moneyadvicescotland

Scotland's Money Charity

RESPONSE

Credit card market study: consultation on persistent debt and earlier intervention remedies

3 July 2017

Background

On 6 June 2017, Money Advice Scotland held a joint consultation event with the Financial Conduct Authority at our offices in Glasgow to discuss the proposals to address persistent credit card debt.

Members in attendance included money advisers from local authorities, citizens advice services and housing associations, as well as a number of insolvency practitioners.

Our event opened with a presentation from Nick Waugh of the FCA's consumer credit policy team who provided a sweeping and informative overview of the consultation. We are also grateful to Luke Tyrrell of the FCA's consumer network team for helping to facilitate the event. Both Nick and Luke provided invaluable insight over the course of the day and this level of engagement is very much appreciated.

Persistent debt

Q1: Do you agree with our proposed definition of persistent debt?

We agree with the proposed definition of persistent debt. By targeting the intervention at customers who are paying more interest than capital over a period of 18 months, the definition captures both customers who may be able to repay more quickly and customers who are in potential financial difficulty. The definition is also effective in terms of excluding customers who are making the active choice to transfer balances between zero per cent interest deals.

Some advisers voiced concerns about the precise wording of the definition, noting that a customer may not consider themselves as in debt until the time comes when they can no longer afford to service minimum payments. During our consultation, a number of advisers noted that the first thought that comes to mind at the proposed definition was debt that has been defaulted on. Alternative definitions suggested by members included customers with a high credit utilisation ratio (for example, 90 per cent plus) or people who are making minimum payments over a long period. However, it was considered that many customers may do this as an active choice and that these alternative definitions may capture people who are not in financial difficulty. In that sense, it is important that a one-size-fits-all approach is avoided.

We are also of the view that the consultation should include closer examination of the reasons that persistent debt is accrued and whether this is linked to the affordability checks undertaken at the outset.

Q2: Do you agree with our proposal for intervention at 18 and 27 months?

The timescales for intervention were broadly considered appropriate. Some members suggested that the initial intervention should take place at 12 months, with monthly follow-ups thereafter. However, it was considered that this may have the effect of diluting the impact of the message.

We also agree that a period of less than 18 months may trigger persistent debt warnings that are a result of seasonal spending such as Christmas or summer expenditure, rather than being an indicator of immediate financial difficulty. The US Financial Diaries research from NYU Wagner's Financial Access Initiative is an important reminder of the volatility of income and expenditure over a 12 month period.[1]

It was suggested that the repetition of the same steps at 27 months may be unlikely to engage the customer given that it failed to do so at the first attempt at 18 months and that a degree of differentiation may be required to muster engagement. The method of communication at both 18 and 27 months was also highlighted as an important factor. Money advisers are well acquainted to clients turning up at offices with a bag filled with unopened mail. It was suggested that a letter notifying the customer that increasing the current rate of repayment would reduce the cost of their borrowing may suffer some the same fate. Members noted that additional forms of communication may include texts or alerts as well as prompts for online banking users. Data from the ONS shows that the number of people using online banking in the UK increased from 30 per cent in 2007 to 60 per cent in 2016.[2]

During presentation that introduced the consultation paper to our members, Nick Waugh outlined the following scenarios of the effect of increasing repayments:

A customer who borrows £3,000 on a credit card with an APR of 19%

Making minimum repayments

- £74 per month, reducing over time
- 27 years and 7 months to repay
- £4,192 in interest

Fixing repayments at £74 per month

- 5 years and 2 months to repay
- £1,576 in interest

Making monthly repayments at £108 per month

- 3 years to repay
- £879 in interest

Members agreed that setting out the significant benefits to customers of minor increases in repayments was particularly effective. We favour an outcome where firms are obliged to set out these illustrative examples to customers. A number of advisers considered it appropriate to include these scenarios in monthly statements, but again, this may run the risk of overkill. If a customer does increase repayments, it was suggested that credit card firms should still be obliged to detail the savings customers have made by taking action.

