# Countdown to Consumer Duty: A closer look at the FCA's Price and Value assessment review

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Representing one of the four core outcomes of the Consumer Duty, the Price and Value standard aims to ensure that financial services consumers can feel safe in the knowledge that the price they pay for a product or service will be reasonable and reflective of the overall benefit it provides.

With the Consumer Duty implementation date fast approaching, the FCA's Price and Value assessment review was intended to provide an overview of how firms across different financial sectors have set about embedding these requirements into their business models.

The study also sought to confirm that the regulator's own internal supervisory and regulatory approaches to fair value reflect industry thinking.

As part of the research, the FCA examined a small sample of 14 firms' fair value assessment frameworks – focusing primarily on larger organisations from areas such as retail banking, consumer investments and consumer finance, as well as payments and digital assets.

**The review assessed each firm's approach against five criteria:**

1. Their understanding of the fair value rules
2. Their methodology for assessing value
3. The extent to which they considered contextual factors
4. The extent to which they assessed differential outcomes
5. The effectiveness of their data-led monitoring and governance strategies

The FCA's feedback commented on the positive initiative firms have shown within their assessment frameworks, in addition to highlighting key areas where they'll need to show improvement in order to comply with the new, higher oversight and customer care standards.

**So, what were the key lessons firms should take away from each of these criteria?**

# Understanding Fair Value

**How clearly does the assessment define 'fair value' and how will this be applied to the firm's products?**

### What did firms get right?

- Many firms set out clear principles for how they plan to apply the concept of fair value - both generally and across their different product lines
- Most also recognised their role as a manufacturer, co-manufacturer or distributor, and understood their respective responsibilities towards customers

### Where do firms need to improve?

- Some frameworks were based on high-level or unevidenced arguments that their business models or ethos are inherently fair value without evidence to back it up
- Others relied on price comparisons with peers as justification of fair value
- A minority of firms didn't give enough thought to the distinction between manufacturers and distributors, and how this affects their role in delivering good outcomes.

**"The true value of a charge will ultimately depend on the service provided and the characteristics of the end customer."**

## TCC advice

**Representing a step up in regulatory obligations from the previous TCF standard, the FCA's new 'show me, don't tell me' approach to supervising the Consumer Duty will require firms to clearly evidence that their products and services are meeting clients' needs at a fair price.**

With this in mind, the review makes clear that you are expected to take an honest look at your own business model and internal processes. You'll need to gather data from multiple sources, employing more thought and sophistication than simply benchmarking charges against competitors.

The true value of a charge will ultimately depend on the service provided and the characteristics of the end customer. These are both multifaceted points and unlikely to neatly correlate to broad comparisons of charges against industry averages – and so relying too much on this type of analysis could obfuscate the experiences of certain types of consumers.

For example, whilst the FCA is not against percentage-based pricing per se, these structures do open up the possibility for consumer harm and so firms will need to have a clear methodology and rationale in order to justify these charges.

Some firms have taken an itemised costing approach – totalling the time and effort involved, value provided and any indirect cost considerations – to show a logical framework for their figures. To this end, as the FCA's Sheldon Mills commented, firms will be expected to take an 'honest and critical' approach to assessing value that doesn't shy away from asking uncomfortable questions.

# Assessing Value

**How thoroughly have costs and benefits to consumers, including non-financial costs and benefits, been considered?**

### What did firms get right?

- Most frameworks outlined a reasonable strategy for assessing the benefits consumers can expect to receive from a product or service – including a sufficiently broad view of the costs to consumers (for example fees and charges, non-monetary costs and potential distribution costs passed on to the end customer)
- Some frameworks also featured a clear discussion on how products sold as part of packages or bundles should be priced, and how these can be assessed for value – with consideration paid to where bundling both does and does not provide value for money

### Where do firms need to improve?

- Some firms had devised a general template for assessing fair value, but didn't elaborate on how this could account for products with different characteristics or address the needs of different target markets
- Other assessments failed to consider the firms' profit margins for the different products and services they offer
- Some frameworks glossed over non-financial concerns such as quality of customer service, and time or effort taken to change or cancel a product, and their impact on fair value

**"Apply an analytical lens to your profit margins to confirm whether they're reasonable"**

## TCC advice

**The main point for firms to understand when assessing value is that the FCA is not judging firms by the cost of the product or service per se, but rather the rationale behind it and how firms can demonstrate the pricing is justified.**

So, when carrying out a value assessment, your focus should be on answering the central question: 'why are we charging what we're charging and how is this fair on the consumer?'.

As a basic example, firms should consider the types of situations that would lead to a product or service being unsuitable or poor value for money for a particular client both at the initial advice stage and throughout product's lifecycle.

