The Financial Inclusion Centre

Financial markets that work for society

FCA CONSULTATION CP17/10

CREDIT CARD MARKET STUDY: CONSULTATION ON PERSISTENT DEBT AND EARLIER INTERVENTION REMEDIES

INTRODUCTION

We welcome the opportunity to respond to this important consultation. Our response is structured as follows:

- A summary of our response (p2);
- A summary of why caps on credit card rates and fees are needed, and why it is important to change market norms in the credit card market (p4);
- Response to specific questions in the consultation paper (p7); and
- Comments on other issues in the CP (p10).

For any further information or questions, please contact:

Mick Mc Ateer
Co-Director
Financial Inclusion Centre
mick.mcateer@inclusioncentre.org.uk

July 2017

SUMMARY OF RESPONSE

- The nature of the problems identified by the FCA's excellent analysis of the credit card market means that any interventions should have three separate but connected objectives:
  - To encourage better consumer behaviours and change market norms in the consumer credit market – that is pre-empt and prevent a build-up of persistent debt and encourage borrowers to pay down debt quicker and so save money;
  - To protect borrowers from exploitative and unfair practices – that is, the application of very high charges to what is in effect a captive market; and
  - To promote a more competitive market – from the consumer perspective.
- It is also important to differentiate between how effective any interventions will be in addressing legacy problems and fixing the market for the future.
- These are the criteria by which we judge the FCA's proposals. With this in mind, we are very pleased that the FCA has recognised the problem and welcome some of the FCA's proposals on interventions to help borrowers manage persistent and problem debt. But, taken in the round, we do not believe that the package of proposals will be effective when measured against those criteria set out above.
- In particular, we are very disappointed and perplexed that the FCA has not included potentially the most effective remedy - capping credit card fees and interest rates on credit cards – for consultation. Capping the total cost of credit would be a more direct way of meeting the desired objectives of encouraging better behaviours and changing market norms, protecting borrowers, and promoting real competition.
- Ruling out a remedy which has been shown to work in similar conditions without even consulting on it, or even explaining the decision, is worrying from a consumer protection perspective. But it also goes against the principles and practices[1] of good regulation.
- The FCA already has a duty to make general rules '*with a view to securing an appropriate degree of protection for borrowers against excessive charges*'[2]. Therefore, it would have been well within the FCA's remit to consult on a total cost of credit cap (including fees and rates). The total cost of credit cap has been a major success from the consumer perspective in the payday lending market. Yet significant numbers of borrowers in the credit card are still paying effective rates of more than 100% and are experiencing more detriment than payday lending borrowers. A cap on fees and rates in the credit card market would be entirely proportionate and would ensure regulatory consistency.
- Behavioural interventions such as those proposed in the CP are very much unproven interventions. Any intervention which requires changes in consumer behaviour involves a great deal of uncertainty. Moreover, to be successful, these interventions will have to produce a substantial amount of behavioural change amongst this particular target market. Achieving this will be laborious and resource intensive. Whereas, capping rates and fees will have a demonstrable, direct and rapid effect on firm behaviour and, therefore, on the financial wellbeing of borrowers.
- The problem now is that because the FCA has not included caps in this consultation this leaves vulnerable consumers exposed to exploitative and unfair charging practices. We urge the FCA to go back to the drawing board and now consult on the introduction of a cap on consumer credit.

---

[1] Openness to ideas, transparency, balance and objectivity, and consultative

[2] See CONC 5A.1.4, FCA Handbook, https://www.handbook.fca.org.uk/handbook/CONC/5A/1.html?date=2016-08-19

Financial Inclusion Centre, 6th Floor Lynton House, 7-12 Tavistock Square, London, WC1H 9LT
info@inclusioncentre.org.uk, www.inclusioncentre.org.uk
Non-profit organisation, Company no: 06272007, Vat no: 144925501

Specifically, we argue that the total cost of credit should be capped at 100% in line with the effective payday loan cap measures.

