

moneyadvicescotland
Scotland's Money Charity

RESPONSE

FINANCIAL CONDUCT AUTHORITY:

**CALL FOR INPUT ON HIGH-COST
CREDIT AND REVIEW OF THE HIGH-
COST SHORT-TERM CREDIT PRICE
CAP**

15 February 2017

About Money Advice Scotland

Money Advice Scotland is Scotland's Money Charity.

We are the national umbrella organisation in Scotland which promotes and champions financial inclusion and the development of free and impartial money advice.

Our mission is to be the driving force towards financial wellbeing for the people of Scotland.

Background

We welcome the opportunity to respond to the Financial Conduct Authority's call for input on high-cost credit and the impact of the HCSTC price cap.

Our response was drafted after holding a consultation event with our membership at our offices in Glasgow on 19 January 2017. Attendees included representatives from insolvency practitioners, local authorities, Citizens Advice Bureaux, housing associations and other advice agencies.

The consultation event featured a presentation from Neil Marshall, Senior Manager in the Consumer Credit Policy Team at the FCA, which provided an excellent overview of the call for input. We are also grateful to Luke Tyrrell of the FCA's Consumer Partnerships team and Martin Kuzmicki of the Strategy Development team who were present at the consultation event and offered invaluable input.

Finally, we are grateful to all Money Advice Scotland members who took the time to attend our consultation event or input views via other methods. These views form the basis of this response.

Section 1: High-cost credit

Q1: Which high-cost products do you think our review should focus on and do you think a more consistent approach to high-cost products is feasible or desirable?

Store cards, rent-to-own agreements and doorstep lending were considered to be the high-cost products that the review should focus on. Members were of the view that the profile of clients who present with debts related to these type of products is similar to those who presented with HCSTC debts prior to the cap. This group of clients are typically in low income households and have few other options when accessing credit.

There was an evident desire from our members to see a consistent approach on high-cost products and this is in no small part a result of the success of the HCSTC cap. As we note later, the price cap was welcomed by our members who attest to the considerable drop-off in this type of credit since the cap's implementation. Members also welcomed the fact that the FCA was investigating the impact of its intervention in the market and agreed that this represented the best type of policymaking.

The success of the HCSTC price cap also sets a precedent for the feasibility of these types of interventions. As the consultation paper notes, however, different high-cost products may not be closely substitutable. With that in mind, the regulator may determine a different approach to capping other high-cost products, but the overall aim to protect consumers against spiralling debt should remain a priority.

Many advisers at our consultation event stressed that high-cost credit continues to offer a lifeline for some consumers – particularly those on low incomes. High-cost credit makes up one of the main components of the poverty premium that sees the poorest pay most for essential goods and service. Recent analysis from the University of Bristol suggested that the poverty premium can be as high as £1,860 per year in circumstances where households are relying on several forms of high-cost credit.¹ The need for credit will always exist so it is important that consumers are protected and can access credit affordably if and when required. Whilst this will not strictly be a specific task for the regulator, advisers were keen to see a renewed focus in this area.

Q2: To what extent is there detriment from high-cost credit products (other than HCSTC)?

The scope for consumer detriment from the high-cost credit products listed above is clear. Rent-to-own was singled out as a recurring cause of detriment for low income and vulnerable consumers. When a client gets into arrears, then this is an extremely difficult cycle from which to escape. In that respect, there are parallels with payday lending. Advisers also provided examples of clients who will stop paying rent and council tax to keep up with payments on rent-to-own.

One adviser at our consultation event raised the case of a vulnerable client who was offered (and subsequently applied for) a £15k bank loan. The client was unsure what to do with the money – underlining the fact that he probably didn't need it in the first instance – but eventually decided to redecorate his home. Regrettably, the client purchased furniture from a rent-to-own provider (which is located close to his bank branch and is a prominent store in the area) on a high-cost weekly credit agreement. What's more, the loan remained in the

¹ University of Bristol, *The Poverty Premium - When low-income households pay more for essential goods and services*, November 2016

client's bank account which impacted on his state benefit entitlement. Rent-to-own providers are often criticised for inadequate affordability checks, but in this example the detriment was partly caused because the credit was not required in the first place.

