Fair Pricing in Financial Services

Discussion Paper
DP18/9

October 2018

How to respond

We are asking for comments on this Discussion Paper by 31 January 2019.

You can send them to us using the form on our website at: www.fca.org.uk/dp18-09-response-form

Or in writing to:

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1 Overview

Introduction

1.1 We are launching a public debate on the fairness of certain pricing practices in financial services. The judgement of when price discrimination is fair is not always straightforward. We recently published a framework on how we might approach this. But this is a complex issue. We want to take into account stakeholder views on our approach so that we are confident that whatever action we take on difficult cases is in the public interest. That is why we are publishing this Discussion Paper and launching a public debate on the topic.

1.2 This discussion paper is published alongside the findings of our work on pricing practices in the retail general insurance sector (Diagnostic Work), and the terms of reference for a Market Study on general insurance pricing practices. The market study will build on the findings of the diagnostic work. It will examine whether pricing practices for home and motor insurance lead to consumer harm and, if so, who is affected and what action, if any, we need to take to address the harm. The feedback to this discussion paper will inform the market study.

1.3 We are publishing this discussion paper because, in line with Our Mission, we think it is important to be transparent about our approach to regulation. We want to take into account stakeholder views as we decide whether and how to act in the markets we regulate.

1.4 We are focusing the debate on the following pricing practices:

- firms charging different prices to different consumers based solely on differences in consumers' price sensitivity (also known as 'price discrimination')
- firms charging existing customers higher prices than new customers (sometimes referred to as 'loyalty pricing' or 'inertia pricing')

1.5 We have concerns that these pricing practices can potentially disadvantage some consumers significantly, in particular the most vulnerable and least resilient consumers.

1.6 These pricing practices have also attracted considerable public interest. For instance, Which? and Citizens Advice have called for action on firms charging high premiums to their longstanding customers. Citizens Advice has also issued a super-complaint to the CMA about excessive prices for disengaged consumers in cash savings, mortgage, home insurance, broadband and mobile markets. The Financial Ombudsman Service Service has recently published a report on complaints it has ruled on where consumers have paid higher insurance premia. The Government's Consumer Green Paper also touched on this issue by saying that they 'believe there should be a new approach by Government and regulators to safeguard consumers who, for whatever reason, remain loyal to their existing supplier so that they are not materially disadvantaged. Exploitation of these customers by charging them significantly higher prices and providing poorer service is a sign of a market that is not working well and should be tackled vigorously'. Wider concerns about fairness of pricing practices have been expressed by other institutions too, such as Money and Mental Health Policy Institute's policy note on travel insurance and mental health issues related to high prices, policy exclusions and poor response to disclosure of mental health problems.

1.7 Where a firm's pricing practices result in poor outcomes for the customer, it may be clear that the firm is not treating its customers fairly or not meeting the customer's information needs in a way which is clear, fair and not misleading. In such cases we may decide to take up these issues with the firm, under our current rules. But in other cases of price discrimination, it may be more difficult to identify and assess any related harm, the groups of consumers who may be affected, and to assess unfairness. For example, there may be groups of consumers who benefit from certain pricing practices, such as those who are willing to shop around frequently. This may include consumers who are vulnerable.

Who does this document affect?

1.8 We are interested in collecting views on the issues in this discussion paper from across society, from consumer groups and from retail financial services firms.

Is this of interest to consumers?

1.9 The debate is about the prices that consumers pay for many financial services products so this paper should be of interest to them. We expect consumers will have a range of different views, depending on their own views on fairness and their experiences of these pricing practices.

Context

1.10 Parliament has given us a single strategic objective: to ensure that relevant markets function well. As part of this, when exercising our general functions, we must advance one or more of our three operational objectives:

- to secure an appropriate degree of protection for consumers
- to protect and enhance the integrity of the UK financial system
- to promote effective competition in consumers' interests

1.11 Parliament has also given us powers to enforce EU and UK competition Law.

1.12 Our Mission 2017 explains our approach to regulating financial markets in line with these objectives and powers. It describes how and why we prioritise, protect and intervene in financial markets in the public interest.

1.13 Building on Our Mission, we recently published Our Approach to Consumers. This sets out our vision for well-functioning markets for consumers, underlining our view that in markets that are working well, consumers are treated fairly. This means that the needs of all consumers, including vulnerable consumers, are considered.

Deciding what is fair

1.14 The prices that firms set for their products, and the way they set them, play a fundamental role in the how well markets function and how fairly consumers are treated. So it is important that we consider the fairness of pricing in markets we regulate. It is also important to consider the harm that may be caused by particular types of pricing practice.

1.15 When supervising the firms we regulate, we assess firms' behaviours against a fairness standard.[1] In some instances where practices are more clearly unfair than others then we could act. For example, we may take action where we find firms have not treated customers fairly in their pricing practices and/or not been clear, fair and not misleading when communicating to consumers about prices. Our competition objective and powers also provide a basis to deal with cases of anticompetitive behavior that may lead to high prices.[2]

When some benefit at the expense of others

1.16 However, fairness issues can often be more complicated and the right course of action for us may be less clear. This is likely to be the case when there are judgements about welfare trade-offs between different groups in society and how the firm approach these. For example, should we act to improve the market outcomes for some people if it will probably lead to worse market outcomes for others? And while some issues may legitimately fall to us to consider, there may also be issues of social policy that fall to Government.

1.17 An example of a practice that can raise such issues is 'price discrimination'. This is the practice of charging different prices to different customers for the same product, simply because some are less sensitive to prices than others.

1.18 Price discrimination is a common practice in many markets. Classic examples include student discounts for cinema tickets, variable airline ticket prices and coffee shop loyalty cards. Most people accept these examples as a normal part of the market and consider they are legitimate commercial pricing practices. Sometimes they can even be seen as improving fairness, since they can open access to consumers who may otherwise not be able to afford the product.

1.19 Equally, there are forms of price discrimination that most people think of as unfair. For example, the Equality Act 2010 makes it illegal to discriminate on the basis of ethnicity, gender or a number of protected characteristics.[3]

1.20 Price discrimination is not necessarily an unfair practice in every case. Whether the particular form of price discrimination a firm uses is fair or unfair can depend very much on the specific circumstances. We have therefore developed a framework for assessing fairness in different cases of price discrimination.

