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House of Lords EU Internal Market Sub-  
Committee  
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London  
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## **House of Lords EU Internal Market Sub-Committee: impact of Brexit on UK competition policy**

Dear Lord Whitty,

The Financial Services Consumer Panel is an independent statutory voice for financial services consumers. The Panel helps the Financial Conduct Authority (FCA) to improve its effectiveness in meeting its consumer protection and competition objectives. Since 2015, the FCA has competition powers, concurrent with the CMA. We work with the FCA and CMA to ensure they take account of the consumer perspective, both retail and small business.

We agree with the Committee that there will be an opportunity to reshape competition policy following the UK's exit from the EU. We would like to comment specifically on the inquiry's first question as it is of most relevance to our remit.

Our consumer research<sup>1</sup> suggests that competition policy should reflect actual consumer behaviour rather than rely on a set of theories that do not stack up in reality. Competition authorities put unreasonable expectations on consumers to take responsibility for driving competition. These expectations are unlikely to ever be met and this undermines regulatory action.

Competition policy that relies on consumers to take action has had only limited effectiveness in markets such as energy. Focusing on remedies that are designed to improve decision-making and switching is likely to be even less effective in financial services markets: most consumers are not empowered to assess and engage with the market in a way that will deliver tangible benefits to them. This is due to a combination of factors, including the complexity of products, opacity of pricing and information asymmetry between firm and customer.

### **What should competition policy in the UK set out to achieve? What guiding principles should shape the UK's approach to competition policy after Brexit.**

#### *Consumers and competition*

When markets are competitive, consumers should be offered variety and choice, with firms striving to win custom on the basis of service, quality, price and innovation. Consumers should feel confident in exercising choice and competition is further strengthened. This benefits not only consumers but the wider economy.

In theory, competition should work because consumers reward firms that meet their needs with their custom, and help to drive unsuccessful firms out of the market. In practice however, there are barriers to this happening in retail financial services. Consumers cannot easily assess the price and quality of products and services, and firms regularly exploit consumers' behavioural biases. Firms may 'game' price disclosure rules or price comparison services by

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<sup>1</sup>Consumer Panel Position Paper, "Consumers and competition": [https://www.fs-cp.org.uk/sites/default/files/fscp\\_consumers\\_and\\_competition\\_position\\_paper.pdf](https://www.fs-cp.org.uk/sites/default/files/fscp_consumers_and_competition_position_paper.pdf)

keeping down headline prices, but charging extra for product features that might reasonably be considered integral to the basic product. The price of some of these 'extras' bears no relationship to the cost of providing the product, for example, the numerous upfront fees and charges on a mortgage, or fees insurers levy for administrative adjustments, such as a change of address.

Typically, actions designed to make consumers more engaged include providing more and better information and the use of price comparison websites. However, choice overload can deter shopping around and reinforce the tendency to stick with the current provider or not purchase a product or service in the first place.<sup>2</sup> European legislation has not caught up with the increasing body of evidence on the ineffectiveness of more disclosure. Disclosure requirements – eg in MiFID2 and the Insurance Distribution Directive – are onerous and unhelpful for consumers, although the discipline of transparency is, in itself, beneficial.

Automated shopping around and switching using algorithms have the potential to provide better consumer outcomes. However, digital comparison tools are not a panacea, and also run the risk of 'information overload' and inertia. When consumers do use them they may revert to 'rules of thumb' or choosing names which are familiar, as already happens with comparison websites.

In addition, digital comparison tools' business models lack transparency. Consumers may not be able to see the basis for rankings, which may be 'paid for' rather than truly impartial. Unfortunately, it is difficult for new providers in the market to do anything other than match the prevailing business model.

Regulators need to be alive to these issues and ensure that the market develops in the interest of all consumers, which will mean looking at supply-side measures. With the introduction of Open Banking and PSD2, firms will have access to consumers' payments data which will provide benefits, but also shifts more power to firms. This will need careful monitoring to show how it has delivered the intended benefits of competition.

Recent research carried out on behalf of the Panel shows that competition authorities rely heavily on one or two consumer segments to drive competition in financial services. These are younger consumers aged 25-44 and older consumers who are mostly retired with more time to shop around. But there are loyal customers for whom sticking to what they know is rational and these customers should not be penalised for this loyalty. However, when it comes to retail financial services sector, such as insurance or credit cards, loyal customers end up paying more.

The FCA currently applies the general principle that consumers should take responsibility for their own decisions. This fails to recognise the information asymmetry that exists between customers and firms, conflicts of interests and behavioural biases. Effective competition policy should aim to address conflicts of interest and information asymmetries, not try to change consumers' behaviour, which is less well understood and far harder to achieve.

Government and competition authorities should also recognise that sticking with products and providers can be a rational decision, particularly when search costs are high and consumers cannot easily judge whether what else is on offer is a better deal.

#### *Supply-side remedies*

The evidence in the Panel's research indicates that levels of shopping around and switching in financial services are unlikely to change significantly without supply-side intervention or innovation. Consumers do not necessarily want a better means of switching between very similar institutions or products; they want to deal with a firm that they can trust and a sector which works to address their needs.

In addition, remedies that focus on prompting consumers to switch do not encourage firms to treat their customers fairly in the first place. There should be more pressure on firms to treat

their customers fairly, for example by automatically moving savers onto the next best available rate, when their fixed or teaser rate ends.

Competition authorities should take robust and effective action to tackle firms' exploitation of consumers' behavioural biases and 'monopolistic competition' where there may be many firms competing but develop market power which results in products, prices and information that are complex and even misleading, inhibiting consumers' ability to shop around and switch. It should be possible to measure consumer outcomes and incentivise firms to behave in ways that support competition. For example, in our position paper we called for competition authorities to focus on supply-side metrics such as reputation measures, product benchmark or price discrimination that would alert customers to the different treatment of similar customers in different groups.

#### *Duty of care*

A recent report by the FSCS showed that only 36% of UK consumers state they have trust in financial services firms. In order to restore trust in the sector, competition policy should seek to address the imperfect balance of power that currently exists between consumers and firms. This will not be achieved by giving customers access to more information or by nudging them to switch products or firm. Instead Government should focus on supply-side measures that help to address imbalances in the industry that hinder competition and lead to poor consumer outcomes.

The Panel has proposed that the Financial Services & Markets Act (FSMA) should be amended to require the Financial Conduct Authority (FCA) to make rules specifying what constitutes a 'reasonable' duty of care that financial services providers should owe towards their customers. A duty of care would oblige providers of financial services to avoid conflicts of interest and act in the best interests of their customers. The Panel believes consumers can only reasonably be expected to take responsibility for their decisions where firms have exercised a duty of care.

#### *Concluding remarks*

The Panel welcomed the Government's announcement of a Green Paper to examine markets that are not working effectively or fairly for consumers. This seems to have stalled since the General Election, we hope that when it does surface it will include a review of competition policy and supply-side interventions that will help foster markets that benefit consumers and the wider economy.

Yours sincerely

Sue Lewis

Chair, Financial Services Consumer Panel