Discussion paper on Fair Pricing in Financial Services: DP 18/9

RESPONSE BY THE FLA

Introduction

1. The Finance & Leasing Association (FLA) is the leading trade association for the UK consumer credit, motor finance and asset finance sectors. FLA member companies include banks, the finance subsidiaries of major manufacturers and independent finance firms. They offer credit services to customers from all social groups, via credit and store cards, personal loans, point of sale finance, motor finance and a number of other consumer credit products, as well as a wide range of leasing and hire purchase services to businesses of all sizes. Members of the Finance & Leasing Association provided £136 billion of new finance to UK businesses and households in the 12 months to November 2018.

2. We welcome the opportunity to comment on FCAs Discussion Paper (DP 18/9) on ***Fair Pricing in Financial Services***. We note that this DP is published alongside the findings of the FCA's work on pricing practices in the retail general insurance sector (Diagnostic Work), and the terms of reference for a Market Study on general insurance pricing practices.

Overview

- As the DP acknowledges, it is published at a time when there have been a number of other publications relating to the pricing of financial services, including the Competition and Market Authority's (CMA) recent response to the Citizens Advice "Super Complaint" on loyalty penalties. It will be important to pull together the various issues raised by each of these publications and ensure a coherent and joined-up overall policy response.

- We note the comments in the DP that none of the FCA's operational objectives explicitly mentions fairness, that this is a very complex issue and the FCA's acknowledgement that it needs to act proportionately to avoid the potential for unintended consequences. Therefore it is welcome that the FCA is aware of the risk that in seeking to improve market outcomes for some consumers, this could lead to worse outcomes for others. The challenge will lie in achieving an appropriate balance.

- Any discussion on possible remedies for addressing issues around fair pricing, should sensibly consider the impact of existing price control measures for both firms and consumers. For example, the price cap in the High Cost Short Term Credit Market has resulted in a significant contraction in that sector, both in terms of the number of firms still operating and access to this form of credit by consumers. There will undoubtedly be differing views on

whether this has been a good customer outcome – but the implications in terms of restricting customer choice, financial exclusion and a major increase in the volume of complaints being referred to the Financial Ombudsman Service are important considerations.

- The FCA will also have received feedback following its recent consultation on a cap in the Rent-to-Own sector, which seeks to cap not only the cost of the credit but also the cost of the goods purchased. This sets a new precedent, the impact of which may not be immediately evident - but which also should be considered as part of this overall public debate on the fairness of pricing.

- We support measures which prompt customers to review their situation, to shop around and make informed decisions. We have already worked with the FCA on 'prompts' in the credit card market, alerting customers when promotional offers are coming to an end. We are also embedding similar alerts in the catalogue and store card sectors when Buy Now Pay Later offers are ending. This ties-in with the FCA's broader work on encouraging solutions which recognise behaviour economics/nudge theory, which works effectively. We believe this is a more proportionate approach, recognising the need for both lender and borrower responsibility, compared to formal price caps where the unintended consequences are rarely mitigated.

Reponses to specific questions

Price discrimination in financial services

Q1: 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?

Yes.

These questions capture the key areas of concern, including whether consumers who may be vulnerable are being treated unfairly; whether adverse effects are significant (though this will need to be clearly defined) and whether significant groups are affected. This latter point will also require careful definition. For example, if a "significant group" comprises consumers who may be vulnerable in some way it may be less relevant to take the actual numbers of consumers affected into account than if the group were larger, but not vulnerable.

At Paragraph 3.13, the DP outlines how the FCA will assess the answers to each of the six questions to identify the potential for harm and evidence of price discrimination. In parallel however, consideration of the drivers for consumers not shopping around for a better deal should also be taken into account – so all aspects are taken into account.

How firms set prices for existing customers

Q2: 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?**
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> **e) The characteristics of the product, including whether it is an essential service**

As Chapter 3 notes, some consumers will be less price-sensitive than others and/or may choose to pay a higher price than might otherwise be available because of the way in which they want to/are able to transact. So, for example, a product might be available very cheaply from one retail outlet, or cheaper still online, but the consumer might enjoy the experience (and possibly convenience) of purchasing it in a particular retail outlet, albeit at a higher price. While this is a retail example, it could apply equally in financial services. The relevance of the price differential will be one of degree. If there is a very significant difference it will matter only if consumers are not aware that they could obtain the same goods or services at a much lower price. So the transparency of firms' pricing is key here.

