Institute
and Faculty
of Actuaries

Consumer access to financial services

IFoA response to the Treasury Committee

14 December 2018

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The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

We strive to act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public policy issues. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.

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Rt Hon Nicky Morgan MP
Treasury Committee
House of Commons
London
SW1A 0AA

14 December 2018

Dear Ms Morgan,

IFoA response to Treasury Committee inquiry into consumers' access to financial services

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Treasury Committee's inquiry. The members of the IFoA work across a range of financial services, including in pension funds and life and general insurance firms. In an increasingly digital world, actuaries are acutely attuned to the impact of online services and data science on their work, and in particular on the customers their industries serve. Under our Royal Charter, the IFoA is committed to serving the public interest, and much of our members' work is focussed on the impact of policy and regulatory change on the public and their ability to understand, access and afford the financial products our members are involved in developing.

We have focussed our answers below on the areas where our members have most expertise. Our response can be summarised as follows:

- The digital age has brought many opportunities for financial services firms to offer an elevated level of service to their customers. Use of online tools will make interaction between firms and customers much more convenient for many. However the growing use of online communication channels and increasing move away from physical infrastructure such as bank branches and the use of cash, risk creating new classes of vulnerable customers amongst those who are unable to access these services. Care should be taken to ensure that these welcome technological advances do not exacerbate financial exclusion in an unintended way. On the other hand, online information and advice services have the potential to enhance the understanding of and engagement with financial services products by some customers hitherto regarded as vulnerable.

- The rise of data science in financial services provides an opportunity for firms to create more tailored products that meet the needs of their customers more closely. However, in insurance in particular, data science is changing the nature of the risk sharing mechanism that is central to these products. Firms are using data to price insurance in a way that more accurately reflects a customer's risk profile (risk pricing), and/or other factors such as sensitivity to price and brand loyalty (inertia pricing). There is a risk that some vulnerable consumers could be adversely affected by these practices.

- In the long term savings market, a range of policy changes has led to increasing complexity. At the same time it is becoming more and more important that customers properly understand the pensions landscape and its growing range of products. As customers become more reliant on these products to fund their retirement, it is crucial that the industry is able to communicate with all its customers in an appropriate manner, with those thought of as traditionally vulnerable of particular concern. The IFoA strongly supports the development of pensions dashboards by the financial services industry in partnership with the Government.

1. How should financial service providers define 'vulnerability'?

a. Examine how financial services firms define 'vulnerability' and assess how practical the Financial Conduct Authority's definition of vulnerability is.

Financial services firms are likely to follow the FCA's definition of vulnerability. We note that, in *FCA Mission: Approach to Consumers*, published in July 2018, the FCA reverted to the definition of a vulnerable consumer that was in its February 2015 occasional paper *Consumer Vulnerability*:

"Someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care."

We support the reversion to this definition of vulnerability, rather than the broader definition that was considered in *FCA Mission: Our Future Approach to Consumers*, published in October 2017, for two reasons:

- We think that the February 2015 definition is in line with employees' and customers' understanding of vulnerability, and with existing policies and processes in financial services firms.
- We agree with feedback to the FCA that the broader definition, under which any consumer may become vulnerable at some time, might have put too much onus on consumers to self-identify their vulnerability.

However, the final part of the original definition of vulnerability, "particularly when a firm is not acting with appropriate levels of care", could be understood as implying that banks have a duty of care to understand the circumstances and needs on individual customers, including the particular circumstances and needs of vulnerable customers (see our response to question 1 part c, below).

The move away from branches to online financial services will have positive and negative implications for customer vulnerability and financial exclusion:

- Positive: New online services that provide information, possibly with links to videos, that are interactive and that are easy to use, have the potential to increase the understanding of financial products by some customers previously regarded as vulnerable.
- Negative: Customers who are not able to get online, whether because of a lack of reception or limited technology skills, will miss out on these new online services and on offers that are only available online.

Because of the dominance of banking and insurance by a limited number of large funds, it is easy to overlook the important contribution to the distribution of financial products, including to poorer customers, that is made by building societies and credit unions. Because of their mutual and non-profit status and their role in local communities, they are likely to maintain their branch offering, and may well provide a good service for vulnerable customers and support financial inclusion.

c. Consider the merits of having a 'duty of care' for financial services providers and examine whether this would increase protection for vulnerable customers.