From a trading standards perspective, members also noted concerns that there is no cooling-off period for rent-to-own if the agreement is signed on trade premises and called for a focus in this area. A further concern around the area of rent-to-own and store cards was that the sale of the goods or items is naturally the priority for the salesperson – this creates a conflict in terms of making the consumer aware of the potential risks. Salespersons are not always adequately trained to explain the agreement. Similarly, in the case of store cards, it was noted that salespersons can receive commission on opening credit accounts and this was felt to be inappropriate.

Q3: Where there is detriment, do you consider that it arises from matters not addressed by our rules, or is it mainly caused by firms failing to comply with the rules?

The case could be made that in the example provided in our answer to Q2, neither the bank initially nor the rent-to-own provider met FCA rules around treating customers fairly. The consumer was vulnerable and neither the loan nor the rent-to-own agreement were marketed or sold to meet his needs.

That said, in other examples detriment is also caused by the cost of the credit itself and the scope for debt to build up rapidly when a consumer falls into arrears. For most consumers, the escalating interest and charges when things go wrong will be the main source of detriment. In the view of our members, this underlines the case for a more consistent approach to high-cost credit products.

For doorstep lending, members noted that certain providers seek to evade the rules. For example, a cap on maximum loan amounts could be side-stepped by issuing a sequence of loans or by issuing multiple loans to people in the same household even where it was clear the credit was for one individual.

Q4: If there is detriment arising from matters not addressed by our rules, what sort of interventions should we consider? What would be the impact?

Again, members supported interventions that addressed the overall cost of the credit. It was considered a useful starting point to presume that things will always go wrong for some consumers and it follows that necessary protections should be put in place.

Q5: Should some of the HCSTC protections be applied more widely? What would be the impact on the cost of or access to credit?

As we mention in our response to Q1, the need for credit will always exist but the role of the regulator should be to provide adequate protection for borrowers. One adviser noted that the ideal product for consumers was “doorstep-lending customer service at credit union rates.” This comment served as a reminder that whilst our members were of the view that more protection was required for consumers, they also took the view that more products were required.

Recent research from the Carnegie Trust found that price is not the main driver in choosing a loan and other elements such as speed of access and trust in lenders was an issue.² This was reflected in comments from advisers that the perception of creditors is often inaccurate. For example, illegal money lenders – typically referred to as loan sharks with connotations of violence – are instead often considered by debtors as friends, even in spite of the clear detriment.

We welcome the fact that the regulator is seeking to understand the impact of market intervention on access to credit. In our view, the move to control the cost of high-cost credit products may also provide the opportunity for a renewed focus on the availability of affordable credit for people on low incomes.

Q6: To what extent do you think overdrafts are a substitute, or alternative, for other high-cost credit products?

Our members were of the view that overdrafts are a very common form of debt for consumers seeking advice, but were not necessarily a substitute for high-cost credit products. Overdrafts were considered a very different product to HCSTC by advisers who noted that consumers, too, have different attitudes towards overdrafts. A number of advisers said that consumers did not think of overdrafts as a debt in the same way that they do of other forms of credit. One adviser noted that for many consumers, an overdraft limit quickly becomes “the new zero” highlighting the fact that there is often little scope for paying it down.

An emerging issue was highlighted in the growing number of young people with overdraft debt, most notably in the case of students who are offered accounts with large overdraft facilities when they start college or university. Typically, students graduate with this overdraft at the maximum limit and this effectively becomes a loan at that point. Andrew Bailey’s Mansion House speech mentioned the growing debate around the intergenerational wealth gap and the regulator may wish to examine the implications of overdraft use by young people in particular.

Q7: What do you think are the key issues the FCA should consider on arranged and unarranged overdrafts respectively?

Overdrafts were considered as relatively easy to access, but far more difficult to deal with when things go wrong. The first response when consumers encounter financial difficulty and contact their bank is often to increase the overdraft limit, but this may not be the correct outcome for every consumer. Instead, increasing the overdraft limit might merely postpone the problem until further down the line and indeed increase the burden of debt. In our view, banks have a role to play in signposting to advice and other services if consumers are repeatedly requesting that an overdraft limit is increased.

