Inside FCA Podcast: What is the Consumer Duty price and value outcome?

OI: Hello and welcome to the Inside FCA Podcast. I'm Ozge Ibrahim and in this episode I'll be speaking with the FCA's Head of Competition Policy, Ed Smith, about the price and the value outcome of the new Consumer Duty. The Duty means that consumers should receive communications they can understand, products and services that meet their needs and offer fair value with customer support they need when they need it. Focussing on what the FCA expects from firms of all sizes, Ed will be discussing the importance of firms assessing their products and services to ensure there is a reasonable relationship between the price paid for a product or service and the overall benefit consumers get from it.

Hello and welcome Ed.
ES: Hello.

OI: What does the price and value outcome mean in the context of the Consumer Duty?

ES: Well, price and value is one of the four outcomes that firms need to assess under the Consumer Duty. There are four, there's the products and services outcome, the price and value outcome, the consumer support outcome and the consumer understanding outcome. Price and value is one of the core ones and essentially what it's saying is that firms need to ensure that the price a customer pays for a product is reasonable compared to the overall benefits that the customer gets from the product. Here at the FCA, we've seen many instances of financial products that represent poor value. Insurance is one example, some insurance products where the customer actually receives few benefits in terms of the cover that they get in relation to what is often quite a significant premium or where they pay broker commissions that can be unreasonable relative to the benefits of the products that they get.
So, other examples might be savings accounts where we've done a lot of work looking at what long standing customers receive in terms of interest rate levels can be quite low and those can represent poor value for those consumers.
And often these examples of poor value are taking advantage, firms are taking advantage of behavioural biases that we as consumers have. So they can use, for example, flashy upfront discounts to hide the true cost of a product to a customer. Or they might try and attract customers at the point of sale through impulse add on products that they probably don't really need and can represent poor value.
Some products take advantage of customers' natural inertia so long-standing customers that have been on the product for a long time can often, as we say with savings products, receive quite low interest rates. So, we have seen examples of poor value and what we're trying to do with the price and value outcome is really to put an onus on firms to address that, to really examine and challenge themselves about whether products are really a reasonable cost compared to the benefits that they give to the customer.

OI: What does the FCA ideally want to see happen then?

ES: So, we want firms to assess upfront the price that customers get out of, the price that a customer pays for the product over time, because often the price can be contingent on the way that a customer uses a product. So, they might get fees throughout the lifetime of the product, they might pay commissions, for example. Look at the price in the round and then compare that to the benefits that the customer gets from the product and make sure that those benefits are commensurate with what the customer is paying. So, really what we want firms to do is to look upfront at that price and value equation, but then consistently through the lifetime of the product to make sure that it represents ongoing value for the customer in terms of the benefits that it's receiving, the way that it's using that product. So, it's an upfront examination of price and value, but then ongoing as the lifecycle of the product evolves.

OI: And what do you say to firms who might say that demonstrating value is challenging?

ES: It's something that all firms must do as part of their marketing of a product, anyway, is to assess what the customer is going to pay for that product and also to assess what the benefits are and that's part of understanding the marketing process usually that the firms go through for a product. So, it's not something that's completely alien to firms to do this. We see three elements of a good value assessment framework, and those elements really draw on the data that the firm will have anyway in terms of the marketing of the product that it puts out there.

As I said before, the first elements of that framework is to ask about the product itself, what are the benefits of the product to the target customer, and this requires an assessment and valuation of those product features that are beneficial to the customer as seen through the eyes of the target customer. So, firms will have a target market, they will have target customers that they want to attract to get the product and they will design that product with those target customers in mind. So, they will have a good idea of the sorts of benefits that they want customers to get from that product. So, it's really kind of going through the eyes of the target customer and understanding what the features of the product are and how the customer might use that and the benefits that they draw from it.

So, it might be things, for example, like the expected returns that a customer might get from an investment product that they invest in, or it might be the additional quality that the customer might get, for example, through lower call waiting times or for example, through having branch access for that product.