The IFoA believes that there is a strong case for introducing a duty of care for financial services, as a positive obligation, as opposed to a prohibition or fiduciary duty. Our recommendation reflects the need to reverse the erosion of trust in banks caused by various scandals, such as PPI mis-selling, derivatives mis-selling, Libor manipulation and more recently, RBS's Global Restructuring Group. These events occurred despite the 'Treating customers fairly' initiative championed by the FCA's predecessor the FSA. That initiative and the FCA's Principles for Businesses, are necessary and important but in our view further safeguards are needed. We believe that a duty of care would make banks and bank employees more conscious of their duty to their customers and would address public frustration that few bank employees have been sanctioned. While recent concerns have related to the behaviour of banks, we think that the duty of care should apply to financial firms and their employees in general.

We suggest that the duty of care should be in the form of a principle, with a supporting standard explaining its application to different products and customer groups. The standard should also be applicable to situations which cannot be anticipated. This last consideration is important given the rapid development of new technologies which may transform many areas of financial activity, for example, through innovative products and services based on Open Banking. We believe a duty of care carefully structured in this way need not increase complexity or reduce innovation.

We suggest that the object of an employee's duty of care should be interpreted in a wide sense. Depending on circumstances, it might encompass not only the client, but also, for example, colleagues, shareholders, lenders or broader society.

2. **Are certain groups of consumers excluded from obtaining a basic level of service from financial services providers?**

   a. Examine which customers can be most disadvantaged when bank branches close and consider whether there is evidence to suggest that bank branch closure leads to increased financial exclusion.

Bank branches are closing for economic reasons. Because of the convenient use of the non-cash payment eco-system, there are fewer customers physically using bank branches. In the majority of cases, where customers use and actually prefer electronic payment methods, the closure of bank branches is not a great inconvenience for most customers. Should the customers wish to use cash, then there are, in urban areas, sufficient numbers of ATMs, paid for by the banking sector, to meet their requirements. The situation is different in some rural and visitor areas where access to cash can be much more problematic. The problems also arise, for merchants receiving cash who now have to find ways to deposit the cash that they receive where there are not sufficient numbers of paying-in points.

However, there are many customers and other users of cash who are unable to handle electronic means of payment for many reasons: some are un-banked, others do not have access to necessary devices or have no internet access. Some lack general, financial or computer literacy, are technically naïve or even just resistant to, or incapable of, change. This group will be most inconvenienced and disadvantaged from the closure of local bank branches.

Moreover, with the reduction of cash usage within the eco-system, it is likely that the cost of providing cash, including the cost of running the ATM network, will increase per unit of cash, and unless this is absorbed by the commercial banks, it will inevitably result in a charge for cash usage in due course. This would disadvantage further those already being disadvantaged.

There is broad consensus, especially through developing countries (including India, Kenya and much of the rest of Africa), that the lack of access to banking infrastructure is a barrier to financial inclusion. It would seem logical to suggest that the continued closure of branches/ATMs in the UK will also increase exclusion. The inability to develop such branch networks has been a key driver for the development of mobile banking in these regions.[1]

Financial institutions are increasingly moving to convince customers to use their digital services. There is a clear poverty premium paid in the case of access to digital services versus physical ones,

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[1] Accenture/ATM Industry Association, ATM Benchmarking Study 2016 and Industry Report, https://www.accenture.com/_acnmedia/PDF-10/Accenture-Banking-ATM-Benchmarking-2016.pdf

where the poorest in our society find it increasingly more difficult to access services and may well end up being charged more as a result. There are many cases in which the best deals are now accessible through apps only, which further excludes poor or vulnerable members of society who cannot afford a smartphone and therefore are excluded from obtaining these deals.

b. Consider how financial services providers plan to cater for customers who will no longer have easy access to a bank branch.

