Response by the APPG on Debt and Personal Finance to FCA call for input on high-cost credit including review of the high-cost short-term credit price cap

Tackling high-cost credit – how better regulation can protect vulnerable consumers

February 2017

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About the All Party Parliamentary Group on Debt and Personal Finance

The All Party Parliamentary Group on Debt and Personal Finance was established in 2003 to provide a forum for MPs and peers to discuss debt and personal finance issues, to monitor legislative developments in this area, and to provide an opportunity for liaison between Members and organisations with an interest in these issues.

The Group is chaired by Yvonne Fovargue MP and the other officers include: Paul Blomfield MP, Nic Dakin MP, Dr Paul Monaghan MP, Jonathan Edwards MP, and Kelly Tolhurst MP. Current priorities for the group include improving the debt recovery practices of government agencies, access to affordable credit, low-income savings, and ensuring struggling households are protected from mounting debts through a statutory Breathing Space scheme.

The Secretariat for the Group is provided by the StepChange Debt Charity Public Affairs team, and funding for the Group's activities is provided by the subscriptions levied on affiliate members.

A full list of members and affiliate members of the group is available at http://www.appgdebt.org/members/

Summary of response

The APPG on Debt and Personal Finance welcomes the FCA's call for input on high cost credit, including overdrafts, and review of the payday loans price cap. We are pleased the FCA has decided to extend the scope of its review to look at problems in both traditional high cost credit markets like the Rent-to-Own sector – the subject of an APPG inquiry in 2014/15 – and guarantor loans – as well as more mainstream products which can become high-cost, such as overdrafts.

Our members are proud to have been part of an incredibly important cross-party campaign that led to the FCA delivering vital new protections for vulnerable payday loan borrowers. At its peak over 75,000 people a year were contacting StepChange Debt Charity for help with payday loan debt problems and many of us were shocked at the harm caused to our constituents by egregious practices that included the draining of accounts, the repeated rolling over of loans and the rapid escalation of debts. Since the FCA's interventions, in particular through its caps on total cost and price, there has been a significant reduction in the riskiest lending in this market and a steep fall in reported problems with arrears.

The FCA's actions in the payday loans market were a watershed in regulation that we believe should pave the way for equally assertive interventions to tackle persistent problems in other high cost lending markets. The FCA should be confident to exercise its strong consumer protection powers to an equal or even

greater extent in other high cost credit markets where there is clear consumer detriment. In particular, the FCA needs to act to protect consumers where competition is weak and markets are concentrated which makes consumers particularly vulnerable to being exploited.

Regulation that protects vulnerable consumers

The APPG believes the experience of financially vulnerable consumers needs to be at the centre of the FCA's thinking on high cost credit regulation. Many lower-income households and other groups are more vulnerable to problem debt, often facing impossible choices between a number of bad options. This might include for instance having to use expensive and unsustainable credit or not being able to deal with the immediate demands for unaffordable payment from another creditor.

The experience of charities like Citizens Advice and StepChange Debt Charity is that it is essential for the regulator to ensure financial services providers are on the side of consumers who have to rely on them when they are at their most vulnerable.

The High Cost Credit review is an opportunity for the FCA to look at how it can better calibrate its regime so that more weight is given to the needs of vulnerable consumers. We believe existing rules and principles could work better and a wider 'duty of care' to consumers – in particular to those in vulnerable situations – could help establish a clearer regulatory baseline.

We believe the FCA should be more transparent about defining what it looks like to secure an 'appropriate level of consumer protection' in each particular high cost credit market – and across the piece more generally. While access to credit is important, the FCA must act to end the high built-in likelihood of certain products and practices causing consumer harm.

Our response to the FCA's call for input addresses the HCSTC sector, rent-to-own companies, guarantor lending, and overdrafts. We believe there is a strong need for further action from the FCA in all of these markets and we set out recommendations for specific measures below.

High cost credit markets often cause very high levels of detriment to consumers. Therefore, in addition to the actions we outline below, we are recommending:

- **The FCA should extend the total cost cap across all high cost credit markets.** The cap on HCSTC has protected borrowers from spiralling loans, they now never have to repay more than 100% of what they borrow. However, consumers in many high cost credit markets remain vulnerable to being exploited. We believe it is vital the regulator caps the cost of credit so that consumers who are vulnerable to very high prices have a clear safety net to rely on.