Or it might be the, let's say, the additional reassurance that a customer gets from having a product that has higher quality coverage, for example in an insurance product, or that might have better facilities to access staff and to call, call centres and etc. So, there are additional benefits that lots of products have and it's a question of the firm really understanding those benefits and putting a value on it from the perspective of the target customer. So, I don't think that's particularly out of line with what lots of firms do anyway in terms of the marketing of their product and understanding the target customer.

OI: So, you've just described generally what a value assessment is, is that correct?

ES: That's one element of the value assessment so, we understand the benefits that the customer gets, but that then needs to be compared against the cost that a customer pays for the product. And that includes not just the upfront price that the customer is charged, but also contingent charges that a typical customer might incur over the lifetime of the product use. So, if a customer might typically incur ongoing usage fees, for example, transaction fees or exit fees, transaction fees in the case of a current account, for example, might happen if the customer is using foreign exchange in their current account. Some customers might incur exit fees when they end a product and switch to another product. That's quite typical, for example, with fixed rate mortgages. So, these need to be factored into the overall cost that a typical customer might pay and compared against the benefits that they receive for that product.

So, what we want that first element of the framework to look at is the product and then to say that are the benefits that the customer receives through the additional quality or through the expected returns, are they commensurate to the overall price of the product, the overall price that the consumer pays for the product?

So, for example, if you take a motor insurance product, it quite often offers additional benefits such as key cover or a courtesy vehicle. Firms need to assess those additional benefits are proportional to the additional costs that the customer incurs and is the customer likely to use those additional

benefits to make that additional cost worthwhile. So, that's looking at the product lens and looking at whether or not the benefits of the product are commensurate with the costs that the customer pays. The second element of a good value assessment framework is at the level of different customer groups.
So, not all customers are typical, different customers use products in different ways and that's going to affect the costs that they incur from the charges they pay on that product, but also the benefits that they receive. So, firms need to check whether there are any cohorts or groups of customers who may receive substantially worse outcomes due to, say, differential pricing or due to outlier behaviours or different ways of using the product that might really incur substantial extra fees. Differential pricing is not necessarily unfair, so some customers may place higher value on particular product features and be prepared to pay more for them. But the important thing is that different customer cohorts are each receiving fair value and the firms need to check for that.

OI: And how does it differ from the existing fair value rules??

ES: Well, there are fair value rules that apply in some of the handbook to particular types of products already, and they have similar frameworks. So, they are about assessing the benefits that customers get from products. So, we have, for example, fair value frameworks for insurance products which look at benefits in terms of the claims that customers make and the data around claims to assess the benefits that they have. So, some of that framework is already in place in certain sectors and certain product areas and really what the Consumer Duty is doing is applying that framework across the piece to all of our retail markets to ensure that at different levels of the supply chain in selling products to customers and final end consumers, firms are looking at fair value across the piece. And so that's what the Consumer Duty is setting up and that's why it's different to our rule book at the moment.

OI: What will the FCA be looking for from firms in terms of how they document and evidence value assessments?

ES: So, what we want is that they use data that they have, be it in relation to how consumers use products, be it in relation to price and charges that they incur. Most firms will have that data, should have that data as part of either profit or loss assessments or marketing strategies. So, this is data that lots of firms will have, some of it may have to be developed specifically and developed a bit further but lots of that data can be used and recycled from data that they've got as part of their marketing, or as part of their revenue assessments. And what we want them to do is really to, again, look at that data in assessing what customers pay over the lifetime of their product, what charges that a typical customer might pay. And then, as I said before, looking at what differential groups of customers might pay, depending on how they use the product and use it differently and again, the data should be there to evidence that. And equally on the benefits side, using data in relation to usage of the product, how consumers use the product over time, what use they are making of the additional services to really assess the benefits of the typical customer. But also, as I say, again, different groups of customers and depending on how they use it, the benefits that they get from that usage pattern. So, we want them to evidence that through data using a framework for assessing fair value that I've just set out.

OI: And what does a good value assessment look like?