- Nevertheless, some of the proposed remedies may make some difference in protecting vulnerable consumers in the meantime until better remedies are adopted. For example, ensuring faster repayments of balances is important as is requiring firms to improve their forbearance practices. It is shocking that only 50% of firms surveyed had a process in place to identify borrowers in persistent debt.
- Rather than focus on persistent debt alone, the FCA should be thinking about *persistent* and/ or *problem* debt. The FCA's approach means that a borrower could end up paying more in fees and rates than principal over a one year period and not be caught by these proposals. By any reasonable definition, paying more in fees and rates than principal over a one year period is *problem* debt. Therefore, it is not clear why the FCA has chosen the particular timing points for determining what is persistent debt and therefore the trigger for interventions. We would prefer if the trigger points were 12 and 24 months.
- Additional measures are needed to change market norms in this market. Therefore, we make two recommendations on this score. The FCA should change the default position on borrowing so that lenders cannot increase credit limits without express request and consent of borrowers. Similarly, the FCA should now actively consider requiring an increase in minimum repayments to a higher default level so that outstanding balances are repaid more quickly – of course, without causing financial difficulties for borrowers involved.
- The FCA has determined that its concerns about unsolicited credit limit increases should be dealt with through voluntary industry remedies. The LSB will monitor and report to the FCA on compliance with this voluntary agreement. Of course, we support any interim initiatives to deal with this problem until more effective measures are introduced. But, it is of concern that the FCA does not appear to have committed to making public the compliance data, nor its own assessments of whether the LSB's monitoring is robust enough. This oversight needs to be rectified. The FCA needs to commit to publishing compliance data plus regular assessments of whether this voluntary initiative is appropriate.

WHY CAPS ON CREDIT CARD RATES AND FEES AND CHANGES TO MARKET NORMS ARE NEEDED

As mentioned, there are three separate but connected objectives for any reform of the credit card market (and wider consumer credit market):

1. To encourage better consumer behaviours and change market norms in the consumer credit market – that is pre-empt and prevent a build-up of persistent debt and encourage borrowers to pay down debt quicker and so save money;
2. To protect borrowers from exploitative and unfair practices – that is, the application of very high charges to what is in effect a captive market; and
3. To promote a more competitive market – from the consumer perspective.

Below, we summarise why capping fees and rates would be the most effective method of meeting the objectives set out above. We also explain why it is critical to change market norms, and how this might be done.

We know from experience that supply side behaviours have a major influence on demand side behaviours. We also know from experience that directly constraining the business models of firms is the most effective form of regulation[3] – certainly compared to weak, indirect demand side interventions.

Capping fees and rates will ensure that firms have reduced incentives to allow borrowers to build up high levels of persistent debt as the opportunities to extract high revenues from borrowers in the form of fees and interest charges will be restricted. Of course, the FCA would argue that its proposed remedies would also incentivise firms not to enable high level of persistent debt. It may be the case that these remedies *might* work. But the FCA's remedies involve a huge amount of uncertainty. Whereas we know that capping fees and rates would have a direct effect on firm behaviours.

Similarly, when it comes to protecting borrowers from unfair practices, it may well be that FCA's remedies *might* work. But, again, these involve a great of uncertainty with regards to lender and borrower behaviour. Whereas, by definition, capping fees and rates directly protects borrowers from detrimental charging structures.

The analysis of the customer journey and the illustration of the potential savings from the various proposals set out in paras 2.53 to 2.57 in the document are very helpful. But, the likelihood of these savings materialising all depend on whether the proposed interventions work. The efficacy of the proposals very much depend on firms behaving and complying with the interventions. Ensuring compliance will require a great deal of monitoring, supervision and enforcement by the FCA.

It also requires borrowers responding well to the interventions and significantly changing their behaviours. However, demand side interventions aimed at changing consumer behaviours do not have a good track record in financial services. The FCA is taking a significant risk with a set of unproven interventions to tackle what is clearly a major detriment affecting vulnerable consumers.