More could be done to encourage awareness of the speed and reliability of online payments services based on Faster Payments, including person-to-person payments by mobile banking. The IFoA also believes that the UK can learn many lessons from payment systems around the world and we recommend that the Bank of England assesses international experiences, including the use of multifunction ATMs. One example of a simple and very inclusive system is M-Pesa, widely used in Kenya where 96% of families have an account and can "text" money to other users. The mobile devices used are simple and very cheap in nature and do not rely on internet access. Accounts could be set up in post offices and the devices distributed free of charge or at minimal costs to subscribers.[2]

c. Examine how providers ensure that their marketing, communications and support services are accessible to vulnerable consumers, including consumers who have low literacy levels.

The pensions and retirement saving industry is an increasingly important consumer-facing financial service which has traditionally been thought of as complicated and inaccessible. This is true for the average consumer and particularly challenging for vulnerable customers. The industry has been fairly criticised in the past for the density of information, for example, in annual pension statements, and for the complex language used within the industry in consumer communications.

More and more individuals are now saving into defined contribution (DC) pensions schemes, as a result of automatic enrolment and the move away from traditional employer-arranged defined benefit (DB) pension arrangements. DC schemes generally demand a more active approach from consumers and the responsibility for the various associated risks sit firmly with the individual, whereas in DB arrangements these risks and responsibilities were borne by someone's employer. It will therefore be increasingly important that all consumers understand and can easily interact with their pension and savings as more and more individuals become reliant on DC savings to fund their retirement. The Government's 'freedom and choice' reforms have further entrenched the need for a good understanding of pensions, as individuals must choose from many more options for how to turn their savings into an income to last throughout their retirement. This will pose particular problems for vulnerable customers but it will be increasingly important that providers put in place support for all customers to help them through the transition to retirement. Moreover, a decline in cognition during retirement will make it increasingly difficult for many customers to make the ongoing decisions that popular drawdown products necessitate.

In this context, there are a number of ongoing initiatives which should be commended for their attempt to improve communications and make them more accessible for consumers. The ABI's 'Making Retirement Choices Clear' initiative for example, has attempted to remove jargon from customer communication and develops a set of agreed terms to make communication clear. Despite being a voluntary initiative, the majority of pension providers have now adopted the principles of the initiative and have begun to implement the new simpler, standardised terms into their communications across all channels.

Many argue that simplicity of pension information will help encourage individuals to engage with their savings and make better decisions. This must of course be balanced with an assurance that

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[2] Institute and Faculty of Actuaries, Cashless Society Working Party, A Cashless Society: Benefits, Risks and Issues, 5.3 Case Study: M-Pesa https://www.actuaries.org.uk/documents/cashless-society-benefits-risks-and-issues

customers fully understand any communication from their pension provider. Retirement products are complex and often have a range of assumptions and significant uncertainty attached. Firms tread a fine line between making communications easy to understand and meeting their regulatory requirements, and this is an ongoing tension for the pensions industry. We are encouraged however to see the DWP endorses the concept of a simplified annual statement, which displays clear information to savers on one side of A4. This should go some way to ensuring that individuals properly understand what their pension provision will mean for their standard of living in retirement and can make changes to their savings behaviour accordingly.

Other initiatives from the Government should help to improve customers' understanding of their pension. Most notably, the pensions dashboard project has potential to transform the way individuals understand their financial situation and can plan for their retirement. The IFoA strongly supports the development of pensions dashboards by the financial services industry in partnership with the Government. Surrounding dashboards with tools and other resources to help aid customers' understanding of their situation will be important to maximise the success of the dashboard as an educational tool. We believe that there will be an essential role for the Government in aiding the industry to deliver dashboards successfully and that there will ultimately be tangible benefits for both industry and Government in achieving this aim.

Similarly, we are encouraged by the Government's commitment to introducing the Midlife MOT which will also be an important step to helping people understand their financial situation into retirement, particularly vulnerable customers including those who do not have access to online tools. We are keen to see the Government build on the success of Pension Wise in the transition to the Single Financial Guidance Body in the New Year. Latest figures show that 9 in 10 customers are happy with the phone or face-to-face services offered by Pension Wise and almost all customers reported that the sessions improved their understanding of their pension options.[3]

e. Consider whether there are barriers to participation which lead to consumers not having a bank account.