When longstanding customers lose out

1.21 One particular form of price discrimination that has attracted attention is where firms charge existing customers more for a product than they charge new customers, but

1 The Conduct of Business sourcebook requires firms to "…act honestly, fairly and professionally in accordance with the best interests of its client…", see COBS 2.1.1R.

2 Agreements between firms on how they set prices are prohibited under UK Competition law. Similarly, firms' profits significantly above the level commensurate with the risk they take tend to be an indicator of poor competition, and where we find evidence of this we may introduce remedies to address the issue.

3 The Act prohibits financial services providers from price discrimination based on some of these characteristics such as gender. It may be permissible to differentiate prices based on other characteristics such as age or disability in prescribed circumstances.

where the cost of providing the service is the same. While this practice is often called 'loyalty pricing', it contradicts most people's understanding of what 'loyalty' involves. Under this practice, consumers are not rewarded for staying with their provider, but penalised with higher prices over time. We describe this as 'inertia pricing'. By inertia, we mean where consumers do not shop around or switch provider regularly, for a broader set of reasons, including loyalty.

1.22 We have previously found evidence of inertia pricing in the Cash Savings and Mortgages markets. Our Diagnostic Work also shows that some consumers who stay with their provider for a long time may pay significantly more than newer consumers, due to multiple price increases at each renewal. We have previously taken some action to address this in general insurance, by introducing rules to require firms to disclose last year's premium on renewal notices. This aimed to encourage some consumers to check their insurance cover and shop around for the best deal at each renewal.

What is covered in this paper

1.23 The rest of the paper is structured as follows:

- Chapter 2 - Explains how, as a regulator, we have promoted fair pricing.
- Chapter 3 - Focuses on price discrimination and explains why it is not always straightforward when assessing fairness. It outlines what price discrimination is, how it occurs in financial services, and gives a case-by-case framework for assessing the fairness, and associated harm.
- Chapter 4 - Looks at a particular form of price discrimination where firms charge their existing customers more than new customers - inertia pricing. Drawing on the framework presented in Chapter 3, it considers the fairness issues associated with inertia pricing in different markets.
- Chapter 5 – Concludes by considering what remedies we might introduce if we thought it was appropriate to take action in the market.

Equality and diversity considerations

1.24 We have considered the equality and diversity issues that may arise from the proposals in this Discussion Paper. Overall, we do not consider that the discussion in this paper 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.

1.25 The topics we discuss in this paper aim to take forward the debate on fair pricing, which may affect groups with protected characteristics (eg if there is a significant overlap between vulnerable consumers and age or disabilities).

1.26 We welcome any input to this Discussion Paper on these matters and we will continue to consider the equality and diversity implications as part of the next steps outlined below.

Next steps

1.27 Throughout this document we ask questions on the issues that we are most interested in hearing about. We are inviting you to participate in the discussion by sharing your views on these issues. To make it easier, we have included a list of all the questions we ask in the document in Annex. We will be open for discussion in November and December and will be hosting roundtable events with key stakeholders, including consumer bodies and parliamentarians, in January.

1.28 We invite you to send us your comments and any accompanying evidence by **31 January 2019**. You can do this through the online response form on our website or by writing to us at the address on page 2.

1.29 We will consider your feedback and then plan to publish a Feedback Statement.

2 Fair pricing and financial regulation

Overview of the chapter

- In this chapter we set out what rules, guidance, processes and other tools we use to encourage fair pricing in the markets we regulate.
- We explain that a lot of our work on fair pricing is driven by our consumer protection objective. In particular, our work on fair pricing typically focuses on how firms behave when dealing with consumers, whether consumers are treated fairly and if firms communicate with them in a way that is clear, fair and not misleading.
- We may also have concerns about the fairness of the pricing models that firms are using. If this is because markets are not working well, then our competition objective and powers could give us a basis to act. We may also consider whether that firms' use of particular pricing models creates a consumer protection issue.
- We explain why we are launching this public debate.

Promoting fair pricing practices in the way we regulate

2.1 Under the Financial Services and Markets Act 2000 (FSMA), when discharging our general functions[4] we must, so far as we reasonably can, act in a way which is compatible with our strategic objective – to ensure that the relevant markets function well – and which advances one or more of its 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

2.2 None of these objectives explicitly mention fairness. But our commitment to fairness is reflected in our principles for business, in Our Mission – which sets out our approach to regulation – and the related 'Approach to' documents that explain our approach in more detail. In Our Approach to Consumers, we describe our vision for well-functioning markets for consumers and explain that in markets that are working, well consumers are treated fairly. This requires that we take the needs of all consumers, including vulnerable consumers, into account. But we also need to have regard to the general principle of regulation that consumers should take responsibility for their decisions.[5]

2.3 In our Approach to Consumers, we commit to keeping our powers and tools and how we use them under review, to ensure we are working effectively to protect consumers.

4 For example, making rules, issuing general guidance or determining the general policy and principles by reference to which the FCA will perform particular functions, see S.1B(6) FSMA 2 012.

5 See S.1C(2)(d) and s.3B(1)(d) FSMA 2012.

As part of this commitment, we have also published a separate Discussion Paper on a duty of care and potential alternative approaches, in recognition of the wider debate on this issue. We launched the Discussion Paper on Duty of Care to understand more fully what outcomes a New Duty might be able to achieve and what a New Duty for firms in financial services might do to enhance behaviour in the financial services market more broadly.

Looking at how firms behave when dealing with consumers

2.4 We promote fairness in firms' pricing practices by setting out what we expect from firms in the way they interact with their customers. We take action where we see that firms are not meeting these expectations. We do this in a number of ways, which we outline below.

Our principles for business

2.5 Our principles for business are high level statements of the core obligations that firms we regulate must meet. These principles provide an overarching framework to govern these firms' actions.

2.6 These principles are directly about fairness. For example, Principle 6 requires firms to pay due regard to the interests of their consumers and to treat them fairly. Principle 7 requires firms to pay due regard to the information needs of their customers, and give them information in a way that is clear, fair and not misleading.

2.7 We have acted in cases we found that firms were not complying with these principles. For example:

- We used Principles 6 and 7 in December 2017, when we fined a big insurance broker £4 million for misleading its customers.
- Our review of the treatment of longstanding customers in the life insurance sector found that some firms weren't complying with Principle 6. We took enforcement action and issued guidance to firms to ensure that they are clear about how we expect them to treat their longstanding customers.

Rules and guidance

2.8 We can make rules which advance one or more of our operational objectives and the firms we regulate must abide by them. We make both high-level rules such as the Principles for Business and more specific ones. All these rules are in the FCA Handbook.

