Consultation response

Fair Pricing in Financial Services (FCA DP18/9)

Response from the Single Financial Guidance Body

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1. About us

1.1. The Single Financial Guidance Body (SFGB) exists to help people make the most of their money and pensions. The SFGB was created under the *Financial Guidance and Claims Act 2018* and brings together the services of the Money Advice Service, The Pensions Advisory Service, and Pension Wise, under one body.

1.2. The SFGB is an Arms Length Body, sponsored by the Department for Work and Pensions, with a joint commitment to ensuring that people throughout the UK have guidance and access to the information they need to make effective financial decisions over their lifetime. We deliver this across five core functions:

- Pensions guidance – to provide information to the public on matters relating to workplace and personal pensions;
- Money guidance – to provide information designed to enhance people's understanding and knowledge of financial matters and day-to-day money management skills;
- Debt advice – to provide people in England with information and advice on debt;
- Consumer protection – enabling the SFGB to work with government and the Financial Conduct Authority (FCA) in protecting consumers; and
- Strategy – to work with the financial services industry, devolved authorities and the public and voluntary sectors to develop and coordinate a national strategy to improve people's financial capability, help them manage debt, and provide financial education for children and young people.

1.3. Our new statutory framework places a clear duty on the SFGB to ensure that information, guidance and advice is available to those in greatest need of it, and in particular the needs of people in vulnerable circumstances.

1.4. The SFGB is funded by levies on both the financial services industry and pension schemes. It is a non-departmental public body and is accountable to the Department for Work and Pensions.

2. Financial capability and fair pricing in financial services

Financial capability

2.1. The SFGB welcomes the FCA launching this public debate on the fairness of pricing practices in financial services. As the statutory body for financial capability, we share the FCA's concern that certain pricing practices have the potential to disadvantage some consumers, in particular the most vulnerable and least resilient consumers. We also believe the issue of fair pricing in financial services relates directly to the issue of financial capability: the fairness of pricing practices depends in large part on the capability of consumers to navigate the products, providers and prices available in the market, and to exercise informed choice.

2.2. As the FCA's *Approach to Consumers* recognises, well-functioning, effective and competitive markets require consumers to be informed, empowered and enabled to make decisions. In other words, it requires consumer financial capability. Where consumer financial capability is lacking, regulation is needed to ensure fairness for consumers by preventing exploitation of the less financially-capable. Consumers with lower levels of financial capability may be less able to make informed choices, and if they are disadvantaged by pricing practices as a result of their lower capability and more limited exercise of choice, these prices are likely to be unfair and indicate problems and ineffectiveness in the market.

2.3. Financial capability is a person's ability to manage money well, both day to day and through significant life events, and to handle periods of financial difficulty. It is driven by personal skills, knowledge, attitudes and motivations, and made possible by an inclusive financial system and supportive social environment. Financial capability helps people achieve the best possible financial well-being.[1]

2.4. The SFGB's financial capability framework (see Figure 1 below) captures the main elements of financial capability – the behaviours underpinning financial capability and the factors impacting it – in a single model, based on accumulated research in money behaviours, abilities and skills and how these interact.

[1] MAS (2015) Financial Capability Strategy for the UK

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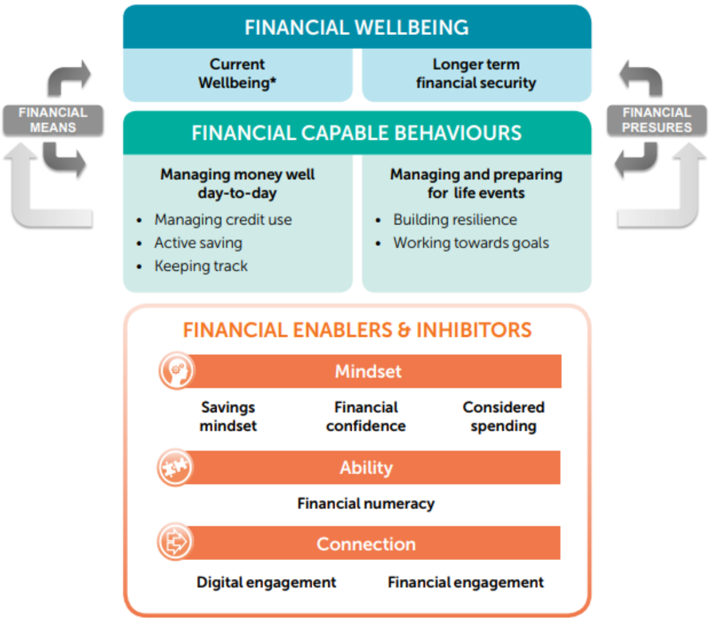
Figure 1: The Financial Capability Framework