- **The FCA should ensure all high cost credit firms strengthen affordability assessments.** The FCA should look at whether any of the existing guidance on responsible lending should be turned into rules. Many creditors support greater clarity and it would bring all lenders in line with those who are trying to get the best outcomes for consumers.

High Cost Short Term Credit (HCSTC) and the impact of the cap

Key issues

The APPG on Debt and Personal Finance believes the FCA's actions to cap the cost of payday loans and protect borrowers from ever-escalating debts has made a positive difference. The cap built on the FCA's specific actions to limit rollovers, warn borrowers of the dangers of late payment and stop companies from draining customers' accounts.

Stronger regulation of the HCSTC market has reduced some of the riskiest lending practices and addressed much of the worst consumer detriment

- StepChange Debt Charity reports the proportion of people coming for help with payday loan debt problems has fallen from its peak of 23% in 2013 to 16% in 2016.
- Citizens Advice reports the number of people it sees with unmanageable payday loans has more than halved. Problems have fallen from over 10,000 a quarter at their peak to just over 4,000 now.
- Both charities say they no longer sees the levels or severity of poor practice in the treatment of customers in financial difficulties, for example, though severely aggressive debt collection and egregious misuse of CPAs.

However, debt advice charities continue to report ongoing problems caused by poor lending practices, in particular through inadequate affordability assessments, and with multiple payday loans:

- Three quarters of StepChange Debt Charity clients surveyed in 2016 were provided a HCSTC loan when they already had outstanding payday loan debt. Over a third (37%) of StepChange clients with payday loan debts continued to have three or more such debts when they turned to the charity for help[i].
- The average amount owed on HCSTC by StepChange Debt Charity clients us still £1,380, just £17 lower than before the price cap regulations came in.

The APPG remains concerned about the treatment of payday loan customers who fall into arrears. The same StepChange Debt Charity survey showed that even when clients told their lender they were facing difficulties:

- 21% continue to have charges and interest added to their debt
- Less than a third (29%) were given an affordable repayment plan[ii]

Impact of the cap on consumers

Members from both sides of the House believe that many if not most borrowers declined access to HCSTC since the cap are likely to be better off.

- **We welcome the fact that since the price cap there has been a marked decline in the numbers of people falling into difficulties with payday loans.** Before the price cap large numbers of borrowers had been lent loans they would always struggle to repay and ended up hit by spiralling interest and charges. Since the introduction of the cap by the FCA, some of the riskiest lending has been curbed, borrowers are paying reduced (though still high) costs, and there is less risk of detriment for consumers. The FCA's own research on the high cost credit market supports the position that payday loans may harm people's finances.

- **We do not believe people declined for HCSTC are instead turning in greater numbers to loan sharks.** Illegal lending is a persistent and serious problem and we will be interested to see the results of the FCA's consumer survey on this issue. However, our most authoritative sources to date are so far united on the evidence they provide as both the Illegal Money lending Teams and Citizens Advice say they have seen no increase in the number of problems caused by loan sharks since the introduction of the price cap.

Recommendations

We remain concerned about continued failings of affordability assessments and people continuing to access multiple payday loans. The FCA has found borrowers holding multiple payday loans are more likely to fall into arrears. We are concerned that measures to try and address this problem on affordability and real-time data sharing have not been strong enough to promote consistent good outcomes.

- **The APPG believes the FCA should strengthen responsible lending provisions so that affordability guidance is turned into responsible lending rules.** For example, making it a minimum requirement for lenders to assess income and expenditure; and for lenders to take into account whether a customer is experiencing difficulties with their existing financial commitments.

- **The APPG believes the FCA should look at stronger action on real-time data sharing so that all HCST lenders are not only sharing data in real time but also using that data to make informed lending decisions.** Real-time data sharing does not in itself compel firms to lend in a responsible way. However, by giving lenders the fullest possible picture, mandatory use of real-time data should generally reduce the riskiest lending and lead to a reduction in the number of consumers who end up with multiple loans. The FCA should

further consider whether other sections of the high cost credit market should also be sharing and using data in this way.

