their last mobile contract<sup>1</sup> and over 65s are twice as likely to have a loyalty penalty for over 12 months.
- This practice needs to stop, and soon. It unfairly penalises loyal consumers and damages the reputation of the sector. Ofcom must ensure its interventions are implemented urgently, as it is clear voluntary action is not forthcoming.
- Our key principles are that handset prices should be transparent and that no consumers should end up paying for a phone that they already own beyond their minimum contract period.
- We welcome Ofcom's decision to take further action in addition to its work on end of contract notifications.
- **We see 2 solutions to the loyalty penalty in the mobile market:**
  - Taken together, Ofcom's consultation proposals on **transparency and automatic handset discounting** would effectively end the loyalty penalty for bundled contracts.
  - **Split contracts** are an existing solution in industry already, and should sit alongside Ofcom's proposals as an option for providers.
- The public supports these measures: 9 in 10 (89%) UK consumers think that providers should be transparent and make it clear what they are charging for airtime and handset parts of a single bundled contract.
- We view other any solution that leaves some consumers open to being charged a loyalty penalty is unacceptable.
- Ofcom should take further action to ensure out-of-contract consumers on bundled contracts no longer pay the loyalty penalty.
- We welcome Ofcom's future work on the broadband loyalty penalty outlined in this consultation. Broadband prices rise by an average of 43% at the end of the contract, costing an average £113 per year. This rip-off must be addressed.

---

<sup>1</sup> Citizens Advice, Reviewing bundled handsets, September 2018

## Contents

### **Do you agree with the concerns we have identified in relation to bundled mobile airtime and handset contracts? 4**

Consumers face a significant mobile loyalty penalty - bundled contracts mean they pay for a handset they already own 4

Nobody should pay for a handset they have already paid off 5

Bundled (handset-inclusive) contracts dominate the market 5

Poor pricing transparency in bundled mobile contracts makes it harder for consumers to make informed choices 6

### **Do you agree with the options we have outlined as potential remedies for the concerns identified? 8**

End-of-contract notifications will not solve the problem alone 8

Transparency on airtime and handset payments is essential 9

Automatic migration to SIM-only is a problematic approach 10

Automatic handset discounting would ensure consumers do not continue to pay the mobile loyalty penalty 11

### **Do you have views on additional solutions we should consider, including on split contracts? 12**

Split contracts are an existing solution that can also achieve the same outcome as transparency plus automatic discounting 12

We have some concerns about consumers being effectively locked in to airtime contracts longer than 24 months 13

Ofcom needs to take stronger action on out-of-contract consumers 13

Further work on the broadband loyalty penalty is welcome 14

# Do you agree with the concerns we have identified in relation to bundled mobile airtime and handset contracts?

Deep, structural price discrimination against disengaged and loyal consumers has been a persistent feature of essential markets for many years.<sup>2</sup> This is particularly problematic in the mobile market, as loyal consumers on bundled contracts continue to pay for their handset even after they have effectively paid it off. We are not aware of this practice in any other consumer markets. Our view is clear: nobody should continue to be charged for a product they have already paid off.

## 1. Consumers face a significant mobile loyalty penalty - bundled contracts mean they pay for a handset they already own

Bundled handset contracts typically last for 24 months, and consumers who wish to leave early can face high exit fees. At the end of the contract, consumers have several options. The mobile handset loyalty penalty comes into effect when consumers do nothing, stay on the same contract and continue to pay the same monthly amount.

**The loyalty penalty affects 1 in 3 consumers in the mobile market.** We found that over a third (35%) of consumers had stayed at least 1 month past the minimum term of their last mobile contract. Many stay for substantially longer - just under 1 in 10 (8%) stayed for over a year. The average overstay is 6 months.<sup>3</sup>

**Our analysis found that the average monthly handset loyalty penalty is £22 per month**, with 4 million consumers overpaying by £490m after the end of their last contract. As a result of this penalty, many consumers could be paying over the odds for mobile handsets without knowing it. And for the premium handsets, not switching could cost consumers as much as £38 per month. Older people, in particular, are twice as likely to suffer the loyalty penalty for longer than 12 months. Our research shows that 13% of over 65s stayed on their contract for over a year after the minimum term ended, compared to 7% of under 65s.

