

Defining consumer vulnerability and disadvantage

Introduction

Currently, terms like ‘vulnerability’ and ‘disadvantage’ are used inconsistently and interchangeably to imply a risk of consumer detriment, and are frequently applied in a fairly unsophisticated way. As a result, they become a blunt tool which reduces their impact.

In particular, use of the terms vulnerability and disadvantage tends to focus heavily on the personal characteristics and circumstances of particular groups of consumers. So that, for example, being vulnerable or disadvantaged is often seen as being synonymous with living on a low income when, in practice, consumers at all income levels are exposed to the risk of detriment.

In addition, it is often implied that all pensioners; anyone with a long-term health condition or disability; and all residents of rural communities are ‘vulnerable’, ‘disadvantaged’, or both. While it may be true that, in some circumstances, these consumer groups are more likely to experience detriment than others, it is unlikely that *everyone* who falls into one of these categories faces the same level of risk. It is also unrealistic and, arguably, patronising to assume that everyone in these categories will experience being a consumer in the same way.

With a new Financial Conduct Authority (FCA), underpinned by a more rigorous and sophisticated consumer strategy, there is an opportunity for financial services regulation to move beyond outdated approaches to identifying the risk of detriment. A more effective framework to help the Panel identify and communicate the risk of consumer detriment to the FCA (and other stakeholders) would support proactive and proportionate regulatory activity by:

- recognising the distinction between being vulnerable to the risk of detriment and actually experiencing it;
- capturing diversity both within and between different consumer groups and recognising the experiences of consumers who fall outside groups commonly perceived to be vulnerable;
- going beyond a consumer’s personal characteristics or income, taking a wider view of their circumstances, resources, experiences and expectations; and
- highlighting the way that the actions of the regulator and providers can make it more risky for consumers to access or use goods and services.

A new framework for identifying and communicating risk of detriment

A number of attempts have been made to define vulnerability by organisations including the Office of Fair Trading (OFT), the Department for Trade and Industry (DTI) and a United Nations (UN) Commission expert group¹, resulting in a variety of outcomes and conclusions but no single, watertight definition. This paper has reviewed

¹ OFT *Vulnerable Consumers and Financial Services*, 1999; United Nations Economic and Social Council, *Enhancing social protection and reducing vulnerability in a globalizing world*, 2000; DTI *Comparative Report on Consumer Protection Regimes*, 2003; Consumer Focus Board report, 2010

the outcomes from all of these attempts and is informed by them, but does not attempt to develop a single 'true' definition of vulnerability. Rather, it seeks to develop an evidence-based operational framework that could be applied in the specific context of financial services regulation.

This paper introduces three distinct but related terms to identify and communicate the risk of consumer detriment². These three concepts are intended to disentangle the different types of risk that consumers experience, facilitating greater consistency in the language used to describe them and clarity about the most appropriate regulatory action required to mitigate the risks in each case.

Vulnerability - means there is a higher risk of consumer detriment but does not mean that the risk actually has, or will, crystallise. The Panel would use this term to highlight issues presenting a potential risk of consumer detriment that requires proactive engagement by the FCA, without waiting for evidence of actual detriment to materialise.

At a disadvantage³ – highlights the extent to which consumers can be put 'at a disadvantage' by the actions of firms. The Panel would use this term to inform the FCA of cases where the activities of regulated firms can significantly increase the risk of detriment for consumers.

Consumer disadvantage – refers to real, material disadvantage of some kind. The Panel would use this term to urge the FCA to take speedy action to address risk that has or is about to crystallise causing actual detriment to consumers.

Each of these concepts has been described in more detail below:

Vulnerability

The reality is that most people are likely to be vulnerable consumers at some point in their lives, in that they face a higher risk of detriment, although not all vulnerable consumers will actually suffer detriment. Vulnerability to the risk of detriment in the financial services market is particularly widespread given the current context of markedly low levels of financial capability in the UK. The Financial Capability Baseline Survey⁴ conducted in 2006, and still the most recent measure of levels of financial capability in the UK, found that:

- 81% of the pre-retired did not think a state pension would provide them with the standard of living they hoped for in retirement, yet 37% of them had not made any additional pension provision;
- 70% of people had made no personal provision to cover an unexpected drop in income;
- almost three million people, two million households, said it was a constant struggle to keep up with commitments;
- 33% of people with relatively simple products, such as general insurance, bought their policy without comparing it to even one other product; and
- 40% of people who owned an equity ISA were not aware that its value fluctuated with stock market performance, while 15% of people who owned a cash ISA thought its value did.

