Fair Pricing in Financial Services: summary of responses and next steps

Feedback Statement
FS19/04

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1 Summary

What is this Feedback Statement (FS) about?

1.1 In October 2018, we published a Discussion Paper (DP) launching a debate on fair pricing in the broad context of financial services.

1.2 In the DP we set out how we think about the issue of fair pricing in retail markets. We presented a framework for how we will assess the fairness of a given pricing practice (the Framework), and we invited responses to 6 questions about the proposed framework and the issue of fair pricing more generally.

1.3 In this Feedback Statement (FS) we:

- summarise the main themes in the submissions we received and, where appropriate, provide our responses
- provide further clarification on how we will apply our Framework in practice
- outline how we will approach the next stage of work, which will focus on operationalising our approach to fair pricing in retail markets

1.4 We see this work as important for the 3 main reasons:

- Ensuring fairness in pricing is an important part of our role as a regulator. It is directly relevant to our strategic objective to make the markets we regulate work for consumers, cutting across our consumer protection, competition, and market integrity operational objectives.
- Issues of fairness in pricing are likely to become increasingly prevalent and complex in the future, particularly as firms' use of new technologies and data becomes more sophisticated. We have recently launched a programme of work that considers the future regulatory framework and explores questions of how a conduct regulator can best serve the public interest. Our approach to fair pricing will feed into that work.
- Concerns about the fairness of certain pricing practices are increasingly being focused on by other regulators and the Government. For example, the CMA's response to the Citizens Advice super-complaint has led to several initiatives that are designed to address concerns about so-called 'loyalty pricing' We recently provided an update on the areas of our work that relate to the CMA's recommendations.

Who this applies to?

1.5 This FS is likely to be of interest to, but not limited to, the following:

- consumer groups and individual consumers
- regulated firms and their representative bodies
- other economic regulators that face similar issues

What we asked for input on

1.6 We presented our 6-question Framework for assessing concerns about the fairness of a given form of price discrimination (Figure 1).

Figure 1: Framework questions to help assess concerns about fairness in price discrimination

	Lesser concern	Greater concern
Who is harmed by price discrimination?	Wealthier consumers – eg time poor, cash rich	Consumers with characteristics which might be deemed vulnerable (eg low income, old age, etc)
How much are these individuals harmed?	Profitability difference between consumer segments is minimal and is immaterial to the harmed segment	Significant profitability differences and the harm has a significant adverse effect on the segment affected
How significant is the pool of people harmed?	Very small minority	Significant group of consumers
How are firms price discriminating?	Transparent and based on behaviour which consumers can easily change (eg switching)	Hidden and based on intrinsic characteristics which consumers cannot easily change (eg personal characteristics)
Is the product/service essential?	Product/service is considered non-essential but desired by some consumers	Essential product/service (eg current account or motor insurance)
Would society view the price discrimination as egregious/socially unfair?	Little concern expressed about practices and firm behaviour widely accepted	Persistent and broad-based concern expressed and firm behaviour seen as poor conduct

1.7 We asked stakeholders whether they agree with the questions in our Framework and whether there are any other questions that we should be considering in our assessment of the fairness of a given pricing practice.

1.8 In addition to inviting comments on the Framework we also asked questions on the following:

- The application of our Framework to the specific case of what we called 'inertia pricing', or 'loyalty pricing' as it is also commonly known.
- What remedies we might draw on if we conclude that a given pricing practice is unfair.

1.9 The full list of questions that we asked in the DP are in Annex 1.

Summary of feedback and our response

1.10 We received 51 formal responses from a wide range of stakeholders. In addition, we hosted a large event that brought together the perspectives of different stakeholders to debate the issues. We have also held several meetings with the FCA Panels and other stakeholders.

1.11 The responses we received can be broadly divided into 3 key themes:

- The content of the specific questions in our Framework and their role in the Framework.
- How the Framework will be applied in practice, including how we might address any harm we identify.
- How we intend to embed our thinking on fair pricing into our regulatory approach and what we will be requiring of firms.

The questions in the Framework

1.12 We received various comments about the specific questions in the Framework. Some involved requests for clarification, some involved suggestions for what we should consider as we gather evidence on them. Others involved challenges to our proposed approach. Overall there was broad support for the Framework and the specific questions in it. The feedback has helped us to better identify where we need to be clearer and it has also informed steps we plan to take to develop our approach.

1.13 It is important to clarify the role of vulnerability in how we think about the fairness of a pricing practice. We think fair pricing is an issue that is relevant for all consumers, and not just vulnerable consumers. However, as we set out in our Approach to Consumers publication, we may be more likely to intervene if the pricing practice results in harm to vulnerable consumers. In determining an appropriate degree of protection for consumers, we expect all firms to exercise extra care where consumers may be vulnerable.

1.14 We also clarify a key point about the role of our question on whether the product / service is essential. This question is not about defining the markets where we are likely to apply our Framework, but how we will assess harm when we have concerns about the fairness of a pricing practice. We will use this question in combination with the other questions in the Framework to form our assessment. Where a product / service is essential, this is likely to affect both the scale and type of consumers who are impacted, as well as the way they engage in the market. Stakeholders should **not** conclude that if a service is not essential then the practice cannot be unfair.

1.15 Another clarification is what we see as the role of society's view in our assessment of the fairness of a given pricing practice. Some stakeholders interpreted this question to mean that we will rely on subjective and possibly time-varying measurement of society's view in our assessment. On the contrary, we think it is important that the FCA leads by exercising judgement using a transparent and objective Framework. Nevertheless, we do think that society's view of the pricing practice is important not only because we regulate in the public interest, but also because if consumers believe particular pricing practices are unfair, then there could be damaging effects on trust in markets and institutions.