**This fits a pattern we see across essential markets**, and can be seen, in effect, as a systematic scam. Nobody would choose to pay these extortionate sums. Most major providers have shown little interest in stopping this practice from harming inert, disengaged consumers that do not switch. And many don't. In response, we have recently used our statutory powers to issue a super-complaint to the Competition and

---

<sup>2</sup> Citizens Advice, Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority, September 2018

<sup>3</sup> Citizens Advice, Reviewing bundled handsets, September 2018

Markets Authority (CMA), estimating that loyal consumers pay a £4.1bn premium across essential services markets, with vulnerable consumers hit hardest.

## 2. Nobody should pay for a handset they have already paid off

We welcome Ofcom's recognition that the mobile handset loyalty penalty is unacceptable. **No consumer should keep paying for a handset they already own.** Our recent analysis found that the average monthly handset loyalty penalty is £22 per month, with 4 million consumers overpaying by £490m after the end of their last contract.<sup>4</sup>

In no other sector do we see this rip off where consumers face the loyalty penalty and are charged for a product they already own: once people have paid back a loan in full, they don't expect to keep paying the lender. We believe that consumers' bills for bundled contracts must automatically reduce at the end of their minimum term to reflect the fact they have paid off the handset element.

Contrary to industry practice we see in bundled mobile contracts, **people strongly feel that loyalty should be rewarded, not penalised.** Nearly 9 in 10 (88%) of consumers believe that long-standing customers in the mobile market should be charged the same or less than newer customers.<sup>5</sup>

As well as being an unacceptable rip-off, public opinion is strongly against the practice: only 1 in 10 (10%) of consumers agree that providers should be allowed to keep charging customers for a mobile handset after they have paid it off. Only 5% of those aged 65 and over think this is acceptable, and consumers in socioeconomic group DE (7%) are also less likely to think it acceptable than those in socioeconomic group AB (13%).

Through the mobile loyalty penalty, millions of consumer have effectively paid twice for the same product. Some commentators have suggested there may be a case for compensation to be paid to consumers who have been ripped off in this way.<sup>6</sup>

## 3. Bundled (handset-inclusive) contracts dominate the market

Most handset-inclusive deals in the UK are bundled contracts, which do not distinguish between the phone and the mobile service.<sup>7</sup> The consumer signs a single agreement and pays a single price for both elements of the service. The phone is supplied as part of the package, but there is no information on how much of the monthly bill goes towards the phone. However, these tariffs are clearly designed so

---

<sup>4</sup> Citizens Advice, Reviewing bundled handsets, September 2018

<sup>5</sup> Citizens Advice, [Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority](#), September 2018