2.9 Some of our rules are aimed at firms' pricing practices. For example, we introduced rules for general insurers to make the information they give consumers more transparent and so encourage them to engage more at renewal in general insurance markets.

2.10 We also issue guidance to firms, providing information and advice on what we expect from them. For example, Principle 6 (treating customers fairly) is supported by 6 customer outcomes that support it. We have given firms examples of good and bad practice, a guide to help them develop management information and measured their progress on this Principle and its outcomes.

Consumer protection legislation

2.11 The FCA has responsibilities and powers to consider complaints and challenge unfair terms in consumer contracts. When we consider a term to be unfair, by the fairness assessment under the Consumer Rights Act 2015 (CRA) or the Unfair Terms in

Consumer Contract Regulations 1999 (UTCCRs), we can take injunctive action against a firm to address the potential issue.[6, 7] However, this fairness assessment is subject to certain exclusions.[8] Where a term fails the fairness test it will not be binding on the consumer and the consumer may rely on the fairness test in taking action in the courts or making complaints to firms and referring them to the Financial Ombudsman Service.

2.12 In addition to CRA, other consumer protection legislation exists, such as the Consumer Protection from Unfair Trading Regulations 2008 and the Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013 as well as specific pricing regulation in certain areas such as the Consumer Rights (Payment Surcharges) Regulations 2012.

Looking at the fairness of firms' pricing models

2.13 As well as making sure firms behave appropriately when dealing with customers, we sometimes have concerns about the fairness of their pricing practices, based on the effects on both competition and consumers.

Improving competition

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

2.15 If consumers feel they have little choice but to pay high prices, this may be a sign that competition is not working well. In these cases we can take enforcement action against breaches in competition law or introduce remedies under our competition objective. For example, we recently published a Cash Savings Discussion Paper where we discuss possible remedies to tackle price discrimination in the easy access cash savings market.

Protecting consumers

2.16 We sometimes see firms using practices that may be considered legitimate commercial practice but which raise questions about their appropriateness and fairness because of the way they are used. In these cases, the judgement of fairness may be more complex.

2.17 One particular theme we find among more complex cases is where there are different outcomes for different customers of the same firm. Here, improving outcomes for one group may only be possible by making outcomes less good for another group. These types of questions can sometimes involve matters of social policy, which means it might be more appropriate for Parliament to handle them. An example of this is the Flood Re scheme which uses a levy on home insurance firms to subsidise the costs of providing flood cover for some consumers. But there may also be questions which are legitimately for us to consider under one or more of our objectives.

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6 Our regulatory guide in the FCA Handbook, The Unfair Contract Terms Regulatory Guide (UNFCOG), explains our policy on how we will use our powers under the UTCCRs and the CRA.

7 Note that the Competition and Markets Authority (CMA) has a leadership role in the enforcement and compliance with unfair terms legislation. However, under its Memorandum of Understanding with the CMA, the FCA will consider the fairness of terms under the CRA in consumer contracts issued by the firms it regulates and their appointed representatives. It should be noted that the Memorandum of Understanding does not stop the CMA considering the fairness of a term issued by an FCA-regulated firm and taking enforcement action against it. There are also other bodies with enforcement powers other than the CMA and FCA.

8 These exclusions are described in S.64, CRA and reg 6(2) UTCCRs. Note however that unilateral variation terms in consumer contracts will be subject to a fairness assessment under the CRA 2015/ UTCCRs, regardless of whether they relate to the price payable under a contract. See also our recently published consultation on unfair variation terms – GC18/2: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015, paragraph 33.

Taking stakeholders' views into account

2.18 When tackling the more difficult questions of fairness it is important that we carefully consider how best to proceed. In line with our Mission, we want to make sure we are clear and transparent about our approach. We think it is appropriate to engage with stakeholders so we are confident that any action we take considers public concerns and the need for public confidence in financial services markets. That is why we are publishing this Discussion Paper and launching a public debate on the topic.

3 Price discrimination in financial services

Overview of the chapter

- In this chapter we describe 'price discrimination' and discuss what factors might decide whether a particular instance of price discrimination is fair and what the potential harms may be.
- We explain what makes price discrimination possible, how firms make it work in practice, and why it raises questions about fairness.
- We explain that price discrimination is not of necessity unfair and that it is sensible to consider the fairness of the practice on a case-by-case basis.
- We present our framework for assessing the fairness, based on potential harm of a given instance of price discrimination. We present this in a broad context of financial services, without referring to any specific example, as each instance is specific.

What is price discrimination

3.1 'Price discrimination' is where firms charge different prices to different customers, who cost the same to serve, based on differences in the customers' price sensitivity. Under price discrimination, customers who are less price sensitive to a product pay more for it than those who are more price sensitive.

3.2 This contrasts with the situation where all customers who cost the same to serve pay the same price for the product (sometimes called 'uniform pricing'). It also contrasts with the situation when one customer pays more than another because they cost more to serve, or because the quality of the products is different (sometimes called 'cost-based pricing').

3.3 Price discrimination is a common practice in many markets. Everyday examples include student discounts for cinema tickets, different airline ticket prices and coffee shop loyalty cards. Most people see these examples as normal features of the market. They may even see them as increasing fairness in the market, because in some cases price discrimination means a greater number of consumers can access the product.

3.4 The fact that some customers pay more than others, even though the cost of providing the product to them is the same, does not necessarily make price discrimination unfair. People's reactions to the fairness of it tend to vary. For example, student discounts are often seen as a fair pricing practice, while higher prices for longstanding customers may be seen as unfair.[9] When the customers who have to pay more clearly show signs of potential vulnerability,[10] price discrimination may seem particularly unfair.

9 For instance, the Discussion Paper 18/06 explores fairness considerations in the cash savings market where longstanding customers receive lower interest rates on their accounts than the newer customers.

10 For definition of vulnerability, see box "Indicators of potential vulnerability" in Chapter 4.

3.5 It can be difficult to spot price discrimination in financial services because the way products are priced can be complex and the costs of serving a customer can vary from person to person. Examples of this include general insurance – where the cost of insuring depends on the customer's specific details - and credit markets – where the customer's credit risk may differ from person to person. For example, responses to our recent Call for Input on Access to Insurance suggest there is a lack of transparency around how travel insurance premiums are calculated and the risk factors that drive quotes. This makes it difficult for consumers to understand whether the quote is a true reflection of their condition. This feedback was received in relation to those living with cancer, but also those with other long term medical conditions.