1.16 One area in the Framework we intend to develop further is the question on **how** firms are price discriminating. The 'how' captures a wide range of factors and we consider this question to be of fundamental importance to the assessment of the fairness of a pricing practice. We will continue to consider what factors within this category would make us more concerned about the fairness of a given pricing practice as we progress our work on fair pricing.

Applying the Framework

1.17 Many respondents commented on or asked questions about the FCA's intended application of the Framework, including (i) how we might use the Framework to reach a determination on matters of fair pricing and (ii) what role the wider effects of a given pricing practice will play in our decision about whether to act.

1.18 It is important that we give firms clarity about how we intend to regulate. At the same time, we need to give this clarity in a way that does not unduly constrain the application of the Framework on a case-by-case basis. Fair pricing is a complex issue with broad application. As a result, our view is that for the Framework to be effective and proportionate, it needs to be **considered in the round** and **retain a significant element of judgement** when it is applied in practice.

1.19 Some Framework questions may carry more weight than others in certain cases, particularly if the answers to those questions reveal a particularly extreme or severe outcome. In most cases, no single question will determine a decision in isolation. The Framework needs to be considered in the round.

1.20 All 6 questions do not need to be answered in a particular way for us to find a pricing practice to be unfair. For example, a firm might target those who value convenience, but if it deploys so-called 'sludge' tactics to increase friction we maybe more likely to consider this unfair.[1] We do not think it is appropriate or possible to remove the need for judgement when considering fair pricing in the broad range of markets that we regulate.

1.21 **We agree that the wider effects of a given pricing practice are important**, and should be considered in our assessment of that practice. The Framework is intended to support an assessment of whether we have concerns about the fairness of a particular pricing practice. However, there are other factors that we would need to consider before coming to a decision on whether to act and what type of intervention would be appropriate. For example, there may be consequences for how firms compete with each other and for the level of trust that consumers have in the market (which in turn links to market integrity). These wider effects could be positive or negative. In some cases, there may be a tension between our fairness and competition goals and this would be considered as part of our decision making.

1.22 We recognise that price is just one element of the value exchange between firms and consumers and that as we consider these factors it will be important to also take into account quality considerations. For example, we would want to understand the

1 This is a term coined by Richard Thaler referring to "practices that appear intentionally designed to discourage behaviour which is in the consumers' best interests."

potential non-price effects (as well as the price effects) of any intervention that is intended to address concerns about an unfair pricing practice.

Figure 2: How the Framework informs what action we may take to address concerns about the fairness of a given pricing practice

Step 1: Do we have concerns about the fairness of the pricing practice?	Step 2: What are the wider effects of the pricing practice?	Step 3: What is the appropriate course of action for the FCA?
Use the 6 question framework to make an assessment	Consider how the practice affects competition and trust in the market	Based on the full range of factors consider whether (and what) intervention is appropriate

Embedding fair pricing into our regulatory approach

1.23 We received various responses about how exactly we intend to embed our thinking on fair pricing into our regulatory approach.

1.24 We think that fair pricing is relevant to the broad range of the FCA's functions, including markets work, supervision, authorisations and enforcement. We do not see any reason to restrict our consideration of fair pricing to particular functions. We intend to embed it into our regulatory approach in a way that ensures it can be applied in all areas where it may have relevance.

1.25 Our statutory objectives give us a remit to consider the issue of fair pricing. However, we recognise that in some instances, particularly when there are clear trade-offs between different groups of consumers or there are negative implications for particular groups of consumers, it may be appropriate for the Government to lead on the issue and set public policy. We will identify where this is the case, and continue to work with the Government and other regulators to address the harm.

1.26 Assessing whether a particular pricing practice is unfair can be complex and the issues can vary from market to market. So, there is no simple formula that determines whether a practice is unfair and we will use our judgment to balance the considerations in specific context. This implies that prescriptive rules are unlikely to be sufficient to incorporate our thinking into a regulatory approach. We consider at this stage that a principles-based approach may be more effective in driving appropriate outcomes, so **we will incorporate our work on fair pricing into the review of our principles, which will be the first strand of our Handbook Review**. We intend to publish a DP on the review of our principles in Q4 2019/20. We will report back on the next phase of our fair pricing work at that time.

Equality and diversity considerations

1.27 We have considered the equality and diversity issues that may arise from the proposals in this FS. Overall, we do not consider that this FS will negatively affect any of the groups with protected characteristics (ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment).

1.28 The topics we discuss in this FS aim to take forward the debate on fair pricing, which may lead to changes which may affect groups with protected characteristics. In applying the Framework and making a judgement on next steps we will consider the impact on different groups.

Next steps

1.29 Our work on fair pricing will continue after this FS:

- We will apply our thinking to issues that we identify in our market specific work. The first application of the Framework will be in the General Insurance Pricing Practices Market Study and we will be publishing the findings from that later this year. This will help inform how we use the Framework in subsequent pieces of market work.
- We will also begin the work required to formally embed our thinking into our regulatory approach. A part of that will involve contributing to the review of our principles, which will be the first strand of our Handbook Review. As set out in our Business Plan, we intend to publish a DP on the review of our principles in Q4 2019/20. We will report on the next phase of our fair pricing work at that time.

2 Why this is important

2.1 When we published our DP we opened a debate about how we should assess the fairness of a given pricing practice, and what if anything the FCA should do if we conclude a given practice is unfair.

