Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Consumer Panel Position Paper - Consumers and Competition

Introduction

There is growing evidence that competition authorities' emphasis on traditional demand-side remedies does not work for consumers. Relying on consumers to take action has had only limited effectiveness in markets such as energy[1], and in financial services markets such as cash savings and current accounts.[2]

While the Panel supports efforts to make switching easier, the evidence shows that providing more information and a few prompts will not overcome consumers' perception that the potential benefits of switching are simply not worth it.

Sticking with the same product and provider can be a rational decision. Consumers should not be penalised for this loyalty; the result should be neutral at worst. Remedies that focus on prompting consumers to switch do not encourage firms to treat their existing customers fairly in the first place.

Against this background, we looked at how far it is reasonable for competition authorities to expect consumers to drive competition, and what else they might do instead. We were also mindful of the rapidly growing market in automated switching services, and how these might affect our conclusions.

Our research is about retail banking markets, but the conclusions are applicable to other financial services retail markets as well.

The Panel's research

In 2016, the Panel commissioned an evidence review and consumer survey to inform and stimulate debate about consumers' role in driving competition in retail financial services markets.[3]

The research shows that competition authorities rely heavily on one or two consumer segments to drive competition. It also explores why some consumers do not switch financial services products, even when prompted to do so and when it is in their interest. Our findings are consistent with other studies[4] that find consumers quickly become disengaged if they receive 'too much' information. They also suggest many consumers adopt a 'satisficing' approach to choosing financial products and services.

Our study begs the question: are current levels of shopping around as good as they are going to get? If they are, what else can competition authorities do to drive effective competition that works in consumers' interests?

Consumers are not all the same

Our study segments consumers based on their attitudes and behaviours in relation to financial services. This helps us understand better:

- The scale of the challenge in getting consumers to drive competition;

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[1] http://webarchive.nationalarchives.gov.uk/20140402141250/http:/www.competitioncommission.org.uk/assets/competitioncommission/docs/2013/remedies/130228_home_credit_evaluation.pdf
[2] The Role of Demand-Side Remedies in Driving Effective Competition, Centre for Competition Policy
[3] https://fs-cp.org.uk/sites/default/files/fscp_consumers_and_competition_thinkpiece_finalpp_jtl_20170306.pdf
[4] Such as FCA Occasional Paper 1 https://www.fca.org.uk/publication/occasional-papers/occasional-paper-1.pdf

- Where the efforts of competition authorities might best be focused; and
- The different levers that may be required for different groups.

It shows that competition authorities are, in effect, relying on one or two segments of 'engaged' consumers to make firms work in all consumers' interest – younger consumers aged 25-44 who are not bank-loyal and are keen to shop around; and older consumers who are mostly retired with plenty of time to shop around for financial services.

In theory, competition should work because these engaged consumers reward firms that meet their needs with their custom, and help to drive unsuccessful firms out of the market. In practice, there are barriers to this happening in retail financial services – including firms exploiting consumers' behavioural biases and consumers acting rationally by sticking with what they know.

Firms may exploit behavioural biases

Consumer behavioural traits shape consumer engagement. One of the most common traits is inertia. In our consumer survey[5], 75% of respondents had at least one product from their main bank aside from a bank account. The most commonly reported reason for this 'loyalty' was convenience, followed by a perceived lack of difference between providers. This chimes with other consumer research carried out for the Panel in 2016, where current account customers told us they saw very little difference between the banks.[6] Other traits such as availability bias (placing more emphasis on information that is recent, familiar or salient) also mean that consumers are unlikely to identify the best outcomes for themselves.

In addition, the evidence points to 'monopolistic competition' in the retail financial services market which means that, although there are many firms and they do compete vigorously, they strive to inhibit consumers' ability to shop around, by developing products, prices and information that are complicated and sometimes misleading.

Sticking with what you know can be rational

There are two explanations for why consumers' passive behaviour is rational. First, there is the nature of search and switching costs (procedural, financial, relational). Once these are all taken into account, the cost of switching may outweigh even quite substantial expected gains from changing product and/or provider. If consumers find it difficult to assess the likely gain from switching, the case for inertia is reinforced.

Second, consumers may follow a 'satisficing' strategy. This means they have a threshold of satisfaction that they are willing to accept rather than aiming to maximise their satisfaction. Satisficing generally results in less search activity and so less effective competition. In our consumer survey, there was evidence of satisficing with bank-loyal respondents commonly saying they had searched the market but chose their bank because it had the best deal – in reality, the products of the big banks are seldom the best available.