How price discrimination works

3.6 There are many factors that affect why some consumers can have lower price sensitivity for a product than others, including:

- **Intrinsic preferences**: Some consumers may be naturally more attracted to the specific features of a product than others.
- **Economic factors**: Some consumers may have more disposable income and fewer budget constraints than others.
- **Cost of search and switching**: Some customers may face different costs of shopping around, or be less likely to shop around, for example, if they do not have internet access or have limited time. Even when they have found a better deal, consumers may find differences in the costs to switch to the different product, for example, having to pay exit or cancellation fees.
- **Limited choice**: Some consumers may be offered fewer alternatives to a product than others, for example, if they have a low credit score.
- **Behavioural biases and context**: A person's choices are often inconsistent with each other, over time or with their stated aims. This could be due to behavioural biases, such as putting off taking action or being unrealistic about their own future behaviour. It could also be due to the context, such as someone going through a highly-stressed period. These biases and context affect how price sensitive consumers are.

3.7 This list gives just some of the factors that affect price sensitivity. Some of them are harder to see than others. For instance, intrinsic preferences are private information and not directly observable.

To price discriminate, firms need to be able to

1 identify and group consumers according to their price sensitivity and

2 set different prices for each of these groups to sell at the price it wants from each of them.

In the example of student discounts for cinema tickets, firms do this by

1 identifying that students have a higher price sensitivity and

2 offering a discount only if the customer can present a valid student ID, so that only students can get the discount and they are unable to re-sell the tickets to non-students.

The effects of price discrimination

3.8 Price discrimination in a market can have a range of effects. These include:

- **Price distribution**: Some customers pay more for a product than they would have done, while others may pay less.
- **Product access**: Some customers who previously found the product too expensive to buy, are now able to buy it at an affordable price.

- **Competition**: Depending on the specific market, there may be either positive or negative effects on competition, which may in turn have implications for overall price levels and quality of service.

3.9 Price discrimination leads to some consumers paying more than others. Theoretically, there can be cases that produce only higher prices, where no particular group 'wins' by paying a lower price than it would under uniform pricing but some groups still pay significantly more than others. There could also be cases with only winners. Here, no consumer pays more than they would under uniform pricing but some consumer can buy the product at a lower price (eg economies of scale might lead to such a scenario).

3.10 So when firms can price discriminate, the outcomes for consumers depend on specific market factors, such as the level of competition in the market and how much a product costs to produce. As a result, the distributive effects of price discrimination (who pays more and who pays less) can vary from case to case. These effects can sometimes be more concerning than others, for example when those with low incomes pay significantly more than other consumers.

What determines whether price discrimination is fair or unfair

3.11 Given that the way price discrimination works and its effects can vary, what factors should we consider in assessing the fairness and harm of price discrimination?

3.12 We recently published a research note that sets out a framework of six questions that we consider when weighing up fairness concerns, which we show below in Figure 1:

Figure 1: 6 evidential 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

3.13 This framework gives us a consistent structure to guide us through these complex issues. For each question, we consider whether there is potential concern. When we take the answers together, we can build an overall view of how fair or unfair a particular case of price discrimination may be. While the answers to each question may not all point toward the same conclusion, gathering evidence on them should give an indication of whether we might have a greater concern about a particular case of price discrimination.

3.14 The next chapter considers these questions on a narrower set of price discrimination cases of inertia pricing.

Questions for consultation

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?**

4 How firms set prices for existing customers

Overview of the chapter

- In this chapter we focus on a specific form of price discrimination where firms charge their existing customers higher prices than new customers – inertia pricing.
- We use several examples of inertia pricing in financial services to show some of the similarities and differences between different types of inertia pricing.
- We illustrate how we can use our fairness framework, shown in the previous chapter, to discuss the fairness of inertia pricing. In particular, we set out two important issues involved in assessing fairness in inertia pricing and the implications for competition:
  - Some consumers are made worse off because of inertia pricing, but others are better off. Consumers who show traits of potential vulnerability may belong to either group.
  - An assessment of fairness should take into account the specific circumstances of the pricing practice. Interventions could lead to worse distributive effects of inertia pricing, as well as higher average prices.

Existing customers often get a worse deal than new customers

4.1 A form of price discrimination that is controversial in both financial services and in other regulated markets is the practice of firms charging existing customers more for a product than they charge new customers. Sometimes, the longer the customer stays with the product, the more they are charged. Or, in the example of cash savings, the longer the customer stays, the lower the savings interest rate they enjoy. This is known as inertia pricing. By inertia, we mean where consumers do not shop around or switch provider regularly, for a broad set of reasons. The practice is also called 'loyalty penalty', for example in the recent Citizens Advice super-complaint to the CMA in the context of mobile, broadband, home insurance, mortgage, and savings markets.

4.2 We give some everyday examples of inertia pricing below:

- A broadband provider offers a deal on a one-year contract for new customers, but the price increases if the customer decides to renew the contract at the end of the promotional period.
- An energy provider offers time-limited deals to new customers but automatically moves them to more expensive 'standard variable tariffs' when the promotional period is over.[11]

11 Ofgem are currently consulting on the design of a default tariff price cap, which is expected to be in place by the end of 2018.

- A financial institution offers a high interest rate on new savings but gradually lowers this rate over time,[12] meaning that consumers who stay with the same bank for the longest time receive the lowest rates.

4.3 We have previously raised our concerns about the impact of inertia pricing for different consumer groups. In our Business Plan 2018/19 we identified the treatment of existing customers as one of our cross-sector priorities, explaining that 'if competition is working well in a market, it should not overly disadvantage existing customers over new customers'.

4.4 We have also gathered evidence as part of our Cash Savings Market Study on the extent to which inertia pricing is present in the easy access cash savings market. And we have expressed concerns about the fairness of outcomes in that market. The Market Study on general insurance pricing practices will explore this subject more closely and extensively in a retail general insurance context."

4.5 Analysing the fairness of inertia pricing is complex because some consumers lose while others may benefit. Vulnerable consumers may fall into both of these groups. The next sections of this chapter illustrate how we can apply our framework (Figure 1) to assess concerns about fairness of inertia pricing. We use specific examples as the focus for our discussion but our questions apply to financial services markets more broadly.