2.2 This work is important for 3 main reasons:

- **Our role as a regulator**: Ensuring fairness in pricing is an important part of our role as a regulator. It is directly relevant to our strategic objective to make the markets which we regulate work well for consumers, cutting across our consumer protection, competition, and market integrity operational objectives. It is important that stakeholders understand how we think about assessing the fairness of firms' pricing practices.
- **The future challenges we expect to see in financial regulation**: Issues of fairness in pricing are likely to become increasingly prevalent and complex in the future, particularly as firms' use of new technologies and data becomes more sophisticated, enabling them to price discriminate more finely. We have recently launched a programme of work that considers the future of financial services regulation, and how we need to adapt to continue to effectively deliver public value and consumer outcomes in the future landscape. Our approach to fair pricing is one element of that work.
- **The broader regulatory context that we operate within**: Other regulators and the Government are increasingly focused on concerns about the fairness of certain pricing practices, both in financial services and in other industries. In this context, it is particularly important that stakeholders understand how we will approach these issues in retail financial services markets.

Fair pricing and our role as a regulator

2.3 Parliament gave us a strategic objective to ensure that the relevant markets function well. It also gave us 3 operational objectives:

1. securing an appropriate degree of protection for consumers
2. protecting and enhancing the integrity of the UK financial system
3. promoting effective competition in the interests of consumers

2.4 Our Mission describes how we work to advance these objectives. It sets out our approach to regulation – how we prioritise and make decisions - and the related 'Approach to' documents explain our approach in more detail.

2.5 We believe that when there is effective competition, markets typically deliver positive outcomes for consumers, by providing more choice, greater innovation, better quality products and service levels, and lower prices. For example, when there is effective competition, firms cannot get away with charging excessive prices for a particular product as consumers can choose a more reasonably-priced alternative. Consumers are also likely to have greater trust in markets and institutions when competition is effective and they perceive pricing practices to be fair.

2.6 However, we also recognise that sometimes competition may not always guarantee fair pricing in the interest of all consumers and in some cases certain consumers may need more protection. This is particularly likely to be the case for vulnerable consumers who may be unable to effectively engage in a particular market and who, as a result, may be more susceptible to detriment. However, our concerns about fairness are not limited to vulnerable consumers.

2.7 The issue of fair pricing links to a more general question about the appropriate level of consumer protection and the appropriate balance between firm and consumer responsibilities. While we should have regard to the general principle that consumers have responsibility for their choices, some pricing practices may exploit situations where consumers are unable to respond appropriately to price change, and this may raise concerns that particular consumers or groups of consumers are being unfairly penalised.[2]

2.8 For this reason, our work exploring options for changes that would increase levels of consumer protection and deliver better outcomes for consumers via a possible Duty of Care that firms should owe their customers is particularly relevant to the topic of fair pricing. Our work on the Duty of Care specifically considers whether the right balance is currently struck between the responsibility of consumers and that of firms. We published a FS on Duty of Care in April 2019, and we have committed to publish a further paper in the Autumn of 2019 in which we will seek views on options for change.

2.9 Also related is our work on how best to protect vulnerable consumers. As part of this we published our Approach to Consumers document in 2018, in which we clarified how we define vulnerability. In our Business Plan 2019/20 we committed to providing further guidance on the identification and treatment of vulnerable consumers.

2.10 In addition to these cross-cutting pieces, we are also already considering the fairness of pricing in several retail markets:

- We published the terms of reference for our market study on General Insurance Pricing Practices alongside our fair pricing DP. We will publish an update on that later this year and that will be the first time we formally apply our fair pricing Framework in a market.
- As part of the High-Cost Credit Review:
  - We published a Policy Statement (PS) in June 2019 confirming that we are introducing major reforms to the overdrafts market. These reforms aim to make overdrafts simpler, fairer and easier to manage.
  - We confirmed in June 2019 new rules in the Buy Now Pay Later (BNPL) market, saving consumers around £40-60 million a year. From 12 November 2019, firms are banned from charging backdated interest on money that has been repaid by the consumer during the BNPL offer period.
  - We announced in March 2019 our final rules for a price cap on Rent-to-Own (RTO). The cap was designed to control prices by limiting both the cost of the product and the charge for credit. The cap was introduced from 1 April 2019 and will save consumers in the UK up to £22.7 million a year.

2 Financial Services and Markets Act 2000 sets out in section 3B the regulatory principles to be applied by the FCA, including 3B(1)(d) 'the general principle that consumers should take responsibility for their decisions'. Section 1C(2)(d) and (e) notes that when advancing our consumer protection objective the FCA must have regard to – (d) the general principle that consumers should take responsibility for their decisions; and (e) the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question.

- In July 2018, we published a DP on price discrimination in the cash savings market, setting out a range of options to address issues faced by longstanding customers in the easy access cash savings market. We intend to publish either a Consultation Paper (CP) or a Feedback Statement (FS) in the second half of this year.
- In March 2019, we published a CP proposing new lending rules designed to help so-called "mortgage prisoners" find a cheaper deal. Mortgage prisoners are customers who are unable to switch to cheaper deals, despite being up to date with their payments.

2.11 Each of these cases have posed complex questions about the fairness of certain pricing practices, but also about the role of those pricing practices in how markets function and how firms compete with each other. This work will help inform how we develop our thinking on the issue of fair pricing.

Fair pricing and the future of regulation

2.12 The environment in which we regulate is constantly changing, and to ensure that we continue to advance our objectives effectively we need to adapt to keep pace with these developments. So, a key cross-sector priority in our Business Plan 2019/20 was to think about the future of financial services regulation. This considers issues like technological change (including Big Data), the duty of care firms should owe their consumers, regulatory perimeter issues (what and who we do and do not regulate) and the balance of rules and principles in our approach to regulation.

2.13 Fair pricing is relevant to each of these broad themes. As the capacity increases for firms to use richer data sets and to apply new technologies, such as Artificial Intelligence, to inform their pricing strategies we are likely to see more sophisticated forms of price discrimination in the markets we regulate and increasingly complex questions of fairness. At the same time, we need to consider what is the appropriate level of protection and the role the FCA should play in issues that lie close to the perimeter.