---

[3] Payday lending caps, stakeholder pensions and RU64, with-profits reforms, the RDR and MMR are notable examples of how supply side interventions (which constrain business models and directly influence market development) are more effective than the demand side interventions (eg. information disclosure) which had been tried before

Financial Inclusion Centre, 6th Floor Lynton House, 7-12 Tavistock Square, London, WC1H 9LT
info@inclusioncentre.org.uk, www.inclusioncentre.org.uk
Non-profit organisation, Company no: 06272007, Vat no: 144925501

In contrast, we know what the effect of capping fees and rates would be. In the scenarios set out in paras 2.53 to 2.57, borrowers would end up repaying balances quicker resulting in greater savings – as well as having the additional benefits of being more effective in preventing new debt from accumulating and encouraging better competition from the consumer perspective.

Similarly, the very helpful analysis in figure 5, p31, shows the extent to which vulnerable borrowers are being penalised by very high penalty fees. Those accounts in severe or serious arrears are paying 4 to almost 5 times more in account fees a year than accounts not in arrears. The bulk of these fees are made up of penalty fees – either late fees or overlimit fees.

The FCA believes that its proposals will help borrowers avoid these fees by reducing the chance of getting into financial difficulty. Again, we have to say that the chance of borrowers benefiting all depends on the success of a set of unproven interventions. Whereas, capping fees and rates would directly and demonstrably benefit borrowers by limiting the damage done by punitive fees and rates.

The case for capping rates and fees is compelling on grounds of consumer protection alone. Moreover, these high fees and rates cannot be justified on consumer deterrence grounds. Some may argue that these penalty fees deter borrowers from reckless behaviours. This is clearly not the case. The existence of these penalty fees has not deterred the widespread levels of persistent and problem debt in this market. Indeed, these penalty fees and rates have simply exacerbated problem debt. In contrast, imposing a cap would certainly deter lenders from lending irresponsibly if they were less able to generate considerable revenues from penalty rates and fees.

Capping fees and rates would also be more effective at creating a truly competitive market. The credit card market is in effect two separate markets. There is a group of consumers for whom the market is working well. But, there is a large group of consumers for whom the market is clearly not working and is causing great detriment – this second group is the focus of this consultation.

A truly competitive market is one which provides good value products that meet consumers' needs, and is populated by firms who act in consumers' interests and treat them fairly. In the conventional model of competition, a competitive market is one characterised by numerous providers and products with high levels of switching activity, low barriers to entry and so on.

But those conventional competition conditions do not always guarantee the desired outcomes for vulnerable consumers in complex markets such as financial services. Conventional interventions such as tackling information asymmetries to encourage the right market conditions are not effective.

In contrast, capping fees and rates is a form of *bounded competition* or *managed market* intervention. These interventions set the boundaries of acceptable behaviour and allow firms to then compete within those boundaries to produce the right outcomes for consumers. Capping fees and charges obviously forces firms to treat borrowers fairly and act in their interests – it directly aligns the interests of firms and consumers; this approach also shapes better, fairer charging structures. In other words, it is a more effective way of producing the better consumer outcomes we seek.

Nor is there anything to suggest that capping fees and rates in this market would stifle true innovation.

The other general point to make is that if we are to tackle the problem of overindebtedness and more generally promote positive financial behaviours, we need to change the current market norms with regards to the selling of consumer credit to large parts of the population.

As it stands, the current norm involves lenders actively (or some would say aggressively) selling credit to a large part of the market which would be classified as relatively passive consumers. Of course, it is fair to say that there are also large numbers of borrowers who are very active in terms of switching and seeking out the best deals, and who manage debt balances effectively.

But, the combination of consumers having access to extra money at a price (ie credit) and widespread advertising of products and services means a large section of the consumer population is *primed to borrow* to finance consumption. In other words, advertisers create the desire, lenders provide the means. There is also a large section who turn to credit cards to make ends meet, even though this credit ends up damaging financial wellbeing. Overall, there is a significant proportion of the population who are clearly being sold undesirable levels of credit. There is no evidence to suggest that providing these consumers with information to tackle information asymmetries and/ or using behavioural economics insights to encourage consumers to adopt more cautious behaviours on borrowing will have a meaningful impact in constraining the growth in problem debt.