Where we see examples of inertia pricing in financial services

4.6 Inertia pricing can take different forms. Annex 2 gives examples of where we have seen it in our work, and from which we identify three common forms of inertia pricing. The list is non-exhaustive and other variations may exist.

- **Bonus rates or introductory offers which expire after a certain amount of time**: Here, consumers are often told the non-promotional price (eg the reversion rate for mortgages) at the outset of the contract. There are also usually regulatory safeguards against unjustified rate changes, such as for mortgages reversion rates.

- **Product replacement tactics**: When prices are reducing, providers can stop marketing old products or services and introduce functionally equivalent ones. While these new ones are sold at cheaper prices to new customers, longstanding customers are still bound to the 'retired' product. The cash savings market is one example.

- **Price-walking**: This involves firms setting below-cost introductory prices which later increase with renewals. We have found evidence that this may be happening in the home insurance market, for example.

12 Firms which rely on unilateral variation clauses to reduce an interest rate in such circumstances must comply with any applicable legal requirements and taking into account any relevant FCA guidance published including our consultation (once finalized) GC18/2: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015.

How the framework for assessing fairness works in practice

4.7 The six evidential questions in Chapter 3 provide a framework for examining the fairness of charging higher prices to longstanding customers. We now apply the framework to inertia pricing to highlight some of the complexities involved in this assessment.

Who benefits and who loses out

4.8 We need to understand who benefits and who loses out from inertia pricing. In particular, we want to know whether the consumers who are most affected may be vulnerable. For instance, in the cash savings market, our Financial Lives Survey 2017 found that consumers who have had their savings accounts for a long time are more likely to show characteristics of potential vulnerability. In 2018 we launched a discussion to understand the impact of providers' pricing strategies on vulnerable consumers in the cash savings market.

4.9 At the same time, some consumers may stand to benefit from inertia pricing if they are prepared to look for better deals, either by negotiating with their current provider or by switching to a different provider. When assessing the fairness of inertia pricing we also want to understand who these consumers are and whether there are vulnerable consumers who benefit.

Indicators of potential vulnerability
Our Approach to Consumers was published in July 2018. In this paper we clarify our definition of vulnerable consumer as someone 'who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care'. It also confirms our approach to understanding vulnerability, which is based on our analysis of four drivers of potential vulnerability:

Our Approach to Consumers clarifies our definition of vulnerable consumer as someone 'who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care'. It also confirms our approach to understanding vulnerability, which is based on our analysis of four drivers:

- Health - health conditions or illnesses that affect ability to carry out day to day tasks
- Resilience – low ability to withstand financial or emotional shocks
- Life events – major life events such as bereavement or relationship breakdown
- Capability – low knowledge of financial matters or low confidence in managing money

These categories are not definitive or exhaustive but aim to help us and firms to identify and understand both the permanent and temporary situations that can indicate potential vulnerability in consumers of financial services.

What are the price differentials and how many people are affected

4.10 When assessing the fairness of inertia pricing, we also need to understand the price paid by each group of consumers and the number of consumers in each group. In doing so, we recognise that different prices might reflect different costs of serving different customers.

4.11 Our diagnostic work found that margins of home insurance products appear to increase with tenure, at least in the first few years. This suggests:

- Consumers may pay more the longer they stay with a provider.
- Firms compete to attract new customers with low prices. There may be opportunities for consumers who frequently shop around to get good deals. Others who do not may end up paying more over time.

4.12 So it is important to consider the overall experience the customer has with a firm over the time they stay with it. A single snapshot in time does not reveal the full picture.

What is the size of the pool of people harmed

4.13 Looking at the price differentials helps us understand the impact on individual consumers. To identify the overall scale of harm, we need to understand how many people pay higher prices as a result of inertia pricing.

Why consumers do not switch to better deals

4.14 Where consumers do not negotiate or switch to better deals, they may pay higher prices. For instance, in the mortgage market, over three quarters of consumers switch to a new mortgage deal within 6 months of moving onto a reversion rate but around 23% do not. In the cash savings market we found that 80% of easy access accounts have not been switched in the last three years.

4.15 The reasons for inertia vary but might include:

- consumers expect that maintaining a longstanding relationship would pay off, eg in home insurance they may believe their provider will settle their claims more readily
- consumers may assume that they are getting the best possible deal, eg because they think their 'loyalty' must be rewarded
- consumers are induced not to act, eg when a price increase (home insurance) or rate reduction (cash saving account) is presented in a way that suggests action is not necessary
- consumers understand that longstanding customers tend to pay more, but:
  - they may decide not to act, for example, because they believe that the costs and time of shopping around outweigh potential gains
  - they may fail to act, for example, forget to shop around before automatic renewal or

  - they have no real alternative because the market has changed over time, for example, where a change in risk factors significantly reduces the number of insurers willing to cover these risks.[13]

4.16 There are many possible reasons for not switching, but we think it is helpful to group them according to two factors:

- A consumer's level of awareness of the pricing model: Do consumers know the consequences of inertia? We are more concerned when consumers do not know.

- A consumer's intention to engage with the market: Is inertia a conscious choice or is it the result of behavioural biases, personal circumstances related to potential vulnerability or other obstacles? We are more concerned when inertia is not a conscious choice.

13 Another example is "mortgage prisoners". Changes may relate to their own circumstances – such as job loss, or market conditions – such as changes in lender's/provider's appetite for the type of risk presented.

4.17 Figure 2 presents some examples of how these factors can combine in the retail home insurance market.

Figure 2: Why consumers do not switch providers after price rises: segmenting customers by awareness and intention

Intention to engage with the market	Consumer knows the consequences of not acting	Consumer does not know the consequences of not acting
Consumer **decides** not to act	**(G1)** • consumers are happy with their current provider and do not want to risk getting a worse experience from an alternative provider • consumers understand the price differential and think it is too small to justify the trouble of shopping around for a better deal	**(G4)** • consumers assume they already have a good deal given their circumstances (risk and preferences) because they think their 'loyalty' must be rewarded • consumers see the price increase but assume it's because of a reassessment of their risk
Consumer **fails** to act	**(G2)** • consumers sign up to a low introductory discount which is clearly transparent with the intention of switching after a year, but do not because they forget or they keep putting off the decision • consumers become disengaged due to temporary situations, such as bereavement or family events happening at renewal time	**(G5)** • less able consumers do not feel confident in comparing and choosing products • vulnerable consumers are totally disengaged from the market, and may not even realise they are paying for an insurance product or paying such a high price for it
Consumer **cannot** act	**(G3)** • consumers have limited options, eg due to special risk circumstances, are less able to switch to a new provider and more likely to be price-walked unless they take the high-risk choice to opt out of home insurance	**(G6)** • Similar to G5

Awareness of the pricing model

* Coding (G1, G2, ...) is used to back-reference each of the six groups in subsequent examples.