2.5. In relation to consumers in more vulnerable circumstances, the *Modernising Consumer Markets* Green Paper recognised that "Vulnerability can arise because of individuals' characteristics, their circumstances, the nature of the market, product or service, or the behaviour of firms. The risk of being vulnerable can change with events, such as bereavement or job loss."[2] Similarly, the FCA's *Approach to Consumers* recognises that vulnerability may be a result of consumers' circumstance, their financial capability or resilience, their physical or mental health, or because of a particular issue or practice they face. The SFGB believes that this is a useful understanding of vulnerability, which encompasses the fact that a consumer's ability to access markets and products can be influenced by one or a combination of their personal characteristics, their circumstances, characteristics of the market, and their relationship to the market from which they are trying to secure the best deal.

2.6. A lack of financial capability can be a driver of vulnerability, and a consequence of experiencing specific vulnerable circumstances. It is important, therefore, to recognise how financial markets are working for those who are less financially capable or who have a restricted access to the market because of a particular vulnerability, for example those who

[2] Department for Business, Energy & Industrial Strategy (2018) Modernising consumer markets: Consumer Green Paper

have limited credit options because of a low income or cannot access certain digital services due to a particular type of disability.

Low financial capability leaves many consumers vulnerable to inertia pricing

2.7. Levels of financial capability in the UK are low, and this affects consumers' use of and engagement with markets. Consumers who have lower financial capability may lack motivation to engage with markets, may lack the confidence to shop around for financial products and services, compare products, and switch providers, and may lack the knowledge and skills to effectively distinguish between available options and choose the right products for them.

2.8. Consumers who have lower financial capability are therefore less able to avoid disadvantageous prices for financial services and are more likely to be subject to price discrimination and loyalty penalties/inertia pricing.

2.9. The UK Financial Capability Survey 2018 shows that many consumers do not shop around for products and services:

- Only 55% of all UK adults (28.6m) shop around for better deals on utilities like gas or electricity;
- Only 57% (29.7m) shop around for better deals on their phone, internet or tv packages;
- 70% (36.5m) shop around for better deals on car or home insurance;
- Just 40% (20.8m) shop around for better deals on credit cards; and
- Only 41% (21.4m) shop around for better deals on bank or savings accounts; and 27% of the working-age population either do not shop around for home or motor insurance at all, or only do so very infrequently.

2.10. Financial capability is influenced by enablers and inhibitors such as numeracy, financial and digital engagement, and financial confidence (see Figure 1). Confidence and numeracy in particular can affect consumers' ability to navigate the marketplace and prices on offer and shop around for products and switch providers.

2.11. Many consumers have low levels of financial confidence. The UK Financial Capability Survey data show:

- 42% of UK adults do not describe themselves as being confident managing their money (giving themselves a score of seven or less out of ten);

- 33% of adults (17.2m) feel nothing they do will make much difference to their financial situation; and
- 63% of adults (32.9m) do not feel they can determine what happens in their lives when it comes to money.

2.12. If consumers lack financial confidence to shop around and compare products and providers, this can reduce their motivation to engage. Our research has found that financial confidence (comprising both confidence managing money day to day and the confidence to make 'financial decisions) is by far the most important individual dimension of the enablers and inhibitors of current financial wellbeing (that is, people's immediate and short-term ability to get by comfortably day-to-day given available resources and pay the bills and meet moderate unexpected expenses, as well as their subjective experiences of their financial situation – the extent to which they worry about money). Confidence is also the most important dimension of longer-term financial security.[3] Confidence is notably lower amongst young adults as well as the lower social grades and income bands.

2.13. Those who lack confidence making decisions about financial products and services and who have lower self-efficacy[4] are less likely to have changed bank account products or providers or done anything to check if they are getting the best deal in the last 12 months.[5] People who felt there was nothing they could do that would influence their own financial situation were significantly less likely to have done anything to check if they were getting the best deal on their account in the last 12 months.[6]

2.14. Low financial confidence therefore inhibits consumer engagement and contributes to consumer inertia, and presents a significant barrier to consumers choosing to switch between products to take advantage of better pricing offers.

