Price and Value Outcome and What is Fair Value in the Wealth Market?

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Introduction

This next article in our series focuses on the 'Price and Value outcome' of the Consumer Duty, including the question of 'fair value'. With its increasing focus on price and value, we have been wary that the FCA is moving closer and closer to price regulation. Whilst this doesn't appear expressly on the FCA's agenda, and perhaps is unlikely to happen in the true sense, the FCA's focus on fair value is, in our view, a step in that direction.

The specific focus of the Price and Value outcome is on the relationship between the price the consumer pays to the overall benefits of a product (e.g. the nature, quality and benefits the customer will experience). Low prices for the end consumer do not always equate to fair value, and high prices do not always demonstrate the inverse - this is a balancing exercise.

On this point, the FCA stated in CP 21/13 that they "are not proposing to limit the margins firms can earn, but firms still need to consider whether the total price paid by consumers is reasonable in relation to the benefits offered by the product or service". This confirms that this is not strictly price regulation.

Value Assessment

Firms will need to have a value assessment process in place which they must be able to evidence to the FCA.

This assessment should take place as part of the initial product or service approval process, and will require periodic review and updating. As part of developing the value assessment process, firms will need to determine what characteristics should be assessed, which may include:

- Benefits to the client (e.g. investment return or administrative/service benefits);
- Cost of the product to the firm; and
- Market analysis of competing or comparable products.

As a starting point, it may be useful to inform the approach firms should take to review sub sectors which are already required to undertake value assessments.

Some wealth management firms will be familiar, for example, with the requirements in the COLL sourcebook for assessing the value of their funds (should they have any):

- The range and quality of services provided.
- The performance of the scheme, after deduction of all payments out of scheme property as set out in the prospectus (in this rule, COLL 6.6.23E and COLL 8.5.19E, “charges”). Performance should be considered over an appropriate timescale having regard to the scheme’s investment objectives, policy and strategy.
- In relation to each charge, the cost of providing the service to which the charge relates, and when money is paid directly to associates or external parties, the cost is the amount paid to that person.
- Whether the AFM is able to achieve savings and benefits from economies of scale, relating to the direct and indirect costs of managing the scheme property and taking into account the value of the scheme property and whether it has grown or contracted in size as a result of the sale and redemption of units.
- In relation to each service, the market rate for any comparable service provided:
    - by the AFM; or
    - to the AFM or on its behalf, including by a person to which any aspect of the scheme’s management has been delegated.
- In relation to each separate charge, the AFM’s charges and those of its associates for comparable services provided to clients, including for institutional mandates of a comparable size and having similar investment objectives and policies.
- Whether it is appropriate for unitholders to hold units in classes subject to higher charges than those applying to other classes of the same scheme with substantially similar rights.

Evidently, not all of these points will be relevant for each type of product or service provided but, for example, consideration of total cost, comparable services provided by the firm to clients and economies of scale are all points that could be incorporated under new value assessments.

Similar to the funds market, the insurance sector has its own rules to follow on fair value which may offer further assistance in determining relevant considerations for evaluation. In the insurance sector, manufacturers must ensure that products offer fair value to customers for a “reasonably foreseeable period", which includes considering whether distribution channels used for their products result in fair value to customers. Distributors must also ensure the distribution strategy is consistent with the aim of providing fair value to the customer.

Value has a similar meaning in this context as it does to the Price and Value outcome as set out in the Consumer Duty, i.e. the relationship between the overall price to the consumer and the quality of the product or service offered.

Other considerations when assessing "fair value" in the insurance sector include:

- The nature of the product, its benefits, their quality and limitations;
- The type and quality of services provided to customers;
- Expected total price to be paid by the customer and its components; and
- How intended distribution arrangements support the intended value of the product.

Fair value considerations are similar and overlap between the insurance and fund management sectors; comparing these (and other examples) may help firms to identify a starting point for deciding what factors are most appropriate in relation to their business and how they can demonstrate fair value. For firms with similar processes in place already, as a result of other existing regulatory obligations, it may be they can leverage processes in place and tailor them appropriately.