Instead, the aim should be to move to a norm where business models are less unconstrained and consumers have to play a more active role in seeking out credit.

The question is: which is the most effective way of constraining the dominant business models in the credit card market? Again, we know from experience in the payday lending sector that the lending cap has resulted in a significant change in the market norm. Capping the total cost of credit on credit card borrowing would similarly constrain business models of credit card lenders.

But, given the scale of the challenge involved in changing market norms in this market, two additional recommendations are needed. The FCA should change the default position on borrowing so that lenders cannot increase credit limits without express request and consent of borrowers. Similarly, the FCA should now actively consider requiring an increase in minimum repayments to a higher default level so that outstanding balances are repaid more quickly – of course, without causing financial difficulties for borrowers involved.

RESPONSE TO SPECIFIC QUESTIONS

Persistent debt

1. **Do you agree with our proposed definition of persistent debt?**

We are not convinced by the FCA's choice of 18 months as the appropriate period over which to assess whether a borrower is in persistent debt. It is important that interventions occur early and do not allow problems to persist longer than is necessary.

Moreover, while it is important to tackle persistent debt, persistency *per se* is not the only issue in this market. The FCA needs to consider the cost of this form of credit and, more generally, fairness. With the FCA's proposals, borrowers could pay more in fees and rates than in repayments of the principle over a one year period without being classified as being in persistent debt. It is difficult to see how this should *not* be considered as problem debt – especially given that this form of debt can be more expensive than payday loans.

We would also emphasise that careful monitoring may be needed to ensure that firms do not deprioritise other borrowers who are in chronic debt (but not in the most severe category). We appreciate this is not the FCA's intention. But firms will need reminding by the regulator.

2. **Do you agree with our proposal for intervention at 18 and 27 months?**

No. It would be more effective if the interventions at this stage were timed at 12 and 18 months. It is not clear what the justification is for not allowing borrowers who have incurred problem debt over a 12 month period to benefit from the proposed interventions.

It is worth pointing out that these interventions would be even more effective from the consumer perspective if there was a cap on interest and fees.

Of course, if a cap was introduced, many borrowers might not reach the threshold for intervention of having paid more in interest and charges than on the principal. But, this is not a problem. The FCA could change the threshold so that the intervention is triggered, say, when the borrower makes payments on interest and charges worth more than 75% of the principal. The key point is that the borrower would be protected much more effectively and the likelihood of persistent problem debt arising is reduced.

3. **Do you agree with our proposals for intervention after 36 months of persistent debt for those customers that can afford to repay more quickly?**
4. **Do you agree that three to four years is a reasonable period over which firms must help customer repay the balance?**

No. We think the trigger for this stage of intervention should be after 24 months.

The three to four year repayment period is appropriate. But, the onus should be on the lender to establish with the borrower whether the repayment can be done more quickly – without putting too much financial strain on the borrower.

Clearly, the FCA will have to monitor firms' compliance with this requirement to help borrowers to repay their outstanding balance more quickly and to ensure that firms are putting the best options in front of borrowers. A total cost of credit cap would also make an important contribution in ensuring that these outstanding balances are paid down as quickly as possible.

We support the requirement for firms to take reasonable steps to ensure that customers do not get into persistent debt on new balances. We would be concerned about the FCA allowing firms too

Financial Inclusion Centre, 6th Floor Lynton House, 7-12 Tavistock Square, London, WC1H 9LT
info@inclusioncentre.org.uk, www.inclusioncentre.org.uk
Non-profit organisation, Company no: 06272007, Vat no: 144925501

much leeway on how to do this. Clearly, there is an incentive for firms to encourage new persistent debts given the revenues earned from uncapped fees and rates. Again, the most effective way to stop firms encouraging new persistent debt is to remove the incentive to do so by capping fees and rates.

5. **Do you agree with our proposals regarding a requirement to exercise forbearance and due consideration for customers in persistent debt who cannot sustainably repay more quickly?**

Yes, we support the proposals to require exercise of forbearance and due consideration for customers in persistent debt. This should apply from the 24 month trigger point. But, we are concerned that the FCA is not prescribing the nature of forbearance at least with regard to reducing or cancelling charges and interest. This should not be optional.