2.15. Numeracy and financial literacy similarly affects financial capability and thereby consumer's ability to navigate the market and shop around to take advantage of the best prices. The Financial Capability Survey 2018 found:

- 49% of all UK adults (25.5m) do not understand the impact of inflation on the real value of money;

[3] MAS (2016) Measuring financial capability – identifying the building blocks
[4] In our Financial Capability Survey, self-efficacy is captured in 'engagement' measures rather than the confidence measures referred to above, and is measured by the extent to which people feel they can determine what happens in their life in relation to money, and the extent to which they feel nothing they do will make much difference to their financial situation
[5] MAS (2015) UK Financial Capability Survey
[6] MAS (2015) UK Financial Capability Survey

- 40% (20.8m) cannot perform a relatively simple calculation to add interest earned to a savings balance; and
- 56% (29.2m) do not understand compound interest.

2.16. Low numeracy is linked to higher consumer inertia: people with lower levels of skills and knowledge were less likely to have changed personal current account product or provider or done anything to check if they were getting the best deal in the last 12 months.[7] People with lower numeracy may therefore be more prone to being disadvantaged by inertia pricing.

2.17. Persistently low financial capability in the UK therefore means that we should not overestimate consumers' ability to choose the right products for them and to move around between products and providers to benefit from the most advantageous prices. Consumers with low financial capability can be more vulnerable to inertia pricing and may be disadvantaged by pricing models that penalise loyalty. The Competition and Markets Authority's (CMA) response to the Citizen's Advice Super Complaint on the loyalty penalty in essential markets late last year recognised that "There is a substantial loyalty penalty paid by consumers each year [and] existing estimates suggest this penalty could be around £4 billion in total across the 6 five markets we have looked at". It is now taking action to address the loyalty penalty, including through bolder use of its existing regulatory powers to tackle harmful business practices, reviewing the case for changing consumer law, and assessing the feasibility of matching price data to a largescale UK survey to improve understanding of who pays the loyalty penalty and whether vulnerable consumers are particularly affected.[8]

3. Responses to consultation questions

Question 1: Do you agree with our six evidential questions to help assess concerns about fairness of individual price discrimination cases? Are there any other questions that are as, or more, important than the ones listed? If so, what are they?

3.1. We agree with the FCA's six evidential questions to assess concerns about the fairness of price discrimination. We would highlight that the issue of consumers' financial capability is fundamental to the question of the fairness of price discrimination practices. In particular, the issue of financial capability underlies questions one and four in the FCA framework (*who is harmed?* – when consumers with characteristics which might be deemed vulnerable are harmed, this presents a stronger case for action; and *how are firms price discriminating?* –

[7] MAS (2015) UK Financial Capability Survey
[8] Competition and Markets Authority (2018) Tackling the loyalty penalty Response to a super-complaint made by Citizens Advice on 28 September 2018, December 2018

when this is based on characteristics which consumers cannot easily change, again the case for action is stronger):

3.2. Who is harmed (Q1)? – The FCA explicitly recognises in its *Approach to Consumers* that low financial capability, including low knowledge of financial matters and low confidence managing money, is a driver of consumer vulnerability. We would encourage the FCA to explicitly reference the financial capability of consumers subject to price discrimination practices in answering this question of who is harmed. It is important for assessments of the fairness of pricing practices to take into account the financial capability of affected consumers, alongside other potential indicators of vulnerability.

3.3. How are firms discriminating (Q4)? – We also agree with the FCA's assessment that where price discrimination is hidden and based on intrinsic characteristics which affected consumers cannot easily change, such as personal characteristics, this presents greater cause for concern and greater likelihood of unfairness. Again, we would encourage the FCA to explicitly reference affected consumers' financial capability here. Question 4 combines two distinct considerations – the transparency of the price discrimination, and the extent to which it is based on behaviour or characteristics consumers are able to change. Financial capability is central to the latter consideration: consumers with lower financial capability have less power to change behaviour to overcome inertia and become more engaged consumers. Price discrimination where inertia is not a conscious choice is a greater cause for concern than where it is the effect of informed consumer choice, and we know that the financial capability of consumers is a key factor in the extent to which choice is exercised. Low financial capability inhibits choice and limits consumers' ability to opt to avoid disadvantageous price discrimination. We believe there would be merit in separating these considerations of choice and transparency, and explicitly referring in the former to the way in which low financial capability affects consumers' ability to change their behaviour such as switching provider in order to take advantage of lower prices.