We do not believe that there are barriers to participation in current account banking in the UK. In particular, the widespread availability of basic bank accounts reduces the risk that less affluent or higher-risk customers might be excluded. That said, we recognise that the closure of branches means that more customers will have to apply for current accounts online. It is therefore important that the online process for opening current accounts, including the provision of proof of identify, is easy to understand and to use.

g. Examine how financial services providers comply with equality legislation and the mechanisms for enforcement.

The increased use and power of data science algorithms could mean that, whilst financial service companies are apparently complying with equality legislation and excluding obvious discriminatory factors from their models, their models might draw enough information from secondary data points to indirectly bring these factors back in. We explore this concept further in our answer to question 3b below.

i. Evaluate how fintech and technological innovation could help those who cannot easily access physical financial services branches.

[3] DWP Pension Wise service evaluation 2017/18: Experiences and outcomes of customers using Pension Wise in 2017/18, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/758517/pension-wise-service-evaluation-2017-18.pdf

The development of innovative online services, using data gathered through Open Banking interfaces, will help all customers, including those who cannot easily access physical branches, in two important ways: shopping around and information and advice:

Shopping around

The future availability of price comparison websites based on customers' individual behaviour and/or risk factors will make it much easier for customers to shop around and to select products that are appropriate for them. This is particularly valuable in product markets such as current accounts, where it is difficult for customers to quantify the cost of current account banking with their own bank, and effectively impossible to quantify this cost with another bank. These new online services should also make it easier for customers to switch between products and between providers. More generally, these new online services should improve customer education and engagement.

Information and advice

Even if customers have not gone to physical branches for transactions, many customers have gone for information and advice. The future availability of personal financial management services will enable customers to bring together banking, insurance and other financial data if they wish to do so. This will make it much easier for people to manage their financial affairs. In addition, these services are likely to provide information and automated advice. It is important that regulations, or regulatory uncertainty, do not limit the provision of information and advice online. This means that, in various products including mortgages, the boundary between information and advice must be sufficiently clear that providers are not discouraged from offering online services because of the risk of fines in the event that what they regard as information might be deemed by the FCA to be regulated advice.

3. **Do vulnerable consumers pay more for financial services products?**

   a. Examine the effectiveness of procedures deployed by financial services providers to ensure that customers properly understand the products that they are purchasing, including those who have low literacy levels.

As mentioned in our answer to question 2c, the IFoA is strongly supportive of initiatives that help people to understand long-term savings products in particular because of their increasing importance in providing income for many in retirement. This information is, and should continue to be, delivered in partnership between financial services providers and the government to maximise public trust in the guidance provided.

   b. Examine whether vulnerable consumers pay prohibitively more for certain financial services products, including travel and home insurance.

The most obvious area in which vulnerable customers pay more - possibly prohibitively more - is personal current accounts (PCAs). We note the FCA's finding that:

"charges for unarranged overdrafts are paid by around 14% of PCA customers but the majority of fees are concentrated on only 1.5% of customers: we estimate that these consumers pay on average around £450 a year in unarranged overdraft fees."

Customers using unarranged overdrafts are likely to include vulnerable customers who have limited financial resources and/or who are not good at managing their money.

We note that the FCA proposes to ban all fixed fees except refused payment fees, to require arranged overdrafts to be charged using a single interest rate for each type of account and to require unarranged overdrafts to be charged using a single interest rate no higher than a fixed percentage uplift of the interest rate for arranged overdrafts[4]. However, if banks were to seek to increase their overdraft interest rates to partly offset their interest lost on fixed fees, there would be an even greater cross-subsidy between overdraft users (including vulnerable customers) and customers not using overdrafts (including affluent customers enjoying genuinely free banking).

More generally, vulnerable customers may pay more for certain financial services products as a result of either risk pricing or inertia pricing:

Risk pricing

Insurers have long gathered data to understand the nature of the risks they are willing to accept. Improvements in the sophistication of data science, along with advances in computing power, offer the potential for a step change in the analysis and pricing of individual risks and in the management of claims. For these reasons, data science is an area of great interest to the IFoA. However, as data science develops, we recognise that there are questions about ethical issues and about how insurers use the information they have about their customers.

