

# Why getting rid of the standard variable tariff is good for all customers

**The Standard Variable Tariff (SVT) discourages customer engagement. It's an open-ended agreement. So, there's no natural trigger point for customers to shop around for a better deal. We know that some customers prefer a rolling tariff, but if everyone were on a fixed-term energy contract, like annual car insurance, then they'd have to think about the cost of renewal. More people would switch energy suppliers, the market would be more competitive and all customers would benefit.**

In all free markets everywhere, engaged customers force firms to compete to meet their needs. Those firms who respond best, by delivering products that customers want, at lower prices with better service, will thrive. Those firms who fail to compete will decline.

Also in all free markets everywhere, some customers are more engaged than others. Those who are prepared to spend the time comparing offers are more likely to find the cheapest ones. But the fact that some customers are on the cheapest deals, while others are not, does not necessarily mean that the others are getting a bad deal.

In fact, those customers who do choose to engage with the market provide benefit to those who do not. And the greater the number of customers who engage, the more the rest benefit. That's because, when more people switch, it becomes riskier for firms to assume that others will not follow suit, and they usually adjust their prices downwards.

The problem for the UK retail energy market is that the Standard Variable Tariff – the most widespread tariff in the market with (60%) of all customers – actually discourages engagement.

The SVT discourages engagement because it has no end date. With fixed-term tariffs, customers get a notice when they reach the end of their term, reminding them to shop around. Customers on SVTs get no such additional reminder; they just receive prompts on bills and annual summaries.

SVT customers might get a prompt if their prices change, but this might not happen very often. For example, British Gas has raised its prices only once in the last three years. But customers on fixed-term tariffs are likely to face price changes more often, when their current contract expires.

So, customers on fixed-term tariffs generally do shop around, and much more than SVT customers, because the end-of-term prompt is so much more powerful. It's a bit like car insurance. The annual renewal notice is a great trigger for action, especially if the premium has gone up!

In the energy market, the number and proportion of customers switching is on the rise. In 2016, the number of domestic customers switching supplier increased by 20% for electricity and 17% for gas. In all, around 17% of customers switch supplier every year, and 42% of customers have switched more than once.

While these figures are encouraging, we believe they could be much higher if more customers behaved like those on fixed-term contracts. In the car insurance market for example, where there is no such thing as an open-ended policy, 35% of customers switch supplier every year.

The answer therefore seems obvious: to increase customer engagement in the UK retail energy market, the SVT should be banned. If SVTs were banned, the switching rates in the energy market (17%) might become more like the car insurance market (35%) – i.e. they could double.

If switching rates increased, then those customers who chose not to engage would be likely to pay less than they do today. That's because, when more people switch, it becomes riskier for firms to assume that others will not follow suit, and they usually adjust their prices downwards.

In any free market, engaged customers benefit those who are not engaged. But if customers are going to engage at all, they need an incentive (i.e. a potential saving) to do so. So, in other words, price differences drive competition, yet competition erodes price differences. That is the paradox of markets.



**Open ended contracts reduce the incentives for customers to actively engage and make positive choices about their provider and tariff. While we will change this for our customers, we believe that Ofgem making this change industry-wide will deepen customer understanding of the choices and nudge all who can benefit towards sustainable behaviour change, benefiting more customers in the process.**