Question 2: Where consumers who shop around get good deals but those inert ones not shopping around do not, what factors should determine whether this trade-off is fair? In particular, to what extent are the following factors relevant:

- **a) The scale of the price differential between consumers?**
- **b) The characteristics of the consumers who are affected? In particular, is it only unfair when it is vulnerable consumers who lose out, or is it also unfair when non-vulnerable customers lose out? Can it also be unfair even when the vulnerable benefit?**
- **c) The reasons why existing consumers do not switch to a better deal?**

d) The transparency of firms' pricing practices?

3.2. We believe that the characteristics of affected consumers and the reasons behind their inertia are key considerations in determining the fairness of inertia pricing. The *reasons why* existing consumers display inertia and do not switch to a better deal to avoid the price discrimination are of paramount importance to the fairness of the discrimination, and the question of consumers' financial capability must be central to these considerations as well as the extent to which the inertia is due to a consumer's vulnerability.

3.3. The FCA's *Approach to Consumers* sets a clear expectation that should take reasonable responsibility for their choices and decisions, and also recognises that certain consumers in more vulnerable circumstances are not in a position to be able to make best decisions or choices. This will include consumers with particular characteristics, such as those who are less digitally engaged or experiencing certain mental health issues, consumers at particular life stages where they are most vulnerable in relation to making good decisions, such as just after a bereavement, and those consumers with low financial capability. It is clear that there is no level playing field for those consumers who will evidently face greater barriers than other consumers and are less able to take action to avoid the price discrimination.

3.4. Cases of price discrimination where consumers, due to their low financial capability, face additional barriers to switching, or do not know about the consequences of their inertia, present greater cause for concern of unfairness than cases where, for example, consumers know about the consequences of inertia but make a conscious rational decision not to act. If consumers who are disadvantaged by price discrimination have low financial capability and are therefore less engaged and face greater barriers to shopping around for better deals, the resultant price discrimination that leaves these more inert consumers paying more than engaged consumers who are more able to navigate the financial services market to find better deals is more likely to be unfair.

3.5. Research by Citizens Advice has found choice is limited by consumer difficulties finding the best deal, understanding the loyalty penalty and by perceived barriers deterring people from switching: 39% of consumers were unaware of the loyalty penalty in essential markets, 35% said it was too hard to shop around, and 25% thought it was difficult to exit existing service contracts.[9]

3.6. There are significant links between consumer vulnerability, financial capability and the extent to which consumers level of engagement is driven by informed and conscious choice. We recommend the FCA to reflect this explicitly in the proposed framework to assess the

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[9] Ogunye, T., Rogers, C., Greenhalgh, L., and McCay, B. (2018) The cost of loyalty Exploring how long-standing customers pay more for essential services

fairness of price discrimination, and to look at whether firms are doing enough to support consumers who are particularly vulnerable and those with low financial capability to increase their financial capability.

Q3: To what extent is it appropriate for firms to target and tailor their pricing approach to consumers who are not likely to respond to future price rises? Does the answer to this depend on the techniques that firms use to achieve this (eg through predictive modelling, product design, communication with the consumer)? Please provide reasons to support your answer.

3.7. Where continued consumer inertia to firms' pricing models leads to potential and real financial detriment and vulnerability, firms should seek to reduce potential harm through these models by factoring in these known consumer characteristics – behavioural, levels of financial capability, confidence, low numeracy – in their design. Expectations of firms may also be shaped by the nature of the product (e.g. whether perennial or whether there are established review points as with insurance renewals), the visibility of price differentials to consumers, the transparency of the tools to target consumers used to both consumers and regulators, and the impacts on consumer groups, especially those in vulnerable circumstances.

Q4: What should we expect firms to do to help reduce the cost to consumers of shopping around and, if necessary, switching to another provider, in particular with respect to:

a) **Helping consumers understand their choices**
b) **The amount of effort required to make their choice**
c) **Not discouraging switching or shopping around**
d) **Being transparent about pricing and what factors are used to determine pricing**

Please provide reasons to support your answer.

Q5: What should longstanding consumers be able to expect of their provider when they become inactive in that particular market? In particular what should be expected of:

a) **The support the provider gives their customers to ensure they are making informed product choices?**
b) **The default outcome in the event of prolonged inactivity (eg contract renewal, contract terminations, or automatic switching to a different product)?**

c) **The maximum price differential they are paying relative to the best available rate for that provider?**

Please provide reasons to support your answer

3.8. It is vital that firms take responsibility for identifying vulnerable customers including those with low financial capability, and have processes in place to take appropriate action where vulnerability is identified. The FCA's Financial Lives survey data shows 50% of consumers display one or more characteristics that signal potential vulnerability.[10] Individual consumers are not always able to recognise their own vulnerability and seek help: our research shows people don't necessarily look for or find the help they need. For example, people sought help and found what they were looking for following just a quarter of all recent life events.[11]