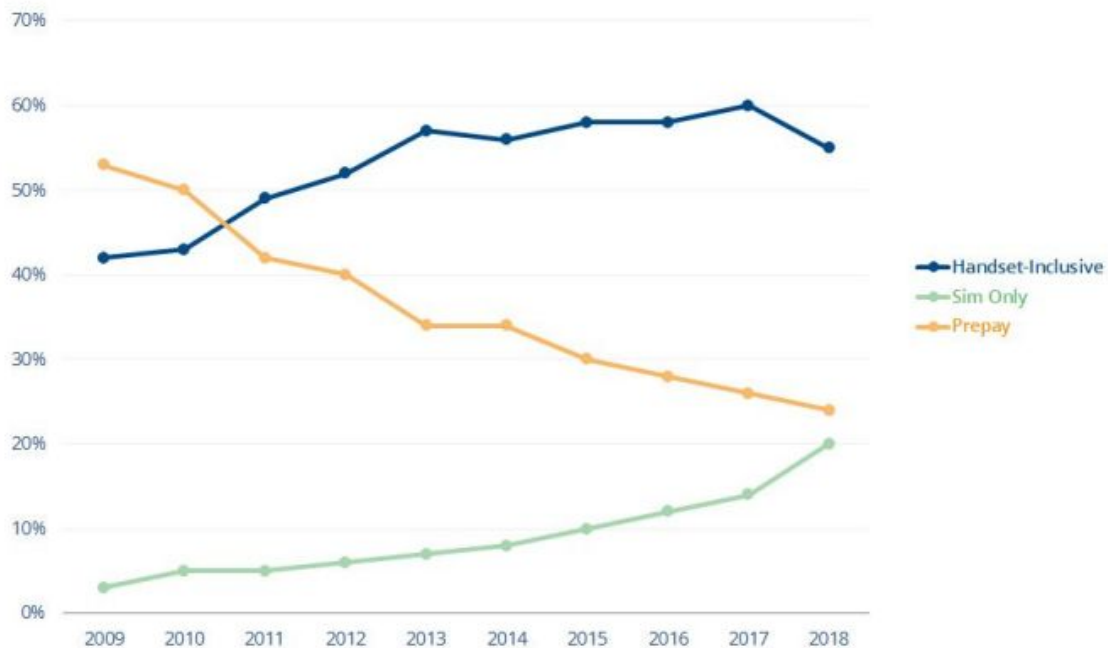
<sup>6</sup> [www.thetimes.co.uk/article/mobile-phone-firms-are-heading-for-a-ppi-style-scandal-swrkkhd8h](http://www.thetimes.co.uk/article/mobile-phone-firms-are-heading-for-a-ppi-style-scandal-swrkkhd8h)

<sup>7</sup> Citizens Advice, Reviewing bundled handsets, September 2018

that networks can recover the cost of the phone, and both networks' and third party retailers' sales materials concentrate heavily on the handset element.<sup>8</sup>

### Fig 1. Handset-inclusive contracts dominate the UK market

UK consumers main phone contract type 2009-2018



Source: Ofcom Technology Tracker 2009-2018

Buying a phone on contract is a significant financial investment. According to Ofcom the average handset-inclusive service costs £35 per month. The overwhelming majority of these contracts will last for 2 years, meaning consumers signing up to a new phone contract are making a commitment to pay on average at least £840. Contracts including the most high end, up to date phones and largest data allowances can end up costing over £2,000 in total.

## 4. Poor pricing transparency in bundled mobile contracts makes it harder for consumers to make informed choices

**9 in 10 (90%) of consumers think providers should make it clear what the cost of each part of a bundled contract is** when they sell a customer a single contract for a mobile handset and airtime.<sup>9</sup> This rises to 94% of consumers aged 55 and over - a demographic that is twice as likely to suffer the mobile loyalty penalty for more than 12 months.<sup>10</sup>

<sup>8</sup> Citizens Advice, Hung up on the handset, April 2016

<sup>9</sup> Citizens Advice commissioned ComRes survey of 2,366 British adults, November 2018

<sup>10</sup> Citizens Advice, Reviewing bundled handsets, September 2018

However, **under bundled contracts it is not made clear to consumers what they are paying** for each element. This lack of transparency makes it hard to compare multiple deals where the handset and airtime components vary - and makes it difficult for consumers to make fully informed decisions.

As a result, **consumer awareness of the mobile handset loyalty penalty is low.** Consumers on bundled contracts are particularly misinformed. Over half (55%) of people on handset-inclusive (bundled) contracts think that buying a phone this way works out as the cheapest option overall compared to 1 in 5 (19%) of SIM-only customers.<sup>11</sup>

**SIM-only deals and separate handset deals are usually cheaper than bundled contracts.** In our September 2018 research, we found that in the majority (73%) of cases, purchasing a new phone on contract is more expensive than buying it outright and pairing it with a SIM-only contract.<sup>12</sup> This is based on our analysis of 721 different bundled contracts. We also found that there was no correlation between the RRP of a handset and the additional cost of buying it as part of a bundled contract. This underlines how hard it is for consumers to compare deals across different providers.

