Chris Gee
Strategy & Competition Division
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

8 February 2019

Dear Chris,

JOINT PRACTITIONER PANEL AND SMALLER BUSINESS PRACTITIONER PANEL RESPONSE TO DP18/9: FAIR PRICING IN FINANCIAL SERVICES

This discussion paper raises important strategic questions around the issue of pricing across financial services which are relevant to both the Practitioner and Smaller Business Practitioner Panels, therefore we have chosen to send a joint response. The Panels have some general observations about the subject, as well as answers to the specific areas addressed by the discussion paper.

We believe the FCA should start with the question of 'what is the right exchange of value?' between the customer and the firm, taking into account all the costs and benefits of the product over time, to establish what is a fair price. There is an important crossover both with the FCA's work on vulnerability and duty of care. Vulnerability lies at the heart of the FCA's work. It is not in itself unfair that different customers pay a different price for the same product, but more work needs to be done on articulating the degree of differential value and what is and is not acceptable.

We acknowledge there are pricing practices within the industry which are not fair, and that this needs to be addressed. Where the FCA can make the most difference is in markets which have found themselves in a sub-optimal equilibrium from which they cannot escape, such as current account pricing. In some markets firms may wish to change their pricing strategy, and to compete on factors other than price, such as dynamic, exciting products, good service and value for money, but without intervention from the regulator risk incurring a first mover disadvantage which is not in the interests of any of their stakeholders. In areas where markets are unfair because of structural issues, intervention is helpful. We would be interested in discussing with the FCA remedies which no one firm can accomplish on their own.

Balance of fairness

The discussion of fairness should be considered alongside the wider principles which the FCA considers when carrying out its work. Firms must take into account Principle 6 of the Principles for Business, treating customers fairly, and the FCA should also take into account the concept of treating firms fairly.

The regulator could focus not only on areas where there are high positive margins, but also high negative margins. The relationship of a firm with its customers means there are a number of potential areas of cross subsidy. For example, a firm may cross subsidise within an individual customer relationship, over a number of products. Or it may cross subsidise within the same product over time, or between different customer groups depending on attributes. Such practices are not inherently wrong, and may be to the overall benefit of the consumer - the objective of this work should be to develop a framework that ultimately self-moderates front and back book pricing.

Looking at the specific issue of new customer pricing discounts it could be argued that some existing customers are harmed by higher pricing. It could also be argued that, when looking at the average price of the product over the range, in fact new customers are receiving too great a benefit. In effect, the new customer discount has become distorted. If the new customer discount price becomes excessive firms can be caught by the 'first mover disadvantage'. The dynamic of the market in seeking to recruit new customers can lead to potentially irrational pricing. For example, it may be that firms are not fully considering the marginal financial value derived from a residential mortgage at less than 1%. This has implications for savers if firms are not covering their running costs and attaining a desirable return on capital from that marginal yield.

A well-functioning market will allow a balanced exchange of value between a firm and customer over time, possibly over many years. Increasing transparency of pricing and cross-subsidy, particularly focusing on promotional pricing which has been as significant source of consumer detriment, is a better solution than driving down profitability in one area. Focusing on one area risks forcing withdrawal of products and services to less profitable and potentially vulnerable customers.

Value

One element which is missing from the discussion is the concept of product and service value. For example, the potential value of a protection product (such as one which pays out for the rebuilding of a house or for a substantial medical bill) needs to be factored into the consumer's decision, as well as the price of the product.

Overall value, which includes elements such as service levels, distribution channels and access, over the lifetime of the product, is as important as the cost. A customer may value their time more highly than the extra cost of not shopping around – as long as this choice is clear to them, the balance of value is fair. They may also value access to a local branch, or an individual agent. We have particular concerns that if remedies are applied which focus too closely on price alone consumers in vulnerable circumstances may be encouraged to opt for products which cost less but also offer lower benefits.

In addition to these comments we have responded to individual questions below. We would be happy to discuss further.

Kind regards,

[Signed]	[Signed]
Anne Richards *Chair, FCA Practitioner Panel*	Craig Errington *Chair, FCA Smaller Business Practitioner Panel*

Feedback on 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?*

We have concerns in this area about the language used to frame the discussion. It is important that the way of looking at the market is articulated in a way that does not pre-suppose either good or poor outcomes. Using the terms 'discrimination' (and elsewhere 'inertia') creates an impression that this is a behaviour which is always wrong. The use, where possible, of more a more neutral term such as 'differentiation' is less likely to lead to unintended bias in the discussion.

On the six evidential questions, it is important that they are considered in context. The questions as framed specifically address the concept of harm. We consider that they should begin with 'what is the right exchange of value?'. Additionally, for the question of 'How significant is the pool of people harmed?' the absolute number of people must be taken into account as well as the proportion. Otherwise there is a risk that resources may be directed at interventions benefitting only a small number of people.

We believe the calibration of the question 'who is harmed by price discrimination?' needs adjusting. Although the issue of vulnerability is relevant, the converse of vulnerability is not wealth. Wealthy customers may equally be vulnerable, and those with fewer resources may be highly financially capable. We suggest this question is adjusted to focus more on the customer's circumstances than their assets. Additionally, the questions should address the behavioural characteristics of customers as a factor in their decision making.

How the FCA might address the harm

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.*

We agree with the statement in paragraph 2.14 that '*In a well-functioning, competitive market firms are free to set prices. Consumers, equipped with the relevant information, can then decide if they want to buy the product at that price. If they think the price is too high, they can simply choose a different product.*'

We believe this is a good start as a description of a well-functioning market. Remedies which focus on this as an objective will be most effective, and therefore we support solutions such as improving clarity of language in information provided and improving the visibility of any cross-subsidisation.

Currently it is not always clear to consumers the extent to which an introductory price may be discounted, and this could be improved. If a firm charges a customer less than cost price, and they don't understand, care or value the discount, both sides of the transaction are disadvantaged, and it is likely that the product will not remain viable in the long term.

We caution against assuming that any remedies can be applied across sectors. The structural differences of individual sectors are significant – for example the pricing of an annually renewable general insurance product will take into account different factors to a pension product which may last for many years or decades, and take into account different risk factors.

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 recommend that in considering the option of price regulation the FCA takes into account the experience of the Canadian pricing model where changes to auto insurance rates are approved and rates published by the regulator. This model arguably produces a market which is more stable, but also less vibrant. It also increases the likelihood of a shift towards commoditisation. This is an example of a situation where focusing too closely on price can lead to a reduction in consumer value as fewer features and options become available.

Any interventions need to take into account the specificities of individual markets, as competition, price transparency and the nature of products varies greatly from market to market. A solution which is appropriate for general insurance, for example, would not necessarily be applicable to the mortgage market, and inappropriate and costly interventions will not be in the interests of consumers.