CONSUMER DUTY ALLIANCE

ESTABLISHING A FRAMEWORK FOR FAIR VALUE

Explaining Consumer Duty's Price and Value outcome.

A framework for fair value means firms being able to clearly demonstrate and evidence how any product or service they provide offers fair value. It is not about the absolute level of fees charged.

GETTING THINGS IN PROPORTION

Fair Value is primarily about ensuring consumers receive the best possible outcomes from products and services in terms of price and benefits, balanced against the commercial reality of advice firms needing to be profitable.

The Financial Conduct Authority (FCA) expects firms to take a proportionate approach (based on size, scale and business complexity) to implementing its requirements. This allows firms some flexibility to consider the factors relevant for their sector and the nuances of their business model.

The FCA has also stated it will focus resources on where the risk and extent of consumer detriment is greatest. So, for smaller firms with less exposure to high-risk product areas and clients less likely to be in vulnerable circumstances, their monitoring of Duty implementation may be less demanding – if they can demonstrate they're taking implementation seriously and in a timely manner.

Whilst firms should apply the concepts of proportionality and reasonableness, if they uncover or suspect poor value, they must take appropriate action immediately to address it.

THREE ACTIONS FOR ALL FIRMS

1. **Confirm role/s**

   Identify their role as a manufacturer, co-manufacturer and/or distributor and understand their respective responsibilities under PRIN 2A.4.

   The complexity of completing a fair value assessment will vary depending on the number of parties within the manufacturing/distribution value chain, and the roles and responsibilities of each party within it.

2. **Review market profile, product benefits and price, distribution agreements**

   Firms that are predominantly distribution should obtain Value Assessments and Target Market Statements from manufacturers then identify the following:

   - The characteristics, objectives and needs of the target market.
   - The benefits the product/service is intended to provide to a consumer.
   - How the price paid by the consumer compares with the breadth and quality of any services provided by the distributor.
   - Whether the distribution arrangements (including any remuneration for anyone in the distribution chain) would result in the product/service ceasing to provide fair value to consumers.

3. **Complete assessment by 31 July 2023**

   This means having methodically assessed the value of products and services offered in a way that reflects the various factors the firm feels are appropriate and aligned to the broad requirements of Consumer Duty (including reasonableness and proportionality).

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HOW THE FCA DEFINES 'FAIR VALUE'

The FCA's definition of 'fair value' does not specify a range of prices or how to calculate it. **Fair value is defined as the amount paid for a product being reasonable relative to the benefits provided by the product.**

It's holistic nature means firms must consider all a product's benefits (tangible and intangible) and compare them to all the costs (financial and non-financial) a consumer is expected to pay for as long as they have the product.

One way to break down costs is:

1. Price/s paid by the consumer.
2. Costs of manufacturing the product.
3. Expected distribution costs of the product or service.
4. The nature, extent and quality of the service consumers receive including non-financial costs they might incur.

For Equity Release, this analysis of consumer costs could include:

- ✔ Advice fees including conveyancer fees and other legal advice fees.
- ✔ Product arrangement fees.
- ✔ Interest (compounded).
- ✔ Property valuation fee including reinspection fees.
- ✔ Indirect property costs e.g., warranties, indemnities and guarantees.
- ✔ Administration fees over the life of the product and/or service.
- ✔ Early repayment charges.
- ✔ Non-financial costs e.g.,unreasonable time and effort to access services.
- ✔ Introducer fees.

ASSESSING VALUE ACCORDING TO THE FCA'S FINAL GUIDANCE

Firms must consider how they apply the concept of fair value overall and across each product line.

The key assessment areas within the FCA's guidance (FG22/5) are listed below:

Clause 7.9: When assessing if a product or service provides value, as a minimum firms must consider the following:

- The nature of a product or service, including its qualities and the benefits it will provide or potentially provide.
- Any limitations of the product or service (e.g., scope of cover for insurance products).
- The expected total price consumers will pay, including all applicable fees and charges over the lifetime of the consumer's relationship with the firm.

Clause 7.12: Depending on the nature of the product or service, firms could assess fair value with consumer surveys, testing or using internal data. Firms should not rely solely on individual consumers or single measures e.g. complaints data, to consider whether the price provides fair value in relation to the benefits.