This does not necessarily make all bundled contracts a bad deal: it is usual to pay more to buy products in arrears, and many consumers will value the ability to spread their payments. But these **additional costs need to be clear if consumers are to make informed choices about whether this is the right purchase method for them.**

---

<sup>11</sup> Citizens Advice, Reviewing bundled handsets, September 2018

<sup>12</sup> *ibid.*

## Do you agree with the options we have outlined as potential remedies for the concerns identified?

Our starting principles are that prices should be transparent and that no consumer should continue to be charged for a product they have already paid off. The first, essential, step to this is to require transparency for both the airtime and handset parts of bundled contracts. In isolation, however, transparency will not solve the loyalty penalty.

We believe there are 2 solutions to ensuring disengaged or loyal consumers that don't shop around are not be ripped off for a loyalty penalty. Ofcom's proposals on **automatic discounting - in combination with transparency** - would be effective in ensuring providers do not continue to charge for a handset. We also believe that **split contracts**, as an existing solution used by industry, achieve this same goal and we explore this further in our response to the final consultation question. Both of these approaches would, if implemented across the whole sector, effectively end the mobile handset loyalty penalty.

However, we have concerns about Ofcom's alternative proposals to ensuring fairer default tariffs - migration to SIM-only - as this presents a range of practical and behavioural difficulties.

### **Potential impacts of interventions on wider prices or switching are secondary**

Ofcom notes that its proposed solutions could have an impact on the pricing of available SIM-only deals. In our view, potential price rises across the board should not be a justification for not taking action against a clearly unfair practice that disproportionately affects vulnerable consumers.

Ofcom also raises the question of whether particular solutions could lead to a reduction in switching or incentives to shop around. The loyalty penalty, by definition, impacts people who do not switch at the end of their minimum term of a bundled contract. Ofcom's priority should be to ensure that the current £22 per month penalty that disengaged and inert consumers currently pay is eliminated.

Further interventions to increase consumer engagement and switching in telecoms should be explored, but not at the expense of decisive action against the handset loyalty penalty.

## **5. End-of-contract notifications will not solve the problem alone**

Citizens Advice supports Ofcom's proposals, set out in its recent consultation, to require providers to notify mobile and broadband consumers when their contract is



nearing an end, and to send a one-off notification to all out-of-contract consumers. Timely, well-designed notifications will help to address the loyalty penalty in both markets, by informing customers of their options once their contract ends and encouraging some to take action. Too few consumers currently know their options, for instance that they could save by switching to a SIM-only deal.

Consumers should be informed of their options, particularly if they can save money. However, for notifications to be effective at encouraging consumers to switch they need to be well designed. As we set out in our response to the end-of-contract notifications consultation, Ofcom should strengthen its proposals by conducting Randomised Control Trials to determine the most effective content and timing, as well as requiring providers to send more than one end-of-contract notification to mobile consumers.

End of Contract Notifications help to inform consumers of important information about their contract, when its ending, and what their options are. They will also help some consumers to switch and avoid paying the loyalty penalty. **But notifications - no matter how well designed - will not be enough to prevent consumers unfairly overpaying** when their contract ends.