[1] http://www.usfinancialdiaries.org/
[2] ONS, *Internet access – households and individuals: 2016*, August 2016

Members were of the view that it is as important to reinforce positive behaviours as it is to address negative behaviours.

The success of auto-enrolment for pensions saving was also held up as an alternative model, whereby a customer would be informed that payments would be automatically increased unless they opt out – an example of nudging customers into making a positive decision. However, our members were not in favour of this option without first establishing affordability with the client.

Q3: Do you agree with our proposals for intervention after 36 months of persistent debt for those customers that can afford to repay more quickly?

Concerns were raised over how firms will establish whether a customer can afford to repay more quickly. What's more, even in cases where it is determined that a customer can afford to repay more quickly, members were uncertain if it was the role of the regulator to remove the choice to continue to make the minimum contractual payments.

A proportion of customers that can afford to repay more quickly may wish to prioritise other costs or payments and that must be respected. Living costs are set to be squeezed in the years ahead with pay growth weak and inflation forecast to rise. Household budgets will already be under pressure in this context and there is the risk that asking people to repay credit card debt more quickly may lead to the type of waterbed effect described in the HCSTC review – the intervention may resolve the issue of persistent credit card debt, but we need to be cognisant to the wider impact on a customer's financial wellbeing.

Q4: Do you agree that three to four years is a reasonable period over which firms must help customer repay the balance?

Three to four years will be a reasonable period for some customers, but not for all. Members questioned the rationale behind deciding on the three to four-year period. In Scotland, the Debt Arrangement Scheme (DAS) allows debtors to repay debts over a "reasonable length of time."[3] However, the average duration of a debt payment program under DAS is currently around 7 years – well beyond the three to four years outlined here – and members were concerned about how the new proposals fit with existing debt solutions.

Persistent credit card debt may be an indicator of underlying financial difficulties. In the consultation document, the FCA estimate that "42% of consumers meeting the persistent debt definition had more than £1,000 available credit on other cards, while 15% had more than £7,000 available card credit." We are concerned that any request to repay within a fixed (albeit reasonable) period may risk unduly prioritising the credit card debt over other debts or commitments. To prevent this, prior to entering any repayment plan, firms should seek to ascertain whether the customer is experiencing difficulty with other debts or commitments and refer to advice services where appropriate.

Members also raised concerns that some customers may agree to repayment plans which are unsustainable if faced with the prospect of a report being made to CRAs.

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[3] https://www.aib.gov.uk/sites/default/files/individual_das_-_debtor_information_booklet.pdf

Q5: 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?

The measure to exercise forbearance that may include a reduction in the rate of interest being charged was welcomed by our members. If a consumer is identified as being in persistent debt with little prospect of coming to a sustainable repayment plan, then this seems to exemplify the type of consumer detriment that the regulator is trying to address with these proposals.

Q6: Do you agree with our proposals regarding suspending use of the credit card?

Whilst agreeing that there will be circumstances where it is appropriate to suspend use of the credit card, we are of the view that making a report to the CRAs should not be included in the proposal for intervention. The consultation document notes that the suspension of a card would likely be reported to CRAs, in which case other lenders would likely be aware of the customer's circumstances. That risk of a report being made to CRAs was considered as overly harsh by our members, particularly where customers are continuing to make the minimum payments. One money adviser described this as penalising a consumer for doing exactly what is being asked of them.

This type of intervention could also push a customer closer to financial difficulty – for example, if they turn to yet more expensive forms of credit in future. The impact of a poor credit score also has repercussions beyond a person's financial wellbeing. One member noted that this can also have implications for employment and housing.

Q7: Do you agree with our proposals for customers who do not engage at 36 months?

Again, the suspension of the card may be considered unduly harsh in some cases given the implications of making a report to CRAs. For example, if a customer is in genuine financial difficulty but is ignoring mail due to anxiety or mental health issues, then suspension and the subsequent report to the CRA may worsen the situation.

Q8: 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?