A characteristic of insurance is risk pooling, where individual risks are shared between groups of policyholders with broadly similar risk characteristics. As data science becomes more sophisticated and enables insurers to better understand and price individual risks, the extent of cross-subsidy between groups of policyholders is likely to decline.

As insurers gain a clearer understanding of individuals' risk characteristics, individuals in certain segments may find that their insurance is more expensive, or harder to obtain. Examples of groups of customers that could be impacted include:

- Young drivers with little driving experience seeking motor insurance;
- People with declining health finding that health insurance becomes too expensive; and
- Older travellers seeking travel insurance, the pricing of which is often broad-brush.

In banking, the equivalent use of data science could in theory lead to relatively higher prices for borrowers perceived to be higher-risk, including less affluent customers who might be considered vulnerable. However, this potentially negative effect may be offset by the positive impact of Open Banking. For example, unsecured personal loans are already risk-priced and substantially online. Currently, the prices for higher-risk borrowers are less transparent than the advertised headline rates for good borrowers. The availability of price comparison websites offering information for individuals based on their personal data should increase competition in higher-risk segments, benefiting higher-risk customers including vulnerable customers.

Inertia pricing

We note the comments about inertia pricing made by the FCA in recent papers such as General Insurance Pricing Practices and Fair Pricing in Financial Services, and we recognise that data science may well increase the capabilities of financial firms to identify different levels of price sensitivity among their customers.

Inertia pricing may have a disproportionately negative impact on vulnerable customers if, as seems likely, they are generally less sensitive to prices and/or less likely to switch. However, some vulnerable customers will benefit from relatively low prices for new customers.

In this context, we note the paper Guiding Principles and Action Points for General Insurance Pricing that was issued by the ABI and BIBA in May 2018. In this paper, the first two of the Guiding Principles are:

1) ABI and BIBA members do not support excessive differences between new customer premiums and subsequent renewal premiums that unfairly penalise long-standing customers.

[4] High-cost Credit Review: Overdrafts, FCA, May 2018, paragraph 4.46

2) ABI and BIBA members commit to working towards better outcomes for long-standing customers. For a stable and consistent outcome, all market participants outside of the ABI and BIBA need to make similar commitments.

d. Evaluate the impact of reducing the number of free-to-use ATMs on vulnerable consumers.

With less use of cash, the unit cost of providing and handling cash is likely to increase and this may shorten the lifespan of free-to-use ATMs. Given the prevalence of 'free-if-in-credit' banking, banks cannot charge for the use of ATMs. So banks may dispose of less profitable ATMs to alternative operators which charge for their use. Charges for using ATMs would bear more heavily on less affluent customers, including vulnerable customers, who are likely to make regular small withdrawals rather than occasional large withdrawals. There is therefore a strong argument for a national ATM strategy that recognises that ATMs provide a service for the public interest.

Establishing and communicating a vision for ATMs within payment services would assist with engaging with key stakeholders and providing strategic direction. The global trend of de-cashing is emotive, particularly in the developed world, with evidence of mistrust towards banks and financial institutions, amongst other issues and risks. Restricting engagement to the payments ecosystem risks ongoing entrenchment of these views, as suggested in the stakeholder analysis in the IFoA published paper "A Cashless Society: benefits, risks and issues".[5] A published strategy would be a key tool for balanced stakeholder engagement.

We note the good work that has already been done by the Payment System Regulator and the Payment Strategy Forum in the broader market for payments services in the UK. We suggest that the Payment Strategy Forum should be asked to carry out a strategic review of ATMs in the UK, bearing in mind the potential impact on vulnerable customers of reduced numbers of ATMs and/or greater charging for use of ATMs, and taking account of international developments in ATMs.

Should you want to discuss any of the points raised please contact Catherine Burtle, Senior Policy Analyst (catherine.burtle@actuaries.org.uk / 020 7632 1471) in the first instance.

Yours sincerely,

John Taylor
President-elect, Institute and Faculty of Actuaries

[5] Institute and Faculty of Actuaries, Cashless Society Working Party, A Cashless Society: Benefits, Risks and Issues, https://www.actuaries.org.uk/documents/cashless-society-benefits-risks-and-issues