Clause 7.13: Firms can choose which factors to use in their value assessments, provided those factors can demonstrate a reasonable relationship between the total price paid and the consumer benefits received.

Clause 7.14: If a product or service does not provide or ceases to provide fair value to consumers, firms must take appropriate action to mitigate and prevent harm, e.g., improve its value or withdrawing it from sale.

ESTABLISHING A FRAMEWORK FOR FAIR VALUE

Firms must also monitor and assess the value of their products and services throughout their life, regularly reviewing their value assessment and taking any appropriate remedial action. This will give consumers more confidence that the product or service will continue to provide fair value.

FCA guidance for distributors

Clause 7.31: Distributors must ensure their own distribution charges represent fair value. All firms in the distribution chain are responsible for the value of their prices and are not required to challenge other firms' value assessments.

Clause 7.32: Distributors must obtain relevant information from manufacturers to understand the intended value of a product or service. They need to understand whether their distribution arrangements (including remuneration for anyone in the distribution chain) would result in the product or service ceasing to provide fair value to consumers.

Clause 7.33: Distributors need to consider the cumulative impact of remuneration received by each person in the value chain on the product's overall value to the consumer, it might result in a higher total fee that does not represent fair value.

Clause 7.42: Consumers with characteristics of vulnerability may be more susceptible to receiving poor value. Firms should be able to evidence to the FCA that the price of the product or service represents fair value for different consumer groups, including those with characteristics of vulnerability.

Clause 7.45: Firms must review value throughout the life of a product or service.

Clause 7.46: Firms must consider the frequency of future value assessments based on factors such as the nature and complexity of the product or service, indicators of consumer harm, the distribution strategy and relevant external aspects.

RECENT FCA UPDATES

Inside FCA Podcast: What is the price and value outcome?

This highlights three elements of a good fair value framework:

1. An assessment of the price that a consumer pays over the lifecycle of the product or service, and comparing that to the benefits that a typical consumer might get from using it.
2. An assessment of whether different consumer groups are getting fair value in the way they use the product or service, and the prices that they're paying for it.
3. An assessment of what is driving the price both at a firm and at the market level.

Findings from FCA's review of 14 firms' fair value frameworks

They state clearly that, as well as assessing the reasonableness of prices compared with benefits, the costs incurred in distribution and how costs and benefits compare against the market generally, *'Firms have discretion to decide the additional factors they use in their value assessments'*.

The FCA highlighted the following **good practice examples:**

- Many frameworks clearly set out principles for how the firm would apply the concept of fair value generally and across product lines.

ESTABLISHING A FRAMEWORK FOR FAIR VALUE

- Most frameworks set out a reasonable view of how to assess the benefits consumers can expect to receive. These also provided a sufficiently broad view of the overall costs to the consumer, including fees and charges, any non-monetary costs, as well as any potential distribution costs to consumers.
- A handful of frameworks contained clear discussion about how to price products sold as a package or bundle and assess them for value. There was a clear consideration of where bundling does, or does not, provide value to consumers. For example, one firm noted that a bundle should not be priced higher than its constituent parts unless there is value to the consumer from the convenience of products being bundled together.
- Many firms considered the interaction between fair value and other elements of the Duty such as the products and services, consumer support and consumer understanding outcomes.
- Many frameworks considered other factors that may affect the firm's assessment of fair value, such as products and services that consumers already hold with the firm.
- Many firms considered consumers' behavioural biases, such as instant gratification or overweighting potential losses, how these may affect the way consumers buy and use products and services and how poor value may result.
- Some frameworks included tailored analysis of fair value for consumers with characteristics of vulnerability. For example, analysing how the needs and objectives for vulnerable consumer groups were likely to differ, how costs and benefits would vary, and indicators to understand the characteristics of consumers in the target market.
- Some firms considered product or service-level cross-subsidies, where some consumers pay higher prices or generate higher profit margins, and the factors to consider when reviewing whether these products or services offer fair value
- Most frameworks set out appropriate data-led plans to monitor and review consumer outcomes and allow sufficient challenge and discussion in the firm's decision-making.
- Most included clear timelines for future value assessments and most addressed the frequency of reviews, for instance corresponding to the expected length of time a consumer would keep a product or the expected renewal pattern.
- Some firms set out clear rectification processes, complete with named owners, to be followed if they identify that a product no longer provides fair value. In some cases, these included triggers which may require a new assessment, such as movements in a certain data indicator, and allowed for discussion and challenge at an appropriate level of seniority.