2.14 We are taking forward work to future proof our principles and rules, including a review of our principles. This review will consider how we can encourage a culture within regulated firms, where decisions are driven by what is right and fair for consumers, rather than solely on whether it is permissible within FCA rules. Part of this work will include consideration of how we can reset our principles to clarify the duty of firms towards consumers and act more vigorously where we see misconduct which breaches FCA principles, even if it does not directly breach our rules.

Fair pricing and the broader regulatory context

2.15 Our work on fair pricing is also related to ongoing work by other regulators, including the Competition and Markets Authority's (CMA) response to the Citizens Advice super-complaint on loyalty pricing. The super-complaint raised issues in several markets across the economy, including 3 financial services markets: cash savings, insurance and mortgages. We had already identified concerns in these markets and we worked closely with the CMA as they conducted their investigation and prepared their response. In their response, the CMA made various recommendations to regulators, including the FCA, and set up a Loyalty Penalty Working Group made up of regulators and relevant government departments. We recently provided an update on the work we have been doing in response to CMA's recommendations. Other industry regulators are also considering what fair pricing means in the sectors that they regulate. For example, Ofcom recently published a DP setting out how they will assess fairness issues. That paper draws on our Framework to develop an approach that is tailored for communications services markets. Ofcom's DP is part of the work Ofcom is doing under its Fairness for Customers programme, which includes the recently published Fairness for Customers commitments, which are designed to raise standards in how companies treat their customers.

2.16 The issue of fair pricing is part of a broader public debate about competition and regulation in these markets. This was reflected in the BEIS Green Paper on Modernising Consumer Markets, which considered the treatment of existing customers and wider issues regarding how consumer markets are changing. BEIS set out various principles for responding to these changes, including that competition and regulation should work together in the consumer interest.

2.17 In line with Our Mission 2017, we think it is important that the FCA is transparent about how we think about the issue of fair pricing. We also recognise that market specific factors can play key roles in the assessment of fairness, so we think it is important that we are clear about how we think about fair pricing in the specific context of retail financial services markets.

3 Feedback and response summary

3.1 We received 51 formal responses to the Discussion Paper (DP) from a wide range of stakeholders. In addition, we hosted a large event that brought together the perspectives of different stakeholders to debate the issues. We also held several meetings with the FCA Panels and other stakeholders.

3.2 The responses we received can be broadly divided into 3 key themes:

- The content of the specific questions in our Framework and the rationale for selecting them for our Framework.
- How the Framework will be applied in practice, including how we might address any harm we identify.
- How we intend to embed fair pricing into our regulatory Framework and what we will be requiring of firms.

3.3 A summary of these themes is presented below.

3.4 We recognise that there is a balance to strike between giving stakeholders clarity on the one hand, but also not being unduly prescriptive on the other and we will continue to carefully consider whether we are getting this balance right.

The specific questions in the Framework

3.5 Respondents had a range of comments about the content of the Framework. This included both the scope of the application (ie what we mean by price discrimination) and the questions themselves.

Our definition of price discrimination

3.6 A number of respondents made the point that a price differential should not be deemed unfair in and of itself. We agree and we think it is worth re-emphasising this point, as we did in our DP. We also think it is worth clarifying that the term 'price discrimination' is a technical term that is purely **descriptive** of the practice and it should not be interpreted to imply anything about the appropriateness of the pricing practice. We defined price discrimination in our DP as firms charging different prices to different consumers based on differences in consumers' price sensitivity.

3.7 On a similar theme, some respondents commented on our use of the word 'harm' in the Framework. This is a term from Our Mission 2017 that captures our level of concern about something and how much we think it should be prioritised. In the context of our Framework it is used to describe the level of concern we have about a particular pricing practice. It is not intended to pre-judge any assessment of fairness, or imply that price discrimination is always harmful. As we set out above and in the DP, in some cases price discrimination can have a neutral or positive effect on outcomes for consumers. We discuss the wider effects of price discrimination, beyond issues of fairness, below. These effects include potential benefits that may arise for consumers as a result of the practice (eg through lower average prices)

3.8 Some respondents also noted that price differences may be due to differences in cost, rather than due to price discrimination. In this work, we are not looking at practices where consumers are charged different prices because of differences in the costs of serving them (including risk, in an insurance or credit context) or differences in the quality of products within our definition of price discrimination. There may be situations where this is of interest to the FCA, but we consider that a separate issue to the current focus.

The consumers who are affected by the pricing practice

3.9 Some respondents commented on the types of consumer affected by a pricing practice, and when we would be concerned. In particular, respondents asked us to clarify the relationship between fairness and vulnerability. For example, 1 submission we received pointed out that during periods of ill-health consumers may not prioritise financial matters and so may have little choice but to renew with their existing provider and accept that this means paying a higher price.

3.10 We think it is important to make clear that **our concern about consumers affected by price discrimination goes wider than vulnerable consumers and includes all consumers.** However, as we set out in our Approach to Consumers publication, we are more likely to intervene if the price discrimination results in harm to vulnerable consumers. In determining an appropriate degree of protection for consumers, we expect all firms to exercise extra care where consumers may be vulnerable.

3.11 In considering whether there is consumer harm from an unfair pricing practice, we will look at the types of consumers affected and whether they are able to act to mitigate any harm. As outlined in our Approach to Consumers publication, we have a general principle that consumers should take responsibility for their choices and decisions. However, we know that there are real factors that might limit certain consumers ability to do so.[3]

How much are the affected consumers harmed?

3.12 Many respondents agreed with our statement that a price differential in and of itself should not be deemed unfair. But they considered large price differentials to be exploitative and unfair, particularly if the customer is 'price walked' over a number of years to a multiple of the original price.

