

Which direction is the FCA walking on prices?



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Yesterday, the FCA published the terms of reference for the forthcoming general insurance market study; a thematic review of the home insurance supervisory programme; and a discussion paper on fair pricing in financial services.¹

Who is affected?

The market study will focus on motor and home insurance, with wider implications for health, pet and travel insurance. The discussion paper also focuses on cash savings and mortgages.

Why now?

The FCA's actions are partly the result of the super-complaint issued by Citizens Advice to the Competition and Markets Authority about the 'loyalty penalty'.² The FCA is also building on the findings of its supervisory review of general insurers (focusing on governance and treating customers fairly).

Also relevant is the Financial Ombudsman Service, which has in some cases ruled in favour of consumers who have seen significant price increases over several years.³

What does fairness in pricing mean?

Fairness is a subjective concept and can be considered in two ways:

1. **The fairness of process.** How did the firm set prices? What data was used in the price-setting process?
2. **The fairness of outcomes.** How do outcomes vary according to customer segments? Are segments of concern (e.g. vulnerable customers) getting a sufficiently good deal?

Consumers paying different prices is common across many areas of the economy, such as student discounts or variable airline ticket prices. However, the FCA is concerned about a certain form of price discrimination according to willingness to pay—the practice of price walking.

What is price walking?

Price walking is where prices for new customers are initially set below the cost to serve, and subsequently increased each year at renewal. There are several reasons why price walking occurs, such

as fierce competition for new customers, some of whom will stay loyal.

The FCA's fairness concerns relate to both procedure (are firms explicitly exploiting biases in pricing models?) and outcomes (are vulnerable customers paying higher prices?). Providers may be required to demonstrate that their pricing is fair.

What will happen next?

After several years of demand-side remedies (such as greater price transparency at renewal), and informed by the effectiveness of these remedies, the FCA appears to be focused on governance.⁴ For example, ensuring that firms understand and evaluate customer outcomes, and have clear and effective customer communications. The FCA is also considering more interventionist supply-side remedies, such as introducing relative price caps or banning price discrimination by tenure.

Case study: the basic savings rate (BSR)

The FCA's recent proposal in a discussion paper about introducing a BSR in the cash savings market has direct parallels to the kinds of price regulation now being considered in insurance markets.⁵ Under the BSR proposal, each provider would be able to set only a single interest rate for all their back-book customers (although pricing for front-book customers would remain flexible). Back-book customers would be considered as those with a tenure of, say, at least one year. The BSR would therefore use the 'mildly inert' to protect the 'highly inert'. The FCA has indicated that it may consider similar remedies in other markets.

Key action: ensuring good governance

Boards should set appropriate pricing principles and have clear oversight of pricing activities and their outcomes. The FCA has found some firms falling short of what it expects in terms of good governance.

Oxera's regulatory advisory team has been advising insurers and brokers, and their boards, on the pricing review, questions about how to evaluate outcomes, and governance.

¹ FCA (2018), '[General Insurance Pricing Practices: Terms of reference](#)', MS18/1.1. FCA (2018), '[Pricing practices in the retail general insurance sector: Household insurance](#)', TR18/4. FCA (2018), '[Fair Pricing in Financial Services](#)', DP18/9.

² Oxera (2018), '[Loyal, lazy or time-poor?](#)', 28 September.

³ FOS (2018), '[Paying the price?](#)', Issue 144.

⁴ See for example FCA (2018), '[Helping credit card users repay their debt: a summary of experimental research](#)', Research Note.

⁵ FCA (2018), '[Price discrimination in the cash savings market](#)', DP18/6.