- **The APPG believes the FCA should consider reducing the level of the total cost cap to take into account detriment from higher cost instalment and running account HCSTC**. The shift in the market away from a "traditional" 30-day product to longer term loans means loans tend to be repaid in smaller instalments over a longer period of time. This can be more manageable. However longer term loans can also be more expensive. A £200 loan from one HCST lender repaid over 30 days would cost around £250; over three months nearly £300; and over six months nearly £350. The FCA should examine whether the unfair cost of rollovers have simply been incorporated into the upfront cost of longer-term loans and therefore look at whether the level of the cap should be reduced.
- **The FCA should consider action to curb HCST loans paid off through 'balloon payments'.** This is when the majority of repayments are made in the final instalment. We believe this could lead to the same kind of debt traps where borrowers struggle to find the final larger instalment so are hit by interest and charges and the build-up of further high cost debt. The FCA should review whether 'balloon payments' are causing consumer harm and take action where necessary.

Rent to Own sector

Key issues

The APPG Debt and Personal Finance welcomes the attention the FCA has paid to the RTO sector since its inquiry in 2014/15[iii]. The RTO sector has more than doubled in size in recent years, with more than 400,000 households using RTO to purchase goods in 2016, up from 210,000 users in 2008. The APPG has highlighted a range of concerns:

- **Rent to own firms charge excessive rates on the goods themselves and on added extras like extended service cover or aftercare**. The bundling of add-ons as a condition of credit can double or triple the cost of essential household goods like fridges, freezers and washing machines.
- **RTO stores target financially vulnerable consumers who cannot afford to pay for goods upfront and are largely a captive market**. Customers are unable to access other forms of credit and the majority are reliant on benefit income. One firm told us that less than 5% of its customers had taken out a payday loan.
- **Affordability checks are poor** and debt advice agencies report cases where vulnerable borrowers have been sold multiple RTO agreements with weekly payments well in excess of the voluntary caps the firms claim to impose.
- **Payment problems in the sector are rife**. The FCA's submission to the Group showed that 50% of RTO customers have fallen into arrears at some stage in the agreement, with BrightHouse telling us 20% of its customers fell more than one month behind.
- **The threat of losing goods means RTO agreements exert pressure on households to prioritise RTO payments ahead of essential bills.** A report by Citizens Advice in 2016 found a quarter of RTO customers they surveyed had fallen behind on other essential bills such as their rent and Council Tax.
- **A significant minority of customers are forced to surrender possessions** they have significant amounts towards. The FCA found that over 10% of RTO customers were forced to surrender goods they could no longer afford or have them repossessed.

A 7.5kg Hotpoint Tumble Dryer cost **£229** at Curry's, **£249** at the Co-Op and **£279** at Argos. At BrightHouse, the total cost with interest, including insurance and compulsory aftercare is **£780**.

Recommendations

The APPG inquiry put forward a number of recommendations for the FCA in its final report in 2015, including stronger consumer protections and the enforcement of existing rules. Since then some progress has been made and we have welcomed the appointment of 'skilled persons' at the three largest RTO providers to oversee improvements and consider remedies for any past consumer detriment.

The APPG believes the bundling of aftercare (for example, BrightHouse's "5-star service") as a compulsory part of the credit agreement is fundamentally unfair. By making cover mandatory for the first 6 months or year of the agreement, companies appear to be charging customers for rights they already obtain under a manufacturer's warranty or repair/replacement rights under consumer law.

Below, we outline the outstanding issues that we believe the FCA should focus on:

- **The FCA should address the compulsory element of these agreements as unfair terms or breaches of the treating customers fairly rules.** By increasing overall prices, we believe the FCA could also take action if it finds these terms are likely to limit competition. The FCA has taken action on insurance add-ons in other markets, for example with the banning of opt-out selling, but has not comprehensive addressed these issues in the RTO sector.
- **The FCA should consider the introduction of new rules so that customers are not pressured into – or forced to buy – service cover at point of sale.** The sale of credit should be separated out from the sale of the extended warranties and insurance and there should be a mandatory cooling off period for both.
- **Affordability assessments should be strengthened.** The FCA's affordability guidance should be applied as rules to RTO lenders and creditworthiness assessments should require, as a minimum, proof of income and expenditure.
- **The FCA should introduce clearer guidance or rules for RTO firms when customers are in financial difficulty.** The APPG has called for new sector-specific protections so that when it is evident customers cannot pay – and the loss of items would result in hardship (for example, through loss of essential goods like a cooker or child's bed) – there should be rules making it clear to firms that it is unfair to pursue the remaining debt.
- **The FCA should consider building on the success of the total cost cap in the high-cost short-term credit sector by extending it to the RTO market**. This would offer financially vulnerable consumers an overarching protection against unfair costs.