3.13 Some respondents noted that, when judging the fairness of a pricing practice, the scale of the price differential and how it changes over time are important considerations. For example, a small and time-limited differential might be viewed as less concerning than one that remains indefinitely.

3.14 There were mixed views on whether profitability was the right metric to use in our Framework. Some agreed with our rationale that when the cost to serve varies by individual (eg because of individual risk factors) the profitability of customer segments could provide better insight into the extent of price discrimination between customer segments. Some also suggested that very high levels of absolute profitability for a given segment would indicate unfair pricing.

3.15 However, other respondents argued that profitability is a firm centric metric and that we should focus on the total harm to consumers. To illustrate, a stakeholder gave

3 Financial Services and Markets Act 2000 sets out in section 3B the regulatory principles to be applied by the FCA, including 3B(1)(d) 'the general principle that consumers should take responsibility for their decisions'. Section 1C(2)(d) and (e) notes that when advancing our consumer protection objective the FCA must have regard to – (d) the general principle that consumers should take responsibility for their decisions; and (e) the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question.

the example of a hypothetical inefficient financial services provider that exploits customers with unfair pricing practices but, because it is inefficient, does not earn substantially different margins on the different customer segments.

3.16 We agree that the focus of our concerns about fairness should be on the welfare of consumers and that it is possible that a firm may engage in pricing practices that are unfair and still lose money. However, in markets such as insurance and consumer credit, it is necessary to consider potential differences in cost to serve to make meaningful comparisons of prices. For these markets, we think that the profitability of a customer segment, when combined with the full range of information, can help us make more meaningful comparisons of price.

How significant is the pool of people who are harmed?

3.17 Some respondents remarked that if a very small group of consumers pay higher prices, then (all else equal) this should clearly be of lesser concern. However, others felt the FCA should still be concerned if, for example:

- they are highly indebted individuals, where paying more for credit may make their situation even more untenable and difficult
- it stopped the practice being rolled out more widely or into other markets

3.18 We think it is important to clarify that it is **not** the case that if we find that a very small minority are harmed, we would automatically conclude that the pricing practice is not unfair. In making our assessment we would consider the proportion of consumers affected alongside an assessment of the other Framework questions. For example, if a small minority of consumers are affected, but we find that these consumers are a particularly vulnerable group of consumers and the level of individual harm is severe, we would likely be more concerned about the fairness of the pricing practice.

3.19 An example of where we judged that an intervention was warranted, even though a relatively small number of consumers are harmed is in the Rent-to-Own sector. We intervened to support consumers even though the market was small because of the type of consumer and the severity of individual harm they faced.

How firms are price discriminating?

3.20 Many of the responses on our question of **how** firms are price discriminating focused on the case of inertia pricing. For that application, stakeholders generally agreed we should consider what factors are driving that inertia before concluding on the fairness of the practice. However, the views on what combination of factors should lead us to be concerned varied significantly.

3.21 Some stakeholders felt that inertia pricing should be considered fair if: (i) pricing structures are transparent; (ii) price increases are clearly explained at the point of purchase; (iii) consumers are notified of pricing changes just before they happen; and (iv) there are no barriers to changing provider.

3.22 Other stakeholders highlighted the complexity of navigating financial services and argued that firms need to go further in supporting consumers throughout the product lifecycle. For example, providing nudges to shop around when introductory offers end, simplifying their product ranges, standardising product information to improve ease of comparison.

3.23 Some respondents felt that whether consumers can act to minimise the effects of price discrimination or not does not make price discrimination acceptable. One consumer body challenged the premise that switching is an 'easily changed' behaviour and always within the control of consumers.

3.24 In general, there was consensus in the responses that it is not acceptable for firms to price discriminate based on differences in consumers' understanding of financial products. Nor did respondents feel it was ever acceptable to specifically target vulnerable consumers with higher prices.

3.25 We consider the question of how firms are price discriminating to be of fundamental importance to the assessment of whether the pricing practice is fair. We welcome the feedback we have received on this question. In practice, this question covers a wide range of potential issues. As we approach the question we think it is helpful to distinguish between 2 sub-questions:

- Why do consumers have differing price sensitivities? The discussion above captures many of these considerations.
- What behaviours are firms adopting to take advantage of the differences in price sensitivities?

3.26 We think there is more work for us to establish the factors under these sub-questions that will determine when we are more likely to be concerned about the fairness of a given pricing practice. We will report back on this in the next stage of work. But in general, there are some drivers of price sensitivity that we would be more concerned seeing form the basis of a differential pricing practice. For example, we recognise that some consumers may value convenience more than others and, depending on the context, we might be less concerned about pricing practices that are based on this variation in willingness to pay. However, if the reason some consumers are willing to pay more than others is because they do not understand the product, then firms should not exploit this by charging them a higher price. Similarly, there are some firm behaviours that we would be more concerned about. For example, if firms actively sought to identify customers who do not understand the product in order to charge them more, we would be particularly concerned.

3.27 Sometimes we may see firm behaviours that are designed to influence consumers' price sensitivity without providing any additional value. The CMA considered this issue in detail in their response to the Citizens Advice super-complaint when they identified harmful business practices that firms use to hinder consumers from 'engaging, switching or getting better deals, such as making it hard to exit a contract or to find information about deals'. These practices, which are sometimes referred to as 'sludge', typically target consumers' preference for convenience, but the fact that firms are actively increasing friction means we may be more likely to find the practice unfair. In general, we would be concerned if we identified practices that are intentionally designed to discourage behaviour that is in the consumers' best interests.

Is the product/ service essential?

3.28 Some stakeholders felt this question was ambiguous and asked for clarification on what products/ services would fall into this category.