In the past 15 years, regulators, Government and consumer bodies have tried to improve consumer decision-making, increase switching and reduce switching costs. These efforts have often led to modest improvements in switching. But they have not been proportionate to the size of the problem - and have not fixed the problem. Analysis of the effectiveness of these interventions in our recent super-complaint shows that in the majority of the cases looked at the increase in switching rates was only around 2-9%.<sup>13</sup>

## 6. Transparency on airtime and handset payments is essential

Mandating greater transparency about the respective costs of the handset and airtime is a welcome step. It is clear that voluntary action from providers is not forthcoming. By blurring the cost of the phone and data allowances, handset-inclusive (bundled) contracts make it hard to know what the best deal is. The lack of transparency means that millions of consumers overpay. Greater pricing transparency would enable consumers to make fully informed decisions about the right deal for their needs.

Some operators, such as O2, enable customers to switch their airtime contract regularly within their minimum period. This can help provide consumers with the flexibility to adapt their spending on mobile airtime to meet their changing needs or circumstances over the course of a contract. We think that where consumers may,

---

<sup>13</sup> Citizens Advice, Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority, September 2018

through their own choice, elect to change the airtime part of their contract within their minimum term, this should be made clear to them in their monthly bills. In addition to transparency of handset and airtime pricing information at the start of a contract, Ofcom should therefore require providers to make it clear in each monthly bill what the consumer is paying for the different elements.

## **7. Automatic migration to SIM-only is a problematic approach**

As Ofcom sets out, one potential solution to the mobile loyalty penalty would be to migrate consumers to a SIM-only deal after their airtime minimum period expires. While we support the principle of eliminating the handset charge from people's contracts, we have concerns about the practicalities of implementing this solution.

Automatically migrating consumers from bundled contracts to SIM-only deals could be overly complex and impractical. There would be multiple factors to consider as part of any migration, including current and future data, minute and text allowances, as well as extras or bolt-ons such as Spotify, international roaming or tethering. Some current bundled contracts include additional services or subscriptions that are not available on a SIM-only deal with an equivalent data or call allowance to the previous bundled contract. It is also unlikely that an equivalent SIM-only package would be available 2 years after the start of the initial bundled contract.

In addition, each of these components in the deal may hold a different value to individual consumers who may have different priorities when selecting a new SIM-only contract. Consumers may therefore face detriment in the form of losing services or paying more if they are switched to the nearest SIM-only alternative.

In the case of bundled contracts, some mechanism for consumers to choose not to migrate would be necessary, given the trade-offs that consumers will have to make with an automatic migration to SIM-only. These practical complications raise the question of whether such a system should be opt-in or opt-out.

Research into consumer behaviour has shown that opt-in systems are far less effective in changing rates of inclusion. For example, behavioural research in pensions has shown that moving from an opt-in to opt-out scheme has significantly boosted enrolment rates - in one case from 49% to 86%.<sup>14</sup> However, while opt-out rates have been lower than expected (8-14% rather than 28%), this still leaves a significant group of people who are not enrolled in the scheme.

As demonstrated above, an opt-out system presents practical difficulties around the package of services or data included in the airtime allowance - consumers may face unexpected detriment if their service package changes without their knowledge, or if they have forgotten the original opt-out terms. On the other hand, if an opt-in

---

<sup>14</sup> Behavioural Insights, [Automatic Enrolment and Pensions: a behavioural success story](#), 2015

approach was adopted, this would result in even more consumers still paying the handset loyalty penalty - this would be unacceptable.

Any approach that permits providers to continue charging the loyalty penalty is unacceptable, regardless of the relative effectiveness of opt-in and opt-out systems. In either scenario, a proportion of consumers would continue to pay the loyalty penalty - which is manifestly not in their best interests. Indeed, if automatic migration were implemented, we would be concerned that providers may be incentivised to structure their bundled and SIM-only offers to increase consumer opt-out rates.

## **8. Automatic handset discounting would ensure consumers do not continue to pay the mobile loyalty penalty**

Beyond pricing transparency, automatic handset discounting is the only one of Ofcom's proposed interventions that would ensure all loyal customers are not ripped off. However, we also think that split contracts would achieve this goal. It is essential that consumers on bundled contracts who take no action after their minimum 2-year airtime term are not unfairly penalised.