Another crucial step will be to apply an analytical lens to your profit margins to confirm whether they're reasonable.

Whilst the FCA's price and value outcome rules don't require firms to charge all customers the same amount - or to make the same level of profit from all customers - and it can be difficult to allocate costs on an individual product basis, the profit margins of a product or service are likely to be a relevant factor in assessing its fair value.

# Considering Contextual Factors

**How has the firm considered broader contextual factors relevant to the overall value of a product or service?**

## What did firms get right?

- Many frameworks had good analysis of the negative impact of 'sludge' practices (e.g. tactics designed to retain customers or avoid customers taking actions that may be to their own benefit, but not the firm's)
- Firms generally paid attention to how products and services that consumers already hold could be assessed for value more accurately
- A number of firms accounted for how consumers' behavioural biases could lead to unsuitable decisions and poor outcomes

## Where do firms need to improve?

- Several frameworks contained insufficient critical assessment of the fairness of the fee structure as a whole
- Some firms didn't consider whether they would need information from other firms in the distribution chain and/or third parties to conduct a thorough fair value assessment

## TCC advice

**What's clear from the FCA's feedback is that the concept of fair value doesn't only apply to the amount paid at the point of purchase.**

Instead, firms should be taking a holistic view that covers the initial cost alongside any additional charges throughout the customer journey, as well as non-financial aspects such as the benefits of the product or service and the quality of the customer support offered post-sale.

Any difficulties encountered when making a claim or complaint, or attempting to terminate a contract, all impact on the customer experience and can impact the overall value of your service offering. And so any effective fair value assessment will need a critical lens to the end-to-end customer journey to root out any friction that could result in poor outcomes.

Similarly, it's important to remember that the costs the consumer pays are a sum of those amassed across the product lifecycle. And what the customer ends up paying can be influenced by lender procuration fees and broker commissions – so, as the FCA's Sheldon Mills points out, 'it's vital that manufacturers and distributors assess fair value across the whole value chain'.

Mills notes: "We have also seen customers pay broker commissions that can be unreasonable relative to the benefits of the products that they get. These are usually invisible to the end consumer but can greatly affect the price and suitability of the product they receive.

"The Consumer Duty is an opportunity for manufacturers and distributors to really understand the impact that different commission models have on the value that consumers receive, and we will be taking a close interest in this aspect of the Duty across sectors."

# Assessing differential outcomes

**How far has the firm considered the range of possible consumer outcomes (e.g. through differential pricing) and the potential impact on vulnerable consumers?**

### What did firms get right?

- Many firms understood the importance of segmenting customers, e.g. highlighting subsets of customers that could be paying disproportionately high margins compared to the benefits received, or subsets of customers at risk of paying higher fees and charges
- Several frameworks contained tailored analyses of fair value for consumers with characteristics of vulnerability

### Where do firms need to improve?

- Some firms made reference to high-level or unevidenced arguments that their business model is fair without supporting evidence
- A number of frameworks didn't consider how product-level cross-subsidies may affect fair value or pay attention to the circumstances where this could lead to consumer harm

**"Without properly segmenting customers firms are unlikely to understand the crucial issues"**

## TCC advice

**A recurring theme of the review is that some firms have relied too heavily on average outcomes at the expense of the outlier customer experiences on either side of the bell curve.**

And whilst averages can serve as a good barometer of everyday performance, without properly segmenting customers firms are unlikely to understand the crucial issues that lead to poor results for consumers.

For example, were signs of vulnerability missed by advisers? Are there blind spots in your monitoring process? Or could your terms and conditions lead to unintended consequences for customers down the road?

Another interesting takeaway from the feedback is the FCA's assertion that, despite the emphasis on consistency and equal treatment, the rules 'do not require firms to charge all customers the same amount, or to make the same level of profit from all customers'.

So, the regulator accepts that some situations may warrant a degree of cross-subsidy. However, given this would inevitably lead to some customers being financially worse off than they otherwise would be, it's currently unclear where the FCA will draw the line and so firms should still exercise caution and ensure any discrepancies can be justified.

# Data and Governance

**How have firms approached using data to measure and monitor fair value, and what does their governance strategy look like?**

### What did firms get right?

- Most firms set out data-driven strategies for monitoring and reviewing customer outcomes on an ongoing basis
- Many also included timelines for conducting value assessments with their frequency adjusted to reflect the expected product lifespan or renewal pattern
- A number of frameworks outlined a clear rectification process for instances where a product is no longer thought to be providing fair value for the customer

### Where do firms need to improve?

- Some firms didn't properly explain how they plan to monitor fair value, including the types of data they intend to use or how they'd address existing data gaps
- A number of frameworks proposed points-based or RAG rates, but didn't outline how these scores would be classified or how consistent accuracy could be ensured

**"It would have been helpful for the regulator to have provided practical examples of MI being collated"**

## TCC advice

**The consensus from across the industry is that firms are finding the requirement to evidence fair value one of the most challenging aspects of implementing the Consumer Duty.**

And it's true that the FCA hasn't been particularly prescriptive about the type of data firms should be collating, resulting in some firms not knowing which of the many options would be most suitable.