Information on pricing should be transparent, so consumers can make informed choices. The more transparency, the more the question of "unfairness" falls away, especially in relation to consumers who are able to access all available access options. Where consumers' access to alternative options is restricted in some way, other measures may be necessary. For example, older consumers may be aware that a service may be available more cheaply online – but not all consumers will have the ability or confidence to transact business online. This opens up questions about whether such groups of consumers – those who would like to benefit from the lowest prices available but who cannot do so for some reason – should be regarded as vulnerable and catered for in some specific alternative way. However it's also important not to generalise – some elderly customers will be very adept at transacting online.

In practice, all the factors listed will be relevant to a certain degree. Where services are 'essential' then even more of a spotlight should be on firms to ensure their pricing structures are fair. The scale of the price differential and which customer groups might be adversely affected should also be considered. From a competition perspective, the need for an appropriate balance is clear as undue constraints could see the number of provider's contract, leaving fewer firms for customers to choose from in respect of essential services.

There will also be broader context issues to take into account when looking at why customers might not switch products. Chapter 4 considers reasons for consumer inertia in the mortgage market and we would also add the following reasons which might prevent a consumer from entering into what might appear to be a cheaper deal.

- Likely or actual changes in personal circumstances (bereavement/relationship breakdown/divorce/marriage) which may mean a move to a cheaper deal isn't possible
- Changes to working patterns – again a move to a cheaper deal may not be possible
- A belief that even cheaper rates may become available in the foreseeable future and an unwillingness to lock in to something which may prove to be less advantageous
- Anticipation of a higher paid job which might open up the possibility of a better deal
- Anticipation/expectation of a change in financial circumstances such as inheritance/maturity of an investment/commencement of pension
- There may also be reasons about which a consumer might be less willing to be forthcoming e.g. if some details had been exaggerated or even falsified at application stage in an effort to borrow more than might otherwise have been approved. Such consumers might wish to keep a low profile until such time as they had been able to pay off some of the loan, rather than risk having their financial circumstances scrutinised.

We note the FCA's recent letter (dated 9 January 2019) to the Treasury Select Committee, which identified the need for an improvement in switching options for mortgage customers who are currently unable to do so. These 'mortgage prisoners' face additional challenges to the ones described above, particularly due to inflexibility of the current lending rules. These customers can only switch to a better rate if they pass a new affordability assessment and meet the strict lending criteria of an active lender. We welcome the FCA's intention to remove some of these barriers and await further clarity from the publication of the upcoming Mortgages Market Study (MMS).

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 depend on the techniques that firms use to achieve this (e.g. through predictive modelling, product design, communication with the consumer)?

Please provide reasons to support your answer.

It may not be unfair to set prices according to predictions about how consumers will respond if the (presumed) increases are proportionate, fair and justifiable. However, any policy which deliberately seeks to exploit consumer inertia is unlikely to be regarded as fair – and any policy/policies which deliberately seek to exploit 'vulnerable consumers' would be unacceptable.

How might we address the harm

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.

The FCA's rules already require firms to communicate with their consumers in a way which is clear, fair and not misleading (PRIN 2.1.1 principle 7). Any communication to a consumer regarding the cost of the service provided should therefore be very transparent and include the actual price being charged, any exit charges/penalties and any other relevant terms and conditions which would apply if the customer remained with the firm. It should not be necessary for a firm to encourage the customer to shop around for an alternative provider or give the consumer information about what a competitor firm might charge for providing the service - since another firm might not provide exactly the same service on exactly the same terms and conditions. Based on that information, it should be for the customer to decide whether they want to look at alternative options/providers. The Price Comparison Website industry is high profile and 'best buy' tables are prevalent and so customers have a good insight as to where to start their search. The development of Open Banking will also provide consumers with easier access to their financial information, which they can use to more readily shop around.

Where a consumer does wish to shop around with a view to switching provider, it would not be unreasonable to expect the consumer to invest time and effort in finding out about suitable alternatives. In the course of doing so the consumer might well need to clarify specific details regarding the terms, conditions and cost of their current arrangement – and the firm must be prepared to answer any queries promptly and accurately. The firm might wish to ask the consumer why they were considering switching to another provider – and might take the opportunity to offer the consumer an alternative deal on more advantageous terms – but it should not withhold any information from the consumer or put pressure on them to remain with the firm.

