FAIR BY DESIGN
Ending the extra costs of being poor

FINANCIAL CONDUCT AUTHORITY (FCA) INVITATION TO COMMENT: DISCUSSION PAPER: "FAIR PRICING IN FINANCIAL SERVICES"

JANUARY 2019

1. INTRODUCTION

1.1. Fair By Design welcomes the Financial Conduct Authority's invitation to comment on the Discussion Paper "Fair Pricing In Financial Services"

1.2. Please note that we consent to public disclosure of this response.

1.3. For more invitation about this response please contact Lucie Russell, l.russell@barrowcadbury.org.uk Tel: 020 7632 9070.

2. ABOUT FAIR BY DESIGN

2.1. Fair by Design is a movement dedicated to reshaping essential services, like energy, finance and insurance, so they don't cost more if you're poor.

2.2. People in poverty pay more for a range of products including expensive energy tariffs for pre-payment meters, high cost loans, rent to own products such as kitchen appliances, and insurance in poorer postcodes. This is known as the Poverty Premium.

2.3. We collaborate with industry, government, and regulators to design out the Poverty Premium, and raise awareness amongst the public to bring about change.

2.4. Our venture fund provides capital to help grow new and scalable ventures to innovate the market.

2.5. Fair by Design was conceived by the Joseph Rowntree Foundation and Big Society Capital and is being led by the Barrow Cadbury Trust. The fund is managed by Ascension Ventures.

RESPONSE TO FCA INVITATION TO COMMENT: DISCUSSION PAPER: "FAIR PRICING IN FINANCIAL SERVICES"

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?**

1.1. On 'How much are these individuals harmed?' we feel that defining this in terms of 'profitability' – even if it is immaterial to the consumer segment – is not appropriate, as this is from the perspective of the firm. The desire to act should be measured by the harm caused to the consumer. For instance the Poverty Premium borne by low income consumers is estimated at a total of £490 a year – with the energy sector being the biggest contributor.[1]

1.2. On 'How significant is the pool of people harmed?' we are concerned that a 'very small minority' should not associated with a 'lesser desire to act.'

1.3. For instance, the rent-to-own (RTO) market is estimated to be around only 400,000 consumers; the market in fact had shrunk (in value) by nearly 50% since 2015. However, the characteristics of the average rent-to-own consumer (low income; tenants; over-indebted) meant that the harm to these consumers was significant enough to warrant a consultation on possible interventions by the FCA.

1.4. In cases where there is a small minority of consumers impacted, while this number of may not further increase, low income consumers in particular are often over-indebted, and delayed intervention may result both in greater harm and make their situation worse.

[1] https://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1615-poverty-premium-report.pdf

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?

2.1. Scale of price differential:

Insurance sector:

2.1.1. Citizens Advice estimated that someone with the average cheapest combined policy would pay an extra £13 after 1 year and £110 after 5 years – up to 70% more for a policy than a new customer. [2]

Energy sector:

2.1.2. OFGEM estimated that the penalty for being on a Standard Variable Tariff (SVT) with a 'Big Six' energy supplier, rather than the cheapest fixed deal in the market, has typically costed between £200 and £350 more per year since 2015. [3]

2.2. Characteristics of consumers affected:

2.2.1. The BEIS' consumer green paper 'Modernizing consumer markets' found that "in energy…and financial services, firms charge increasingly higher prices to customers who have not recently switched provider…and it is often the vulnerable who suffer disproportionately…huge choice…can be complex and difficult for consumers to compare." [4]

2.2.2. However, the FCA's Financial Lives survey, published in October 2017, suggests that half of UK adults have characteristics of potential vulnerability in relation to their financial resilience and capability.[5] Potential vulnerability covers those who may suffer disproportionately if things go wrong; the reasons for this can vary from suffering a recent life event (such as redundancy, bereavement or divorce) to low financial capability i.e. managing money or knowledge about financial matters. The reason may also be a health-related problem.

2.2.3. There is therefore transience to vulnerability which, combined with increasing housing costs and stagnating or low pay, suggest that a significant proportion of consumers' financial situations are fluid and they are therefore at risk of subsequently suffering greater harm.

2.2.4. In an online survey of consumers who identified as low income, conducted by Fair By Design, and in conjunction with Gingerbread,[6] one respondent said:

- "Quite frankly it makes me angry that people in lower incomes aren't given more help."