Our consumer survey, and other consumer research[7], suggests that lack of time to shop around is not the only (or even the main) factor in consumers' passive behaviour. Research carried out by Citizens' Advice[8] found that consumers who were coached to use 'good engagement' in markets (including reading reviews, consulting others and reading terms and conditions) took much longer to shop around and were less happy with the outcome than those who used 'natural' engagement (whatever they would normally do). This might reflect dissatisfaction spending time shopping around rather

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[5] https://fs-cp.org.uk/sites/default/files/fscp_consumers_and_competition_thinkpiece_finalpp_jtl_20170306.pdf
[6] https://www.fs-cp.org.uk/sites/default/files/fscp_banking_culture_-_report_-_final.pdf
[7] http://www.open.ac.uk/business-school-research/pufin/sites/www.open.ac.uk.business-school-research.pufin/files/files/WORKING-PAPER-Shopping-around-in-multiple-markets-Lowe-Nov15.pdf
[8] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Finalreport-Againsttheclock.pdf

than doing something else; or that finding out more about products and services makes people more anxious about the trade-offs required to make a decision, which is different from the commonly cited problem of 'choice overload'.

Automated shopping around and switching: a way forward?

Evidence indicates that 'information' remedies are unlikely to have significant impact on levels of shopping around and switching in financial services. A different approach is needed.

Research[9] suggests that markets can function more competitively, with lower prices and less price obfuscation, when computers replace consumer decisions. Automating shopping around and switching using technology and algorithms is already happening in financial services – so the question is not 'will this happen?' but 'when will it become the norm?' and 'are regulators and consumers prepared?'

The Panel's research[10] outlines how this new market is already developing. It sets out how consumers could drive competition by delegating choice to new types of services that automate decision-making based on consumers' own profiles and preferences. This has the potential to provide better consumer outcomes.

However, regulators need to ensure that this market develops in the interest of all consumers, which means looking at the supply-side. For example, while the automated process relies on technology, the 'shop window' to such services could be via phone or branch e.g. terminals in supermarkets or post offices, making the services available to 'offline' as well as 'online' financial consumers. Other priority issues for the Panel are:

- **Understanding the cost of 'free' services –** Firms that offer aggregation or comparison services 'for free' need to find ways of making a profit, for example by selling customer data to other firms. It should be clear to the customer how a firm uses their data as part of its business model to make money.
- **Managing consent in a data-rich world –** The ability to merge account data with geographical data, social media data, health data or behavioural data collected from other sources complicates the issue of informed consent. Consumers should be made aware that the data they consent to share could be supplemented by data that they did not consent to share, or consent to share for this purpose, or did not realise was publicly available.
- **Preventing consumer exploitation –** Firms could use transactional information to market other products beyond financial services. They could use it to assess how much the consumer is willing to pay for a service, their propensity to use credit or take out insurance add-ons. Checks and balances (such as algorithmic governance) are required so that firms do not exploit data in ways that are detrimental to consumers.
- **Improving transparency of digital comparison tools (DCTs) –** At present, digital comparison tools (DCTs) lack transparency.[11] Consumers cannot see the basis for rankings, which may be 'paid for' rather than impartial. DCTs also encourage an over-reliance on price in assessing suitability. For DCTs to work for consumers they should be independent; have commercial relationships that are transparent; not use opaque commission-based business models; and avoid conflicts of interest.
- **Supporting product innovation –** It is unclear what will happen once there is real product innovation in the retail financial services market. DCTs will not list or compare products that have not yet reached a critical mass. If consumers are

[9] Kalayci, K. and Potters, J. (2011) 'Buyer confusion and markets prices' in *International Journal of Industrial Organisation*, Vol 29, Issue 1, January, pp.14-22.
[10] https://fs-cp.org.uk/sites/default/files/fscp_consumers_and_competition_thinkpiece_finalpp_jtl_20170306.pdf
[11] https://assets.publishing.service.gov.uk/media/58d930deed915d06b0000038/dcts-summary-of-update-paper.pdf

to use DCTs to drive competition, the DCTs must not create a barrier to new entrants and innovative products.

- **Accepting the limits of consumer-driven competition –** At least in the short term, new DCTs and automated services will mainly benefit those one or two consumer segments that already shop around and switch. It may take longer and be more challenging to extend their appeal to other consumer segments. Accepting the limits of consumer-driven competition also increases the onus on competition authorities to focus more attention on effective supply-side remedies. Moreover, these new types of service do nothing to challenge the problems faced by consumers who are marginalised or excluded from financial services, e.g. because firms don't want to serve them or do not offer the products and services they want at a price they can afford. These issues sit at the intersection of financial regulation and public policy, as the FCA's Mission consultation highlighted, rather than in the realms of competition.