It should not be up to consumers to opt-in to any "fairer default tariffs" at the end of their minimum term: no provider should keep charging people for a handset they have already paid off. Indeed, nearly 9 in 10 (89%) consumers agree that providers should automatically reduce the cost of a customer's monthly bill once they have paid off the cost of the handset. It is therefore imperative that any regulatory interventions implemented by Ofcom ensure there is no loophole that would allow consumers to be charged for a product they already own. Even if there was full transparency of pricing and effective end-of-contract notifications, without automatic handset discounting some people would still pay the mobile loyalty penalty. This would be unacceptable.

Consumer inertia is a real, and widespread, barrier to switching. For consumers who have held their current mobile phone contract (including a handset) or more than a year, those aged 65 and over are more likely (41%) to say they have stayed with their provider as they think they are on the best deal available than those aged 18-34 (29%). Those in socioeconomic group DE are also marginally more likely to feel this way (39%) than average (35%).<sup>15</sup>

As many consumers may feel there is little incentive to switch provider to seek a better deal, it is essential that the onus is not placed on them to do so. Automatic handset discounting would eliminate the mobile handset loyalty penalty, particularly for less engaged consumers who are less able or less inclined to shop around.

---

<sup>15</sup> Citizens Advice commissioned ComRes survey of 3,030 British adults, 2018.

## **Do you have views on additional solutions we should consider, including on split contracts?**

Ofcom's proposed option to introduce automatic handset discounting in combination with pricing transparency would address the mobile loyalty penalty. We also believe that split contracts, an existing solution used by industry, can achieve this goal.

### **9. Split contracts are an existing solution that can also achieve the same outcome as transparency plus automatic discounting**

Split contracts consist of 2 linked contracts: an airtime agreement for the mobile service, and consumer credit agreement for the phone. Each has a separate monthly price, and consumers are billed for each separately (although for simplicity they can also be presented in promotional materials as a single price). Once the handset loan is paid off, consumers stop receiving those bills and continue to pay for the airtime service only.

They therefore stop the handset loyalty penalty and provide much-needed transparency to consumers. As an existing solution that works already, we believe that split contracts should sit alongside Ofcom's consultation proposals for pricing transparency plus automatic handset discounting for bundled contracts.

In its consultation, Ofcom states that EE, Three and Vodafone have all indicated that they are likely to adopt split contracts in future. Ofcom also notes that if providers made it clear what the different cost elements of a bundled handset are:

*"It is possible that providing this information may result in a separate agreement for the handset which could fall within consumer credit agreement rules. This would be a matter for providers to clarify with the FCA."*

This presents some ambiguity about where the regulatory responsibility - whether the FCA or Ofcom - would lie for enforcing conditions on a single contract. We have previously had conversations with Ofcom and the FCA to try and find a solution to this problem, but did not find a clear resolution. While we believe pricing transparency and handset discounting would be an effective intervention, but would welcome clarifications on how the regulatory arrangements would work.

It is important to note that the FCA's regulations contain some consumer protections which Ofcom's do not. These include, but are not limited to:

- The requirement to assess whether consumers can afford the financial commitment they are taking on
- A mandatory 30 day cooling off period for all credit agreements regardless of the channel used to sign up

- Detailed rules on appropriate debt collection practices

**It is imperative that the handset loyalty penalty is ended urgently, and ambiguity over whether consumer credit agreement rules apply should not be a barrier.**

In relation to requiring split contracts, Ofcom also argues that restricting providers' ability to bundle services could lead to a "reduction in innovation and less competition in the provision of mobile services and, ultimately, to poorer outcomes for consumers". We don't fully agree with this argument. We have shown that bundled contracts are often not in consumers' financial best interests and, if they are to be a part of a well-functioning market, Ofcom must introduce pricing transparency and automatic handset discounting as a matter of urgency. There is no reason for providers to use bundled contracts as a way to hide the costs of airtime and handset elements and to make it harder for consumers to make informed choices about the deal that is right for their individual needs.