Other Price and Value Outcome Considerations

Part of this outcome is about how a client perceives the product/services he or she has received and the value of them. The difficulty in looking at fair value from this perspective lies in the fact that clients do not have the full picture and, particularly unsophisticated retail clients, are unlikely to have sufficient knowledge to fully assess whether they receive fair value. Customers will, however, have an opinion on the products and services they are provided, and have a view on whether they value those offerings. It is important firms ask clients about this as part of the firm's fair value assessment.

Customer satisfaction surveys may be necessary but not sufficient. Other relevant points to consider include:

- Ensuring the product is designed appropriately for the target market and ensuring transparency of product so that clients can determine whether it satisfies their needs. Primarily this relates to the 'Product and Services outcome', but where a product/service is not appropriately designed, there is an increased chance the service does not offer fair value. This helps demonstrate how the Consumer Duty outcomes will be linked.
- Packaged products should be considered at a component level.
- Distributors should obtain information on a manufacturer's assessment so they can factor this into their distribution arrangements.
- This outcome does not prevent charging different groups more/or less for the same/similar products, but there should be a sufficient rationale for doing so (e.g. customers using lending products may carry differing levels of credit risk and therefore justify a difference in price). With regards to investment businesses, this may be relevant for products or service subject to percentage charging.
- For example, consider the rationale for charging 1% for a service. Client A has a £1m account and Client B has a £100k account. This means Client A is paying 10 times for what is likely a very similar or the same service. Is this acceptable?

Platforms and the Implications of Service on Fair Value

Investment firms may struggle with fair value considerations, but we wonder if platforms may be some of the hardest hit when it comes to fair value. While we expect circumstances to have changed since, the Final Report into the Investment Platforms Market Study published in 2019 stated at paragraph 4.4:

> "A notable 7% of 'direct to platform' (non-advised) consumers had tried to switch platforms but failed to do so in the last three years mainly due to the time involved, the complexity of the process and exit fees. So we are concerned that consumers face significant barriers to switching to firms that are better able to meet their needs or offer better value for money."

The FCA was talking about service issues which prevent clients from obtaining better value for money. Some barriers to exit listed in the final platform report were:

- The time taken to effect the transfer owing to different processes and systems in place;
- Concern about time out of market. This concern would be increased by the time taken for the transfer to take place;
- Concerns or difficulties with conversion of units;
- General complexity and/or lack of understanding by the consumer of the role of platforms; and
- Exit fees.

Fees and Charges

In addition to difficulty swapping platforms (and, as a potential consequence, advisers), the costs and charges that disclosure platforms provide to clients can be more difficult to understand than traditional IFAs/DFMs. While traditional offerings may charge one simple management, advice or administration fee, platforms will often present various ad-hoc charges. This has a number of implications:

- Are there any further elements which need to be considered by platforms to determine fair value at a service level when it's unknown what clients will actually pay? For example, two clients with £100k on a platform may be charged significantly different fees based on the types and number of trades and investments purchased (not including fund charges):
    - Do firms needs to consider this, if so, how?
    - Is running a 'typical' client scenario sufficient for the service? Do there need to be multiple scenarios to evidence fair value for this service?
- Should platforms consider various different cost offerings, for example caps on trade costs after a certain number/amount?
- Where firms have different pricing strategies, do firms need to inform clients of 'better deals', should a client be able to benefit from them?

Conclusion

The Price and Value outcome will require firms to think carefully as to how they can evidence that their products and services provide fair value to consumers. Whilst we expect a lot of firms already consider their services to be fairly valued, every firm will need to be able to demonstrate this. In addition, we expect there to be a number of difficult questions raised about specific scenarios, such as the percentage based fee example and the platforms case study above. We will have to keep a watching brief over some of these questions.

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