The CMA’s Open Banking recommendations cites account switching as a method in which consumers can secure better deals. In these situations, the regulator should also be mindful of potential detriment that can be caused by switching. One adviser at our consultation event offered the example of a client who had been inundated with communication encouraging them to switch to a reward account with interest paid on any balance and cashback on

² Carnegie UK Trust, *Meeting the need for affordable credit*, 2015

certain bills. The client had an authorised overdraft, however, meaning that the charges and interest applicable on this reward account would significantly outweigh any benefits.

Q8: What measures could be taken to address these and what would be the risks and benefits?

Overall, our members were of the view that the measures set out by the Competition and Markets Authority did not go far enough. The monthly maximum unarranged overdraft charge (set by banks themselves) falls short of what our members considered necessary to protect consumers. Which? has published research that calculates the cost of going into an unarranged overdraft with some providers at 180 per cent of value of the loan.³

Our members were of the view that an overall cap set by the regulator was required. Given the high likelihood that overdraft users do fall into an unarranged overdraft – Which? report that 1 in 2 users do so at one point or another – it is important to implement that extra layer of protection for consumers.

The CMA's recommendation to make banks send prompts and alerts to consumers who are about to slip into overdraft to help them try and avoid unnecessary charges was welcomed, but also has limitations. For example, a person might receive the alert and instead turn to a still more expensive form of high-cost credit. It was suggested that banks may take a more proactive approach to signposting clients to advice and guidance when it is apparent that they are in difficulty.

Banks can also do more to set up repayment or restructuring plans for overdrafts. According to members at our consultation, this practice used to be more common whereby banks would decrease the overdraft facility in increments each month. In the experience of our members, this is no longer an option in many cases. On the other side of this argument, the risk of reducing an overdraft limit too quickly may lead to risks for consumers.

More generally, we are of the view that communications around the account balance available to consumers should be clearer. One member noted that if a consumer has £40 in an account but also has a £2,000 overdraft, then the available balance will read as £2,040. Whilst this is strictly true, it may give the wrong message to some consumers and particularly those who are vulnerable.

³ Which?, *Overdraft charges more expensive than payday loans*, 9 July 2016

Section 2: HCSTC price cap review

Q9: Please provide evidence and/or views on:

– the reasons for the substantial reduction in applications from consumers for HCSTC and the reduction in acceptance rates by firms

One member from an insolvency firm noted that the authorisation process had been particularly effective in filtering out some of the more unscrupulous product providers. This may contribute to the reduction both in terms of applications from consumers and acceptance rates.

– whether this decline will continue, plateau, or lending will increase

In our view it is difficult to comment on whether the reduction in HCSTC applications will continue, plateau or increase as this will be influenced by a range of external socio-economic factors. Bank of England data shows that total outstanding consumer credit is higher than at any point since December 2008.⁴ If, as forecasted, essential living costs such as food and energy prices continue to rise in the years ahead, we may yet see consumers with few other options turning back to HCSTC.

– the impact of the price cap on the viability of HCSTC and how this might differ for online and high-street, and

Members at our consultation event did not offer views on this area.

– the impact on loan duration and product development more generally of the structure and level of the price cap

Members at our consultation event had little evidence that the HCSTC price cap had led to the development of new products which were leading to consumer detriment.

Q10: Do you have views and evidence on the risks for consumers of using HCSTC post-cap? Do you agree with our initial assessment that risks of falling into arrears have reduced?

As we note throughout this response, members welcomed the price cap and attest to a considerable drop in clients coming through money advice agencies with financial difficulties that are a consequence of HCSTC. The price cap is extremely effective in limiting the rapid accumulation of arrears via charges and interest.

One of the key risks post-cap (also highlighted in the consultation paper) is the tendency for consumers to move to longer term HCSTC. In that respect, the risk of falling into arrears may now be delayed over a longer period and this certainly merits close attention.