3.9. For this reason, the SFGB is supportive of the introduction of a New Duty of Care that would give financial services firms a positive obligation to promote customers' best interests and a fiduciary duty not to cause harm to a customer's financial interests.[12] Consumers face complex financial choices, and the way firms communicate and structure propositions can do more or less to enable and support consumer capability. A New Duty with a positive obligation to promote customers' best interests could encourage firms to identify potential customer harm and avoid it, in line with the stated aim of the FCA's mission to focus on prevention rather than cure.

3.10. Firms can play an important role in helping to improve customers' financial capability and helping to reduce the causes of inertia and the barriers to greater engagement. For example, firms can use simple, salient, clear and timely explanations of prices to improve customer understanding and awareness of pricing and their options (for instance, the FCA's requirement on firms to display the previous year's quote on insurance policy renewal notifications; presenting prices before and after initial deals for new customers in pounds rather than percentages; using video explanations alongside text; presenting key points in checklists/Q&As; and using interactive tools). Communicating at the right time – for example not only at the point of sale, but also reminding customers through 'nudges' (for example text message alerts) – when initial deals are due to finish and shift to more expensive tariffs, can help consumers to understand the consequences of staying put versus looking for another deal, and prompt consumers to increase engagement and shop around.

3.11. There is more for financial services firms to do to empower consumers to make informed choices, including better understanding of what people need to know and when they need to know it when making financial decisions. As the statutory body for financial capability, with a

[10] FCA (2018) Understanding the financial lives of UK adults
[11] Money Advice Service (2017), Right Place, Right Time – Helping people with their finances when they need it most
[12] Money Advice Service (2018), Money Advice Service Response to FCA Duty of Care discussion paper

function to develop and co-ordinate a national strategy to improve the financial capability of members of the public, the ability of members of the public to manage debt, and the provision of financial education to children and young people, the SFGB seeks to work with financial services firms to improve communications to consumers to increase their engagement and help them to make more active, informed choices.

3.12. When consumers become inactive in a particular market, we believe they should be able to expect that their provider makes the consequences of that inactivity clear, and makes it easy for consumers to understand and compare products and to switch providers.

Q6: On the discussion on potential remedies in this paper:

a) **Do you agree with the types of remedies that we have set out? If not, please explain which type of remedy you disagree with and why.**

b) **Are there other types of remedies that we should consider that do not fit into these categories? If so please explain them and what adverse effect you think they would remedy, mitigate or prevent.**

c) **Are there particular examples from other sectors, or other countries, that you think we should consider to inform our approach? If so, please provide detail and references where possible.**

3.13. We are responding to this question in general terms rather than commenting specifically on the types of remedies set out. We agree that a combination of demand-side and supply-side remedies may be required to address the harms of inertia pricing. Some characteristics of vulnerability and persistently low financial capability and low levels of financial confidence, numeracy and knowledge mean that many inert consumers have quite limited capability to become more active and shop around to compare products, and the most inert and vulnerable consumers may not be reached by demand-side remedies alone. This therefore places a limit on the extent to which demand-side remedies may remedy harms – and highlights that it is vital to invest in ensuring people have the basic skills needed to stay in control of their finances and make decisions about products and services. A balance of demand-side and supply-side remedies will therefore be required.

3.14. In line with the FCA's evidential questions on who is harmed, how much, the size of the group of people harmed, and the essential-ness of the product/service, we would like to see the FCA focus inertia pricing remedies in the product markets that affect most consumers, such as motor/home insurance, and day-to-day banking.

3.15. The FCA might also consider approaching remedies for inertia pricing in a similar way to the approach taken to remedying persistent debt, with a series of escalating interventions stepped according to the length of time the consumer has been inactive and subject to inertia pricing. As well as regulation securing a fair and transparent framework for competitive markets, remedies and interventions, there are big opportunities to focus remedies and interventions to help consumers engage with and build their financial capability through their financial lives. This will have benefits for consumers, markets and regulators in the longer-term. Inertia pricing remedies could include firms similarly issuing an escalating series of prompts to customers at set intervals, with consumers who have been inert for longer periods of time (and who may be more likely to be in vulnerable circumstance) being contacted more actively (moving from letters notifying customers that better prices are available, to text messages 'nudging' customers to change, to direct phone calls offering help to switch, for instance) by firms.

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