² Adapted from Whyley C *Defining disadvantage*, National Consumer Council, 2008

³ George M and Lennard L *Consumer disadvantage: the role of providers* National Consumer Council, 2008

⁴ *Financial Capability in the UK: establishing a baseline*, Financial Services Authority

Vulnerable consumers may not require the regulator to take any particular action on their behalf, but it is important both the Panel and FCA is aware of the situations and circumstances that make people vulnerable. These should be taken into account through the regulatory model. Vulnerability can stem from a range of situations and circumstances, including:

The type of financial products and services involved

Consumers can be vulnerable as a result of the type of financial products and services they are seeking to use.

- People who are *using a financial product or service for the first-time* are more at risk of making poor choices because they have little or no experience to inform their decisions and may not have the skills to use them correctly.

Example 1

People who are new to transaction banking are at higher risk of getting into difficulties with unauthorised overdrafts and charges for missed direct debits⁵. Gaining access to credit cards for the first time, especially for young, first-time credit users, has also been attributed with increasing the risk of problem debt⁶.

- *Significant one-off or long-term financial products* including mortgages, pensions and investments, where products can be complex and difficult to compare, and where consumer detriment can take a long time to crystallise, present particular risks to consumers.

Example 2

The Panel has long been concerned about the risks posed by traded life policies for retail consumers and is pleased the FSA has signalled that traded life policies should not be sold to retail investors.

- *Products and services requiring specialist knowledge or skills* can also make consumers particularly vulnerable especially where they rely heavily on sales staff or advisers to provide all the information necessary for an informed choice.

Example 3

There are a number of investments that require specialist knowledge or skills to assess whether they are suitable for an individual consumer's needs and personal circumstances. These consumers are reliant on the recommendations of their adviser yet, as the Key Data and Arch cru scandals highlight, some consumers were mis-advised to invest in these funds.

- Consumers can be especially vulnerable when it comes to buying *financial services that are linked to other products or purchases*.

Example 4

The widespread mis-selling of Payment Protection Insurance (PPI) was characterised by consumers believing they were obliged to take out the policy, not knowing they had bought it, or being sold policies they were never eligible to claim on. The Panel has separately raised concerns with the FSA about the suitability and the level of

⁵ Ellison A, Whyley C and Forster R, *Realising banking inclusion: the achievements and challenges*, HMT 2010

⁶ Dearden et al, *Credit and debt in low-income households*, JRF, 2010

transparency of packaged bank accounts.

- Products associated with *adverse circumstances or times of distress* can also be risky, because consumers may be over-optimistic or reluctant to think about their likelihood of using them and so may not scrutinise them carefully or take rational decisions.

Example 5

In identifying priority issues for the FCA to consider in advance of the transfer of consumer credit regulation, the Panel is concerned about the risk of consumer detriment associated with debt relief products including consolidation loans and paid-for debt advice, as well as products that target people in financial difficulty, such as Sale and Rent Back.

Consumers' circumstances, capacities and preferences

Vulnerability can also arise as a result of the experiences, expectations and capacity that consumers bring to transactions. For example:

- Consumer decisions made at time of stress and upheaval, for example, following a *major life change*, such as bereavement, marriage breakdown, the birth of a child or the onset of financial difficulties. When this happens, people face new situations, often requiring multiple decisions with little opportunity to think or weigh up options that can have long-lasting consequences. These consumers are extremely vulnerable to making poor decisions or being unable to make a decision at all.

Example 6

The Panel remains concerned about banks' failure to help consumers and meet requirements around enduring power of attorneys.