ES: So, as I say, I think we've got three elements that we would want to see in a good value assessment framework. The first is the product assessment, I've talked about that, it's about assessing the price that a customer pays over the lifecycle of the product and comparing that to the benefits that a typical customer might get from using that product. So, we've gone through that

before, the second element I've also touched on which is about different groups of customers getting different types of benefit, paying different charges, and really be clear for the firm on whether each of those different groups are getting fair value in the way that they're using the product and the prices that they're paying for the product. As I said, different customers use products in different ways, they pay different charges as a result, they get different benefits as a result. Looking at those groups, does each of those groups get fair value from that? And again, this is really looking at the sorts of behavioural biases that some customers might have in the way that they use the product that might lead to unfairness because they are either not switching away from the product when they don't get any benefits from it, or they may be using it in ways that hadn't been anticipated by the firm, and the firm needs to be conscious of that.
And then the final element of a good value assessment is to have a look at what is driving the price both at a firm and at the market level. And here it can be quite useful to see how the price of the product has moved over time, and for the firm to ask itself, well, what is driving that price movement? Is it a result of higher costs? Have costs been rising over the time, or might it actually reflect rising margins and higher profits that the firm is getting from the sales of those products. So, is the firm using those price increases also to cross-subsidise other products in its portfolio, which might create unfairness between different groups of customers?
It can also be helpful here to consider how market dynamics are affecting the price of the product. So, is the market characterised by weak competition from other firms or by weak consumer engagement and low switching? And if that is the case, then it may be easy for firms to sustain poor value products over time without then being subject to competition, and that creates the risk that some of their products in that portfolio might represent poor value. So, the firm needs to ask itself, is it able to sustain a price which is substantially out of line with either similar products in the market or products that it might have in its own portfolio which are cheaper but actually have the same amount of benefit or cost than the other products in its portfolio.

OI: How important is it that firms benchmark against the market?

ES: So, I think it's one element that firms can look at and it's part of this final element of the assessment that I think I just touched on, which is looking across the market and looking also within its own portfolio of products to sort of benchmark it against other similar types of product. So, having a look at products that have similar features, similar benefits and asking yourself, well, is my price in line with those products? If it's not in line with those products, if it's higher than those products, what are the additional benefits that justify that additional price? So, benchmarking is an important part of that, it's not the only part of it I think firms need to satisfy themselves that the product in and of itself is fair value, but then go on to ask itself and looking over the market and looking within the products that it also sells; does this particular product represent fair value against those benchmarks?

OI: You've talked about products where there's something for sale. What about whether where we think about a service, for example, such as a bank account, what does a good value assessment look like there and how does it work?

ES: Well, people often say that a bank account is free and therefore, you know, it can't be possible that that its poor value but actually if it is genuinely free of charge, if a product is genuinely free of charge, then we wouldn't really expect a firm to do a value assessment of it, but actually, it's very rare that a service is genuinely free. Even when there's no explicit charge for the service customers usually pay contingent charges like, for example, overdraft fees with bank accounts or transaction fees for certain types of transaction. And it's also important that firms assess all those charges, both for a typical customer and for the different cohorts of customers that might use the product in different ways. So, some customers will use their overdraft and incur fees for that and again, it's important that the firm assesses whether those customers, those groups of customers, are getting fair value. Customers also pay in terms of opportunity costs, so even if a product might appear free to some extent, they're still paying a cost which might be foregone interest rates, for example, on a current account. So, you know, a customer who maintains a large balance in a current account will be paying quite a lot in terms of the interest foregone that it might get if it actually put that money into a savings account. But the bank is still earning interest from lending out that money to other customers. So, there are sort of foregone elements of cost that need to be incurred, need to be taken into account as well.

OI: Does the rising cost of living have an impact on how firms should assess the fair value of their products? And if so, how?

ES: Yeah, the cost of living is really important context for the Consumer Duty, it's doubly important in hard times that customers can be sure they're getting fair value for the products and are not being ripped off or paying for services that they don't really use or value. So, given the cost-of-living crisis in context, it's really important that firms challenge themselves on whether the cost of the product is commensurate with the benefits that a customer receives. So, I think the important thing is that cost of living really underlines the importance of the price and value outcome. The other thing is that cost of living will also increase the vulnerability of certain customers and put some customers in really desperate situations.
And so, firms really must factor this in both in their charging structures to ensure those charging structures are fair but also in another element of the Consumer Duty, and the support they give to customers that are facing very difficult circumstances. So, cost of living is really important, really important context for firms implementing the Consumer Duty.