The FCA highlighted the following as **examples requiring improvement:**

- Using a single generalised template for assessing fair value across several markets.
- High-level or unevidenced arguments that a firm's business models or ethos are inherently fair value.
- Insufficient thought to the distinction between manufacturers and distributors in PRIN 2A.4, and the requirements that apply.

- No reference to the firm's profit margins on different products and services. While 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.
- Not considering the types of non-financial costs and benefits that consumers may reasonably expect to pay or receive.
- Insufficient consideration to whether they needed information from other firms in the distribution chain and/or third parties to properly assess fair value.
- When assessing fair value to different groups of consumers (a central theme of the rules) some frameworks tended to rely on average outcomes rather than analysis to understand the full distribution of outcomes.
- Some assessments appear to identify differential pricing between consumer groups, but no assessment and demonstration of how each group of customers receives fair value.

HOW TO ASSESS OVERALL VALUE

Define and assess overall fair value

All firms must establish how they will assess fair value within their organisation and use the assessment to validate whether they are achieving this aim.

They should use a Fair Value Framework or methodical approach to show how they are assessing fair value, and with reference to their risk appetite for fair value.

Assess, articulate and evidence fair value at client segmentation level

As well as price and tangible benefits, all fair value work should include intangible benefits, e.g.:

- The value of recommending an adviser led platform, reducing the risk of scams and clients withdrawing all their funds without any adviser interjection – of particular value for those in vulnerable circumstances and perhaps more prone to scams.
- The value of multiple channels for consumers to use and to obtain support for a product or service.
- The value of coaching, training and guidance a firm provides to its staff.
- The value of thorough goal setting and risk management.
- The value inherent in non-regulated aspects of advice.

"Fair value" does not mean distributing the cheapest product or service available or driving prices down to this point.

A product perceived to be higher quality and providing more support may still be fair value even though it costs more than a 'no frills' basic online-only product.

HOW TO ASSESS TANGIBLE COSTS

Advice costs v standard fees charged

If the cost of delivering advice is low relative to standard advice fees charged, the firm should assess the extent to which it can argue fair value. For example, a high charge and low cost may be reasonable if it reflects an investment in streamlining processes to deliver a highly efficient business model. Calculating the cost of delivery could be as simple as listing all the standard processes and activities, then calculating the delivery cost based upon typical time taken and who is involved (adviser/paraplanner or administrator).

ESTABLISHING A FRAMEWORK FOR FAIR VALUE

Non-standard advice fees.

Firms could consider an exercise to identify any outliers to their standard advice fees (e.g., additional or one-off services) in each of their target market segments, then assess the cost of delivery for any additional or bespoke services.

BENCHMARKING

Firms should consider benchmarking their products or services against internal and external equivalents to ensure they don't provide less value to consumers.

Internal benchmarking between comparable products and/or services can help to determine their relative profitability and whether they're within acceptable boundaries.

CLIENT FEEDBACK

Seeking regular feedback from clients can provide useful evidence of fair value and its delivery across client segments, especially those in vulnerable circumstances.

CONSUMER UNDERSTANDING

Firms should also review their fees and charges alongside Consumer Duty outcome three, consumer understanding. Firms should be able to demonstrate that the fees charged to the target market can be reasonably understood allowing consumers to fully assess the benefits in relation to the price paid.

If firms identify that unclear or misleading information is provided as part of the product or service, they must assess to what extent this increases the costs relative to the benefits of the service.

GOVERNANCE OF FAIR VALUE

Firms must ensure governance arrangements are in place to review, approve and monitor the performance of fair value assessments over time.

Examples of triggers for ongoing review of a fair value assessment include:

- ✔ A product feature changes and reduces the benefits available to a select consumer group.
- ✔ The profitability of a product or service exceeds a reasonable level, as pre-defined within the firm's risk appetite for fair value.
- ✔ Material changes to the target market characteristics of a product/service
- ✔ Material changes to the features, limitations, or benefits of a product or service.
- ✔ Consumer-facing services not performing in line with service level agreements or operational thresholds.
- ✔ Material changes to the distribution strategy.

Go to **www.consumerduty.org** for more information and support on financial vulnerability and Consumer Duty.