- Some groups of consumers *are more likely to believe marketing and advertising information* without questioning it. This may be because they are 'new' or inexperienced consumers, such as young people, those on the margins of financial services, or new migrants. Or it may be because they desperately want to believe something to be true.

Example 7

Some people who are heavily in debt have proved susceptible to the marketing of payday loans, debt consolidation loans, fee-charging debt advice and sale and rent back products, which can end up making their situation considerably worse.

- Other consumer groups, especially those characterised by low self-esteem, such as young people from chaotic backgrounds, and people with certain mental health conditions bring *particular behavioural drivers* to financial transactions which make them less likely to defer gratification and more susceptible to problem debt.

Example 8

The Prince's Trust has expressed concern that young people are more frequently defaulting on loans due to mental health problems. The Personal Finance Education Group (pfeg) is also concerned that young people living independently on low incomes are resorting to Pay Day loans to smooth budgetary peaks and troughs due to a lack of appropriate banking products.

- The way that people prefer to conduct transactions can also increase their vulnerability. Some people, including the very elderly, people with some mental health conditions, and those with low or unpredictable incomes, have a strong preference for face-to-face and cash transactions. Both are becoming increasingly rare, leaving people with a more limited choice of goods and services which may not offer good value for money. It can also mean that people who prefer to pay in cash end up paying more because of the additional costs and charges associated with cash transactions.

Example 9

In 2007, Save the Children estimated the 'poverty premium' – the additional costs associated with living in poverty and paying for goods and services in cash – to be in the region of £1,000 per year, per family. It is very likely that this premium is now considerably higher⁷.

- Finally, people with *low language, literacy and numeracy skills* can also be particularly vulnerable as consumers. They not only face additional barriers in finding and understanding the information they need to make good choices, but will also find it harder to put right any mistakes they make or problems they encounter. This would include people who do not speak English as a first language, and some people with mental health problems, cognitive and sensory disorders, as well as people who struggle with literacy and numeracy.

Example 10

The Panel is aware of potential consumer detriment in relation to Islamic mortgages, where less knowledgeable Muslims take out such products may not be aware of the double counting of solicitors' costs which apply.

Where and how people live

- *Living in a high risk area* can make consumers vulnerable to restricted choices in relation to insurance against risks such as flooding, theft or burglary. Conversely, more risky products such as sub-prime, high cost credit and illegal lending are more prevalent in areas of high deprivation.

Example 11

The joint industry-Government agreement on the provision of flood insurance is due to end in April 2013. As part of its industry visit, Working Group B heard first hand how failing to develop an alternative agreement or solution could lead to a significant increase in the cost of insuring homes at risk of flooding.

⁷ Strelitz J and Kober C *The Poverty Premium*, Save the Children, 2007

- *Physical and geographical isolation* also can severely limit the choices and opportunities that are open to consumers in relation to some financial products.

Example 12

People living in remote rural or very deprived urban areas have seen the withdrawal of local branch networks for banking and insurance. Those who are unable to get around independently, including the very elderly and some people with physical and mental health problems, can face problems accessing even the financial services that are available locally. Without access to the right transport options – public or private – these consumers are unable to go elsewhere to find what they need, without incurring significant costs in time, money and hassle.

- People *who do not live independently* including those living in care homes or prisons, and long-term hospital patients, have much less control over day-to-day transactions and may have to rely on a third party to manage their financial affairs.

Example 13

As already cited in Example 6, banks have been failing to meet the requirements and help consumers with enduring powers of attorneys. This can create difficulties for those reliant on families or friends to manage their finances.

Exposure to multiple or sustained risk of detriment

While the majority of vulnerable consumers are likely to be able to manage the risks they face in the financial services market without proactive regulatory intervention, some groups of vulnerable consumers face such a high degree of risk that their needs should be taken into account by the regulator. These include consumers who:

- face exposure to multiple risks at the same time for example, young people who are newly financially independent, especially those leaving care; prisoners and ex-offenders; people approaching retirement; people managing money for the first time, especially following bereavement; and those experiencing a sudden drop in income.