Measuring consumer outcomes from competition

The key test for competition working in the interests of consumers is whether consumers can switch to a product or service they know is better value for money, and whether firms respond to this by producing products and services that better meet consumers' needs at a competitive price.

It should be possible to measure consumer outcomes and incentivise firms to behave in ways that support competition. Measures that relate directly to desirable outcomes for consumers should be indicators of competitive conditions in a general sense, and also evidence of whether competition is working well in the interests of consumers.

With a focus on these requirements, our research suggests the following supply-side metrics:

- **Price discrimination –** Firms could be required to publish the average price for:
  - A representative existing customer and identical new customer
  - Groups of customers of specified types
  - Groups representative of firms' actual customer base (in a similar way to the requirements for publishing indicative APRs).

  This would alert customers to the different treatment of similar customers in different groups and act as an incentive for firms to reduce price discrimination.

- **Reputation measures –** Composite indices of the reputation of firms, including for example, frequency of complaints as a ratio of customer base and incidence and amount of fines. At a firm level, this would alert customers to firms that do not prioritise customer service and create an incentive for firms to improve. At the market level, it would serve as an indicator of quality.

- **Product benchmark -** A measure of whether products, as a minimum, match a set of core features. This measure could:
  - Indicate to consumers that their basic needs will be met by this product
  - Incentivise firms to meet this threshold and avoid 'hollowing out'
  - Help regulators and consumers see through spurious product differentiation.

Conclusions and recommendations

The Panel wants to inform and stimulate debate among competition authorities, government and consumer organisations about the limits of consumer-driven competition and alternative ways to make competition work in the interests of financial services consumers.

Competition authorities place high expectations on consumers to make markets work competitively. But the evidence shows that, for most consumers, buying financial services is a chore. It is clear from the Panel's research that firms are using consumers' behavioural biases against them. A small group of consumers is engaged in the market, and will follow information prompts as well as shop around. However, this group is not large enough to drive competition, or to make firms change their behaviour.

The focus on driving active consumer engagement to help make markets work competitively also neglects the possibility that consumers may be acting rationally in not switching, once all factors are considered.

This highlights the scale of the challenge to competition authorities: firms will continue to exploit loyalty if information remedies and a reliance on switching are the only proposed solutions. Regulators are beginning to take more action to ensure that financial services customers are not penalised for their loyalty. The FCA's cash savings sunlight remedy[12], for example, intends to bring to light firms' strategies towards their long-standing customers. Market commentators, and the published facts themselves, should encourage firms not to want to be bottom of the list. The FCA also intends to conduct a review of pricing practices in general insurance. We hope this work demonstrates a move away from demand-side remedies, and addresses the poor practice among firms that results in poor customer outcomes.

The evidence also indicates that levels of shopping around and switching in financial services are unlikely to change significantly without supply-side intervention or innovation. There is an emerging new market in automated shopping around and switching services, but new-generation services based on old-style business models will not serve consumers any better. Complex and opaque services, lengthy terms and conditions, business models based on commission or murky pricing strategies, will not lead to better outcomes for consumers or a need for firms to change their behaviours. Recent research from BACS and the Current Account Switching Service (CASS)[13] concluded that the challenge for any new model is *"whether it can stimulate new product innovation, or if it simply leads to process improvements in consumers' financial management".*

Based on the evidence, the Panel calls for:

- Competition authorities to take robust and effective action to tackle supply-side problems like firms' exploitation of consumers' behavioural biases and 'monopolistic competition' where products, prices and information are complex and sometimes misleading.
- The FCA to introduce tougher measures to make sure that 'loyal' financial services customers are not penalised by the firms they trust.
- Competition authorities and regulators to act now to make sure the new generation of shopping around and switching services do not simply repeat the problems of the past and further weaken rather than strengthen consumers' position in the financial services market.
- The FCA to develop robust supply-side consumer outcome measures that incentivise firms to behave in ways that support competition. The FCA should require firms to make these publicly available, both direct to consumers and to market commentators; and incorporate them in digital comparison tools as well. Since they play directly back into the assessment and publication of providers' product quality and service standards, measures like these should also play a part in, for example, the FCA's work on service quality information to consumers of retail banking (the 'service level indicators').

We welcome feedback on the Position Paper and the research. Please send any comments to enquiries@fs-cp.org.uk.

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[12] https://www.fca.org.uk/news/news-stories/cash-savings-sunlight-remedy
[13] https://www.bacs.co.uk/documentlibrary/competitive_current_account_market.pdf