Guarantor lending

Key issues

Guarantor loans are usually for a larger amount than the typical payday loan. The average guarantor loan debt of StepChange Debt Charity clients in the year to June 2016 was £3,754. While StepChange Debt Charity has seen an increase in the number of clients with guarantor loans debt problems from nearly 3,000 in 2013 to over 10,000 in 2016, it is unclear whether they are being used as direct substitutes for payday loans.

The APPG on Debt and Personal Finance is concerned about a number of issues in the sector:

- **Guarantor lending puts borrowers who get into financial difficulties under increased pressure to repay** because of the risk of jeopardising a key relationship, for example with a friend or family member acting as a guarantor. This means they might wrongly prioritise debt payments ahead of essential bills.
- **Guarantors face a potentially open-ended liability** – there is currently nothing stopping guarantor lenders from transferring interest and charges from the borrower to the guarantor – this makes the guarantor potentially liable for a far higher debt than anticipated.
- **Debt collection practices can be aggressive and intrusive.** Guarantors in particular can be threatened with a charging order or an attachment of earnings before court proceedings have even begun.
- **Guarantor loans are being used to consolidate other high cost debts.** Guarantor lenders say people often come to them having already taken out payday loans[iv] and debt advice agencies have raised concerns that debt consolidation in this way might not always be affordable or in a potential customer's best interests.
- **Problems with a lack of forbearance and due consideration when borrowers are in default or arrears**. If a borrower misses payments, the creditor can go straight to the guarantor to demand payment, putting guarantors under pressure of trying to help out someone they have been a guarantor for.

Case study: A StepChange Debt Charity client had a debt management plan that included a guarantor loan debt. The client was concerned as this guarantor lender had been contacting them wanting money to be paid outside of the plan and had also been contacting their guarantor asking for money. The lender threatened that

they would be taking the client and guarantor to court and that they would recover money from the guarantor's house if necessary.

Case study: A StepChange Debt Charity client reported that a guarantor lender they had a debt with was contacting her and her guarantor on a daily basis wanting payment for the debt. This is despite the client explaining that she was unable to afford high repayments. This was causing considerable stress to the client and was also causing the guarantor to get annoyed with the client. This placed stress and strains on the friendship between the client and the guarantor.

Recommendations

- **Strengthen affordability checks.** The FCA should look at extending the same creditworthiness assessments to guarantors as for borrowers to make sure guarantors are able to stand behind the loan without getting into difficulties.

- **Total cost cap**. The FCA should consider building on the success of the total cost cap in the high-cost short-term credit by extending it to the guarantor loans market. This would offer financially vulnerable consumers an overarching protection against unfair costs.

- **Liability for fees and charges.** The FCA should ensure that guarantors do not have a potentially open-ended liability. This might be achieved through putting in place a rule that lenders can only seek to recover the original balance outstanding from the guarantor when a borrower has defaulted.

Overdrafts

Key issues

Overdrafts are commonly used by British borrowers and in the past year around three in ten (29%) people with personal current accounts in the UK have been overdrawn.[v] Overdrafts can be a flexible form of borrowing and most people only use their overdrafts for a couple of months a year. However, the Competition and Markets Authority's (CMA) analysis showed that over half (51%) of overdraft users went into unarranged overdraft in 2014 and **a significant minority (10%) were heavy unarranged overdraft users, going over their limit for nine months or more.**[vi] Once people are in a cycle of overdraft repayments and charges, it can be very difficult to escape.

It is clear that unarranged overdraft charges can be excessive.

- Analysis by consumer group Which? shows how unarranged charges can be more expensive than payday loans. Its analysis shows that consumers needing as little as £100 can be charged up to £156 more by some banks than allowed by the cap on high cost short term credit, when the same amount is borrowed over the same period[vii].
- The CMA's investigation found over a million instances where consumers incurred unarranged charges in excess of £75 in a month and over half a million instances where consumers incurred cumulative unarranged overdraft charges in excess of £100 in a month.[viii]
- StepChange Debt Charity research shows two thirds of its clients with overdrafts are regularly exceeding their limit, doing so an average of five out of the last 12 months. The same survey showed these borrowers are on average hit by extra unarranged charges of £45 a time—a total of £225 a year.[ix]

How overdrafts can lead to problem debt

Research by StepChange Debt Charity shows that overdrafts are a significant part of the debt landscape with unarranged overdraft charges a key factor trapping people in the cycle of problem overdraft debt.