Example 14

The Panel has been concerned about consumers' ability to access financial advice, particularly as they come to secure an appropriate income in retirement from their pension. These individuals face multiple and significant risks when making a decision about their retirement income that is, in most cases, fixed for their life.

- whose circumstances mean they will be vulnerable over a long period of time.

Example 15

People living on long-time low incomes would typically fall into this group, including those that are reliant on Government incapacity or work related benefits. These people are particularly at risk following changes to the benefit system introduced by the Government's system of Universal Credit.

In these circumstances risk factors having a compounding, as well as a cumulative effect, and are extremely likely to crystallise into actual detriment. To help address

this, the Panel should seek to encourage the FCA to conduct early and on-going investigations to identify consumer groups within the financial services market who face multiple or long-term risks of detriment, and embed this knowledge in its model. An awareness of particularly vulnerable groups will support the FCA's ambitions for early intervention and product regulation.

Putting consumers 'at a disadvantage'

It is often assumed that consumers are vulnerable or experience detriment entirely due to their own needs, abilities or characteristics. Consumers can, however, be put 'at a disadvantage' as a result of factors that are completely beyond their control. In this respect, they have been put *at a disadvantage*, by the actions of firms⁸ without their consumer behaviour having changed at all.

Consumers can be put at a disadvantage as a result of the way that goods and services are delivered.

- The *move away from face-to-face delivery* has disadvantaged consumers who find it difficult to cope with remote transactions. Consumers who have not changed their product or provider have, nevertheless, found themselves needing to have access to a telephone, bear the cost of calls, and conduct often complex conversations without being able to see the person they are talking to. In addition, people who are unable to use a telephone or a computer to research products or make purchases, find themselves with less choice, pay higher prices and get poorer value-for-money. These consumers haven't changed their behaviour – but they have been put at a disadvantage by changes in the way financial products and services are delivered.

Example 16

Some older people and low-income consumers have found it difficult to adapt to the loss of face-to-face financial services provision and, in particular, relationship banking. As well as finding telephone-based services impersonal, costly and, in some cases, inefficient they struggle with menu-based telephone calls and with remembering passwords and PIN numbers⁹.

- *Increasing complexity in the market.* While many consumers benefit from market diversity and competition, this complexity can also make it harder to weigh up choices and make decisions. In addition, where people's ability to shop around is restricted by, for example, contract lock-ins, as with mortgages, or where the most attractive deals are only available to new customers, a widespread practice in the general insurance market, good initial choices can be rapidly undermined.

Example 17

The Consumer Panel has recently raised concerns about the plight of 'mortgage prisoners' - unable to switch providers, often because the value of their property has fallen and is now worth less than their mortgage – who have no choice but to accept lenders' post-contractual Standard Variable Rate increases.

- Consumers can also be put at a disadvantage by *poor customer service* either at the point-of-sale or, more importantly, post-sale - when it may be too late to put

⁸ George M and Lennard L *Consumer disadvantage: the role of providers* National Consumer Council, 2008

⁹ Ellison A, Whyley C and Williams S, *The 'older old' and people living with disability*, forthcoming, the Payments Council

things right. Poorly trained and/or inappropriately incentivised staff who do not provide potential customers with the information or support they need, undermine consumers' ability to make effective, informed choices about financial products. Further, consumers who have made a good choice at the point of sale could find themselves at a considerable disadvantage later on, if their ongoing relationship with the firm is conducted via a badly run call centre.

Example 18

The Financial Ombudsman Service identifies poor customer service as a key factor underpinning many of the complaints they receive from consumers, especially among customers who are attempting to claim on an insurance policy.

- Finally, a firm's policy on *complaints* can have a huge impact on consumers' experience. Firms that are unhelpful when things go wrong put consumers at considerable disadvantage, leaving them unable to resolve problems to their satisfaction and deterring others from even making a complaint, because of the hassle involved with little anticipation of success.

Example 19

An FSA review of complaints handling among banks in 2010 found poor practice among most of the banks that were assessed, stemming from weaknesses in banks' culture, particularly their governance arrangements, policies and procedures and was reflected in our file review results. Two of the banks included in the review had such poor complaint handling procedures that they were referred to FSA Enforcement for further investigation of complaint handling.