3.29 We agree with the way the CMA define essential services/ products in their response to the super-complaint, namely as those services/ products that consumers need to participate in society and the economy, and where significant harm might arise if consumers are not able to access the service.

3.30 If a product is essential, then any concerns we have about the fairness of a pricing practice are likely to be increased, as consumers have no choice but to use the product. This might mean there are many people affected by the practice, including vulnerable consumers. In addition, if consumers are purchasing the product because they have to rather than because it is a product they are interested in, then they may be less engaged in the market or less able to understand the product.

3.31 As with the other questions in the Framework, we will use this question in combination with the other questions within the Framework to make our overall assessment. Stakeholders should **not** conclude that if a service is not essential then the practice cannot be unfair.

Society's view of the pricing practice

3.32 We received several responses about our question on society's view of the fairness of the pricing practice. Some respondents considered it to be an important part of the Framework. Others suggested that this question should not be part of the Framework, emphasising that the FCA should establish objective standards for fairness, rather than relying on a subjective and possibly time-varying measurement of society's view.

3.33 We also received feedback on the practicality of gathering evidence on this question. Some stakeholders asked how we would seek to gauge society's views and there were suggestions for how we might approach this, including using deliberative forums which bring together a representative panel of the public to provide insights.

3.34 We intend for Question 6 to be interpreted broadly and considered in the round alongside the other questions in the Framework. We do not think society's view of a particular pricing practice should be the deciding factor within the Framework, neither do we see it as a substitute for our own role in assessing the pricing practice. On the contrary, we think it is important that the FCA leads by exercising judgement using a transparent framework.

3.35 However, we do think that **society's view of the pricing practice is important**, and we think that that question should remain in the Framework. There are 2 main reasons for this:

- We regulate in the public interest, and if there are wide held views that a particular pricing practice is unfair then we should at least seek to understand why.
- If consumers do not believe firms are engaging in fair pricing practices, then there could be damaging effects on trust in markets and institutions and ultimately the integrity of the market. This in turn could lead to reduced engagement amongst consumers.

3.36 Precisely what we mean by 'society's view' may vary by context. One interpretation could be that firms should consider whether they would be willing to explain and defend their pricing practice to their customers and shareholders if the practice were to receive public scrutiny.

3.37 There is also no set method that we have for gathering evidence for this question and we may use a variety of sources of evidence, both qualitative and quantitative, depending on the specific case. We welcome the feedback we received on methodologies we might consider in particular market contexts.

How the Framework will be applied in practice

3.38 Several respondents asked questions about the application of the Framework, including (i) how to use the Framework to reach a determination on fair pricing, (ii) how we will consider the wider effects of a given pricing practice and (iii) how we will consider what is the appropriate intervention.

Using the Framework to reach a determination on fair pricing

3.39 Respondents asked for more detail about how the Framework could be used to reach a determination on fairness when considering a specific pricing practice. In many cases, for example, the answers to the 6 questions may not all point in the same direction for a specific pricing practice.

3.40 It is important that we give firms clarity about how we intend to regulate, but at the same time we need to give this clarity in a way that does not unduly constrain the application of the Framework on a case-by-case basis. Fair pricing is a complex issue with broad application. As a result, our view is that for the Framework to be effective and proportionate it needs to be **considered in the round** and **retain a significant element of judgement** in its application to particular cases.

3.41 Some Framework questions may in certain cases carry more weight than others, particularly if the answers to those questions reveal a particularly extreme or severe outcome. In most cases, no single question will determine a decision in isolation. The Framework needs to be considered in the round.

3.42 All 6 questions do not need to be answered in a particular way for us to find a pricing practice to be unfair. For example, we would be more concerned where the number of consumers harmed is high, but even if the number of consumers harmed is relatively small we might still find a particular pricing practice to be unfair, depending on responses to the other questions.

3.43 For similar reasons, we do not think it is appropriate to remove the need for judgement when considering fair pricing. In principle, we could be much more prescriptive in our assessment of fair pricing. For example, by banning particular pricing practices in any context. But we think it unlikely that would achieve good outcomes in all cases given that the effect of a pricing practice is complex and context-dependent.

3.44 We view the DP and this FS as part of an ongoing programme of work on fair pricing, and we will continue to develop our approach as necessary. We recognise that there is a difficult balance to strike between giving firms clarity on the one hand, but also not being unduly prescriptive on the other. As we develop our approach to fair pricing and embed it in our regulatory approach, we will continue to carefully consider whether we are getting this balance right.

Considering the wider effects of a pricing practice

3.45 Some respondents noted that a pricing practice can have wider effects beyond unfairness. A pricing practice can, for example, affect the extent to which firms compete with each other, a point we noted in the DP.

3.46 We agree that the wider effects of a given pricing practice are important, and should be considered in any assessment of that practice. The Framework can be thought of as the first part of a broader, sequential decision-making framework that accounts for possible wider effects of the pricing practice. It leads us to a decision about how to act on concerns about the fairness of a given pricing practice.

3.47 The first step in the sequential structure is to consider whether a pricing practice is unfair, using the Framework we introduced in the DP.

3.48 The second step is to consider whether the pricing practice has wider effects beyond fairness, including on competition in the market and the extent to which consumers are engaged. These wider effects can mitigate or exacerbate any concerns we may have following our initial application of the Framework. For example, a pricing practice could support increased competition (which could benefit consumers through lower prices, higher quality and increased innovation, and might, depending on the context, mitigate any finding of unfairness) or it could cause consumers to disengage and search less (which would exacerbate any finding of unfairness). We set out our general approach to assessing competitive effects such as these in 'Approach to Competition'.

