The Money Charity response to the General Insurance Pricing Practices Study Terms of Reference (Nov 2018)

The Money Charity is the UK's leading financial capability charity.

We believe that being on top of your money means you are more in control of your life, your finances and your debts, reducing stress and hardship. And that being on top of your money increases your wellbeing, helps you achieve your goals and live a happier more positive life as a result.

Our vision is for everyone to be on top of their money as a part of everyday life. So, we empower people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives.

We believe financially capable people are on top of and make the most of their money in five key areas:

- Planning (including budgeting)
- Saving
- Debt
- Financial services products
- Everyday money (including wages, cash, bank accounts)

1. Introduction

The Money Charity is pleased to have the opportunity to respond to the FCA's proposed Terms of Reference for its forthcoming market study into General Insurance Pricing Practices. This issue is relevant to our constituency and to financial education in general, and we think the proposed TOR address serious issues of consumer welfare. The study should provide an opportunity to review the way insurance pricing has developed and put in place principles and regulations for improvement.

Personalised price discrimination has become pervasive in insurance pricing, including adjusting prices to consumers' switching or non-switching behaviour ('demand-based price discrimination'). Our view, which we have expressed in previous responses to FCA consultations, is that this type of pricing is non-transparent, unhelpful to financial capability, exploitative of too many consumers and, for those who do switch regularly, a nuisance.[1]

It has to be remembered that insurance pricing is only one of the product categories in which demand-based price discrimination takes place. Consumers face price discrimination in savings, insurance, utilities and other services and need to keep switching, or threatening to switch, their service contracts in order to get the best prices. This means web site browsing, phone calls, waiting times, negotiating menu systems, conversations with customer service staff etc, which is time consuming and wasteful of individual, firm and national resources. It also damages any feeling of trust that may have previously existed between consumers and their providers, refutes the concept of 'customer loyalty' and encourages consumers to adopt a promiscuous and purely transactional relationship with the firm they buy from. We doubt that this is the best foundation for twenty-first century business practice.

As we have argued previously,[2] demand-based price discrimination should be considered a competition failure, rather than a competition success.

2. Aspects of the TOR which we support

In general, we support the TOR, subject to some additions as outlined below. In particular we support:

- The quantification of harm.
- The particular focus on consumers in vulnerable situations.

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[1] See, for example, The Money Charity response to FCA *Approach to Competition*, March 2018. Available at: https://themoneycharity.org.uk/work/policy/consultation-responses/

[2] Ibid.

- The focus on fairness, including examining consumers' perspectives and attitudes to the fairness/unfairness of discriminatory pricing.[3]
- The focus on transparency/non-transparency and shortcomings in the way pricing and renewal information is communicated to customers.
- Potential remedies and the approaches taken in other countries.[4]

These aspects of the TOR provide a basis for a broad-based study of the practice of discriminatory pricing from the consumer point of view and with the interests of consumers in vulnerable situations in the foreground, as they should be.

3. Areas where the TOR could be developed further

There are two areas where we think the TOR could be developed further:

3.1 The issue of excessive or 'deadweight' costs

While the TOR mentions the issue of excessive costs,[5] its current wording seems to regard costs mainly as a private issue for consumers and firms. We would like to see this expanded to a full socio-economic evaluation of costs, which in our view is the right context because such costs have implications for the productivity of the UK economy as a whole. For example, employees may carry out some of their product search and switching activity while at work, costing their employer time and money and potentially reducing the output of their firm. The resources applied on the firm side to switching (customer service teams, training, software experts and pricing models, etc) may be better applied to other activities, for example building the UK's export base.