Consumer disadvantage

Refers to situations in which risks to consumers have crystallised, impacting in some way on their current or future well-being. Consumer disadvantage manifests in a range of ways along the continuum outlined below:

- consumers knowingly holding a product that does not meet their needs and who are unable to resolve the situation.

Example 20

A very large number of consumers that hold mortgage endowments could be left with a shortfall to pay off their mortgage. The endowment is not meeting the needs of these people or, in many cases, the promises made when it was sold. Any individual without separate funds to cover the shortfall to purchase their home will be left needing to work longer or sell their house.

- consumers unknowingly holding a product that will not meet their needs;

Example 21

A significant number of self-employed people were mis-sold a PPI policy by their bank or credit provider, even though they were unable to claim under the policy.

- consumers only discovering that a product does not meet their needs at the point they come to use it.

Example 22

There can often be a mismatch between consumers' expectation of an insurance policy they have purchased and the cover it actually provides. In some cases this is because the scope of the policy was not communicated clearly at the point it was sold, possibly because of a focus on price, while some contracts simply do not provide appropriate cover – this is particularly a problem with so call 'low-value' general insurance products.

- consumers being locked in to a product that no longer meets their needs or where the value is significantly reduced.

Example 23

With-profit savings policies, which are currently held by 25 million policyholders and used to save for retirement or pay off a mortgage, are both opaque and inflexible. Any consumer wishing to surrender a with-profit policy will likely incur charges through a Market Value Reduction (MVR).

- consumers who face very limited choice in the market because of their particular needs or circumstances.

Example 24

This is a problem experienced by many older consumers shopping for travel insurance, as the policies available either have age restrictions or include significant age related premiums loadings making them unaffordable.

- consumers who are forced to pay significantly higher prices than others for financial products and services in order to get their needs met.

Example 25

Consumers with adverse credit histories are often unable to access mainstream credit products and instead use higher APR products offered in the sub-prime market.

- consumers who self-exclude because they are only able to access financial goods and services with conditions attached that significantly reduce their value or make them inappropriate.

Example 26

Citizens Advice reports that some people living in deprived communities prefer to get a dog to protect their property than take out contents insurance due to the cost and conditions of the policy and their distrust of insurers.

- consumers who self-exclude because they are only able to access financial goods and services at a price that makes them poor value for money.

Example 27

Many young drivers are unable to access affordable insurance cover meaning they are unable to own a car, choose to drive without insurance or take out a policy in their parents name (which is a form of 'fronting' and constitutes fraud).

- consumers who self-exclude because they lack the knowledge, confidence or skills necessary to negotiate the market, or because they believe providers would refuse to serve them.

Example 28

This particularly affects some young people who lack the confidence or feel too intimidated to access banking services. These individuals usually only become banked when they need access to an account to receive wages, benefits or a student loan.

- consumers who self-exclude because the financial goods and services available in the market do not meet their needs.

Example 29

Some consumers choose not to access a bank account or mainstream credit product as the services available do not meet their needs.

- consumers who are unable to access financial goods and services because they do not have access to ‘passport’ products, like a bank account.

Example 30

Access to some services, such as direct debits, is conditional on a consumer having access to a bank account. Yet many consumers do not hold an account despite these potential benefits. Evidence suggests customers that previously held a bank account, but have subsequently become unbanked, incurred charges for going overdrawn or making late payments which negated any direct debit discounts they received.

- consumers who are unable to access financial products and services they need because firms refuse to provide them.

Example 31

As already cited in Example 24, some insurers refuse to provide cover for older consumers. This is particularly true of travel insurance products.

Conclusions

Through the formation of the FCA, the Panel has an opportunity to influence the priorities of the new conduct regulator and encourage it to deliver on its promise to tackle consumer detriment before it becomes widespread. In fulfilling this role, the Panel should base its assessment of consumer vulnerability and disadvantage on the definitions set out in this paper. This will deliver a more improved understanding of indicators and risk factors as well as ensuring all consumers are protected by the new financial services regulatory structure.