Q11: Do you have any evidence of adverse consequences for consumers as a result of being declined for HCSTC?

Members noted that clients had often exhausted all other options by the time they had applied for HCSTC. Most clients who presented with HCSTC debts also had various other debts. The consultation paper corroborates this view noting that, on average, declined

⁴ Bank of England, *Money and Credit*, 31 January 2017

applicants hold £4,300 in debt at the time of applying for HCSTC. When these clients were declined HCSTC, advisers said that this was often the prompt to seek advice or help. Some advisers were concerned that the same trigger does not exist following the implementation of the price cap and that this may be concealing problem debt.

Members had little direct evidence of adverse consequences for consumers as a result of being declined for HCSTC. However, it was considered important to note that consumers may not necessarily be seeking out other forms of credit. Advisers noted that certain consumers may be relying on other types of support such as through making applications to the Scottish Welfare Fund or using foodbanks. In our view, the FCA's investigation should also consider whether or not there has been a spike in enquiries to other forms of support out with turning to credit.

We are aware that the FCA has undertaken work to determine whether the HCSTC cap has led to an increased demand for illegal money lending. Last year, Money Advice Scotland were amongst a range of representatives to attend FCA roundtable events to gather evidence in this area. One adviser at our consultation had encountered a client who had used an illegal lender as an alternative to a payday loan. However, it was unclear if this client had a history of turning to unauthorised lending, or whether this was a one-off. Generally, clients won't raise the issue of illegal lending at all, or will instead refer to money owed to friends and family that must be repaid as a priority. This strikes at the central difficulty around the discussion of illegal money lending – namely that this type of credit is covert by its very nature and thus difficult to measure any fluctuations in demand. That said, members attending our consultation day had not witnessed a definitive increase in debts as a result of illegal money lending.

Q12: Do you agree that consumers do not generally move to other high-cost credit products as a result of being declined for HCSTC?

Members noted an increase in low income debtors presenting with other high-cost credit products such as rent-to-own, store cards and doorstep lending. Again, the question of whether these same clients would have presented with these issues in any case is one that we could only speculate on.

The so-called “waterbed effect” may also be delayed. An attendee at our consultation event noted that the terms of a rent-to-own agreement, for example, are typically longer than other types of credit and this increases the likelihood of consumers getting into difficulty in the long run.

Q13: What are the implications for consumers of increasing loan duration for HCSTC?

As we note in our answer to Q12, our members took the view that the longer an arrangement runs on, then the more likely it is that the consumer may hit a snag. People on low incomes who depend on HCSTC are typically in less secure employment such as zero-hour contracts, self-employment or juggling multiple jobs. This makes shocks to income far more likely. In turn, this may impact on the ability to service repayments and increase the likelihood of falling into arrears.

Q14: Do you have views or evidence that the HCSTC price cap has had an impact on other high-cost products: e.g. because consumers use those products as an alternative?

Some members reported an increase in rent-to-own debts, but we are unable to comment on whether this is directly correlated to the HCSTC price cap. The primary concern about rent-to-own remains the excessive cost that means that those with the least often pay the most. It was considered essential to tackle this in and of itself, whether or not any increase in demand for this product was caused directly by the price cap.

As mentioned in Q11, one adviser mentioned the case of a client who had used an illegal lender, although this did appear to be the exception rather than a trend. It was also unclear whether the client in question would have used this type of lending *as well as* HCSTC.

Q15: Do you have evidence that the definition of HCSTC is providing opportunities for firms to evade the HCSTC price cap (and HCSTC regime more generally)?

Members at our consultation event had no evidence of the definition of HCSTC providing opportunities for firms to evade the cap.

Section 3: HCSTC repeat and multiple borrowing

Q16: What are your views on our analysis of the data and market with regard to repeat and multiple borrowing?

Much of the data analysis reflected the anecdotal experience of our membership. Moreover, we welcome the close engagement with the money advice sector who are often a bellwether for emerging issues that are causing consumer detriment.

Q17: Do you have any further evidence on repeat and multiple borrowing?

Members at our consultation event had no further evidence to report on repeat and multiple borrowing.