Yes, but this must be matched by equivalent attempts to make customers aware of these changes. It cannot be stressed enough that the proposals represent a significant shift in the relationship between credit card firms and their customers. With that in mind, a publicity campaign will likely be necessary to bring the changes to the attention of customers who may overlook correspondence and fall foul of the repercussions at month 36.

Q9: 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?

We broadly welcome the proposal that firms must treat a customer with forbearance where the customer is unlikely to repay the balance within a reasonable period. Again, we would reiterate that a reasonable period will be different for different customers and this presents a challenge in having a set period that is applicable to all customers.

Q10: Do you agree with our proposals for commencement of the Handbook provisions?

Yes.

Q11: Do you agree with our proposals regarding overlap between persistent debt and earlier intervention and CONC 7.3.4R?

Yes. In particular, we welcome the proposal that "that the communication requirements at 18, 27 and 36 months under the persistent debt intervention would not apply where a customer's account is already subject to equivalent or more favourable treatment." The effect of the persistent debt proposals should never be to put the customer in a worse scenario.

Earlier intervention

Q12: Do you agree with our proposal to require credit card firms to monitor other data in addition to a customer's repayment record?

Yes. A number of members at our consultation event noted an increase in clients who are using credit cards to meet what would typically be considered as essential living costs, such as supermarket bills, energy bills and fuel costs. Regrettably, money advisers will only be able to identify this when clients have already presented with problem debt. By monitoring data, credit card firms may be able to identify this at an earlier stage, however, and direct customers towards help and advice.

Customers who are consistently using credit cards to withdraw cash or to deposit funds to gambling accounts should also be flagged as an indicator of possible financial difficulty. It should be noted that we support these measures of earlier intervention even when a customer is not defined as being in persistent credit card debt.

Q13: Do you agree firms should be required to take appropriate action where there are signs of actual or possible financial difficulties?

Yes, absolutely. As we note in our previous answer, credit card firms are often uniquely positioned to determine if a customer is in financial difficulty and should be obliged to act when this is identified.

Q14: 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.

Q15: 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?

Members agreed that suspending, reducing, waiving or cancelling any further interest or charges was an appropriate action where a customer is showing signs of actual or possible financial difficulties was an appropriate action.

The example of accepting token payments for a reasonable period of time in order to recover from an unexpected income shock was welcomed, but members noted that this seemed akin to minimum payments by another name. Questions were also raised over what constituted a "reasonable period." That said, if this action was undertaken alongside suspending, reducing, waiving or cancelling further interests or charges, then this would go some way to assisting customers in financial difficulty.

Notifying the customer of the risk of escalating debt, additional interest or charges and of potential financial difficulties was also considered an appropriate action. As we outline in previous answers, however, the method by which the message is communicated is often as important as the message itself.

Perhaps unsurprisingly, members also favoured the proposal to provide contact details for free debt advice providers and encouraging the customer to contact one of them. It was noted, however, that this may put pressure on advice services that are already under strain in the face of budget cuts. Money advisers attest to the growing prevalence of people with debts that are closely linked to living costs such as council tax, housing and utility arrears, rather than consumer credit debts. If the upshot of the proposals is to drive people who are currently not seeking advice towards advice services, then this will need to be matched with additional investment in free debt advice.

There is a risk that if customers cannot access free debt advice that other advice providers may pick up these cases. We are concerned about the growing number of people in debt options – particularly Protected Trust Deed – when other solutions may be more suitable. This tends to be driven by lead generators and our Manifesto 2017 called for closer scrutiny of this practice.[4] In our experience, many of these firms also fail to carry out a complete assessment of income and expenditure which results in unsustainable agreements and consumer detriment.

In terms of appropriate actions that were not mentioned within the consultation, our members also supported the option of a moratorium similar to the breathing space measures currently available via the Debt Arrangement Scheme in Scotland and outlined within the 2017 General Election manifestos from both the Conservatives and Labour.

[4] http://www.moneyadvicescotland.org.uk/sites/default/files/MAS_manifesto_2017_2.pdf