6. **Do you agree with our proposals regarding suspending use of the credit card?**

Yes, we agree with these proposals. These strike the right balance between protecting borrowers from incurring further persistent debt and enabling 'emergency' spending. It is encouraging that borrowers will be made aware of debt advice charities at each stage.

Under our preferred model, borrowers would be contacted at 12 and 24 months with appropriate interventions, with a further 12 months before the customer's card would be suspended (that is, 36 months).

The FCA rightly highlights the potential risk of borrowers turning to payday/ HCSTC loans, and other forms of costly credit. This is a good time to remind the FCA that the best way to constrain the ability of the payday lending sector to target vulnerable credit card borrowers is to retain the very successful cap on payday loans.

Overall, the objective must be to prevent borrowers getting into such a state that forbearance is required. This can be best done by capping fees and charges which have the effect of accelerating the accumulation of high levels of debt.

One final point here is that it is must cause for concern that 15% of those in persistent debt had more than £7,000 credit available to them on other credit cards[4]. This suggests to us that lending practices and borrower risk profiling may not be as effective as it should be.

7. **Do you agree with our proposals for customers who do not engage at 36 months?**

We agree that borrowers should have their ability to use their card suspended if they do not engage at 36 months. But, it is not appropriate for the FCA to allow firms discretion over how to treat borrowers whose card has been suspended. Clearly, limits need to be placed on the level of fees and rates applied to the balance to prevent acceleration of the debt.

8. **Do you have any views on the potential need for novation of existing contracts or modifying agreements in order to suspend or cancel customers' use of their card, provide forbearance or put in place a repayment plan?**

We agree this should be allowed. But the FCA should make clear to firms that this can only be done on the basis that any novation would be used to benefit the borrowers involved, not to confer a commercial advantage for the firm.

[4] See para 2.46 of the consultation paper

Financial Inclusion Centre, 6th Floor Lynton House, 7-12 Tavistock Square, London, WC1H 9LT
info@inclusioncentre.org.uk, www.inclusioncentre.org.uk
Non-profit organisation, Company no: 06272007, Vat no: 144925501

9. Do you agree with our proposal that the firm must treat a customer with forbearance where the customer is unlikely to repay the balance in a reasonable period under a repayment arrangement?

Yes. We support this proposal. Clearly, limits need to be placed on the level of fees and rates applied to the balance to prevent acceleration of the debt.

10. Do you agree with our proposals for commencement of the Handbook provisions?

Yes. We very much support the proposal to require compliance with rules three months after they come into force. It is important to activate these proposals as quickly as possible to protect vulnerable borrowers. But, we also hope that the FCA will now recognise the need for caps on fees and rates and consult on their implementation as soon as is practicable.

11. Do you agree with our proposals regarding overlap between persistent debt and earlier intervention and CONC 7.3.4R?

Yes. We support the proposals regarding the interaction between persistent debt, earlier intervention, and CONC 7.3.4R. But, it is worth reiterating that, for these proposals to work, they will have to be monitored and supervised very closely and tough sanctions applied where breaches are found.

Earlier intervention

12. Do you agree with our proposal to require credit card firms to monitor other data in addition to a customer's repayment record?

Yes. We support this proposal. It is important that credit card firms have a more holistic and realistic view of the financial position of borrowers. As mentioned, it is worrying that 15% of borrowers in persistent debt had more than £7,000 of card credit available to them. It is difficult to understand how/why multiple credit providers are willing to extend so much credit to borrowers in such financial difficulty.

13. Do you agree firms should be required to take appropriate action where there are signs of actual or possible financial difficulties?
14. Do you agree that signs of actual or possible financial difficulties should include where there is a significant risk of one of the matters in CONC 1.3.1G occurring?

Yes. We support the proposal that firms should be required to take appropriate action where there are signs of actual or possible financial difficulties.

Yes, we agree that the risk of matters in CONC 1.3.1G occurring should be taken as a sign of actual or possible financial difficulties. However, we would add evidence of persistent minimum payments, and existence of multiple credit cards with high credit utilisation.