While transparency of pricing is important, we would not support firms having to set out *what factors are used to determine pricing* if this was to include commercially sensitive information. This point was recently also recognised in the FCA's final guidance on the Fairness of Contract Terms where the need to provide and detailed information about pricing policies was not included.

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 (e.g. contract renewal, contract termination, 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.

Firms will know how much each of their customers is paying for a particular service and for how long. Where long-standing customers are being charged significantly more than new customers, firms should consider whether more pro-active engagement might be appropriate. It may be that the customers have not realised the size of the differential between what they are paying and what a new customer might be asked to pay and have assumed that, as loyal and long-standing customers, the firm would not seek to exploit their inertia. Whilst it is entirely reasonable that firms may wish to offer promotional discounts and incentives in order to attract new customers, a review process should avoid the situation where customers could be inert for a protracted period.

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.**

We do have some concerns with certain supply-side remedies (e.g. see 'auto-renew' example below). In the majority of cases we believe that most harm scenarios can be solved by demand-side remedies which focus on helping consumers make better decisions. Key here are information remedies which help change behaviours. This can further be aided by 'nudging' consumers in the right direction (using behavioural 'nudge theory').

The problem with some supply-side remedies is that they tend to be structural and extremely restrictive on legitimate business practices that can help innovation and ultimately increase price competition within markets. For example, supply side remedies which involve restricting the way firms design and price products are likely to fall into this category. Price regulation should only be used as a very last resort when every other market intervention has failed. We would also be concerned with any form of product structure restrictions/interventions, unless there is serious market harm and all other interventions have failed.[1] As the paper rightly suggests

[1] This is a point particularly important in the context of proposals for the introduction of a price cap on rent-to-own (RTO) products (see FCA CP18/35). This supply-side remedy is justified in terms of the FCA's broad powers

the principle of proportionality is an important guide in order to achieve the desired result with the least intrusive remedy possible. Similarly, as the FCA alludes to, more intrusive remedies need more careful consideration as they may have negative unintended consequences on those parts of the market they are trying to remedy.

In paragraph 5.5 the discussion paper says: "*Usually, interventions we make on the demand-side are less intrusive than supply-side remedies. However, sometimes we find that consumers do not respond to demand-side interventions. In these cases, supply-side remedies might give us more direct options for intervention*". In most cases we believe that maximising information and price transparency is enough for consumers to then make their own choices. Consumers need to be able to take some responsibility for their own decisions based on transparent market information. A good example here is making consumers more aware of 'inertia pricing' and how they can avoid it. This should also help lead to more competitive markets based on price. In the case of vulnerable consumers then we agree more help/intervention from firms may be needed. But again this can usually be remedied via demand-side remedies with some extra intervention from firms.

We agree with information disclosure remedies (demand-side remedies), however, we do have concerns with supply-side remedies that change the structure of markets e.g. the FCA suggestion of making longer contracts compulsory. This is a product design change which may in some circumstances stifle innovation and ultimately result in increased as opposed to decreased prices. The direct intervention in contract terms (length) appears to be to try to directly influence firms pricing strategies which form part of a healthy competitive market. We think this should be avoided as far as possible. On the other hand, we agree with the CMA that reminders and nudges (part of the informational remedy family) is a very good way to get consumers both engaged and to change their behaviours.

The FCA should exercise caution before considering removing or restricting firms' ability to "auto-renew" certain products, in particular those which relate to essential services such as home or motor insurance. In the latter case the consumer could find themselves in breach of the criminal law if not adequately insured. The provider firm should be responsible for reminding the consumer that renewal is due within a specific period. It should remind them what they paid for the previous period of cover - now rightly required under FCA regulation - and set out clearly what the cost will be of renewing the same cover on the same terms and conditions. The consumer is then put in a position where they may compare and contrast offers from other providers, and make an informed decision as to whether to renew.
In relation to direct pricing interventions, the FCA is right in saying this could result in some consumers paying more. There are also, as mentioned, complexities here in some markets where cost-based pricing needs to be taken into account e.g.

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under FSMA to advance its consumer protection objective. We understand that the grounds for challenging such interventions from a competition perspective are limited, and would have to demonstrate that any adverse effects on competition outweighed the benefit to consumers.

With that in mind, however, we reiterate the point that there needs to be a clear case made for the extent of market harm that justifies this sort of intervention, and crucially, that previous interventions have failed.

insurance is a classic example here. Similarly, a complete price discrimination ban could stifle competition by disallowing firms to compete for new business by offering special offers (often called teaser rates).

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