StepChange Debt Charity helped 177,000 people with overdraft debt in 2016 and:

- More than half of its clients have overdraft debt.
- Overdrafts are the second most common type of debt owed (after credit cards) – 52.1% of StepChange clients have overdraft debt.
- The average overdraft debt among these clients is £1,700

Households living in their overdrafts and those in chronic financial difficulties often face impossible choices between meeting the cost of essential bills or going further overdrawn or over their overdraft limit.

- These households can struggle to get out of their overdraft as fees and interest on arranged overdrafts can build up over a long period of time making it increasingly more difficult to get out of the red.
- These households are also more likely to be at the edge of their overdraft limit and if they go over they face the substantial and punitive unarranged charges we have seen that push them into difficulties. If people do not have the means to get out of their unarranged overdraft, this can lead to persistent charges making it harder to avoid financial difficulties each successive month.

Case study – persistent unarranged overdraft fees causing an overdraft debt trap: A 42 year old man called StepChange Debt Charity for help having racking up significant overdraft charges after losing his job. Interest on his overdraft and persistent charges for going over his limit meant that on average £80 a month was added to his balance. In the course of a year, the man's overdraft debt increased by over £1,000 through interest and unauthorised overdraft charges.

Case study – small unplanned overdraft becoming a £1,000 debt: A 38 year old woman came to StepChange Debt Charity with spiralling overdraft debts after getting divorced. The increased burden of managing financial commitments on her own meant slipping into an unplanned overdraft by £90. This led to a cycle of being constantly in and out of her unarranged overdraft, with overdraft debts increasing to £1,000 due to interest and unarranged overdraft charges.

Recommendations

A cap on the monthly cost of unarranged overdrafts

The APPG on Debt and Personal Finance is concerned that the CMA's maximum monthly charge on unarranged overdrafts – to be set by the banks themselves – is likely to have extremely limited impact. The four major high street banks that make up 77% of the market already set their own caps on charges which can be as much as £90 a month. There is little financial incentive on the banks to lower their existing charges given the substantial revenues they generate. The CMA found that £1.2 billion of banks' revenues in 2014 came from unarranged overdraft charges. Therefore it is unclear how this remedy will lead to a significant reduction in the level of charges consumers pay.

There is a clear need for an unarranged overdraft charge cap to be set by the FCA as an independent regulator. We do not believe competition remedies will work in this area of the market so it is essential the FCA goes further than the CMA and takes action to tackle the role of overdrafts in problem debt. The FCA has

stronger consumer protection powers than the CMA and is best placed to balance the competing priorities of lenders and consumers and set an effective and fair cap. The FCA has a good track record in this area introducing a cap on the cost of payday loans which has reduced the detriment faced by financially vulnerable consumers. We believe a centrally regulated MMC cap is more appropriate than leaving it to the banks and that the FCA as the independent regulator is best placed to set this cap.

Overdraft charges: earlier forbearance

As well as capping unarranged charges, we believe there are other measures the FCA should take to address persistent overdraft debt and tackle the detriment it causes.

- The FCA should explore what more can be done by lenders to support people who are trapped in an overdraft cycle and give them better and more manageable ways of paying down their debts. For example, banks could identify where customers are struggling with their overdraft and separate their debt from the transactional banking facilities (This might be achieved by converting the overdraft into a loan at a non-punitive interest rate). This would bring vital stability to household finances and provide a sustainable and affordable way of repaying their debt balance.

- The FCA should work with banks to do more to identify customers who are regularly going over their overdraft limit or struggling to get out of their arranged overdraft over a long period of time. Being identified as a 'heavy overdraft users' would mean instead of continuing to face charges, this would be a trigger for customers to get additional support – such as signposting to free debt advice and offering customer repayment plans.

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[i] StepChange Debt Charity (2016) Payday loans the next generation: Changes to the high-cost short-term credit market since the introduction of the price cap
[ii] ibid
[iii] http://www.appgdebt.org/inquiry/final-report/
[iv] https://www.lovemoney.com/news/15679/amigo-loans-danger-guarantor-50-apr
[v] GfK NOP (2015) Personal current account investigation: A report for the Competition and Markets Authority
[vi] CMA retail banking market investigation: provisional findings report, APPENDIX 7.4, Annex C
[vii] http://press.which.co.uk/whichpressreleases/overdraft-charges-could-cost-156-more-than-payday-loans/
[viii] CMA retail banking market investigation: provisional findings report 9.116.
[ix] https://www.stepchange.org/Mediacentre/Pressreleases/Unarrangedoverdraftcharges.aspx