4.18 How much we should be concerned about the fairness of inertia pricing may depend on the reasons why consumers display inertia. For example:

- our concerns might be less if consumers knew about the consequences of inertia, and were taking a rational decision not to act (G1)
- our concerns would be greater if consumers knew about the consequence of inertia but failed to engage with the market (G2) or were unable to switch (G3)
- our concerns would be greater if consumers did not know the consequences of inertia and decided to renew at the higher price for reasons not based on facts or that make them more likely to be misled (G4)
- we might be especially concerned if consumers did not know the consequences of inertia and appear to be totally disengaged (G5 and G6).

4.19 Identifying the causes of inertia will help us determine not only the size of the harm but also which of our tools might best tackle it, if we took action. We discuss this further in the next chapter.

Fairness and our approach to consumers
When we assess fairness, it is important we consider both how aware consumers are that new customers tend to get lower prices and why they do not act when their prices go up. This is consistent with Our Approach to Consumers where we 'expect consumers to take reasonable responsibility for their choices and decisions'.

However, 'we expect firms to frame decisions for customers based on real world consumer behaviours and not to exploit biases. We also expect them to exercise extra care where consumers may be vulnerable.'

For instance, some consumers may expect loyalty to be rewarded because they are put off by the burden of shopping around each year and of doing so for many different products. We recognise that consumers may decide to stay engaged in some – but not all – markets. Indeed, markets may work well even if only a minority of consumers actively shop around.

What is the nature of the product and is it essential

4.20 This question is important because it may affect how willing consumers are to engage with the market. Where consumers are less engaged, they may be more susceptible to inertia pricing. For example, people sometimes buy insurance products because they feel it would be the sensible thing to do (eg for peace of mind), and sometimes just because they must (eg motor insurance is required to drive a car and buildings insurance to have a mortgage). Additionally, consumers' access to insurance can be important for financial resilience, for instance in the case of home insurance. As a result, insurance is a product that is often not optional, it can be complex, and requires engagement not just at point of sale but recurrently at each renewal.

How firms' use of data affects the fairness of inertia pricing

4.21 Consumers respond differently to price rises at renewal. Some decide the renewal price does not represent a good deal and switch, others decide it is not a good deal but do not want to spend time and effort shopping around and switching. Others may not even realise their prices have gone up or that better deals are available.

4.22 Information about individual consumers' likely responses can help firms decide what prices to offer them – both new customers and those renewing. For example, there are incentives to offer good deals to attract a consumer they believe is unlikely to act on subsequent price rises and therefore become profitable in future.[14]

4.23 For this reason, within legal boundaries, firms may want to vary both the initial offers and the renewal prices between customers, based on their assessment of their potential inertia. This assessment may be done using data about a consumer and their current characteristics or past behaviours. The use of consumers' personal data is subject to broader legal requirements under data protection law. Discrimination based on consumers displaying certain protected characteristics is also restricted by the Equality Act 2010. In this discussion, we are interested in data that can be used for price discrimination within legal boundaries but which may not necessarily be perceived as fair.

Big data, competition and fairness
We made a Call for Input to give us a better understanding of how retail general insurance firms are using data and analytics, and the potential impact on both consumer outcomes and competition. Our focus was on private motor and home (buildings and contents) insurance.

We found that firms' growing use of data is not currently limiting effective competition in motor and home insurance, although we recognise issues may evolve in the future. We also found that the increasing amount of data from a wider range of sources, alongside sophisticated analytical tools, might lead to factors other than risk and cost in pricing becoming more widespread. In the feedback statement we raised specific concerns if:

i. Firms use these practices to earn a higher profit margin from consumers who tend to be loyal, vulnerable or older, or

ii. Pricing for reasons other than cost or risk limits effective competition, for example by increasing barriers to other firms entering the market

14 There exist other options firms can pursue to cover potential losses when they expect consumers to switch early, for instance hidden charges or sale of add-ons. This may be relevant to an assessment of what might happen if firms stopped offering personalized prices based on inertia.

How the nature of competition in the market affects the fairness debate

4.24 When we assess the fairness of inertia pricing, we need to understand the competitive dynamics that lead to different market outcomes, and in particular the role that inertia pricing plays in the way firms compete with each other. Important issues include:

- Whether inertia pricing creates barriers to new firms entering and expanding in a market.
- If firms were unable to raise prices for existing customers, they may increase prices for new customers or for other services, or provide a poorer quality of service.
- If another pricing model, such as uniform pricing, became the predominant model, this might lead to changes to competition that result in greater harm to more consumers.

4.25 It is important not to overlook the potentially positive role that some forms of this practice can play in supporting competition and innovation. For example, firms that are trying to enter a market may see introductory offers and price discounts as useful ways to attract customers and build the sort of market share that will allow them to compete effectively with existing providers. Such incentives are likely to be particularly important in markets where consumer inertia is common. Where the practice does support greater competition, this can lead to greater choice for consumers, lower average prices and greater levels of innovation.

4.26 The issues outlined here are important for assessing fairness. For example, if we conclude that inertia pricing is unfair because of how it affects certain consumer groups, then we would want to understand what the outcome for those groups could be under an alternative model, as well as wider implications for other consumers.

Questions for consultation

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.

5 How might we address the harm

Overview of the chapter

- In this chapter we explore some of the remedies that can be used to reduce or prevent negative effects on consumers caused by inertia pricing.
- We do not make suggestions relating to specific action in any market. Instead, we give a high-level discussion on our broad options, using examples of relevant action we have taken.
- Ultimately our decision to intervene, and how we choose to do so, will depend on the specific circumstances in the market, and what is proportionate. The CMA is currently conducting a cross-sector investigation into the "loyalty penalty" and the outcome of that investigation may also influence how we proceed.

We can use demand-side and supply-side remedies

5.1 We have a wide range of tools we can use to address harm. In general, we group them into two broad categories:

1. **Demand-side remedies**: These focus on helping consumers make better decisions. In the case of inertia pricing, that includes: lowering the costs of shopping around and switching, and reducing other causes of consumer inertia.
2. **Supply-side remedies**: These focus on firms, and can involve restricting the way firms design, market and price products. They may include price regulation and product structure restrictions.