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[2] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20penalty.pdf

3 Social Market Foundation, Eliminating the Poverty Premium in energy (2018)

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/699937/modernising-consumer-markets-green-paper.pdf

[5] https://www.fca.org.uk/publication/research/financial-lives-consumers-across-uk.pdf

[6] Conducted between 25 – 29 January 2019.

Energy sector:

2.2.5. OFGEM estimated that 64 percent of accounts with the 'Big Six' energy suppliers were on a Standard Variable Tariff (SVT)[7] These tariffs offer the poorest value, and the high percentage indicates that consumers are not acting when their fixed tariff deals come to an end.

2.2.6. 39 percent of customers living in low income households (defined as earning less than £16,000) have never switched energy supplier.[8]

Insurance sector:

2.2.7. Across the UK, 12.9m households are paying a loyalty penalty – this amounts to 63% of the home insurance market.[9]

2.2.8. And those on low incomes or who are disabled are less likely to actively engage in the market to get a better deal when an insurance policy renews.[10]

Elderly consumers:

2.2.9. 32% of those paying the loyalty penalty for their insurance policy, are over 65.[11]

2.2.10. 16 per cent of pensioners in the UK – 1.9 million – were on low incomes (defined as less than 60 per cent of median household income after housing costs) in 2016/17.[12]

2.2.11. The Big Six energy suppliers account for around 76% of market share[13] and 40-50 million customers. That nearly two thirds of their customers are on a Standard Variable Tariff equates to around almost 25 million people or 10 million households[14].

2.2.12. Similarly, almost two-thirds of customers in the insurance market are paying a loyalty penalty.[15]

2.2.13. These figure suggest that the number of people paying over the odds for their energy or insurance is not an issue that can be resolved by encouraging consumers to switch – or one that is limited to vulnerable consumers.

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7 Social Market Foundation, Eliminating the Poverty Premium in energy (2018)
8 Ibid
9 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20penalty.pdf
10 Ibid
11 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20penalty.pdf
12 Age UK, Poverty in later life, 2018
13 https://www.ofgem.gov.uk/data-portal/electricity-supply-market-shares-company-domestic-gb
14 Based on ONS average household size of 2.4
15 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20penalty.pdf

2.3 Reasons why existing consumers do not switch;

2.3.1 OFCOM found that low income consumers have less access to the internet – the primary means of comparing and switching providers: the proportion of adults in DE6 households who do not go online is almost double the UK average (22% vs. 12%).[16]

2.3.2 The CMA's energy market investigation found that customers on low incomes, or with disabilities, or limited levels of education, are less likely to use Price Comparison Websites (PCWs)[17].

2.3.3 Lower access rates among low income consumers – in addition to simply not owning a computer or internet-enabled device because of the associated cost – may also be down to a lack of ability to use the internet, or confidence i.e. a fear of crime, lack of trust, or not knowing where to start online.

2.3.4 Age UK's research found that nearly of quarter 65-74 year olds have not been online recently, defined as within the last three months.[18]

2.3.5 While these consumers may be considered as failing to act (per the FCA's schema of why consumers do not switch providers after price rises), this suggests an imbalance in fairness of opportunity, as elderly consumers and those on low incomes are digitally excluded, unable to even access the market and compare providers.

2.3.6 Additionally, low income consumers, worried about their financial situation, have less capacity (literal and cognitive) to devote time to managing their utility suppliers.[19] This is known as a 'scarcity mindset'. In this instance, these consumers would be in the G5 group of the FCA's schema of why consumers do not switch providers after price rises. Consumers are disengaged with the market and may not even realise they are paying a high price for a product.

2.3.7 For those low income consumers who decide not to act (group G1), The University of Bristol found that reasons included risk aversion and the need to retain tight budgeting control.[20]

2.3.8 Indeed, survey respondents told us that:

- "The ironic thing is that most low income families will have a far better grasp of their finances then a family who aren't forced to count every penny."
- "No time to compare prices and I'd be concerned there may be a one off switching fee"

[16] https://www.ofcom.org.uk/__data/assets/pdf_file/0011/113222/Adults-Media-Use-and-Attitudes-Report-2018.pdf
17 Competition and Markets Authority, 2016, 'Energy Market Investigation - Summary of Final Report'
[18] Age UK, Everything is online nowadays, 2018
[19] Citizens Advice, The Cost of Loyalty 2018
[20] Sara Davies *et al*, *Paying to be poor* (University of Bristol, 2016)

Mental health:

2.3.9 Money and Mental Health Policy Institute's survey found that 82 per cent of people with mental health problems said the thought alone of switching and shopping around was exhausting.