3.49 A consequence of this dynamic is that some consumers may benefit from a pricing practice that we consider to be unfair (for example, where increased competition leads to lower prices). In such circumstances, we may have to consider trade-offs between outcomes for different consumer groups.

3.50 The third and final step is to consider whether intervention is required and what remedies, if any, might be appropriate. This is likely to be case-specific, but a general theme that will guide us is whether the pricing practice is market-wide or limited to a small number of firms. We will also consider the implications of any potential remedy on competition.

3.51 As we set out above, we think it is important to retain an element of judgement when it comes to trading off the results of Step 1 and Step 2. In some contexts, wider effects are important, in others (such as if there is strong evidence that the pricing practice is significantly unfair) they may be less important.

Figure 2: How the Framework informs what action we may take to address concerns about the fairness of a given pricing practice

Step 1: Do we have concerns about the fairness of the pricing practice?	**Step 2: What are the wider effects of the pricing practice?**	**Step 3: What is the appropriate course of action for the FCA?**
Use the 6 question framework to make an assessment	Consider how the practice affects competition and trust in the market	Based on the full range of factors consider whether (and what) intervention is appropriate

The remedies we might use to address harm caused by unfair pricing practices

3.52 We asked respondents to comment on possible remedies where we conclude a pricing practice is unfair and that an intervention is appropriate.

3.53 In the case of inertia pricing, some respondents questioned whether demand-side remedies would be effective at shifting inert consumers to action, even if they are carefully designed. Many respondents thought that giving consumers additional information would be unlikely to solve the problem.

3.54 When designing demand side remedies, respondents encouraged the FCA to:

- Not put the onus on the consumer to take action.
- Be clear about what is driving the inertia in the particular case.
- Not assume that low income consumers are time rich.
- Recognise that effective product comparisons require standardisation of how all product information is presented, not just price. This makes comparison easier for consumers (reducing the cost of shopping around) and ensures consumers are comparing like for like.

3.55 Some consumer bodies were more supportive of supply side remedies because they viewed disclosure remedies as less effective at addressing harm from unfair pricing practices. However, a number of firms said that such interventions should only be used as a last resort. Some firms supported the equalising of price differentials between new and existing customers, claiming that in some circumstances firms may not be able to unilaterally abandon the practice while still being able to compete effectively in the market.

3.56 When we consider what remedy to use, we will take into account the nature of competition in the market and recognise the potential for any unintended consequences. Stakeholders also identified some potential unintended consequences that we should be aware of. These are summarised below.

3.57 **Reducing competition**: Many respondents raised concerns that in some circumstances there could be a trade-off between improving the 'fairness' of pricing and the level of competition in the market. For example, they pointed out that some supply side remedies could make new entry to the market more difficult, inhibit the ability of firms to use discounts to gain market share; reduce incentives for consumers to engage; and increase aggregate and average prices in the market. There was also concern it could increase market concentration and that the impact would be felt disproportionately by smaller firms. Stakeholders requested that the FCA be clear about how it will balance fairness and competition in cases where there is tension.

3.58 **Making things worse for the most vulnerable**: There was also concern that interventions that created higher average market prices and uniform pricing could prevent those with lower incomes accessing the market. Some were also concerned that interventions that affect insurance firms' profitability might cause them to rationalise the provision of insurance to riskier categories, disproportionately affecting those with protected characteristics.

3.59 **Consumers switching to worse deals:** Respondents raised concern that interventions to encourage switching (such as autoswitching), may not always be desirable. The private medical insurance (PMI) market was provided as an example.

Some stakeholders identified that switching regularly in this market may result in consumers being unable to attain cover for existing medical conditions.

3.60 **Decreasing consumer engagement:** A number of respondents noted that care should be taken when using disclosures, in particular requiring the disclosure of pricing practices which may be complicated and may work to confuse and overwhelm consumers, causing them to disengage from the market.

3.61 **Causing consumers to unduly focus on price:** Some stakeholders raised concerns that intervening to require more price transparency may cause undue focus on price, causing consumers to overlook non-price factors or make price comparisons of products that are not the same. In addition, firms may respond to consumers over-focusing on price when making their product choice by reducing product quality. Respondents highlighted that transparency needs to be on all factors that consumers value to stimulate competition that is more sustainable and deliver a market that is more beneficial to consumers. They also flagged that auto-switching interventions would need careful design, to ensure consumers are not switched to cheaper products which may not necessarily provide better value for money.

3.62 **Exposing consumers to risk:** Some stakeholders highlighted the possibility that in some cases consumers may be exposed to risk as a result of an intervention. For example, some insurance firms raised the concern that removing auto-renewals would leave inert (and potentially vulnerable) consumers exposed to insurance risk.

3.63 We welcome the feedback on the things we should think about as we consider potential remedies to address concerns about unfair pricing practices in general. In practice our decision about whether to make an intervention, and the intervention we decide to make, will be done on a case-by-case basis and will take into account the full range of relevant factors. This is part of the overall decision-making approach illustrated in Figure 2.

Embedding fair pricing into our regulatory approach

3.64 We received various responses regarding how exactly we intend to embed fair pricing into our regulatory framework. We will consider this in the next stage of our work on fair pricing. In keeping with the commitment to transparency in Our Mission 2017, we set out how we see this further work developing regarding (i) what tools we see our work on fair pricing being applied to, (ii) how we see our role when it comes to fair pricing and (iii) the form in which we intend to embed fair pricing into our regulatory approach.

Application to our regulatory toolkit

3.65 Respondents asked for more detail about where across the FCA's functions (including authorisations, supervision, enforcement and markets work) we think that fair pricing is relevant.