5.2 Not all remedies fall neatly into these categories - some remedies have both demand-side and supply-side features. For example, some of our interventions that are designed to help consumers make better decisions involve us putting restrictions on firms.

5.3 When we consider a remedy, we take into account the specific context, the outcomes we want to achieve, and the consequences of intervening. To do so, we also draw on existing research, such as the UKCN consumer remedies project. Responses to this paper will also inform our future thinking.

5.4 The principle of proportionality is an important guide, so that we can achieve the desired result with the least intrusive remedy possible. More intrusive remedies also need more careful consideration so that we are aware of the way the market is likely to respond and any possible unintended consequences.

5.5 Usually, interventions we make on the demand-side are less intrusive than supply-side remedies. However, sometimes we find that consumers do not respond to demand-side interventions. In these cases, supply-side remedies might give us more direct options for intervention.

Demand-side remedies aim to help some inert consumers become more engaged

5.6 How effective a particular demand-side remedy will be depends on the specific reasons for the consumers' inertia. The discussion in Chapter 4 on the causes of consumer inertia provides the basis for our discussion on demand-side remedies in this chapter.

We may use remedies to raise awareness of firms' pricing practices

5.7 One possible reason for inertia is that consumers do not understand that their service provider has an inertia-based pricing strategy. Consumers may even expect their loyalty to be rewarded and assume there is no point in shopping around. If we think that this is the case then we can consider remedies to increase consumers' awareness of this pricing practice.

5.8 These remedies may involve collecting data from different providers about their pricing practices and making the comparisons publicly available. Our aim is for commentators and media to use this information to raise awareness among consumers, rather than consumers searching themselves. These remedies also create incentives for firms to compete to perform better.

5.9 This approach could work particularly well if consumers have strong views about the fairness of inertia pricing. In some cases, making consumers aware of inertia pricing practices, highlighting the harm and identifying the firms that have the largest price differentials, could deter firms from using inertia pricing. We have used these remedies to draw attention to the lowest rates on back book cash savings accounts.

We may seek to reduce the costs of shopping around and switching

5.10 Consumers incur costs, in the form of lost time and effort, when they shop around for deals. They often incur further costs when they select a deal and switch their provider. These costs may make consumers less willing to engage with the market.

5.11 If we think that consumers are not engaging in the market because they think the costs are too high to make it worthwhile, we might consider ways to reduce these costs. We could do this in a number of ways, including:

- **Information disclosures**: This means changing the type of information firms give consumers or changing the way they present it. This can make information more relevant to consumers and save them time in finding the information.

- **Using data sharing to support intermediaries**: Such as brokers or consumer advisers who could identify inert consumers who are getting bad deals and find them better deals.

- **Making longer-term contracts compulsory**: Changes to product design (supply-side remedies) could also reduce the costs of shopping around and switching. For instance, requiring firms to provide longer-term contracts could reduce how often consumers have to make decisions to avoid price rises, and potentially reduce the costs they incur in doing so.

We may seek to address behavioural or contextual causes of inertia

5.12 People can inevitably make mistakes when choosing and using financial products – this is only natural. Mistakes can happen for many reasons, from personal stress to misunderstanding the product. If we think this is a cause of consumer inertia, we can design remedies to address it.

5.13 One approach is to use reminders and nudges – small 'prompts' that can lead to better decisions. This is a broad category of remedies that may take many forms. For instance, it can vary by the communications channel (eg annual statement, text-message, email), timing of implementation (eg right before renewal), and design.

Example: Nudges to help consumers reduce overdraft charges
Consumers can incur substantial charges on their Personal Current Account (PCA), especially for small amounts of unarranged borrowing and unpaid items. In some cases, this could reflect a genuine demand for credit. However, evidence suggests that consumers could have avoided some of these incidental charges if they had known what their balance was.

A recent policy initiative by the Competition and Markets Authority required firms to automatically enroll consumers into two types of alerts: unarranged overdraft and unpaid item alerts. These are sent via SMS or app at the right time, specifically:

- Unpaid items (retry alert) – When the bank sees a consumer doesn't have enough funds for a scheduled transaction, they send the consumer an alert message (typically in the morning). The consumer can then transfer funds before the afternoon cut-off time to fund the transaction.
- Unarranged overdraft – When a consumer's balance dips below £0 or arranged overdraft limit, the bank sends an alert (typically in the morning) and the consumer can transfer funds before the afternoon cut-off time.

Those simple reminders proved very effective in reducing incidental charges:

- automatic enrolment into unpaid item alerts reduces charges by 21-24%
- automatic enrolment into unarranged overdraft alerts reduces charges by 25%.

5.14 Another option to reduce inertia is to increase the relevance of financial decisions between different groups of consumers. In designing possible approaches, we can also draw inspiration from present and past international experiences, noting the differences from the UK. For instance, Hungary used to have a nationwide insurance renewal period once a year (see box below). Having a specific day or week in the year where consumers are able to renew or switch their providers could in principle help deal with issues such as procrastination and inattention. It could also lead to better exchange of information about different prices being offered, through conversations between people, potentially reducing search costs for individuals.

Example: Statutory campaign period for car insurance in Hungary
Before 2014, car liability and voluntary insurance in Hungary had a 'statutory campaign period'. Insurance companies could only change their prices during that period. During that week, intense press and information campaigns focused consumers' attention, raising their awareness and motivation to switch.

This statutory campaign period was abolished in 2014, with the aim of giving insurance companies more flexibility to react to market changes. However, the Hungarian Competition Authority (GVH) found that this has led consumers to being less motivated to switch. According to GVH, removing the statutory campaign period might have at least partly contributed to the increase in prices that started in 2014.

5.15 However, demand-side remedies may not be enough to address the harm, as the most inert consumers are often not reached through them. These consumers may also be vulnerable. For example, insurance renewal may be the last task on the mind of someone going through a period of ill health or through redundancy. In such cases, it may be more appropriate to use supply-side remedies to address the harm. Our credit card persistent debt remedies offer an example of this type of a remedy. We adopted a set of measures that includes firms having to offer help to customers in persistent debt to repay it more quickly.

Supply-side remedies put restrictions on product design and pricing

5.16 Where appropriate, we may consider restrictions on the product design, as well as direct restrictions on pricing practices.