2.3.10 Nonetheless, more than two thirds (69 per cent) recognized that switching suppliers is the key to getting the best deal on essential services.[21]

2.3.11 These consumers would be in the G2 group, where they are disengaged due to temporary situations, such as mental health crises, but are aware of the consequences of the not acting.

Loyalty penalty:

2.3.12 In cases where insurance premiums had risen year on year, eventually reaching levels that customers – or their relatives considered unfair – the Financial Ombudsman found that people had been counting on businesses to do the right thing.[22]

2.3.13 The Financial Ombudsman also found that "from the complaints we see, it's clear insurance is an area where people may feel they've been penalized for staying put. In particular, people who've stuck with their insurer for a number of years are telling us they've discovered they're paying far more than new customers – or more than they'd pay for similar cover elsewhere."[23]

2.3.14 We can infer from this, and the statistics, that a significant proportion of consumers are in group G4, thinking that their 'loyalty' must be rewarded.

2.3.15 Consumers are often targeted by appealing introductory offers encouraging them to switch provider; however, after a year of the company making a loss on these new customers, they are subsequently subject to price-walking.

2.3.16 Expecting customers to switch to better deals, especially when they are vulnerable is not a panacea for the Poverty Premium. Yet more competition in markets should not be the outcome, rather it should be fairness.

2.3.17 Survey respondents told us:

- "I think long standing customers should get better benefits and deals as it's usually new customers that get good deals."
- "My insurance renewal quotes that my current insurer send are always higher than I paid previously. What makes it worse is if I do a quote from the same insurer I always find it cheaper."
- "Deals are offered to new customers only."
- "There is no discount for loyalty."
- "Loyalty doesn't seem to matter anymore."
- "Loyalty isn't always rewarded."
- "There is no benefit to loyalty."

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[21] Money and Mental Health Policy Institute, Levelling the playing field. 2017

[22] Financial Ombudsman Annual Review 2018

[23] https://www.financial-ombudsman.org.uk/publications/ombudsman-news/144/144-insurance-pricing.html

2.3.18 Our points in response to question 1.2 all raise the issue of the balance of responsibility between a consumer and firm, and/or duty of care, as well as the efficacy of "nudging."

2.3.19 Vulnerable consumers in particular should not be expected to protect themselves by making the right choices about the right products.

2.3.20 In our roadmap for tackling the Poverty Premium[24] we refer to this 'myth of the super consumer,' that is, very few have the time or know how to compare the prices of every product or service they buy. Additionally, the market is often complex and overwhelming – should firms not be providing fairer more equitably priced products for everyone?

2.3.21 We must also consider the quality of switching, rather than simply the volume. Are consumers who have moved providers actually getting a better deal?

2.4 Transparency of firms' pricing practices:

We consider supply-side factors for consumers not switching, alongside the transparency of firms' pricing practices.

Insurance:

2.4.1 Insurance markets and products are very complex. Just 53% of insurance customers are confident they could identify unfair charges - so many are unlikely to act.[25]

2.4.2 This is likely the case for all consumers; they simply do not have the capacity to interrogate their policy wording.

2.4.3 Since the FCA's introduction of rules for insurance providers to supply a comparison with the previous year's price alongside a renewal quote, people are more likely to notice price increases (24% vs 19%).

2.4.4 Of those consumers who identified an increase in their premium, only 7% renewed without shopping around.[26]

2.4.5 However, given that 32% of consumers renewed their policy without checking for better deals first, we can infer that there was also a high percentage of consumers who remained with their supplier at an increased cost, despite shopping around. The possible reasons for these consumers' decisions have already discussed under question 1.2

2.4.6 Survey respondents told us that:

- "With utilities, [there are] some suppliers I've never heard of, so how do I know they're reputable?"
- "I don't understand the way bills are priced or my usage."
- "I'm sick of multiple tariffs from the same supplier, massive differences in prices, [and a] lack of genuine support in a timely manner if you have an issue.

[24] https://fairbydesign.com/wp-content/uploads/2018/09/FbD-Roadmap-Artwork-Web-with-revision.pdf
[25] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Report%20-%20Insurance%20loyalty%20penalty.pdf
[26] Ibid

It's too long to be able to refer to Ombudsman. Energy firms are pretty much untouchable. [You] end up with a choice between low tariffs from smaller companies who often go bust or security with a larger firm but astronomical prices. I don't understand how they can report massive profits when I'm living on tins of baked beans so I can afford to keep the heating on and my child warm. Makes me sick."