3.66 Each of these functions plays a different, although complementary, role in our regulation of the firms and markets within our remit. We think that fair pricing is relevant in all of them. So, we think fair pricing should be considered broadly across the FCA's functions. We do not see any reason to restrict its applicability to particular functions at this stage, and we intend to develop the Framework in a way that ensures it can be applied in all areas where it may have relevance.[4]

The FCA's role in this context

3.67 Respondents noted that in some cases the fairness of firms' pricing practices might best be considered by the Government, rather than the FCA.

3.68 Fair pricing is within our remit, given our statutory and operational objectives: **fair pricing is relevant to each of our operational objectives**. We regulate in the public interest, and will act where necessary. However, we recognise that in some instances, particularly where there are difficult trade-offs between different consumers or significant implications for some groups of consumers, it may be appropriate for the Government to take a lead in setting public policy. Where this is the case we will continue to work with the Government and other regulators to address the issue.

Form of regulation

3.69 Respondents asked for more detail on how exactly we intend to embed fair pricing within our regulatory framework. In particular, whether we intend to set out prescriptive rules or more general principles.

3.70 We will consider this in the next stage of our work. As described above, we think that assessing whether a given pricing practice is fair in different contexts necessarily requires a degree of judgment or discretion. So, prescriptive rules are unlikely to be appropriate in this case and we consider at this stage that a principles-based approach may be more effective in driving appropriate outcomes. We will consider fair pricing as part of the review of our principles, which will be the first strand of our Handbook Review. We intend to publish a DP on the review of our principles in Q4 2019/20, and will report back on the next phase of our fair pricing work at that time.

4 The Framework focuses on the fairness of price discrimination, which is a type of pricing practice, and is relevant to the exercising of our FSMA powers. In addition to our FSMA powers, we have other tools available to address the fairness of pricing practices. For example, under consumer law, the price of a contract may be relevant to an assessment of whether a relationship between a customer and lender is unfair under the Consumer Credit Act (CCA) and, if a price-related term is not transparent and prominent, this might result in that term being considered unfair under the Consumer Rights Act (CRA 2015). The Framework is not relevant for these tools.

4 Our next steps

4.1 Our work on fair pricing will continue after this Feedback Statement:

- We will apply our thinking to issues that we identify in our market specific work. The first application of the Framework will be in the General Insurance Pricing Practices Market Study. We will be publishing the findings from that later this year. The application to that case will also help inform how we use the framework in subsequent pieces of market work.
- We will also begin the work required to formally embed our thinking into our regulatory approach. A part of that will involve contributing to the review of our principles, which will be the first strand of our Handbook Review. As set out in our Business Plan, we intend to publish a Discussion Paper on the review of our principles in Q4 2019/20. We will report on the next phase of our fair pricing work at that time.

Annex 1
Discussion Paper questions

Price discrimination in financial services

Q1: **Do you agree with our 6 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?**

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?
e. The characteristics of the product, including whether it is an essential service?

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 (eg through predictive modelling, product design, communication with the consumer)?**

Please provide reasons to support your answer.

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.

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 (eg 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.

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.

Annex 2
Glossary of terms

Back-book	The stock of existing or longstanding customers. See also front-book.
Big data	Broadly defined as: the use of new or expanded data sets, new technologies to generate, collect and store data and advanced analytical techniques. In the context of this paper, its ability to gain insights on Choices
Competitive dynamics	The strategic interaction between sellers and buyers in a market that leads to a price being determined.
Cost-based pricing	The practice in which firms set prices solely to reflect costs. More specifically, charging a proportionate mark-up over marginal cost. Costs may vary for different reasons, eg quality of service or differences in how much it costs to serve each customer. Sometimes also called price differentiation. (Cost-based pricing is different to price discrimination, where prices reflect other features such as how much customers are prepared to pay).
Demand-side	Consumers or customers, typically thought of in aggregate terms.
Engaged Consumers	Consumers who understand the market and give time and attention to their decisions about products and services. As a result, they are more likely to shop around, switch providers and negotiate a good deal. The opposite of inert consumers and are often 'front-book' (new) customers.
Front-book	Stock of (relatively) new customers for a given supplier. This also includes the stock of customers who switch to a new product with the existing supplier. See also Back-book.
Inert consumers	People who do not engage actively with their existing financial product provider. For example, they do not review terms, prices or product options at renewal or other 'decision points', such as when a fixed term or bonus rate ends. This could be a rational choice (eg due to time and effort costs) or behavioural (eg limited decision-making due to specific framing or salience) or because they trust their supplier to offer them a fair price. This need not be a permanent characteristic - customers who are inert may become active in the future. Sometimes called inactive or unengaged consumers. There may also be a significant overlap between this group and the group of vulnerable consumers (see below).
Inertia pricing	A particular type of price discrimination where firms charge different prices based on how likely the customer is to switch. For instance, charging higher prices to existing customers than to new customers for similar insurance products.
Loyalty pricing	See Inertia Pricing

Loyalty penalty	Where firms charge higher prices to consumers that stay with them, than they do to new consumers or those that negotiate. It is a form of price discrimination.
Price discrimination	The practice in which firms charge different prices to different consumers based only on differences in price sensitivity and levels of engagement (see price sensitivity, and compare to cost-based pricing).
Price sensitivity	For the purposes of this discussion, propensity to shop around, propensity to switch, willingness-to-pay at an individual level, and a customer's propensity to ask questions or file complaints.
Price-walking	A pricing practice that involves firms setting low (teaser) introductory prices which are later increased with renewals. This can include below-cost introductory prices but not necessarily.
Sludge	Practices that appear intentionally designed to discourage behaviour which is in the consumers' best interests.
Supply-side	Firms or suppliers.
Switching	The process of consumers changing to another service provider.
Vulnerable consumer	Someone whose personal circumstances make them especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care. For details, see Our Approach to Consumers.

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