We may put restrictions on the way firms design products

5.17 When firms design products to identify the more inert consumers, or even make inertia worse, we may choose to restrict certain features of these products. Options we could take on product design include:

- **Changing the product's 'default' structure**: A product's default option is the one consumers are put into if they don't take any action. Changes could include removing 'auto-renewals by default' and outright bans on auto-renewals to overcome the `default bias''.
- **Breaking up product packaging**: When several products are combined into one 'package', it can be more difficult for consumers to compare different products, shop around and switch. Consumers may also overestimate the value of a packaged product when it is presented in a particularly attractive way, as we found with packaged bank accounts.
- **Simplifying tariffs**: If the complexity of pricing structures is leading to lower consumer engagement, we could require firms to produce a simpler structure.

We may put direct restrictions on prices

5.18 Finally, the most direct way we could intervene to prevent price discrimination is by restricting the way firms set the prices of their products. Some pricing such as insurance is complex and could affect how effectively we could develop and enforce direct price regulation. We would need to consider how we can separate price discrimination from cost-based pricing (which is based on the different risks consumers have). We also need to think carefully about what the likely response from the market would be if we put restrictions on prices, eg some prices to consumers could go up.

5.19 The options available to us are not limited to simply setting an absolute cap on prices. For example:

- A **relative price cap** (sometimes called a price collar), could impose limits on the differences in prices firms charge to new and longstanding consumer groups.
- A **price discrimination ban**, to stop (complete ban) or reduce (partial ban) any pricing differences between consumers based on how many times they renew with the same provider. Partial bans are a less restrictive option that allow firms some price variation for new customers (eg teaser rates). Promotional offers to new consumers are sometimes shown to have a positive impact on competition, which may also affect how we think about fairness.

Example: Policy option in cash savings market
The cash savings market offers over 2000 different easy access cash savings products. Our recent Discussion Paper looked at the option of requiring firms to applying single interest rates (BSRs), respectively, to all easy access cash savings accounts and to all easy access cash ISAs which have been open for a set period of time (for example, 12 months). This would limit firms' ability to price discriminate based on how long consumers' have had held the same account. It would also increase transparency and effectively curb the proliferation of comparable products on the market. At the same time, by preserving the flexibility to vary prices in the introductory period (eg 12 months), the policy option aims to maintain the firms' ability to attract new customers with introductory deals.

The action we take will depend on what we find in the market

5.20 When we consider what action is appropriate, we use the principle of proportionality. That means we aim to use the least intrusive remedy possible to deal with the harm we have identified and achieve the market outcome we want.

5.21 Ultimately, how effective a particular remedy is will depend on the causes of how prices are set and the type of problems we find. We will also look at how a remedy can affect the outcomes for different groups of consumers.

5.22 For instance, requiring enhanced information disclosure may be enough to get those consumers who don't know what they are missing out on by their inertia, to act. However, information disclosure alone may not help consumers who are less financially aware because they cannot properly compare alternative products. If demand-side remedies would not necessarily be effective then taking action on product design or pricing is the most appropriate intervention. We may also look at a package of remedies to address harm that combine demand and supply-side remedies. For example, we did this for credit card charges.

5.23 Our remedies may involve costs for firms, consumers or both. When we design remedies, we look at who should bear the burden of mitigating or tackling the causes of harm. For instance, to protect vulnerable consumers we may ask firms to invest resources in designing the appropriate default products, instead of simply sending reminders to nudge consumers into looking at alternative offers.

5.24 The CMA is currently investigating concerns raised by Citizens' Advice that people who stay with their provider can end up paying significantly more than new customers. We will work closely with the CMA in their investigation and we recognize that, as a possible outcome of their investigation, the CMA may also have recommendations for action in the markets we regulate.

Questions for consultation

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 1
List of questions

Price discrimination in financial services

Q1: **Do you agree with our six evidential questions to help assess concerns about fairness of individual price discrimination cases? Are there any other questions that are as, or more, important than the ones listed? If so, what are they?**

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?

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

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d) being transparent about pricing and what factors are used to determine pricing

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Please provide reasons to support your answer.

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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.

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Annex 2
Examples of inertia pricing

1. In this section we illustrate how inertia pricing works in practice by outlining some examples in the cash savings, mortgages, and retail general insurance markets.

Example 1: Easy access cash savings
Cash saving accounts are popular products and about 97% of UK adults have one. Our 2015 Cash Savings Market Study found that providers hold significant amounts of consumers' savings balances in accounts opened long ago (eg more than 5 years ago). Savings providers, on average, pay lower interest rates on easy access accounts held for a long time than on accounts opened more recently. The Study also noted that the costs to providers of providing cash savings accounts do not generally increase with the age of the account.

This topic is being discussed as part of our recent Discussion Paper, which explores the potential harm that price discrimination causes to longstanding customers. We are particularly concerned that consumers who have held their savings accounts for a long time are more likely to show characteristics of potential vulnerability.

Example 2: Mortgage market
Most mortgage products sold in the UK offer a short-term introductory deal (often a fixed interest rate) after which the rate changes to another (reversion) rate. This reversion rate is often an SVR (Standard Variable Rate) or a rate linked to a benchmark rate. Moving to a reversion rate involves an increase in interest rate and so in monthly repayments. At this point it usually makes financial sense for the consumer to switch to a new mortgage product. The mortgage contract usually allows them to do that free of charge (or at minimal cost), either with the existing lender (internal switch) or a new lender (external switch).

Yet around one quarter of consumers do not switch within six months after moving on to a reversion rate, and some of them could have got a better deal. The difference between the reversion rate and the (lower) rate they would pay in a new contract gives an initial indication of the extra cost consumer incur by not switching. There are many factors involved, such as the way competition works in practice, that lead to these pricing outcomes. One possible explanation is that if the non-switching consumers are less price sensitive, then firms can increase these prices and thus price discriminate on grounds of inertia.

Example 3: Home insurance market
Our Diagnostic Work has identified that in the home insurance market, customers who have renewed with one insurer for many years are on average paying much higher prices than new customers. This creates a question of whether it is fair for certain consumers to pay more than others where the costs of supply are the same, especially if some consumers pay less than the cost to supply. There may also be difficult trade-offs between those who benefit and those who lose out, especially if vulnerable consumers fall into both groups. These issues will be explored further in our Market Study on home and motor insurance.

Annex 3
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 and behaviours can help inform general insurance pricing.
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.
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.
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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