## **10. We have some concerns about consumers being effectively locked in to airtime contracts longer than 24 months**

We welcome the concerns Ofcom raises in its consultation that split contracts that include handset loans longer than 24 months may present a significant barrier to switching. We think that Ofcom should consider intervening against split contract providers who use them to effectively lock people into airtime agreements beyond 24 months.

Some providers offer consumers the chance to purchase a handset through a credit agreement that lasts longer than the maximum airtime contract length permitted. This enables consumers to spread payments for a handset over a longer period (often at 0% finance over 30/36 months), which can make the cost of an expensive handset more affordable.

However, for the providers we have been able to check,<sup>16</sup> the customer is only able to switch to another airtime provider after 24 months if they have paid off the handset agreement in full in a single payment. For a flagship smartphone, this could present a one-off barrier to switching of hundreds of pounds.

## **11. Ofcom needs to take stronger action on out-of-contract consumers**

Ofcom should collect more data on this group of disengaged consumers to identify specific, targeted interventions that would help reduce the loyalty penalty they pay.

---

<sup>16</sup> We checked this scenario for O2, Virgin Mobile, Tesco Mobile and Sky Mobile (October 2018)

While interventions to stop future rip-offs are welcome, our research found that 8% of consumers paying the loyalty penalty stayed more than 12 months after their last contract ended - affecting hundreds of thousands of people.

Ofcom should consider further measures to ensure consumers who are currently out-of-contract on bundled contracts do not continue to pay the handset loyalty penalty - including how an automatic handset discount could be applied to this group.

## **12. Further work on the broadband loyalty penalty is welcome**

Paragraphs 2.17 to 2.20 in the consultation refer to further work that Ofcom intends to carry out on the loyalty penalty in the broadband sector. In contrast to the mobile loyalty penalty where the issue is over continuing to pay for a product that has already been paid off, broadband consumers are often subject to significant price increases at the end of their minimum term.

In the broadband market, prices rise by an average of 43% when the minimum contract period ends. On average, broadband customers on the cheapest basic tariffs with the top 5 providers face a loyalty penalty of £113 per year once they enter the post-contract period.<sup>17</sup> As set out above, notifications will only benefit a relatively small number of consumers. Many more will continue to overpay.

Ofcom should therefore investigate ways to address the loyalty penalty in the broadband market. Solutions should reflect the evolving nature of the market but one option could be the possibility of introducing requirements on providers to offer vulnerable customers their most competitive deal.

Ofcom should also require broadband companies to report how many of their customers are out of contract, how long they've been out of contract, and how much extra on average they are paying compared to in contract customers. This data should be broken down by different demographic groups, including age and income. Gathering this information would ensure that policymakers are able to monitor the extent of the loyalty penalty in the the broadband market, and supply a substantial evidence base if further regulatory intervention becomes necessary.

Older broadband users are more likely to stick with the same broadband contract, and therefore experience the loyalty penalty. Almost 6 in 10 (59%) customers aged 65 and over are paying the broadband loyalty penalty, having been in their contract longer than the minimum period, compared to 38% of those under 65.<sup>18</sup>

---

<sup>17</sup> Citizens Advice, Exploring the loyalty penalty in the broadband market, April 2017

<sup>18</sup> Citizens Advice commissioned ComRes survey of 3,030 British adults.

# We help people find a way forward

Citizens Advice provides free, confidential and independent advice to help people overcome their problems.

We advocate for our clients and consumers on the issues that matter to them.

We value diversity, champion equality, and challenge discrimination and harassment.

We're here for everyone.



**[citizensadvice.org.uk](https://citizensadvice.org.uk)**

Submitted November 2018

Citizens Advice is an operating name of The National Association of Citizens Advice Bureaux.

Registered charity number 279057.