- "No more multiple tariffs. I just want an honest, transparent, eco energy company who charges one price per unit for every customer. The more you use, the more you pay."
- "The energy companies should simplify bills and cut down on jargon people don't understand."

3. **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)?

3.1. 71% of respondents to our online survey stated that they would be happy with companies using their data “in the future, in order for firms to know their customers better, and so they get you the right product or services”

3.2. Respondents told us:

- “I’d be prepared to give my incomings [and] outgoings if they could set a price according to that”

3.3. There may be an opportunity for open data to highlight potential vulnerability – for instance, whether an individual’s income has decreased in consecutive months

3.4. However, as firms’ use of data in predictive modelling increases, and there is greater individualised pricing, there is a risk of less transparency.

3.5. Indeed, one survey respondent suggested that:

- “It will yet again end up with those on low incomes or with debt being classed as high risk and therefore paying massively over the odds. They know how much per unit they pay wholesale, pick a profit margin and bloody well stick to it.”

3.6. Regarding data not to collect, some survey respondents did say:

- “Anything outside of the details of the service, no personal data.”
- “What I spend my money on day to day.”

3.7. There must also be agreement of what data elements are off the table, for instance, protected characteristics. There is also a responsibility of firms to ensure that their algorithms are working.

4. **What should we expect firms to do to help reduce the cost to consumers of shopping around and, if necessary, switching to another provider:**

4.1. **helping consumers understand their choices**

4.2. **the amount of effort required to make their choice**

5. **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:**

5.1. **the support the provider gives their customers to ensure they are making informed product choices?**

5.2. **the default outcome in the event of prolonged inactivity (eg contract renewal, contract termination, or automatic switching to a different product)?**

5.2.1. On the subject of energy firms automatically switching consumers to a tariff other than a Standard Variable when their deal ended, respondents to our survey felt that:

- "[Firms should] promise they will switch you."
- I like that idea [of auto-switching] as I usually forget when nearing the end of a contract even with reminders so this would be great for customers."
- "I assumed they did [auto-switching] anyway! Happy for that."
- "They should [auto-switch], rather than allowing people to be charged more for the same product/service."

5.2.2. However, some consumers were still keen to retain a final say:

- "If it was the best deal and a text/email to inform me."
- "As long as there was notification."
  "I want to know first so I can check I am getting a good deal."
- "That would save time but you'd need to think about it first."
- "That should be the customer's choice, as there may be better deals from other providers."

5.3. **not discouraging switching or shopping around**

5.3.1. Some survey respondents felt that:

- "The providers should help with the switch process."
- "You'd need a genuinely independent body for that to work."

5.4. **being transparent about pricing and what factors are used to determine pricing**

5.5. **the maximum price differential they are paying relative to the best available rate for that provider?**

6. **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.

Demand-side remedies:

6.1. In the energy sector, the FCA should require firms to ensure vulnerable consumers are on good value deals instead of expensive standard variable tariffs, when much cheaper tariffs are available. This could be achieved through automatic switching when a fixed term deal expires.

6.2. Energy firms could work with social landlords to ensure tenants are defaulted onto the cheapest energy tariff – and that this is maintained when the property is vacant ahead of the next tenant.

Supply-side remedies:

6.3. Firms should work with the FCA to improve market-wide systems for flagging vulnerability.

6.4. This could mimic the FCA’s rules for interventions for consumers in persistent credit card debt, whereby data is used and intervening steps are taken at 18, 27 & 36 months.

6.5. Firms must now offer customers in persistent debt help to repay the debt more quickly. This includes steps such as an interest reduction where customers cannot afford increased repayments.

6.6. Regulation was needed in this market as consumers accumulating and sustaining debt at great cost was profitable for lenders, meaning firms had little incentive to change how they operate.

6.7. The FCA could use its regulatory sandbox to stimulate product innovation for consumers that are disengaged – current innovation tends to focus on engaged consumers. This could solve the “first mover” problem.

6.8. For instance, a low cost, ‘no frills’ insurance product for low income households – who often only have specific items to ensure, rather than blanket ‘contents.’

6.9. The FCA could use its convening power to highlight best practice by firms in fair pricing, as an incentive for other firms to follow suit.

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.