Other markets and services, such as fund management or ongoing servicing for investments have found themselves faced with the opposite challenge, having fewer obvious points of hard data to pull from.

To this end, it would have been helpful for the regulator to have provided practical examples of MI being collated – for example profit margins, claims ratio, early surrenders and defaults – and how these could be combined to provide an accurate picture of a product's value for money.

Many firms also elected to use points-based or Red-Amber-Green (RAG) ratings to assess where their strengths and weaknesses lie. However, whilst these can be useful in some cases, it's vital that they're backed up with enough data and critical analysis to ensure the thresholds between the points and ratings are robustly defined and able to account for all the variables involved.

# Build a compliance strategy that's Consumer Duty ready

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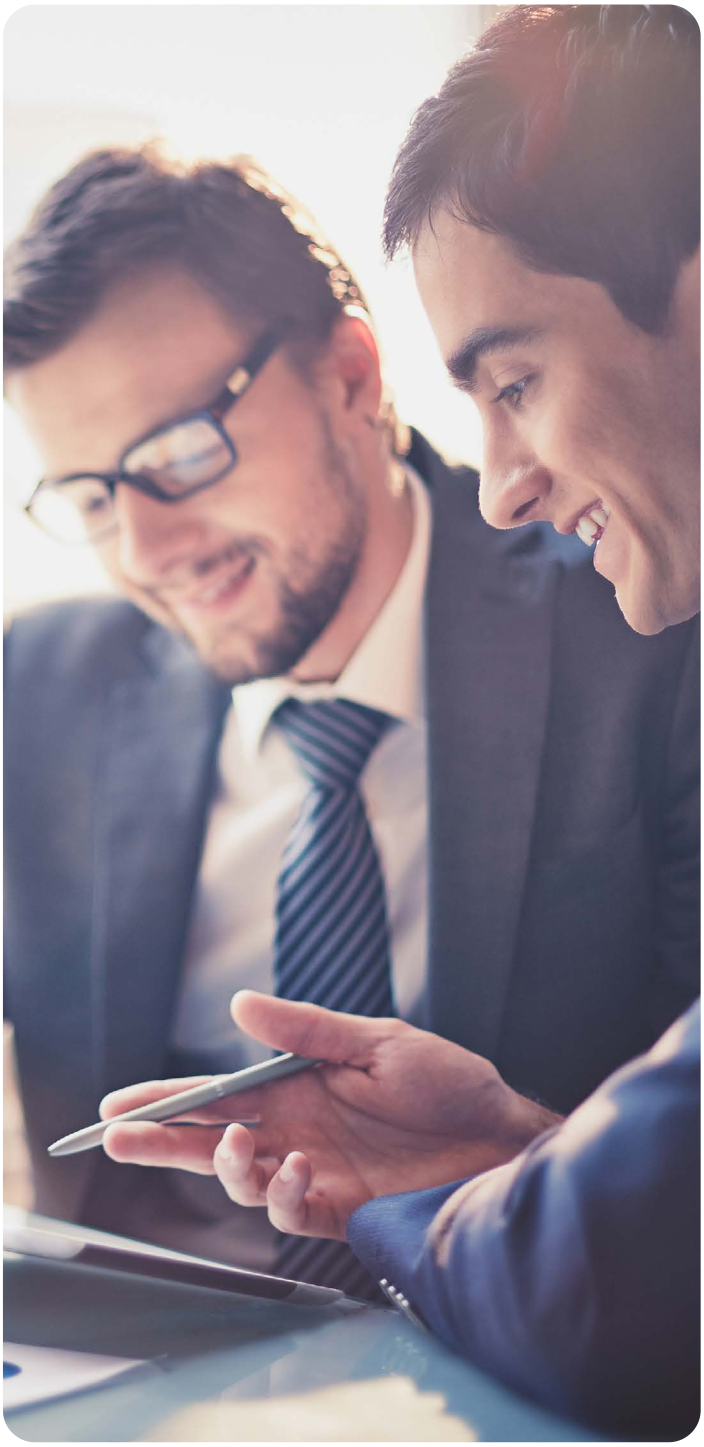

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## Get in touch

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