15. Do you agree with the proposed examples in guidance in CONC on what may constitute appropriate action where a customer is showing signs of actual or possible financial difficulties?

Yes. But, these measures would be even more effective if fees and rates were capped.

Financial Inclusion Centre, 6th Floor Lynton House, 7-12 Tavistock Square, London, WC1H 9LT
info@inclusioncentre.org.uk, www.inclusioncentre.org.uk
Non-profit organisation, Company no: 06272007, Vat no: 144925501

COMMENTS ON OTHER ISSUES RAISED IN THE CP

Control over credit limit increases

The FCA has determined that its concerns about unsolicited credit limit increases will be dealt with through voluntary industry remedies. The LSB will monitor and report to the FCA on compliance with this voluntary agreement.

Of course, we support any interim initiatives to deal with this problem. But, it is of concern that the FCA does not appear to have committed to making public the compliance data, nor its own assessments of whether the LSB's monitoring is robust enough. This oversight needs to be rectified. The FCA needs to commit to publishing compliance data plus regular assessments of whether this voluntary initiative is appropriate.

But, the main issue is that, as presented, the voluntary remedy is too confusing. We have doubts about its efficacy. Consumers will have to choose between operating under an opt-in or opt-out basis. Those who do not make a choice will be offered credit increases in opt-in basis by default. It does not take much to imagine the difficulties involved in ensuring that this information is presented fairly and transparently to potentially affected consumers and monitoring compliance with this approach. Even if the information is presented fairly and transparently, there is little reason to believe it will significantly change behavioural norms in lending markets nor stop high cost credit being sold to consumers.

In the long term, the most effective solution is for the FCA to change the 'default' position on borrowing. It is difficult to understand why the FCA doesn't just insist that firms cannot increase a credit limit without the express request and consent of the borrower.

This is an important point with wider implications beyond consumer credit. Many households in the UK have very low levels of financial resilience and financial security. That is, they are overindebted and/ or lack sufficient accessible savings to fall back on in the event of encountering financial difficulties. Taking on significant amounts of debt affects the ability of consumers to balance household budgets and to save for the future. This imbalance is partly down to the behavioural and psychological barriers in financial services which mean that it is too easy to borrow and too hard to save.

If we are to change these behavioural norms, barriers need to put in place to make consumers think twice before borrowing and to stop lenders exploiting behavioural biases. Consumers should not be 'defaulted' into borrowing by increases in credit limits. This approach would be more effective at preventing problem debt arising. But, it would also not prevent borrowers who have genuine need of credit from applying for it. The key is that changing the default puts borrowers in control of the relationship between them and the lender.

Testing behavioural remedies to address under-repayment

We look forward to seeing the results of the FCA's testing of various ways for presenting repayment options. In particular, we look forward to seeing the results of the tests on removing the anchor of the minimum repayment. At this stage, it must be said that this seems like an extremely risky option.

Financial Inclusion Centre, 6th Floor Lynton House, 7-12 Tavistock Square, London, WC1H 9LT
info@inclusioncentre.org.uk, www.inclusioncentre.org.uk
Non-profit organisation, Company no: 06272007, Vat no: 144925501

The penny must be dropping now that many consumers are rarely 'economically rational' and, in all likelihood, will never be – certainly not to the extent assumed by conventional economic theories which still hold that, if only the right conditions were created and information asymmetries tackled, active consumers would make markets work.

The use of the minimum repayment option clearly has a significant impact on the amount borrowers repay. The most direct way of addressing this problem would be to increase the minimum repayment (that is a direct constraint on the supply side) rather than continue to try behavioural interventions aimed at changing demand side behaviours. We strongly urge the FCA to consider this option as a priority.

This marks the end of our submission.

Financial Inclusion Centre
July 2017

Financial Inclusion Centre, 6th Floor Lynton House, 7-12 Tavistock Square, London, WC1H 9LT
info@inclusioncentre.org.uk, www.inclusioncentre.org.uk
Non-profit organisation, Company no: 06272007, Vat no: 144925501