In the literature on price discrimination, 'deadweight' costs have a prominent place, to the extent of being quantified in the relevant mathematical models. Thomas 2012, for example, reflecting on an inertial pricing model with one third of customers switching, argues that:

> "This high level of switching is socially inefficient: it arises as an artefact of the market structure, not as a result of changing brand preferences, and so represents a deadweight loss to society."[6]

It may be said that time spent searching for and comparing products is a natural part of a market economy, something that consumers do, and expect to do, across a wide

[3] MS18/1.1, paragraph 1.18
[4] MS18/1.1, paragraph 1.21
[5] MS18/1.1, paragraphs 1.19 and 4.12.
[6] Thomas RG 2012, 'Non-Risk Price Discrimination in Insurance: Market Outcomes and Public Policy', *The Geneva Papers* 37, 27-46, p 42. Available at: www.guythomas.org.uk

range of goods and services. There is some truth in this, but in relation to general insurance and other similar services, there are two strong counter-arguments:

First, much of the time wasted switching involves having to re-buy the same product. If we buy a TV set or a fridge, we don't have to re-buy it a year later and renegotiate the terms. Once the item is paid for, it is definitively 'bought' and we keep it as long as we want to, which could be many years. The same thing for insurance would be a product that once chosen, we could stick with for five or ten years, relying on the renewal price being fair and the customer service being good.

Second, some types of consumption are inherently 'hedonic' in their nature, with the pleasure beginning with search, carrying on through purchase and then into the use of the product: for example, car buying, fashion clothes, restaurant buying of food and drink, house purchase and renovations and, to some extent, day-to-day shopping, where there is a positive balance between search costs and the experience or use value of the product in question. Some people enjoy watching *Top Gear* and trying out new cars. Some people enjoy scrolling fashion sites while waiting for the lift. Many people enjoy watching property programmes on TV. These are search and buying experiences that have positive experiential value.

But among these products we do not find insurance, savings accounts, gas supply, electricity, phone, broadband or water. These products are the necessities of life, seen by most people as boring and often overcomplicated, with excessive search costs and little hedonic payback. We want to spend as little time as we can on these purchases, for them to be as automatic and predictable as possible. We want good value (naturally) but not at the expense of spending many hours a year scrutinising phone bills, electricity tariffs and the fine print of insurance policies.

The industries that supply these goods and services know this. Demand-based price discrimination is perfectly designed to take advantage of natural human inertia when it comes to essential services, to reward only those who approach consumption with squirrel-like intensity and to charge everyone else as much as feasible.

We suggest that a full study of the deadweight costs of switching be added to the TOR.

3.2 The nature of the firm-consumer relationship

As pointed out in our introduction above, demand-based price discrimination contradicts the idea of 'customer loyalty' and encourages consumers to adopt a promiscuous and purely transactional relationship with the firm they buy from. In our view, the TOR should address whether this is beneficial, in the round, for UK consumers, firms and the

UK economy and society. Is it the right basis for twenty-first century business practice, or would we be better to work toward customer-firm relationships based on long-term buying, trust and reciprocal loyalty?

There is a large literature on relationship-based marketing,[7] which tends to regard it as superior and the successor paradigm to the pre-1980s approach of transactional marketing, which emphasised the instant of the sale, rather than the long-term relationship. From this point of view, the transactional approach being taken by the UK insurance industry could be seen as a retrogression to a superseded model and an unlikely starting place for success in business in the twenty-first century.

At the core of demand-based price discrimination is an attempt to trick the customer into paying a higher price than they otherwise would pay, by relying on consumer inertia and distraction at renewal time. It may take several years until the consumer wakes up to what is going on and finally gets round to switching provider. In the meantime they have been highly profitable. On the other hand, the consumer may be aware of the firm's pricing strategy and try to trick them back by switching provider after a single year, while still benefiting from the cross-subsidy from 'loyal' customers, then switching again after another year, and so on. It may be argued that mutual trickery is not the best foundation for the relationship between an industry and its customers.

All the more so in the case of the UK financial services sector, which is trying to recover from its loss of prestige and public confidence caused by the 2008 crash and subsequent scandals. The FCA has an interest in the culture[8] of the financial services sector and in helping the sector recover its reputation through better, regulated behaviour.

This being the case, we suggest that the nature of the firm-consumer relationship be added to the TOR, with the study looking carefully at which type of relationship (transactional or relational) offers the best long-term future for the sector, its customers and UK society as a whole.

(end)

[7] See for example, Godson, M. 2009. *Relationship marketing*. Oxford: Oxford University Press.

[8] https://www.fca.org.uk/news/press-releases/fca-publishes-discussion-paper-transforming-culture-financial-services