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

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25 June 2019

Consumer Panel Position Paper –
The Case for Automatic Upgrades

Background

The Panel has been calling for financial services firms to have a new duty of care, in order to bring about the better treatment of financial services customers. A new duty of care, in the Panel's view, would help address the current situation of firms failing to comply with the principles for businesses yet without technically breaching any of the other more specific FCA rules. Such instances of 'legal but not right' behaviour by firms cause detriment to consumers that the Panel wants to see stopped.

One of the potential follow-ons from a duty of care could be the idea of automatic upgrades for customers left in poorly performing products (e.g. with high costs and charges or low returns).

An automatic upgrade would require firms to move customers in poorly performing or poor value products onto better, comparable products offered by the same provider.

In order to understand the potential value of automatic upgrades as a policy, the Panel commissioned Europe Economics to conduct research to estimate the likely financial detriment to consumers when they are trapped in poorly performing products. This could occur because:

a. There is an existing deal available to other customers, but you are left where you are;
b. There is a product on more favourable terms, but you will be auto-renewed into a price greater than would be charged to new customers;
c. You are trapped in a product with high exit-fees, complex terms or are unable to switch due to your characteristics, your financial situation or the firm's affordability rules, meaning it will be more expensive or impossible to move to another product or provider even if they offered more favourable terms; or
d. You have taken out a product with one firm and have then been sold on to another.

Loyal customers losing out

Loyal customers can be the ones who are charged the most. They may be too busy to search for and switch to better products; do not switch due to behavioural biases; are trapped with their existing provider; or are not aware that better alternatives exist. The Panel is concerned that in many cases it may be the financially most vulnerable who face the higher charges.

Consumers' differing propensity to switch means firms do not treat all customers fairly

The FCA and CMA have often proposed information and switching remedies in a bid to address shortcomings in the way markets work. These may benefit consumers who are likely to switch but they are not sufficient alone to drive good outcomes for all consumers. Many consumers may be time poor or put off by the complexity of the decision because of jargon and too much unhelpful information. The Panel conducted research in 2017[1] which found that 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 create sufficient switching or the threat of switching can lead firms to respond by putting up prices for consumers they know are unlikely to switch. Remedies that rely on consumers to switch to get better treatment could put an unfair onus on consumers to act, given information, resource and capacity asymmetries. Switching should always be easy, timely and convenient for consumers who choose to move, but it should not allow firms to treat their remaining or existing customers unfairly.

A data-driven nirvana?

There is some hope that Open Banking, pensions dashboard and other data-driven and fintech-based competition remedies may help drive a better deal for all consumers. But while these services will undoubtedly produce certain benefits, it is debatable that they will deliver a tech-driven nirvana that will address the harm to consumers of staying in poor value products when better ones are offered by their existing providers. 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, and complex business models will not lead to better outcomes for consumers or a need for firms to change their behaviours.

Research and methodology

The Panel's aim in carrying out this research was to encourage the FCA to explore the pros and cons of introducing an automatic upgrade remedy across the financial services sector. The research sought to do this by identifying the potential detriment of being trapped in poorly performing products for different types of consumers who have an 'average' number of financial services products.

The research used the FCA's 'Financial Lives' data[2] to identify the products that are held by the 'average' consumer in several different groups. The eight products examined were current accounts; cash ISAs; credit cards; mortgages; investment products; pensions; home insurance and income protection. Where possible, the Financial Lives data was used to provide the average amount held or the average size of the debt in the various products.

Specifically, the Panel asked Europe Economics to look across this suite of eight products, to assess the following:

- The estimated cost per product to consumers who stay in a poor performing product;
- The overall estimated cost for different 'average consumers' of staying with poorly performing products and services;
- The potential financial benefit if consumers were to be auto-upgraded to the best product available from their existing provider;
- The benefits and drawbacks of policy solutions for consumers in poorly performing or poor value products, considering policies implemented historically in the financial services sector and in other jurisdictions and sectors; and
- The consequences and potential costs of stopping cross-subsidisation as a result of introducing a policy such as an automatic upgrade.

[1] FSCP research: Consumers and Competition (https://www.fs-cp.org.uk/sites/default/files/fscp_consumers_and_competition_position_paper.pdf)

[2] The Panel is grateful to the FCA for its help and advice in accessing and using the Financial Lives data.

Research results

The results show that the costs of remaining in poorly performing or poor value products can represent a notable proportion of a consumers' annual income.

Some consumers could be incurring loyalty penalties in excess of 5% of annual income, and it is not impossible to imagine that for some consumers these costs are as high as 10% of their income. Based on the profiles used in the research, these are likely to be consumers with an average income and a range of standard financial products, with relatively large amounts of debt. Mortgages and credit cards are the two largest drivers of loyalty penalties for those that hold these products. In the case of credit cards, the Panel's greatest concern is the possible loyalty penalty for consumers who fail to pay off their balance in full each month. The evidence suggests this loyalty penalty can be large.

The research presents the possible loyalty penalty for a range of consumer profiles. More data would be necessary to calculate the aggregate level of detriment across all of the products Europe Economics examined. Greater access to market data would also allow the estimates for individual products to be refined – for example, detailed data on how consumers use their current account could be used to refine the estimate of how much individual consumers could benefit from using an alternative current account or by automatically sweeping their balances into a high interest savings account.

Many policy solutions proposed by regulators to enhance competition or consumer outcomes require consumers to be more engaged in the market. These typically involve redrafting or reframing the information given to consumers and expecting them to search, compare and switch products within the same provider or switch to a different provider. However, there are arguments that searching and switching take up a large proportion of consumers' time and represent a cost burden that is not always reflected in these policy discussions.

Policy recommendations

This research demonstrates the potential detriment for consumers of remaining in poorly performing products and the need to ensure that all consumers are treated fairly. As the Panel has identified, providing consumers with more complex jargon-filled information and prompting them to switch will not be effective in tackling this detriment for the majority who do not move. It unfairly puts the onus on consumers in the context of asymmetries of information, capacity and resources between them and firms.

The Panel has three key policy recommendations for the FCA:

1. **A new automatic-upgrade rule**: The FCA should consider the merits of introducing a new auto-upgrade rule across all of the sectors the Panel has identified. This could either require firms to automatically upgrade consumers into the best available product or offer them a choice of better quality and better value products which suit their needs.
2. **Expand the fair pricing work to all sectors**: The FCA has started to develop a framework for fair pricing practices and has conducted detailed market studies into pricing practices in insurance, mortgages and long-standing insurance-based investment customers. This fair pricing work should be expanded to all product sectors.
3. **Calculate the total detriment across all sectors**: The FCA should use its increased data access and capability to calculate the total detriment to consumers from failing to auto-upgrade across all product areas and use this as a key indicator of where it should prioritise its resources.