OI: And would the rules on price and value serve to prevent firms negotiating fees with clients?

ES: I think the short answer to that is no. As I've said above, it's okay for firms to charge customers different prices. And equally it's okay for manufacturers to negotiate different deals with different distributors. The important thing is to check that, as I said before, there aren't groups of end customers who are getting poor outcomes as a result. So, you know, if it does result in different groups of customers paying different prices, that may be okay but what the firm needs to check is that those customers paying different prices are still getting fair value at the end, they're still receiving the benefits and they still consider those benefits to be commensurate with even higher prices that they may be paying ultimately.

OI: And how would you like to see manufacturers and distributors collaborating to assess fair value of a product?

ES: So, it's really important that manufacturers and distributors do collaborate to assess fair value. The cost that a customer pays for a product is an amalgam of charges that are levied throughout the supply chain. So, the price or fee that a manufacturer charges for the product, plus any fees or commissions charged by distributors or intermediaries. So, a manufacturer must be able to demonstrate that their product, plus any associated charges, be it commissions, be it fees that advisors might levy, ultimately provide fair value for the target market. And that includes making consideration of the overall charges that the customer might pay as part of that distribution strategy. In turn, the distributor needs to obtain information from the manufacturer, such as a high-level summary of the benefits to the target market, information on overall prices or fees and confirmation that the manufacturer considers that the total benefits are proportionate to the total cost.

And then once they've got that confirmation from the manufacturer, the distributor itself needs to ensure that its own fees, its commissions, or charges are fair value for the additional distribution services that that distributor is providing. So, in that way, you ensure that all parts of the supply chain are assessing the fair value of their product and making commensurate changes to ensure that the customer receives value, fair value in the end for the overall price that it pays.

OI: And how will the FCA monitor whether products are fairly priced and good value?

ES: So, in the implementation period - there's an implementation period that lasts till July of 2023 for new and existing products - and then there's an additional year to July ’24 for back-book or closed products. In that implementation period, firms need to undertake the value assessments of all their products using the data and evidence that I talked about and satisfy themselves either that they are fair value or if not, then make necessary changes to the price or structure of the benefits to ensure that customers do receive that fair value. So, firms will need to use an appropriate framework for assessing value, and I've mentioned the three elements of the framework that we think are important to that assessment. And having done that, having used that framework, supply and use the evidence that they've got, they need to make the changes that they deem necessary to ensure that fair value, that consumers are receiving fair value within that implementation period. And then once the Duty has come into force, we are planning a programme of supervisory and if necessary, enforcement work to ensure that firms have implemented the Duty correctly. So, we will be particularly interested in areas like, say, back-book charging or exit fees or low value products that have perennially been under the FCA’s microscope. We'll be looking to ensure that firms have made the changes that we think are necessary to bring those products into line with fair value, a fair value framework. So, that's what we're expecting firms to do.

OI: Finally, what are the implications for firms who don't meet the criteria of the fair value outcome?

ES: Well, as I say, we are developing a programme of supervisory and if necessary, enforcement work. So, if, you know, firms aren't conducting a proper assessment of the price and value of their products, if they haven't used appropriate evidence to demonstrate that it's fair value, if they haven't thought about different cohorts of customers and the sort of value that they're receiving; I think firms can expect us to take action, including enforcement action against them once they once the Duty is in force.

OI: Thank you for your time today, Ed. You can find more information on the Consumer Duty on our website. And the final non-handbook guidance for firms contains lots of examples of good and poor practice in relation to the price and value outcome of the Consumer Duty. Stay tuned for more dedicated podcasts covering different areas of the Duty. I'm Ozge Ibrahim, thank you for listening and join us again soon on the Inside FCA Podcast.